UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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| In Re: Stock Exchanges Options Trading Antitrust Litigation | Master Docket No. M-21-79 (RCC)<br>99 Civ. 0952<br>MDL No. 1283 |
| This Document Relates To:<br><br>ALL ACTIONS | |

# MEMORANDUM OF UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN OPPOSITION TO MOTION OF OPTIONS EXCHANGE DEFENDANTS TO DISMISS CONSOLIDATED ANTITRUST CLASS ACTION COMPLAINT


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## TABLE OF CONTENTS

## TABLE OF AUTHORITIES

**Cases** **Page(s)**



**Statutes and Rules**



**Other Materials**

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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The United States submits this Memorandum to express its view that the federal antitrust laws are not impliedly repealed with respect to agreements, prohibited by the Securities and Exchange Commission ("SEC"), not to list options on more than one exchange.

**INTEREST OF THE UNITED STATES**

The United States has primary responsibility for enforcing the federal antitrust laws, which express the nation's fundamental economic policy in favor of free competition. Although in some circumstances the design of federal regulatory programs clearly indicates that Congress intended this policy to defer to other federal policies, such implied antitrust immunity must be found only when and to the extent necessary to make a federal regulatory program work as Congress intended. The United States is concerned that the Exchange Defendants' arguments for implied antitrust immunity here, if accepted, would unjustifiably restrict application of the antitrust laws and cause serious damage to the nation's fundamental economic policy. The Antitrust Division of the U.S. Department of Justice is currently investigating possible agreements not to list options on more than one exchange.

**STATEMENT**

1. The Consolidated Antitrust Class Action Complaint ("Complaint") alleges that five national securities exchanges (the "Exchange Defendants") and others agreed among themselves that they would not multiply list options (i.e., list the same option class on more than one exchange) that already were listed by one of the exchanges. Complaint ¶¶ 1,3. Plaintiffs allege that such an agreement is a per se violation of Section 1 of the Sherman Act, id. ¶¶ 4, 8, and we assume for purposes of this Memorandum that the allegation is correct -- provided only that no implied repeal of the antitrust laws applies to that agreement. The Complaint notes that "the U.S. Department of Justice . . . announced that it had subpoenaed records from the [exchanges] concerning, 'agreements' between various Defendants 'in artificial . . . restraint of trade.'" Complaint ¶ 156. These subpoenas relate to an ongoing Antitrust Division investigation.

2. SEC Rule 19c-5 provides that the rules of each national securities exchange "shall provide" that "no rule, stated policy, practice, or interpretation of this exchange shall prohibit or condition, or be construed to prohibit or condition or otherwise limit, directly or indirectly, the ability of this exchange to list any stock options class because that options class is listed on another options exchange." 17 C.F.R. 240.19c-5(a)(3). As the SEC explained, the national securities exchanges "are prohibited from restricting the listing of any new stock options class to a single exchange." 54 Fed. Reg. 23963, 23963 (June 5, 1989).

The SEC proposed this rule after preliminarily determining that "exchange rules prohibiting multiple trading may now be inconsistent with the [Securities Exchange Act of 1934, as amended], particularly because they may impose a burden on competition no longer necessary in furtherance of the Act's purposes." Id. at 23965. It explained that it proposed the rule pursuant to statutory provisions that "codify a Congressional intent that the U.S. securities markets, including options markets, be free from competitive restraints to the furthest extent possible consistent with the other goals of the Act." Id. at 23970.[1]

The alleged agreement, if it exists, appears to contravene Rule 19c-5. We do not understand the Exchange Defendants to contend that it does not, at least for purposes of their motion to dismiss.[2]

3. The Exchange Defendants have now moved to dismiss the complaint, pursuant to Rule 12(b)(6), Fed. R. Civ. P., on the ground that "Congress has impliedly repealed the antitrust laws as those laws might be applied to conduct of the exchanges relating to the listing of option classes, and replaced them with a regulatory scheme," Memorandum of Law in Support of Options Exchange Defendants' Motion to Dismiss Consolidated Antitrust Class Action Complaint ("E.D. Mem.") 2, even as to conduct the regulators have, in the exercise of their

[1]The rule provided a phase-in period, see 54 Fed. Reg. 23963, 23969 (June 5, 1989), but has been fully in effect since December 1994. Complaint ¶17.

