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NOTES

FEDERAL LEGISLATION TO ENHANCE COMPETITION IN THE SECURITIES INDUSTRY

A relative absence of public control in the securities industry made possible the 1929 "crash" which in turn led to subsequent legislation to provide increased investor protection.¹ Similarly, unsettled market conditions in the late 1960's² stimulated attempts to remodel the earlier legislation to solve problems which policymakers have begun to appreciate in recent years, particularly problems surrounding the role of competition in the securities industry. Already the Securities and Exchange Commission (SEC) has acted on its own initiative to promote competition by abolishing fixed-rate dealer commissions.³ The 94th Congress recently enacted the Securities Acts Amendments of 1975⁴ which, by modifying the role of the SEC, can enhance competition in the securities industry while providing investor protection. The legislation promotes development of a central market system which will intensify competition by informing potential buyers and sellers about all transactions and quotations in a particular security.⁵

Congressional reformers further believed that to resolve issues affecting competition, basic changes in the SEC's regulatory authority were needed to permit Commission review of challenges to actions by the bodies that provide self-regulation for the industry: the exchanges and the National Association of Securities Dealers (NASD). The Act permits the SEC to review actions concerning discipline and denial of membership⁶ and to review and amend rules enunciating policy decisions of the self-regulatory bodies, either upon its own initiative or upon petition by an aggrieved party.⁷ By

1. See note 15 *infra* & accompanying text.

2. The financial and operational crises of the securities industry in the late 1960's are described in detail in HOUSE SUBCOMM. ON COMMERCE & FINANCE, SECURITIES INDUSTRY STUDY REPORT, H.R. REP. NO. 1519, 92d Cong., 2d Sess. 3-13 (1972).

3. See note 236 *infra*.

4. Pub. L. No. 94-29 (June 4, 1975). The Act arose from and reflected the individual efforts of each house of Congress. The House of Representatives passed H.R. 4111, 94th Cong., 1st Sess. (1975), on April 24, 1975. 121 CONG. REC. H3258 (daily edition). For a discussion of the House bill as introduced, see notes 195-98 *infra* & accompanying text. The Senate passed S. 249, 94th Cong., 1st Sess. (1975), on April 17, 1975. 121 CONG. REC. S6189 (daily edition). For a discussion of the Senate bill as introduced, see notes 223-32 *infra* & accompanying text.

5. Pub. L. No. 94-29 § 7 (June 4, 1975), adding § 11A to the Securities Exchange Act of 1934.

6. *Id.* § 16, amending § 19 of the Securities Exchange Act of 1934.

7. *Id.*

such measures, this legislation offers the promise of providing the enhanced competition desired in the securities industry.

Appreciation of the gradual recognition of the need for increased competition in the securities industry is necessary for an understanding of the present reforms. Until recent years, securities industry policymakers did not perceive the need to define the role of competition among market-makers.⁸ Antitrust litigation concerning securities exchanges, brokers, and dealers sparked perception of the problem by challenging the anticompetitive effects of regulation. Adjudicating those challenges, courts consistently held that competition does play a role in securities regulation and struck down regulatory action not in accord with antitrust policy; in the process, courts have evolved standards for balancing antitrust and securities regulation policies.⁹ Concurrently, industry policymakers, responding to the antitrust challenges, have conducted in-depth studies¹⁰ to provide data upon which to premise regulation that maximizes competition while furthering the investor protection intended by federal securities legislation. Seeking those objectives, reformers turned first to the existing federal securities legislation for its guidance regarding competition; while the drafters of forty years past clearly intended no absolute antitrust exemption, a more detailed assessment has been difficult.

THE RATIONALE OF SECURITIES REGULATION

The Securities Exchange Act of 1934¹¹ was a response to the stock market crash of 1929 and the ensuing depression.¹² Unlike its predecessor, the Securities Act of 1933¹³ which was designed to require full disclosure to investors, the subsequent Act was intended to grant

8. According to the SEC definition, a "market maker" is a "dealer who, with respect to a particular security, holds himself out (by entering indications of interest in purchasing and selling in an interdealer quotations system or otherwise) as being willing to buy and sell for his own account on a continuing basis otherwise than on a national securities exchange." 17 C.F.R. § 240.17a-9(f)(1) (1974).

9. For a discussion of judicial treatment of antitrust attacks upon the securities industry, see notes 57-125 *infra* & accompanying text.

10. For a discussion of the various studies conducted during the past several years, see notes 126-232 *infra* & accompanying text.

11. 15 U.S.C. §§ 78a-78hh (1970).

12. The present purpose is not to expound upon the economic tragedy of 1929. For detailed analysis of causes and effects of the 1929 crash, see J. GALBRAITH, *THE GREAT CRASH* (3d ed. 1972); A. ROMASCO, *THE POVERTY OF ABUNDANCE* (1965); G. SOULE, *PROSPERITY DECADE* (1947).

13. 15 U.S.C. §§ 77a-77aa (1970).

broad regulatory powers over the securities market to the newly formed Securities and Exchange Commission.¹⁴ One commentator has stated: "As a few critics at the time recognized, the market crash did not occur from greed alone or only because predatory individuals exploited ignorant investors. The crash occurred, in part, because institutions, including the Investment Bankers Association and the New York Stock Exchange, lacked the will, the ability, and the administrative apparatus necessary to regulate greedy and predatory individuals."¹⁵ The result was a two-pronged attack by Congress upon the securities market: first, to correct abuses which led to the 1929 crash; second, to provide the Government with sufficient regulatory power to prevent future abuses not then foreseen specifically.

The Senate Committee on Banking and Currency, in advance of the 1934 Act, investigated stock exchange practices for more than two years.¹⁶ From that extended investigation, certain practices of the New York Stock Exchange (NYSE) were targeted as the principal concerns of the Securities Exchange Act. Among them were the following: excessive use of credit resulting in speculation on small margins; extensive manipulation of prices by pools, options and short-swing trading; and the failure of listed corporations to provide adequate information to investors.¹⁷ Particular provisions of either the Securities Act of 1933 or the Securities Exchange Act of 1934 were intended to eliminate, partly or wholly, all of these abuses.¹⁸

Congress realized, however, that merely attacking particular abuses would be insufficient to prevent a recurrence of the 1929 crash. Both the Senate Banking and Currency Committee report¹⁹ and the presidentially commissioned Roper Report²⁰ reflected the

14. SEC Securities Exchange Act Release No. 9950 (Jan. 16, 1973).

15. M. PARRISH, *SECURITIES REGULATION AND THE NEW DEAL* 39 (1970).

16. See REPORT OF THE SENATE COMM. ON BANKING AND CURRENCY ON STOCK EXCHANGE PRACTICES, S. REP. NO. 1455, 73d Cong., 2d Sess. (1934) [hereinafter cited as S. REP. NO. 1455]. That investigation produced more than twenty volumes of testimony and exhibits. President Franklin D. Roosevelt also recognized the great need for regulation of the securities industry and directed the Secretary of Commerce, D. C. Roper, to form a committee to study exchange practices. SEC Securities Exchange Act Release No. 9950 (Jan. 16, 1973).

17. For a discussion of the pre-crash abuses of the securities market, see Loomis, *The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940*, 28 GEO. WASH. L. REV. 214, 217 (1959); Tracy & MacChesney, *The Securities Exchange Act of 1934*, 32 MICH. L. REV. 1025 (1934).

18. See notes 37-39 *infra*.

19. S. REP. NO. 1455, *supra* note 16, at 48-49.

20. COMM. ON STOCK EXCHANGE REGULATION, 73D CONG., 2D SESS., REPORT TO SECRETARY OF

opinion that self-regulation by the NYSE was an undependable method of policing the securities market. Both reports indicated a need to provide a pervasive system of regulation with discretionary powers in an administrative agency.²¹ Establishment of a regulatory system was the means chosen to accomplish the 1934 Act's second goal, the prevention of unspecified future abuses. While expressly confronting some of the abuses not corrected by the Securities Act, the drafters of the later Act primarily were determined "[t]o provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes."²²

Seeking the two goals of reform and regulation of the securities market, the drafters of the Securities Exchange Act articulated particular objectives sought by their system of regulation. Protection of the general public from the practices that led to the crash of 1929 was the primary aim of the Act.²³ Legislators closest to the project were unanimous in their desire to restore investor confidence in the securities market.²⁴ Two qualities deemed essential to the long-range effectiveness of the regulatory system were a minimum of specific regulatory provisions and a maximum of discretionary powers in a strong administrative agency; the consensus was that the delicate and complex market required a flexible means of supervision that could react and experiment with a minimum of procedural

COMMERCE (Comm. Print 1934). See note 16 *supra*.

21. President Roosevelt also favored strict regulation of the securities market. In letters to the Chairman of the Senate Committee on Banking and Currency and the Chairman of the House Committee on Interstate and Foreign Commerce, he wrote: "I have been definitely committed to definite regulation of exchanges which deal in securities and commodities. . . . I am certain that the country as a whole will not be satisfied with legislation unless such legislation has teeth in it." H.R. REP. NO. 1383, 73d Cong., 2d Sess. 2 (1934).

22. Preamble to the Securities Exchange Act of 1934, ch. 404, 48 Stat. 881.

23. Senator Duncan U. Fletcher, Chairman of the Senate Committee on Banking and Currency, echoed this desire when he introduced a proposed bill to regulate the securities market: "The bill just introduced for the regulation of securities exchanges is one of the series of steps taken and to be taken for the purpose of bringing safety to the general public in the field of investment and finance." 78 CONG. REC. 2270 (1934).

24. See *id.* at 7697 (statement of Chairman Rayburn of the House Committee on Interstate and Foreign Commerce); *id.* at 7925-26 (statement of Representative Chapman); *id.* at 7689-90 (statement of Representative Sabath). All were members of the House Committee on Interstate and Foreign Commerce, which conducted extensive hearings on proposed legislation for the regulation of the securities market.

delay.²⁵ Flexibility demanded the grant of broad powers to the administrative agency and provided the reason for establishing the new Securities and Exchange Commission, rather than continuing the policy of the Securities Act whereby the Federal Trade Commission was the administrator.²⁶ Dissatisfaction with self-regulation therefore resulted in what Congress hoped would be a powerful watchdog agency with great flexibility to perform its regulatory function.

Legislative history clearly indicates the regulatory objectives of the drafters of the Securities Exchange Act; equally important, however, to determining the role contemplated for competition in the securities industry by Congress is the intended application, if any, of the antitrust statutes existing in 1934.²⁷ The Securities Exchange Act provides no explicit exemption from antitrust laws, and commentators have agreed that neither the history nor the general scheme of the securities laws suggests that Congress intended any general immunity.²⁸ The district court in *United States v. Morgan*²⁹ concurred:

It must be borne in mind that this whole statutory scheme was worked out with the greatest care by members of the Congress thoroughly aware of antitrust problems, often in close contact and cooperation with those who were later to administer the

25. James M. Landis, a member of the Roper Committee and a Commissioner of the Federal Trade Commission, discussed these regulatory goals in various House hearings. *Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. (1934). See also 78 CONG. REC. 811 (1934) (statement of Representative Mapes).

26. The concept of a broadly empowered agency was advocated all but unanimously. See, e.g., 78 CONG. REC. 7862 (1934) (statement of Representative Lea advocating strong regulatory power); *id.* at 7696 (statement of Chairman Rayburn answering critics of proposed legislation, who believed the bill gave too much power to administrative authorities). But see *id.* at 8092 (statement of Representative Sabath supporting a large delegation of power to the existing administrative agency, the FTC). The SEC itself later recognized the intent of Congress to grant it very broad powers to effect changes in exchange rules. See SEC Securities Exchange Act Release No. 9950 (Jan. 16, 1973).

27. Antitrust legislation existing at the time the 1934 Act was considered included the following: Clayton Act, ch. 323, 38 Stat. 730 (1914); Federal Trade Commission Act, ch. 311, 38 Stat. 717 (1914), as amended by Act of May 12, 1933, ch. 25, § 10, 48 Stat. 31; Sherman Anti-Trust Act, ch. 647, 26 Stat. 209 (1890).

28. Nerenberg, *Applicability of the Antitrust Laws to the Securities Field*, 16 CASE W. RES. L. REV. 131, 132 (1964); Note, *Antitrust and the Stock Exchange: Minimum Commission or Free Competition?*, 18 STAN. L. REV. 213, 229 (1965); Note, *The Application of Antitrust Laws to the Securities Industry*, 10 WM. & MARY L. REV. 136, 146 (1968).

29. 118 F. Supp. 621 (S.D.N.Y. 1953).

intricate phases of this well articulated and comprehensive plan of regulation of the securities business, and in possession of the fruits of many prolonged and penetrating investigations. They intended no exemption to the Sherman Act; and it is hardly probable that they would inadvertently accomplish such a result.³⁰

The SEC itself previously had considered its only case focusing upon the anticompetitive effect of a NYSE rule and anticipated the later judicial interpretation by holding that a violation of the Sherman Act was also a violation of the Securities Exchange Act.³¹

Since Congress did not exempt the securities industry expressly from the operation of the antitrust laws and no intention to do so on the part of the drafters is clearly evident, any immunity must be founded upon the premise that statutes regulating this industry impliedly repeal contrary provisions of antitrust laws. The Supreme Court, however, has opposed strongly repeal by implication of antitrust statutes. In *United States v. Philadelphia National Bank*,³² the Court stated: "Repeals of the antitrust laws by implication from a regulatory statute are strongly disfavored . . ."³³ The Court reiterated the theme three years later in *Carnation Co. v. Pacific Westbound Conference*,³⁴ wherein it described antitrust law as a "fundamental national economic policy" that "we cannot lightly assume" to be inapplicable to a particular industry.³⁵ The inevitable conclusion from the statute and case law therefore is that the drafters intended no antitrust exemption.³⁶

Provisions of the Securities Exchange Act

Application of antitrust laws complements the protection which

30. *Id.* at 697.

