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NOTES

THE NEW YORK STOCK EXCHANGE MINIMUM COMMISSION RATE STRUCTURE: ANTITRUST ON WALL STREET

In *Silver v. New York Stock Exchange*,¹ the Supreme Court refrained from totally immunizing the activities of the New York Stock Exchange (NYSE) from the restraints of the antitrust laws by exempting only those "particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act . . ."² While this decision represented a unique approach to the continuing controversy over the accommodation of two conflicting economic models³—the regulatory and the competitive—it left to the lower federal courts the task of determining the exact scope of the Exchange's exemption on a case-by-case basis. In *Kaplan v. Lehman Brothers*⁴ one aspect of the Exchange's self-regulatory system, the minimum rate structure, was unsuccessfully attacked as violative of the antitrust laws, and after the Supreme Court denied certiorari,⁵ Wall Street financiers thought the battle had been won.⁶ Far from being settled, however, the issue has again been spotlighted. In a memorandum⁷ submitted in response to the Securities and Exchange Commission's invitation for comments on a proposed rule to modify the rate

¹ 373 U.S. 341 (1963), discussed at notes 94-107 *infra* and accompanying text. *Silver* was the "first and only expression of the Supreme Court with respect to the relationship between the securities laws and the antitrust laws . . ." 111 Cong. Rec. 19019 (1965) (letter from Manuel F. Cohen, SEC Chairman, to Sen. A. Willis Robertson, Chairman of Senate Committee on Banking and Currency.)

² 373 U.S. at 361.

³ See, e.g., Helmetag, *Railroad Mergers: The Accommodation of the Interstate Commerce Act and Antitrust Policies*, 54 VA. L. REV. 1493 (1968).

⁴ 250 F. Supp. 562 (N.D. Ill. 1966), *aff'd*, 371 F.2d 409 (7th Cir.), *cert. denied*, 389 U.S. 954 (1967), discussed at notes 108-119 *infra* and accompanying text.

⁵ 389 U.S. 954 (1967) (Warren, C. J., dissenting).

⁶ The Wall Street Journal, referring to the case as a "landmark action," grossly overstated its holding by concluding that the NYSE was "immune from antitrust challenge in fixing uniform commission rates . . ." Wall St. Journal, Nov. 14, 1967, at 2, col. 1.

⁷ *Selected Comments on SEC Proposed Rule on Give-ups and NYSE Proposal on Commission Rates*, CCH FED. SEC. L. REP. No. 198 at 16-31 (extra ed. May 3, 1968) [hereinafter cited as *SEC Comments on Proposed Rule*]. On January 17, 1969, the Department of Justice filed another memorandum proposing a five-year plan for the gradual elimination of fixed commission rates. Fixed rates on all trading exceeding \$50,000 would be abolished immediately; thereafter, the ceiling would be lowered by \$10,000 per year. Department of Justice, Memorandum of the Department of Justice before the SEC, Commission Rate Structure of Registered National Securities Exchanges, File No. 4-144, Jan. 17, 1969 [hereinafter cited as Justice Dep't Memo.].

structure,⁸ the Department of Justice challenged the antitrust exemption afforded the minimum commission rates. This "surprising entry"⁹ prodded the SEC to hold public hearings¹⁰ to explore "whether a minimum exchange commission rate structure is necessary, and if so to what extent" ¹¹

OVERVIEW OF THE COMMISSION RATE STRUCTURE

The antitrust problems currently raised by the NYSE's rate structure have their origin in the rules and practices which have traditionally characterized the Exchange and have determined its relationship to the rest of the securities industry.¹² The NYSE has set its own commission rates since the Buttonwood Agreement of 1792.¹³ These minimum rates,¹⁴ prescribed by

⁸ SEC Securities Exchange Act Release No. 8239 (Jan. 26, 1968) (restricting give-ups). See note 37 *infra*.

⁹ Wall St. Journal, April 30, 1968, at 34, col. 1. Nor did the challenge escape the fanfare of election year politics. President Nixon, during the recent campaign, referred to the Justice Department intervention as a "heavy-handed bureaucratic regulatory" scheme, Wall St. Journal, Oct. 3, 1968, at 4, col. 3, and a Republican National Committeeman instituted suit to delay SEC proposals until after the inauguration of the new president, Washington Post, Oct. 12, 1968, at E7, col. 1.

¹⁰ SEC Securities Exchange Act Release No. 8324 (May 28, 1968). For statutory authority to call public hearings, see 15 U.S.C. § 78u(a) (1964).

Congressional leaders have also expressed a keen interest in the subject. See Washington Post, Dec. 14, 1968, at E9, col. 1 (Sen. Harrison Williams, Chairman of the Subcommittee on Securities of the Senate Committee on Banking and Currency, announced future hearings to consider the antitrust implications of minimum commission rates); Wall St. Journal, Dec. 11, 1968, at 3, col. 2 (Rep. Emanuel Celler, Chairman of the House Judiciary Committee, urged antitrust action against the NYSE to invalidate Exchange Rule 394 which restricts members from trading listed stocks with nonmembers). See notes 46-47 *infra*.

¹¹ SEC Securities Exchange Act Release No. 8324 (May 28, 1968) (letter from Manuel F. Cohen, SEC Chairman, to Robert W. Haack, President of the NYSE).

¹² For a comprehensive discussion of the NYSE's rate structure, see REPORT OF SPECIAL STUDY OF SECURITIES MARKETS OF THE SECURITIES AND EXCHANGE COMMISSION, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2, at 294-351 (1963) [hereinafter cited as SPECIAL STUDY]. This study was the product of a Congressional directive to the SEC "to make a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations . . ." 15 U.S.C. § 78s(d) (1964). See also H.R. REP. NO. 882, 87th Cong., 1st Sess. (1961).

¹³ We, the Subscribers, Brokers for the Purchase and Sale of Public Stock, do hereby solemnly promise and pledge ourselves to each other, that we will not buy or sell from this day for any person whatsoever, any kind of Public Stock at a less rate than one-quarter percent Commission on the Specie value, and that we will give a preference to each other in our Negotiations. In Testimony whereof we have set our hands this 17th day of May, at New York, 1792. SPECIAL STUDY, pt. 2, at 295, quoting A. EAMES, THE NEW YORK STOCK EXCHANGE 14 (1894).

¹⁴ In practice, however, "[t]he minimum has become the maximum." R. BAKER & W. CARY, CORPORATIONS, CASES AND MATERIALS 718 (Supp. 1968). See note 39 *infra*.

the NYSE Constitution,¹⁵ are compulsory for Exchange membership,¹⁶ and are followed by the American Stock Exchange and the regional exchanges.¹⁷

Besides fixing the commission for ordinary transactions, the rate structure precludes price competition on volume trading and ancillary services. Rates are fixed as a percentage of the value of each round lot¹⁸ regardless of the size of the transaction.¹⁹ This round-lot system does not allow for any volume or block discount, despite the fact that the cost of handling a transaction involving a large number of shares is not proportionately higher than the cost of a smaller volume transaction. Ancillary services comprise a wide spectrum of activity, including the safekeeping of customer securities, collecting dividends on stock left in the broker's care, forwarding proxy materials, furnishing investment advice and obtaining market quotations.²⁰ The rigid rate structure includes the cost of services in the commission fee whether or not a customer takes advantage of them, but the provision of these services remains "the most significant area of competition among members of the Exchange."²¹

The NYSE rules discriminate in favor of members by charging them markedly lower rates than are charged nonmembers and by permitting members to pay separate rates for clearing and executing rather than the all-inclusive rate paid by outsiders.²² Moreover, members are permitted to

¹⁵ [T]hese commissions shall be at rates not less than the rates in this Article prescribed; and shall be net and free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement direct or indirect.

NYSE CONST. art. XV, § 1, *reprinted in* 2 CCH NYSE GUIDE ¶ 1701 (1962).

No member, allied member, member firm or member corporation shall make a proposition for the transaction of business at less than the minimum rates of commission prescribed in this Article.

NYSE CONST. art. XV, § 7, *reprinted in* 2 CCH NYSE GUIDE ¶ 1707 (1962).

Any return, rebate, discount or allowance of commission resulting from an order given by a member . . . and payable by a member . . . of another exchange in connection with the execution of such order shall be collected by the member . . . giving such order and may not be shared with a non-member of the Exchange.

NYSE CONST. art. XV, § 8, *reprinted in* 2 CCH NYSE GUIDE ¶ 1708 (1962).

¹⁶ NYSE CONST. art. XV, § 7, *reprinted in* 2 CCH NYSE GUIDE ¶ 1707 (1962), see note 15 *supra*. NYSE members transact approximately 80% of the business on the national exchanges. SEC Securities Exchange Act Release No. 8239 at 4 n.2 (Jan. 26, 1968).

¹⁷ "Since 1958, the rates have been identical, and the rules governing commissions have also been similar in scope and effect. When the NYSE changed its nonmember rates in 1959, the Amex promptly followed suit." SPECIAL STUDY, pt. 2, at 299.

¹⁸ Round lots consist of multiples of 100 shares. A different procedure is used for odd-lot transactions. *Id.* at 325. For a general discussion of odd-lot dealers, see *id.* at 171-202.

¹⁹ *Id.* at 311.

²⁰ *Id.* at 321.

²¹ *Id.*

²² *Id.* at 297. Member rates can be separated into executing only, clearing only and

split fees among themselves, whereas such arrangements with nonmembers are prohibited.²³ This discrimination naturally has adverse effects on the nonmember professional; in order to retain his customer's business, a nonmember dealing in securities traded only on the NYSE is forced to charge the customer the same commission which he pays to the NYSE member, thereby incurring a loss equal to the expenses incident to the transaction. As with other Exchange rules, the NYSE insures compliance with its commission rate rules by fining,²⁴ suspending or expelling²⁵ violators.

The prospect of losing the business of nonmember professionals has led to the development of practices by which members can circumvent the Exchange's rigid rate structure. The anti-rebate rule can be bypassed through various reciprocal business arrangements²⁶ whereby NYSE members return commission business to nonmembers. This can be accomplished if a NYSE member places business with a broker who is only a member of a regional exchange even though the NYSE member occupies a seat²⁷ on the regional exchange or the stock is also listed on the Big Board.²⁸ A similar result is achieved by referring over-the-counter business to nonmembers in cases where the NYSE member possess adequate facilities to execute the transaction himself. Another variant calls for reciprocity in the form of special services. The clearance of nonexchange transactions,²⁹ office space,³⁰ installation and maintenance of wire services,³¹ special research³² and promotional materials and displays are all sanctioned conduits through which returns

clearing and executing. Executing consists of using the facilities of the Exchange to locate a seller (or buyer) and consummating the trade. Clearing involves making the arrangements for actual exchange of stock certificates. *Id.* at 295.

²³ NYSE CONST., art. XV, § 8, *reprinted in* 2 CCH NYSE GUIDE ¶ 1708 (1962), see note 15 *supra*.

²⁴ NYSE CONST., art. XIV, § 13, *reprinted in* 2 CCH NYSE GUIDE ¶ 1663 (1962).

