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## IX. STOCK EXCHANGES AND THE ANTITRUST LAWS

Under the Securities Exchange Act of 1934, the national securities exchanges are given wide leeway in promulgating rules for regulating member firms.<sup>1</sup> However, the SEC reviews, and in some instances revises, exchange rules pursuant to its duty to grant or withhold registration of an exchange and its power to oversee exchange operations generally.<sup>2</sup> When an exchange's rules conflict with the provisions of the antitrust laws,<sup>3</sup> the question arises whether these regulations are immune from antitrust scrutiny. The solution to the problem is complicated by the indirect nature of the SEC's supervision: whether the rules are impliedly exempt from the antitrust laws by the securities acts or whether they are private actions subject to antitrust scrutiny is uncertain.

The Supreme Court in *Silver v. New York Stock Exchange*<sup>4</sup> examined this conflict and attempted to reconcile the policies of the antitrust and securities acts. Silver, a broker-dealer who was not a member of the New York Stock Exchange, alleged that an Exchange decision, made without notice or a hearing, which required member firms to sever their private wire connections with his office was a boycott in violation of the Sherman Act.<sup>5</sup> The Court found that the SEC had only general review powers over the Exchange's rules and did not have jurisdiction to hear complaints about individual applications of a rule.<sup>6</sup> Since "[r]epeal [of the antitrust laws] is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary,"<sup>7</sup> and because

<sup>1</sup> Section 5 of the 1934 Act, 15 U.S.C. § 78e (1970), makes unlawful exchanges of securities involving interstate commerce on an unregistered exchange. Section 6, *Id.* § 78f, provides for registration procedures but grants the exchanges substantial freedom in adopting their own rules by allowing all rules which are consistent with the securities laws. *Id.* § 78f(c).

<sup>2</sup> When an exchange makes application to the SEC for registration, before granting registration, the Commission reviews the exchange's rules to insure that they comply with the securities laws and are "just and adequate to insure fair dealing and to protect investors." § 6(d), 15 U.S.C. § 78f(d) (1970). Further, § 19(b) gives the SEC power to change exchange rules in twelve specific areas if fair dealing and investor protection require. *Id.* § 78s(b).

<sup>3</sup> The relevant federal antitrust provisions include the Sherman Act, 15 U.S.C. §§ 1-7 (1970); the Clayton Act, *Id.* § 15; and the Robinson-Patman Act, *Id.* § 13.

<sup>4</sup> 373 U.S. 341 (1963).

<sup>5</sup> *Id.* at 343-47.

<sup>6</sup> *Id.* at 358-59.

<sup>7</sup> *Id.* at 357.

the SEC could not hear the case, the Court decided the case on its merits.<sup>8</sup> Therefore, where the Commission has no jurisdiction over a dispute the courts may hear the case.

The Seventh Circuit subsequently extended the *Silver* ruling beyond a situation in which the SEC had no review powers to areas over which the Commission had potential, but unexercised, supervision. In *Thill Securities Corp. v. New York Stock Exchange*,<sup>9</sup> the alleged violation was the Exchange's anti-rebate rule which prevented a member firm from sharing a commission on a sale with a nonmember firm, even if the latter had furnished the order.<sup>10</sup> The defendant Exchange argued that since the SEC had review power over exchange rules fixing commission rates, the SEC should have exclusive jurisdiction of the case.<sup>11</sup> The circuit court found, however, that the proper interpretation of *Silver* required a test of whether judicial review of the anti-rebate rule under the antitrust laws would "frustrate the purposes of the Securities Exchange Act or make it substantially ineffective."<sup>12</sup> Finding no evidence of actual SEC review,<sup>13</sup> and no indication that judicial review would interfere with the policies of the 1934 Act, the court reversed the district court's grant of summary judgment to the Exchange.<sup>14</sup> Thus, following *Silver* and *Thill Securities*, the emerging rule seemed to be that where the SEC could not review the application of an exchange rule, or even where it had potential but unexercised review power, the courts would hear the case and would attempt to harmonize the operation of the securities acts with the goals of the antitrust laws.

Following *Thill Securities*, the next logical step in extending the jurisdiction of the courts in antitrust cases would allow the courts to

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<sup>8</sup> *Id.* at 358-61. The Court held the Exchange liable for not giving the plaintiff notice of the decision to sever the wires and an opportunity to be heard. Notice and hearing requirements, the majority determined, would further rather than defeat the goals of the 1934 Act. 373 U.S. at 361-67.

In some instances, however, summary procedures by the exchanges may be justified. The plaintiff in *J. R. Williston & Beane, Inc. v. Haack*, CCH FED. SEC. L. REP. ¶ 94,921 (S.D.N.Y. Dec. 23, 1974), a member of the New York Stock Exchange, complained of his summary suspension after inspectors found that he did not meet the Exchange's net capital requirements. The court found that in the crisis atmosphere at the time of the "Salad Oil Scandal," justified this summary action.

<sup>9</sup> 433 F.2d 264 (7th Cir. 1970), *cert. denied*, 401 U.S. 994 (1971).

<sup>10</sup> *Id.* at 266-67.

<sup>11</sup> *Id.* at 267. Section 19b(9) gives the Commission revision power over "the fixing of reasonable rates of commission." 15 U.S.C. § 78s(b)(9) (1970).

<sup>12</sup> 433 F.2d at 269-70.

<sup>13</sup> *Id.* at 270-71.