31. *In re* Rules of the New York Stock Exch., 10 S.E.C. 270, 273-74, 281, 283, 287-88, 292 (1941). In the same case, the SEC explicitly stated that it should consider the effects which enforcement of a particular rule might have on competition. *Id.* at 287.

32. 374 U.S. 321 (1963).

33. *Id.* at 350.

34. 383 U.S. 213 (1966).

35. *Id.* at 218. For earlier decisions presenting the identical view of repeal by implication, see *Silver v. New York Stock Exch.*, 373 U.S. 341, 357 (1963); *United States v. Borden Co.*, 308 U.S. 188, 198 (1939).

36. The obvious implication of this conclusion is that the antitrust laws do apply to the securities industry. For examples of the application of antitrust laws to various regulated industries, see *Nerenberg*, *supra* note 28, at 132 n.8.

the drafters of the Securities Exchange Act intended for investors through reform and regulation of the securities industry. To achieve that goal, the Act granted the SEC specific powers, some of which were aimed at the abuses of the unregulated stock market, such as the speculation³⁷ and manipulation³⁸ which were considered the two major evils at the time of the 1929 market crash.³⁹ In addition to those provisions, the Act authorized the SEC to regulate the securities industry directly and to supervise its self-regulation. Success of the pervasive regulation intended by the Act depends upon the effectiveness of those powers.

Direct powers of regulation given to the SEC include broad authority to make necessary rules and regulations for the execution of the functions vested in it by the Act.⁴⁰ Among those functions are the following: approval or denial of an exchange's application for registration;⁴¹ segregation and limitation of functions of members, brokers, and dealers;⁴² control of over-the-counter markets;⁴³ and suspension or withdrawal of the registration of a securities exchange or of a security and suspension or expulsion of a member or officer of an exchange.⁴⁴ In conjunction with these powers, the SEC is given authority to investigate, to seek injunctions, and to prosecute offenses.⁴⁵ Though these broad regulatory powers should have established

37. Speculation in the stock market had taken many forms. Among these was the short sale which the 1934 Act regulated specifically. 15 U.S.C. § 78j (1970). The drafters allowed the SEC to exempt certain classes of these transactions from a general prohibition. One example of SEC protection of the right to sell short has been the exemption of the odd-lot dealer. See 17 C.F.R. § 240.10a-1 (1974). Another type of speculation controlled by the Act was the granting of loans by brokers. See 15 U.S.C. § 78g (1970).

38. Manipulation encompasses a multitude of sins, including wash sales, pool operations, false tips, and stop-loss orders. The Act deals with these abuses in detail. See 15 U.S.C. § 78i (1970).

39. A provision-by-provision analysis of the Securities Exchange Act of 1934 is beyond the scope of this Note. The purpose is merely to show, through selected portions of the Act, whether the intentions of the drafters were achieved. For an in-depth review of the entire Act see Hanna, *The Securities Exchange Act of 1934*, 23 CALIF. L. REV. 1 (1934); Hanna & Turlington, *Protection of the Public under the Securities Exchange Act*, 21 VA. L. REV. 251 (1935).

40. 15 U.S.C. § 78w(a) (1970).

41. *Id.* § 78f(e). The Commission is also granted the power to exempt an exchange from registration. *Id.* § 78e.

42. *Id.* § 78k.

43. *Id.* § 78o.

44. *Id.* § 78s.

45. *Id.* § 78u.

the pervasive regulatory system desired by the drafters,⁴⁶ gaps in SEC regulatory powers have become evident since 1934, increasing the significance of the second type of Commission power, supervision of exchange self-regulation.⁴⁷

Despite dissatisfaction with the ineffective NYSE self-regulation prior to 1929, the drafters of the Securities Exchange Act refused to abandon the concept altogether. Instead, they substituted "supervised self-regulation" by empowering the SEC to alter or supplement the rules of an exchange with respect to such matters as financial responsibility of members, reporting transactions on the exchange, and fixing reasonable rates of commission.⁴⁸ Some of these areas overlap with the provisions of the Act aimed at individual abuses, but under supervised self-regulation, the SEC can go beyond the skeletal provisions of the statute to supervise extensively the daily operation of the exchanges.⁴⁹ Indicative of the failure to realize the potential of its supervisory power,⁵⁰ however, is the fact that the SEC has used that power only once regarding the anticompetitive effects of a stock exchange rule.⁵¹ Exercise of the statutory

46. At its enactment, commentators hailed the Act as a tremendous experiment in complete regulation by a governmental body. See Tracy & MacChesney, *The Securities Exchange Act of 1934*, 32 MICH. L. REV. 1025, 1037 (1934).

47. Accentuating the importance of the second SEC power, a recent Chairman of the Commission found it inconceivable that the Government today even could attempt to prescribe a fully detailed pattern of doing business in the securities market. Cary, *Self-Regulation in the Securities Industry*, 49 A.B.A.J. 244 (1963).

48. 15 U.S.C. § 78s(b)1-13 (1970). There are 13 areas of self-regulation indicated by the Act, including one entitled "similar matters." While Chairman of the SEC, Mr. Justice Douglas stated his concept of supervised self-regulation: "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). The Securities Acts Amendments of 1975, Pub. L. No. 94-29 § 16 (June 4, 1975), broadened the Commission's authority to alter or amend the rules of an exchange. See notes 270-77 *infra* & accompanying text.

49. "The purpose of the self-regulation provisions of the Securities Exchange Act was to delegate governmental power to working institutions which would undertake, at their own initiative, to enforce compliance with ethical as well as legal standards in a complex and changing industry." *Silver v. New York Stock Exch.*, 373 U.S. 341, 371 (1963) (Stewart, J., dissenting).

50. See 2 L. LOSS, *SECURITIES REGULATION* 1182 (2d ed. 1961); Note, *Antitrust and the Securities Industry: Lessons from the Shipping Industry*, 55 CORNELL L. REV. 96, 100 (1969). One reason for this failing is that the language of the statute limits the Commission's rule-changing authority to specific areas and does not authorize the agency to examine exchange rules before they take effect. See 15 U.S.C. § 78s(b) (1970).

51. *In re Rules of the New York Stock Exch.*, 10 S.E.C. 270 (1941). See note 31 *supra* & accompanying text.

powers given to the SEC thus has not fulfilled the statutory objective of establishing a pervasive regulatory scheme.⁵²

In addition to the Commission's ineffective use of the powers given to it by law, the drafters' intent has been frustrated by their failure to give the SEC jurisdiction to consider individual grievances resulting from the enforcement of particular exchange rulings.⁵³ This omission contrasts sharply with the broad grant of power to alter or supplement rules of the exchanges. Because in practice the Commission has not reviewed exchange rules before they become effective,⁵⁴ it has been virtually powerless to prevent injury which may result from the implementation of a rule. If enforcement of a particular rule harms an individual, the SEC cannot correct that injury by altering the particular rule; its power is limited to changing the rule prospectively. Additionally, although judicial review of orders of the Commission is provided in the United States courts of appeals, the judicial review is from orders of the Commission only, not directly from exchange rulings pursuant to self-regulation.⁵⁵ One result of this particular gap in the legislation has been a series of antitrust attacks upon exchange rules.

The legislative history and text of the Securities Exchange Act of 1934 demonstrate the objectives of the drafters. While they contemplated pervasive regulation of the securities industry, this goal was achieved only in part primarily because of a lack of sufficient power in the SEC,⁵⁶ the Commission's lack of jurisdiction to hear individual grievances against stock exchange rules, and a general

52. Former Justice Goldberg stated emphatically that "the statutory scheme of that Act is not sufficiently pervasive to create a total exemption from the antitrust laws. . . ." *Silver v. New York Stock Exch.*, 373 U.S. 341, 360-61 (1963).

53. See *Silver v. New York Stock Exch.*, 373 U.S. 341, 357 (1963); Bicks, *Antitrust and the New York Stock Exchange*, 21 BUS. LAW. 129, 137 (1965); Westwood & Howard, *Self-Government in the Securities Business*, 17 LAW & CONTEMP. PROB. 518, 525 (1952). The Securities Acts Amendments of 1975, Pub. L. No. 94-29 § 16 (June 4, 1975), granted the SEC the authority to consider such individual grievances. See notes 262-69 *infra* & accompanying text.

54. See note 50 *supra*. Section 16 of the Securities Acts Amendments of 1975, Pub. L. No. 94-29, § 16 (June 4, 1975), now requires the Commission to approve or disapprove a rule change by formal order.

55. 15 U.S.C. § 78y (1970). The Commission's findings of fact, if supported by substantial evidence, are conclusive. *Id.* § 78y(a). Appeal to the court of appeals does not operate automatically as a stay of the Commission's order. *Id.* § 78y(b).

56. Some commentators have found the SEC's power under the Act to be illusory. Note, *Antitrust and the Stock Exchange: Minimum Commission or Free Competition?*, 18 STAN. L. REV. 213, 216-17 (1965); 45 N.C.L. REV. 301, 307 (1966).

vagueness in the statute regarding the intended relationship between securities regulation and the antitrust laws. This last draftsmanship shortcoming has prompted aggrieved individuals to turn to the judicial branch in an effort to eliminate anticompetitive exchange practices that the Commission has ignored or has been powerless to correct.

ANTITRUST ATTACKS UPON THE SECURITIES MARKET

The Supreme Court, in *Silver v. New York Stock Exchange*,⁵⁷ began the assault on the regulatory system of the Securities Exchange Act by specifying the deficiencies in the scheme and by accepting for the courts at least partial responsibility for correction of the deficiencies. In *Silver*, a nonmember of the NYSE had applied for, and been granted temporarily, private wire connections with member securities firms by the Exchange. Without prior notice, the NYSE later refused permanent authorization and ordered the member firms to remove the connections.⁵⁸ Having been handicapped seriously by the loss of critical communications, the non-member firm brought suit against the NYSE for treble damages, claiming a concerted refusal to deal with it by Exchange members in violation of the Sherman Act.⁵⁹

In its decision, the Supreme Court stated firmly its guiding principles. First, the Securities Exchange Act provides no express exemption from the antitrust laws.⁶⁰ Second, repeal by implication is disfavored and will be employed "only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary."⁶¹ Third, the antitrust statutes do not conflict with the SEC's regulatory function because the Commission has no jurisdiction over particular applications of exchange rules.⁶² Fourth, while recognizing that some self-regulation within the scope of the Act may be justifiably anticompetitive, the Court stated that the

57. 373 U.S. 341 (1963).

58. *Id.* at 343-44.

59. 15 U.S.C. §§ 1-2 (1970). The Clayton Act allows "[a]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws" to seek treble damages. Clayton Act § 4, 15 U.S.C. § 15 (1970).

60. 373 U.S. at 357.

61. *Id.* See also *United States v. Borden Co.*, 308 U.S. 188, 198 (1939) (indicating that absent detailed, comprehensive economic regulation, Court not to imply exemption from antitrust regulation, but to give effect to both systems of regulation if possible).

62. 373 U.S. at 358. See notes 53-55 *supra* & accompanying text.

controverted instance of self-regulation occurred under "totally unjustifiable" circumstances.⁶³ The result of the landmark decision has been the unequivocal recognition that antitrust laws apply, at least generally, to stock exchange practices,⁶⁴ although an apparent judicial desire to limit the case to its facts⁶⁵ has precluded any avalanche of antitrust attacks upon exchange rules.

One such case, however, was *Kaplan v. Lehman Brothers*.⁶⁶ In this shareholder's derivative suit alleging that the NYSE schedule of minimum commission rates constituted per se a conspiracy in restraint of trade, the district court granted the defendants summary judgment, the court interpreting the *Silver* opinion as an explicit statement that no action by an Exchange, pursuant to its rulemaking authority, could constitute a per se antitrust violation.⁶⁷ In a brief opinion, the court of appeals affirmed the *Kaplan* decision,⁶⁸ and the Supreme Court, despite a bitter dissent by Chief Justice Warren,⁶⁹ denied certiorari.

Plentiful subsequent criticism of the *Kaplan* decision⁷⁰ may have

63. *Id.* at 361. The Court stressed the need for notice and hearing to justify anticompetitive effects of self-regulation. *Id.* at 361-63.

64. Thus the *Silver* case provided some of the impetus for the plans to restructure the securities market. For an excellent analysis of this important case, see Ginsburg, *Antitrust and Stock Exchange Minimum Commissions: A Jurisdictional Analysis*, 24 U. MIAMI L. REV. 732, 739-40 (1970). See also Note, *Antitrust laws and the Securities Exchanges*, 66 NW. U.L. REV. 100, 101-03 (1971); Comment, *An Approach for Reconciling Antitrust Law and Securities Law: The Antitrust Immunity of the Securities Industry Reconsidered*, 65 NW. U.L. REV. 260, 298-301 (1970) [hereinafter cited as *Approach*]; Note, *The Application of Antitrust Laws to the Securities Industry*, 10 WM. & MARY L. REV. 136, 152-56 (1968).

65. See, e.g., *Cowen v. New York Stock Exch.*, 371 F.2d 661 (2d Cir. 1967). In *Cowen* an employee of a member firm discharged for his alleged involvement in a questionable transaction, brought suit on the grounds of procedural unfairness. The case was dismissed because, unlike *Silver*, notice of charges and the reasons for dismissal had been given to the plaintiff.

66. 250 F. Supp. 562 (N.D. Ill. 1966), *aff'd*, 371 F.2d 409 (7th Cir.), *cert. denied*, 389 U.S. 954 (1967).

67. 250 F. Supp. at 564. "Since review is afforded within the system of securities regulation, there is no need to resort to the antitrust laws for a remedy." *Id.* at 566. The court also reasoned that Congress was aware of fixed commission rates at the time the Securities Exchange Act was enacted; by choosing not to prohibit them, the legislature gave fixed rates tacit approval. *Id.* at 564.

