



2007

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Recommended Citation

Hannibal Travis, *Are Issuers of and Dealers in Securities Immune from Lawsuits Arising Under Federal and State Antitrust Laws?*, 34 *Preview U.S. Sup. Ct. Cas.* 296 (2007).
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March, 2007

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Are Issuers of and Dealers in Securities Immune from Lawsuits Arising Under Federal and State Antitrust Laws?

by Hannibal Travis

PREVIEW of United States Supreme Court Cases, pages 296–301. © 2007 American Bar Association.

Case at a Glance

Conduct potentially subject to regulatory scrutiny by federal agencies such as the Securities Exchange Commission (SEC) is not necessarily immune from antitrust liability. The Supreme Court previously held that an anticompetitive conspiracy in the mutual fund industry was immune from antitrust liability because the SEC had the primary statutory authority to prohibit or permit such conspiracies. This case raises the question of whether another alleged conspiracy—to restrict the availability of certain initial public offerings of securities (IPOs)—is similarly immune.

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ISSUES

In a private treble damages action under the Sherman Act, 15 U.S.C. § 1 et seq., alleging anti-competitive conduct during federally regulated public offerings of securities, is the standard for implied antitrust immunity the potential for conflict with the securities laws, as petitioners contend, or a specific record of congressional intent to immunize such conduct and/or past SEC authorization or compulsion of the conduct at issue, as the Second Circuit held?

Does implied immunity from antitrust liability exist for issuers and dealers in securities in light of the express provision of Congress in the federal securities laws that private securities claims “shall be in addition to any and all rights and remedies at law or equity”?

In a private treble damages action alleging commercial bribery under section 2(c) of the Robinson-Patman Act, 15 U.S.C. § 13(c), are issuers or dealers in federally regulated securities impliedly immune from suit due to the potential for conflict with the federal securities laws?

FACTS

Respondents are direct or after-market purchasers of about 900 IPO stocks. Technology- and Internet-related companies, including Amazon.com, eBay, Priceline.com, and Global Crossing, issued many of these IPOs. Petitioners include ten leading investment banks accounting for 73 percent of the total dollar value of all equity underwritings in the United States at the start of the relevant period, which spans from 1997 to 2000. Other petitioners are institutional investors, notably Fidelity Brokerage and Janus Capital. The underwriter petitioners include Bear Stearns, Citigroup Global Markets, Credit Suisse Securities, Deutsche Bank Securities, the Goldman Sachs

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ARGUMENT DATE:
MARCH 27, 2007
FROM: THE SECOND CIRCUIT



Group, Lehman Brothers, Merrill Lynch, Morgan Stanley, and Robertson Stephens. These leading underwriters obtained responsibility from issuers for allocating shares of “hot issues,” as many technology stocks were (and continue to be), and they formed syndicates to purchase IPOs from issuers and resell them to investors. In this way, issuers raised capital to expand their businesses, and underwriters allocated IPO shares to those customers paying the highest commissions. Underwriters also preferred buyers unlikely to “flip” the shares, thereby reducing their price and broadening their availability.

Respondents have filed class actions on behalf of all persons who bought the relevant IPOs underwritten by respondents during the period in question, either directly or in the aftermarket. Respondents allege that petitioners conspired to inflate aftermarket prices above IPO prices by more than eight times the rate prevailing in the early to mid-1990s, before the conspiracy began. They also allege that petitioners tied IPO shares to purchases of additional shares of the IPO stocks in the aftermarket at inflated prices and commissions, the issuer’s secondary offerings, other less attractive securities, and/or inflated commissions on trades in other securities. In addition, respondents allege that petitioners used their investment analysts to distribute overly optimistic and misleading “buy” and “outperform” recommendations, which inflated aftermarket prices and defrauded investors. Respondents claim in the Billing Complaint that this course of conduct violated Section 1 of the Sherman Act, 15 U.S.C. 1, and in the Pfeiffer Complaint that it violated the commercial bribery provision of the Robinson-Patman Act, 15 U.S.C. § 13(c).

