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Do Federal Securities Regulations Trump State Antitrust Law?

Can federal legislation implicitly repeal antitrust laws enacted by individual states? This question not only implicates the differing policy rationales behind securities regulation and antitrust law, but also the notion of a limited federal government. It was confronted in a decision last month concerning the intersection of federal securities and antitrust — both state and federal — law in *In re Initial Public Offering Antitrust Litigation*, 2003 WL 22474835 (S.D.N.Y. 2003).

Before discussing the decision, the different aims of securities regulation and antitrust enforcement must be noted. On the one hand, Congress has passed securities regulation, such as the Securities and Exchange Act of 1934, to protect "the economic health of ... investors, exchanges, and the securities industry."[1] Unfortunately, the need for strong securities legislation (and enforcement of such legislation) has become paramount over the last two years as a seemingly unending number of Wall Street conflict-of-interest scandals continues and incidents of investor fraud — fraud that has concerned, among other things, the preparation and audit of financial statements, the recommendation and assessment of "independent" analysts, and the purchasing of mutual fund shares by large institutional investors — are revealed.

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On the other hand, antitrust laws have been enacted by Congress and various state legislatures to serve as "comprehensive charter[s] of economic freedom," as the U.S. Supreme Court wrote in *Northern Pacific Railway v. United States*, 356 U.S. 1, 4 (1958).

Their goal is to protect the competitive process and, ultimately, the consumer by deterring and enjoining business practices and transactions that improperly inflate price, restrict output or reduce product innovation.

'IPO Antitrust Litigation'

In *IPO Antitrust Litigation*, Southern District Judge William Pauley III granted defendants' motion to dismiss the antitrust claims of two putative classes.

The plaintiffs alleged that the defendant investment banks conspired to violate the Sherman Act, Robinson-Patman Acts and various state antitrust statutes. Specifically, it was charged that the investment banks, among other things, agreed to (i) add "additional anticompetitive charges" to direct purchases of IPO shares, and (ii) "tie-in" aftermarket purchases of securities to the sale of IPO securities — a sale technique known as "laddering."

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Relying on *Northwest Pacific Railway*, Judge Pauley held that the "conduct alleged ... was impliedly immune from antitrust scrutiny [because] any other result would force the defendants to navigate the Scylla of securities regulation and Charybidis of antitrust law."

The doctrine of implied immunity is well established under federal antitrust law.[2] The principle "is grounded in the shibboleth that Congress does not intentionally vitiate its own regulatory mandates," wrote Judge Pauley.

As noted above, the aims of the Securities Exchange Act — an investor-centric statute — and the federal antitrust laws — consumer-centric statutes — are not always co-extensive. Courts are thus sometimes forced to reconcile them when allegations of anticompetitive practices in securities markets are raised. This reconciliation need occur "only where there is a plain repugnancy between" antitrust provisions and the Securities Exchange Act.[3] It is premised on Congress' intent in adopting its own securities and antitrust schemes.

Overlapping Statutes

But what happens when federal securities regulation overlaps with state antitrust law? The overwhelming majority of states have adopted provisions aimed at precluding anticompetitive conduct. Indeed, "at the time of the enactment of the Sherman Act [in 1890], 21 States had already adopted their own antitrust laws," the Supreme Court noted in *California v. ARC America Corporation*, 490 U.S. 93, 101 fn 4 (1989).

In this respect, the Court held in *ARC America Corporation*, that "given the long history of state common-law and statutory remedies against monopolies and unfair business practices, it is plain that [antitrust compliance] is an area traditionally regulated by the States. ... Congress intended the federal antitrust laws to supplement, not displace, state antitrust law."

The doctrine of implied immunity does not apply to antitrust laws adopted by state legislatures. Implied immunity is only relevant to the question of whether Congress intended to repeal its own antitrust laws when adopting specific regulatory legislation.

How then can federal securities legislation and state antitrust law be reconciled when they conflict? Surely, it would be inequitable if entities that have engaged in certain practices that were explicitly blessed by the SEC were to be held liable for violating state antitrust maxims.

When confronted with this question, Judge Pauley held in *IPO Antitrust Litigation* that "reason and common sense compel the conclusion that the same conduct that is immune from Sherman Act antitrust scrutiny must also

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be immune from state antitrust scrutiny. Any other outcome would eviscerate the implied immunity doctrine.

