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Monopolies–Immunity from Antitrust Liability--Minimum Commission Rates of Stock Exchanges [*Kaplan v. Lehman Brothers*, 371 F.2d 409 (7th Cit. 1967)]

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versed the position it took in *Ker v. California*.[65] Moreover, by requiring the state to prove *beyond a reasonable doubt*[66] that the error did not contribute to the conviction, the Court may have formulated a test so strict as to impose indirectly a test which makes any trial error ground for automatic reversal,[67] a concept which the majority of the Court specifically rejected.[68] The new rule may also affect the finality of state convictions by subjecting more of them to attacks via habeas corpus in federal district courts.[69] Finally, the case is also significant in that it illustrates the creation by the Court of what appears to be a twilight zone of power.

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MONOPOLIES — IMMUNITY FROM ANTITRUST LIABILITY — MINIMUM COMMISSION RATES OF STOCK EXCHANGES

Kaplan v. Lehman Brothers, 371 F.2d 409 (7th Cir. 1967), *petition for cert. filed*, 36 U.S.L.W. 3031 (U.S. July 4, 1967).

In *Silver v. New York Stock Exchange*[1] the United States Supreme Court first considered whether the Securities Exchange Act of 1934[2] immunizes the self-regulatory activities of stock exchanges from antitrust liability.[3] Observing that the statute contains no express exemption,[4] the Court stated that "exchange self-regulation is to be regarded as justified in response to antitrust charges only to the extent necessary to protect the achievement of the aims of the Securities Exchange Act."[5] Stated more explicatively, the conduct of an exchange is subject to regulation by the antitrust laws unless such submission would impair the supervisory powers of the Securities Exchange Commission (SEC) or otherwise impede the maintenance of an honest and stable market.[6]

The recent case, *Kaplan v. Lehman Brothers*,[7] presented a legal

65 In *Ker* the Court stated: "We reiterate that the reasonableness of a search is *in the first instance a substantive determination to be made by the trial court* from the facts and circumstances of the case and in light of the 'fundamental criteria' laid down by the fourth amendment and . . . this Court . . . ." Ker v. California, 374 U.S. 23, 33 (1963) (emphasis added).

66 Text accompanying note 21 *supra*.

67 Respondent's Petition for Rehearing, *supra* note 64, at 2.

68 Text accompanying notes 13-16 *supra*.

69 Respondent's Petition for Rehearing, *supra* note 64, at 7.

question which forced the Seventh Circuit to interpret the Supreme Court's broad statements in *Silver.* The plaintiffs in *Kaplan* brought a shareholder's derivative suit on behalf of five mutual funds[8] and a representative class action on behalf of the funds' shareholders against the New York Stock Exchange (NYSE) and four of its members.[9]

The complaint alleged that adherence by the defendants to the NYSE rule prescribing the minimum commissions to be charged for all transactions executed on the exchange[10] constituted a combination and conspiracy in restraint of trade and, consequently, a violation of section 1 of the Sherman Act.[11] The plaintiffs prayed that treble damages be assessed against the defendants pursuant to section 4 of the Clayton Act.[12] It was further requested that the minimum commission rules of the exchange be declared null and void and that

1 373 U.S. 341 (1963). The case was brought by an over-the-counter broker who charged that the New York Stock Exchange had violated the Sherman Anti-Trust Act, 15 U.S.C. §§ 1-7 (1964) [hereinafter cited as Sherman Act], by ordering its members to discontinue wire connections with him without affording notice or opportunity for a hearing. The Court imposed liability on the ground that no justification can be offered for self-regulatory conduct where the exchange invokes its rules without granting those affected thereby an occasion to explain their positions. 373 U.S. at 361.

2 15 U.S.C. §§ 78a-hh (1964) [hereinafter cited as Exchange Act].

3 *See* Sherman Act, 15 U.S.C. §§ 1-7 (1964); Clayton Act, 15 U.S.C. §§ 12-27 (1964).

4 373 U.S. at 357.

5 *Id.* at 361.

6 *Cf.* Exchange Act §§ 2, 28(a), 15 U.S.C. §§ 78b, 78bb (1964); Conference Report on Exchange Act, 78 CONG. REC. 9930, 10,248 (1934).

7 371 F.2d 409 (7th Cir. 1967), *petition for cert. filed,* 36 U.S.L.W. 3031 (U.S. July 4, 1967).