²⁵ NYSE CONST., art. XIV, § 6, *reprinted in* 2 CCH NYSE GUIDE ¶ 1656 (1962). An illustration of the severity of NYSE penalties was provided in a recent action in which the NYSE suspended and fined a member \$10,000 for violating the anti-rebate rules. *Wall St. Journal*, Oct. 11, 1968, at 5, col. 2.

²⁶ For a general discussion of these practices among the mutual funds, see SPECIAL STUDY, pt. 4, at 213-35.

²⁷ See *The Rules of the New York Stock Exchange*, 10 S.E.C. 270 (1941) ("multiple trading case" in which the SEC invalidated the NYSE rule prohibiting members from trading listed securities on the regional exchanges). See generally SPECIAL STUDY, pt. 2, at 923-24.

²⁸ SPECIAL STUDY, pt. 2, at 302. A NYSE member need only name a regional-only member as a "clearing agent" on the regional exchange for him to receive up to a 50% split fee under the regional exchange rules irrespective of the functions performed. SEC Securities Exchange Act Release No. 8239 at 5 (Jan. 26, 1968).

²⁹ Rule 381, *reprinted in* 2 CCH NYSE GUIDE ¶ 2381.18 (1962).

³⁰ Rule 343, *reprinted in* 2 CCH NYSE GUIDE ¶ 2343.11 (1962).

³¹ Rule 359, *reprinted in* 2 CCH NYSE GUIDE ¶ 2359.10 (1962).

³² Rule 440, *reprinted in* 2 CCH NYSE GUIDE ¶ 2440A (1962).

to nonmembers are permitted by the Exchange, even though the equivalent in cash is prohibited.³³

The most controversial of the remunerative methods is the so-called "give-up."³⁴ Not only does this device circumvent the anti-rebate rule, but it also allows discounts on volume transactions. In its most elementary form, a customer³⁵ directs that a specified percent of the executing broker's commission, sometimes as high as seventy-five percent,³⁶ be given up to a designated broker. In effect, the executing NYSE broker acts as a vehicle through which an institutional investor can reward other brokers for services unrelated to the particular transaction, such as promoting mutual fund shares or supplying statistics, research, wire facilities and quotations.³⁷ If the designated broker is a member of the NYSE and therefore within the ambit of the Exchange's fee-splitting rules, the give-up may be in cash; otherwise, other reciprocal devices are used.³⁸ The impact of the give-up in undermining the NYSE rate schedule has been intensified by the fact that a dual member is subject to the more permissive regional exchange rules when trading on the regional exchanges. NYSE nonmembers have gained "practical access to the New York Stock Exchange"³⁹ because sub-

³³ Rule 369(1), reprinted in 2 CCH NYSE GUIDE ¶2369 (1962). The *Special Study* accurately commented that this distinction was "obviously a fine one." SPECIAL STUDY, pt. 2, at 304.

³⁴ Professor Paul Samuelson has called the device "nefarious." NEWSWEEK, Sept. 23, 1968, at 89. See also SEC, REPORT ON THE PUBLIC POLICY IMPLICATIONS OF INVESTMENT CO. GROWTH, H.R. REP. NO. 2337, 89th Cong., 2d Sess., ch. 4, at 162-88 (1966).

³⁵ The principal users are institutional investors, including mutual funds, foundations, insurance companies, educational institutions, pension funds and trust departments of banks. SPECIAL STUDY, pt. 2, at 837.

³⁶ SEC Securities Exchange Act Release No. 8239 at 3 (Jan. 26, 1968).

³⁷ SPECIAL STUDY, pt. 2, at 317. Give-ups also create substantial conflicts of interests for the a managers of the investment companies because the channeled income is used to serve their own self-interests rather than benefit the stockholders of the fund. SEC Securities Release No. 8239 at 9 (Jan. 26, 1968); 33 SEC ANN. REP. 8 (1967). As a result of reciprocal agreements the managers are pressured into transacting business with participating nonmembers rather than selecting the best available market in terms of cost, managerial experience and expertise of the individual firm. SPECIAL STUDY, pt. 2, at 309-10. Accordingly, SEC rule 10b-10, proposed pursuant to the antifraud provisions of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1964), the Investment Advisors Act of 1940, 15 U.S.C. §§ 80b-1 to 80b-21 (1964), and certain provisions of the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-52 (1964), "would prohibit investment company managers from directing brokers executing transactions for an investment company to divide their compensation in any way with other brokers unless the benefits of such division accrue to the investment company and its shareholders." SEC Securities Exchange Act Release No. 8239 at 1 (Jan. 26, 1968).

³⁸ See notes 29-32 *supra* and accompanying text.

³⁹ SEC Securities Exchange Act Release No. 8239 at 11 (Jan. 26, 1968) (letter from Robert W. Haack, NYSE president, to Exchange members). These practices induced Mr. Haack to remark that the rate structure "is ceasing to be a 'minimum.'" *Id.*

stantially all of the securities traded on the regional exchanges are also traded on the Big Board⁴⁰ and fee splitting with brokers who are not members of the regional exchanges is sanctioned by the rules of the regional exchanges. Thus, the give-up system has resulted in a channeling of business from the NYSE to the regional exchanges.⁴¹ Moreover, institutional investors, attempting to improve their positions, have secured seats on the regional exchanges⁴² for affiliates whose sole function is to obtain give-ups and other reciprocal benefits for their institutional sponsors.⁴³

The rigidity of the rate structure has also led to an increase in the trading of NYSE listed securities in the over-the-counter market. This so-called third market⁴⁴ is composed of nonmember firms whose operations are geared to the needs of the institutional customers.⁴⁵ Exchange Rule 394(a)⁴⁶ prohibits NYSE members from dealing in this market without prior permission.⁴⁷ Free from the restrictions of Exchange rules, the third market permits rate reductions on volume trading and eliminates the costs of an-

⁴⁰ *Id.* at 4 n.2.

⁴¹ See, e.g., Phalon, *Regional Exchanges Moving in on Big Board—From Boston to the Coast, Their Trading is Mounting*, N.Y. Times, Nov. 7, 1965, § 3, at 1, col. 3.

⁴² See, e.g., Jennings, *The New York Stock Exchange and the Commission Rate Struggle*, 53 CALIF. L. REV. 1119, 1142-43 (1965) (mutual fund affiliates, as members of regional exchanges, can trade in NYSE listed stocks without paying a commission to a NYSE member).

⁴³ SEC Securities Exchange Act Release No. 8239 at 3 (Jan. 26, 1968). The NYSE has asked the SEC for a moratorium on institutional membership pending the outcome of the SEC hearings. Wall St. Journal, May 5, 1969, at 6, col. 2.

⁴⁴ The term was first used by the *Special Study*. For a general discussion of this market, see SPECIAL STUDY, pt. 2, 870-911; Weeden, *The Third Market*, DUKE UNIVERSITY SCHOOL OF LAW CONFERENCE ON SECURITIES REGULATION 171-90 (Mundheim ed. 1965); Polakoff & Sanetz, *The Third Market—The Nature of Competition in the Market for Listed Securities Traded Off-Board*, 11 ANTITRUST BULL. 191 (1966); Comment, *The Third Market—Challenge to the New York Stock Exchange*, 20 SW. L.J. 640 (1966). Use of the third market should be distinguished from reciprocity agreements as a means of escaping the inflexibility of the NYSE rate structure. Give-ups are proper only where fixed commission rates exist; therefore, they are not used on the third market. SEC Securities Exchange Act Release No. 8239 at 5 (Jan. 26, 1968).

In addition to the exchanges, over-the-counter trading in unlisted securities, and the third market, there exists a so-called "fourth market" in which institutional investors deal directly with each other. See Silberman, *Bypassing Brokers—Institutional Investors Begin Trading Stocks Directly Among Themselves*, Wall St. Journal, Jan. 11, 1965, at 1, col. 1.

⁴⁵ The third market is not a complete market for brokers; instead, it includes a limited variety of securities that are favored by institutional investors. Jennings, *supra* note 42, at 1151.

⁴⁶ Except as otherwise specifically exempted by the Exchange, members and member organizations must obtain the permission of the Exchange before effecting a transaction in a listed stock off the Exchange, either as principal or agent. Rule 394(a), reprinted in 2 CCH NYSE GUIDE ¶ 2394 (1962).

⁴⁷ At the SEC hearings, both Exchange Rule 394(a) and Rule 394(b), which pro-

cillary services which are "of little interest or value" to institutional investors.⁴⁸ Besides offering reduced commission rates, third market trading involves less delay for large block transactions and avoids a ticker report with its attendant influence on prices.

The Rate Structure: Subsequent Developments

The intervention of the Department of Justice stimulated activity by the SEC and pressured the NYSE into reluctant reforms.⁴⁹ Prior to this intervention commission rate negotiations between the SEC and the Exchange had been unproductive;⁵⁰ since then, the SEC not only ordered the recent hearings but also submitted an interim schedule⁵¹ to the Exchange which included a volume discount and a caveat that the matter of give-ups was still "under continuing consideration."⁵² Although the pressure of the Justice Department may appear to be an encroachment upon SEC jurisdiction, it does give the SEC leverage in dealing with the Exchange.⁵³ Negotiations have led to the adoption of a NYSE plan⁵⁴ which provides for a volume dis-

vides for a cumbersome and ineffective procedure for members to trade in the third market, were attacked as a concerted refusal to deal in violation of the antitrust laws. N.Y. Times, Nov. 8, 1968, at 67, col. 7. Rep. Emanuel Celler, Chairman of the House Judiciary Committee, has urged the Department of Justice to bring suit against the NYSE to invalidate Rule 394, *id.*, Dec. 11, 1968, at 3, col. 2, but the Justice Department decided to wait until after the SEC hearings. *Id.*, Jan. 8, 1969, at 2, col. 4.

In late 1964 the NYSE proposed a volume discount in a package deal which also included a raise in commission rates and mandatory service fees to bring "about the return of some of the business lost . . . to the third market." *Id.*, Dec. 31, 1964, at 3, col. 1 (remarks of Keith Funston, former NYSE President). However, some members feared a rate war with the third market. The package deal was discarded because the SEC demanded "full documentation" before implementing the rate increase. *Id.* One year later only the volume discount was still alive. *Id.*, Jan. 3, 1966, at 4, col. 1.

⁴⁸ SPECIAL STUDY, pt. 5, at 140.

⁴⁹ Wall St. Journal, June 28, 1968, at 3, col. 1.

⁵⁰ *Id.*, May 31, 1968, at 8, col 3; *id.*, April 30, 1968, at 34, col. 1.

⁵¹ The SEC proposed interim measures include:

- (1) the reduction of rates for that portion of an order involving round lots in excess of 400 shares, and alternatively, to eliminate requirements for minimum commissions for all orders in excess of \$50,000.
- (2) the implementation of appropriate reductions in the current intramember rate for non-executing firms or eliminate requirements for minimum intramember charges to such non-executing firms.

SEC Securities Exchange Act Release No. 8324 (May 28, 1968). The new schedule has already caused commotion on Wall Street because "[i]t's believe [*sic*] commission income is nearly 20% below what the same transactions would have produced under the old schedule." Wall St. Journal, Jan. 23, 1969, at 2, col. 3.

