New York Law Journal

SERVING THE BENCH AND BAR SINCE 1888

Web address: http://www.law.com/ny

VOLUME 229—NO. 14 WEDNESDAY, JANUARY 22, 2003

SECOND CIRCUIT REVIEW

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Implied Immunity From the Antitrust Laws

THIS MONTH'S COLUMN examines two recent decisions of the U.S. Court of Appeals for the Second Circuit in which the court addressed the doctrine of implied immunity from the antitrust laws. Both cases — *In re Stock Exchanges Options Trading Antitrust Litigation*, Nos. 01-7371, 01-7580, 2003 WL 77100 (2d Cir. Jan. 9, 2003) (*In re Options Trading*) and *Friedman v. SSB, Goldman Sachs, Merrill Lynch, et al*, No. 01-7207, 2002 WL 31844676 (2d Cir. Dec. 20, 2002) — arose in the context of alleged securities-related conduct. In each instance the Second Circuit affirmed a decision of the U.S. District Court for the Southern District of New York dismissing an antitrust complaint on grounds of implied immunity.

Under the doctrine of implied immunity (also known as implied repeal or implied revocation), conduct otherwise violative of the antitrust laws is immune from liability under those laws if their enforcement would impinge upon a congressionally sanctioned regulatory framework. As the Second

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Circuit notes in the *Friedman* decision, the doctrine of implied immunity rests on three Supreme Court cases: *United States v. Nat'l Ass'n of Sec. Dealers, Inc.*, 422 US 694 (1975) (*NASD*), *Gordon v. New York Stock Exch. Inc.*, 422 US 659 (1975) and *Silver v. New York Stock Exch.*, 373 US 341 (1963). In addition to the three seminal Supreme Court decisions, at least two previous Second Circuit opinions, *Finnegan v. Campeau Corp.*, 915 F2d 824 (2d Cir. 1990) and *Strobl v. New York Mercantile Exch.*, 768 F2d 22 (2d Cir. 1985), have also contributed significantly to the development of the implied immunity doctrine. Read in tandem, the Second Circuit's latest decisions, in *Friedman* and *In re Options Trading*, clarify the doctrine in an important way.

'Friedman'

Plaintiffs in *Friedman* were retail investors who bought stock in initial public offerings (IPOs) that had been brought to market by the 16 named defendant underwriters. Plaintiffs alleged that the defendant underwriters conspired to prevent plaintiffs from "flipping" (i.e., immediately reselling) shares that they had acquired in the IPOs. According to the allegations of the complaint, the defendants penalized individual investors who flipped shares by depriving those investors (and their brokers) of shares in future IPOs. This conduct, plaintiffs alleged, had the effect of artificially increasing stock prices in the aftermarket by restricting the available supply of shares. Plaintiffs brought an antitrust class action claiming that the alleged conduct violated §1 of the Sherman Act.

The defendants moved to dismiss, arguing that the alleged conduct was immune from antitrust scrutiny. The district court agreed, and the Second Circuit affirmed.

Recognizing that "repeal by implication is not favored," the Second Circuit began its analysis by stating that "[i]mplied immunity will exist only where there is a plain repugnancy between the antitrust and regulatory provisions." *Friedman*, 2002 WL 31844676, at *2 (internal quotations omitted). In an important qualification, however, the Court emphasized that "the 'plain repugnancy,' or conflict, between antitrust and securities laws extends to *potential* as well as real conflicts." Id (emphasis added). Though not essential for the *Friedman* decision, this qualification would assume dispositive significance in *In re Options Trading*.

Level of 'Plain Repugnancy'?