8 The mutual funds involved were the One William Street Fund, Inc., The Lehman Corp., Energy Fund, Inc., The Dominick Fund, Inc., and The Chemical Fund. For an excellent description and analysis of mutual funds see SECURITIES AND EXCHANGE COMMISSION, REPORT OF THE SPECIAL STUDY OF THE SECURITIES MARKETS, H.R. DOC. NO. 95, 88th Cong., 1st Sess., pt. 4, at 89 (1963) [hereinafter cited as SPECIAL STUDY]; Lobell, *The Mutual Fund: A Structural Analysis,* 47 VA. L. REV. 181 (1961).

9 The member firms were Lehman Bros., Goodbody & Co., Dominick & Dominick, Inc., and Paine, Webber, Jackson & Curtis. The investment advisors to the five mutual funds mentioned in note 8 *supra* were also made nominal defendants.

10 The New York Stock Exchange commission rates and service charges are set forth in N.Y.S.E. CONST. art. XV, in 2 CCH NYSE GUIDE § 1701. Noncompliance with these rates subjects a member to suspension or expulsion from the exchange.

11 15 U.S.C. § 1 (1964).

12 15 U.S.C. § 15 (1964). The plaintiffs alleged that their actual damages were the difference between the commission rates charged pursuant to the exchange rules and the rates that would have been available if free and open competition had existed in the market. Kaplan v. Lehman Bros., 250 F. Supp. 562, 563 (N.D. Ill. 1966), *aff'd,* 371 F.2d 409 (7th Cir. 1967), *petition for cert. filed,* 36 U.S.L.W. 3031 (U.S. July 4, 1967). The plaintiffs also prayed for actual damages, unmultiplied, on the theory that the alleged misconduct also violated the Exchange Act. *Id.*

such rules be replaced by open competition among the various member brokers.

In affirming the district court's summary judgment in favor of the defendants, the Seventh Circuit found that "the antitrust laws are inapplicable to the New York Stock Exchange insofar as its prescribing of minimum commission rates is concerned."[13] In arriving at this conclusion the court tested and sustained two related hypotheses.[14]

First, since section 19(b) of the Exchange Act[15] authorizes the SEC "to alter or supplement the rules of . . . [an] exchange . . . in respect of such matters as . . . the fixing of reasonable rates of commission," the Act obliquely empowers the exchanges to establish minimum commission rates, for if they were not so empowered, there would be no need for a provision sanctioning Commission oversight.[16] Therefore, since the Exchange Act was enacted subsequent to the Sherman Act, the later statute exempted those charging exchange commission rates from antitrust liability by implication.[17]

Second, because section 19(b) of the Exchange Act empowers the SEC to alter exchange commission rates, that agency's consideration of antitrust principles, as reflected in authorized commission rates, should not be subject to judicial alteration. To hold otherwise would interfere with the Commission's supervisory powers over the exchanges.[18]

The court's first premise unquestioningly adopts the view that section 19(b)'s reference to *reasonable* rates of commission necessarily authorizes the exchanges to establish and maintain *minimum* rates of commission. However, nothing in the legislative history of

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[13] 371 F.2d at 411.

[14] Because of the brevity and turbidity of the court's opinion, it is impossible to determine with certainty the exact grounds upon which the *Kaplan* decision was based. However, in light of the district court's statements and the innuendoes in the opinion of the Seventh Circuit it seems reasonable to conclude that the holding rested upon these two hypotheses. *See* Bicks, *Antitrust and the New York Stock Exchange*, 21 Bus. Law. 129, 149-54 (1965); Jennings, *The New York Stock Exchange and the Commission Rate Struggle*, 21 Bus. Law. 159 (1965).

[15] 15 U.S.C. § 78s(b) (1964).

[16] *See* Kaplan v. Lehman Bros., 250 F. Supp. 562, 564-65 (N.D. Ill. 1966), *aff'd*, 371 F.2d 409 (7th Cir. 1967), *petition for cert. filed*, 36 U.S.L.W. 3031 (U.S. July 4, 1967).

[17] 371 F.2d at 411.