"To shield the Securities regulatory regime from encroachment by the Sherman Act, only to expose the regime to assault by a swarm of state antitrust claims, would shatter the federal regulatory framework for national securities markets."

Questionable Legal Means

While the ends reached by Judge Pauley on this issue are undoubtedly correct — especially when implied immunity is premised on active regulation of a given practice by the SEC — the legal means that he relied on to reach this conclusion are lacking, if not questionable.

The legal concept that applies to the question of whether state statutes have been effectively repealed by congressional legislation is preemption, not implied immunity. Indeed, "it is accepted that Congress has the authority in exercising its Article I powers to pre-empt state laws," the Supreme Court wrote in *ARC America Corporation,* the seminal authority concerning preemption of state antitrust laws.

In that case, the high Court held that, in order to find implied preemption of state antitrust law — "an area that is traditionally regulated by the states" — a plaintiff "must overcome the presumption against finding preemption [of state antitrust laws]." This presumption can only be overcome if "compliance with both state and federal law is impossible ... or when the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of the Congress."

Since, for the most part, the objectives of securities and antitrust law are complimentary, it may be difficult to demonstrate that compliance with both laws is impossible. However, even if dual compliance is not impossible, state antitrust law may act as an obstacle to the accomplishment and execution of securities regulation where the SEC has actively regulated a given investment-related practice that state antitrust law would condemn.

To the extent that state antitrust laws would deviate from the explicit regulatory mandates of the SEC, in order to protect the regulatory integrity and authority of the SEC, as well as to provide legal certainty to investment-related businesses, implied preemption of state antitrust law should be found.[4]

Both state antitrust law and federal securities legislation serve important purposes. However, when there is a conflict between these regimes and the SEC has actively regulated a particular securities practice, the courts should apply the implied preemption doctrine. In this manner, investment houses and Wall Street players will be provided with certainty in their business strategies and regulation of these entities will be more efficient.

(1) *Gordon v. New York Stock Exchange, Inc.*, 422 U.S. 659, 689 (1975); see e.g., *Silver v. New York Stock Exchange*, 373 U.S. 341, 349 (1963):

> The need for statutory regulation of securities exchanges ... are properly understood in the context of a consideration of both the economic role played by exchanges and the historical setting of [the Securities Exchange Act.] Stock exchanges perform an important function in the economic life of this country. They serve, first of all, as an indispensable mechanism through which corporate securities can be bought and sold. To corporate enterprise, such a market mechanism is a fundamental element in facilitating the successful marshaling of large aggregations of funds that would otherwise be extremely difficult to access. To the public the exchanges are an investment channel which promises ready convertibility of stock holdings into cash. The importance of these functions in dollar terms is vast. ... Moreover, because trading on the exchanges, in addition to establishing the price level of listed securities, affects securities prices in general, and because such transactions are often regarded as an indicator of our national economic health, the significance of the exchanges in our economy cannot be measured only in terms of the dollar volume of trading.

(2) *Silver*, supra, (while recognizing the concept of implied immunity, court holds that refusal to deal by NYSE with non-member is not immune from antitrust attack); *Gordon*, supra, (fixed commission rates established by stock exchanges was immune from antitrust scruniny); *United States v. National Association of Securities Dealers, Inc.*, 422 U.S. 694 (1975) (certain practices relating to the distribution of securities to mutual funds are impliedly immune from the antitrust laws).

(3) *Friedman v. Solomon/Smith Barney, Inc.*, 313 F.3d 796, 799 (2d Cir. 2002) (quoting *Finnegan v. Campeau Corp.*, 915 F.2d 824, 828 (2d Cir. 1990)); *Silver*, supra, ("Repeal 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. This is the guiding principle to reconciliation of the two statutory schemes.") What constitutes "plain repugnancy" between the federal securities and antitrust law is arguable. For example, in an amicus brief, New York Attorney General Eliot Spitzer argued that because the SEC failed to exercise its authority to regulate the practices at issue in *IPO Antitrust Litigation*, "plain repugnancy" between the securities and antitrust regimes should not be found. In other words, Mr. Spitzer contended that the subject practices should not be immune from federal antitrust prosecution because of the SEC's failure to regulate these practices.

(4) See e.g., *Gordon* at 689-90 ("Given ... the confidence that Congress has placed in the [SEC], and the active roles the SEC and the Congress have taken, permitting courts throughout the country to conduct their own antitrust proceedings would conflict with the regulatory scheme authorized by Congress rather than supplement that scheme.")