Federal Legislation to Enhance Competition in the Securities Industry
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. Similarly, unsettled market conditions in the late 1960's 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. The 94th Congress recently enacted the Securities Acts Amendments of 1975 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.

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 membership 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. 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.
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. 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. Concurrently, industry policymakers, responding to the antitrust challenges, have conducted in-depth studies 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 1934 was a response to the stock market crash of 1929 and the ensuing depression. Unlike its predecessor, the Securities Act of 1933 which was designed to require full disclosure to investors, the subsequent Act was intended to grant

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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.


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. GALEBAITH, THE GREAT CRASH (3d ed. 1972); A. ROMASCO, THE POVERTY OF ABUNDANCE (1965); G. SOULE, PROSPERITY DECADE (1947).

broad regulatory powers over the securities market to the newly formed Securities and Exchange Commission.\textsuperscript{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."\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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 report\textsuperscript{19} and the presidentially commissioned Roper Report\textsuperscript{20} reflected the

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\item M. Parrish, Securities Regulation and the New Deal 39 (1970).
\item See notes 37-39 infra.
\item S. Rep. No. 1455, supra note 16, at 48-49.
\item 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. 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."

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. Legislators closest to the project were unanimous in their desire to restore investor confidence in the securities market. 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

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).


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. 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. 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. 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. The district court in United States v. Morgan 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


26. The concept of a broadly empowered agency was advocated all but unanimously. See, e.g., 78 Cong. Rec. 7662 (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).


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.3\(^3\)

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.3\(^1\)

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,3\(^2\) the Court stated: "Repeals of the antitrust laws by implication from a regulatory statute are strongly disfavored . . . ."3\(^3\) The Court reiterated the theme three years later in Carnation Co. v. Pacific Westbound Conference,3\(^4\) wherein it described antitrust law as a "fundamental national economic policy" that "we cannot lightly assume" to be inapplicable to a particular industry.3\(^5\) The inevitable conclusion from the statute and case law therefore is that the drafters intended no antitrust exemption.3\(^6\)

Provisions of the Securities Exchange Act

Application of antitrust laws complements the protection which

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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.
33. Id. at 350.
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 speculation\(^\text{37}\) and manipulation\(^\text{38}\) which were considered the two major evils at the time of the 1929 market crash.\(^\text{39}\) 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.\(^\text{40}\) Among those functions are the following: approval or denial of an exchange's application for registration;\(^\text{41}\) segregation and limitation of functions of members, brokers, and dealers;\(^\text{42}\) control of over-the-counter markets;\(^\text{43}\) 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.\(^\text{44}\) In conjunction with these powers, the SEC is given authority to investigate, to seek injunctions, and to prosecute offenses.\(^\text{45}\)

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).


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).


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, 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.

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. 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. Indicative of the failure to realize the potential of its supervisory power, however, is the fact that the SEC has used that power only once regarding the anticompetitive effects of a stock exchange rule. Exercise of the statutory


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).


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, 350-51 (1963).


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*, 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. Having been handicapped seriously by the loss of critical communications, the nonmember 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.

In its decision, the Supreme Court stated firmly its guiding principles. First, the Securities Exchange Act provides no express exemption from the antitrust laws. 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." 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. Fourth, while recognizing that some self-regulation within the scope of the Act may be justifiably anticompetitive, the Court stated that the

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58. Id. at 343-44.
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. The result of the landmark decision has been the unequivocal recognition that antitrust laws apply, at least generally, to stock exchange practices, although an apparent judicial desire to limit the case to its facts has precluded any avalanche of antitrust attacks upon exchange rules.

One such case, however, was *Kaplan v. Lehman Brothers*. 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. In a brief opinion, the court of appeals affirmed the *Kaplan* decision, and the Supreme Court, despite a bitter dissent by Chief Justice Warren, denied certiorari.

Plentiful subsequent criticism of the *Kaplan* decision may have

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


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.


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 554.

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

69. 380 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.

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* 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. 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 Act and therefore exempt from antitrust attack. 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. 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. Tacit agreement with Chief Justice Warren's dissent in *Kaplan* perhaps can be inferred from the Supreme Court's denial of certiorari in *Thill* 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. Industry self-regulation could

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*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, 550-61 (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."


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.


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. a 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. 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. 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 laws and found that NASD’s purported antitrust immunity pursuant to the Maloney Acts 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

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, specifically finding no immunity to arise merely from the SEC's "close supervision of the NASD in this area." 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., 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, 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." 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.

This, the court said was the "different case" cited in Silver. 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

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84. 451 F.2d at 247.
85. Id. For further discussion of Harwell, see 23 SYRACUSE L. REV. 956 (1972).
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: "[B]oth 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.\(^77\) 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).
\(^96\) 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.\(^9\)

*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.\(^10\) 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.\(^11\) 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.\(^12\) 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.*,\(^13\) 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.\(^14\) 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

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\(^9\) Id.

