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Trade Regulation—Antitrust Challenge to Stock Exchange's Prohibition Against Commission Sharing—Thill Securities Corp. v. New York Stock Exch.

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CASE NOTE

Trade Regulation—Antitrust Challenge to Stock Exchange's Prohibition Against Commission Sharing—*Thill Securities Corp. v. New York Stock Exch.*[1]—The New York Stock Exchange is an unincorporated association consisting of individuals and allied firms whose members transact the vast majority of the brokerage business in stocks in the United States.[2] Article XV, Section 1 of the Exchange Constitution provides that commissions paid to any member shall be "net and free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement, direct or indirect."[3] Thill Securities Corporation, a broker-dealer in securities and a nonmember of the Exchange, instituted a class action on behalf of the firm and all others similarly situated, charging that in promulgating and enforcing the anti-rebate provisions of Article XV the members of the Exchange have engaged in a combination and conspiracy in restraint of trade, and have monopolized the securities industry.[4] Thill sought a declaratory judgment that the Exchange regulations violate Sections 1 and 2 of the Sherman Act and Section 4 of the Clayton Act, an injunction prohibiting their further enforcement, and $21 million in treble damages for lost profits, plus counsel fees and expenses.

In support of its motion for summary judgment, the Exchange urged that Section 19(b) of the Securities Exchange Act of 1934[5] im-

[1] 5 Trade Reg. Rep. ¶ 72,911, at 86,468 (E.D. Wis. Aug. 26, 1969).

[2] SEC, *Report of the Special Study of the Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2, 45 (1963). At the close of 1962 there were 1366 members of the Exchange, of which 1101 were affiliated with 672 member firms, 259 were individual members and 6 were inactive. To be considered a "member firm" at least one member of the Exchange must be a general partner or a director holding voting stock. Id.

[3] Id. at 302.

[4] 5 Trade Reg. Rep. ¶ 72,911, at 87,468. The suit was brought under §§ 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2 (1964) and § 4 of the Clayton Act, 15 U.S.C. § 15 (1964).

Section 1 of the Sherman Act provides, in part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States . . . is declared to be illegal . . . .

Section 2 of the Sherman Act provides in part:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor . . . .

Section 4 of the Clayton Act provides in part:

> Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore . . . and shall recover threefold the damages by him sustained, and the cost of suit including a reasonable attorney's fee.

[5] Section 19(b) reads in part:

> The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary

poses a duty of self-regulation on the Exchange, subject to review by the SEC. The Exchange also argued that this section impliedly authorizes the Exchange to fix reasonable rates of commission, and that the power to prohibit sharing of commissions between members and non-members is an "integral and necessary" part of such authority. Therefore, it was maintained that section 19(b) immunizes this practice from challenge under the antitrust laws.[6]

On the Exchange's motion for summary judgment, HELD: The Exchange prohibition against sharing commissions is merely one method of regulating commissions, and is thus a valid exercise of its self-regulating authority as conferred by Section 19(b) of the Securities Exchange Act of 1934. In addition, the SEC is currently reviewing the entire structure of commission rates, and such supervision constitutes adequate review and control of the complained of activities. For these reasons the prohibition against sharing commissions is immune from attack under the antitrust laws.

The potential conflict between the antitrust laws and congressional mandates to administrative agencies has already occasioned many difficulties; barring congressional intervention these are likely to continue.[7] Two previous cases, *Silver v. New York Stock Exch.*[8] and *Kaplan v. Lehman Bros.*,[9] presented direct challenges to New York Stock Exchange practices and required interpretation of the relationship between the antitrust laws and the powers of the SEC. In *Thill* the court was again confronted with a challenge to Exchange practices, and was again required to examine this relationship. Although the court relied heavily on the language of *Silver* and *Kaplan*, it is submitted that it in fact failed to follow the holding of *Silver*, and erred in applying the holding of *Kaplan* to the facts presented.