68. 371 F.2d 409 (7th Cir. 1967).

69. 389 U.S. 954 (1967). In his dissent, the Chief Justice characterized the broad, ambiguous language of the court of appeals as a "blunderbuss approach" which fell "far short of the close analysis and delicate weighing process mandated by this Court's opinion in *Silver*." *Id.* at 957.

70. See, e.g., Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public*, 22 STAN. L. REV. 675, 690 (1970): "But *Kaplan* departed dramatically, and I think wrongly, from

been one reason that the same court of appeals altered its analysis in the next major attack upon a NYSE rule. The exchange practice to which the plaintiff objected in *Thill Securities Corp. v. New York Stock Exchange*⁷¹ was the anti-rebate rule, which prohibits a member from sharing a commission with a nonmember even if the nonmember originally received the customer's order.⁷² The district court had found that the anti-rebate rule was within the scope of self-regulation authorized by section 19(b) of the Securities Exchange Act⁷³ and therefore exempt from antitrust attack.⁷⁴ Reacting to Chief Justice Warren's dissent in *Kaplan*, the court of appeals remanded the case for a determination of whether the antitrust legislation could be reconciled with the Securities Exchange Act.⁷⁵ Such a requirement for specific reconciliation is the very essence of the *Silver* decision; its absence in *Kaplan* is the main reason that case received heavy criticism.⁷⁶ Tacit agreement with Chief Justice Warren's dissent in *Kaplan* perhaps can be inferred from the Supreme Court's denial of certiorari in *Thill*⁷⁷ since the result of the denial was to require the NYSE to justify its anticompetitive conduct as necessary for the successful operation of the securities laws. The *Thill* decision indicates a judicial resolve not to abdicate primary jurisdiction over the antitrust issue.⁷⁸ Industry self-regulation could

Silver when it turned to the merits of the case. No effort was made to answer the question that *Silver* said had to be answered: whether fixed minimum commissions were necessary to make the 1934 Act work." *Accord*, Johnson, *Application of Antitrust Laws to the Securities Industry*, 20 Sw. L.J. 536, 560-61 (1966): "The fallacy in the *Kaplan* argument is pointed out in the *PNB* [*United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963)] and *California* [*California v. FPC*, 369 U.S. 482 (1962)] cases. There it was made clear that the presence of review power or approval power of one sort or another is not sufficient justification for exemption from the antitrust laws."

71. [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,479 (E.D. Wis. 1969), *rev'd*, 433 F.2d 264 (7th Cir. 1970), *cert. denied*, 401 U.S. 994 (1971).

72. 433 F.2d at 266-67. The NYSE claimed that the challenged rule was an essential aspect of its authorization to fix commission rates under the Securities Exchange Act. *Id.* at 267.

73. 15 U.S.C. § 78s(b) (1970).

74. [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,479, at 98,261.

75. 433 F.2d at 271, 273-74.

76. The change of approach by the Court of Appeals for the Seventh Circuit, requiring detailed analysis of the anticompetitive effects of a NYSE rule otherwise apparently within the scope of legitimate self-regulation, is the basis for a conclusion that *Thill* reversed *Kaplan*. Comment, *Antitrust Immunity of the National Association of Securities Dealers Under the Maloney Act*, 14 B.C. IND. & COM. L. REV. 111, 122 (1972).

77. 401 U.S. 994 (1971).

78. See 433 F.2d at 272.

not justify itself merely by SEC rubber-stamp approval because the SEC's power of review was delineated unclearly and the expertise that would support exercise of primary jurisdiction lay in the courts, not the Commission, for antitrust issues.

Since the decision in *Thill*, the major point of concern in several significant cases has been the purported immunity of the self-regulatory bodies from antitrust laws. In *Harwell v. Growth Programs, Inc.*⁷⁹ an investment contract provided for an "in and out" privilege, which allowed a purchaser of mutual fund shares to convert up to 90 percent of his shares into cash, then reinvest the cash in shares without paying a commission.⁸⁰ The National Association of Securities Dealers (NASD) issued an interpretation of its rules which made it a violation for members to cooperate in unlimited "in and out" privileges. Although the defendant's compliance with the interpretation effectively denied the plaintiffs a valuable contract right, the district court gave summary judgment for the defendant on the ground that the NASD was immune from antitrust liability.⁸¹ Remanding the case for trial on the merits, the court of appeals assumed *arguendo* that the defendant's activities normally would have been violative of antitrust laws⁸² and found that NASD's purported antitrust immunity pursuant to the Maloney Act⁸³ did not immunize all association activities. Rather, the court relied upon *Silver* to extend immunity to the NASD for the purpose of industry regulation under SEC authority only when necessary for the effective operation of the Maloney Act. Having equated the NASD immunity with exchange antitrust immunity, the court of appeals then applied the *Silver* doctrine to the specific actions before it. It remanded the case for a determination of whether the NASD's interpretation was necessary for the effective operation of the Maloney

79. 315 F. Supp. 1184 (W.D. Tex. 1970), *rev'd*, 451 F.2d 240 (5th Cir. 1971), *cert. denied*, 409 U.S. 876 (1972).

80. The contract "permitted the use of the privilege for speculating on short swings of the market. This resulted in massive withdrawals and reinvestments, often on the same day, and an alleged dilution of the interests of the other . . . shareholders." 451 F.2d at 243-44 n.1.

81. 315 F. Supp. at 1184.

82. 451 F.2d at 246.

83. 15 U.S.C. 78o-3(n) (1970), provides: "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." Commentators and courts generally have construed this clause to grant immunity from the antitrust laws to NASD activity. See, e.g., *Approach*, *supra* note 64, at 290-91.

Act,⁸⁴ specifically finding no immunity to arise merely from the SEC's "close supervision of the NASD in this area."⁸⁵ Instead of limiting the *Silver* doctrine to its facts, the appellate court in *Harwell* thus extended it to another section of the Securities Exchange Act and another self-regulatory body.

Not only has *Harwell* not been followed, however, it has been cited only in *Haddad v. Crosby Corp.*,⁸⁶ which involved an antitrust complaint alleging a conspiracy to prevent development of a secondary market for the distribution of mutual fund shares. Considering the application of antitrust laws to statutes controlling the mutual fund industry,⁸⁷ the court found it "authoritatively recognized that the Maloney Act, superimposed upon the regulatory scheme of the 1940 Act, provides a limited immunity for participants in the primary distribution system of mutual fund shares under SEC-approved NASD rules."⁸⁸ Moreover, the court added:

Even if a specific exemption granted by the Maloney Act were deemed to be inadequate to grant immunity from the impact of the antitrust laws . . . [i]n the case at bar . . . there exists a pervasive regulatory scheme coupled with a legislative history manifesting congressional intent to immunize the investment company industry from the operation of the antitrust laws to the limited extent necessary to carry out the purpose of the independently defined federal policy legislated in the regulatory act, i.e., the Investment Company and Maloney Acts.⁸⁹

This, the court said was the "different case" cited in *Silver*.⁹⁰ By finding immunity from antitrust statutes in the pervasive regulation of the mutual fund industry, the *Haddad* court implies its own conformity with *Silver*, in which the SEC had exercised no systematic review, but suggests that the *Harwell* court incorrectly applied

84. 451 F.2d at 247.

85. *Id.* For further discussion of *Harwell*, see 23 SYRACUSE L. REV. 956 (1972).

86. 374 F. Supp. 95 (D.D.C. 1973).

87. Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to -52 (1970); Maloney Act, 15 U.S.C. § 78o-3 (1970).

88. 374 F. Supp. at 103.

89. *Id.* at 109-11.

90. The *Silver* court reserved judgment on whether an antitrust court could act "[s]hould review of exchange self-regulation be provided through a vehicle other than the antitrust laws." In such a situation, the Court wrote, "a different case as to antitrust exemption would be presented." *Silver v. New York Stock Exch.*, 373 U.S. 341, 360 (1963).

the *Silver* doctrine to the supervised self-regulatory activities of the NASD.⁹¹

This apparently sound analysis in *Haddad* accords with *Gordon v. New York Stock Exchange, Inc.*⁹² the most recent and perhaps most definitive treatment of the antitrust issue since *Silver*. In *Gordon* the Court of Appeals for the Second Circuit found *Silver*'s "different case"⁹³ presented in an antitrust challenge to the fixed commission rate structure employed by the Exchange. The specific complaint was that volume discounts, competitive rates on portions of orders in excess of \$500,000, and a surcharge on orders below 1000 shares constituted price discrimination, and that fixed rates for all other trades constituted price fixing.⁹⁴ Affirming the district court's dismissal of the complaint for lack of jurisdiction, the court of appeals held fixed commission rates to be within the congressional policy of exchange self-regulation, supervision of which was delegated to the SEC expressly in section 19(b) of the Securities Exchange Act.⁹⁵ The court specifically found: "[Both] the language and the history of the 1934 Act, together with the sound policy behind supervised exchange self-regulation, mandate the conclusion that Congress intended to exempt from the antitrust laws the exchange practice of fixing commission rates."⁹⁶

The court read *Silver*'s discussion of a core of exchange self-regulation necessary to make the 1934 Act work as necessarily referring to the 12 practices outlined in section 19(b) of the Securities Exchange Act; for the court to act in one of these areas would conflict with a power of review expressly delegated to the SEC and frustrate or render ineffective the congressional scheme.⁹⁷ Ensuring both fair dealing and the protection of investors in the face of what would otherwise be per se violations of the antitrust laws was the task of the Commission, and accomplishment of these goals would be "too hazardous with two hands on the tiller."⁹⁸ Moreover, the

91. 374 F. Supp. at 111.

92. 498 F.2d 1303 (2d Cir. 1974), cert. granted, 95 S. Ct. 491 (1974).

93. See note 90 *supra* & accompanying text.

94. 498 F.2d at 1304. The allegation was that such price discrimination violated the Robinson-Patman Act, 15 U.S.C. § 13(a) (1970), and that the fixed commissions constituted price fixing within the meaning of the Sherman Act, 15 U.S.C. §§ 1-2 (1970).

95. 15 U.S.C. § 78s(b) (1970).

96. 498 F.2d at 1305-06.

97. *Id.*

98. *Id.* at 1308.

court found that the SEC in fact had exercised wide-reaching, systematic review and regulation of the controverted fixed commission rates.⁹⁹

Thill was partially distinguished by the court on the basis that the anti-rebate rule in the earlier case is not included in the section 19(b) list and thus perhaps not within the "core" of antitrust immunity.¹⁰⁰ The district court in *Gordon* had noted the absence of a record of active SEC review in *Thill* and the danger that the refusal to share commissions could be used as a weapon against a particular competitor.¹⁰¹ Both the district court and the court of appeals drew the line there, however, disavowing any intent to imply the existence of concurrent jurisdiction for the SEC and the courts over all potentially anticompetitive practices.¹⁰² For the first time the jurisdiction of the court in securities antitrust cases thus was delineated and the "different case" question reserved in *Silver* identified and resolved. Where the SEC review of self-regulatory body actions is pursuant to section 19(b) of the 1934 Act and the SEC has maintained active review, its jurisdiction is exclusive. In other areas under the Act, the jurisdiction of the courts is concurrent with that of the SEC.

The district court which had dismissed *Gordon* applied this jurisdictional definition in *Jacobi v. Bache & Co.*,¹⁰³ determining that the propriety of a service charge, which had been recommended by the Board of Governors of the New York Stock Exchange and specifically approved by the SEC, was within the primary jurisdiction of the SEC and not subject to direct antitrust attack.¹⁰⁴ Nonetheless, the specific application of the service charge challenged by the complaint, the concerted refusal of NYSE firms to pay registered representatives a portion of the charge, was held to be only partly within the regulatory function of the Commission, since it concerned the

99. *Id.*

100. *Id.* at 1310.

101. *Gordon v. New York Stock Exch.*, 366 F. Supp. 1261, 1267 (S.D.N.Y. 1973).

102. *Id.*; 498 F.2d at 10. The court of appeals in *Gordon* was quick to note that by refusing jurisdiction, it was not leaving the plaintiff without a remedy. Two avenues of review remained: review provided pursuant to the Administrative Procedure Act, 5 U.S.C. §§ 702, 704 (1970), and review of a SEC order under 15 U.S.C. § 78y (1970). In either case, the court should consider the weight given by the Commission to anticompetitive factors.

103. 377 F. Supp. 86 (S.D.N.Y. 1974).

104. *Id.* at 93. The court followed *Gordon* in determining that the service charge was within the direct regulatory and supervisory authority of the SEC under section 19(b), 15 U.S.C. § 78s(b) (1970). 377 F.2d at 93.

relationship between a member firm and its employees rather than investor protection.¹⁰⁵ Accordingly, the court exercised concurrent jurisdiction and applied *Silver* to reconcile the conflicting policies of the securities laws and the antitrust laws.¹⁰⁶ It found that the service charge was necessary to the operation of the Securities Exchange Act, that it constituted neither a price-fixing scheme in its application to compensation nor any other antitrust violation, and that its purpose and effect comported with the protection of investors and the smooth and fair administration of the securities markets intended by the securities laws.¹⁰⁷

The exercise of jurisdiction in *Bache* seems consistent with that in *Thill*, *Gordon*, and *Silver* and supports the argument that the Securities Exchange Act of 1934 did not effect a pervasive regulatory scheme. Taken together with *Haddad*,¹⁰⁸ these cases put into perspective the immunity of the NASD activities and cast doubt upon the application of the *Silver* doctrine to the NASD in *Harwell*.¹⁰⁹ The court in *Bache* rejected the defendant's contention that the SEC had either exclusive or primary jurisdiction;¹¹⁰ other courts similarly have rejected the claim of primary jurisdiction.¹¹¹ The Supreme Court, however, has twice addressed the issue, and its conclusions well could be applicable to the SEC, particularly in view of the expansion of that body's jurisdiction pursuant to the Securities Acts Amendments of 1975.¹¹²

The first of the two Supreme Court cases, *Ricci v. Chicago Mercantile Exchange*,¹¹³ arose as an antitrust complaint against the Chicago Mercantile Exchange for conspiring with its members to deny the plaintiff membership in violation of Exchange rules and the Commodity Exchange Act.¹¹⁴ Although remanding the case to the

105. *Id.* The court extended the holding of *Merill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117 (1973), that unless the rule came within the SEC's mandate to protect the investing public and to assure just and equitable trading practices, it would not require the preemption of conflicting state law. *Ware* was not applicable directly since in *Bache* the conflicting law was federal, not state, law. 377 F.2d at 93.

