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Supreme Court Holds that the Federal Securities Laws Implicitly Preclude Application of the Antitrust Laws to the Underwriting of Initial Public Offerings

On June 18, the Supreme Court held that the United States securities laws implicitly preclude application of the antitrust laws to allegedly collusive conduct by syndicates of underwriters participating in initial public offerings. The Court reached its decision on the grounds that there is a "plain repugnancy" between the antitrust laws and the extensive regulatory program governing the offering of securities enforced by the SEC under the securities laws. *Credit Suisse Securities (USA) LLC, f/k/a Credit Suisse First Boston LLC, et al. v. Billing, et al.*, — S.Ct.—, Case No. 05-1157, 2007 WL 1730141 (June 18, 2007).

The decision undoubtedly will have important implications regarding the extent to which the antitrust laws may be applied to other conduct regulated by the securities laws, or in the context of other regulated industries. In addition, the decision will make it more difficult for class plaintiffs to use other laws to avoid the strictures of the securities laws, particularly as courts and Congress continue to require heightened proof in securities cases to avoid the economic harm caused by lawsuits based upon "fraud-by-hindsight."

The Complaints in *Billing*

In January 2002, plaintiffs, a group of 60 investors, filed two antitrust class action lawsuits against a group of investment banks, alleging claims under § 1 of the Sherman Act, ch. 647, 26 Stat. 209, as amended, 15 U.S.C. § 1; § 2(c) of the Clayton Act, 38 Stat. 730, as amended by the Robinson-Patman Act, 49 Stat. 1527, 15 U.S.C. § 13(c); and various state antitrust laws. Plaintiffs alleged that between March 1997 and December 2000, defendants had acted as underwriters, forming syndicates that helped execute the IPOs of several hundred technology-related companies. The complaints allege that the underwriters "abused the . . . practice of combining into underwriting syndicates" by agreeing among themselves to impose harmful conditions upon potential investors – conditions that the investors apparently were willing to accept in order to obtain an allocation of new shares that were in high demand.

More particularly, plaintiffs alleged that the underwriting firms had agreed with one another that they would not sell shares of a popular new issue unless the buyer agreed to pay "additional anticompetitive charges" over and above the agreed-upon IPO share price plus underwriting commissions. These additional charges took the form of: (1) investor promises "to place bids... in the aftermarket at prices above the IPO price"("laddering" agreements); (2) investor "commitments to purchase other, less attractive securities" ("tying" arrangements); and (3) investor payment of "non-competitively determined" commissions, including the "purchas[e] of an issuer's shares in follow-up or 'secondary' public offerings (for which the underwriters would earn underwriting discounts)." The complaints further alleged that these purportedly collusive practices artificially inflated the share prices of the securities in question.

The Lower Court Decisions

Defendants moved to dismiss the complaints on the ground that the federal securities laws implicitly precluded application of the antitrust laws to the conduct in question. The United States District Court for the Southern District of New York (Pauley, J.) granted defendants' motion to dismiss, holding that application of the antitrust laws to the conduct overseen by securities regulators would create both

actual and potential conflict with the SEC's authority. *In re Initial Public Offering Antitrust Litigation*, 287 F. Supp. 2d 497 (S.D.N.Y. 2003). In particular, the District Court explained that implied immunity from the antitrust laws was appropriate because the SEC either expressly permitted the challenged conduct or had the power to regulate it, such that, in the absence of implied immunity from the antitrust laws, a conflict would arise "with an overall regulatory scheme that empowers the [SEC] to allow conduct that the antitrust laws would prohibit."

On appeal, the United States Court of Appeals for the Second Circuit (Wesley, J.) reversed, reasoning that there could be no implied immunity from the antitrust laws without a showing that Congress had anticipated, and clearly intended, a repeal of the antitrust laws with respect to the alleged conduct. *Billing v. Credit Suisse First Boston Ltd.*, 426 F.3d 130 (2d Cir. 2005). The Second Circuit determined that Congress had not "forsworn the paradigm of competition," that there was no congressional intent to immunize defendants' conduct from the antitrust laws, and that there was no conflict between the antitrust and securities laws.

The Supreme Court Decision

The Supreme Court, in a 7-1 majority opinion authored by Justice Breyer, rejected the Second Circuit's analysis in its entirety and held that "the securities laws are 'clearly incompatible' with the applications of antitrust laws in this context." 2007 WL 1730141 at *9.