In *Silver* a non-member broker-dealer alleged that his business was damaged when, without notice to him, the Exchange directed the removal of private wire and ticker services connecting his office to

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> or appropriate for the protection of investors or to insure fair dealing in securities . . . by rules or regulations or by order to alter or supplement the rules of such exchange . . . in respect of such matters as . . . (9) the fixing of reasonable rates of commission, interest, listing, and other charges . . . .

15 U.S.C. § 78s(b) (1964).

[6] 5 Trade Reg. Rep. ¶ 72,911, at 87,469.

[7] For a thorough discussion of this problem see Hale & Hale, Competition or Control I: The Chaos in the Cases, 106 U. Pa. L. Rev. 641 (1958); Hale & Hale, Competition or Control II: Radio and Television Broadcasting, 107 U. Pa. L. Rev. 585 (1959); Hale & Hale, Competition or Control III: Motor Carriers, 108 U. Pa. L. Rev. 775 (1960); Hale & Hale, Competition or Control IV: Air Carriers, 109 U. Pa. L. Rev. 311 (1961); Hale & Hale, Competition or Control V: Production and Distribution of Electrical Energy, 110 U. Pa. L. Rev. 57 (1961); Hale & Hale, Competition or Control VI: Application of Antitrust Laws to Regulated Industries, 111 U. Pa. L. Rev. 46 (1962), Nerenberg, Applicability of the Antitrust Laws to the Securities Field, 16 Case W. Res. L. Rev. 131 (1964).

[8] 373 U.S. 341 (1963).

[9] 250 F. Supp. 562 (N.D. Ill. 1966), aff'd, 371 F.2d 409 (7th Cir. 1967), cert. denied, 389 U.S. 954 (1967).

those of several member firms. The plaintiff contended that both services are necessary adjuncts to the successful operation of a brokerage firm, and that the Exchange's action constituted a concerted refusal to deal and was thus a per se violation of the antitrust laws. The Supreme Court agreed that, absent authorization by federal legislation, the activities complained of would constitute a per se violation of the antitrust laws. In response to the defendants' argument that such authorization is given in the Securities Exchange Act of 1934, the Court stated that since "[t]he Securities Exchange Act contains no express exemption from the antitrust laws," any repeal must be by implication.[10] Noting that repeals by implication are not favored, the Court held that repeal 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."[11]

Applying this test to Silver's allegations, the Court noted that Silver was not directly assailing an Exchange rule, but rather the manner in which a particular rule had been enforced. While section 19(b) gives the SEC power to review and make changes in Exchange rules, it does not provide for SEC supervision of their enforcement. Thus, on this issue the Court found no express conflict between the two Acts. However, the existence of the SEC's reviewing powers, together with the provisions of section 6(b),[12] which require that Exchanges have rules for disciplining members, and section 6(d),[13] which permits registration of only those Exchanges which have such rules, viewed in light of the historical development of federal regulation of exchanges, indicate that Congress intended that exchanges provide mechanisms for self-regulation.[14] However, the Court found that where such self-regulation involves practices which violate the antitrust laws, the practices can be justified only if they can be shown to be "necessary to protect the achievement of the aims of the Securities Exchange Act." On the facts presented, the Court found that no possible justification could be advanced for failing to provide for notice and a fair hearing prior to the removal of the wire services, and that therefore the practices complained of were not immune from challenge under the antitrust laws.[15]

The Court's holding in *Silver* formed the basis for the decision in *Kaplan v. Lehman Bros.*,[16] in which mutual fund shareholders brought suit against the New York Stock Exchange, four member firms and several nominal mutual fund defendants, charging that by setting minimum commission rates the members of the Exchange had engaged in a conspiracy in violation of Section 1 of the Sherman Act. The district court recognized that, as in *Silver*, absent sanctions in the

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[10] 373 U.S. 341, 357 (1963).
[11] Id.
[12] 15 U.S.C. § 78f(b) (1964).
[13] 15 U.S.C. § 78f(d) (1964).
[14] 373 U.S. at 351-53.
[15] Id. at 361.
[16] 250 F. Supp. 562 (N.D. Ill. 1966).

