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ANTITRUST AND THE SECURITIES INDUSTRY

RICHARD W. MCLAREN

This article was adapted from a speech delivered by Assistant Attorney General McLaren before the Investment Bankers Association of America on October 29, 1969 in New York City. Mr. McLaren's remarks are particularly relevant to the specialized coverage of this issue as he highlights a number of significant contemporary legal problems in the areas of securities law and trade regulation.

Over the years, the securities industry has been fairly unaware of antitrust, or else has regarded it with a high degree of disinterest. Of late—like the pretty girl on her first trip to Italy—the industry has developed not only an awareness, but a painful alertness to the "pinch" of antitrust.

Or, to thoroughly mix metaphors, antitrust may well be regarded as a brash interloper. After all, there is a vast age difference between the securities industry and the onset of antitrust laws; investment banking is nearly as old as commerce itself, and the securities industry has been with us since the Nation was founded; antitrust is of relatively recent vintage, and, like any newcomer, is sometimes viewed with suspicion and apprehension.

In spite of this distrust, it should be recognized that the relationship can be profitable for both the securities industry and those that are authorized to enforce the antitrust laws. Both share a common goal—to make the securities markets in this country as efficient as they can be. This is a matter of great importance, not only to the securities industry, but also to the country as a whole. It is also a difficult matter, as it is always difficult to adapt institutions from the tranquility of a quieter past to the needs of a demanding future. In this regard, the securities industry must realize that the antitrust laws have an important contribution to make here.

I. THE *Silver* CASE

The Antitrust Division's interest in the securities industry began with the Supreme Court's 1963 decision in the now-famed case of *Silver v. New York Stock Exch.*[1] Mr. Silver, a broker who was not a member of the New York Stock Exchange, had a private business wire connecting his office with those of several New York Stock Exchange member firms. A committee of the Exchange, composed of other mem-

[1] 373 U.S. 341 (1963). For discussions of the applicability of *Silver* to recent antitrust cases, see Comment, The Liability of Private Accrediting Associations Under the Sherman Act, the Constitution, and the Common Law, 11 B.C. Ind. & Com. L. Rev. 285, 297-98 (1970) and 11 B.C. Ind. & Com. L. Rev. 332, 333-34 (1970).

ber firms, collectively decided that Silver's private wires should be discontinued. Without granting Silver a hearing, they directed the member firms to terminate Silver's connection. Silver claimed that this was a boycott in violation of the antitrust laws, and the Supreme Court agreed.

The rule of that case became applicable to antitrust efforts in the securities field: Anticompetitive activities of stock exchange members are subject to the antitrust laws unless the activities are necessary to achieve a legitimate goal of the Securities Exchange Act.[2]

II. Fixed Broker Commission Rates

One of the most difficult problems concerns the application of the *Silver* principle to particular practices in the securities industry—most notably, the fixed commission rate system.[3] The question is whether rate fixing and related practices are necessary to achieve a legitimate goal of the Exchange Act. If they are necessary, then they are legal; if they are not necessary, then they are subject to the Sherman Act, just like any other agreement in restraint of trade. The question of "necessity" is a matter of evidence, not emotion.

The customer-directed "give-up" of brokerage commissions, whereby one broker gave up some of his fixed commission to another, had demonstrated that brokerage commissions were fixed at far too high a level, at least for the large institutional investor. Some brokerage firms had been able to give away 70 percent of their commissions and still make a large profit.

The complex "give-up" mechanisms which were needed in order to comply with the non-rebate rules of the various stock exchanges ranged from the bizarre to outright chicanery. "Give-ups" totalling millions of dollars were ending up in mysterious Swiss bank accounts,[4] and even in the hands of a clever woman in the Bahamas, who was characterized as a "simple housewife." The SEC decided that it was time to investigate the commission "give-up" practices and issued a notice of inquiry asking for comments from interested parties.

Since it appeared to the Antitrust Division that most of the evils of the "give-up" could be eliminated if competitive principles were applied to the fixed rate structure, it filed a memorandum with the SEC suggesting that the Commission hold hearings to determine

[2] 373 U.S. at 364.