106. 377 F.2d at 93-95.

107. *Id.* at 98.

108. See notes 86-91 *supra* & accompanying text.

109. See notes 79-85 *supra* & accompanying text.

110. 377 F. Supp. at 93.

111. See, e.g., *Thill Sec. Corp. v. New York Stock Exch.*, 433 F.2d 264, 272 (7th Cir. 1970).

112. See notes 249-277 *infra* & accompanying text.

113. 409 U.S. 289 (1973).

114. 7 U.S.C. §§ 1-17b (1970).

trial court, the court of appeals in *Ricci* stayed further proceedings pending an administrative determination by the Commodity Exchange Commission (CEC).¹¹⁵ The controversy resembled that presented in the securities cases: "[C]onduct seemingly within the reach of the antitrust laws [was] also at least arguably protected or prohibited by another regulatory statute enacted by Congress. . . . [T]he other regime includes an administrative agency with authority to enforce the major provisions of the statute"¹¹⁶ But the case differed from *Silver* and its successors in that the CEC had obvious jurisdiction and a clear right to judicial review was provided.¹¹⁷

The Supreme Court allowed the agency to make the initial determination, while it remained ready to act on the antitrust issue after the Commission made its determination.¹¹⁸ In so finding, the Court reaffirmed the *Silver* principle regarding implied repeal of the antitrust laws, but decided to use the agency as a factfinder to determine if the denial of membership was pursuant to a valid exchange rule. If the Commission found the action violative of a rule, then the problem would no longer exist; if the Commission upheld the denial of membership as being pursuant to a valid rule, then the Court would be in a position to "make a more intelligent and sensitive judgment as to whether the antitrust laws will punish what an apparently valid rule of the Exchange permits."¹¹⁹ Justice Marshall dissented, arguing that even if the Commission were to refuse to invalidate the rules, the decision would mean only that such rules were not prohibited by a specific provision of the Commodities Exchange Act. Such a refusal could not be taken to mean that the rule serves any useful purpose or that it meets the *Silver* requirement. He therefore viewed the conferring of primary jurisdiction upon the Commission as useless.¹²⁰

115. 447 F.2d 713 (7th Cir. 1971)

116. 409 U.S. at 299-300.

117. *Id.* at 301. In *Silver*, the Court noted the SEC's lack of authority to review specific instances of enforcement of exchange rules, thus obviating any question of primary jurisdiction. 373 U.S. at 357-58.

118. 409 U.S. at 301-302.

119. *Id.* at 308.

120. Justice Marshall argued strongly against referring the case to the agency since it would be unable to resolve all the issues which were raised. In addition, because the Commission was authorized but not required to hear the case, its jurisdiction would be merely discretionary. He also argued that the conspiracy complaint was clearly within the jurisdiction of the courts without the necessity of any prior factfinding by the Commission. *Id.* at 309-21.

What is most significant about the case is the clear assent to the principle of ultimate review of antitrust matters by the courts. The majority favored primary jurisdiction in the Commission only because it ultimately would help the court determine whether the particular rule merited insulation from antitrust attack. Clearly, the *Silver* doctrine is intended to control.¹²¹

The Supreme Court reaffirmed and applied *Ricci* in *Chicago Mercantile Exchange v. Deaktor*.¹²² Defending against charges of price manipulation and failure to enforce its own rules, the Exchange contended that its actions were taken pursuant to its duty of self-regulation, that they were within the jurisdiction and oversight of the Commodity Exchange Commission, and that they were therefore beyond the reach of the antitrust laws. The Court accepted the Exchange's argument that the Commission first should be allowed to determine whether the actions were performed in discharge of the statutory duty.¹²³

Lower courts have not attempted to extend the Supreme Court's holdings in *Ricci* and *Deaktor* to invoke the doctrine of primary jurisdiction in securities cases;¹²⁴ instead they have followed an approach similar to that of the dissent in *Ricci*.¹²⁵ The role which the doctrine will serve in securities cases will depend upon developments outside the judicial branch concerning the regulation of competition in the securities industry. Those extrajudicial developments are responses to widely recognized problems in the present structure, and they ultimately may have a greater impact on anti-competitive practices in the securities industry than any of the judicial attacks premised upon antitrust statutes.

RECENT STUDIES OF THE SECURITIES MARKETS

Instability in the securities industry during the late 1960's and the early 1970's stemmed partially from the late 1960's sales boom which, because of the inefficiency of brokerage house methods for handling mass trading, led to an extreme backlog of paperwork, the

121. Another case clearly enunciating this view was *Zuckerman v. Yount*, 362 F. Supp. 858 (N.D. Ill. 1973), which held that an exchange's membership requirements cannot be immune from antitrust laws without first passing the *Silver* test: the anticompetitive rules must be necessary to make the Securities Exchange Act work.

122. 94 S. Ct. 466 (1973).

123. *Id.* at 467.

124. See note 111 *supra* & accompanying text.

125. See note 120 *supra* & accompanying text.

consequent demise of less efficient brokerage houses, a curtailment of trading hours and days, and a loss of public confidence in the market.¹²⁶ Litigation challenging various aspects of exchange self-regulation and SEC supervision also increased. Together, these occurrences emphasized the overall inability of "supervised self-regulation" to control effectively the securities market in a manner envisioned by the drafters of the Securities Exchange Act.

Investigations abounded. The Securities Investor Protection Act of 1970¹²⁷ was an early response directing one investigation.¹²⁸ In addition, Congress conducted two major investigations;¹²⁹ the SEC supported two major studies,¹³⁰ published two "white papers" on its conception of the future of the securities industry,¹³¹ and promulgated rules which have begun to implement that concept;¹³² and both the NYSE¹³³ and the Treasury Department¹³⁴ conducted studies. These investigations were extremely broad, covering virtually every aspect of the securities markets. The present analysis,

126. SEC, STUDY OF UNSAFE AND UNSOUND PRACTICES, (Letter of Transmittal to Senate and House of Representatives), in [Special Studies Transfer Binder] CCH FED. SEC. L. REP. ¶ 74,801, at 65,501 (Dec. 28, 1971).

127. 15 U.S.C. §§ 78aaa-78lll (1970). Through the Act, Congress provided for the establishment of the Securities Investor Protection Corporation (SIPC), *id.* § 78ccc(a), which was to establish the SIPC Fund with an initial balance of not less than \$75 million, *id.* § 78ddd. The purpose of the fund is to protect customers of registered broker-dealers from financial loss, to the extent of \$50,000 each. *Id.* § 78fff(1).

128. An SEC study into practices deemed unsafe or unsound was required by 15 U.S.C. § 78kkk(h) (1970).

129. HOUSE SUBCOMM. ON COMMERCE AND FINANCE, SECURITIES INDUSTRY STUDY REPORT, H.R. REP. NO. 1519, 92d Cong., 2d Sess. (1972); SENATE SUBCOMM. ON SECURITIES, 93d Cong., 1st Sess., SECURITIES INDUSTRY STUDY REPORT (Comm. Print 1973). By July 1973, there were no fewer than five congressional committees investigating some aspect of the securities industry. 212 BNA SEC. REG. & L. REP. A-9 (July 25, 1973).

130. SEC, INSTITUTIONAL INVESTOR STUDY REPORT, in [Special Studies Transfer Binder] CCH FED. SEC. L. REP. ¶ 74,701 (March 10, 1971) [hereinafter cited as INSTITUTIONAL INVESTOR STUDY]; SEC STUDY OF UNSAFE AND UNSOUND PRACTICES, in [Special Studies Transfer Binder] CCH FED. SEC. L. REP. ¶ 74,801 (Dec. 28 1971) [hereinafter cited as UNSOUND PRACTICES].

131. SEC, POLICY STATEMENT ON THE FUTURE STRUCTURE OF THE SECURITIES MARKETS, in [Special Studies Transfer Binder] CCH FED. SEC. L. REP. ¶ 74,811 (Feb. 2, 1972) [hereinafter cited as FUTURE STRUCTURE]; SEC, POLICY STATEMENT ON THE STRUCTURE OF A CENTRAL MARKET SYSTEM, in 196 BNA SEC. REG. & L. REP. D-1 (Apr. 4, 1973) [hereinafter cited as MARKET STATEMENT].

132. Rule 17a-15, 17 C.F.R. § 240.17a-15 (1973); rule 19b-2, 17 C.F.R. § 240.19b-2 (1973).

133. MARTIN, THE SECURITIES MARKETS, in [1970-1971 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,184 (Aug. 5, 1971) [hereinafter cited as MARTIN REPORT].

134. TREASURY DEPARTMENT, PUBLIC POLICY FOR AMERICAN CAPITAL MARKETS (1974).

however, will concentrate solely on aspects of the various reports which relate to the competitive structure of the securities markets and the ineffective system of exchange regulation.

Institutional Investor Study

The first significant report was the SEC's Institutional Investor Study.¹³⁵ Congress, in authorizing the study, expressed concern that the growing holdings of institutional investors might cause the demise of the auction market with its numerous free buyers and sellers.¹³⁶ The purpose of the study was to determine the effects of such holdings and transactions by institutional investors upon the maintenance of orderly securities markets, upon issuers of securities, upon the interests of the public, and upon the economy in general.¹³⁷ One particularly grievous deficiency in market and exchange operation identified by the study was the fixed minimum commission rate structure:

As will be apparent from the recurrent references to brokerage commission rates . . . , the Commission regards non-competitive, fixed minimum commission rates on securities transactions of institutional size as the source of a number of difficulties in the development of institutional investing and the trading markets for equity securities. The clear conclusion from the Study Report is that *competitive brokerage rates should be required* at least on such transactions.¹³⁸

The Commission developed objectives regarding the direction in which it believed the changing market should move. Its goal was a strong central market system, competitively based, with minimum restraints on trade. It desired to preserve the virtues of the agency auction market and to provide equal access rules for all market-makers and qualified broker-dealers. The central market system could be formed by using modern communications and data processing to link all of the trading markets nationally, while preserv-

135. INSTITUTIONAL INVESTOR STUDY, *supra* note 130.

136. H.R. REP. NO. 1665, 90th Cong., 2d Sess. 2 (1968).

137. *Id.* at 2-4.

138. INSTITUTIONAL INVESTOR STUDY, *supra* note 130, at 65,314 (emphasis supplied). The Commission indicated that it already had begun the implementation of this recommendation by notifying the NYSE that negotiated commission rates on institutional size orders (\$500,000 or more) would be required by April 1, 1971. *Id.* For further development of the commission rates issue, see notes 164, 236 *infra* & accompanying text.

ing their geographic separation and regional character. The SEC saw its own role in the formation of the new market system to be moderately passive: its task would not be to predetermine the structure, but rather "to observe and, if necessary, to modify the structure which evolves . . . [if] changes occur that appear inconsistent with the public interest."¹³⁹ Clearly in 1971, the SEC did not anticipate the abandonment of industry self-regulation to establish itself as the prime mover in the restructuring of the securities market. Instead it apparently was ready to sit, watch, and keep the shotgun ready.¹⁴⁰

The Martin Report

Five months after the Institutional Investor Study was submitted to Congress, William McChesney Martin completed a study which the NYSE had commissioned.¹⁴¹ Martin, a former Chairman of the Board of Governors of the Federal Reserve System and a former President of the NYSE, had obvious qualifications for conducting such a study. One commentator has suggested, however, that Martin's background also worked to create a preference for NYSE policies and procedures and that this preference was evidenced by his reliance upon the NYSE as the core of his proposed central system.¹⁴²

Martin's suggested solution to the financial and operational ills of the industry was the creation of a central exchange system as opposed to the SEC's central market system, developed to provide a "single, national auction market for each security qualified for listing."¹⁴³ A central exchange system would permit equal access for a maximum number of broker-dealers,¹⁴⁴ but would deny membership to institutional investors.¹⁴⁵ Implementation of negotiated rates

139. INSTITUTIONAL INVESTOR STUDY, *supra* note 130, at 65,335.

140. See Mr. Justice Douglas' view of industry self-regulation, *supra* note 48.

141. MARTIN REPORT, *supra* note 133, at 80,555.

142. Martin's major premise, that the NYSE be the "heart and center of all operations of the national securities market and NYSE procedures . . . [be] the norm for those operations . . . is never questioned; it is not even made explicit . . ." Folk, *Restructuring the Securities Markets—The Martin Report: A Critique*, 57 VA. L. REV. 1315, 1374 (1971).

143. MARTIN REPORT, *supra* note 133, at 80,557.

144. *Id.* While Martin speaks in favor of access, he limits the access to a "maximum number" which apparently would not include all. The SEC approach favors access for all who meet the competency and capital requirements. See notes 171-76 *infra* & accompanying text.

