The Application of Anti-Trust Laws to the Securities Industry

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INTRODUCTION

From the early beginnings of the first stock exchange to the present, the securities industry has enjoyed varying degrees of immunity from antitrust liability. Early abuses of this freedom contributed to the financial disaster of 1929 and led to the securities legislation of the 1930's. Even under such legislation, however, the position of the securities industry vis-a-vis antitrust regulations remained undefined. In 1966 one writer observed that "After more than thirty years of federal regulation in securities, important questions about the role of antitrust—and, implicitly, about the role of regulation itself—remain to be answered. The questions, however, are now being posed." ¹

Much has transpired since 1966 and many questions have been answered. The purpose of this study is to analyze, against a background of earlier developments, the broad effects of the answers given. However, there are many questions yet unanswered, and a further purpose here is to present probable future developments in this active area of the law.

BACKGROUND

As with any study, the first step must be a delineation of concepts. This task is all but unnecessary when dealing with such a well-known domain as the securities industry and its markets. However, to emphasize the true dimensions of the problems dealt with here, a recitation of the statistics in this area may be beneficial.

Of major concern here will be the securities markets, particularly the stock exchanges and to a lesser extent the over-the-counter market. To note that the stock exchanges serve important functions in the American economy, not the least of which is as an indicator of that economy,² would be only to recite what is general knowledge. How-

ever, the broad scope of the securities markets should be noted. At the end of 1961 individuals had accumulated net financial savings of approximately $900 billion, of which more than one-half was held in direct interests in corporations. Furthermore, life insurance companies and private pension funds held an additional $93 billion in corporate securities while personal trust funds controlled still another $57 billion in securities. At about the same time, it was estimated that these securities were held by over 17 million individuals. That the activities of the stock markets affect a great segment of the nation’s population, a great deal of its wealth, the financial fate of firms with outstanding stock, the fate of firms floating new issues, and the very fabric of the nation’s economy is clear.

Of the various stock exchanges, the New York Stock Exchange (hereinafter referred to as NYSE), of course, is by far the largest in terms of both number of issues traded and dollar volume. In 1962 the New York exchange handled eighty-six percent of the total volume of all registered exchanges—a total of 47.4 billion dollars. This volume was divided among 1,366 members. While the regional exchanges now account for ten percent of the total value of securities traded on exchanges, most of the regional transactions are in securities also traded on the Big Board, as the NYSE is often called.

Because it is the largest exchange, the NYSE will be dealt with at length in this study. Of particular interest here are some of the rules and practices of the NYSE. One of the most questionable practices of the exchange is its setting of “minimum” commission rates to which member firms are required to adhere. Such a rate structure obviously allows for no price competition among brokers. More importantly in light of recent developments, the present rate structure makes no sig-

3. Id. at n. 6; Securities and Exchange Commission, Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 9, 10 (1963) [hereinafter referred as Special Study].
4. Id.
5. Special Study, supra note 3.
6. Id. at 10.
10. Due to the increasingly important role which the regionals have been playing in the American securities markets, however, the discussion of the New York exchange will not be to the exclusion of the regional exchanges.
significant allowance for large volume transactions. Another source of much criticism is the NYSE rule which requires broker-dealers who are not NYSE members to pay the full public commission rate although such nonmembers make up a significant segment of customers on the exchange.\textsuperscript{11} While not the only source of criticism, these two rules have been the most common focus of the questioning glances cast at the exchanges by their antitrust critics.

Making the problems presented by the exchange rules more urgent and complex are the recent developments in the securities industry which have brought a marked increase in the volume of trading on all exchanges,\textsuperscript{12} and an even more significant increase in the trading done by, and the resultant importance of, the "institutional investors," generally mutual funds.\textsuperscript{13} These developments have brought various changes to the regional exchanges as well as to the NYSE.\textsuperscript{14}

It is these standing practices and recent changes which have provided the background, and some would say the impetus, for the recent antitrust attacks against the securities industry.

\textbf{THE BASIC CONFLICT}

There is a basic conflict between the antitrust laws and the statutes regulating the securities industry. While the former prohibit any restraints of trade, the latter give securities exchanges powers of self-regulation including the power to make restrictive agreements, although no clear exemption of the exchanges is provided in the antitrust laws.

The antitrust laws generally and the Sherman Act particularly are plainly designed to prevent any kind of restraint of trade,\textsuperscript{15} and "to break up and dissolve monopolistic or restraining combinations, conspiracies or agreements not to compete."\textsuperscript{16} Courts have often given broad interpretation to the provisions of the Sherman Act, to the point of finding that the Act condemns the bare possession of the power to fix prices or exclude competitors as well as the actual exercise of such

\begin{itemize}
  \item \textsuperscript{11} Special Study, supra note 3, at pt. 2, pp. 301, 302.
  \item \textsuperscript{12} \textit{Id.} at pt. 1, p. 11.
  \item \textsuperscript{14} SEC Release No. 8239, supra note 13, at 2.
  \item \textsuperscript{16} United States v. Morgan, 118 F. Supp. 621, 738 (S.D.N.Y. 1953).
\end{itemize}
power,\textsuperscript{17} and that the Act guarantees not only the right to create markets, but also the right to enter established markets.\textsuperscript{16} While the courts have often applied these principles,\textsuperscript{19} on one occasion the United States Court of Appeals for the First Circuit noted that the exclusion of competitors from a market is per se a violation of Section Two of the Sherman Act.\textsuperscript{20} Such strict interpretations have been applied against various types of associations or exchanges.\textsuperscript{21}

In view of the interpretation that has been given the antitrust laws, any type of exchange association is in a precarious position relative to such laws whenever the association must restrict membership, for such restriction is a restraint of trade and limits access to the market. However, exchanges are forced to enact some restrictive rules by the finite limits of physical facilities.\textsuperscript{22} By their inherent qualities, exchanges are thus placed in a dilemma regarding antitrust laws.

The courts themselves have often seemed likewise to be in a dilemma on the application of antitrust laws to exchanges. One court emphasized the purpose for which the exchange is operated and the intended beneficial results of any restrictive practices in its attempt to define what constitutes restraint of trade,\textsuperscript{23} while another court sympathized with a produce exchange's physical limitations and attempted to set forth criteria of membership which would not violate the Sherman Act.\textsuperscript{24} In writing of the securities exchanges, one author has observed that any restrictive act of the exchanges, even for purposes of self-regulation, "contravenes the spirit, and may contravene the letter, of the antitrust laws."\textsuperscript{25} Various practices of the stock exchanges, especially the re-

\textsuperscript{17} Gamco, Inc. v. Providence Fruit & Produce Bldg., 194 F.2d 484, 487 (1st Cir.),\textit{ cert. denied}, 344 U.S. 817 (1952).  
\textsuperscript{18} Id.  
\textsuperscript{19} An example of such an application of antitrust law in an early case is United States v. Terminal R.R. Ass'n, 224 U.S. 383 (1912) which is discussed below; see also Note, \textit{Antitrust and the Stock Exchange: Minimum Commission or Free Competition?}, 18 Stan. L. Rev. 213, 214 n. 8 (1965).  
\textsuperscript{20} Gamco, Inc. v. Providence Fruit & Produce Bldg., 194 F. 2d 484, 486-87 (1st Cir.),\textit{ cert. denied}, 344 U.S. 817 (1952).  
\textsuperscript{21} Such cases are discussed below; for a compilation of several exchange cases see also Sterling, \textit{Stockbrokers Going Public: Antitrust Aspects of Exchange Rules}, 13 U.C.L.A. L. Rev. 563, 569, (1965).  
\textsuperscript{22} Id.  
\textsuperscript{23} United States v. Tarpon Springs Sponge Exch., 142 F.2d 125, 127-28 (5th Cir. 1944).  
\textsuperscript{24} Gamco, Inc. v. Providence Fruit & Produce Bldg., 194 F.2d 484, 487 (1st Cir.),\textit{ cert. denied}, 344 U.S. 817 (1952).  
\textsuperscript{25} Sterling, \textit{supra} note 21, at 571.
stricting of membership (exclusion of competitors) and setting of commission rates (price fixing), clearly would subject the exchanges to antitrust liability in the absence of any exemption.