[2]The plaintiffs state that the SEC has commenced its own investigation of the alleged conduct, Plaintiffs' Memorandum of Law in Opposition to Defendants' Motions to Dismiss the Consolidated Antitrust Class Action Complaint ("P. Mem.") 7, and the Exchange Defendants do not challenge that statement, but instead rely on it. Reply Memorandum of Law in Support of Options Exchange Defendants' Motion to Dismiss Consolidated Antitrust Class Action Complaint ("E.D. Reply") 13.

statutory authority, determined to burden competition in a way unnecessary to further the purposes of the Securities and Exchange Act of 1934, as amended by the Securities Act Amendments of 1975 (the "Exchange Act").[3]

## ARGUMENT

**Congress Has Not Impliedly Repealed The Federal Antitrust Laws With Respect to Anticompetitive Exchange Conduct that Contravenes Rule 19c-5.**

Congress, of course, may provide explicitly by statute that a particular corner of commerce is to be governed by some regulatory scheme to the complete exclusion of the federal antitrust laws. Moreover, statutes establishing regulatory regimes may, but do not necessarily, imply congressional intent to exclude the federal antitrust laws to some extent.

As the Exchange Defendants concede, the Exchange Act contains no express provision immunizing the conduct alleged in this case from antitrust scrutiny. The courts have found implied antitrust immunity for certain conduct within the jurisdiction of the SEC and (a) authorized by statute until barred by regulatory decision, or (b) approved by the regulators. But neither the Supreme Court nor the courts of appeals have ever gone to the extreme required by the Exchange Defendants' argument here; never have they held that there is implied immunity from the federal antitrust laws for conduct that is <u>prohibited</u> by the SEC. In the absence of strong reason to believe that Congress intended to deprive those injured by anticompetitive conduct of their ordinary antitrust remedies and to leave both punishment and deterrence of anticompetitive conspiracies to administrative procedures, this Court should not take the extraordinary step Exchange Defendants urge upon it.

[3]We do not address other grounds urged in support of dismissal.

## I. Implied Antitrust Immunities Are Disfavored, and When Found At All Are Strictly Limited

Businesses frequently believe their lot would be improved were they free from the federal antitrust laws, and so "claims of antitrust immunity in the context of various regulated industries," National Gerimedical Hospital and Gerontology Center v. Blue Cross of Kansas City, 452 U.S. 378, 388 (1981), are frequent as well. As a result, "[t]he general principles applicable to such claims are well established," id., although not mentioned by the Exchange Defendants. Because "[t]he antitrust laws represent a 'fundamental national economic policy,' id., quoting Carnation Co. v. Pacific Westbound Conference, 383 U.S. 213, 218 (1966), "'[i]mplied antitrust immunity is not favored, and can be justified only by a convincing showing of clear repugnancy between the antitrust laws and the regulatory system.'" Id., quoting United States v. National Association of Securities Dealers, 422 U.S. 694, 719-20 (1975) ("NASD"). In particular, "'Repeal is to be regarded as implied only if necessary to make the [subsequent law] work, and even then only to the minimum extent necessary. This is the guiding principle to reconciliation of the two statutory schemes.'" Id., quoting Silver v. New York Stock Exchange, 373 U.S. 341, 357 (1963).

In applying these principles, even in the context of heavily regulated industries, the Supreme Court has "refused . . . a blanket exemption, despite a clear congressional finding that some substitution of regulation for competition was necessary," id. at 392, citing Carnation, 383 U.S. at 217-19 (declining to find "an unstated legislative purpose to free the shipping industry from the antitrust laws"); Otter Tail Power Co. v. United States, 410 U.S. 366, 373-74 (1973) (finding no legislative "purpose to insulate electric power companies from the operation of the antitrust laws" despite Federal Power Commission regulation). Instead, close examination of the statutory and regulatory context is required to determine whether particular conduct is immune.

The Exchange Defendants rely on Gordon v. New York Stock Exchange, 422 U.S. 659 (1975), which they interpret to establish a much more liberal standard for inferences of antitrust immunity in regulated industries. E.D. Mem. 13. They offer the following standard, which they profess to draw from Gordon:

> First, the court must determine whether the SEC is authorized by statute to regulate and supervise the challenged conduct. Second, the court must determine whether the SEC has exercised that authority. And third, the court must inquire whether, on an ongoing basis, the SEC has the responsibility to apply standards to the challenged conduct which are different from and could conflict with the requirements of the antitrust laws.