145. *Id.* at 80,562.

would be delayed pending evaluation of his present proposals.¹⁴⁶ The third market, the over-the-counter market in sales of NYSE-listed stocks made by broker-dealers who are not exchange members, would be eliminated by requiring stocks to be traded either on the national auction exchange or on the over-the-counter market, but not on both.¹⁴⁷ The NYSE would be reorganized to prepare it to serve as the basic unit of the national exchange system.¹⁴⁸ Seeking recognition of its quasi-public nature, the NYSE would ask Congress for antitrust immunity coextensive with the scope of the SEC's control under the Securities Exchange Act.¹⁴⁹

When Martin's study was commissioned early in 1971, the NYSE was well on its way toward altering its traditional anticompetitive stance, the Exchange's Committee on Membership Qualifications already having announced its support for institutional membership and negotiated rates. After publication of the Martin report, however, the Exchange reversed its position to adopt again a more anti-competitive posture.¹⁵⁰

Unsafe and Unsound Practices Study

The next report to appear concerning the securities markets was the SEC's Study of Unsafe and Unsound Practices.¹⁵¹ Mandated by section 11(h) of the Securities Investor Protection Act of 1970,¹⁵² the study sought to determine both the causes of and the cures for the paperwork crisis. It found a wide range of contributing factors,¹⁵³ almost all of which were the result of inadequate self-regulation by the exchanges, but noted that remedial steps already had been taken in virtually every problem area.¹⁵⁴ Claiming a need for addi-

146. *Id.* at 80,562-63.

147. *Id.* at 80,557. The over-the-counter market for unlisted securities, the "second market," would remain intact but apparently separate. For a discussion of the various levels of trading, see *Approach*, *supra* note 64, at 261-62.

148. MARTIN REPORT, *supra* note 133, at 80,557-60.

149. *Id.* at 80,563-64.

150. Folk, *supra* note 142, at 1350-51.

151. UNSOUND PRACTICES, *supra* note 130.

152. 15 U.S.C. § 78kkk(h) (1970).

153. UNSOUND PRACTICES, *supra* note 130, at 65,503. Among these problems were insufficient capital, insufficient control over securities, inadequate restrictions over the use of customer's securities and cash held by the brokerage houses, and inadequacies in recordkeeping, delivery, clearing, and transfer facilities. *Id.*

154. *Id.* at 65,504-07.

tional legislative authority to complete the task,¹⁵⁵ the SEC sought the following significant powers: authority to oversee the development of a unified securities processing system for clearance, settlement, and transfer of securities;¹⁵⁶ authority to control rulemaking of self-regulatory bodies, to approve or disapprove new rules and proposed amendments to existing rules, and to abrogate old rules or require amendments to them;¹⁵⁷ authority to enforce directly the rules of the self-regulatory bodies;¹⁵⁸ and authority to review all disciplinary proceedings of self-regulatory bodies either on appeal or upon its own motion with power to affirm, reverse, or modify the penalty imposed.¹⁵⁹ The SEC report thus detailed the deficiencies which had resulted from inadequate self-regulation and supervision, and outlined remedial amendments to the SEC's grant of power in the Securities Exchange Act.

SEC Policy Statement on the Future Market Structure

Perhaps at least partly in answer to the Martin Report, the SEC restated its concept of the central market system and explicated the methods for effectuating such a central system in its Policy Statement on the Future Structure of the Securities Markets.¹⁶⁰ SEC Chairman Casey stated as the overall objective the creation of "markets which are public markets, staffed by professionals, retaining the confidence of individual investors . . . , and providing necessary depth and liquidity, by unification and by reliance on competition within the market structure, not outside it."¹⁶¹ He identified three prerequisites for attaining the overall objective: simplicity and directness of operations in the securities markets; adaptation of the market to the growing institutional business, while maintaining

155. *Id.* at 65,508.

156. This requested power would enable the Commission to require standardized procedures and to accelerate automation. With such control over "back office" practices, another crisis similar to that in the late 1960's could be precluded. *Id.*

157. *Id.* at 65,509. Because the SEC's power to control rulemaking by the NASD then was broader than its power over the exchanges, this provision would bring uniformity as well as a significant increase in SEC power. *Id.* See generally *Approach*, *supra* note 64, at 284-92. See also note 212 *infra* & accompanying text.

158. *UNSOUND PRACTICES*, *supra* note 130, at 65,509-10.

159. *Id.* at 65,510. Congress has considered granting all of the powers requested in this report. See notes 197, 215 *infra* & accompanying text.

160. *FUTURE STRUCTURE*, *supra* note 131.

161. *Id.* at 65,611.

confidence and participation of the individual investors; and continued availability of professional services to investors without any decline in the standards for such services.¹⁶² The SEC was confident that these prerequisites could be met through use of a "central market system" (CMS), which it defined as follows: "[It is] a system of communications by which the various elements of the marketplace, be they exchanges or over-the-counter markets, are tied together. It also includes a set of rules governing the relationships which will prevail among market participants."¹⁶³

Going well beyond the Institutional Investor Study, the SEC announced its intention to lower further the threshold for requiring negotiated commission rates to \$300,000 in April 1972,¹⁶⁴ and determined that, while institutional membership should not be allowed for the purpose of recapturing commissions, it should be allowed at least to the extent of permitting institutional acquisition or establishment of a broker-dealer who carries on a general business with the public.¹⁶⁵ Despite a contemplated "unbundling" of commission rates,¹⁶⁶ the SEC still would require the broker-dealer to include in

162. *Id.* at 65,611-12.

163. *Id.* at 65,614. Through the system of communications, all transactions in securities and all quotations would be made available to all broker-dealers, all of whom would have access to the market, and all market-makers would compete with each other. *Id.* The Commission noted that a plan allowing access for nonmembers, though limited by a provision for a 40 percent discount from prescribed commission rates, had been instituted already by the NYSE. *Id.* The third market, rather than being eliminated as the Martin Report had recommended, would be integrated into the central market system. *Id.* Institution of such a system would require elimination of NYSE rule 394 which prohibits members from transacting any business in the third market. See note 182 *infra*. See generally Note, *NYSE Rules and the Antitrust Laws—Rule 394—Necessary Restriction or Illegal Refusal to Deal?*, 45 ST. JOHN'S L. REV. 812 (1971).

164. FUTURE STRUCTURE, *supra* note 131, at 65,619. This action allowed commission rates to be negotiated on the portion of an order which exceeds the breakpoint, which previously was set at \$500,000. The SEC decided that the benefits of competition far outweighed the evils of negotiated rates. It saw the negative effects of the fixed minimum commission rate structure to be primarily the dispersion of trading in listed securities to the third market and the regional exchanges, the development of reciprocal practices of various kinds, and increased pressure for institutional membership. *Id.* at 65,618-19. Each of these could be eliminated with the elimination of the fixed rates, the final step which the SEC took in January 1975. See note 236 *infra*.

165. *Id.* at 65,623. The Commission noted the difficult conflict of interest problems presented by the allowance of institutional membership and by the presence of broker-dealers who also engage in money management, but it indicated a belief that these problems should be resolved by Congress, not by the SEC. *Id.* at 65,623-24.

166. "Unbundling" is the practice of charging a separate fee for each service, such as execution or research, which is provided. *Id.* at 65,620.

his service, beyond mere execution of a transaction, the evaluation of its suitability for the customer, with the result that, at least some portion of the research expense would remain a part of every transaction.¹⁶⁷ In its policy statement, the SEC thus evidenced clear recognition of the need for competitive commission rates and provided the first definite guidelines for implementation of the central market system.

In late 1972 and early 1973 the SEC moved toward effectuating its policy statement by promulgating two rules, both concerning areas considered prerequisite to the establishment of a central market system.¹⁶⁸ In November 1972, it issued rule 17a-15,¹⁶⁹ which required that the exchanges and the NASD submit plans to the Commission for the nationwide dissemination of prices and volume of all completed transactions. Providing for such dissemination was believed to be the necessary first step toward establishment of the communications network that would be the central market system.¹⁷⁰ The second effort by the SEC was its promulgation, in January 1973, of rule 19b-2 concerning institutional membership on securities exchanges.¹⁷¹ By the rule, initially effective in March 1973 with a three-year period for complete implementation, membership on all exchanges would be open to all who meet minimum competency and capital requirements and who do a "predominantly public business."¹⁷² The effect of the limiting phrase is to require that

167. *Id.* Under the fixed minimum commission rate structure, every customer paid the same rate and received not only execution of his order, but the support of an organization, including vast research services. If rates were made competitive, it would be presumed that some firms would offer "bargain prices" on execution only, enabling the customer to save the research costs. Here, the SEC placed a minimum limit on services which must be provided to the customer.

168. For a discussion of the abolition of fixed commission rates by the SEC, see note 236 *infra*.

169. 17 C.F.R. § 240.17a-15 (1973).

170. The second part of the communications tie is the quotation system. The only action yet taken to implement the second step has been the issuance of a proposed rule 17a-14 by the SEC. See CCH FED. SEC. L. REP. ¶ 79,931 (Aug. 21, 1974). It has been suggested, however, that the basis of the system already exists in the form of the NASD Automated Quotation System (NASDAQ), and that its expansion to include NYSE and American Stock Exchange (AMEX) stocks would provide the desired quotation system. Establishment of the system in this fashion would save the NYSE an estimated \$8 million expense of developing a duplicate system. See 208 BNA SEC. REG. & L. REP. A-10 (June 27, 1973) (remarks of Representative John Moss). See also Russo & Wang, *The Structure of the Securities Market—Past and Future*, 41 *FORD. L. REV.* 1, 36-41 (1972).

171. 17 C.F.R. § 240.19b-2 (1973).

172. SEC Securities Exchange Act Release No. 9950 (Jan. 16, 1973).

the principal purpose of membership be the conduct of public securities business; such a purpose would be deemed to exist if at least 80 percent of the member's business is performed for or with persons other than "affiliated" persons.¹⁷³

The institutional membership rule is among the most controversial developments in the securities industry. In both the House and the Senate, the 80 percent threshold drew immediate criticism¹⁷⁴ and provoked the introduction in both houses of legislation to nullify rule 19b-2.¹⁷⁵ Opponents of the rule also have had some success

173. 17 C.F.R. § 240.19b-2(a) (1973). The definition of "affiliated" has been the source of a continuing controversy involving the SEC, the NYSE, and both houses of Congress. See notes 190-91 *infra* & accompanying text. Under rule 19b-2, the SEC will include within the 80 percent "public" group a series of transactions which otherwise would be deemed non-public, such as transactions by a registered specialist in a security in which he is so registered. 17 C.F.R. § 240.19b-2(a) (1973). "Affiliated persons" include those persons "controlling, controlled by, or under common control with such member, . . . [a]ny principal officer, stockholder or partner of such member or any person in whose account such person has a direct or material indirect beneficial interest; and . . . [a]ny investment company of which such member [or one in a common control position is an] investment adviser" *Id.* § 240.19b-2(b).

The rule's control test eliminates the "parent test" of NYSE rule 318, which required the primary purpose of any member, or the "parent" of any member, to be the transaction of business as a securities broker or dealer. SEC Securities Exchange Act Release No. 9950 (Jan. 16, 1973). A presumption of control exists for all persons with more than 25 percent of the voting stock of a member and for all persons who are entitled to more than 25 percent of the profits. 17 C.F.R. § 240.19-2(b)(2) (1973). The presence of investment discretion alone, however, does not constitute control. *Id.* Insurance companies managing pension fund assets through separate accounts, without any other indicia of control, would be deemed to be conducting a public business. Where the pension fund was an insured plan, the insurance company would be selling insurance and not money management service, since it would be investing assets for its own account. This latter type of business therefore would be considered nonpublic or affiliated. SEC Securities Exchange Act Release No. 9950 (Jan. 16, 1973).

174. See 183 BNA SEC. REG. & L. REP. A-2 (Jan. 3, 1973).

175. H.R. 5050, 93d Cong., 1st Sess. (1973), proposed forbidding any dealings between broker-dealers and affiliated accounts. *Id.* § 205. H.R. 4111, 94th Cong., 1st Sess. (1975), would have written into the proposed Securities Reform Act of 1975 a general prohibition of dealings between broker-dealers and affiliated accounts, with specific exceptions. *Id.* § 105. It would have granted a three-year grace period for an exchange member who had acquired that status and the affiliated account by January 16, 1973. *Id.*

The Senate, taking a different approach from the House, passed S. 470, 93d Cong., 1st Sess. (1973), in June, 1973. It would not have barred institutional membership for at least five years and would have allowed affiliate trading until April 30, 1976, or until no fixed rate commission structure existed on any exchange, whichever was later. Then, it would have effected a graduated two-year elimination of affiliate trading, reducing the permissible level to 20 percent, then 10 percent, before finally restricting exchange membership to firms with no affiliate trading. *Id.* § 2. Senate reformers later introduced the Securities Acts Amendments of 1975, S. 249, 94th Cong., 1st Sess. (1975), which would have retained the gradual prohibition of affiliate trading, but without reference to a specific termination date. *Id.* § 5.

in the courts.¹⁷⁶ Promulgation of the rules, nevertheless, clearly demonstrated the SEC's firm intent to proceed with development of the central market system and to attack the anticompetitive aspects of the present system.

SEC Policy Statement on a Central Market System

The SEC's most recent considered treatment of its developing concept of the structure and regulatory framework for the central market system was published in April 1973.¹⁷⁷ This statement evaluated the findings of advisory committees established by the previous policy statement¹⁷⁸ and reviewed results precipitated by rules 17a-15 and 19b-2. The Commission reiterated the importance of the communications links, noting progress in the development of a sale reporting system and a quotation system.¹⁷⁹ The Commission restated its position that the third market should be integrated into the central market system¹⁸⁰ and that all members of the system

Either of the proposals apparently would have abrogated rule 19b-2. Senator Williams, introducing S. 249, specifically stated that section five of the proposed Act would require that rule 19b-2 be withdrawn. 121 CONG. REC. S433 (daily ed. Jan. 17, 1975).