Securities Exchange Act, the defendants' activities would constitute a per se violation of the Sherman Act. In this case, however, the activity complained of was not the manner in which a particular rule had been enforced, but the promulgation of the rule itself. Since section 19(b) gives the SEC power to review exchange rules regarding "the fixing of reasonable rates of commission," the district court reasoned that Congress intended that securities exchanges should have the power to make such rules. Furthermore, since the SEC is empowered to review such rules "there is no need to resort to the antitrust laws for a remedy."[17]

It has been suggested, however, that the decision in *Kaplan* was not compelled by section 19(b). The Department of Justice has remained adamant in its opposition to the Exchange's practice of setting minimum rates, and has stated that "[t]he ruling in *Kaplan,* especially in the absence of any plenary review by the Supreme Court, did not foreclose the need for resolution of the application of *Silver* in this context, in order to determine the scope of antitrust jurisdiction."[18] It is in fact arguable that Congress, in passing section 19(b), never contemplated the development of a set of fixed minimum commission rates. In view of the implications for both consumers and the economy in general, and the fact that from an antitrust standpoint an agreement to set minimum prices is considered inherently unreasonable, legislative clarification is needed.

In *Kaplan* the district court also found that the issue of the "reasonableness" of commission rates should not be left to the courts, who might disagree in their interpretations. The court observed that "[t]o leave the determination of reasonableness to the prospective decisions of the agency [SEC] which is especially qualified and responsible for the general supervision of the industry will assure the intention of Congress as well as the interests of the public."[19] Apparently this faith in the efficacy of the SEC was not shared by Chief Justice Warren, who dissented from the Supreme Court's denial of certiorari in *Kaplan* on the basis of the plaintiffs' allegations that the SEC's reviewing powers were purely discretionary, that previous SEC investigations into rate increases were based solely on the limited statistics provided by the Exchange, and that neither the SEC nor the Exchange had formulated any standards in this area.[20]

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[17] Id. at 566.

[18] Comments of the United States Department of Justice on SEC Securities Exchange Act Release No. 8239 (Jan. 26, 1968), reprinted in CCH, Selected Comments on SEC Proposed Rule on Give-Ups and NYSE Proposal on Commission Rates, 18 n. 3 (1968) [hereinafter cited as Selected Comments].

[19] 250 F. Supp. at 566.

[20] 389 U.S. 954, 956-57 (1967). Chief Justice Warren observed:

> The court below, in a two-page opinion, held that a repeal of the antitrust laws was required to make the Securities Exchange Act work, and that "the self-regulatory function of the exchange has been exercised by virtue of § 19(b). . . ." In my view, this blunderbuss approach falls far short of the close analysis and delicate weighing process mandated by this Court's opinion in *Silver*.

In *Silver,* as noted above, the Court was concerned with the manner in which a particular Exchange rule was applied. In *Kaplan,* on the other hand, the plaintiff attacked the validity of an Exchange rule itself. *Thill,* which resembles *Kaplan* in that the plaintiff was making a broad attack on the promulgation of an Exchange rule, differs from *Kaplan* in that nowhere in the Securities Exchange Act of 1934 is the SEC expressly given jurisdiction to review the allocation of commissions between Exchange members and non-members. In addition, it may be argued that section 19(b) does not impliedly authorize the Exchange to promulgate such rules. However, the *Thill* court, citing a phrase in the circuit court's opinion in *Kaplan,* asserted that the prohibition against sharing commissions was " 'one method of regulating commission rates,' and therefore, like the Exchange practice of establishing minimum commissions, is immune from the antitrust laws."[21] It is unfortunate that the *Kaplan* court phrased its conclusion in such broad terms. Section 19(b) does not authorize exchanges to "regulate" all aspects of commission rates; at most, it authorizes the fixing of the level of commissions charged. There is no suggestion that in enacting section 19(b) Congress intended Exchanges to regulate the allocation of commissions once they are determined to be "reasonable."