Many would argue that antitrust exemption is to be found in the securities acts of 1933 and 1934, most notably the 1934 Securities Exchange Act (hereinafter referred to as the Act), which construct the system of regulation of the securities industry and provide for substantial self-regulation by the securities exchanges.26 To fully understand the continuing controversy on this point, a study of the Act itself is necessary.

The Securities Exchange Act of 1934

Before the securities laws were enacted, the stock exchanges were viewed by the courts, Congress and the industry as private clubs, and as such were generally exempt from any antitrust liability.27 The NYSE has had a minimum commission rate structure ever since its founding as a limited-membership association in 1792.28 Although some such restraint of trade was obvious to all, the exchanges generally went unfettered.29 Some have pointed out that even with this knowledge, Congress did not see fit to write restrictions on these questionable practices into the Act of 1934, and therefore must have intended to exempt such practices.30 While this point is open to dispute, it was clear just prior to the passage of the Act that the business community itself was unable to control effectively the abuses within the securities industry, and government regulation was seen as the best answer.31

Of the major securities acts, it is the 1934 Act which deals most with the trading markets.32 Based on the recognition that the securi-

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27. Jennings, Self Regulation In the Securities Industry: The Role of the Securities and Exchange Commission, 29 LAW & CONTEMP. PROB. 663, 667-69 (1964); Note, supra note 19, at 223.


29. Nerenberg, Applicability of the Antitrust Laws to the Securities Field, 16 W. Res. L. REV. 131, 136 (1964). Mr. Nerenberg at the time of publication of this article was an attorney in the Office of the General Counsel of the SEC.


32. The major focus of the 1933 act is on the distribution of new issues of stock—i.e., the introduction of a new security into the trading markets. See Bicks, Antitrust and the New York Stock Exchange, 21 BUS. LAW. 129, 131 (1965).
ties exchanges are affected with a national public interest which necessitates regulation of their trading, the Act sets forth the machinery for such "reasonably complete and effective" regulation, and the powers of the various regulatory bodies to which are allocated the tasks of regulation.\(^{33}\)

The Act, and more particularly section 19(b) of the Act,\(^ {34}\) defines the power of the Securities and Exchange Commission (hereinafter referred to as SEC) over the exchanges. Of primary concern among these is the authority of the SEC to review and approve, or indirectly alter, rules of the exchanges.\(^ {35}\) Explicitly set out is the authority to see that reasonable rates of commission are established.\(^ {36}\) Pursuant to these provisions, it has been held that the SEC has the power to order changes in exchange rules,\(^ {37}\) and the duty to see that "just and adequate" rules are adopted.\(^ {38}\) The Commission's ultimate power is its authority to suspend the operations of an exchange for as long as twelve months, or to suspend or expel a member or officer of an exchange, for failure to comply with Commission directives.\(^ {39}\)

It has been observed that, despite the "apparent ubiquity" of the regulatory scheme set forth by the Act, there still remain "significant gaps" in the regulations.\(^ {40}\) Such gaps result from the lack of uniformity in the application of the regulations,\(^ {41}\) and from such things as the SEC's lack of authority over the means of applying various rules.\(^ {42}\)

While the Act does enumerate pervasive powers for the Commission, there are also basic anomalies in its powers for, while it can review many exchange rules, the statute does not grant the SEC any jurisdiction over an exchange member's breach of an exchange rule.\(^ {43}\)

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33. In re Rules of the NYSE, 10 S.E.C. 270, 293 (1941).
35. For further discussion, see SEC Release No. 8239, supra note 13, at 5; Kaplan v. Lehman Bros., 250 F. Supp. 562, 564-65 (N.D. Ill. 1966); Jennings, supra note 27, at 671; Sterling, supra note 21, at 572.
37. See Jennings, supra note 27.
38. In In re Rules of the NYSE, 10 S.E.C. 270 (1941), the "court" found a basis for SEC power over exchange rules in subdivisions (5), (9), (11), and (13) of § 19(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78 s (b) (1964).
39. See Jennings, supra note 27, at 671.
40. Asch, supra note 1, at 214; Bicks, supra note 32, at 146.
41. Asch, supra note 1, at 214.
42. Nerenberg, supra note 29, at 138.
43. Jennings, supra note 27, at 671-72.
The Commission is thus unable to consider individual grievances. This situation of the SEC having the power of general oversight but lacking jurisdiction over specific violations confuses any attempt to interpret antitrust exemptions.

Less confusing is the Maloney Act's (Section 15 of the Exchange Act) specific exemption of the National Association of Securities Dealers (hereinafter referred to as NASD), the only organization of over-the-counter broker-dealers. The SEC is given broader powers of review over NASD actions than over exchange actions. However, NASD members are bound by statute to observe more equitable trading practices than are exchange members.

The ambiguity of the Act in spelling out the powers of the Commission results in the extent of these powers being much debated. It is asserted that by general rules of construction, the provisions of 19(b) should be broadly construed so as "to accomplish its purposes," and this conclusion is borne out by study of indices of Congressional intent regarding this Act. Interpretations of these provisions of the Act and their legislative history has led to the conclusion that in enacting the legislation Congress did not contemplate endorsement of any price-fixing or exemption from any antitrust liability.

Varying interpretations of the statute have also raised jurisdictional questions as to whether initial SEC consideration is a prerequisite to judicial review of an exchange action or rule. While the Commission contends that the courts should not have original antitrust jurisdiction over the securities exchanges, the courts have held that an initial SEC review is not necessary to the presentment of a case for judicial re-

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44. Silver v. New York Stock Exchange, 373 U.S. 341, 357 (1963); Bicks, supra note 32, at 137.
45. Maloney Act, 15 U.S.C. § 78 o-3(n) (1964); Jennings, supra note 27, at 676; Note, supra note 19, at 225.
46. Jennings, supra note 27, at 664.
47. In re Rules of the New York Stock Exchange, 10 S.E.C. 270, 293 (1941). It is clear from [the language of Section 19(b)] that Congress did not intend to empower this Commission to alter or supplement all rules of a national securities exchange. At the same time, it is plain that the language "such matters as" and "similar matters" calls for a broad construction of the section. Id. at 294.
48. Id. at 286-87.
49. Note, supra note 19, at 218-19, 225.
50. Id. at 214.
51. Id. at 227.
view. The differences are again attributable to different interpretations of the Act.

The actual practice can hardly be disputed, however, and that practice is one of SEC oversight—i.e., review—of actions of the elements of the securities industry, most notably of the exchanges. The reasons for such oversight were enumerated by the SEC Special Study of the Securities Markets as 1) to assure that the self-regulatory agencies actually assume the responsibility and perform the duties assigned to them, 2) to limit anticompetitiveness to only the necessary restrictions, and provide effective regulation in return for such restrictions, and 3) to recognize that self-regulatory agencies operate as quasi-public utilities and should be restricted as such. William L. Cary, former chairman of the SEC, has hailed the Commission's oversight as advantageous to the industry. He points out that such oversight can correct any inadvertent mistakes made by the exchanges, and that such interaction is stimulating and simultaneously meets the need for periodic re-examination of the role and performance of exchange members. Mr. Cary would also stress, however, that SEC supervision need not, and should not, stifle initiative for self-regulation by the exchanges. He believes those within the industry should have the freedom to make suggestions and "effective improvements in standards" without discouragement. This concept is a recurring one in any discussion of the securities self-regulation.