176. In March 1973, the Philadelphia-Baltimore-Washington (PBW) Exchange requested the Court of Appeals for the Third Circuit to stay rule 19b-2. *PBW Stock Exch., Inc. v. SEC*, 485 F.2d (3d Cir. 1973), *cert. denied*, 94 S. Ct. 1992 (1974). The exchange, with 43 percent of its trading volume transacted by institutional members who were not in compliance with the rule, would stand to suffer substantial loss if the rule were allowed to stand. Many of the member firms of the PBW, as institutional investor affiliates, would be wholly unable to comply with the 20 percent limit upon affiliate trading. *Id.* at 720. The court granted the stay as to the PBW, but the rule, modified to some extent due to the pending litigation, became effective for the rest of the industry on March 29, 1973, instead of March 15, 1973, as first promulgated. SEC Securities Exchange Act Release No. 10052 (Mar. 22, 1973). Nevertheless, the ultimate decision of the court in September 1973 was to dismiss the suit brought by the PBW for lack of jurisdiction. The majority found that the SEC had the option to proceed either by rule, regulation, or order under section 19(b) of the Securities Exchange Act, but that section 25(a) allowed review only of an order. 485 F.2d at 733. They found no statutory authority for direct review in the court of appeals of either a rule or a regulation of the SEC. *Id.* That jurisdictional decision made consideration of the merits of the PBW attack on the SEC's approach to the institutional membership question unnecessary. *Id.* PBW was followed when the Court of Appeals for the District of Columbia Circuit refused jurisdiction to review a "rule or regulation." *Natural Resources Defense Council, Inc. v. SEC*, 258 BNA Sec. REG. & L. REP. A-11 (D.C. Cir. June 17, 1974).

177. MARKET STATEMENT, *supra* note 131.

178. Among three advisory committees created in connection with the earlier statement was one to study the central market system. See FUTURE STRUCTURE, *supra* note 131, at 65,624-25.

179. A quotation system had been made the subject of a proposed rule. See note 170 *supra*.

180. MARKET STATEMENT, *supra* note 131, at D-3.

should be free to trade in any security eligible for inclusion in the central market system.¹⁸¹ The statement further recommended uniform rules for exchanges to prohibit the inclusion of anticompetitive rules such as NYSE rule 394.¹⁸² Additionally, each exchange should increase the maximum level to which nonmembers can negotiate access to exchanges.¹⁸³ The SEC has taken no further action to im-

181. *Id.* at D-4.

182. *Id.* at D-4 to -5, D-13. New York Stock Exchange rule 394 requires that members of the Exchange obtain its permission before making a transaction in a listed stock of the Exchange, either as principal or agent. The effect of rule 394 is to require NYSE firms to trade in listed stocks, either on the floor of the Exchange or on another registered exchange, and to prevent these firms from dealing with nonmembers who trade in the third market. The rule inhibits competition by discouraging transactions off the floor of the Exchange, although a better deal might be possible elsewhere. HOUSE SUBCOMM. ON COMMERCE AND FINANCE, SECURITIES INDUSTRY STUDY REPORT, H.R. REP. NO. 1519, 92d Cong., 2d Sess. 126 (1972).

The goals of eliminating market fragmentation, the scattering of buying and selling interests to diverse locations, and preserving an auction-agency market would be effected through the use of two basic trading rules, pursuant to Approach II as recommended by the Advisory Committee on a Central Market System. SEC, ADVISORY COMM. REPORT ON A CENTRAL MARKET SYSTEM, 192 BNA SEC. REG. & L. REP. I-1 (March 3, 1973). The Committee had recommended two alternative "Approaches," both of which would retain the concepts of the composite tape, and floor and market specialists. *Id.* at I-2, I-4. Both recognized the advantages of an auction market and the need for protection of prior public orders, and both would provide broad access, competition between market centers and all types of market-makers, and regulations to govern market activity and market-makers. *Id.* The significant difference was that Approach I would build on existing, relatively independent, self-regulatory market centers and link them with communications systems. It would prevent fragmentation by restricting trading in listed securities to the exchange, thus effectively destroying the third market. *Id.* at I-3. Approach II viewed the central market system as "a network of brokers and dealers trading in qualified listed securities, who may or may not be exchange members, operating both from offices . . . and on exchange floors, linked together by a real time communications network . . ." *Id.* at I-4. They would be governed by uniform rules under a new governing body consisting of major exchanges and the NASD. *Id.* All broker-dealers would be required to become members of at least one of the self-regulatory bodies, *id.* at I-7, and market-makers would be required to register with the market center to which they belonged, subject to SEC oversight. *Id.* It was Approach II that met with the Commission's approval. MARKET STATEMENT, *supra* note 131, at D-3.

The first of two basic rules, the Auction Trading Rule, would provide price priority for public orders throughout the system. By entering the limit order into a central electronic repository where it would not be available to the public, and by requiring a broker to check this repository prior to any transaction, the order would be protected against the execution of any transaction anywhere else in the system at an inferior price. *Id.* at D-4. The second rule is the Public Preference Rule, which would require dealer transactions to be at a higher purchase price or a lower sales price than available from broker transactions representing public orders. *Id.* at D-5.

183. *Id.* at D-12. The SEC believed the prevailing 40 percent discount on the NYSE to be inadequate, since reciprocity continued to provide nonmember broker-dealers a partial return on the commission, thereby making the effective discount greater than 40 percent. *Id.*

plement those proposals; nevertheless, the central market system since has moved closer to realization because of increasing congressional attention to the anticompetitive nature of the securities industry.

House of Representatives Study

While both houses for some time had been investigating the securities industry, the House of Representatives was first to publish a full report.¹⁸⁴ Finding insufficient enforcement of self-regulatory rules, generally inadequate regulation of the industry, and a dearth of competition, the subcommittee made a variety of wide-ranging recommendations designed both to restructure the industry and to provide more complete control by the SEC.

Foremost among the recommendations in the report were those relating to the central market system. Reaffirming most of the concepts set forth by the SEC in its first market statement,¹⁸⁵ the subcommittee advocated the rescission of NYSE rule 394 and similar rules and the provision of equal access to all broker-dealers.¹⁸⁶ Membership in an exchange would be superseded by membership in the central market system and any broker-dealer would be allowed to make a market in any security traded within the system. Competition would be an essential element in establishing the system.¹⁸⁷ Because fixed minimum commission rates were found not to be in the public interest, competitively determined rates would be required on all transactions.¹⁸⁸

The major point of departure from the SEC position concerned the question of institutional membership. The House subcommittee proposal would remove all bans on institutional membership, seeking the broadest possible participation in the market and requiring only that all broker-dealers meet minimum competency and capital requirements.¹⁸⁹ Seeing more harm than good, however, in the 80

184. HOUSE SUBCOMM. ON COMMERCE AND FINANCE, SECURITIES INDUSTRY STUDY REPORT, H.R. REP. NO. 1519, 92d Cong., 2d Sess. (1972) [hereinafter cited as HOUSE STUDY].

185. *Id.* at 123-30. See notes 160-73 *supra* & accompanying text. These concepts are the creation of a consolidated tape and composite quotation system, removal of barriers to competition between potential central market system members, and uniformity of exchange rules and regulations. HOUSE STUDY, *supra* note 184, at 123.

186. HOUSE STUDY, *supra* note 184, at 123. See note 182 *supra* & accompanying text.

187. HOUSE STUDY, *supra* note 184, at 128.

188. *Id.* at 131-46.

189. *Id.* at 148.

percent rule provided by SEC rule 19b-2,¹⁹⁰ the subcommittee would recognize the conflicting interests of broker-dealers who manage money and money managers who desired to be broker-dealers by forbidding all transactions by a broker-dealer for an affiliate.¹⁹¹ Finally, the report addressed the scope of the antitrust immunity afforded to the industry by the Securities Exchange Act and the regulatory scheme administered by the SEC. Contrary to the repeated assertions of the NYSE and the SEC,¹⁹² the subcommittee decided that the Supreme Court quite clearly had answered the question in *Silver*.¹⁹³

The practical outcome of the House report was the introduction, in March 1973, of an omnibus securities bill, the Securities Exchange Act Amendments of 1973.¹⁹⁴ The provisions designed to foster competition in the securities industry were reintroduced as the Securities Reform Act of 1975¹⁹⁵ which adopted the House report's major provisions, including a grant to the SEC of direct authority

190. *Id.* at 151-52. In a letter to each exchange on February 15, 1972, the SEC had proposed that the exchanges amend their rules to prohibit membership to firms whose primary function is to redirect, rebate, or recapture commissions; to eliminate any "parent" test for exchange membership; and to restrict membership to firms doing the "predominant portion" of their business for "non-affiliated" customers. The Commission, while voicing openness on the meaning of the term "predominant," opined that it would require approximately 80 percent public business. [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,529 (Feb. 15, 1972). When the exchanges showed reluctance to accomplish these suggested amendments, the SEC proposed rule 19b-2, which would require the amendments to be made. [1972-1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,929 (Aug. 3, 1972).

191. HOUSE STUDY, *supra* note 184, at 148-49. This resolution of the problem effectively would disallow any trading for affiliates by exchange members. The subcommittee believed the SEC rule would have undesirable effects, such as forced mergers of firms, adverse impact upon regional brokerage firms, bookkeeping problems, and "churning" of public accounts in order to stay at the 80 percent level. *Id.* at 151-52. None of these problems would arise under a complete prohibition of affiliate trading. *Id.* at 152.

One additional difficulty with either rule is the definition of "affiliated." The NYSE proposed to define it to exclude "pension funds" but not other types of money management, such as mutual funds. *Id.* at 151. The House subcommittee found that NYSE interpretation to be discriminatory against non-NYSE members and institutional investors. *Id.* Later interpretations, among them SEC rule 19b-2, included non-insured pension funds of insurance companies in the non-affiliated classification, but considered insured funds to be affiliated business. See note 173 *supra*.

192. See, e.g., SEC Reply Memorandum, *Thill Sec. Corp. v. New York Stock Exch.*, 205 BNA SEC. REG. & L. REP. E-1 (E.D. Wis. 1973).

193. HOUSE STUDY, *supra* note 184, at 160-61. See notes 57-63 *supra* & accompanying text.

194. H.R. 5050, 93d Cong., 1st Sess. (1973).

195. H.R. 4111, 94th Cong., 1st Sess. (1975). The provisions of the Securities Acts Amendments of 1975, Pub. L. No. 94-29 (June 4, 1975), include the essential elements of the House bill. See notes 233-77 *infra* & accompanying text.

over the rules of the exchanges and the NASD.¹⁹⁶ It would have authorized review by the SEC of all exchange actions which refuse membership or which discipline members,¹⁹⁷ and it would have directed the SEC to take steps to establish a national central market system.¹⁹⁸

Senate Study

Paralleling the House study, the Senate securities subcommittee spent 18 months delving into the securities industry before publishing its report in February 1973.¹⁹⁹ In the study, the subcommittee found that lax enforcement of industry and SEC rules, especially those pertaining to net capital requirements, contributed to the paperwork crisis of the late 1960's.²⁰⁰ Because the SEC already had taken action toward terminating exemptions from the financial responsibility rules and had raised the net capital requirements, no corrective legislation was deemed necessary.²⁰¹ The subcommittee believed that the proper pricing mechanism should be competition, rather than fixed commission rates which were deemed to be artificial incentives for taking transactions from one market to another to reduce or recover commission charges.²⁰² Judging from the experience of the earlier introduction of competitive rates for transactions involving more than \$500,000, reliance upon competition to set rates was thought to provide an end to the artificial incentive while having no adverse effect upon market liquidity.²⁰³ Again, however, the

196. H.R. 4111, 94th Cong., 1st Sess. §§ 102-09 (1975).

197. *Id.* § 102. The four powers requested by the SEC at the conclusion of their Unsound Practices Study all would have been granted by the bill. See notes 155-59 *supra* & accompanying text.

198. H.R. 4111, 94th Cong., 1st Sess. § 501 (1975).

199. SENATE SUBCOMM. ON SECURITIES, 93D CONG., 1ST SESS., SECURITIES INDUSTRY STUDY REPORT (Comm. Print 1973) [hereinafter cited as SENATE STUDY].

200. *Id.* at 4.

201. *Id.* at 4-5.

202. *Id.* at 6. Although the common law duty of the broker is to obtain the best execution of the transaction for the customer, the fixed commission rates on the NYSE, coupled with rule 394, prevented brokers from fulfilling this duty. The Senate subcommittee would eliminate rule 394 and all similar restrictive rules in conjunction with eliminating the use of fixed rates. These two proposals would be instrumental in the formation of a central market system. See Russo & Wang, *supra* note 170, at 21.

203. SENATE STUDY, *supra* note 199, at 6-7. Liquidity refers to the ease with which an investor may convert his securities into cash. A traditional argument of the NYSE has been that the elimination or serious modification of the auction market would result in a loss of the ability of the market to absorb selling when there is no buying and a loss of liquidity.

subcommittee did not regard legislation as necessary since the SEC was moving toward further reduction of the breakpoint to \$100,000 by April 1974.²⁰⁴

The Senate study found the question of institutional membership to be tied to the issue of fixed commission rates. The NYSE, it noted, had approved expansion of brokerage houses into money management, while denying admittance of money managers to the exchange. Not only did that decision give the brokers a competitive advantage, but it suggested conflicts of interest.²⁰⁵ Reflecting as much dissatisfaction with the Martin Report's espousal of the status quo as with the SEC's 80-percent rule,²⁰⁶ the subcommittee would prohibit any business transactions by brokers with affiliates or with managed institutional accounts of any class. This proposal was modified, however, by the time the Senate approved legislation affecting institutional membership.²⁰⁷

Envisioning the central market system as a marriage of the best of the auction market, with its centralized trading, and the dealer market, with its market-making strength, the Senate subcommittee generally concurred in the SEC proposals. It noted that 17 percent of the trading in NYSE-listed stocks during the surveyed time period was conducted away from the floor, either on the regional exchanges or in the third market.²⁰⁸ Discounting the NYSE's fears of further fragmentation of trading, the subcommittee chose not to impede the competitive tendency.²⁰⁹ It saw as the primary objective

This argument is basic to the NYSE's advocacy of a national central exchange system with the NYSE as the core, especially since the NYSE sees itself as an auction market. See MARTIN REPORT, *supra* note 133, at 80,556; Folk, *supra* note 142. See generally Russo & Wang, *supra* note 170; Note, *NYSE Rules and the Antitrust Laws—Rule 394—Necessary Restriction or Illegal Refusal to Deal?*, 45 ST. JOHN'S L. REV. 812 (1971).