The district court dismissed the respondents’ claims, holding that antitrust liability for the alleged conduct would create both actual and potential conflicts with the securities regulation framework established by Congress and the SEC. The court pointed out that the SEC expressly allows underwriters to create syndicates to allocate IPO shares and that it has the power to regulate the other alleged conduct. The court also held that the underlying conduct is immune from state antitrust law for these reasons. *In re IPO Antitrust Litigation*, 287 F. Supp. 2d 497, 521-24 (S.D.N.Y. 2003).

The Second Circuit vacated and remanded the district court’s dismissal of the complaints. The court held that the refusal by Congress and the SEC to immunize the conduct alleged in the complaints, coupled with the SEC’s decision to prohibit manipulative tying of one security to another with the purpose of inflating prices above competitive levels, precluded a finding of implied immunity for the investment banks’ and underwriters’ alleged conduct. The court stated that implied immunity from antitrust liability was not appropriate in the absence of a showing that Congress had been aware of the underlying conduct and chose either to immunize it from antitrust scrutiny or to grant the SEC the authority to actually compel the conduct and/or expressly permit it at its discretion. The court indicated, however, that the regulatory context might, without guaranteeing immunity, guide the application of antitrust law to the circumstances of a particular case, perhaps resulting in no antitrust liability where it might otherwise exist.

On petition for rehearing en banc, no judges of the Second Circuit voted for a rehearing. In petitioning for

certiorari, the underwriters and institutional investors argued that the Second Circuit’s decision created confusion and a circuit split regarding whether the standard for implied antitrust immunity in the securities context is solely whether the SEC exercises regulatory supervision over an activity (as petitioners described other circuits as holding), including by permitting it, or whether courts should also inquire (as the Second Circuit did) into whether the SEC has actually prohibited or authorized the activity in the past, or has the power to compel it.

CASE ANALYSIS

Petitioners argue that implied immunity is appropriate because the SEC has regulatory authority, which it has actually exercised, over tie-in agreements and similar conduct relating to IPO allocations. They also maintain that permitting respondents’ antitrust claims to go forward threatens to chill activities important to raising capital for business enterprises. Finally, they claim that respondents’ lawsuit seeks treble damages relief that would undermine the remedial scheme for deceptive and manipulative activities in the securities markets established by Congress and the SEC.

First, petitioners point out that the SEC has the statutory authority under the Securities Exchange Act to regulate syndicates led by underwriters, as well as the extent and disclosure of underwriter commissions, price discrimination among the customers of underwriters, transactions fixing or stabilizing stock prices, the allocation of shares among underwriters’ customers based upon the payment of commissions or other criteria, and other aspects of the IPO process. The SEC’s authority is “pervasive” and “plenary,” they assert, and therefore

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cannot exist simultaneously with “duplicative” and “inconsistent” standards derived from antitrust law. Pet. Br. at 19-20, 26 (quoting *Gordon v. New York Stock Exch.*, 422 U.S. 659, 691 (1975); *United States v. National Association of Securities Dealers* (NASD), 422 U.S. 694, 734-35 (1975)). The SEC has exercised its authority to prohibit underwriters from tying IPOs to purchases or sales of other securities, inquiring prior to allocating IPO shares as to their customers’ expected aftermarket orders for the shares, inducing aftermarket bids or purchases of an IPO stock before it is distributed, or otherwise fixing or stabilizing aftermarket prices.