Prior to the adoption of the Exchange Act, the ungoverned self-regulation enjoyed by the exchanges became ever more obviously inadequate "with acceleratingly grave consequences." When this situation ultimately led to passage of the Act, the program created was never one of total displacement of exchange self-regulation. The intention was that the exchanges would take the initiative and responsibility for the promulgation of the regulations by which each exchange would operate, while the government was intended to play only a resi-

52. Id. at 217. Much of the controversy revolves around questions of "preclusive jurisdiction." See generally Id. at 214, 216.
53. Special Study, supra note 3, at pt. 2, pp. 328-29; Bicks, supra note 32, at 156-57; Jennings, supra note 27, at 680; Nerenberg, supra note 29, at 133-34; Note, supra note 19, at 232.
54. Cary, Self-Regulation in the Securities Industry, 49 A.B.A.J. 244, 246 (1963). Mr. Cary was chairman of SEC at the time the article was published.
55. Id.
56. Id. at 244, 247.
dual role. Basic to this regulatory scheme is an interplay of public and private responsibility, with each partner filling any vacuum allowed to develop by the other partner, but with the ideal of exchange "initiative" and SEC oversight being maintained. The Act designates specific duties to the exchanges as their part of the self-regulatory partnership. Of primary importance is the duty to enforce all SEC rules, but the exchanges also have the responsibility of both enacting rules of their own to maintain proper conduct among exchange members and of seeing that such rules are properly enforced.

While this regulatory scheme is an intricate one, some have pointed out that there is nothing inherent in the scheme to insure against antitrust violations, but that the scheme does contemplate restraint of trade. While it is argued on one hand that some self-regulatory acts are exempt from antitrust liability, it is claimed on the other hand that "[u]nbridled self-regulation must not be permitted to cause competitive injury" where acts are beyond the scope of the Exchange Act and that some form of review must be found. This, then, is the basis of the dispute over exemption of the exchanges under the Act.

The Conflicting Views

Arguments over exempting the securities industry generally and the exchanges in particular, and leaving all control to the SEC, usually center around differing interpretations of relevant statutes. Those arguing against exemption find their greatest strength in the interpretation of Congressional intent so stating. This view is perhaps best expressed by Judge Medina in United States v. Morgan:

58. Id. at 352, 364. Some have argued that the present power of the SEC is only illusory and that the Commission should be granted the power of continuing administrative review. Note, supra note 19, at 217; 45 N.C. L. Rev. 301, 307 (1966). Professor Asch contends, however, that the SEC would face the impossible task of policing every phase of market activity if the Commission were given more power. Asch, supra note 1, at 215.

59. Bicks, supra note 32, at 134, 136, 158; Nerenberg, supra note 29, at 139. The government-private sector partnership has been put to a severe test during the recent unprecedented bull markets with wrongdoers often not being located until long after damage was done. Jennings, supra note 27, at 665.


63. Id. at 361.

64. Nerenberg, supra note 29, at 138-39.
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 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.65

This position is supported by many others who have studied the “legislative history” and the “general scheme” of the Act.66

Some writers, however, find additional bases for the no-exemption argument. One such additional argument is that the antitrust laws represent a broad economic policy which cannot be lightly ignored due simply to the enactment of a special scheme.67 Others rely similarly on the philosophy behind the antitrust laws, as well as noting the failure of the SEC to act against questionable anti-competitive practices.68 References are also made to cases in other industries where the courts have found no antitrust exemption in similar circumstances.69 These are but a sampling among many arguments which are advanced against exempting the securities industry from antitrust liability.

Holding understandably opposite views are those who feel the industry should be exempt and that the SEC should be the only supervisor of industry practices. Such arguments are usually built around the need for free self-regulation and the regulatory efficiency of the SEC.70 It is argued that to promote a policy of self-regulation it is necessary to allow the exchanges an assurance of freedom from antitrust liability in order for them to more effectively regulate the activities of their members when such regulation must take a form inconsistent with the standards of “fair trade.”71 Examples are available of occasions where such exemption was needed and in which self-regulatory actions would have otherwise been impeded.72

68. Note, supra note 19, at 233-37.
70. Note, supra note 19, at 232-33.
71. Id.; Sterling, supra note 21, at 573.
72. Bicks, supra note 32 at 138-40. This whole view is placed under question by
The other major argument advanced in support of exemption relies on the efficiency of the SEC in handling matters of the security industry, balanced against the likelihood of long, expensive, private antitrust suits which might arise without such exemption.\textsuperscript{78}

To argue that the exchanges are now exempt from antitrust liability one must rely on a repeal of the antitrust laws which is only implied, for there is no express exemption in the Securities Exchange Act itself.\textsuperscript{74} This substantially weakens such arguments, for it is fundamental that repeals are to be regarded as implied only to the minimum extent necessary, and such implications are strongly disfavored by the law.\textsuperscript{75}

Therefore, while there are some arguments put forth for exemption, these are strongly outweighed by those against exemption. This is in line with the general movement toward subjecting the securities industry to antitrust scrutiny, as discussed further below. To fully appreciate these developments, however, one should study them in the perspective of earlier problems encountered in the simultaneous application of the antitrust and the securities laws.

Problems have resulted from the simultaneous application of the two statutes and when such conflicts have arisen and do arise, in courts or in academic discussions, the reasonable solution has seemed to be a reconciliation of the two schemes rather than a complete overpowering of one by the other.\textsuperscript{76} That there will be conflict is obvious: the securities acts prescribe schemes of regulation but any regulation implies at least some restriction of competition and the extreme of restricted competition is contrary to antitrust policy.\textsuperscript{77} There is here a basic conflict of goals, for the goal of antitrust legislation is competition while the goal of regulatory legislation is restriction.\textsuperscript{78}

\textsuperscript{73} Asch, supra note 1, at 232; Sterling, supra note 21, at 574. These arguments can be countered with claims that the SEC is too closely tied to the securities industry to effectively regulate the industry and that other industries with similar regulatory bodies are subject to antitrust liability.


\textsuperscript{76} Silver v. New York Stock Exchange, 373 U.S. 341, 357 (1963); Nerenberg, supra note 29, at 134.

\textsuperscript{77} Asch, supra note 1, at 228.

\textsuperscript{78} Id. at 215.
Two general means of approaching the conflict have been presented: one of questioning which element of government, the courts or the administrative agency (SEC), should have jurisdiction to determine the accommodation between the two extremes,\(^79\) and one of questioning the substantive criteria to be applied in resolving conflicts.\(^80\) While the two approaches are not exclusive,\(^81\) they mark the two most frequent bases of analysis.

Although the question of jurisdiction has always been present, it has not always received emphasis simply because the Antitrust Division of the Justice Department and the SEC have for various reasons never "crossed swords,"\(^82\) and in private litigation the question could be avoided by the court's noting lack of SEC jurisdiction over specific instances of antitrust abuse.\(^83\) Where the question has come before a court, the question of SEC "primary jurisdiction" was held inapplicable and the court was found to have full jurisdiction.\(^84\) Under circumstances similar to those involved in the usual SEC-court confrontation, it has been held in another industry that the courts have the "primary jurisdiction."\(^85\) This would seem to be the correct interpretation for, as was noted in a securities industry case, an SEC decision, while not binding, can have a persuasive effect on the courts in reaching a later decision in the same case.\(^86\) Thus, the jurisdictional question, although to some extent academic, is usually resolved in favor of the courts.