It is submitted, therefore, that there is no required repeal, express or implied, of the antitrust laws as applied to the prohibition on commission sharing. Under the holding in *Silver,* therefore, the Exchange may continue to enforce the prohibition only if it can prove that it is necessary in order to make the Securities Exchange Act work. The Exchange did argue that the prohibition is an "integral" part of the authority to fix commission rates, and the court apparently accepted this view, but neither the court nor the Exchange has thus far articulated any rationale supporting this position. Indeed, it is arguable that no such rationale exists.

The predominant purpose of the Securities Exchange Act of 1934 is found in the Act itself. In section 2 Congress indicated that it found the securities markets "affected with a national public interest which makes it necessary to provide for regulation and control . . . to insure the maintenance of fair and honest markets . . . ."[22] In section 6(d) the SEC is given authority to register exchanges when it finds "that the rules of the exchange are just and adequate to insure fair dealing and to protect investors . . . ."[23] In addition, section 19(b) indicates that the SEC may intervene when action is necessary "for the protection of investors or to insure fair dealing in securities . . . ."[24] Nowhere in the Act is there any indication that Congress contemplated a restriction of competition between members and non-members; this would appear to be in direct conflict with the aims of the Act.

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[21] 5 Trade Reg. Rep. ¶ 72,911, at 87,470, quoting *Kaplan,* 371 F.2d at 411.
[22] 15 U.S.C. § 78b (1964).
[23] 15 U.S.C. § 78f(d) (1964).
[24] 15 U.S.C. § 78s(b) (1964).

In 1961 Congress directed the SEC "to make a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations . . . ."[25] The resulting 1963 *Report of the Special Study of the Securities Markets*[26] determined that, rather than effectuating the purposes of the Exchange Act, the prohibition on fee sharing has caused great difficulty for some brokers, and much confusion in the industry. The *Special Study* indicated that a non-member broker must charge his customers the same commission he must pay to the member who places the order on the New York Stock Exchange; thus, the non-member not only fails to make a profit on the transaction, but must absorb the costs and overhead on other transactions.[27] Therefore, it is obvious that the rates set by the Exchange determine commission rates for the entire industry, to the detriment of the individual investors sought to be protected by Congress. In addition, member firms, anxious to retain the business and good will of non-member firms but prohibited from sharing fees, develop complicated methods of reciprocating:

> [The member firm] may place business on a regional exchange with a nonmember who is a member of that exchange even though (a) the member is also a member of the regional exchange (dual member) and could have placed the business there directly or (b) the security is traded on the NYSE as well as the regional exchange (dual listing) so that the dual member could have effected the transaction directly on the NYSE. [The member firm] may place orders for unlisted securities with the nonmember to be transacted over the counter, even though the member firm may have a trading department capable of effecting the transaction directly. This reciprocal commission business is generally placed under arrangements involving "reciprocal ratios" of 2 to 1, 3 to 1 or similar ratios; that is, the NYSE member will direct $1 in commissions to the nonmember for each $1.50, $2, or $3 of commissions received. The ratio always favors the NYSE member.[28]

The findings of the *Special Study* indicate that three undesirable results flow from the Exchange prohibitions on commission sharing. First, the complexity of the "reciprocal" practices cannot help but create administrative and pricing difficulties, both of which tend to work to the disadvantage of the investor. Secondly, smaller firms cannot always utilize the services provided by member firms to non-member firms in lieu of commissions. Thus, even among non-member firms,

[25] 15 U.S.C. § 78s(d) (1964).

[26] SEC, Report of the Special Study of the Securities Markets, H. R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2, 45 (1963).

[27] Id. at 301 (footnotes omitted).

[28] Id. at 302 (footnotes omitted). Members may also accomplish the same objectives by furnishing non-members with office space, special research, displays, and other services. Id. at 308.

the larger are more likely to survive in the competition. The demise of the small firm might eventually deny the small investor a market in which to transact his business. Finally, the desire to place reciprocal orders may prevent member firms from transacting their business "in the best available market."[29] This last problem is perhaps the most serious and is exactly what the Securities Exchange Act is designed to prevent.