⁵² SEC Securities Exchange Act Release No. 8324 at 2 (May 28, 1968) (letter from Manuel F. Cohen, SEC Chairman, to Robert W. Haack, NYSE President).

⁵³ Wall St. Journal, April 30, 1968, at 34, col. 1.

⁵⁴ The NYSE plan was a counterproposal to the one submitted by the SEC. Letter from Robert W. Haack to Manuel F. Cohen, *reprinted in* CCH FED. SEC. L. REP.

count on transactions involving over 1000 shares, reduction in intra-member rates, and the abolition of give-ups.⁵⁵ This retreat by the NYSE does not represent an attempt to dilute the commission rate structure, but rather an attempt to fortify that structure against an anticipated attack at the SEC hearings.⁵⁶

RELATIONSHIP BETWEEN THE SECURITIES INDUSTRY AND THE ANTITRUST LAWS

The legality of the commission rate structure has been challenged on the ground that it constitutes price fixing, a per se violation⁵⁷ of section 1 of the Sherman Act.⁵⁸ In the leading case,⁵⁹ *United States v. Socony-Vacuum Oil Co.*,⁶⁰ a price fixing agreement was held to be illegal despite its reasonableness,⁶¹ and in *United States v. National Association of Real Estate Boards*,⁶²

(Current vol.) ¶ 77,599 at 83,279 (1968). The SEC accepted the plan, SEC Securities Exchange Act Release No. 8399 (Aug. 30, 1968); the NYSE Board of Governors approved, Wall St. Journal, Oct. 11, 1968, at 3, col. 2; and the membership voted 925 to 266 to accept, *id.* Oct. 25, 1968, at 2, col. 3. The American Stock Exchange version passed 316 to 206. *Id.*, Nov. 4, 1968, at 6, col. 3. The NYSE has recently begun a comprehensive study of the entire rate structure. This effort to formulate a permanent schedule will last from 12 to 18 months and cost \$400,000. N.Y. Times, Jan. 23, 1969, at 65, col. 4.

⁵⁵ See note 37 *supra*. As of January 2, 1968, the NYSE favored retention of give-ups but with a limitation on the "percentage amount which may be so given-up." SEC Securities Exchange Act Release No. 8239 at 12 (Jan. 26, 1968) (letter from Robert W. Haack, NYSE president, to Exchange members).

⁵⁶ "The question the Exchange must face is whether the continuance of give-up practices will weaken the economic basis for minimum commissions." NYSE Special Membership Bull., reprinted in CCH FED. SEC. L. REP. (Current vol.) ¶ 77,564 at 83,192 (1968).

⁵⁷ ATTORNEY GEN.'S NAT'L COMM. TO STUDY THE ANTITRUST LAWS, REPORT at 12 (1955).

⁵⁸ 15 U.S.C. § 1 (1964) makes illegal

[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations

For a general discussion of the applicability of the antitrust laws to the securities industry, see Asch, *The Antitrust Laws and the Regulated Securities Markets*, 11 ANTI-TRUST BULL. 209 (1966); Bicks, *Antitrust and the New York Stock Exchange*, 21 BUS. LAW. 129 (1965); Johnson, *Application of Antitrust Laws to the Securities Industry*, 20 SW. L.J. 536 (1966); Nerenberg, *Applicability of the Antitrust Laws to the Securities Field*, 16 W. RES. L. REV. 131 (1964).

⁵⁹ SEC Comments on Proposed Rule at 20 (comments of the Department of Justice).

⁶⁰ 310 U.S. 150 (1940).

⁶¹ 310 U.S. at 218; *accord*, *United States v. Trenton Potteries Co.*, 273 U.S. 392, 396-98 (1927); *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290, 341-42 (1897). *But see* *Board of Trade v. United States*, 246 U.S. 231, 238 (1918) (standard is "whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition"). See generally Bork & Bowman, *The Crisis in Antitrust*, 65 COLUM. L. REV. 363, 365 (1965); von Kalinowski, *The Per Se Doctrine—An Emerging Philosophy of*

involving a plan comparable to the NYSE rate structure, the Supreme Court held that the prescribing of standard commissions by a real estate board was per se unlawful:

[A]n agreement, shown either by adherence to a price schedule or by proof of consensual action fixing the uniform or minimum price, is itself illegal under the Sherman Act, no matter what end it was designed to serve.⁶³

The courts have not deviated from this position in subsequent cases⁶⁴ and the NYSE has not contested this precedent;⁶⁵ instead, the Exchange relies upon an implied exemption theory to immunize it from antitrust liability.

Antitrust Exemptions in General

Antitrust exemptions can be either express⁶⁶ or implied.⁶⁷ Such exemptions arise because in many areas Congress has shifted from the usual policy of "prohibiting restraints on competition to one of providing relief from the rigors of competition."⁶⁸ Because of the paramount importance attached

Antitrust Law, 11 U.C.L.A. L. REV. 569 (1964); Loevinger, *The Rule of Reason in Antitrust Law*, 7 PRAC. LAW. 17, 19-21 (Nov., 1961); Montague, "Per se Illegality" and the Rule of Reason, 12 ABA ANTITRUST SECTION 69 (1958).

The rationale of the per se doctrine is that some practices "because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958).

⁶² 339 U.S. 485 (1950).

⁶³ *Id.* at 489.

⁶⁴ "Throughout the period under study [1955-1968], the courts have uniformly reiterated that horizontal price fixing arrangements are unlawful *per se*." ABA, 1955-1968 ANTITRUST DEVELOPMENTS 2 (1968).

⁶⁵ The NYSE memorandum submitted to the SEC during the recent hearings does not discuss price-fixing. NYSE, Memorandum of the NYSE before the SEC, Commission Rate Structure of Registered National Exchanges, File No. 4-144, Aug., 1968 [hereinafter cited as NYSE Memo.], reprinted in CCH FED. SEC. L. REP. (Current vol.) ¶ 77,587 (1968).

⁶⁶ *E.g.*, 7 U.S.C. § 291 (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) (McCarren-Ferguson exemption for state regulation of insurance industry); 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).

⁶⁷ *E.g.*, *Eastern R.R. Presidents Conf. v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); *Parker v. Brown*, 317 U.S. 341 (1943). For a comprehensive list of exemptions created by Congress and the courts up to 1961, see Pogue, *The Rationale of Exemptions from Antitrust*, 19 ABA ANTITRUST SECTION 313, 330-54 (1961).

⁶⁸ *FCC v. RCA Communications, Inc.*, 346 U.S. 86, 92 (1953).

to antitrust enforcement,⁶⁹ exemptions—both express and implied—are narrowly construed.⁷⁰ Express exemptions are limited on the theory that if “Congress had desired to grant any further immunity, Congress doubtless would have said so.”⁷¹ In dealing with implied exemptions, however, courts have no easily discernable expression of congressional intent on which to rely. The argument most frequently advanced in seeking an implied exemption is that Congress, by delegating authority to a regulatory agency, has preempted the usual antitrust jurisdiction of the courts.⁷² But this argument must overcome the strict standard that the Supreme Court has announced: “Repeals of the antitrust laws by implication from a regulatory statute are

⁶⁹ See *Carnation Co. v. Pacific Westbound Conf.*, 383 U.S. 213, 218 (1966) (“the antitrust laws represent a fundamental national economic policy”); *United States v. Philadelphia Nat’l Bank*, 374 U.S. 321, 348 (1963) (antitrust policy serves a “felt indispensable role . . . in the maintenance of a free economy”); *Pan Am. World Airways, Inc. v. United States*, 371 U.S. 296, 324 (1963) (the Sherman Act “embodies perhaps the most basic economic policy of our society”); *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 359-60 (1933) (the Sherman Act is a “charter of freedom” comparable to constitutional provisions).

⁷⁰ The Supreme Court has repeatedly declined to hold that a congressionally enacted regulatory scheme completely displaces the antitrust laws absent an unequivocally declared congressional purpose to do so. See, e.g., *California v. FPC*, 369 U.S. 482, 485 (1962); cf. *United States v. Radio Corp. of America*, 358 U.S. 334 (1959) (Federal Communications Act held no bar to antitrust suit against TV and radio licenses); *Georgia v. Pennsylvania R.R.*, 324 U.S. 439 (1945) (Interstate Commerce Act does not immunize railroads from prosecution for unfair rate fixing); *Pan Am. World Airways, Inc. v. United States*, 371 U.S. 296, 304-05 (1963) (broad CAB jurisdiction over unfair air trade practices does not preempt antitrust suits) (dictum). See also ABA, 1955-1968 ANTITRUST DEVELOPMENTS 189 (1968) (concluding that judicial interpretation has not substantially expanded any exemption); Orrick, *The Recent Erosion of Certain Antitrust Exemptions*, 10 ANTITRUST BULL. 667 (1965).

The Court’s approach to implied exemptions is analogous. Not only are they disfavored, see note 73 *infra*, but their scope has been narrowly confined to conform to the need asserted. See *Silver v. New York Stock Exchange*, 373 U.S. 341, 357-58 (1963).

For a criticism of recent Supreme Court cases applying the antitrust laws, see Merkel, *The Other Anti of Antitrust*, 46 HARV. BUS. REV. 53 (March-April 1968).

⁷¹ *United States v. Borden Co.*, 308 U.S. 188, 201 (1939). The NYSE has attempted to subvert this rationale by citing congressional inaction as proof that Congress intended to exempt the Exchange from the antitrust laws: “If Congress had intended otherwise, it would have said so.” NYSE Memo. at 10, reprinted in CCH FED. SEC. L. REP. (Current vol.) ¶ 77,587 at 83,235 (1968).

⁷² See, e.g., *Pan Am. World Airways, Inc. v. United States*, 371 U.S. 296 (1963); *California v. FPC*, 369 U.S. 482 (1962); *United States v. Radio Corp. of America*, 358 U.S. 334 (1959). For an analysis of an implied antitrust exemption in another context, see Comment, *Alabama Power Company v. Alabama Electric Cooperative: Rural Electrification and the Antitrust Laws—Irresistible Force Meets Immovable Object*, 55 VA. L. REV. 325 (1969). See generally Hale & Hale, *Competition or Control I: The Chaos in the Cases*, 106 U. PA. L. REV. 641 (1958); Hale & Hale, *Competition or Control VI: Application of Antitrust Laws to Regulated Industries*, 111 U. PA. L. REV. 46 (1962).

strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions."⁷³

Subject to the general rule that exemptions will be narrowly construed, there are two grounds on which an implied exemption may be based. First, an exemption may arise if an agency is responsible for enforcing some "competitive standard clearly delineated by [statute]."⁷⁴ Although the Court frequently speaks of this type of exemption in terms of the "pervasiveness"⁷⁵ of agency regulation, extensive regulation by the Federal Communications Commission and the Federal Power Commission has not sufficed to provide an antitrust exemption.⁷⁶ In *United States v. Radio Corporation of America*,⁷⁷ an exchange of television stations was attacked as violative of the Sherman Act.⁷⁸ The Federal Communications Commission had consented to the transaction as required by section 310(b) of the Communication Act of 1934.⁷⁹ RCA contended that this required approval vested the FCC with primary jurisdiction and that an attack could be made only on direct review of the license grant. The Court rejected this argument holding that the Commission lacked the statutory power to resolve antitrust questions since its approval was based on a broad standard of "public interest, convenience, and necessity"⁸⁰ rather than on anti-

⁷³ *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 350-51 (1963). The principle is a modification of the older, more general canon of construction that "repeals by implication are not favored." *United States v. Tynen*, 78 U.S. (11 Wall.) 88, 92 (1870) (dictum); see *Henderson's Tobacco*, 78 U.S. (11 Wall.) 652, 657 (1870).