The solution to the problem of jurisdiction is much less complex, and perhaps also less important, than that of substantive criteria. As has been noted, there has been relatively little litigation involving application of antitrust laws to the securities industry.\(^87\) It has been suggested that the atomistic composition of the securities markets dampens any government concern over problems of concentrations of power.\(^88\) How-

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\(^79\) Nerenberg, \textit{supra} note 29, at 134.
\(^80\) Asch, \textit{supra} note 1, at 228-30; Sterling, \textit{supra} note 21, at 572.
\(^81\) Asch, \textit{supra} note 1, at 230.
\(^82\) Bicks, \textit{supra} note 32, at 157-58.
\(^87\) Asch, \textit{supra} note 1, at 216.
\(^88\) \textit{Id.}
ever, the prospects of increased concentration in the future, plus the basic conflict of objectives warrants a consideration of the substantive problems involved. 89

As might be expected, there are those who hold that antitrust policy must predominate in interpreting the regulatory legislation unless the goals of such legislation are to be impaired. 90 In cases where the 1934 act has been applied—most often to commodity exchanges—antitrust policy has usually been strictly applied. 91

On the other hand, it is maintained that regulatory considerations should prevail in any conflict with the antitrust laws because of the need for such regulation to protect a vulnerable investing public and the significance of the industry to the national economy. 92 It is further argued that the effect of restrictive practices that might draw antitrust attack is in fact negligible relative to the whole securities industry. 93 Another argument advanced is that "the securities industry is an obvious candidate for free and vigorous competition" in that it lacks any natural tendency to monopolization and government subsidization is not required—in short, the industry lacks those elements which require antitrust control in other industries. 94

In any consideration of which principles should be applied in antitrust litigation in the securities industry, the position of the SEC has obvious relevance. The Commission "clearly believes that it should in general consider antitrust doctrine in performing its regulatory function. . . ." 95 However, the SEC has reportedly followed a policy of condoning as not illegal per se any arguments containing provisions for such things as fixed offering prices, and price maintenance and stabilization. 96 Only on one occasion has the SEC applied consideration of the anticompetitive effects of a rule. In *In the Matter of the Rules of the NYSE*, the SEC holding indicated an interpretation that any rule

89. *Id.* at 214; Sterling, *supra* note 21, at 571-72.
91. *See Id.* at 227.
93. An argument based on the negligibility of the effect of restrictive practices conversely supports the contention that antitrust exemption is unwarranted since the application of antitrust laws to such practices would likewise have only a negligible effect. Sterling, *supra* note 21, at 570.
95. *Note, supra* note 19, at 227.
which violated antitrust policy also violated the Exchange Act via section 6(c) which requires exchange rules to conform to the aims of the Exchange Act.\textsuperscript{97}

This, then, is the basic conflict: a conflict between the interests of antitrust and those of the securities industry, interests which assume their most tangible form in the statutes discussed above. The conflict is also evident, however, in what litigation there has been in this limited area.

\textbf{The Courts' Handling of the Conflict}

As has been repeatedly noted above, there has been little SEC-initiated litigation applying antitrust laws to the securities industry. There has nonetheless been enough significant litigation in this area to make possible a determination of the position of the courts in the conflict between antitrust laws and the securities industry.

In considering cases which are pertinent to the application of antitrust laws to the securities industry and particularly to the exchanges, one finds cases involving industries somewhat similar to the securities industry, and a few cases involving even more similar circumstances in that they involve the application of antitrust laws to various types of exchanges.

Of the first variety, the application of antitrust laws to particular situations in similar industries, is one of the earliest cases of antitrust litigation in this general area: the 1912 case of \textit{United States v. Terminal Railroad Association}.\textsuperscript{98} This early case held that the control by one association of substantially all means of rail access to Saint Louis was a violation of antitrust policy,\textsuperscript{99} thereby applying antitrust laws to the exclusion of competitors. Recent cases in the area of antitrust have followed a like pattern of applying antitrust laws to the exclusion of competitors, with such litigation occurring perhaps most often in cases of mergers or various practices of industry associations.\textsuperscript{100} These recent cases have also followed a pattern of refusing to


\textsuperscript{99} \textit{Id.} at 394, 411-13.

recognize an implied exemption from antitrust laws, and as a result, have been cited as espousing principles applicable to the securities industry.  

Most directly applicable to the securities exchanges in particular are earlier court decisions applying antitrust laws to the exchanges of various other industries. The earliest of these is *Board of Trade of the City of Chicago v. United States*, wherein an attempt was made to apply the antitrust laws to a commodities exchange in Chicago. The case revolved around a rule which fixed the price of certain types of grain from the close of the exchange on one day to its opening on the next. In holding that the rule did not violate antitrust laws, the Supreme Court set forth an antitrust criterion which has been averred to ever since when it stated:

> But the legality of an agreement or regulation cannot be determined by so simple a test as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition, or whether it is such as may suppress or even destroy competition.

In the case at hand the Court found the rule to be "a reasonable regulation of business" and justifiable. Some twenty-six years after the *Board of Trade* ruling there came another attempt to apply antitrust prohibition to an exchange, which met with more success. The litigation was brought by the United States against the Tarpon Springs Sponge Exchange, and was based on allegations that the exchange controlled virtually the entire market for natural sponges in the United States to the derogation of that industry. The Court of Appeals for the Fifth Circuit granted judgment

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102. Board of Trade v. United States, 246 U.S. 231 (1918).

103. *Id.* at 237.

104. *Id.* at 238. The Court also noted that the background, history, and purpose of a regulation should be considered in ruling on whether the regulation restrains trade.

105. *Id.* at 237, 239-41.

106. United States v. Tarpon Springs Sponge Exch., 142 F.2d 125 (5th Cir. 1944).

107. *Id.* at 127.
for the United States, finding in effect that the exchange was guilty of conspiracy.\textsuperscript{108}

Antitrust laws—i.e., the Sherman Act—were again effectively applied to an exchange in the 1950 case of \textit{American Federation of Tobacco Growers v. Neal},\textsuperscript{109} where the Fourth Circuit Court of Appeals held that the Danville (Virginia) Tobacco Association had used its power to exclude the plaintiff from the area's tobacco market and thereby eliminate competition.\textsuperscript{110}

The same thinking that brought antitrust triumphs in the two earlier cases was followed in \textit{Gamco, Inc. v. Providence Fruit and Produce Building},\textsuperscript{111} as a produce exchange-like association was held to be in violation of Sections One and Two of the Sherman Act. The holding was grounded on the association's refusal to admit the plaintiff produce company to what was in effect the only produce market in the city.\textsuperscript{112}

While antitrust policies came to be readily applied to exchanges other than those in the securities industry, the courts were more reluctant to submit the securities exchanges to antitrust liability.

The first major attempt to apply antitrust laws to the securities industry came about in \textit{United States v. Morgan},\textsuperscript{113} where the Antitrust Division sought to apply such laws to the syndicate method of distributing new issues of securities. \textit{Morgan} was a civil suit by the United States against seventeen brokerage houses charging the defendants with violation of Sections One, Two and Four of the Sherman Act\textsuperscript{114} in their formation of an alleged combination or conspiracy to monopolize the securities markets.\textsuperscript{115} Judge Medina, who ruled on the case, saw \textit{Morgan} as a "head-on collision" between the SEC and the Antitrust Division.\textsuperscript{116}

In his analysis of the situation in \textit{Morgan}, Judge Medina applied the \textit{Board of Trade} test. He stated that nothing presented to the court

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\textsuperscript{108} \textit{Id.} at 126-28.
\textsuperscript{109} \textit{American Fed'n of Tobacco Growers v. Neal}, 183 F.2d 869 (4th Cir. 1950).
\textsuperscript{110} \textit{Id}.
\textsuperscript{111} \textit{Gamco, Inc. v. Providence Fruit & Produce Bldg.}, 194 F.2d 484 (1st Cir. 1952).
\textsuperscript{112} \textit{Id}.
\textsuperscript{115} One interesting aspect of the charges in \textit{Morgan}, as alluded to by Judge Medina, is that the alleged conspiracy was to have been formed about 1915 and to have flourished from that time to 1953 under the very noses of the SEC, ICC, and various Congressional investigations (of which there were many in the 1930's) without detection. \textit{See} \textit{United States v. Morgan}, 118 F. Supp. 621, 629-33 (S.D.N.Y. 1953).
\textsuperscript{116} \textit{Id.} at 694.
would permit him any conclusion but that the "rule of reason"—i.e., the principles of the Board of Trade decision—still stood.\footnote{Id. at 635, 689, 690-91.} In so applying the rule of reason, the court held the syndicate system to be a legitimate means of distributing securities and one not aimed at fixing prices.\footnote{Id. at 829; Asch, supra note 1, at 219-20.} The court found that the members of the syndicates fall into the "joint ventures" classification which is not subject to Sherman Act liability.\footnote{United States v. Morgan, 118 F. Supp. 621, 690 (S.D. N.Y. 1953); Note, The Investment Bankers Case: The Use of Semantics to Avoid the Per Se Illegality of Price Fixing, 63 Yale L.J. 399, 402 (1954).} While sentiment is not unanimous,\footnote{Some have held the Sherman Act is applicable to all businesses and should therefore be applied in cases such as Morgan note, supra note 119, at 406-07.} Morgan has been seen as (with the exception of Silver, infra) the only "square holding" on the application of the Sherman Act to the stock exchanges.\footnote{United States v. Morgan, 118 F. Supp. 621 (S.D. N.Y. 1953). The decision was never appealed.}