The arguments against the anti-rebate rule, combined with pressure from government and other sources, seem to have impressed the New York Stock Exchange itself. In a letter dated January 2, 1968, the president of the Exchange stated that the board of governors had adopted several proposals regarding the structure of commission rates, including a "discount in the minimum commission schedule" for certain qualified non-member dealers.[30] Should this proposal be put into effect, the Exchange's constitutional provisions prohibiting rebates would probably be amended. It is thus evident that, contrary to the Exchange's contention in *Thill,* the prohibition on commission sharing is neither an "integral and necessary" element of the fixing of reasonable rates of commission, nor an exercise of Exchange self-regulation necessary to make the Exchange Act work. Thus, under the holding in *Silver,* the promulgation of such rules is not immune to antitrust attack.

The *Thill* court noted that the SEC is currently conducting hearings on all aspects of the commission rate structure,[31] and stated that "such supervision constitutes more than adequate review and control of the Exchange's practices."[32] While the review being undertaken by the SEC might have formed the basis for a denial of equitable relief, it is irrelevant in an action for damages based on past conduct. In addition, whatever its powers to effect changes in Exchange rules, the SEC has no power to award damages. Assuming that the plaintiff's allegations are true, the SEC's review can hardly be called an "adequate" remedy.[33]

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[29] Id. at 309-10.

[30] Letter from Robert W. Haack, President of the New York Stock Exchange to all members, Jan. 2, 1968, reprinted in Selected Comments 14-15. It has been suggested that the discount be set at one-third of the commission rate. Letter from Robert W. Haack to Manuel F. Cohen, SEC Chairman, June 27, 1968, reprinted in [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,585, at 83,229.

[31] In January, 1968, the SEC published both its proposed Rule 10b-10, which would prohibit investment companies or mutual fund managers from directing the sharing of commissions on securities transactions unless the benefits of such sharing accrue to the investment company, mutual fund or its shareholders, and the New York Stock Exchange Proposals on Commission Rates. Because of certain conflicts between the two proposals, the Commission announced that it would solicit the views of all interested parties and conduct hearings before taking further action. Selected Comments 12-13. These hearings are concerned with all aspects of the commission rate structure.

[32] 5 Trade Reg. Rep. ¶ 72,911, at 87,471.

[33] It is entirely possible that the expensive and complicated system of "reciprocal dealings" mentioned above would prevent Thill from proving its damages with the degree of certainty required in suits under the Sherman Act. Judgments in antitrust actions cannot be based on speculation, even though the defendant has, by his own wrong,

In conclusion it is submitted that the court erred in following the language of *Kaplan* rather than the holding in *Silver*. Section 19(b) of the Securities Exchange Act refers not to the "regulation" of commissions, but to the "fixing" of commissions. The *Thill* court's broad reading of this section has extended its scope to encompass any activity which the Exchange might argue facilitates its regulation of the structure of commission rates, and has done so in the absence of any clear congressional intent to effectuate such a policy. In addition the Court has failed to require, or at least to articulate, any justification for the Exchange's policy. There is every indication that the primary objective of the Securities Exchange Act of 1934 was the protection of investors, and that the Exchange's rules regarding the prohibition of commission sharing have weakened this objective by creating an atmosphere in which competition among dealers is stifled. In an area as complicated and sensitive as the trading of securities, and as vital to the economy, such an approach seems an unfortunate abdication of responsibility.

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precluded an exact determination of the damages. Bigelow v. RKO Radio Pictures, 327 U.S. 251, 264 (1946); Volasco Prods. Co. v. Lloyd A. Fry Roofing Co., 308 F.2d 383, 392 (6th Cir. 1962), cert. denied, 372 U.S. 907 (1963); Associated Press v. Taft Ingalls Corp., 340 F.2d 753, 769 (6th Cir. 1965). The fact that the plaintiff might experience difficulty in proving damages should not preclude his having an opportunity to attempt it.