However, commentators have viewed the principle as less than sacred. Kestenbaum, *Primary Jurisdiction to Decide Antitrust Jurisdiction: A Practical Approach to the Allocation of Functions*, 55 GEO. L.J. 812, 820 (1967) ("the rule is, indeed, that such immunity will not be implied except when the Court thinks it ought to be."); 33 A.B.A. ANTITRUST L.J. 5 (1967) ("there does not seem to be an incontestable principle that every exemption must necessarily be interpreted narrowly").

⁷⁴ *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 351 (1963). Compare *Pan. Am. World Airways, Inc. v. United States*, 371 U.S. 296 (1963), with *California v. FPC*, 369 U.S. 482, 485 (1962) and *United States v. Radio Corp. of America*, 358 U.S. 334 (1959).

⁷⁵ See, e.g., Hale & Hale, *Mergers in Regulated Industries*, 59 NW. U.L. REV. 49, 54 (1964) ("The key word is 'pervasive.'").

⁷⁶ There is doubt whether any regulatory scheme exists that is sufficiently "pervasive" within the Court's definition to totally displace the antitrust laws. See Johnson, *Application of Antitrust Laws to the Securities Industry*, 20 SW. L.J. 536, 553 & nn.117-18 (1966). In *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963), the antitrust laws were applied even though "[t]he regulation of banking may be more intensive than the regulation of any other industry" 1 K. DAVIS, *ADMINISTRATIVE LAW* § 4.04 at 247 (1958). The Court itself remarked that "the agencies maintain virtually a day-to-day surveillance of the American banking system." 374 U.S. at 329.

⁷⁷ 358 U.S. 334 (1959).

⁷⁸ 15 U.S.C. §§ 1, 4 (1964).

⁷⁹ 47 U.S.C. § 310(b) (1964).

⁸⁰ *Id.*

trust criteria.⁸¹ Similar reasoning was employed by the Court in *California v. Federal Power Commission*,⁸² where the Government attacked the merger of a gas company with a pipeline company. After initiation of the antitrust suit, the companies submitted an application for merger and received Power Commission approval pursuant to section 7 of the Natural Gas Act.⁸³ In holding that the administrative decision should have been suspended pending completion of the antitrust suit, the Court emphasized that the FPC lacked the statutory authority to adjudicate antitrust issues and therefore could not preempt the Court's antitrust jurisdiction.⁸⁴

A comparison of these cases with the Court's decision in *Pan American World Airways, Inc. v. United States*⁸⁵ reveals that the requisite "pervasiveness" is not established merely by thorough regulation; in addition, there must be something "built into the regulatory scheme which performs the antitrust function."⁸⁶ In *Pan American* the Court held that the Civil Aeronautics Board had exclusive jurisdiction over questions of injunctive relief against the division of territories or allocation of routes among carriers. The crucial factors in the Court's decision were the statutory delegation of responsibility to consider some antitrust factors,⁸⁷ and the explicit provision for

⁸¹ In reaching its conclusion, the Court relied upon §§ 311, 313 of the Federal Communications Act, 47 U.S.C. §§ 311, 313 (1964), formerly 48 Stat. 1086-87 (1934). Section 311 directed the FCC to refuse to license a station whose license had been previously revoked by a court under § 313, which made the antitrust laws applicable to the "manufacture and sale of and . . . trade in radio apparatus and devices . . ." 358 U.S. at 340 n.6.

⁸² 369 U.S. 482 (1962).

⁸³ 15 U.S.C. § 717f(c) (1964) (merger conditioned upon FPC certificate of "public convenience and necessity"). The Court indicated that while antitrust considerations are "plainly relevant" under this standard, 369 U.S. at 484, this in itself did not establish a "pervasive" regulatory scheme. *Id.* at 485.

⁸⁴ The Court noted that there was no express antitrust exemption for FPC-approved mergers in the Natural Gas Act, nor would the Court interpret § 7 of the Clayton Act, 15 U.S.C. § 18 (1964), to include such an exemption. 369 U.S. at 486. This construction is supported by § 20(a) of the Natural Gas Act, 15 U.S.C. § 717s(a) (1964), which advises the FPC to communicate "apparent violations of the Federal antitrust laws to the Attorney General, who, in his discretion, may institute the necessary criminal proceedings."

⁸⁵ 371 U.S. 296 (1963).

⁸⁶ *Silver v. New York Stock Exchange*, 373 U.S. 341, 358 (1963).

⁸⁷ 371 U.S. at 304. The critical provisions of the Federal Aviation Act, 49 U.S.C. §§ 1301-1542 (1964), were § 411, 49 U.S.C. § 1381 (1964) (CAB jurisdiction over "unfair methods of competition in air transportation"), and §§ 408-409, 49 U.S.C. §§ 1378-1379 (1964) (CAB authority over consolidations, mergers, purchasers, leases, operating contracts, acquisition of control of an air carrier, and interlocking relations). Furthermore, the enforcement of the Clayton Act as it applies to air carriers is vested in the CAB, 15 U.S.C. § 21(a) (1964). In *Pan American*, however, the Court went on to say that the CAB does not "have jurisdiction over every antitrust violation by air carriers." 371 U.S. at 311-12.

judicial review of these CAB determinations.⁸⁸ In *United States v. Philadelphia National Bank*,⁸⁹ the absence of these two factors resulted in the conclusion that section 7 of the Clayton Act⁹⁰ was applicable to a bank merger even after approval by the Comptroller of the Currency.⁹¹ In holding that the Comptroller lacked authority to enforce the antitrust laws, the Court noted that although the Comptroller was required to consider the anti-competitive effects of a merger application, "he was not required to give this factor any particular weight."⁹² Furthermore, there was "no specific provision for judicial review of his decision."⁹³ From the language in these cases it would appear that both criteria—explicit statutory authority to consider antitrust variables and judicial review of the exercise of that authority—are essential for an implied exemption based upon the "pervasiveness" of agency regulation.

A second type of exemption from the antitrust laws may be implied where such an exemption is necessary for the successful operation of a regulatory scheme. Whereas an exemption based on "pervasiveness" extends to the full scope of the agency's responsibility for providing nonjudicial antitrust enforcement, the "necessity" exemption is recognized only to the extent that it is essential to the effectuation of the regulatory statute. The hallmark case raising the "necessity" inquiry is *Silver v. New York Stock Exchange*.⁹⁴ Silver, a nonmember of the Exchange who engaged in over-the-counter trading, had received temporary NYSE approval of wire connections with member firms. When these connections were later severed as "required by the Exchange's Constitution and rules,"⁹⁵ Silver charged that the *ex parte* termination constituted a collective refusal to deal in violation of section 1 of the Sherman Act.⁹⁶ The district court held that the antitrust laws were applicable to the NYSE action because the termination of the wire connections went beyond the scope of NYSE's power granted by the Exchange Act.⁹⁷ Reversing this decision, the Second Circuit con-

⁸⁸ 49 U.S.C. § 1486 (1964).

⁸⁹ 374 U.S. 321 (1963); *accord*, *United States v. First Nat'l Bank & Trust Co.*, 376 U.S. 665 (1964).

⁹⁰ 15 U.S.C. § 18 (1964).

⁹¹ The Comptroller General had approved the merger pursuant to 12 U.S.C. § 215 (1964). Under the Bank Merger Act of 1960, 12 U.S.C. § 1828 (c) (1964), such approval is conditioned upon the receipt of reports by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Attorney General. All three reports concluded that the "merger would have substantial anti-competitive effects . . ." 374 U.S. at 333.

⁹² 374 U.S. at 351.

⁹³ *Id.*

⁹⁴ 373 U.S. 341 (1963).

⁹⁵ *Id.* at 344.

⁹⁶ 15 U.S.C. § 1 (1964).

⁹⁷ 196 F. Supp. 209, 221-22 (S.D.N.Y. 1951), *rev'd*, 302 F.2d 714 (2d Cir. 1962), *rev'd*,

strued the Exchange Act as comprehending such activity⁹⁸ and allowed an exemption.⁹⁹ The Supreme Court declined to follow the rationale of either of the lower courts.¹⁰⁰ Instead, the Court declared that in the absence of the Exchange Act the severance of the wires would "constitute a *per se* violation of § 1 of the Sherman Act,"¹⁰¹ but then concluded that the rule applied by the NYSE was "germane"¹⁰² to its statutory duty of self-regulation¹⁰³ and therefore within the scope of the Exchange Act. The Court recognized that the issue raised by the NYSE action was "the extent to which the character and objectives of the duty of exchange self-regulation contemplated by the Securities Exchange Act are incompatible with the maintenance of an antitrust action."¹⁰⁴ Nevertheless, this ultimate issue was avoided by the Court's decision that the NYSE had exceeded its authority under the Act by severing Silver's wire connections without notice, explanation or an opportunity for a hearing,¹⁰⁵ and in so doing had failed to reach the "threshold of justification."¹⁰⁶ The Court did state, however, that the test for resolving conflicts between antitrust and regulatory statutes is the necessity of an antitrust exemption:

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.¹⁰⁷

Application of the Antitrust Laws to the Commission Rate Structure

The *Silver* case was purportedly applied in *Kaplan v. Lehman Brothers*,¹⁰⁸

373 U.S. 341 (1963) (although the district court's disposition was reinstated, the Supreme Court relied on different grounds).

⁹⁸ 302 F.2d 714 (2d Cir. 1962), *rev'd*, 373 U.S. 341 (1963).

⁹⁹ "The Exchange is exempt . . . because it is exercising a power which it is required to exercise by the Securities Exchange Act." 302 F.2d at 721.

¹⁰⁰ 373 U.S. at 356-57.

¹⁰¹ *Id.* at 347, *citing* *Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, 364 U.S. 656 (1961); *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959); *Fashion Originators' Guild of America v. FTC*, 312 U.S. 457 (1941). For a discussion see Barber, *Refusals to Deal Under the Federal Antitrust Laws*, 103 U. PA. L. REV. 847 (1955); Rahl, *Per Se Rules and Boycotts under the Sherman Act: Some Reflections on the Klor's Case*, 45 VA. L. REV. 1165 (1959).

¹⁰² 373 U.S. at 356.

¹⁰³ This was implied by interpreting §§ 6(b), 6(d) of the Exchange Act, 15 U.S.C. §§ 78f(b), (d) (1964), to include a duty to regulate members' transactions and relationships with nonmembers.

¹⁰⁴ 373 U.S. at 358.

¹⁰⁵ *Id.* at 361-62.

¹⁰⁶ *Id.* at 365.

¹⁰⁷ *Id.* at 357.