204. SENATE STUDY, *supra* note 199, at 5. See note 236 *infra*.

205. *Id.* at 8.

206. *Id.* at 9. The Senate subcommittee was as critical of the SEC's definition of "affiliated" as it was of the rest of the SEC approach. Pension funds managed by a broker would be considered unaffiliated business by the SEC, while those funds managed by an insurance company would be deemed affiliated. See notes 173, 190-91 *supra* & accompanying text. Such a definition would perpetuate the competitive unfairness between different groups of money managers. SENATE STUDY, *supra* note 199, at 9.

207. S. 470, 93d Cong., 1st Sess. (1973), passed by the Senate in June 1973, would not bar such affiliated transactions until after fixed commission rates were no longer present on any exchange. S. 249, 94th Cong., 1st Sess. (1975), incorporated that provision as section 5. See note 175 *supra*.

208. SENATE STUDY, *supra* note 199, at 10.

209. *Id.* Although fragmentation has been a major NYSE fear because of the potential

the linking of all of the market facilities in which a particular stock is traded to provide potential buyers and sellers with composite reporting of transactions in and quotations for that security to facilitate the execution of orders.²¹⁰ Supervision of the market would require regulation or legislation to ensure priority for public orders, to strengthen the market's ability to handle large block trades, and to govern the activities of the dealers and other professionals operating within the system.²¹¹

To augment control over the market and over the self-regulatory bodies in particular, the subcommittee would modify the Securities Exchange Act to give applicants for exchange membership the same right to a hearing and to SEC review which applicants to the NASD now have under the Maloney Act;²¹² exchange members who are disciplined also would have a right to such review. The SEC would gain authority to disapprove or modify exchange disciplinary procedures²¹³ as a part of the subcommittee's effort to emphasize that all exchange and NASD self-regulatory authority is subject to SEC review.²¹⁴ Additional powers requested by the SEC in its study of unsound practices were considered,²¹⁵ but the Senate subcommittee, unlike the House subcommittee,²¹⁶ saw no reason for the SEC to enforce directly the rules of the self-regulatory bodies or to increase the penalty imposed when the Commission reviews disciplinary pro-

reduction of depth and liquidity, it could provide the public with lower charges and better broker-dealer performance. See note 203 *supra*.

210. SENATE STUDY, *supra* note 199, at 10-11. The principal difficulties foreseen in implementing the system were the obtaining of necessary agreements among the exchanges and the NASD and the elimination of restrictive rules such as NYSE rule 394. The Senate felt that both of those difficulties should be resolved by December 31, 1973. *Id.* at 11. The study endorsed the proposal of a "neutral body" vendor of required market information as presented by the SEC in rule 17a-15. *Id.* at 10.

211. *Id.* at 11-12.

212. 15 U.S.C. § 78o-3(g) (1970). The Act gives the SEC power to review actions taken by a national securities association by which any member or other person is aggrieved. The absence of any similar power of review regarding the securities exchanges has led to the various collateral attacks on exchange actions, especially in the antitrust area. See *Approach*, *supra* note 64, at 290.

213. SENATE STUDY, *supra* note 199, at 14.

The subcommittee also noted that those procedural safeguards required by the Supreme Court in *Silver* to be given to nonmembers by the exchanges had not been provided. Therefore, statutory amendment would be the appropriate means to assure this protection. *Id.* at 14-15.

214. *Id.* at 15.

215. *Id.* at 16.

216. See note 197 *supra*.

cedures.²¹⁷ Power for the Commission to disapprove or to require changes to rules of self-regulatory bodies was approved, however.²¹⁸

Examining previous litigation, the Senate subcommittee found that judicial review had been limited unduly by statutory gaps and by the SEC's excessive reliance upon procedural technicalities, leading to a proliferation of collateral attacks premised upon anti-trust or due process issues;²¹⁹ the subcommittee would amend the law to establish clearly the availability of direct judicial review.²²⁰ Regarding the function of the judiciary in antitrust matters and the antitrust immunity of the securities industry, it found the *Silver* doctrine to be quite clear, the subcommittee seeing no merit in the SEC's argument that Commission approval of self-regulatory action should immunize the industry from antitrust attack.²²¹

Legislation introduced in the Senate as a result of its study came first in the form of several bills rather than as one omnibus bill as in the House.²²² In the 94th Congress, Senate reformers introduced the Securities Acts Amendments of 1975²²³ as a consolidation of the several bills which had passed the Senate in the previous Congress to implement the proposals contained in the Senate study. The institutional membership provisions of the bill would have phased out trading for affiliates over a period of years, but only after the discontinuance of fixed commission rates by all exchanges.²²⁴ The proposed legislation would have given the SEC the regulatory authority to review disciplinary actions and denials of membership by the self-regulatory bodies,²²⁵ to discipline these bodies for failures to

217. SENATE STUDY, *supra* note 199, at 16-17.

218. *Id.* at 16.

219. *Id.* at 18-19. Such a technicality was used effectively by the SEC to avoid review of rule 19b-2 in *PBW Stock Exch., Inc. v. SEC*, 485 F.2d 718 (3d Cir. 1973), in which the court of appeals determined that it could review an order, but not a rule, under section 25 of the Securities Exchange Act. See note 176 *supra*.

220. SENATE STUDY, *supra* note 199, at 18.

221. *Id.* at 19-20.

222. Four major bills were introduced in the 93d Congress: S. 470, 93d Cong., 1st Sess. (1973) (passed by the Senate on June 18, 1973); S. 2058, 93d Cong., 1st Sess. (1973) (passed by the Senate on Aug. 1, 1973); S. 2474, 93d Cong., 1st Sess. (1973) (passed by the Senate on Sept. 16, 1974); S. 2519, 93d Cong., 1st Sess. (1973) (passed by the Senate on May 27, 1974).

223. S. 249, 94th Cong., 1st Sess. (1975). The Securities Acts Amendments of 1975, Pub. L. No. 94-29 (June 4, 1975), essentially enact the Senate bill. See notes 233-77 *infra* & accompanying text.

224. *Id.* § 5(b). See note 175 *supra*.

225. S. 249, 94th Cong., 1st Sess. § 15 (1975), amending § 19 of the Securities Exchange Act of 1934. The bill also would have required the institution of the minimum procedures for

enforce their own rules,²²⁶ and to "abrogate, add to, or delete from" the rules of these bodies.²²⁷ Seeking establishment of a central market system,²²⁸ the bill would have amended the Securities Exchange Act to guarantee the SEC the authority to regulate securities communications systems,²²⁹ to remove competitive restraints,²³⁰ and to control the activities of market-makers operating in the third market.²³¹ The agency also would have been able to approve trading of unlisted securities on an exchange,²³² stocks then would gravitate toward the type of market, whether auction or dealer, that is warranted by their trading characteristics.

The events of the twelve years since *Silver*, particularly of the last five years, thus have forced a new awareness of the problems of the securities industry and a search for possible remedies. Through all of the various reports and most of the court decisions has run a recognition that the need to centralize and modernize the industry is acute, and that this modernization must restore competition as a prime force in the market by a legislative determination of the appropriate role for the SEC, both in relation to the industry and in relation to the antitrust jurisdiction of the courts.

due process which the *Silver* court set down: notice of any final action by any self-regulatory body which is adverse to either a member or a nonmember would have been filed with the SEC and would have been reviewable by that agency. S. 249, 94th Cong., 1st Sess. § 15 (1975), amending § 19(d) of the Securities Exchange Act of 1934.

226. S. 249, 94th Cong., 1st Sess. § 15 (1975), adding § 19(h)(1) to the Securities Exchange Act of 1934.

227. S. 249, 94th Cong., 1st Sess. § 15 (1975), amending § 19(c) of the Securities Exchange Act of 1934. The bill would have required the Commission to review any proposed amendments to the rules of a self-regulatory body in a formal rulemaking procedure with notice and hearing. S. 249, 94th Cong., 1st Sess. § 15 (1975), amending § 19(b) of the Securities Exchange Act of 1934. A similar procedure would have accompanied any attempt by the SEC to amend a rule. S. 249, 94th Cong., 1st Sess. § 15 (1975), amending § 19(c) of the Securities Exchange Act of 1934. The proposed legislation also would have permitted a person adversely affected by a rule of the SEC to seek judicial review of that rule. S. 249, 94th Cong., 1st Sess. § 19 (1975), amending § 25(b) of the Securities Exchange Act of 1934.

228. S. 249, 94th Cong., 1st Sess. § 2 (1975), would have amended section 2 of the Securities Exchange Act of 1934, to add a further purpose for the Act: "to remove impediments to and perfect the mechanisms of a national market system for securities . . ."

229. S. 249, 94th Cong., 1st Sess. § 6 (1975), adding § 11A to the Securities Exchange Act of 1934.

230. S. 249, 94th Cong., 1st Sess. §§ 4, 11(b), 15, 17 (1975), amending §§ 6, 15A, 19, 23 of the Securities Exchange Act of 1934.

231. S. 249, 94th Cong., 1st Sess. § 11(d) (1975), amending § 15(c)(5) of the Securities Exchange Act of 1934.

232. S. 249, 94th Cong., 1st Sess. § 7(a) (1975), adding § 12(f)(1)(C) to the Securities Exchange Act of 1934.

RESOLUTION OF ANTICOMPETITIVE PROBLEMS

With the background of developing case law and congressional and administrative studies, the proposals before the 94th Congress culminated in the passage of the Securities Acts Amendments of 1975,²³³ which is essentially the Senate version with only minor changes.²³⁴ The final Act embodies a recognition of the need for reorganization of the industry to increase compliance with antitrust policy while protecting the interests of the participants in securities trading and addresses the three central anticompetitive problems: institutional membership, a central market system, and SEC primary jurisdiction.

Institutional Membership

At the heart of the reorganization lies the question of institutional membership on the exchanges and the related issue of the appropriate method for setting commission rates on institutional-size transactions. The impetus for institutions to gain exchange membership has been the desire to recoup the large commissions paid to exchange members under the fixed commission rate structure.²³⁵ Abolition of the fixed rate structure by the SEC in January 1975²³⁶ thus should end one aspect of the long-running controversy.²³⁷ Some incentives will remain, nonetheless, for money managers and broker-dealers to be able to perform overlapping functions.²³⁸ The

233. Pub. L. No. 94-29 (June 4, 1975).

234. See notes 223-32 *supra* & accompanying text.

235. The Senate subcommittee recognized that the developing pressures for exchange membership by financial institutions was the result of fixed commission schedules that fail to account for the economies of scale involved in large transactions. SENATE STUDY, *supra* note 199, at 64.

236. The SEC has adopted rule 19b-3 which prohibits the national securities exchanges from requiring their members to charge fixed commission rates for transactions conducted on the exchanges. The prohibition became effective May 1, 1975, for public rates, those which exchange members charge on transactions for nonmembers, and a similar prohibition will become effective May 1, 1976, for floor brokerage rates, those charged to exchange members. SEC Exchange Act Release No. 11,203 (Jan. 23, 1975). For the text of rule 19b-3, see CCH FED. SEC. L. REP. ¶ 26,284 (Jan. 29, 1975).

237. For discussion of this issue, see Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public*, 22 STAN. L. REV. 675 (1970).

238. Institutional investors sometimes desire affiliation with a broker-dealer to diversify the scope of their financial business, while at the same time providing an additional source of capital to the broker-dealer. Broker-dealers desire to engage in money management to obtain a steady source of income to supplement cyclical brokerage income. Additionally, with

SEC's rule 19b-2, although limiting the extent to which such combined services can be performed by exchange members, fails to safeguard against the abuses inherent in such a combination of functions.²³⁹ The better remedy, that adopted in the 1975 Act,²⁴⁰ uniformly prohibits exchange members and their affiliates from conducting transactions for any account which they manage. That proposal comports with antitrust policy because it opens exchange membership to all who meet the requisite competency and capital standards. Furthermore, the limitation upon the type of customer a member may serve is within the scope of the Securities Exchange Act and in compliance with the antitrust laws since it furthers the protective purpose of the Act while fostering no competitive imbalance among competing money managers. A long phase-in period, as provided in the 1975 Act,²⁴¹ will facilitate compliance to avoid complaints such as that brought against rule 19b-2 by the Philadelphia-Baltimore-Washington Exchange.²⁴²

The Central Market System

Resolution of the fixed commission and institutional membership controversies will eliminate a number of deficiencies that have provoked antitrust complaints against the securities industry. In light of the changes in the market structure portended by the various studies and the anticompetitive effects of present regulation, however, it is necessary to fashion a market structure that will maximize

the internalized brokerage function, the institutional investor may reduce his transactional expense by avoiding payment of a commission to an independent profit-seeking broker. *SRLR Comment*, 221 BNA SEC. REG. & L. REP. A-2 (Oct. 3, 1973).

239. The abuses inherent in the combination of the brokerage and money-management functions are primarily due to the conflicting interests of the persons who perform both functions. For a discussion of these various abuses, including "churning" accounts, dumping inventory into managed accounts, and discrimination against certain customers, see *SENATE STUDY*, *supra* note 199, at 75-77.

240. Pub. L. No. 94-29, § 6 (June 4, 1975). The Act does recognize certain limited exceptions to the broad prohibition. *Id.*

241. The Act includes a delay until May 1, 1978, in the effectiveness of the prohibition for transactions on an exchange by a member who had that status on May 1, 1975. *Id.*

242. See note 176 *supra*.

competition. Because of the nearly unanimous sentiment in favor of its development,²⁴³ including sanction in the 1975 Act,²⁴⁴ the central market system appears to be the structure of the securities market of the future.