Ten years after the Morgan decision, a significant antitrust-securities markets case, Silver v. New York Stock Exchange,\footnote{Silver v. New York Stock Exchange, 373 U.S. 341 (1963).} reached the United States Supreme Court, and the decision of the Supreme Court applying the Sherman Act to the NYSE has had a marked impact. Silver was brought by the owner of two Texas securities firms dealing in municipal bonds, which were registered broker-dealers and NASD members.\footnote{Id. at 343.} To better his trading position, provide convenience to other broker-dealers, and improve his business generally, Mr. Silver obtained direct private telephone wires to certain NYSE members. The Exchange granted "temporary" permission for such wires;\footnote{Id. at 344-44.} then, without prior notice to Silver, the Exchange ordered the wires removed, which was done within approximately two weeks.\footnote{Id. at 344, 361.} Mr. Silver put forth an extensive effort to learn the charges or reasons behind the abrupt action but the Exchange refused to reveal such information.\footnote{Id. at 344, 361.} Mr. Silver's volume of business dropped substantially.\footnote{Id. at 344.}

Based on Sections One and Two of the Sherman Act\footnote{15 U.S.C. §§ 1, 2 (1964).} and Sec-
tions Four and Sixteen of the Clayton Act,\(^\text{129}\) the complaint in Silver charged in its major point that the NYSE had violated the cited antitrust laws in that the Exchange allegedly "conspired with its member firms to deprive petitioner" of the particular services in question.\(^\text{130}\) The relief sought consisted of treble damages under the antitrust laws and a permanent injunction against the NYSE's refusing members permission to grant such wire connections.\(^\text{131}\) The district court's order granting a summary judgment and injunction\(^\text{132}\) was partially overruled by the court of appeals decision that exchanges were exempt from antitrust laws.\(^\text{133}\) As noted below, the Supreme Court overruled this holding.

Although the only technical issue brought to the Supreme Court was the validity of the summary judgment,\(^\text{134}\) the issue was much broader. Mr. Justice Goldberg formulated the issue at the beginning in the Court's decision by stating:

We deal here today with the question, of great importance to the public and the financial community, of whether and to what extent the federal antitrust laws apply to securities exchanges regulated by the Securities Exchange Act of 1934.\(^\text{135}\)

Later in the opinion the issue is seen as a question of extent—the extent to which the exchanges' duty of self-regulation under the securities act is incompatible with the antitrust laws.\(^\text{136}\) While the issue was also phrased broadly as a test of the government-private enterprise partnership,\(^\text{137}\) the bare issue was simply whether the NYSE, in acting by


\(^{130}\) Silver v. New York Stock Exchange, 373 U.S. 341, 345 (1963); Bicks, supra note 32, at 129.


\(^{132}\) Id. at 345-46. Ruling in favor of the plaintiff, the district court granted summary judgment and a permanent injunction against the Exchange's denial of wire connections with nonmembers. The court found the antitrust laws to be directly applicable to the Exchange, and the court further concluded that the actions in question constituted a per se violation of those antitrust laws.

\(^{133}\) Silver v. New York Stock Exchange, 373 U.S. 341, 346-47 (1963). The court of appeals reversed the summary judgment granted in the district court on a finding that the Exchange was exempt from antitrust liability because its actions in question were performed in exercise of the Exchange's powers under the Securities Exchange Act.


\(^{135}\) Id. at 342; see also Bicks, supra note 32, at 129.


\(^{137}\) Id. at 366.
rules adopted under machinery of the Act of 1934, is liable under or exempt from the antitrust laws.\footnote{138}

Though the implications of the holding may be varied, the Silver decision on the basic issue is clear: the NYSE is liable under antitrust laws even though it is acting pursuant to rules adopted under the machinery of the 1934 Act.

The Silver court found the act of self-regulation in question to be in violation of the antitrust laws. The key to the decision, however, was that the action was unjustified in that it was not in furtherance of the purposes of the Securities Exchange Act. The Court stated:

Our decision today recognizes that the action here taken by the Exchange would clearly be in violation of the Sherman Act unless justified by references to the purposes of the Securities Exchange Act, and holds that that statute affords no justification for anti-competitive collective action taken without according fair procedures.\footnote{139}

Thus, the holding of the Court incorporates the statement earlier in the opinion that

It is plain, to begin with, that removal of the wires by collective action of the Exchange and its members would, had it occurred in a context free from other federal regulation, constitute a per se violation of § 1 of the Sherman Act. The concerted action of the Exchange and its members here was, in simple terms, a group boycott depriving petitioners of a valuable business service which they needed in order to compete effectively as broker-dealers in the over-the-counter securities market.\footnote{140}

Though based on a procedural point, the Silver holding is a clear application of antitrust law to the securities exchanges.\footnote{141}

The reasoning of the Silver court necessarily revolved around which, if either, statute should be applied to the fact situation presented. The Court noted that a claim of a right to self-regulation under the Securities Act is a valid defense against antitrust laws only to the extent that

\footnote{138. \textit{Id.} at 343.}
\footnote{139. \textit{Id.} at 364; \textit{see also Id.} at 361.}
\footnote{140. \textit{Id.} at 347.}
\footnote{141. \textit{See also Id.} at 370 (dissenting opinion).}
such action is necessary to preserve the aims of the Act. The Court clearly found, however, that no policy of the Act is furthered by an exchange's failure to give any notice or to give an opportunity for a hearing on charges of violating an exchange rule. The action of the NYSE in Silver actually defeats the aims of the Act, for it destroys public confidence in the securities industry. The Court reasoned that the Exchange's acts so obviously exceeded the Exchange's powers under the Exchange Act, that the situation did not even approach one in which a justification for the acts might be considered. In the Court's view, the Exchange had clearly violated antitrust law.

As noted above, the Court applied the "rule of reason" in Silver as the guiding light for the exchanges in matters of antitrust. By thus making antitrust liability rest on concepts of fair play instead of on reconciliation of antitrust and securities statutes, the Court in effect sidestepped the issue of interpreting the statutes.

The Silver holding has been hailed as the ideal solution to the situation and it has been noted that had the Supreme Court taken the position of either of the two lower courts, the results would have been less satisfactory to all concerned. Following the district court's position would have held the exchanges subject to unlimited antitrust liability and would have thus impaired their powers of self-regulation and the effectiveness thereof. On the other hand, the Court's strictly following the court of appeals holding would have brought blanket exemption to the exchanges and left them free to engage in almost any practices without fear of antitrust reprisals.

It has been maintained that the effect of Silver should be limited to its own facts and should not, for example, be used to penalize an exchange for necessarily acting swiftly to isolate a nonmember and protect the public. Indeed, the emphasis on procedure in Silver has distinguished it from later decisions resting on more substantive matters, and thereby perhaps limited its effect.

142. Id. at 361.
143. Id.
144. Id.
145. Id. at 365.
146. Id. at 360.
147. Bicks, supra note 32, at 130; Nerenberg, supra note 29, at 137-38, 140; see Asch, supra note 1, at 223.
148. See Asch, supra note 1, at 223; Comment 59 Nw. U.L. Rev. 70, 76-77 (1964).
149. 59 Nw. U.L. Rev. 70, 75 (1964).
150. Asch, supra note 1, at 227.
While the specific applicability of *Silver* may be limited, in a more general sense its significance has been great. One author has stated that "*Silver* opened the door to antitrust liability and established a method of analysis for ascertaining a violation." It is generally recognized as a "square holding" on the application of antitrust laws to the stock exchanges.