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

a class action and shareholder's derivative suit directly challenging the commission rate structure as violating section 1 of the Sherman Act. The district judge granted defendants' motion for summary judgment on two grounds: First, the complaint alleged a per se violation,¹⁰⁹ and *Silver* had held that action taken by the Exchange pursuant to its statutory rule-making authority could not be per se illegal under the Sherman Act.¹¹⁰ Even assuming that the district court was correct in finding that the Exchange Act "by the plainest implication"¹¹¹ vests the NYSE with authority to fix minimum rates, this ground could easily be obviated by drafting pleadings which did not rely on the per se argument.¹¹² Furthermore, *Silver* explicitly stated that finding an exception to the per se theory was "only the beginning, not the end, of inquiry."¹¹³

Second, the district court decided that SEC authorization to alter or supplement NYSE rules preempted antitrust jurisdiction.¹¹⁴ The court founded this argument on dictum in the majority opinion in *Silver*; after emphasizing that there was no statutory provision for agency or judicial review of the Exchange's termination of *Silver*'s wire connections, Mr. Justice Goldberg observed that "[s]hould 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."¹¹⁵ The *Silver* opinion specifically noted that this was "an issue we do not decide today."¹¹⁶ Furthermore, the *Kaplan* conclusion does not follow inevitably from the dictum on which the court relies; *Silver* never said that such a "different case" would necessitate a different result. The context of Mr. Justice Goldberg's remarks suggests that the other vehicle inherent in the regulatory scheme may have to protect the same competitive policies that are embodied in the antitrust laws.¹¹⁷ At a minimum, *Kaplan* should have recognized that the Supreme Court's language invites some appraisal of the efficacy of the other vehicle in protecting the public interest against the Exchange's abuse of its self-regulatory powers.¹¹⁸ In sum, the *Kaplan* opinion inadequately deals with

¹⁰⁹ 250 F. Supp. at 564.

¹¹⁰ 373 U.S. at 348-49.

¹¹¹ 250 F. Supp. at 565.

¹¹² The Department of Justice has apparently taken this approach. See *SEC Comments on Proposed Rule* at 18 n.3.

¹¹³ 373 U.S. at 349.

¹¹⁴ 250 F. Supp. at 565-66.

¹¹⁵ 373 U.S. at 360.

¹¹⁶ *Id.* at 358 n.12.

¹¹⁷ "Applicability of the antitrust laws, therefore, rests on the need for vindication of their positive aim of insuring competitive freedom. Denial of their applicability would defeat the congressional policy reflected in the antitrust laws without serving the policy of Securities Exchange Act." *Id.* at 360.

¹¹⁸ Chief Justice Warren, dissenting from the majority's denial of certiorari in *Kaplan*, called the Court of Appeals' opinion "blunderbuss" and "scanty." 389 U.S. at 957.

the complex and important antitrust issues raised by the NYSE commission rate structure, and the Supreme Court's denial of certiorari merely means that these issues have yet to be settled.¹¹⁹ Accordingly, there must be a full analysis of the three legal bases that may be asserted to justify the Exchange's long-established practice of fixing minimum commission rates: (1) implied congressional authorization of rate-fixing as an essential part of the Exchange's self-regulatory function,¹²⁰ (2) the displacement of normal judicial antitrust jurisdiction because of the "pervasiveness" of SEC regulation under the Exchange Act,¹²¹ and (3) the "necessity" of minimum rates to implement the policies of the Act.

The Commission Rate Structure and the Self-Regulatory System

Under the self-regulatory concept embodied in the Securities Exchange Act of 1934,¹²² the exchanges are not only the objects of supervision by the SEC but also exercise regulatory powers over their own members. As pointed out in the Senate Report accompanying the Exchange Act bill,

the initiative and responsibility for promulgating regulations pertaining to the administration of their ordinary affairs remain with the exchanges themselves. It is only where they fail adequately to provide protection to investors that the Commission is authorized to step in and compel them to do so.¹²³

¹¹⁹ The *Kaplan* opinion has not dissuaded the Department of Justice, see note 112 *supra*.

¹²⁰ The "implied congressional authorization" argument is a modification of the "express exemption" rationale. See note 71 *supra* and accompanying text. In essence, the NYSE contends that § 19(b) of the Exchange Act, which provides for SEC review of Exchange rules pertaining to "the fixing of reasonable rates of commission," implicitly authorizes the exchanges to fix their own rates free from the antitrust laws.

¹²¹ Relying in part upon the Supreme Court's dictum in *Silver*, see text at note 159 *infra*, the NYSE does not specifically argue that the regulatory scheme established by the Exchange Act is sufficiently "pervasive" to confer a total exemption upon the Exchange. This issue is nevertheless important not only because the Court's conclusion is dictum and not necessarily controlling but also because the "pervasiveness" inquiry is essential to a complete legal analysis of an implied antitrust exemption.

¹²² Former SEC Chairman Douglas graphically described self-regulation as "letting the exchanges take the leadership with Government playing a residual role. Government would keep 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." W. DOUGLAS, *DEMOCRACY AND FINANCE* 82, (Allen ed. 1940).

¹²³ S. REP. NO. 792, 73d Cong., 2d Sess. 13 (1934). This "partnership between government and private enterprise," *Silver v. New York Stock Exchange*, 373 U.S. 341, 366 (1963), was originally a compromise necessitated by the sheer magnitude of such a regulatory task, see *Hearings on Stock Exchange Practices Before the Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess., pt. 15, at 6582 (1934); the bitter opposition of the financial community, see 2 A. SCHLESINGER, *THE AGE OF ROOSEVELT, THE COMING OF THE NEW DEAL* 463 (1959); and the tradition of Exchange self-regulation itself, see

The Act's self-regulatory provisions require the exchanges to register with the SEC,¹²⁴ file copies of their rules,¹²⁵ satisfy the SEC that their rules are "just and adequate to insure fair dealing and to protect investors,"¹²⁶ provide sanctions against rule violations,¹²⁷ and agree to enforce the rules.¹²⁸ The statute permits an exchange, once registered, to adopt new rules without prior SEC approval,¹²⁹ but the Exchange must file amendments with the SEC.¹³⁰

The SEC has direct regulatory authority over several matters, including floor trading,¹³¹ specialists and odd-lot dealers,¹³² short sales,¹³³ and manipulative or deceptive devices.¹³⁴ There is no provision for SEC review of exchange rule enforcement in particular instances,¹³⁵ an omission which led to the Court's intervention in *Silver*.¹³⁶ Nor does the SEC have power to penalize members for violating exchange rules.¹³⁷ The SEC does, however, have power to request changes in exchange rules in a wide range of areas. Section 19(b) authorizes the Commission to request changes in the rules, and if, after an opportunity for a hearing the exchange refuses, the SEC may order changes that are

necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange . . . in respect of such matters as

Westwood & Howard, *Self-Government in the Securities Business*, 17 LAW & CONTEMP. PROB. 518, 518-22 (1953). *But cf.* H.R. REP. NO. 1383, 73 Cong., 2d Sess. 3 (1934) (emphasizing the failure of private exchange controls).

¹²⁴ 15 U.S.C. § 78e (1964).

¹²⁵ 15 U.S.C. § 78f(a) (1964).

¹²⁶ 15 U.S.C. § 78f(d) (1964).

¹²⁷ 15 U.S.C. § 78f(b) (1964) (rules must include provisions for expulsion, suspension, or disciplinary action against member conduct "inconsistent with just and equitable principles of trade . . .").

¹²⁸ 15 U.S.C. § 78f(a) (1) (1964).

¹²⁹ 15 U.S.C. § 78f(c) (1964).

¹³⁰ 15 U.S.C. § 78f(a) (4) (1964).

¹³¹ 15 U.S.C. § 78k(a) (1964).

¹³² 15 U.S.C. § 78k(b) (1964).

¹³³ 15 U.S.C. § 78j(a) (1964).

¹³⁴ 15 U.S.C. §§ 78i, 78j(b) (1964).

¹³⁵ 2 L. LOSS, *SECURITIES REGULATION* 1178 (2d ed. 1961).

¹³⁶ 373 U.S. at 357.

¹³⁷ SPECIAL STUDY, pt. 4, at 704. When an investigation discloses possible violations, the SEC usually refers the case to the particular exchange. If the exchange takes no action, the Commission can then suspend or revoke the exchange's registration under § 19(a)(1), 15 U.S.C. § 78s(a)(1) (1964), for a violation of its continuing duty to enforce its rules and regulations. L. LOSS, *supra* note 135, at 1178; see *Baird v. Franklin*, 141 F.2d 238, 244 (2d Cir.) (dissenting opinion), *cert. denied*, 323 U.S. 737 (1944).

... (9) the fixing of reasonable rates of commission, interest, listing, and other charges ... and (13) similar matters.¹³⁸

From this section the NYSE concludes that Congress impliedly authorized the Exchange to fix minimum commission rates subject to SEC review as an essential part of its self-regulatory function.¹³⁹ However, this contention fails upon closer scrutiny of the Act itself, its legislative history, and its implementation by the SEC.

The list of items subject to SEC review under section 19(b) is illustrative rather than exclusive.¹⁴⁰ Unless the enumerated items and all "similar matters" are assumed to be indispensable parts of the self-regulatory system, the purpose of the provision must be to explain the general scope of SEC review rather than insulate all exchange rules from antitrust remedies. Even if some kind of rate-fixing were justified, section 19(b) nowhere suggests that a *minimum* schedule of rates is necessary. That section only empowers the SEC to alter or supplement exchange rules regarding the fixing of *reasonable* rates, which arguably may include minimum, maximum or even negotiated rates.¹⁴¹ Moreover, when Congress has desired to prescribe minimum rates in other fields, it has so specified.¹⁴² Here Congress not only failed to specifically authorize minimum rates, but on the contrary, employed a reasonableness standard which is ambiguous in a rate-fixing context.¹⁴³

¹³⁸ 15 U.S.C. § 78s(b) (1964). The Court has concluded that this section impliedly gives the SEC power to "disapprove any rules adopted by an exchange . . ." *Silver v. New York Stock Exchange*, 373 U.S. 341, 357 (1963).

¹³⁹ The Exchange also relies upon § 3(a)(3), 15 U.S.C. § 78c(a)(3) (1964), which defines a member of an exchange as one 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 . . ." The contention is that only by the fixing of a uniform minimum commission rate can a "yardstick" be established with which to determine if the fee to the general public exceeds the member fee. NYSE Memo. at 7, reprinted in CCH FED. SEC. L. REP. (Current vol.) ¶77,587 at 83,234 (1968). The Department of Justice characterizes the clause merely as an alternative condition to exchange membership which becomes inoperative when members can no longer be serviced at lower costs. It is neither inconsistent with a competitive rate system nor indicative of a congressional intent to impliedly repeal the antitrust laws. Justice Dep't Memo. at 30-31.

¹⁴⁰ Justice Dep't Memo. at 23.

¹⁴¹ "[M]any of the knottiest problems of rate structure and establishment of 'reasonable' rates . . . might be enormously simplified if 'reasonable' rates were not necessarily conceived of as minimum ones." SPECIAL STUDY, pt. 2, at 323. See *id.*, pt. 5, at 106-07 (recommending a maximum-minimum schedule); Nerenberg, *Applicability of the Antitrust Laws to the Securities Field*, 16 W. RES. L. REV. 131, 150-51 (1964).