[18] *See id.* In arriving at this conclusion the Seventh Circuit relied heavily upon dictum in the *Silver* case suggesting that antitrust immunity might exist where the self-regulatory activities of an exchange are exposed to SEC review. Silver v. New York Stock Exch., 373 U.S. 341, 360 (1963) (dictum). However, the *Silver* Court emphasized that it was not resolving that question. *Id.* at 358 n.12.

the Exchange Act supports this reasoning.[19] Minimum commission rules were mentioned only twice while the bill was in committee,[20] and on neither occasion was there any suggestion that the statute would empower the exchanges to establish such rates.[21]

Furthermore, when Congress has desired to grant antitrust immunity in similar situations, it has expressly manifested that intent,[22] but the Exchange Act makes no mention of anticompetitive exemption. In fact, section 28(a) of the Act states that "the rights and remedies provided by this title shall be *in addition to any and all other rights and remedies that may exist at law or in equity*."[23] A federal district court explained in *United States v. Morgan*:[24]

> [T]his whole statutory scheme was worked out with the greatest care by members of the Congress thoroughly aware of the antitrust problems . . . and in possession of the fruits of many prolonged and penetrating investigations. They intended no exemption to the Sherman Act; and *it is hardly possible that they would inadvertently accomplish such a result.*[25]

Because the Exchange Act fails to expressly provide for antitrust immunity and the legislative history of the statute intimates no such exemption, the *Kaplan* court's hypothesis appears to be unjustified and insufficient to support its conclusion.[26]

Furthermore, merely because minimum commission rates have

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19 *Accord*, Nerenberg, *Applicability of the Antitrust Laws to the Securities Field*, 16 W. RES. L. REV. 131, 150-51 (1964); Note, *Antitrust and the Stock Exchange: Minimum Commission or Free Competition?*, 18 STAN. L. REV. 213, 224-25 (1965); *see* SPECIAL STUDY pt. 2, at 300.

20 *Hearings on Stock Exchange Practices Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st & 2d Sess., 6467, 7483-84, 7752-57 (1933-1934).

21 The Exchange Act's congressional draft bill originally authorized the SEC to require *uniformity* in commission rates. However, while the bill was in committee, it was argued that the proposed legislation would enable the exchanges to charge "all that the traffic will bear," for the Commission had no power to alter rates unless they were inconsistent. *Id.* at 7705. Shortly thereafter, for no apparent reason, the word "uniform" was replaced by "reasonable," thus giving the SEC the authority to fix all rates. By relating this change to the original committee objections, one could justifiably infer that Congress had no intention of empowering the exchanges to establish commission rates free from antitrust liability. Note, *supra* note 19, at 224-25; *see* Nerenberg, *supra* note 19, at 150-51.

22 *E.g.*, Clayton Act § 6, 15 U.S.C. § 17 (1964) (exempting labor organizations); Webb-Pomerene Act, 15 U.S.C. § 62 (1964) (exempting associations of producers engaged in export trade); Walter-McCarran Act, 15 U.S.C. § 1012 (1964) (limited exemption of insurance companies); Reed-Bulwinkle Act, 49 U.S.C. § 5b(9) (1964) (exemption of rate agreements among carriers).

23 15 U.S.C. § 78bb(a) (1964) (emphasis added).

24 118 F. Supp. 621 (S.D.N.Y. 1953).

25 *Id.* at 679 (dictum) (emphasis added).

26 *Accord*, Nerenberg, *supra* note 19, at 150-51; Note, *supra* note 19, at 219-25. *Contra*, Bicks, *supra* note 14, at 152-53.

been maintained by the New York Stock Exchange since its inception,[27] is insufficient for exemption from the antitrust laws. The original immunity undoubtedly arose from the early restricted concept of interstate commerce;[28] however, the modern view of trade restraints, ignoring many of the technical inadequacies of the past,[29] certainly encompasses the minimum commissions of stock exchanges.[30]

In relation to the court's second premise, the question to be resolved is whether the antitrust laws are inapplicable to the minimum commission structure of stock exchanges because section 19(b) of the Exchange Act authorizes the SEC to alter such rates. The rationale supporting this exemption is that, since regulation of the securities field necessarily impedes competition to some extent, the SEC should consider antitrust principles while exercising its supervisory powers over the exchanges.[31] Entrusting this duty to the Commission — the body most thoroughly acquainted with the securities industry — places the SEC in a position to evaluate the total effect of any exchange activity and to administer the antitrust laws accordingly.[32]

In considering the court's theory it should first be noted that there is nothing novel about applying the antitrust laws to an industry which is already subject to governmental control or regulation.[33] Also, the mere fact that a regulatory agency approves an anticompetitive activity does not necessarily preclude the imposition

27 *See* B.F. SHULTZ, THE SECURITIES MARKET — AND HOW IT WORKS 2 (1963). The exchange was established on May 17, 1792, by the famous Buttonwood Tree Agreement which obligated 24 brokers to give preference to each other in their dealings and to charge no less "than one quarter per cent Commission of the Specie value." Quoted in *id.* at 2.