Perhaps the greatest significance of *Silver* is its reaffirmation of the "rule of reason," and the application of that rule to an otherwise per se offense.

The *Silver* court foresaw that the decision would discourage exchanges from straying into unjustified regulatory practices, and would also make antitrust courts more effective by requiring a clarification of the circumstances of any alleged antitrust breach.

While such a general effect cannot be discerned, after the ruling in *Silver* the NYSE revised its rules governing wire connections between members and nonmembers so as to minimize antitrust risks but maintain regulatory goals. While this is but a single example of an immediate effect, the significance of *Silver* can hardly be denied.

Many have foreseen an avalanche of antitrust claims seeking further Supreme Court delineation of what is and is not subject to antitrust liability in the securities industry, since the *Silver* decision provides no clear guidelines. While some litigation has arisen out of *Silver*, as noted below, the volume has not been significant. The significance of *Silver* lies in the fact that it has destroyed the immunity from antitrust once so snugly enjoyed by the securities industry and its markets. One writer describes the significance of *Silver* thus:

> Antitrust now probes beyond particular NYSE enforcement or disciplining moves to question the legality of the complex of rules that comprise and buttress the Exchange's basic rate structure. Involved here are legal issues passed on only obliquely by *Silver*, and policy questions that run deep in terms of the NYSE's future role.

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153. *Id.* at 228.
To date the most significant litigation relying on the Silver holding is *Kaplan v. Lehman Brothers.* In *Kaplan,* the plaintiffs claimed that the action was instituted on behalf of five mutual funds and their shareholders. The five named defendant firms, which the plaintiffs claimed were brokers for the funds, were nominal defendants only; the actual defendants were the NYSE and four Exchange members. In essence, then, the action was one by shareholders of mutual funds against the NYSE and exchange members who managed the funds.

The complaint in *Kaplan* states that an avowed purpose of the NYSE was to set minimum commission rates and that "[t]his arrangement amounts to a combination and conspiracy in restraint of trade in violation of Section One of the Sherman Anti-trust Act, 15 U. S. C. § 1, et seq . . . ," and that the mutual funds had thereby been damaged in an amount equal to the difference between the fixed commission rates and those that would have existed under free competition. The plaintiffs sought both treble damages under the Sherman Act and actual damages under the Exchange Act on the theory that the enumerated practices were in violation of the Act, as well as a declaratory judgment finding the rules of the NYSE null and void insofar as applicable to a fixed minimum commission rate. The court recognized the impact of the question presented, stating:

A seeming conflict between the federal antitrust laws and the Securities Exchange Act of 1934 is the source of this controversy. . . . Reconciliation of these . . . is a matter of considerable moment to the financial community and to the investing public.

The court nonetheless entered summary judgment for the defendants.

In holding as it did, the *Kaplan* court saw the question of violation as turning upon an interpretation of the Act of 1934. The court rejected the claim of the plaintiffs that rates set by the Exchange could not be "reasonable" as intended by the language of the Act, and held

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159. *Id.* at 562.
160. *Id.* at 562-63.
161. *Id.* at 563.
162. *Id.* at 562.
163. *Id.* at 566.
164. *Id.* at 563.
the terms to refer to reasonable rates such as those provided for public utilities. The court could then answer the claim that the rates were too high by stating that the remedy for unreasonably high rates lies with the regulatory body—the SEC. In effect the reasoning applied in Kaplan placed the fixed commission rate structure under the protection of the 1934 Act and exempt from antitrust liability.

In reaching its result the Kaplan court cited the Silver holding although the two cases are significantly different. Where the action in question in Silver—the means of applying an exchange rule—was beyond the scope of SEC review and thus not subject to any regulation, the rule in question in Kaplan was clearly within the SEC’s power to review and thus was subject to regulation. As the Kaplan court pointed out, in the situation in Kaplan, “review is afforded within the system of securities regulation, [and] there is no need to resort to the antitrust laws for a remedy.” In essence the difference between Silver and Kaplan is that, where procedural safeguards were lacking in Silver, such safeguards are provided in Kaplan by the SEC’s power of review over the setting of “reasonable” rates of commission.

Nevertheless, both parties in Kaplan agreed that the principles of Silver were applicable in determining the question in Kaplan; the difference of positions came in the application of Silver principles. The plaintiffs based their case solely on the argument that the fixing of commission rates is per se a violation of antitrust law, but the Silver holding is squarely against that position. The Kaplan court stated that Silver “makes it plain that action taken by the Exchange and its members, pursuant to its statutory authority to make rules, is not illegal per se under the Sherman Act.” On this basis the court in Kaplan concluded that “[r]ules adopted by an Exchange under the authority of the Act are not illegal per se,” and thus ruled against the plaintiffs.

The significance of Kaplan lies in its further clarification of the Silver holding and its establishing the immunity from antitrust liability of exchange actions which are clearly within SEC regulation.

165. id.
166. id. at 566.
167. id.
168. id. at 565; Comment, 45 N.C. L. Rev. 301, 303 (1966).
170. id. at 564.
171. id.
172. id. at 565.
The case which would seem most directly to address the issues on which previous decisions have not taken clear positions has unfortunately never been decided by a court. *Thill Securities Corporation v. New York Stock Exchange,*\(^{173}\) has been pending in the district court for several years but has never been ruled upon. Filed by a registered broker-dealer as a class action "on behalf of all securities brokers and dealers in the United States similarly situated," the *Thill* complaint charges the NYSE with violation of Sections One and Two of the Sherman Act and Section Four of the Clayton Act. All members of the NYSE are named as co-conspirators in an alleged combination and conspiracy in restraint of interstate commerce intended to restrain trade by (1) preventing competition between members of the Exchange for payment of a share of commissions to non-member broker-dealers, (2) preventing competition and negotiations between Exchange members and non-members for such a sharing of commissions, and (3) depriving non-member broker-dealers of the opportunity to share commissions on transactions which were solicited by such broker-dealers but which must be channeled through Exchange members as the sole means of access to the Exchange. The plaintiffs asked that the NYSE be enjoined from preventing the sharing of commissions and that treble damages in the amount of $21 million be granted. At the time of this writing, the latest court action in the *Thill* case was the denial of the defendant's motion to dismiss on jurisdictional grounds. The Exchange has subsequently filed a motion for summary judgment on the ground that the Sherman Act is not applicable to the Exchange's constitution and rules due to the exclusive jurisdiction granted to the SEC by Section 19(b) of the Securities Exchange Act of 1934. The Exchange appears to be relying heavily on the *Kaplan* holding, but also makes reference to the current SEC study of the commission rate structure. It may be anticipated that the present developments in policies of the SEC and the NYSE will have a marked effect on the conduct of the case and the significance of its eventual holding.

**Means of Avoiding Restrictive Rules**

While the question of the legality of restrictive exchange practices was being debated in the courts, those whose business requirements conflicted with the restrictive rules were developing means of circumventing the rules. Due to various developments in the securities mar-

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kets, it became increasingly obvious that certain rules and practices of the exchanges—and the NYSE in particular—were indeed restrictive of free competition. As this occurred, those whose livelihood revolved around the markets, especially institutional investors and non-member broker-dealers, saw deeper and deeper cuts in their potential profits which were attributable to exchange regulations, most notably the fixed commission rate structure, which costs large investors astronomical brokerage fees, and the limited membership which increases relative costs for non-member brokers.

Recent developments have brought the fixed commission rate structure under particularly harsh criticism. Perhaps the most significant of these recent developments is the great increase in market activity by institutional investors, who deal in large blocks of stock and are thus damaged most by the absence of a volume discount in commission fees. Further questioning of the NYSE rate structure has come with the observation that commission rates have not decreased, and were increased in 1958, despite a continuous increase in the volume of trading on the Big Board. A combination of many such forces has brought into serious doubt the justifications offered for the fixed commission rate structure in its present form. As noted above, some chose to test the rules in the courts. Others, however, developed intricate means of circumventing the letter of the law by arrangements among brokers to achieve the ends of reduced rates.