[3] See, e.g., Thill Securities Corp. v. New York Stock Exch., 5 Trade Reg. Rep. ¶ 72,911, at 86, 468 (E.D. Wis. Aug. 26, 1969), noted in 11 B.C. Ind. & Com. L. Rev. 332 (1970).

[4] For discussion of the use of secret Swiss bank accounts by United States citizens to evade United States securities laws, see Comment, Secret Swiss Bank Accounts as a Mechanism for Violating United States Securities Laws: An Analysis of Proposed Solutions, 11 B.C. Ind. & Com. L. Rev. 194 (1970).

whether price fixing was necessary to make the Exchange Act work. The SEC then ordered hearings, which are still in progress.

At the close of the first phase of those hearings, the stock exchanges agreed to outlaw the "give-up" and reduce the fixed rates on large transactions. That rate reduction is estimated to have saved the investing public $150 million annually. Nevertheless, the Antitrust Division has argued to the SEC that more competition in brokerage rates would not only be in the public interest but would result in even greater earnings and redound to the ultimate benefit of the industry.

The chief benefit from competitive commission rates would be rates—at the wholesale as well as retail level—which more nearly approximate the cost of providing the service. This would eliminate the pressure for the customer-directed "give-up," as well as reciprocity arrangements, both of which can only work when commission rates are fixed at a higher level than the free market would set them. This would also be a start toward getting down to the fighting trim which the industry is going to need if it is to survive the onslaught of the computer market—which soon may succeed the so called "third market" in drawing off the volume business which can and will be handled at a lower, cost-justified rate than is now available.

Another benefit from competitive rates would be the separation of charges for the various services provided by the brokerage firm. Under the present fixed-fee system, the customer may pay for research and promotional services whether he wants them or not. In a competitive market, the customer would have the choice of paying for ancillary services only when he needs them.

A third benefit would be to improve the overall performance of the central securities market as a whole, not simply the New York Stock Exchange. In other words, competitive rates on the Exchange will reduce the incentives to non-members, including large institutions, to trade off the Exchange whenever possible. Such rates will also eliminate the need to discourage members from trading off the floor in order to protect an artificial rate structure.

These membership and access questions were discussed at some length in the Antitrust Division's brief filed with the SEC this past January. Suffice it to say that, standing alone, they raise some serious antitrust questions; and, under *Silver*, they would not be allowed to stand unless they could be shown to be necessary to make the Securities Exchange Act work.

It should be explained that there is a general antitrust rule that, when a private group controls access to a market, it must grant access to that market on an equitable and nondiscriminatory basis to all those in the trade. This rule has been specifically applied by the courts to tobacco and other produce markets as well as to such other diverse

enterprises as the Associated Press[5] and the St. Louis Terminal Railway.[6] Leaving any possible question of necessity to be determined by the SEC, the rule of these cases seems to have equal application to the New York Stock Exchange.

Physical limitations such as, for example, floor space, may require limitations on membership, but such factors would not seem to justify a highly preferential rate to an individual or firm just because he or it happens to be a "member." Competitive rates would solve this problem because "members" and "non-members" alike would secure brokerage and clearing at rates close to the approximate cost of the services involved.

III. Stock Exchange Membership

The question of membership limitations has also been brought to the fore by another recent development—the NYSE proposal to permit wider public ownership of broker-dealer member corporations. While the Antitrust Division welcomes this proposal because it potentially opens up stock exchange membership to a larger class of participants and paves the way for the infusion of needed capital into the Exchange community, it is somewhat disturbed by the conditions which are obviously designed to prevent institutional investors from gaining membership on the Exchange.

The pressure for institutional membership would largely disappear if, as advocated, commission rates for institutional investors were determined by the forces of competition. Conversely, it seems inevitable that so long as fixed rates, as well as rules designed to exclude institutions, continue in effect, giving the appearance of benefitting the existing membership at the expense of mutual fund investors, pressure on the rates, the rules and indeed on the whole structure of the NYSE must be expected to continue. In all candor, a "private club" approach to exchange membership appears to be short-sighted as well as contrary both to the purposes of the Securities Exchange Act of 1934 and the principles of the antitrust laws.