28 *E.g.*, Hopkins v. United States, 171 U.S. 578, 594 (1898).

29 *See* United States v. National Ass'n of Real Estate Bds., 339 U.S. 485 (1950); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

30 *See generally* Note, *supra* note 19, at 219-24.

31 *See* Bicks, *supra* note 14, at 149-54.

32 *See* Silver v. New York Stock Exch., 373 U.S. 341, 360-61 (1963) (dictum); SPECIAL STUDY pt. 4, at 707.

33 *See* Hale & Hale, *Competition or Control I; The Chaos in the Cases*, 106 U. PA. L. REV. 641 (1958); Hale & Hale, *Competition or Control II; Radio & Television Broadcasting*, 107 U. PA. L. REV. 585 (1959); Hale & Hale, *Competition or Control III; Motor Carriers*, 108 U. PA. L. REV. 775 (1960); Hale & Hale, *Competition or Control IV; Air Carriers*, 109 U. PA. L. REV. 311 (1961); Hale & Hale, *Competition or Control V; Production & Distribution of Electrical Energy*, 110 U. PA. L. REV. 57 (1961); Hale & Hale, *Competition or Control VI; Application of the Antitrust Laws to Regulated Industries*, 111 U. PA. L. REV. 46 (1962); Schwartz, *Legal Restriction of Competition in the Regulated Industries: An Abdication of Judicial Responsibility*, 67 HARV. L. REV. 436 (1954).

of antitrust liability.[34] Thus, unless there is some clear and overriding reason for immunity, stock exchanges and their minimum commission rates should be subject to the antitrust laws, irrespective of the existence of SEC supervision over the securities field.[35]

Although there are convincing arguments both for[36] and against[37] the maintenance of minimum commission rates by stock exchanges, it is significant that the *Kaplan* court never even considered whether there is a compelling reason for affording them antitrust immunity.[38] The court simply found that, since "the fixing of minimum commissions is one method of regulating commission rates," the antitrust laws are inapplicable for "in this situation the self-regulatory function of the exchange has been exercised by virtue of § 19(b)."[39] Admittedly, a self-regulatory function has been performed; the question, however, is whether a clear basis exists for antitrust exemption. By avoiding this issue, the *Kaplan* court sidestepped the underlying problem before it.

In addition, a major fallacy permeates the court's assumption that, since section 19(b) authorizes the SEC to alter and supplement exchange commission rates, that body will observe the antitrust laws while exercising its general supervisory powers over the securities market. In reality, the Commission has been reluctant to exert its powers against the exchanges.[40] Since its inception in 1934, the

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

35 Nerenberg, *supra* note 19, at 132.

36 Those supporting the maintenance of minimum commissions argue that abolition of such rates would create conflicts of interest for broker-dealers, inhibit trading on regional exchanges, produce evasive tactics (such as lumping small orders together) on the part of nonmembers of an exchange seeking to obtain volume discounts, and generally lower the standards of business conduct. *See* SPECIAL STUDY pt. 2, at 319. *See generally* Note, *supra* note 19, at 236-37.

37 Those opposing the maintenance of minimum commissions argue that such rates are highly discriminatory against nonexchange members, that they force investors to pay for services that they do not need, and that investors would generally benefit if commission rates were established in a competitive fashion. *See* SPECIAL STUDY pt. 2, at 297. *See generally* Nerenberg, *supra* note 19, at 147-49; Note, *supra* note 19, at 233-37. One of the most adamant critics of the minimum commission structure is Professor George J. Stigler of the University of Chicago who is presently crusading for the total abolition of all such rates. Jennings, *supra* note 14, at 178.