<sup>14</sup> *Id.* at 275.

hear cases involving exchange rules over which the SEC had exercised actual supervision. The Second Circuit in *Gordon v. New York Stock Exchange, Inc.*,<sup>15</sup> however, recently declined to allow such an extension. The *Gordon* plaintiff, representing a class of securities purchasers, alleged that the minimum commission system violated the anti-trust laws.<sup>16</sup> The court found not only that § 19(b)<sup>17</sup> of the 1934 Act granted the SEC revision powers over commission schedules, but also that the SEC was actually supervising and reforming the commission system.<sup>18</sup> Holding that these facts sufficiently distinguished *Silver*, the Second Circuit upheld the district court's grant of summary judgment in favor of the defendant.<sup>19</sup> In reaching this conclusion, the court examined the language, the legislative history, and the policy behind the Securities Exchange Act.

Section 19(b) of the 1934 Act, the circuit court found, created a "core of exchange self-regulation necessary to make the 1934 Act work."<sup>20</sup> The court reasoned that since this section gives the SEC revision powers over exchange rules "fixing reasonable rates of commission," the commission rate question should be excluded from antitrust review under the *Silver* test.<sup>21</sup> As support for this conclusion, the decision examined the legislative history of the Act which indicated that Congress consciously granted rate fixing power to the exchanges acting under SEC supervision. The court added that such a grant of power "made clear [Congress'] judgment of the Commission's competence to assume the central role in assuring investor protection and exchange fair dealing."<sup>22</sup> Moreover, the court noted that the SEC was currently scrutinizing the entire commission rate

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<sup>15</sup> 498 F.2d 1303 (2d Cir.), *cert. granted*, \_\_\_ U.S. \_\_\_, 95 S. Ct. 491 (1974).

<sup>16</sup> More specifically, the plaintiff alleged that the discount allowed for large volume trading, allowance of negotiated rates only for orders in excess of \$500,000, and a surcharge on transactions involving less than 1,000 shares were all part of a system of price discrimination which violated the Robinson-Patman and Sherman Acts. 498 F.2d at 1304.

<sup>17</sup> 15 U.S.C. § 78s(b)(9) (1970).

<sup>18</sup> 498 F.2d at 1308-09.

<sup>19</sup> *Id.* at 1311.

<sup>20</sup> *Id.* at 1306. The reference by the court was to the *Silver* opinion in which the Court left open the question of whether an antitrust court could hear cases involving exchange rules which the SEC actively reviews. "Were there Commission jurisdiction . . . for scrutiny of a particular exchange ruling . . . a different case would arise concerning exemption from the operation of laws designed to prevent anticompetitive activity, an issue we do not decide today." *Silver v. New York Stock Exch.*, 373 U.S. 341, 358 n.12 (1963) (citations omitted).

<sup>21</sup> See text accompanying note 7 *supra*.

<sup>22</sup> 498 F.2d at 1307.

system and was slowly introducing negotiated rates in the place of fixed rates.<sup>23</sup> Consequently, judicial interference with the SEC's program could frustrate the 1934 Act's goal of maintaining solvent and fair securities firms by increasing the economic problems caused by the introduction of a negotiated rate system. Thus, the Second Circuit concluded that judicial activity should be restricted to review of the SEC's decisions pursuant to the provisions of the Administrative Procedure Act.<sup>24</sup>

A district court in the Seventh Circuit, however, refused to follow the *Gordon* court and instead exercised jurisdiction in the commission rate case of *Fredrickson v. Merrill Lynch, Pierce, Fenner & Smith*.<sup>25</sup> The district judge, following the maxim of construction that repeal by implication is strongly disfavored, found that the courts had secondary jurisdiction over commission rate cases which was concurrent with the primary jurisdiction of the SEC.<sup>26</sup> Deciding that it would be useless to remand the case to the SEC because the Commission's actual review<sup>27</sup> of rates demonstrated its approval of the challenged rate structure, the court retained jurisdiction in the case.<sup>28</sup>

Although the question of whether fixed commission rates violate the antitrust laws has been essentially mooted by the SEC's adoption

<sup>23</sup> *Id.* at 1308-09. The introduction of negotiated rates was by necessity a slow and guarded process due to the potentially disruptive effects a negotiated rate system might have on marginal brokerage firms.

<sup>24</sup> *Id.* at 1311.

*Jacobi v. Bache & Co.*, 377 F. Supp. 86 (S.D.N.Y. 1974), *app. pdg.*, 2d Cir., CCH FED. SEC. L. REP. ¶ 73,031 presented the question of whether exchange rules governing the basis for determining registered representatives' commissions were subject to antitrust scrutiny. Finding that the SEC had broad review powers over the commission rate system, the court held that rules governing the registered representatives' commissions were not within the SEC's review jurisdiction. Thus the court heard and determined the case.

Similarly, the district court in *Abbot Sec. Corp. v. New York Stock Exch.*, 384 F. Supp. 668 (D.D.C. 1974), found that there was sufficient discretion left within the SEC's guidelines for the exchanges to act in a manner contrary to the antitrust laws. *Id.* at 670. For this reason, the court retained jurisdiction of the case.

<sup>25</sup> CCH FED. SEC. L. REP. ¶ 94,792 (N.D. Ill. Sept. 9, 1974).

<sup>26</sup> *Id.* at 96,630-31. "The precise function of the doctrine of primary jurisdiction is to guide a court in determining whether the court should refrain from exercising its jurisdiction until after an administrative agency has determined some question . . ." 3 K. DAVIS, ADMINISTRATIVE LAW TREATISE, § 19.01, at 3 (1958). See *Ricci v. Chicago Mercantile Exch.*, 409 U.S. 289, 307 (1973); 1 F. VON BAUR, FEDERAL ADMINISTRATIVE LAW §§ 213-225 (1942).

<sup>27</sup> Both the *Gordon* and the *Fredrickson* courts relied on the SEC's active review of commission rates but reached different results under different theories.

<sup>28</sup> CCH FED. SEC. L. REP. ¶ 94,792, at 96,631.