¹⁴² See, e.g., 49 U.S.C. §§ 13(4), 15(1), 316(e), 318 (1964) (ICC power to set "maximum and minimum" rates for rail, water, and motor carriers); 49 U.S.C. § 1482(i) (1964) (CAB authorized to fix "maximum and minimum" rates for air carriers); 47 U.S.C. § 205(a) (1964) (FCC power to set "maximum and minimum" rates for wire and radio).

¹⁴³ See text at note 167 *infra*. While the NYSE stresses that the "experience of

Since the references to legislative history cited by the NYSE as authorizing minimum rates are not drawn from a comprehensive discussion of the rate structure,¹⁴⁴ they are unconvincing in establishing any legislative intent.¹⁴⁵ Some of these references allude not to the NYSE but to the Federal Trade Commission rate-fixing that was proposed in the original draft,¹⁴⁶ and in three other cases appear to contemplate maximum, not minimum, rates.¹⁴⁷ The existence of only eight such references¹⁴⁸ in the voluminous, multi-

the Exchange and the expertise of the SEC accumulated in applying the statutory standard of reasonableness" evidences an implied authority to fix minimum rates, NYSE Memo. at 27, *reprinted in* CCH FED. SEC. L. REP. (Current vol.) ¶ 77,587 at 83,243 (1968), the *Special Study* concludes that this standard has been without "comprehensive and consistent public articulation, on the part of the Exchange or the Commission." SPECIAL STUDY, pt. 2, at 343.

¹⁴⁴ For general descriptions of the background of the enactment of the Exchange Act of 1934, see 2 A. SCHLESINGER, *THE AGE OF ROOSEVELT, THE COMING OF THE NEW DEAL* ch. 29 (1959); Gadsby, *Historical Developments of the S.E.C.—The Government View*, 28 GEO. WASH. L. REV. 6 (1959); Tracy and MacChesney, *The Securities Exchange Act of 1934*, 32 MICH. L. REV. 1025, 1033-36 (1934).

¹⁴⁵ An early draft of the Exchange Act contained the phrase "uniform rate" rather than "reasonable rate." H.R. 7852, 73d Cong., 2d Sess. (1934). During the hearings on the bill, it was suggested that "uniform" be deleted:

While . . . your bill would give the Federal Trade Commission the right to prescribe uniform rates of commission, it does not otherwise authorize the Commission to fix rates, which it seems to me it should do and would do by striking out the word "uniform." That would permit the Commission to fix rates. . . . [T]he commissions charged should either be fixed by some governmental authority or be supervised by such an authority. As matters now stand, the exchange can charge all that the traffic will bear, and that is a burden upon commerce.

Hearings on Stock Exchange Practices Before the Senate Comm. on Banking and Currency, 73d Cong., 2d Sess., pt. 16, at 7705 (1934). The NYSE concludes that the deletion was to authorize the Federal Trade Commission to fix rates, which historically means fix minimum rates. NYSE Memo. at 10, *reprinted in* CCH FED. SEC. L. REP. (Current vol.) ¶ 77,587 at 83,235. The Department of Justice cites the passage to demonstrate the breadth of the SEC's powers and the policy of protecting investors from excessive rates. Justice Dep't Memo. at 27. However, the *Special Study* reports that no formal explanation was given for the change. SPECIAL STUDY, pt. 2, at 300. One commentator has inferred from the deletion that Congress did not intend to exempt commission rates from the antitrust laws. 19 W. RES. L. REV. 167, 170 n.21 (1967). But see Note, *Antitrust and the Stock Exchange: Minimum Commission or Free Competition?*, 18 STAN. L. REV. 213, 225 (1965). See also Brief for SEC as Amicus Curiae at 17 n.26, *Kaplan v. Lehman Bros.*, 371 F.2d 409 (7th Cir.), cert. denied, 389 U.S. 954 (1967).

¹⁴⁶ S. 2683 & H.R. 7853, 73d Cong., 2d Sess. (1934).

¹⁴⁷ Justice Dep't Memo. at 28, *citing* 78 CONG. REC. 8303 (1934) (remarks of Rep. Pertengill); *id.* at 8091-92 (remarks of Rep. Wadsworth); *id.* at 8490 (remarks of Sen. Hastings).

¹⁴⁸ *Hearings on Stock Exchange Practices Before the Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess., pt. 13, at 6075, 6080 (1934); *Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess., 320-21, 423-24 (1934); 78 CONG. REC. 8087, 8092, 8490, 8493 (1934).

volume hearings¹⁴⁹ and extensive debates,¹⁵⁰ and no mention whatsoever of minimum rates in the committee¹⁵¹ and conference¹⁵² reports, also undercuts the NYSE's argument that the fixing of minimum rates was considered part of the self-regulatory system of the Exchange Act.

Because administrative activities pursuant to the regulatory statute that created the agency are helpful in interpreting ambiguous legislative directives,¹⁵³ the history of the SEC's use of section 19(b) as a regulatory tool is significant. If it could be shown that the SEC carefully scrutinized changes in the NYSE commission rate structure, then perhaps the argument that Congress intended the Exchange to set minimum rates subject to SEC review would be persuasive. On the contrary, however, the Commission's role in reviewing previous rate increases¹⁵⁴ has been little more than passive.¹⁵⁵ Although the SEC can force the Exchange to abandon its minimum commission rates under its general power to request changes in the NYSE's rules, the Commission has no procedure for regular or systematic review of the Exchange's rules;¹⁵⁶ indeed, its power under section 19(b) has been used only once in the history of the SEC, and then in an area other than commission rates.¹⁵⁷

Exemption Based on "Pervasiveness"

Since the Exchange Act does not expressly provide for an antitrust exemption, the pattern of regulation under the Act must be examined to determine whether SEC and Exchange activities impliedly exempt the NYSE commission rate structure from the antitrust laws. According to the Court,

¹⁴⁹ The Senate hearings alone include twenty parts and over 9,000 pages of testimony.

¹⁵⁰ See 2 L. LOSS, *SECURITIES REGULATION* 784 n.2 (2d ed. 1961).

¹⁵¹ H.R. REP. NO. 1383, 73d Cong., 2d Sess. 25-26 (1934); S. REP. NO. 792, 73d Cong., 2d Sess. 13 (1934). Both reports refer generally to the SEC's powers under § 19(b) with no mention of rate-fixing.

¹⁵² H. R. REP. NO. 1838, 73d Cong., 2d Sess. (1934).

¹⁵³ See *Power Reactor Dev. Co. v. International Union of Elec. Workers*, 367 U.S. 396, 408 (1961); *Norwegian Nitrogen Prods. Co. v. United States*, 288 U.S. 294, 315 (1933); *United States v. Jackson*, 280 U.S. 183, 193 (1930).

¹⁵⁴ There were increases in 1938, 1942, 1947, 1953, and 1958. For a brief discussion of the circumstances surrounding these rate increases, see *SPECIAL STUDY*, pt. 2, at 328-33, 344-45.

¹⁵⁵ The SEC did not even complete its review of the 1958 rate increases until several months after the increases took effect. *Id.*, pt. 2, at 332. This inaction has not gone uncriticized. See *id.*, pt. 4, at 719; Jennings, *The New York Stock Exchange and the Commission Rate Struggle*, 53 CALIF. L. REV. 1119, 1144 n.86 (1965); Johnson, *Application of Antitrust Laws to the Securities Industry*, 20 SW. L.J. 536 (1966); Note, *Antitrust and the Stock Exchange: Minimum Commission or Free Competition?*, 18 STAN. L. REV. 213, 235 (1965).

¹⁵⁶ *SPECIAL STUDY*, pt. 4, at 712.

¹⁵⁷ *Id.*, pt. 2, at 344. For the one case where the SEC invalidated an Exchange rule, see note 27 *supra*.

the first implied exemption inquiry is whether the regulatory scheme established by the Exchange Act is sufficiently "pervasive."¹⁵⁸ Although the dictum in *Silver* broadly states that the self-regulatory scheme in the Exchange Act is not "pervasive" enough to create a total exemption,¹⁵⁹ the Court was there dealing with an Exchange rule insulated from SEC review. The Court specifically avoided the issue of whether review through a vehicle other than the antitrust laws could confer a total exemption.¹⁶⁰ This reservation suggests that it is at least possible that direct supervision of the NYSE by the SEC, regardless of the breadth of the Commission's regulatory power, is enough in some contexts to confer an exemption. But whether the SEC's supervision over "the fixing of reasonable rates of commission" is one of those contexts is the continuing controversy.

The SEC recognizes that "where the Commission has jurisdiction to review and pass upon particular Exchange activities, as it has in the area of commission rates under Section 19(b) . . . , antitrust immunity *may*, under some circumstances, be implied."¹⁶¹ On the other hand, the SEC acknowledges that such an exemption "necessarily contemplates that full consideration be given to the policies of the antitrust laws . . . in evaluating any aspect of the commission rate structure or any proposals for its revision."¹⁶² However, unless the SEC has been delegated antitrust responsibilities co-extensive with its review power, there is still "nothing built into the regulatory scheme which performs the antitrust function,"¹⁶³ and mere agency approval or review of private activity pursuant to broad statutory standards has rarely been sufficient justification for an exemption.¹⁶⁴ Therefore, the existence of SEC review of the "fixing of reasonable rates" does not present a "different case as to antitrust exemption"¹⁶⁵ from that examined in *Silver*;

¹⁵⁸ *Silver v. New York Stock Exchange*, 373 U.S. 341, 347 (1963).

¹⁵⁹ 373 U.S. at 360-61.

¹⁶⁰ See text at note 115-16 *supra*.

¹⁶¹ SEC Securities Exchange Act Release No. 8239 at 1-2 (Jan. 26, 1968) (emphasis added). Following this reasoning, the SEC in 1965 suggested an extension of its authority over the Exchange coupled with an antitrust exemption. 111 CONG. REC. 19019-22 (1965) (letter from Manuel F. Cohen, SEC Chairman, to Sen. A. Willis Robertson, Chairman of Senate Committee on Banking and Currency). However, the proposal met stiff congressional opposition. See N.Y. Times, Aug. 19, 1965, at 37, col. 6-7 (letter from Rep. Emanuel Celler, Chairman of the House Judiciary Committee, to the SEC vigorously opposing any antitrust immunity for the NYSE); *id.*, Sept. 8, 1965, at 63, col. 3 (Sen. Philip Hart opposing any Exchange exemption).

¹⁶² SEC Securities Exchange Act Release No. 8329 at 2 (Jan. 26, 1968); see 111 CONG. REC. 19021 (1965) (remarks of Manuel F. Cohen, SEC Chairman).

¹⁶³ *Silver v. New York Stock Exchange*, 373 U.S. 341, 358 (1963).

¹⁶⁴ Compare *California v. FPC*, 369 U.S. 482 (1962) and *United States v. Radio Corp. of America*, 358 U.S. 334 (1959), with *Pan. Am. World Airways, Inc. v. United States*, 371 U.S. 296 (1963).