One of the less covert means of avoiding the exchanges’ commission rate structure is the practice of many brokerage houses of offering “special services” to large customers. These services take the form of free wire connections, ticker tape and teletype connections and special extensive analytical and statistical services, all of which would otherwise cost the large investors sizable funds. All such services are pro-

174. See pages 1 and 2, supra, for a further discussion of the increased influence of institutional investors in the securities markets. See also Bicks, supra note 32, at 147-48.


176. The Special Study states at page 312 of Part 2 that:

[T]he member reciprocates for profitable security commission business by furnishing special services, i.e., services varying in content, scope, and depth from those provided the average public customer. The different needs of each class of customer may dictate performance of different services, but there is no clear line of demarcation; many of these special services are useful to both professionals and nonprofessionals in the security commission business.

For an example of such special services, see The Wall Street Journal, July 11, 1968, at 15, col. 1.
vided in return for the institutional investor's doing business with the brokerage firm at the set public rate of commission. Smaller investors who pay the same rate, however, are unable to receive such special treatment.\textsuperscript{177} The various brokerage firms utilize the special services only to compete for the large block orders.\textsuperscript{178} These dealings are all in terms of services, however, with no monetary amounts involved.

Basic to most of the other techniques employed are agreements whereby a customer—often a mutual fund—directs the broker executing that customer's order to funnel part of the executing broker's commission to another designated broker.\textsuperscript{179}

While there are many varying types of such arrangements, most can be classified under the general title of "give-ups."

In its purest form, [a give-up] is an arrangement whereby a major customer, such as a mutual fund, directs a brokerage firm executing an order to yield part of its commission to another broker for a service unconnected with the order, such as selling mutual fund shares.\textsuperscript{180}

Give-ups may occur on a broker's own initiative, but they generally are directed by the broker's customer. Probably the most common use of give-ups is by mutual fund managers to reward broker-dealers who have sold that fund's shares.\textsuperscript{181} The percentage of commission given up varies according to the bargaining between the fund-customer and the broker, but it is common for as much as sixty percent to be turned over to another broker, and much higher amounts have been reported, as discussed below.\textsuperscript{182} NYSE rules only allow members to give up commissions to other members,\textsuperscript{183} but it is possible for funds to arrange for give-ups to be directed to almost any broker even though the order is placed on the NYSE by placing the orders with a

\textsuperscript{177} Special Study, supra note 3, at pt. 2, p. 321.
\textsuperscript{178} Id.
\textsuperscript{179} SEC Release No. 8239, supra note 13, at 3; for a detailed example of reciprocal transactions, see The Wall Street Journal, July 12, 1968, at 3, col. 2.
\textsuperscript{181} SEC Release No. 8239, supra note 13, at 3.
\textsuperscript{183} Special Study, supra note 3, at pt. 2, p. 317; SEC Release No. 8239, supra note 13, at 3; Bicks, supra note 32, at 148.
NYSE firm which is also a member of the regional exchange on which the recipient broker trades. By knowledgable use of give-up arrangements, a customer can give rebates to almost any broker in the country. By means of the "third market" it is even possible to direct rebates to brokers in the over-the-counter market.

The techniques of avoiding the rate structure have taken various forms, but together these have had a significant effect on the incomes of many brokerage firms. Answers to a questionnaire for the SEC Special Study indicated that forty-one of the brokerage firms responding relied on reciprocal arrangements for at least forty percent of their income. On the other hand, officials of various NYSE firms testifying before the SEC hearings of July, 1968, indicated their firms give up as much as ninety percent of the commission on some transactions.

Probably the greatest effect of the reciprocal practices has been felt on the regional exchanges where "sole" members—i.e., firms which are members of only a regional, as opposed to a New York, exchange—rely heavily on the commission from reciprocity agreements. The volume of business on the regionals is also increased by their use to record "cross" transactions between two customers whose orders have been matched by a broker. The result has been a revitalization of the regional exchanges.

The causes of reciprocal practices generally are set forth clearly in the Special Study's discussion of the causes of give-ups:

The reciprocal give-up and the special services for volume and block customers both stem from the fact that the NYSE commission rate structure does not formally recognize such customers as deserving treatment different from the average round-lot customer. What the rate schedule fails to do, the industry accomplished informally, unevenly, and largely covertly, by means

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185. The customer is prevented from directing a rebate to himself to thereby reduce the commission he must pay, however. See Special Study, supra note 3, at pt. 2, p. 317, n. 569.
190. Comments of the Dep't of Justice, supra note 9, at 60-61.
of these arrangements. The consequences parallel those resulting from the failure of the schedule to recognize nonmember professionals as a separate class. Three consequences are quite similar: the troublesome problem of administration in the case of special services; the distortion of cost date; and the channeling of business to the regional exchanges.\textsuperscript{191}

THE RESULTING CHANGES

That the existing circumstances required substantial alteration was made increasingly obvious. The Special Study questioned whether any changes were necessary when the present system was achieving desired results via the various informal arrangements. However, it was seen that a continuation of the present system would lead only to administrative problems, conflicts of interest, cost distortions of exchange and broker income and expenses, and an irrevocable impact on the regional exchanges.\textsuperscript{192} The Special Study concluded that a revision of the rate structure, including rates for non-members, was in order.\textsuperscript{193} When procedures to bring about such a revision were commenced, the analysis of the then-present situation was clearly substantiated.\textsuperscript{194}

As discussions of revision of the commission rate structures continued, the NYSE itself proposed certain rule changes apparently to ease criticism of its rate structure and prevent any substantial loss of revenues in the future. The SEC saw the NYSE proposals as based on threats to the depth and liquidity of the NYSE market and to the profitability and financial stability of member firms posed by (1) the development of give-ups and reciprocal business practices, (2) the competitive advantages being acquired by the regional exchanges, and (3) the leakage of commission revenues outside the NYSE.\textsuperscript{195}

The NYSE proposed to (1) incorporate a volume discount into the minimum commission schedule, (2) support continuation of customer directed give-ups to a limited percentage given up, (3) prohibit reciprocal practices resulting in \textit{de facto} rebates of NYSE commissions,

\begin{footnotes}
\item 191. \textit{Special Study}, \textit{supra} note 3, at pt. 2, p. 318. (Footnotes omitted.) An additional cause of the success of the reciprocal practices is the brokers' willingness to accept reduced commissions on large transactions. \textit{See} SEC Release No. 8239, \textit{supra} note 13, at 3.
\item 192. \textit{Special Study}, \textit{supra} note 3, at pt. 2, pp. 309, 342-46, 951.
\item 193. \textit{Id.} at pt. 2, p. 311.
\end{footnotes}
even on other exchanges, (4) permit a discount in the rate schedule for non-member broker-dealers, and (5) adopt rules, if so ordered by the SEC for all exchanges, limiting membership to bona fide broker-dealers.\textsuperscript{198} While the proposals were inexact, it was expected that they would be clarified in the future.\textsuperscript{197}

The effect which the SEC saw as being sought by the NYSE in its proposals was to (1) limit the major types of reciprocal business, (2) establish a maximum percentage of commission that could be given up, (3) prevent regional exchanges from offering different and more liberal give-up arrangements, and (4) prevent institutional membership on exchanges.\textsuperscript{198} Intentionally or not, the NYSE proposals would clearly affect the regional exchanges.\textsuperscript{199}

It is significant to note that the original NYSE proposals called for continuation of give-ups.\textsuperscript{200} This position was later reversed, as discussed below.

Subsequent to the NYSE proposals, the SEC proposed Rule 10b-10 which would allow the continuation of give-ups and reciprocal business practices but would simply require that where institutional investors were involved the institutional funds and not their managers would receive the benefit of such arrangements.\textsuperscript{201} The SEC reasoned that if a fund manager has the means to recapture for the benefit of the fund a portion of the commissions paid, he is under a fiduciary duty to do so.\textsuperscript{202} While the SEC saw its proposal of Rule 10b-10 and the NYSE proposals as alternative approaches to the same problem,\textsuperscript{203} the latter were in fact broader in scope.