Id. 13-14.[4] Gordon, however, does not sanction any departure from the principle that implied antitrust immunity is justified only by a convincing showing of clear repugnancy between the antitrust laws and the regulatory scheme. Indeed, the Court expressly reaffirmed this principle in Gordon, 422 U.S. at 682, and later cited Gordon as authority for the principle in National Gerimedical, 452 U.S. at 388.

Gordon addressed only conduct (fixing commission rates) approved by the SEC at the time it occurred. Although, as the Exchange Defendants point out, the SEC had changed its policy by the time of the Court's decision so that it forbade fixed commission rates, E.D. Mem. 16;

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[4]The Exchange Defendants may not view this standard as applicable beyond the SEC context, thus implicitly relying on the analyses of the specific statutes, regulatory policies, and regulatory actions in Gordon and other cases. If limited to the SEC context, their argument is erroneous only with respect to that context.

E.D. Reply 7, the plaintiffs were seeking treble damages for an injury inflicted at a time when the rate fixing was permitted by the Exchange Act and approved by the SEC.[5] Despite the lack of conflict between regulatory policy and the antitrust laws as of the time of its decision, the Court realized that to impose liability for conduct approved by the SEC at the time it occurred would create just such a conflict and prevent the intended operation of the Exchange Act should the SEC ever change its regulatory policy, as the Exchange Act permitted it to do. 422 U.S. at 689-91. It does not follow that the Court would have rejected application of the antitrust laws to conduct prohibited by the SEC at the time it occurred.

NASD, on which the Exchange Defendants also rely, E.D. Mem. 16-17; E.D. Reply 9-10, also does not address immunity for conduct disapproved by the SEC, for none of the conduct there challenged had been disapproved. The Court concluded that the conduct at issue in seven of the eight counts of the complaint in that case was authorized by the applicable statute provided it did not "contravene any rules and regulations the [SEC] may prescribe" and that it did not so contravene. 422 U.S. at 721. In the Court's view, Congress clearly intended that mutual funds be authorized "to impose transferability of negotiability restrictions, subject to [SEC] disapproval." Id. at 726. As to the remaining count, which addressed conduct not specifically authorized by statute, the Court, noting that the SEC "weighs competitive concerns in the exercise of its continued supervisory responsibility," id. at 736, concluded that "the investiture of such pervasive supervisory authority in the SEC suggests that Congress intended

[5]Gordon, filed in 1971, included a claim for treble damages of $1.5 billion. 422 U.S. at 661 n.3. The challenged rates had been subject to "the scrutiny and approval of the SEC." Id. at 689 (emphasis added).

to lift the ban of the Sherman Act from association activities approved by the SEC." Id. at 733 (emphasis added).[6]

In short, to claim immunity, the Exchange Defendants must convincingly show a "clear repugnancy" between the applicable regulatory scheme and enforcement of the antitrust laws against anticompetitive conduct prohibited by the regulatory scheme. They must show that to make the regulatory scheme work, the antitrust laws must be repealed even as to conduct the regulatory scheme has barred because it is unnecessarily anticompetitive.[7]

## II. There Is No "Clear Repugnancy" Here Between Application of the Antitrust Laws and the Regulatory Scheme

The Exchange Defendants offer no reason to believe that application of the federal antitrust laws to anticompetitive conduct prohibited by SEC rule enacted pursuant to the Exchange Act would prevent the Exchange Act from working precisely as intended, and we are aware of none. Courts have in the past routinely held that the antitrust laws apply to conduct either prohibited or not approved through the applicable regulatory scheme even

[6]Neither Finnegan v. Campeau Corp., 915 F.2d 824 (2d Cir. 1990), E.D. Mem. 18, nor Harding v. American Stock Exchange, Inc., 527 F.2d 1366 (5th Cir. 1976), E.D. Mem. 19, speaks to implied repeal with respect to disapproved conduct. In Finnegan, the Second Circuit concluded that statute and regulation permitted the challenged joint bidding for corporate control: "Congress has allowed competing bidders to make a joint bid under the Williams Act and the SEC's regulations." 915 F.2d at 830. In Harding, the challenged conduct by an exchange was both pursuant to an exchange rule subject to the usual SEC control and covered by a formal order of the SEC in the particular case. 527 F.2d at 1370.