¹⁶⁵ *Silver v. New York Stock Exchange*, 373 U.S. 341, 360 (1963).

instead, the requisite "pervasiveness" still depends upon the scope of the SEC's power to consider antitrust variables.

While section 19(b) does provide for Commission review of "reasonable rates," it does not limit the SEC's power nor delegate the antitrust function to the SEC by providing standards comparable to antitrust criteria. Unlike the Federal Aviation Act standards which the Court relied on in the *Pan American* case,¹⁶⁶ the standard of reasonableness in section 19(b) scarcely constitutes a mandate to apply antitrust principles. The Supreme Court has expressed doubt concerning the reliability of reasonableness in this context by remarking that "neither law nor economics has yet devised generally accepted standards for the evaluation of rate-making orders. . . ."¹⁶⁷

The absence of antitrust language in the Exchange Act takes on special significance when viewed in the light of the Act's other provisions. In the first place, the Act preserves all existing rights and remedies.¹⁶⁸ This presumably includes antitrust rights under the Sherman Act, and hence is indicative of an intent not to exempt the Exchange activities from antitrust considerations by implication. Secondly, in passing other securities laws, Congress has expressly provided review standards comparable to antitrust criteria where it intended an antitrust exemption. The Maloney Act,¹⁶⁹ a 1938 amendment to the Exchange Act, requires the registration of national associations of over-the-counter securities dealers, and expressly exempts these associations from the application of any conflicting laws,¹⁷⁰ but con-

¹⁶⁶ See note 87 *supra*.

¹⁶⁷ *In re Permian Basin Area Rate*, 390 U.S. 747, 790 (1968) (dictum).

¹⁶⁸ "The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity . . ." 15 U.S.C. § 78bb(a) (1964). Cf. *United States v. Morgan*, 118 F. Supp. 621, 697 (S.D.N.Y. 1953) (dictum).

¹⁶⁹ 15 U.S.C. § 78o-3 (1964). For discussion of the operative features of the Maloney Act, see Frey, *Federal Regulation of the Over-the-Counter Securities Market*, 106 U. PA. L. REV. 1, 43-45 (1957); Westwood & Howard, *Self-Government in the Securities Business*, 17 LAW & CONTEMP. PROB. 518, 518-25 (1952); Note, *The NASD—An Unique Experiment in Cooperative Regulation*, 46 VA. L. REV. 1586, 1587-89 (1960); Note, *Over-the-Counter Trading and the Maloney Act*, 48 YALE L. J. 633 (1939).

¹⁷⁰ "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 provision of this section shall prevail." 15 U.S.C. § 78o-3(n) (1964). This section has been interpreted as an explicit exemption for the over-the-counter dealers. See *International Ass'n of Machinists v. Street*, 367 U.S. 740, 809-10 n.16 (1961) (Frankfurter, J., dissenting); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 227 n.60 (1940); *National Ass'n of Securities Dealers, Inc.*, 19 S.E.C. 424, 478 n.9 (1945). Some commentators have tried to explicate the difference in congressional treatment of over-the-counter dealers and the exchange members by theorizing that the Maloney Act was needed as an incentive to join national securities associations, whereas none were needed to bolster exchange membership. Westwood & Howard, *supra* note 169, at 528; SPECIAL STUDY, pt. 4, at 502-03.

ditions their registration with the SEC on the promulgation of rules which

provide safeguards against unreasonable profits or unreasonable rates of commissions . . . [and] remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.¹⁷¹

Both the exemption language and the antitrust standards manifest a congressional intent to insulate national securities associations from the antitrust laws, while the Exchange Act's regulation of the NYSE and other organized securities exchanges is devoid of either type of exempting provision. Lastly, even if the reasonableness standard encompasses antitrust considerations, the Act is too vague to warrant an antitrust exemption. It not only fails to specify how much weight the SEC should give to antitrust criteria¹⁷² but also neglects to require that the SEC apply the reasonableness standard to all NYSE rules. The SEC's discretion in these matters is reflected in the fact that SEC powers under section 19(b) have "been formally employed only once in the Commission's history, and then in an area other than commission rates."¹⁷³ In sum, an antitrust exemption for the commission rate structure can hardly be based on the "pervasiveness" of a regulatory scheme which embodies an inadequate and amorphous standard that neither need be nor is applied with any degree of certainty.

Exemption Based on "Necessity"

Since the Exchange Act neither specifically authorizes the NYSE minimum rate structure nor establishes a "pervasive" system of SEC supervision and Exchange self-regulation, the rate structure's immunization from the antitrust laws depends upon its necessity to fulfill the principal policies of the Exchange Act—the maintenance of a strong centralized securities market and the protection of investors.¹⁷⁴ It is not within the scope or competence of this Note to resolve the complex economic issues surrounding the impact of the minimum rate structure upon the objectives of the Exchange Act; indeed, "no one can be absolutely certain of the consequences of

¹⁷¹ 15 U.S.C. § 78o-3(b)(7) (1964). The NYSE emphasizes that this section specifically prohibits minimum commission rates while no such provision appears in the Exchange Act. NYSE Memo. at 8, reprinted in CCH FED. SEC. L. REP. (Current vol.) ¶ 77,587 at 83,234 n.2 (1968).

¹⁷² See text at note 92 *supra*.

¹⁷³ SPECIAL STUDY, pt. 2, at 344. For the one case where the SEC invalidated an Exchange rule, see note 27 *supra*.

¹⁷⁴ SEC Comments on Proposed Rule at 20.

abolishing minimum commission rates”¹⁷⁵ However, the areas of disagreement between the NYSE and the Justice Department can be delineated and the dispositive factual issues put into proper perspective in order to determine how the disagreement might best be settled.

The NYSE argues that the elimination of minimum commissions would have three major adverse effects upon the securities market: (1) dampen the incentives for Exchange membership, thereby turning the NYSE into an association of floor brokers and undermining its function as a central auction market, (2) produce destructive competition which would bankrupt smaller commission-oriented brokerage firms, and (3) lead to discriminatory pricing.

Central Auction Market.—The NYSE contends that in the absence of preferential member rates, member firms would withdraw from the Exchange in order to cross orders in their own offices, trade on the third market, or negotiate directly with NYSE floor brokers, whichever would be the most profitable.¹⁷⁶ The impact of this membership decline would be severe. There would be an inevitable loss of liquidity in the auction market, and the ensuing inability of the Exchange to absorb considerable volumes of demand and supply would produce greater price fluctuations, leaving the broker unsure of obtaining a sales price reasonably close to the price of the previously traded share.¹⁷⁷ Consequently, brokers would exert diligent efforts to secure the most favorable prices only on behalf of their large institutional accounts, not the small investors.¹⁷⁸ With the erosion of the NYSE as a central auction market, the small investor also would lose other benefits of the Exchange, such as the “detailed, continuous record of transactions,”¹⁷⁹ and the imposition of “rigorous standards of disclosure”¹⁸⁰ upon listed companies. Furthermore, by withdrawing from the Exchange, brokerage firms would avoid the extensive self-regulation and surveillance

¹⁷⁵ THE NEW YORK STOCK EXCHANGE, REPORT ON THE ECONOMIC EFFECTS OF NEGOTIATED COMMISSION RATES ON THE BROKERAGE INDUSTRY, THE MARKET FOR CORPORATE SECURITIES AND THE INVESTING PUBLIC 1 (August, 1968) [hereinafter cited as NYSE ECONOMIC REP.]; accord, THE BUSINESS LAWYER, Nov., 1965 at 182 (“You can’t quite predict what would happen”) (remarks of Phillip A. Loomis, Jr., General Counsel of the SEC).

¹⁷⁶ NYSE ECONOMIC REP. at 23. The firms most likely to withdraw from Exchange membership are the brokers who do business exclusively with the public investor and rely upon other members for the floor execution and clearance of these transactions. At present there are 134 of these brokers accounting for 10% of the total securities commission income. *Id.* To remain competitive, the integrated firms who do execute and clear their own orders would then “split into two separate entities, one handling public business, the other floor business,” with only the former withdrawing. *Id.* at 25.

¹⁷⁷ *Id.* at 14-16.

¹⁷⁸ *Id.* at 37.

¹⁷⁹ *Id.* at 39.

¹⁸⁰ *Id.* at 41.

envisioned by the Exchange Act,¹⁸¹ thereby putting "the immense burden of regulating that portion of the industry which had previously been subject to Exchange regulation . . . upon the SEC, which is not presently equipped to discharge such a burden."¹⁸²

The Department of Justice, on the other hand, argues that the maintenance of a centralized market does not depend on artificial incentives such as high commission rates; rather, "the economic pressure for efficient trading will itself assure the centralized market."¹⁸³ Since execution and clearance on the Exchange floor would be less costly and time-consuming than trading within a single firm, large scale office crosses would be abandoned.¹⁸⁴ Moreover, lower commissions produced by a competitive system would strengthen the NYSE by stimulating business and recapturing some of the trading lost to the third market.¹⁸⁵ As for the disincentives produced by the costs of self-policing, the incremental costs of Exchange self-regulation over other forms of regulation—National Association of Securities Dealers, SEC or broker self-imposed regulation—are negligible and therefore not a deterrent factor.¹⁸⁶ However, even if a significant number of members threatened to withdraw from the Exchange, the Justice Department suggests more workable alternatives than rate-fixing to preserve a centralized market. Either the standard of regulation applicable to nonmembers could be raised,¹⁸⁷ or increased NYSE membership could be fostered by requiring the membership of all brokerage firms that do a minimum business in listed securities.¹⁸⁸ Accordingly, membership would no longer be governed by the highest bid for a seat, but by meeting established qualifications.¹⁸⁹

Destructive Competition.—In those industries characterized by high fixed costs, destructive competition occurs when competitive pricing drives prices toward an incremental out-of-pocket cost level lower than the average unit cost,¹⁹⁰ thereby "eroding the capital base needed for operations in the public interest."¹⁹¹ It is particularly prevalent during periods of poor business and excess capacity because in the short-run it is better to minimize losses by producing at the marginal cost level than to stop production completely.¹⁹²

¹⁸¹ *Id.* at 26.

¹⁸² NYSE Memo. at 20, reprinted in CCH FED. SEC. L. REP. (Current vol.) ¶77,587 at 83,240 (1968).

¹⁸³ Justice Dep't Memo. at 53.

¹⁸⁴ *Id.* at 60-61.

¹⁸⁵ *Id.* at 46.

¹⁸⁶ *Id.* at 66.

¹⁸⁷ *Id.* at 176.

¹⁸⁸ *Id.* at 177-78.

¹⁸⁹ *Id.* at 178.

¹⁹⁰ NYSE ECONOMIC REP. at 50.

¹⁹¹ Justice Dep't Memo. at 108.

¹⁹² NYSE ECONOMIC REP. at 51; see P. SAMUELSON, *ECONOMICS: AN INTRODUCTORY ANALYSIS* 454-55 (6th ed. 1964).