Petitioners argue that the scope of the SEC’s jurisdiction has expanded since the 1960s to include the authority to preserve competitive conditions by establishing rules governing the securities industry and commencing enforcement proceedings in case of violations. They thereby distinguish an important case from the 1960s in which the Supreme Court found no implied immunity by virtue of the Securities Exchange Act against a claim challenging an alleged group boycott of non-member firms by the members of the New York Stock Exchange. *Id.* at 24 (citing *Silver v. New York Stock Exchange*, 373 U.S. 341, 357-58 (1963)). Petitioners also attempt to distinguish a number of cases refusing to find implied immunity, pointing out that these other statutes did not regulate the affected industries as pervasively, instead regulating banking, electricity, and health care planning with a lighter touch. *Id.* at 34-35 (citing *United States v. Philadelphia National Bank*, 374 U.S. 321 (1963); *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973); *National Gerimedical Hosp. & Gerontology Ctr. v. Blue Cross of Kansas City*, 452 U.S. 378 (1981)).

Second, petitioners argue that the securities markets will be damaged if antitrust liability is imposed on them, citing the SEC and the brief amicus curiae of the United States. Petitioners highlight aspects of the securities and civil RICO laws as passed by Congress and interpreted by the Supreme Court that were intended to reduce the likelihood that markets and businesses will be harmed by treble damages or class actions in which fraud cannot be pleaded properly. Allowing persons who invest in speculative markets to seek treble damages for their losses in antitrust actions would undermine this regulatory structure and send capital investments abroad, they argue. Petitioners maintain that ordinary civil juries are not qualified to make the subtle distinctions that “experts” at the SEC might make between preventing flipping and gauging long-term investor interest in an IPO, which are potentially permissible, and parceling out IPO shares based on fixed commitments to buy IPO shares at a given quantity or price in the aftermarket, which are not allowed under the Securities Exchange Act and the SEC’s regulations.

Finally, petitioners object to the findings of the Second Circuit that immunity may be improper where another statute or regulation also prohibits the conduct underlying a Sherman Act claim, and that the Sherman Act is flexible enough to account for legitimate regulatory concerns. On the former issue, they contend that in the securities, telecommunications, labor relations, and aviation contexts, the Supreme Court has held that a prohibition on the underlying conduct does not preclude a finding of implied immunity where there is a potential for conflict between the statutory schemes erected by Congress. On the latter issue, they insist that a

“jury untrained in law or economics” cannot perform an adequate rule of reason analysis, and that in any event the securities laws advance interests such as promoting capital formation that may not be consistent with maximizing competition according to the rule of reason.

Respondents argue that the Second Circuit’s decision to allow their claims to proceed should be affirmed in all respects, or in the alternative that their complaint should be determined to satisfy the pleading standards for antitrust claims affecting the securities industry proposed by respondents and amicus curiae the United States, or that they be granted leave to replead.

Respondents make four principal arguments in support of the Second Circuit’s decision. First, they contend that there is no actual or potential conflict between the antitrust laws and either the Securities Exchange Act or the SEC’s regulatory authority. Second, they maintain that their complaints adequately allege unlawful conduct that is separable from any conduct that is permitted by the SEC. Third, they distinguish the implied immunity cases relied on by petitioners as resting on statutes or agency decisions expressly permitting the conduct alleged to violate the antitrust laws. Lastly, they say that petitioners’ arguments regarding alleged dangers posed to the securities markets by the antitrust laws should be addressed to Congress, rather than the courts, and are in any event factually and legally wrong.

The Billing respondents argue at the outset that the Securities Exchange Act of 1934 and the Securities Act of 1933 both contain “savings” clauses expressly denying antitrust immunity to individuals or institu-

tions that are subject to regulation under the securities laws. The Securities Exchange Act, for example, provides that “the rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity....” Res. Br. at i, 18 quoting 15 U.S.C. § 78bb(a). The Billing respondents suggest that Congress enacted this provision in order to preserve antitrust remedies against “pools” among securities dealers to drive up prices in order to sell stocks at a large profit to the public, which may have caused or contributed to the stock market crash of 1929. They maintain that there is no conflict, and no implied immunity, where both the antitrust laws and another federal statute condemn the conduct at issue. Both the Securities Exchange Act and the SEC have consistently prohibited the tying of IPO allocations to additional consideration, so there is no conflict and no implied immunity according to the Billing respondents. The Pfeiffer respondents describe their Robinson-Patman Act commercial bribery claim as alleging secret payments by institutional investors to fiduciary investment banks, in the form of excessive commissions and trades in “tied” securities, and in exchange for personal benefit to the investors. The Securities Exchange Act bans manipulation of aftermarket prices and communication of false analyst reports, and (the Pfeiffer respondents say) confers no authority upon the SEC to permit payment of excessive commissions to underwriters in exchange for such measures to inflate aftermarket prices.