[7]There is no need for this Court to address whether the alleged Exchange Defendant conduct would be immune from antitrust scrutiny if the SEC had in fact approved it. The Exchange Defendants have not claimed such approval. Should the question ever arise, we assume it would be resolved by applying the applicable general principles in light of Gordon and NASD.

though the antitrust laws were repealed for approved conduct. Thus in United States v. Borden Co., 308 U.S. 188, 197-201 (1939), the Court held that, although the Sherman Act was repealed with respect to agricultural marketing agreements approved by the Secretary of Agriculture pursuant to the Agricultural Marketing Agreement Act of 1937, it was not repealed with respect to agricultural marketing agreements not so approved. And in Carnation, 383 U.S. at 216-17, the Court concluded that price fixing agreements approved by the Federal Maritime Commission pursuant to the Shipping Act were exempt from the antitrust laws although unapproved agreements remained subject to the antitrust laws.

In Ricci v. Chicago Mercantile Exchange, 409 U.S. 289 (1972), the Court specifically addressed the general problem that

> arises when conduct seemingly within the reach of the antitrust laws is also at least arguably protected or prohibited by another regulatory statute enacted by Congress. Often, but not always, the other regime includes an administrative agency with authority to enforce the major provisions of the statute in accordance with that statute's distinctive standards, which may or may not include concern for competitive considerations.

409 U.S. at 299-300 (emphasis added). Ricci had brought an antitrust case challenging the Chicago Mercantile Exchange's transfer of his membership to another, contending that the transfer was contrary to the Exchange's rules, to the Commodity Exchange Act, and to the Sherman Act. The Court, affirming a stay pending administrative proceedings before the Commodity Exchange Commission pursuant to the Commodity Exchange Act, said that if the transfer "was pursuant to a valid rule," the antitrust court would then have to consider immunity. Id. at 303. "On the other hand, if . . . loss of his membership was contrary to Exchange rules, the antitrust action should very likely take its normal course, absent more

convincing indications of congressional intent than are present here that the jurisdictional and remedial powers of the Commission are exclusive." Id. at 303-04.

In Strobl v. New York Mercantile Exchange, 768 F.2d 22, 24 (2d Cir. 1985), the Court of Appeals for the Second Circuit considered, and squarely rejected, the argument that "conduct specifically prohibited by the Commodity Exchange Act cannot be the basis for a treble damage award under the antitrust laws." Reading Gordon, Silver v. New York Stock Exchange, 373 U.S. 341 (1963), and other Supreme Court decisions to provide that implied repeal of the antitrust laws may be found only "when such laws would prohibit an action that a regulatory scheme might allow," 768 F.2d at 27, the court found no immunity because both the Commodity Exchange Act and the antitrust laws prohibited the challenged conduct (price manipulation), so there could be no conflict between the statutes.[8] Here, although the Exchange Act does not bar the SEC from changing its policy and permitting agreements like the one plaintiffs allege here, there is no possibility of conflict arising from a holding that the antitrust laws continue to apply to conduct that contravenes SEC rules.

The Exchange Defendants offer no "more convincing indications of congressional intent . . . that the jurisdictional and remedial powers of the Commission are exclusive,"

[8]The court also rejected the argument, supported by two cases from the Northern District of Illinois, that because there was an implied private right of action under the Commodity Exchange Act, with damage, statute of limitations, and other features that differed from those under the antitrust laws, no right of action was available under the antitrust laws because of the "specific over general" principle even though there was no implied repeal of the antitrust laws. 768 F.2d at 29-31.

Ricci, 409 U.S. at 303-04.[9] They suggest that if exchange conduct "were subject to antitrust scrutiny, courts applying the antitrust laws with their focus on competition might subject the exchanges to different standards of conduct," E.D. Mem. 39, than the SEC applies. This speculative risk, if it exists at all, is surely minimal if this court holds no more than that the antitrust laws are not repealed with respect to conduct that SEC rules prohibit.[10] The SEC itself is, by statute, charged with abrogating or disapproving exchange rules "having the effect of a competitive restraint it finds to be neither necessary nor appropriate in furtherance of a legitimate regulatory objective." S. Rep. No. 94-75, at 13 (1975), reprinted in 1975 U.S.C.C.A.N. 179, 191. There should be little conflict over what has been disapproved under that standard.