Implied immunity analysis — i.e., the determination whether a putative conflict rises to the level of "plain repugnancy" — requires "a fairly fact-specific inquiry into the nature and extent of regulatory action that allegedly conflicts with antitrust law." Id. at *3. Given the allegations of the complaint, of particular relevance in *Friedman* was the nature and extent of regulatory action in connection with "flipping" restrictions and other IPO-related price-stabilization measures. As an initial matter, the Court found it significant that "Congress was aware of stabilization practices when it passed the Exchange Act," but nonetheless "declined to prohibit pegging, fixing or stabilizing practices outright and instead gave the SEC authority to regulate them." Id. at *4-5. The Court then surveyed how the SEC had exercised that authority in the intervening years. The Court found that time and again — in 1940, 1955, 1963 and, most recently, in 1994 — the SEC "revisited the stabilization issue and modified existing regulations, but did not prohibit the practice." Id. at *5. The SEC took no action despite being fully aware that "stabilization in the aftermarket to combat flipping was 'not uncommon and may act to support the price of the offered security in the aftermarket.' " Id. (quoting SEC Release Nos. 33-7282, 34-37094, at 1740). In light of this history, the Second Circuit concluded that the SEC's decision to permit price stabilization measures was "both deliberate and significant." Id.

This conclusion was important to the Court's holding, for "plain repugnancy" between the antitrust laws and SEC regulation, such as would give rise to implied immunity, "may, but need not, involve affirmative SEC action." Id. at *4. "Conflict," the Court noted, "also can exist where the SEC has jurisdiction over the challenged activity and has deliberately chosen not to regulate it." Id. Section 9(a)(6) of the Exchange Act permits price-stabilization measures except insofar as such practices are specifically prohibited by the SEC. Inasmuch as the SEC has chosen not to prohibit restrictions on flipping, those restrictions are permissible under the Exchange Act. The antitrust laws, by contrast, arguably prohibit such practices, as was alleged in the *Friedman* complaint. The Second Circuit concluded, therefore, that, with respect to restrictions on flipping, there is a clear conflict between the antitrust laws and the regulatory structure erected by the Exchange Act. Accordingly, the Second Circuit affirmed the district court's ruling that the defendants' alleged activity was immune from antitrust liability.

'In re Options Trading'

The *Options Trading* plaintiffs were investors who had purchased equity options. They alleged that the defendant stock exchanges "had conspired to restrict the listing and trading of particular options to one stock exchange at a time, thereby restraining trade in such options in violation of §1 of the Sherman Act." *In re Options Trading*, 2003 WL 77100, at *1.

In sharp contrast to the conduct at issue in *Friedman*, the SEC considered the conduct alleged in *Options Trading* to be in violation of SEC rules. Indeed, the SEC had investigated conduct such as that alleged by the plaintiffs and had found that certain stock exchanges had, in fact, blocked the listing of options on multiple exchanges. As a result of its investigation, the SEC censured the offending exchanges and forced them to take corrective actions. See id. at *4.

Notwithstanding the fact that the conduct alleged by plaintiffs had been found by the SEC to be in violation of SEC regulations, the defendant exchanges moved to dismiss the complaint on the grounds of implied immunity.

In the district court, the Department of Justice and the SEC each filed amicus briefs in support of plaintiffs. Both argued against finding implied immunity. The SEC argued that because the SEC "has addressed the precise conduct at issue and has decided to prohibit it in order to provide competition among the exchanges," the case did "not present a situation where … the antitrust laws are impliedly repealed, such as where the securities laws authorize the conduct or the Commission has approved or permitted it, either expressly or implicitly." Id. at *5.

The record left no doubt that the conduct alleged by plaintiffs violated an SEC rule. In 1989, the SEC had adopted Rule 19c-5 which, as of 1991, prohibited any stock exchange from adopting any rule, policy or practice that limited its ability to list any equity options. See id. at *3. The record also revealed, however, that considerable regulatory vacillation had preceded the adoption and ultimate implementation of Rule 19c-5.