Second, the Billing respondents argue that their allegations of collusion and conspiracy to inflate and fix aftermarket prices are separable from their allegations of conduct permitted by the securities laws or

the SEC. They concede that an underwriting syndicate organized as a joint venture may have a legitimate interest in jointly agreeing to a fixed IPO price, allocating the risk of inadequate purchasers at the agreed-upon price, assessing and enhancing demand at that price, and organizing the prospective allocation of the IPO shares. They deny, however, that petitioners acted legitimately in jointly announcing tying requirements for IPO purchases, discussing the amount of “laddering” or purchasing at inflated aftermarket prices to be imposed on purchasers, and monitoring customers’ aftermarket trades and other underwriters’ IPO allocation activities.

This argument is directed primarily at the suggestion of the United States as *amicus curiae* that petitioners’ pervasive regulation theory of implied immunity be rejected, but that the petition for certiorari be granted on the rationale that respondents’ allegations of unlawful collusion are inextricably intertwined with activities that are permitted under the securities laws. The United States implies that the respondents’ complaints should be dismissed as relying impermissibly on legitimate conduct, or that the respondents should be compelled to specify their allegations in more detail, or that pretrial discovery or limited or summary judgment should be used to narrow the scope of the trial.

Third, the Billing respondents contend that the regulatory context in petitioners’ implied immunity cases, *Gordon* and *NASD*, was very different than the context of their case. Specifically, the context of *Gordon* was that Congress found that commissions fixed by securities exchanges could be beneficial, while it came to no such conclusion as to price manipulation or the maintenance of “pools” to inflate the price

of stock offerings in the aftermarket. The SEC also expressly approved the fixing of commission rates, which it declined to do for the tying of securities offerings together. Similarly, the context of *NASD* was that Congress intended to restrict the emergence of secondary markets for the “flipping” of mutual fund shares, and the SEC authorized the NASD to enact rules and procedures to restrict these secondary markets. The Pfeiffer respondents emphasize in particular that Congress required the SEC to ban manipulation in securities markets, by commercial bribery or otherwise, and conferred no power to allow it.

Finally, the Billing respondents point out that treble damages under the antitrust laws are necessary and were intended by Congress to deter and compensate victims of unlawful actions. They compensate plaintiffs for their difficulties in detecting and litigating antitrust violations. The importance of antitrust remedies, the Pfeiffer respondents contend, is underlined in this case by industry “capture” of the SEC, and its consequent failure to prevent tying and “laddering” of IPO stock transactions despite investigations in the early 1960s, early 1980s, and late 1990s. The Billing respondents emphasize that a prior antitrust class action recovered over \$1 billion for persons and entities overcharged by market-makers and securities dealers as a result of a conspiracy to widen price “spreads,” triggering a government investigation and a consent decree.

Regarding petitioners’ factual claim that antitrust liability will inhibit capital formation and drive IPO overseas, respondents cite a report commissioned by the London Stock Exchange and the City of London Corporation finding that issuers are

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attracted to the London markets by the lower underwriting and related professional fees prevailing there compared to New York. From this evidence they infer that petitioners' conspiracy to inflate underwriting commissions and IPO prices are damaging the securities markets, and that antitrust enforcement is the answer.