By providing potential buyers and sellers with instant awareness of all transactions and quotations in a particular security, the central market system can intensify competition among market-makers and yield the traditional free market advantages as competing market-makers, required to deal in volume to maximize profits, try to attract business by bidding higher or offering lower than their competitors.²⁴⁵ Instant communication of all quotations also will have the effect of reducing spreads between bids and offers as the investing public increases its awareness of available bids and offers.²⁴⁶ Implementation of the system will contribute further to competition since it should require elimination of anticompetitive rules, such as NYSE rule 394, pursuant to expanded SEC regulatory powers. Whether elimination of the anticompetitive exchange rules should precede implementation of a composite quotation system may be a debatable question, but the weight of argument would seem to favor altering the exchange rules at the time that the composite system is implemented.²⁴⁷ Market fragmentation is the principal result of the present limited market-maker competition, fostering trading imbalances and reducing market liquidity; with a central market system, market-making capacity should increase, adding to the liquidity and depth of the marketplace.²⁴⁸

243. The SEC, the Senate, and the House have all indicated in reports that they support development of a central market system. *MARKET STATEMENT*, *supra* note 131, at D-1. *HOUSE STUDY*, *supra* note 184, at 117-30; *SENATE STUDY*, *supra* note 199, at 89-105. *But see* *MARTIN REPORT*, *supra* note 133, at 80,557.

244. Pub. L. No. 94-29, § 7 (June 4, 1975), adds section 11A to the Securities Exchange Act of 1934, a new section devoted to a national market system, which states that the SEC is "directed . . . to use its authority under this title to facilitate the establishment of a national market system for securities" *Id.*

245. Interestingly, beneficial results have been realized from the market competition created by the desire to attract institutional investors. This competition was a major inducement for NYSE acceptance of competitive commission rates, and it has reduced the spread between bid and asked prices for NYSE-listed stocks in transactions involving competing market-makers. *SENATE STUDY*, *supra* note 199, at 93-94.

246. *MARKET STATEMENT*, *supra* note 131, at D-2, D-3.

247. The quotation system is fundamental; without its implementation the central market system remains only an expectation. The existence of rule 394 would be wholly inconsistent with the philosophy of the central market system, and its continued existence after the quotation system is in operation would destroy the effectiveness of that system. *Id.* at D-13.

248. *Id.*

SEC Primary Jurisdiction

These various changes in the market structure will contribute significantly to increased competition in the securities industry. Provisions of the 1975 Act²⁴⁹ recognize that certain changes in the regulatory system were needed, however, to assure expeditious and appropriate resolution of issues involving competition without the necessity of collateral antitrust attack in the courts. Vesting the SEC with authority to review the actions of the self-regulatory bodies can replace much of the antitrust litigation with direct judicial review of Commission activities and force the SEC to accept the regulatory role envisioned for it by the drafters of the Securities Exchange Act of 1934. Discussions of such a system often have arisen in the context of granting an administrative agency primary jurisdiction to determine whether self-regulatory action complies with antitrust laws.²⁵⁰ Professor Davis, discussing the question of agency primary jurisdiction in antitrust cases, identified some of the advantages of administrative review.²⁵¹ He observed that the problem is not simply the application of antitrust laws, but the accommodation of antitrust policy with regulatory policy.²⁵² Despite the disaffinity for repeal by implication apparent in its *Silver* decision, the Supreme Court recognized that antitrust law should be relaxed to the extent necessary to make the Securities Exchange Act work.²⁵³ That recognition, combined with Professor Davis' further comments, supports the propriety of initial SEC review:

The courts are obviously well equipped to make initial decisions involving application of the antitrust policy. But, before the particular regulatory agency has defined the particular regulatory policy in the particular case, the courts are not well equipped to make initial decisions involving accommodation of the antitrust policy to the regulatory policy After the agency has thus provided a better basis for judicial judgment, the courts may exert their power of judicial review, including the

249. Section 16, Pub. L. No. 94-29, § 16 (June 4, 1975), enlarges the SEC's oversight authority, previously contained in section 19 of the Securities Exchange Act of 1934.

250. *E.g.*, *Ricci v. Chicago Mercantile Exch.*, 409 U.S. 289 (1973); *Chicago Mercantile Exch. v. Deaktor*, 94 S. Ct. 466 (1973).

251. 3 K. DAVIS, *ADMINISTRATIVE LAW TREATISE* § 19.05, at 25 (1958).

252. *Id.* See also *McLean Trucking Co. v. United States*, 321 U.S. 67, 94 (1944) (dissenting opinion).

253. See note 61 *supra* accompanying text.

determination of such questions as whether or not the agency has given excessive or insufficient weight to the advantages of competition.²⁵⁴

The concept of SEC review is supported further by the inhibitory effect that the apprehension of antitrust liability has upon the self-regulatory bodies. The Martin report indicated that the fear of treble damages as a result of good faith regulatory action inhibits the self-regulatory bodies in fulfilling their statutory mandate.²⁵⁵ Although preliminary agency review would not, and should not,²⁵⁶ immunize self-regulatory action from judicial examination of potentially anticompetitive activities,²⁵⁷ it can reduce considerably such inhibitory fears inasmuch as the convenience of administrative review for an aggrieved party should reduce the desirability of antitrust litigation. A requirement that the SEC provide a complete statement of its reasons and findings would facilitate judicial balancing of the competing policies involved when the SEC supports the contested self-regulatory action.²⁵⁸ If the SEC disagrees with the self-regulatory action, the 1975 Act permits the Commission to enter an order against the action or to supplant it with its own rule.²⁵⁹ The inhibition of the self-regulatory bodies resulting from the threat of treble damages in antitrust litigation in any event should be reduced. Action taken by a self-regulatory body pursuant to an SEC directive should not constitute an unlawful conspiracy since it is taken to comply with governmental authority.²⁶⁰

Additional support for SEC review of industry self-regulatory activities arises from the potential contribution of such review to an orderly regulatory system. Confusion generated by collateral antitrust attack as a result of the differing positions of the various district courts on antitrust issues may be reduced since initial review by the Commission often may determine that the self-regulatory

254. 3 K. DAVIS, *supra* note 251, § 19.05, at 25.

255. MARTIN REPORT, *supra* note 133, at 80,563-64.

256. See 3 K. DAVIS, *supra* note 251, § 19.05, at 24-25.

257. Section 20, Pub. L. No. 94-29, § 20 (June 4, 1975), amends section 25 of the Securities Exchange Act of 1934 to broaden judicial review of the SEC's increased authority.

258. Section 16 of the Securities Acts Amendments of 1975, Pub. L. No. 94-29, § 16 (June 4, 1975), requires the Commission to approve or disapprove a proposed rule change by formal order, but does not require explicitly a formal statement of reasons and findings.

259. Pub. L. No. 94-29, § 16 (June 4, 1975), amending § 19(c) of the Securities Exchange Act of 1934.

260. See, e.g., *United States v. Rock Royal Co-operative, Inc.*, 307 U.S. 533 (1936). Cf. *Eastern R.R. Presidents Conf. v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961).

action was unjustified under the securities law, thereby eliminating any need to resort to the courts.²⁶¹

In delineating specific areas where SEC review should be provided, policymakers have divided the self-regulatory bodies' proceedings into actions directed against particular persons and actions directed toward establishing general policy. The Securities Exchange Act provides for SEC review of NASD disciplinary actions, upon the initiative of the SEC or upon petition of an aggrieved person.²⁶² No such review was provided for disciplinary actions taken by the exchanges, however, although no rationale is apparent for the distinction. By the Securities Acts Amendments of 1975, Congress amended the 1934 Act to provide SEC review of exchange disciplinary actions,²⁶³ because the competitive policy considerations involved render such determinations subject to attack by antitrust litigation. Similarly, review of denials of NASD membership is provided,²⁶⁴ but until the 1975 Act there was no review of similar exchange action.²⁶⁵ As noted by the Senate subcommittee in its study report: "[I]t will become increasingly important as the industry moves toward a central market system to assure that no qualified broker or dealer is denied access to the system at any point at which he may wish to enter it. This means . . . that the SEC must have the authority to review adverse self-regulatory actions to insure that a denial of membership is not capricious or discriminatory."²⁶⁶ Denial of membership is a subject for judicial scrutiny because of the competitive implications of such refusals, but prior SEC review of these actions should eliminate the need for collateral antitrust attack.

Actions taken against nonmembers can involve antitrust policy as much as can actions taken against members. The *Silver* case enunciated the requirement that such actions be accompanied by procedures affording the adversely affected party notice, hearing, and an opportunity to answer.²⁶⁷ Since such procedures never have been

261. See notes 113-120 *supra* & accompanying text for a discussion of a similar situation under the Commodity Exchange Act.

262. 15 U.S.C. § 78o-3g (1970).

263. Pub. L. No. 94-29, § 16 (June 4, 1975), *amending* § 19 of the Securities Exchange Act of 1934.

264. 15 U.S.C. § 78o-3g (1970).

265. Pub. L. No. 94-29, § 16 (June 4, 1975), *amending* § 19 of the Securities Exchange Act of 1934.

266. SENATE STUDY, *supra* note 199, at 154.

267. See notes 60-65 *supra* & accompanying text.

adopted by the self-regulatory bodies,²⁶⁸ Congress required them in the 1975 Act and afforded SEC review to an aggrieved party to assure full administrative analysis of the competing policies involved.²⁶⁹

Although their actions toward particular persons in individual circumstances obviously can hamper competition, the self-regulatory bodies also can affect competition through their broad authority to promulgate rules which establish general policy. The Securities Exchange Act only scantily defined the scope of that rulemaking authority. With respect to securities exchanges, the Act gave broad license: "Nothing in this chapter shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this chapter"²⁷⁰ As a result of such undefined rulemaking authority, exchanges have made rules in areas requiring economic determinations which clearly involve antitrust policy. Because, in the past, the extent of SEC power to review and alter rules promulgated by the self-regulatory bodies was unclear, Congress expressly empowered the SEC to review and alter the rules of the exchanges and the NASD upon the initiative of the Commission or upon the petition of an aggrieved party.²⁷¹ Providing the SEC the power to review those rules can reduce the need for antitrust attacks. To facilitate SEC review, Congress has required the self-regulatory agencies to provide a statement of the basis and purpose of all rules,²⁷² comparable to that required by the Administrative Procedure Act.²⁷³ This requirement can eliminate delays caused by SEC requests for additional information and stimulate public comment concerning proposed rules.

In its review of those rules, the SEC has been required by the 1975 Act to enter a formal order approving or disapproving the rule.²⁷⁴ A complete statement of the Commission's findings and reasons will

268. *Intercontinental Indus. Inc. v. American Stock Exch.*, 452 F.2d 935, 940-41 (5th Cir. 1971).

269. Pub. L. No. 94-29, § 16 (June 4, 1975), *amending* § 19 of the Securities Exchange Act of 1934.

270. 15 U.S.C. § 78f(c) (1970).

271. Pub. L. No. 94-29, § 16 (June 4, 1975), *amending* § 19 of the Securities Exchange Act of 1934.

272. *Id.*

273. 5 U.S.C. § 553 (1970).

274. Section 16 of the Securities Acts Amendments of 1975, Pub. L. No. 94-29, § 16 (June 4, 1975), requires the Commission to approve or disapprove a proposed rule change by formal order, but does not require explicitly a formal statement of reasons and findings.

facilitate judicial review of SEC action and increase public confidence in the review system. Previously, much of the SEC policy-making has been conducted in private meetings with the self-regulatory agencies.²⁷⁵ Justice Frankfurter, in his opinion in *SEC v. Chenery Corp.*²⁷⁶ stated the need for expressed reasons and findings by the SEC:

[T]he courts cannot exercise their duty of review unless they are advised of the considerations underlying the action under review. . . . [I]f the action is based upon a determination of law as to which the reviewing authority of the courts does come into play, an order may not stand if the agency has misconceived the law. . . . [T]he orderly functioning of the process of review requires that the grounds upon which the administrative agency acted be clearly disclosed and adequately sustained. "The administrative process will best be vindicated by clarity in its exercise."²⁷⁷

To the extent that SEC review is to achieve the objective of eliminating collateral antitrust attack, the agency must make available its findings regarding the reconciliation of the securities laws and the competitive policies of the antitrust laws.

CONCLUSION

Antitrust litigation concerning the securities industry over the past decade has made apparent the inability of the regulatory system to assure maximum competition while maintaining an orderly regulatory process. Exhaustive studies, particularly those conducted for Congress, culminated in the Securities Acts Amendments of 1975, a bill well designed to remedy the deficiencies now so apparent in the 1934 Act. The recent legislation demonstrates that substantial agreement exists concerning enhancement of competition through the implementation of the central market system and will enable the industry, under the active supervision of the SEC, to become more competitive. The 12 years years since *Silver* have demonstrated the haphazard and irresolute development of competitive standards, inherent in a system which provides only

275. Note, *Informal Bargaining Process: An Analysis of the SEC's Regulation of the New York Stock Exchange*, 80 YALE L.J. 811, 812 (1971).

276. 318 U.S. 80 (1943).

277. *Id.* at 94, quoting *Phelps Dodge Corp. v. NLRB*, 313 U.S. 177, 197 (1941).

collateral attack to settle grievances. The grant of review power to the SEC will ensure not only cohesive and coherent progress toward vigorous competition, but also will guarantee a hearing to all aggrieved parties. The requirement that the SEC speak in formal orders, moreover, will curtail avoidance of judicial review on technicalities or terminology.²⁷⁸ Finally, by invoking primary jurisdiction in those cases brought directly to the courts, the benefits of a standardized application of the Commission's expertise can be employed, further enhancing the benefits sought in the original Act, the protection of investors and the assurance of fair and orderly securities markets.

278. See note 219 *supra* & accompanying text. See also *Kixmiller v. SEC*, 492 F.2d 641 (D.C. Cir. 1974).