\(^10\) Id. at 1310.


\(^12\) 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.


\(^14\) 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. Accordingly, the court exercised concurrent jurisdiction and applied Silver to reconcile the conflicting policies of the securities laws and the antitrust laws. 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.

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, 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. The court in Bache rejected the defendant's contention that the SEC had either exclusive or primary jurisdiction; other courts similarly have rejected the claim of primary jurisdiction. 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.

The first of the two Supreme Court cases, Ricci v. Chicago Mercantile Exchange, 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. 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 supra & accompanying text.

109. See 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 supra & accompanying text.


trial court, the court of appeals in Ricci stayed further proceedings pending an administrative determination by the Commodity Exchange Commission (CEC). 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 . . . ." 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.

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. 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." 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.

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 anticompetitive 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

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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.\textsuperscript{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 1970\textsuperscript{127} was an early response directing one investigation.\textsuperscript{128} In addition, Congress conducted two major investigations;\textsuperscript{129} the SEC supported two major studies,\textsuperscript{130} published two "white papers" on its conception of the future of the securities industry,\textsuperscript{131} and promulgated rules which have begun to implement that concept;\textsuperscript{132} and both the NYSE\textsuperscript{133} and the Treasury Department\textsuperscript{134} conducted studies. These investigations were extremely broad, covering virtually every aspect of the securities markets. The present analysis,

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  \item 127. 15 U.S.C. §§ 78aaa-78llll (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(f)(1).
  \item 128. An SEC study into practices deemed unsafe or unsound was required by 15 U.S.C. § 78kkk(h) (1970).
\end{itemize}
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. 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. 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.

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.

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-

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135. INSTITUTIONAL INVESTOR STUDY, supra note 130.
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
would be delayed pending evaluation of his present proposals.\textsuperscript{148} 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.\textsuperscript{147} The NYSE would be reorganized to prepare it to serve as the basic unit of the national exchange system.\textsuperscript{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.\textsuperscript{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.\textsuperscript{150}

\textbf{Unsafe and Unsound Practices Study}

The next report to appear concerning the securities markets was the SEC's Study of Unsafe and Unsound Practices.\textsuperscript{151} Mandated by section 11(h) of the Securities Investor Protection Act of 1970,\textsuperscript{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,\textsuperscript{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.\textsuperscript{154} Claiming a need for addi-

\textsuperscript{146} Id. at 80,662-63.
\textsuperscript{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 \textit{Approach}, supra note 64, at 261-62.
\textsuperscript{148} Martin Report, \textit{supra} note 133, at 80,557-60.
\textsuperscript{149} Id. at 80,563-64.
\textsuperscript{150} Folk, \textit{supra} note 142, at 1350-61.
\textsuperscript{151} Unsafe Practices, \textit{supra} note 130.
\textsuperscript{153} Unsafe 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.
\textsuperscript{154} Id. at 65,504-07.
tional legislative authority to complete the task, 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; 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; authority to enforce directly the rules of the self-regulatory bodies; 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. 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. 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.” 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. UNsouD PRAcr~nces, 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.\textsuperscript{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.”\textsuperscript{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,\textsuperscript{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.\textsuperscript{165} Despite a contemplated “unbundling” of commission rates,\textsuperscript{166} the SEC still would require the broker-dealer to include in

\begin{footnotes}
\item[162] Id. at 65,611-12.
\item[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. \textit{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. \textit{Id.} The third market, rather than being eliminated as the Martin Report had recommended, would be integrated into the central market system. \textit{Id.} Institution of such a system would require elimination of NYSE rule 394 which prohibits members from transacting any business in the third market. \textit{See} note 182 \textit{infra.} See generally \textit{Note, NYSE Rules and the Antitrust Laws—Rule 394—Necessary Restriction or Illegal Refusal to Deal?}, 45 St. John’s L. Rev. 812 (1971).
\item[164] \textit{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. \textit{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. \textit{See} note 236 \textit{infra.}
\item[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. \textit{Id.} at 65,623-24.
\item[166] “Unbundling” is the practice of charging a separate fee for each service, such as execution or research, which is provided. \textit{Id.} at 65,620.
\end{footnotes}
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. 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. In November 1972, it issued rule 17a-15, 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. The second effort by the SEC was its promulgation, in January 1973, of rule 19b-2 concerning institutional membership on securities exchanges. 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." 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.


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. ¶ 79,331 (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).