The flimsiness of the Exchange Defendants' concerns is illustrated by their repeated reliance on the SEC's approval of the transfer of the New York Stock Exchange's options market operations to the Chicago Board Options Exchange. E.D. Mem. 39; E.D. Reply 19-

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[9]Legislative history suggests that Congress assumed the antitrust laws would continue to apply as the SEC facilitated the development of a national market system, subject to "any ultimate judicial reconciliation of the policies of the Exchange Act with those of the antitrust laws." S. Rep. No. 94-75, at 12 (1975), reprinted in 1975 U.S.C.C.A.N. 179, 190.

[10]Although this case clearly involves no diversity of standards of conduct, there would be ways to avoid conflict even in doubtful cases. Rejecting claims of a complete antitrust exemption by implication from the Shipping Act in Carnation, the Court noted that in prior Shipping Act cases it had held that "courts must refrain from imposing antitrust sanctions for activities of debatable legality under the Shipping Act in order to avoid the possibility of conflict between the courts and the Commission," had concluded that primary jurisdiction to make initial factual determinations should be vested in the Federal Maritime Commission, and had ruled out "an unconditional injunction in the absence of a Commission determination disapproving future operations under" the unapproved agreements. 383 U.S. at 220-21. Similarly, the Court in Ricci affirmed a stay, 409 U.S. at 291, to permit the Commission to address certain issues of fact and the meaning of exchange rules. Id. at 305.

20; Reply Memorandum of Defendant New York Stock Exchange, Inc. in Further Support of Motion to Dismiss 3-5. According to the Exchange Defendants, "the SEC considered whether there was an agreement to refrain from multiple listing -- an issue presented in this action -- and concluded that there was not," E.D. Mem. 39, citing SEC Release No. 34-38541, SEC Release No. 34-38542. Assuming there was any such SEC "conclusion,"[11] courts have ample means of avoiding conflicts with administrative agencies over factual determinations without ousting the antitrust laws. See note 10 supra.

Ultimately, the Exchange Defendants' concern is that "[t]he possibility that the SEC could change the rules relating to multiple listing of option classes again is not remote." E.D. Mem. 40. But the speculative possibility of a future conflict cannot justify blanket antitrust immunity. The court can, and should, hold that the alleged conduct, which as alleged contravenes both SEC rule and the Sherman Act, is, like other conspiracies in restraint of trade, subject to the federal antitrust laws. To avoid any possible future conflict with SEC regulatory policy, the court should consider including in any injunction language permitting

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[11]Release 34-38541 states that the SEC "disagrees with [the] assertion that the Transfer Agreement constitutes an illegal sale of a 'franchise' in NYSE Options," and that the SEC believes that the NYSE's agreement to pay CBOE half a million dollars should NYSE decide to reenter the options business within a year "does not constitute a 'noncompetition' agreement." 62 Fed. Reg. 23516, 23519 (April 30, 1997). Release 34-38542 expands upon this, saying that "there is no agreement between NYSE or CBOE to restrict dual listing of options or to restrict, monopolize or foreclose any market." 62 Fed. Reg. 23521, 23524 (April 30, 1997). But it also strongly suggests the SEC did not intend these comments to represent a conclusion that there was no agreement such as alleged here. The Release indicates that these comments were based not on an SEC investigation, but rather on "the representations of the NYSE," id. at 23523: "The Exchange states that the proposal is not monopolistic or an unlawful circumvention of Commission policy on dual listing of options. The Exchange states that it has no agreement with CBOE to restrict dual listing of options or to restrict, monopolize or foreclose any market." Id. at 23522-23.

otherwise enjoined conduct should the SEC, acting pursuant to statutory authorization, permit such conduct in the future.

**CONCLUSION**

The court should hold that there is no implied repeal of the antitrust laws with respect to alleged conduct prohibited by SEC rule.

Respectfully submitted,


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Dated: Washington, D.C.
June 1, 2000