In reaching its holding, the Court relied on its prior rulings in *Gordon v. New York Stock Exchange, Inc.*, 422 U.S. 659 (1975); *United States v. National Assn. of Securities Dealers, Inc.*, 422 U.S. 694 (1975); and *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963). Synthesizing these earlier rulings, the Court held that to determine whether the antitrust laws have been repealed implicitly by the securities laws, the following factors should be considered: "(1) the existence of regulatory authority under the securities law to supervise the activities in question; (2) evidence that the responsible regulatory entities exercise that authority; (3) a resulting risk that the securities and antitrust laws, if both applicable, would produce conflicting guidance, requirements, duties, privileges, or standards of conduct . . . [and] (4) . . . the possible conflict affected practices that lie squarely within an area of financial market activity that the securities law seeks to regulate." *Id.* at *9.

The Court concluded that the first, second and fourth criteria were readily satisfied, recognizing that underwriters' efforts to jointly promote and sell newly issued securities are central to the proper functioning of well-regulated capital markets. The Court further found that the securities laws grant the SEC considerable power to regulate all such underwriting activities, and that the SEC has continuously exercised that power. In consequence, the Court's inquiry focused on the third criteria – *i.e.*, whether there was a conflict between the securities laws and antitrust laws "that rises to the level of incompatibility." *Id.* Put another way, the Court questioned: "Is an antitrust suit such as this likely to prove practically incompatible with the SEC's administration of the Nation's securities laws?". *Id.* The Court answered that question in the affirmative.

In reaching its decision, the Court found that, due to the specialized knowledge required to parse the SEC's rules and distinguish permissible from prohibited conduct, there was a "serious risk" that antitrust courts would produce inconsistent results. As the Court noted:

> Now consider these factors together – the fine securities-related lines separating the permissible from the impermissible; the need for securities-related expertise (particularly to determine whether an SEC rule is likely permanent); the overlapping evidence from which reasonable but contradictory inferences may be drawn; and the risk of inconsistent court results. Together these factors mean there is no practical way to confine antitrust suits so that they challenge only activity of the kind the investors seek to target, activity that is presently unlawful and will likely remain unlawful under the securities law. Rather, these factors suggest that antitrust courts are likely to make unusually serious mistakes in this respect. And the threat of antitrust mistakes, *i.e.*, results that stray outside the narrow bounds that plaintiffs seek to set, means that underwriters must act in ways that will avoid not simply conduct that the securities law forbids (and will likely continue to forbid), but also a wide range of joint conduct that the securities law permits or encourages (but which they fear could lead to an antitrust lawsuit and the risk of treble damages). And therein lies the problem. *Id.* at *8.

The Court further reasoned that the securities regulators proceed with great care to "distinguish the encouraged and permissible from the forbidden." The threat of antitrust lawsuits, the Court determined, could alter seriously underwriter conduct in undesirable ways, inconsistent with the careful determination of the regulators. As such, the Court concluded that "to an allow an antitrust lawsuit would threaten serious harm to the efficient functioning of the securities markets." *Id.* at *13. In addition, the Court found that the need for antitrust enforcement was "unusually small" because the SEC itself "actively enforces the rules and regulations that forbid the conduct in question" and the securities laws likewise provide a remedy for injured investors. *Id.* at *8-9.

The Court also expressed a concern that allowing antitrust claims here would weaken the heightened pleading

requirements in the Private Securities Litigation Reform Act, which Congress passed to weed out "unmeritorious securities lawsuits." *Id.* at * 9. "To permit an antitrust lawsuit risks circumventing these requirements by permitting plaintiffs to dress what is essentially a securities complaint in antitrust clothing." *Id.*

The Practical Effects of the Decision

Within the securities industry, the Supreme Court's ruling likely will foreclose the ability of plaintiffs to apply the antitrust laws to other activities regulated and supervised by the SEC, beyond the underwriting practices specifically at issue in *Billing*. The decision also will make it more difficult for class plaintiffs to avoid the strict requirements of the securities laws simply by pleading an antitrust claim.

In addition, the Court's ruling in *Billing* increases the likelihood that implied immunity from antitrust laws will be recognized in other regulated industries where the regulatory scheme is enforced by a government agency and where application of the antitrust laws may discourage beneficial conduct that the regulator might wish to encourage.

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