But whether the Antitrust Division is right on these issues or not, it is only the advocate; matters are now in the hands of the SEC which is the court and, at least in the first instance, must determine these issues. The Antitrust Division is anxious that the Commission resolve these questions, particularly the fixed rate issue, as rapidly as possible. For one thing, it would indeed be unfortunate if member corporations were to sell their stock to the public before the Commission decided whether the way they conduct their business may be continued.

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[5] See, e.g., Associated Press v. United States, 326 U.S. 1 (1945).

[6] See, e.g., United States v. Terminal R. R. Ass'n, 224 U.S. 383 (1912).

It should be emphasized that SEC approval of fixed rates has its drawbacks as well as its advantages. If fixed rates are upheld, the industry must accept the burden of regulation along with its presumed advantages.

The view of the Antitrust Division is that antitrust serves as a preferable alternative to ever-increasing government regulation. The American public long ago determined that if the free market did not function well as an economic regulator, government must do the regulating. The function of the Antitrust Division is to keep the free market mechanism operating so that government regulation will be held to an absolute minimum. The drama now being played out before the SEC presents the rather curious spectacle of a government agency—in this case, the Department of Justice—arguing for free market competition, and private business—in this case the stock exchanges—battling in effect for government price regulation. As a firm believer in competition, it is submitted that if the exchanges win the battle, they may lose the war.

IV. Conglomerate Mergers

The Antitrust Division's perspective on the new multi-industry corporations stresses three considerations. First, it is not opposed to conglomerate firms as such, new or old; it recognizes there is much to be said for them. It is not even opposed to conglomerate acquisitions. In fact, it would welcome foothold acquisitions by the conglomerates in concentrated industries, since this would aid competition. Section 7 of the Clayton Act[7] outlaws mergers which threaten competition. And there is no question whatsoever that section 7 is intended to apply with as much force to conglomerate mergers as to traditional horizontal and vertical mergers, where the effect is anticompetitive. Congress made that abundantly clear when it enacted the Celler-Kefauver Amendment to Section 7[8] in 1950.

Second, the enforcement efforts of the Antitrust Division represent no radical departure from established law; such factors as the elimination of potential competition, the creation of the power to engage in reciprocity, the entrenchment of a leading firm in a concentrated market, the triggering of additional mergers, have been specifically recognized by the Supreme Court as grounds for enjoining conglomerate mergers under Section 7 of the Clayton Act, and these factors are set forth in the Merger Guidelines issued by the Johnson Administration. Thus, it is fair to say that the efforts of the Division have been very careful. Indeed, it has filed but five conglomerate merger cases—all of which are solidly grounded in these established precedents.

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7 15 U.S.C. § 18 (1964).

8 Clayton Act § 7, 15 U.S.C. § 18 (1964), formerly ch. 25, § 7, 38 Stat. 631 (1914).

Finally, the Division believes that the pace and scale of the merger trend as it existed in the Spring of 1969—with more and more giant firms merging with one another, or acquiring leading firms in smaller industries—could have been ignored only at the risk of serious and perhaps irreversible damage to the competitive economy. Such a trend is precisely the kind of danger that Congress clearly legislated against in amending section 7 in 1950. It is the Division's assigned task to insure that such danger is averted by the bringing of lawsuits to enjoin or undo anticompetitive mergers. A side effect of such activity, in enforcement theory at least, is to develop a deterrent. To the extent that the Division is not able to deal with anticompetitive mergers on this case by case basis, remedial, and much more rigidly repressive, anti-merger legislation should be expected.

It is too early to assess the Division's program. It clearly has not put an end to merger activity; it has not prevented outsiders from breaking into new markets, nor has it prevented those who wished to do so from selling out. Indeed, mergers are currently continuing at a record rate. It does appear, however, that fewer mergers involve combinations of giant firms, or acquisitions of leading firms in one market by very large firms in other markets—the types of mergers which the Supreme Court has ruled anticompetitive, and against which the Division has moved in its five cases. Whatever the cause, the trend seems to be a constructive one.

One final observation: there have been some charges that the Division is trying to frustrate the growth aspirations of the newer conglomerate companies, and to protect "The Establishment." This is simply not true. The Division is entirely uninterested in who may end up in control of a combination of companies; its interest is strictly in preventing their union if it is an anticompetitive one.

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