SIGNIFICANCE

A finding by the Supreme Court that petitioners enjoy implied immunity for the alleged tying and manipulation of IPO securities will have sweeping implications for the financial industry, the antitrust laws, and the future of the regulatory state. First, the securities markets will be thrown back into the relatively lax enforcement environment administered by the SEC, potentially reinforcing an existing trend toward consolidation of the financial industry. Second, expanding implied antitrust immunity into any area in which there is arguably "pervasive" regulation by another statutory scheme or administrative agency will dramatically cut back on the reach of the Sherman Act, our nation's fundamental economic law. Third, such a ruling will once again express a strong preference by the Supreme Court for regulation by administrative experts applying complex economic formulas over courts and juries operating on a common-law model to resolve disputes in concrete cases using broad congressional provisions.

Although it is impossible to predict whether exclusive supervision by the SEC over allegations of manipulation of securities markets will reduce or increase the incidence of anti-competitive conduct, the penalties imposed by the SEC on persons or firms engaging in monopolization or collusion are likely to be a shadow of what they would be in an antitrust class action. As a result,

one of the main themes of the briefing in this case is tort reform, giving rise to analogies between this case and prior attempts to preclude courts or juries from adjudicating class actions or imposing punitive damages in large-scale securities fraud, products liability, environmental pollution, or civil rights cases. The investment banks and institutional investors are anxious to have the SEC and NASD arbitrators resolve allegations of systematic tying of securities, manipulation of aftermarket prices, charging of excessive compensation, bribery and collusion, and fraudulent stock reports. They argue that juries untutored in law or economics will make a mess of the industry and dry up capital markets. Class counsel, by contrast, maintain that the banks and investors want simply to retain their unlawful gains by denying aggrieved parties any remedy and capturing the regulatory process. They paint a picture of an American financial industry losing its global preeminence as a result of collusion and the manipulation of prices and commissions and suffering from an oppressive control by the largest banks over the allocation, pricing, and resale of IPO securities.

Reduced antitrust enforcement due to SEC supervision might also accelerate the concentration of the financial industry, as evidence by the rapid decline in the total number of banks in the United States since the 1980s, and mega-mergers in the industry such as that between Morgan Stanley and Dean Witter. If collusion and concentration are factors in inflating securities prices, as respondents allege, than a finding of implied immunity might also contribute to economic instability due to speculative bubbles.

The continued relevance of the antitrust laws in the information age may be called into question if

implied immunity combines with other doctrines to preclude most antitrust liability in a wide variety of industries. As regulatory jurisdiction expands, the extension of implied immunity to any area subject to "pervasive" administrative regulation may leave little remaining threat of antitrust liability. Monopolization and collusion may be channeled primarily into aspects of the business world that are highly regulated, as the deterrence effect of antitrust class actions and treble damages fades away. Should the Supreme Court abandon notice pleading in the antitrust context, as the telecommunications industry and the United States suggest in this term's *Bell Atlantic Corp. v. Twombly*, No. 05-1126, that would encourage lower courts to dismiss many more cases before trial.

Finally, a conclusion that implied immunity exists in this case will send a powerful message to lower courts to steer well clear of the jurisdiction of federal administrative agencies such as the SEC, Federal Communications Commission, Environmental Protection Agency, and Food and Drug Administration. Finding implied immunity to exist not only when a regulatory agency mandates, but also when it simply permits or even prohibits a course of conduct, covers many possibilities. This would reinforce a trend to defer to administrative resolutions of complex problems despite instances in which political pressures or conflicts and gaps in statutory frameworks, lead to agency inaction. As a result of this trend, litigants have faced difficulties in challenging such conduct as discrimination by owners of broadband networks against their competitors, the greenhouse emissions of the manufacturing and energy industries, the nicotine-delivery technologies of the tobacco industry, or tactics to suppress the generic manu-



facturing of pharmaceuticals. One's evaluation of this trend may depend on whether one inclines to the view that administrative agencies enjoy superior institutional competence to handle complex problems and promulgate uniform standards, or one believes that they are simply more subject to industry capture and capricious statutory construction.

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