Options trading began in 1970; by 1973, the SEC was studying whether to allow the simultaneous trading of a given class of options on multiple exchanges. In 1974, the SEC concluded that further study was necessary before it would allow a given class of options to be traded on more than one exchange. Id. at *2. Two years later, in 1976, the SEC permitted two stock exchanges to trade options that were listed on other exchanges. In 1980, after a comprehensive review of options trading, the SEC found that still further study was required to determine "whether to continue its current policy of restricting multiple trading in exchange-traded options or whether to permit a more unfettered competitive environment in which an options exchange would be free to trade any eligible options class." Id. at *3 (quoting SEC Release No. 16701 (March 26, 1980)). That same year, the SEC approved a plan, proposed by the exchanges, that permitted the multiple listing of certain options, but limited to a single exchange the listing of any new equity option. In 1987, the SEC began the rule-making process that ultimately led to the adoption of Rule 19c-5 and the prohibition on rules, policies or practices that would limit an exchange's ability to list any equity option. But, even after the rule was adopted in 1989 the SEC delayed its implementation for nearly three years. Only in 1994 did Rule 19c-5 take full effect and all equity options became eligible for multiple listing. See id. at *3-4.

The Second Circuit

It was against this backdrop that the district court and, then, the Second Circuit evaluated the defendants' claim of implied immunity. Plaintiffs argued that there was no conflict between the Exchange Act and the Sherman Act because agreements to limit the listing and trading of equity options to one exchange were prohibited by both the Sherman Act and Rule 19c-5. The court rejected this argument, concluding instead that the Exchange Act "impliedly repeals §1 of the Sherman Act with respect to the listing and trading of equity options, because the implied repeal is necessary to preserve the authority of the SEC to regulate that conduct." Id. at *11.

The Second Circuit noted that "[t]he Exchange Act itself does not prohibit agreements for exclusivity in options listing, and … the [SEC] has taken varied positions with respect to the appropriateness of multiplicity, in part because under the Exchange Act it is concerned with more than just the protection of competition, which is the 'sole aim of antitrust legislation.' " Id. (quoting *Gordon*, 422 U.S. at 689). When considering whether to require or prohibit the multiple listing of equity options, the SEC, by virtue of its mandate under the Exchange Act, needed to "balance[] the interest of promoting competition, on the one hand, against undesirable potential effects, on the other hand, such as market fragmentation, financial injury to regional exchanges, and 'deleterious structural changes in the markets,' in order to carry out its statutory duty to enhance 'the economically efficient execution of securities transactions.' " Id. (citations omitted).

The statutory duty to strike a balance among sometimes conflicting goals means that the SEC can adopt rules that favor other goals over competition and can revise the relative prioritization of goals at any time. Thus, in the course of exercising its statutory authority to regulate the listing and trading of equity options, the SEC "has at times encouraged multiple listing and at times disapproved of that practice." Id. at *13. "Although the SEC's present stance is that agreements for exclusive listing are forbidden, the Commission has the power to alter that position if it concludes that other concerns within its domain outweigh the need to protect competition." Id. Insofar as the Exchange Act allows the SEC, as it sees fit, to permit or to forbid multiple listing, the Second Circuit concluded that there was "no way to reconcile that SEC authority, which may be exercised to permit agreements for exclusive listings of equity options, with the antitrust laws." Id. Consequently, the Court held, the conduct alleged by plaintiffs was immune from antitrust liability.

Plaintiffs' argument to the contrary, which emphasized the fact that the defendants' alleged conduct violated Rule 19c-5, "misperceive[d] the proper analytical focus." Id. at *12. According to the court, "[t]he appropriateness of an implied repeal does not turn on whether the antitrust laws conflict with the current view of the regulatory agency; rather it turns on whether the antitrust laws conflict with an overall regulatory scheme that empowers the agency to allow conduct that the antitrust laws would prohibit." Id. Because the SEC could permit agreements for exclusive listings of equity options if it chose to, such agreements were immune from antitrust scrutiny, despite the fact that they were currently banned by the SEC.

Conclusion

Together, *Friedman* and *In re Options Trading* make clear that anticompetitive conduct may be immune from antitrust liability even if such conduct allegedly violates securities regulations. The determinative issue is whether the relevant securities statute absolutely proscribes the conduct in question. So long as the SEC has the statutory authority to permit the anticompetitive conduct, then the conduct enjoys implied immunity from the antitrust laws, regardless of whether the SEC has in fact chosen to allow the conduct.