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.\textsuperscript{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 criticism\textsuperscript{174} and provoked the introduction in both houses of legislation to nullify rule 19b-2.\textsuperscript{175} Opponents of the rule also have had some success

\begin{itemize}
\item \textsuperscript{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).
\item 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).
\item 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.
\item 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.
\end{itemize}
in the courts.\textsuperscript{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.

\textit{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.\textsuperscript{177} This statement evaluated the findings of advisory committees established by the previous policy statement\textsuperscript{178} 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.\textsuperscript{179} The Commission restated its position that the third market should be integrated into the central market system\textsuperscript{180} and that all members of the system

\begin{itemize}
  \item 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. RES. S433 (daily ed. Jan. 17, 1975).
  \item 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), \textit{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. \textit{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. \textit{Id.} That jurisdictional decision made consideration of the merits of the PBW attack on the SEC's approach to the institutional membership question unnecessary. \textit{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).
  \item Market Statement, \textit{supra} note 131.
  \item Among three advisory committees created in connection with the earlier statement was one to study the central market system. See Future Structure, \textit{supra} note 131, at 65,624-25.
  \item A quotation system had been made the subject of a proposed rule. See note 170 \textit{supra}.
  \item Market Statement, \textit{supra} note 131, at D-3.
\end{itemize}
should be free to trade in any security eligible for inclusion in the central market system. The statement further recommended uniform rules for exchanges to prohibit the inclusion of anticompetitive rules such as NYSE rule 394. Additionally, each exchange should increase the maximum level to which nonmembers can negotiate access to exchanges. 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 Suecomm. 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. 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, the subcommittee advocated the rescission of NYSE rule 394 and similar rules and the provision of equal access to all broker-dealers. 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. Because fixed minimum commission rates were found not to be in the public interest, competitively determined rates would be required on all transactions. 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. Seeing more harm than good, however, in the 80

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, 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. 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, the subcommittee decided that the Supreme Court quite clearly had answered the question in *Silver.*

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. The provisions designed to foster competition in the securities industry were reintroduced as the Securities Reform Act of 1975 which adopted the House report's major provisions, including a grant to the SEC of direct authority

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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.


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


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

**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. 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. 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. 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. 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.
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

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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.\textsuperscript{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.\textsuperscript{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;\textsuperscript{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 procedures\textsuperscript{213} as a part of the subcommittee's effort to emphasize that all exchange and NASD self-regulatory authority is subject to SEC review.\textsuperscript{214} Additional powers requested by the SEC in its study of unsound practices were considered,\textsuperscript{215} but the Senate subcommittee, unlike the House subcommittee,\textsuperscript{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-

\textsuperscript{210} See note 203 supra.

\textsuperscript{211} 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.

\textsuperscript{212} See note 197 supra.
Power for the Commission to disapprove or to require changes to rules of self-regulatory bodies was approved, however. 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 antitrust or due process issues; the subcommittee would amend the law to establish clearly the availability of direct judicial review. 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.

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. In the 94th Congress, Senate reformers introduced the Securities Acts Amendments of 1975 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. The proposed legislation would have given the SEC the regulatory authority to review disciplinary actions and denials of membership by the self-regulatory bodies, to discipline these bodies for failures to

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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).
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.


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 . . . ."


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, which is essentially the Senate version with only minor changes. 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. Abolition of the fixed rate structure by the SEC in January 1975 thus should end one aspect of the long-running controversy. Some incentives will remain, nonetheless, for money managers and broker-dealers to be able to perform overlapping functions. The

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).
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. The better remedy, that adopted in the 1975 Act, 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, will facilitate compliance to avoid complaints such as that brought against rule 19b-2 by the Philadelphia-Baltimore-Washington Exchange.

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 Sénate 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,\textsuperscript{243} including sanction in the 1975 Act,\textsuperscript{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 cen-
tral 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.\textsuperscript{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.\textsuperscript{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 com-
posite system is implemented.\textsuperscript{247} Market fragmentation is the prin-
cipal result of the present limited market-maker competition, fos-
tering 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.\textsuperscript{248}

\textsuperscript{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 139, at 89-105. But see Martin
Report, supra note 133, at 89,557.

\textsuperscript{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.

\textsuperscript{245} Interestingly, beneficial results have been realized from the market competition cre-
ated 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.

\textsuperscript{246} Market Statement, supra note 131, at D-2, D-3.

\textsuperscript{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.

\textsuperscript{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, indentified 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

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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.
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.
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.
266. Senate Study, supra note 199, at 154.
267. See notes 60-65 supra & accompanying text.
adopted by the self-regulatory bodies, 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.

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 . . . ." 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. 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 comparable to that required by the Administrative Procedure Act. 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. A complete statement of the Commission's findings and reasons will

272. Id.
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. Justice Frankfurter, in his opinion in SEC v. Chenery Corp. 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."

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

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