38 In deference to the Seventh Circuit, the various interests may have been weighed but not mentioned in the opinion. Quite possibly the actual basis for the *Kaplan* decision was the court's feeling that the imposition of liability would have profound adverse effects upon the stability of the securities market. However, if this is true, great confusion could have been avoided by the court's being more explicit.

39 371 F.2d at 411.

40 *Accord*, Nerenberg, *supra* note 19, at 157-60; *see* Cary, *Self-Regulation in the Securities Industry*, 49 A.B.A.J. 244, 246 (1963).

SEC has invoked its 19(b) powers on only one occasion,[41] and in that instance the future existence of nearly all the regional exchanges was in great jeopardy.[42] Moreover, the Commission has never forcibly altered an exchange's commission rate structure, and there is little to indicate that it has even thoroughly investigated proposed rate revisions.[43] Under these circumstances can it truthfully be said that the SEC *reviews* the minimum commission rates established by stock exchanges?

By holding as it did, the Seventh Circuit has made it possible for stock exchanges to flagrantly abuse the antitrust policy of fair trade without fear of retribution.[44] If the courts defer to SEC jurisdiction, but the Commission refuses to exercise its supervisory powers, the exchanges are in a position to charge as much as they wish for their services.[45] Such a situation would not only harm investors, but it could eventually lead to the demise of the stock exchanges themselves.[46]

In conclusion, it should be emphasized that the proposition favoring the administration of certain aspects of the antitrust laws by the SEC has considerable merit.[47] However, the theoretical bene-

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

42 N.Y.S.E. CONST. art. XVI, § 8, precluded any Exchange member from dealing "outside the Exchange in securities dealt in on the Exchange." When the NYSE announced that any member violating this rule would be subject to expulsion, the many members serving as odd lot dealers on the regional exchanges resigned from these positions because they could no longer avail themselves of the substantial profits derived from transactions involving dually listed securities. Since few other regional exchange members had sufficient resources to serve as odd lot dealers, the continued existence of many exchanges was in doubt. Rules of the New York Stock Exch., 10 S.E.C. 270, 274-92 (1941).

43 SPECIAL STUDY pt. 2, at 328-33. In fact, the NYSE increased its rates in 1958 while the SEC was still considering their reasonableness. Eleven months later the exchange voluntarily revised them when the Commission finally recommended that they were excessive. *Id.* at 344-45.

44 Section 25 of the Exchange Act, 15 U.S.C. § 78y (1964), provides for judicial review of Commission orders. However, if the SEC refuses to even consider a matter, it appears doubtful that such inaction could be reviewed by the courts.

45 This is exactly what the Exchange Act was designed to prevent; the policy of investor protection should not be so easily circumvented. *See* note 21 *supra* & accompanying text.

46 Largely because of the minimum commission structure of stock exchanges, nonmember brokers have been receiving a larger volume of business through the third market. Without the restrictions of minimum rates, these brokers are able to charge less than member dealers. *See* Jennings, *supra* note 14, at 165-66. Furthermore, a "fourth market" has recently developed which completely bypasses all brokers by featuring direct trading of blocks of stocks by large institutional investors. *Id.* at 166 n.20.

47 Mr. Manuel F. Cohen, Chairman of the SEC, has recently stated:

> [T]he Commission with its responsibility and concern for these matters is in the best position to comprehend and reconcile the diverse factors and con-

fits are without practical meaning unless the Commission actively utilizes those powers with which it is vested.[48] Until it becomes evident that the Commission is scrutinizing exchange rates for undesirable anticompetitive effects, the courts should be extremely hesitant to grant any antitrust immunity.

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siderations that may bear upon the public interest in the manifold circumstances under which [antitrust] questions may arise. Ad hoc determinations in the antitrust courts of complex matters such as these could have an undesirable impact upon the quality of the markets and the interests of the investing public. Letter from SEC to Senate Committee on Banking and Currency, July 30, 1965, in 111 CONG. REC. 19,019, 19,022 (1965).

[48] Although the SEC could probably assume active supervision over exchange commission rates under the present provisions of the Exchange Act, it would be preferable if new legislation were enacted providing for a definite procedure by which all rate revisions would be subjected to review prior to their date of effectiveness. Such legislation could further specify the scope of the antitrust immunity and explain what principles are to be applied by the SEC. *Cf. id.* at 19,019. *See generally* Jennings, *supra* note 14, at 172-79.