Although the function of the competitive price mechanism is to allocate society's resources most efficiently by driving useless capacity from the market,¹⁹³ the NYSE argues that excess capacity during slack times must be tolerated in order to satisfy greater demands during peak business activity, particularly since the securities industry is subject to huge volume fluctuations.¹⁹⁴ Furthermore, the Exchange stresses that since the larger brokerage houses derive substantial income from their underwriting activities, the victims of destructive competition would not necessarily be the most inefficient firms; diversified firms could withstand a drop in rates, whereas the "firms which *are* heavily commission-oriented would be the ones forced to leave the field."¹⁹⁵

The Department of Justice refutes the NYSE's forecast of economic disaster by challenging the application of a destructive competition model to the securities industry. First, fixed costs in brokerage firms, especially office space, manpower, and data processing equipment, while high, are not immobile; these facilities can be productive in operations other than the commission business, such as over-the-counter trading or managing mutual fund shares.¹⁹⁶ Second, the diversity in both the size of brokerage firms and the type of their activities evidences the lack of potential economies of scale¹⁹⁷ that would lead to a significant concentration of brokers under competitive pricing.¹⁹⁸ Finally, the need for excess capacity to handle peak business loads is illusory; excess capacity to meet increased demand during short-run fluctuations, similar to seasonal variations in other industries, is considered in ordinary "entrepreneurial decisions."¹⁹⁹ More important, however, is the fact that minimum rates alone do not insure adequate facilities to meet the trading demand. Despite unparalleled prosperity in the past, the industry has not yet developed capacity sufficient to handle average trading volume.²⁰⁰ If the brokerage firms were competing with each other, perhaps they would be forced to invest more of their profits in these needed facilities.²⁰¹ The Justice Department further argues that even if competitive rates do result in the insolvency of some firms, rate-fixing is

¹⁹³ See P. SAMUELSON, *supra* note 192, at 67-68.

¹⁹⁴ NYSE ECONOMIC REP. at 52.

¹⁹⁵ *Id.* at 75.

¹⁹⁶ Justice Dep't Memo. at 113-21.

¹⁹⁷ "In economic terms, [economies of scale] exist if average costs per unit of output decline with an increase in the size of the firm." *Id.* at 121.

¹⁹⁸ *Id.* at 121-32.

¹⁹⁹ *Id.* at 135, quoting C. KAYSEN & D. TURNER, ANTI-TRUST POLICY 197 (1959). The Department of Justice contends that in the securities industry "as in other industries, normal profit levels would sustain 'peak load' capacities needed for normal business." *Id.* at 136.

²⁰⁰ *Id.* at 134.

²⁰¹ *Id.*

not the proper preventive since it does not control nonbrokerage activities.²⁰² Firm solvency can better be protected by expanded supervision,²⁰³ and investors might best be protected against loss by the establishment of a mandatory system of customer insurance for brokers.²⁰⁴

Discriminatory Pricing.—The NYSE emphasized that the effects of a competitive pricing system on the financial security of individual investors are even more far-reaching, for destructive competition also implies undue discrimination in pricing. During slack periods brokers would cut their rates to the level of variable costs only for the economically powerful institutional accounts.²⁰⁵ At this low rate, the institutional accounts would be making no contribution to fixed costs, so the broker would be forced to shift all fixed costs to “smaller, less-powerful traders.”²⁰⁶ However, the Justice Department views this development as remote since some brokers could realize greater profits by undercutting the rates of the diversified firms and specializing in small investor trading.²⁰⁷ If necessary, a “posting system” could be established under SEC auspices to require brokers to announce rates on small transactions,²⁰⁸ thus providing an inexpensive procedure for full disclosure.

The Department of Justice stresses two other characteristics of competitive rates: their substantial benefits to the securities market, and their feasibility. Not only would prices be forced down to levels reflecting true costs but the problems associated with reciprocity arrangements and give-ups would be eliminated.²⁰⁹ Moreover, the quality of ancillary services would be enhanced. By segregating the cost of these services from the total commission cost, customers could avoid payments for “tie-in” services, “churning,” and “dead weight” promotional material.²¹⁰ And since the institutional investor would still demand research services, the same information could be made available to small investors at a nominal fee.²¹¹ The feasibility of competitive rates is evidenced by past experience in institutional trading and trading in the over-the-counter markets.²¹² Because bargaining for give-ups by institutional investors is analogous to price negotiations between buyers and sellers, competitive pricing “would [not] be

²⁰² *Id.* at 180.

²⁰³ *Id.* at 181.

²⁰⁴ *Id.* The Department of Justice recommended a system of public insurance similar to that established by the Federal Deposit Insurance Act, 12 U.S.C. §§ 1811-31 (1964).

²⁰⁵ NYSE ECONOMIC REP. at 83-87.

²⁰⁶ *Id.* at 84.

²⁰⁷ Justice Dep't Memo. at 185.

²⁰⁸ *Id.* at 188.

²⁰⁹ See *supra* notes 26-47 and accompanying text.

²¹⁰ Justice Dep't Memo. at 82-84.

²¹¹ *Id.* at 86.

²¹² *Id.* at 88-96.

any different . . . mechanically, than what goes on today.”²¹³ Furthermore, the over-the-counter markets in listed and unlisted securities have operated without a fixed minimum with no adverse effects upon either the brokers or the investing public.²¹⁴ Trading in these markets is “characterized by vigorous, healthy competition at substantially lower rates.”²¹⁵

CONCLUSION

When omnipresent antitrust policy collides with a congressional attempt to regulate a segment of the national economy, there remains the difficult problem of reconciling conflicting mandates. In resolving these conflicts courts have had difficulty in formulating helpful principles beyond the general rule that antitrust exceptions are narrowly construed. Subject to this general rule, implied exemptions are based upon either the “pervasiveness” of agency regulation or the “necessity” of the activity in question in achieving the objectives of the regulatory scheme. Juxtaposing the traditional minimum commission rate structure of the NYSE with these standards, SEC supervision of certain of the Exchange’s self-regulatory activities lacks a sufficiently explicit congressional directive for antitrust variables to be considered “pervasive.” Although “necessity” then remains the dispositive factual inquiry, it must further be determined which forum can best resolve this issue.

Courts

Although one district court has bluntly concluded that the NYSE rate structure is exempt from the antitrust laws,²¹⁶ subsequent courts may be asked to decide whether the rate structure is “necessary” to the objectives of the Exchange Act. If such a case arises, the burden of justifying the rate structure’s necessity would be upon the Exchange because an implied exemption based on “necessity” operates as an affirmative defense to an antitrust claim. The Court in *Silver* supported this burden of proof allocation by remarking that an activity “within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim.”²¹⁷ The Department of Justice has persuasively rebutted each argument the NYSE has put forth in support of an antitrust exemption, and unless the Exchange can disprove the feasibility of the Justice Department’s suggested alternatives²¹⁸ for avoiding the financial hardships of competitive rates, the burden will not have been discharged.

²¹³ *Id.* at 91.

²¹⁴ *Id.* at 93.

²¹⁵ *Id.* at 95.

²¹⁶ *Kaplan v. Lehman Bros.*, 250 F. Supp. 562 (N.D. Ill. 1966), *aff’d*, 371 F.2d 409 (7th Cir.), *cert. denied*, 389 U.S. 954 (1967).

²¹⁷ 373 U.S. at 361.

²¹⁸ See text at notes 187-89, 203-04, 208 *supra*.

The more important question, however, is whether a court is the proper forum for resolving the "necessity" issue. In most antitrust trials, the ultimate disposition is a factual determination supported by extensive factual data. But in judging the effects of a competitive pricing system on the securities market, the courts are faced with diverse economic theories, all speculative in nature. The judicial system does not have the flexibility to fashion and adopt an imaginative remedy replete with appropriate safeguards; the judge can only decide either that the rate structure is necessary and therefore exempt from the antitrust laws, or that the structure is unnecessary and open to antitrust attack. Where the ultimate decision has profound effects upon the economy, and where alternative forums for resolving the issue are available, the courts should exercise restraint and leave jurisdiction to more flexible and expert bodies.

Congress

Because of the far-reaching effects that may result from an application of the antitrust laws to the NYSE's minimum rate structure, the "necessity" issue is of a uniquely legislative character and could best be handled by Congress. If minimum rates are essential, an express statutory exemption from the antitrust laws can be enacted; otherwise, Congress can expose the rate structure to the antitrust laws or abolish minimum rates completely. Congress might also determine that the SEC is the most appropriate body to decide the rate structure issue; clear legislative language could easily confer the necessary jurisdiction, either with or without an antitrust exemption. Congress, however, has previously been requested to resolve these problems and has refused to act.²¹⁹

New York Stock Exchange

The most expedient method of handling the problems posed by the NYSE's minimum rate structure is for the Exchange itself to attempt to resolve the issue, either by an abolition of minimum rates, or more realistically, by adopting a plan whereby minimum rates are gradually lowered in specified types of transactions until the effects of total abolition can be determined. If the exchange truly believes that minimum rates are necessary to the securities industry, it at least has the responsibility of demonstrating the impracticability of the Justice Department's suggested alternative measures. Unfortunately, such a responsibility has not yet been accepted by the NYSE. In the incipient phases of the present controversy, the Exchange favored the retention of give-ups, but after the intervention of the

²¹⁹ See note 161 *supra*.

Department of Justice, the Exchange restricted give-ups²²⁰ and adopted an interim commission rate structure²²¹ in an effort to shield itself from anti-trust attack. Similarly, the NYSE's economic study concluded that fixed rates were necessary; however, continued criticism appears to have influenced the Exchange to reconsider its position by initiating a new study.²²² 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.

Securities Exchange Commission

Because of the expertise of the SEC in the securities area, and because the Commission is ostensibly neutral and apolitical, that body is the most realistic choice to resolve the "necessity" issue. By applying its expertise to the information gathered in the recent hearings, the SEC may be able to determine whether the minimum rates are necessary to fulfill the policies of the Exchange Act. If so, the Commission can authorize the NYSE to continue its present practices, but under more detailed supervision. If the minimum rate structure is not necessary, the Commission, pursuant to section 19(b), can order the Exchange to institute a competitive system. However, considering the speculative nature of the economic issue, it is probable that a concrete resolution is impossible. Therefore, the SEC has the responsibility to use its discretion in seeking a solution to the controversy. At present, the most feasible solution is the Justice Department's suggestion²²³ that minimum commissions be eliminated immediately on transactions over \$50,000, with a \$10,000 reduction every year for the ensuing five years. While this plan appears to discriminate against the small investor, it allows the SEC to evaluate the effects of eliminating the minimum rate structure before total elimination.

The need for careful evaluation prior to any transition to competitive rates has been demonstrated by the length and completeness of the SEC hearings. Because of the historical existence of the minimum rate structure and the NYSE's insistence that minimum rates are necessary to a viable securities industry, the courts, Congress, the NYSE and the SEC have been reluctant to change the status quo without knowing the full consequences of such a change. The speculative nature of a shift to competitive rates and the sensitivity of the securities business surely demand caution, but not inaction.

P. C. G.

²²⁰ See note 37 *supra*.

²²¹ See notes 51 & 54 *supra*.

²²² See note 54 *supra*. The NYSE has recently challenged the Dep't of Justice's economic position. CCH FED. SEC. L. REP. (Current vol.) ¶ 77,707 (1969).

²²³ See note 7 *supra*.