In announcing its proposed Rule 10b-10 in a release which also included the NYSE proposals, the SEC invited all interested persons to submit views and comments on both proposals. The many responses received were generally predictable: the regional exchanges were anxious that NYSE rule changes not injure their competitive position; brokers relying heavily on give-ups were anxious to see those practices continued; and the National Association of Securities Dealers was

\textsuperscript{196} Id. at 11.
\textsuperscript{197} Id. at 7-8.
\textsuperscript{198} Id. at 6-7.
\textsuperscript{199} Id. at 7.
\textsuperscript{200} Id.
\textsuperscript{201} Id. at 9.
\textsuperscript{202} Id. at 8.
\textsuperscript{203} Id. at 10.
anxious to see that the interests of those in the over-the-counter market were protected.204

Probably the most significant response filed was that of the Department of Justice. In a strongly worded brief the Department came out in opposition to any limits on give-ups and reciprocal business practices so long as there remained a minimum rate structure.205 The NYSE proposal to continue give-ups was however attacked because it would continue all of the complexities, distortions and fiduciary hazards of the old rate system.206 The Department argued that there actually was no minimum rate structure when part of the commission could be given away. It was made clear that the Justice Department favored abolition of the rate structure and the introduction of complete rate competition among brokerage houses. The Department maintained that when this occurred, give-ups and reciprocal practices generally would disappear.207 Discounts to non-member brokers as proposed by the NYSE received the support of the Justice Department because they were seen as one means of allowing access to the market on reasonable terms to those who were not Exchange members.208 On the matter of a volume discount, the position of the Justice Department was that the NYSE proposal to continue give-ups clearly indicated that the volume discount proposed would not bring commissions to the level approximating the cost savings of large transactions.209 As might be expected, the Justice Department's brief sparked much debate.

Some four months after the SEC had proposed Rule 10b-10 and had taken under consideration the NYSE proposed rules changes, the SEC specifically requested, pursuant to the provisions of section 19(b) of the 1934 Act, that the NYSE adopt a revised commission rate schedule offering reduced rates for round-lot transactions in excess of 400 shares or, alternatively, that the NYSE abolish all minimum commission rates for orders in excess of $50,000. The request was presented as "an interim measure." 210 The reaction of the NYSE was to declare

205. Comments of the Dept of Justice, supra note 9, at 55, 57.
206. Id. at 55.
207. Id.
208. Id. at 57.
209. Id. at 54-55.
both alternatives unacceptable and to propose an interim measure of its own. The NYSE interim proposal called for a volume discount for transactions of more than 1,000 shares for most stocks and for negotiation of commission rates for transactions in which commissions of $100,000 or more were involved. Of particular importance in the NYSE proposal was the Exchange's willingness to abolish customer directed give-ups, which was seen as "an important concession" to the SEC position. The difference between the two proposals was a marked one.

In the midst of proposals and counter-proposals, the SEC called public hearings on the issues being so heatedly debated. As with the earlier call for responses to the initial SEC and NYSE proposals, the hearings produced generally predictable results. Of special interest was the position of the NYSE in arguing in support of the present rate structure on the ground that to change the structure would bring disastrous economic effects in the form of "destructive price competition," and that the SEC was without the power under the 1934 Act

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211. The NYSE maintained the SEC proposals were unacceptable because (1) any abolition of the minimum rate structure would be unacceptable to the Exchange, and (2) the 400-share proposal would place an undue burden on those handling Exchange paperwork. The Wall Street Journal, July 11, 1968, at 3, col. 2.


214. In announcing the hearings, the SEC stated that the hearings were being called "to consider whether any changes should be made in the rules, policies, practices and procedures of registered national securities exchanges respecting commission rate structure." The Commission further stated that:

Information developed by the Commission has led it to conclude that present commission rate structure rules, practices and policies do not, in fact, provide for fixed minimum commission charges on many exchange transactions.

SEC Release No. 8324, supra note 216, at 1. In a more detailed announcement of hearings procedures, the SEC stated that:

[T]he factual inquiry will deal with matters such as (i) commission rate levels for exchange members (intra-member rates) and for non-members, (ii) the services for which such commission rates pay and the costs allocated thereto, (iii) give-ups and reciprocal practices among different categories of members and non-members, (iv) membership by financial institutions, (v) economic access to exchange markets by non-member broker-dealers, (vi) competition among exchanges and among exchanges and other markets, and (vii) the necessity for restrictions on access of exchange members to the third market.


to abolish the rate structure.\textsuperscript{216} The basic position of the NYSE was presented in its brief to the SEC, wherein it concluded that

\begin{quote}
[T]he concept of minimum rates of commission fixed by Exchange action, subject to the SEC's powers of review and revision, is firmly rooted in the provisions of the 1934 Act and must be adhered to unless Congress can be persuaded that changes in the 1934 Act are in the public interest.\textsuperscript{217}
\end{quote}

While it did not participate in the first part of the SEC hearings, the Department of Justice stated that it saw the interim proposals as a move in the right direction; it was clear however, that the Department maintained an interest in a permanent solution involving what it would consider an economically realistic rate structure.\textsuperscript{218}

During a recess of the SEC hearings there occurred the most significant development in this area of the past several years. The SEC gave its approval to the NYSE interim proposal and the NYSE agreed to take immediate steps to put the proposal into effect. By December 5, 1968, there is to be instituted by the NYSE a volume discount on transactions of more than 1,000 shares, the customer directed give-up will be abolished (although other forms of reciprocal practices are to remain), and lower floor brokerage and clearance charges will be put into effect for members. Both SEC Chairman Cohen and NYSE President Haack repeatedly stated that the accepted measures were only interim provisions, but the effect of the provisions was nonetheless significant.\textsuperscript{219}

Reaction to SEC acceptance of the NYSE proposal was varied. While the full effect on regional exchanges could not be immediately ascertained, it was felt that adverse reaction would be heard from those who will suffer a decrease in income upon cessation of the customer directed give-up. It was estimated that NYSE members themselves would suffer a reduction in income of $150 million due to the volume discount which may bring further adverse reaction within the NYSE membership itself as the new rule goes into effect.\textsuperscript{220}

\textsuperscript{216} Id. Aug. 22, 1968, at 8, col. 1.
\textsuperscript{219} Id. Sept. 5, 1968, at 3, col. 1-2.
\textsuperscript{220} Id.
At the time of this writing the SEC hearings are due to resume shortly with the Department of Justice appearing for the first time. The tone of the Department's testimony could well set the pattern for further developments in this volatile area.

CONCLUSION

After remaining aloof and immune from antitrust liability for decades without fearing price-fixing charges, even though exchanges strictly enforced a set commission rate schedule, or reprisals for limiting competition even though trading on exchanges was restricted to members only, the stock exchanges and the securities industry generally have now seen the handwriting on the wall in the form of a number of court decisions and the increased "interest" of the Antitrust Division of the Department of Justice, and have begun a process of change which will undoubtedly result in more competitive securities markets. The very fact that so much concern has been registered, and that changes are being made, demonstrates a responsiveness to public rights, needs, and demands which has seldom been seen before in the securities industry. While the only negotiated commissions to date are for very large transactions and while there is yet to be made any real change in the exchanges' restrictive membership policies, the move—a very definite move—is being made in the direction of such more competitive provisions. The future will see securities markets wherein rates of commissions are generally negotiable or flexible from one broker to another and wherein trading is open to all qualified broker-dealers. The move to such a market will however be a slow one. Changes are needed; these changes must be to freer competition.  

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221. The NYSE interim proposal was accepted by the members of the Exchange on October 24, 1968, and a very similar plan was adopted by the members of the American Stock Exchange on November 1, 1968. Both exchanges were to put the new schedules into effect on December 5, 1968. The Wall Street Journal, Nov. 4, 1968, at 6, col. 3; Id., Oct. 25, 1968, at 2, col. 3.