UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE INITIAL PUBLIC OFFERING ANTITRUST LITIGATION	:	Case No. 01 CIV 2014 (WHP)

MEMORANDUM OF THE UNITED STATES AS AMICUS CURIAE

R. HEWITT PATE
Acting Assistant Attorney General

CATHERINE G. O'SULLIVAN
NANCY C. GARRISON
GEORGE S. BARANKO
Attorneys
Antitrust Division
U.S. Department of Justice
601 D Street NW
Washington, DC 20530
(202) 514-1531

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE INITIAL PUBLIC OFFERING ANTITRUST LITIGATION	:	Case No. 01 Civ. 2014 (WHP)

MEMORANDUM OF THE UNITED STATES AS AMICUS CURIAE

The United States submits this Memorandum in response to the Court's request for its views regarding the implied immunity issue raised by defendants' motion to dismiss the complaint under Rule 12(b)(6).

STATEMENT OF INTEREST

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. Accordingly, the United States has an interest in the well-established rule that, although federal regulatory statutes on occasion clearly indicate that Congress intended to limit antitrust enforcement to prevent conflict with other federal policies, implied repeal of the antitrust laws is disfavored and may be found only when and to the extent necessary to make a federal regulatory program work as Congress intended.

QUESTION PRESENTED

Whether antitrust complaints alleging that defendant underwriters violated the federal antitrust laws by imposing charges and conditions prohibited by the securities laws and SEC regulations should be dismissed under Rule 12(b)(6) on implied immunity grounds.

STATEMENT

Plaintiffs are purchasers of certain technology stocks ("the Class Securities"). Defendants are major investment banks; they underwrote initial public offerings (IPOs) of those stocks and provided brokerage services. Am. Complaint ¶¶33, 35.[1] The Amended Complaint alleges that the defendants agreed "to require from customers consideration in addition to the underwriters' discount . . . for allocations of shares of initial public offerings of certain technology-related companies . . . and to inflate the aftermarket prices for such Class Securities, in violation of Section 1 of the Sherman Antitrust Act, 15 U.S.C. §1." Am. Complaint ¶1. Plaintiffs contend that "pursuant to defendants' combination, conspiracy and agreement" these major underwriters required customers to pay, in addition to the authorized IPO prices, additional

[1] "Amended Complaint" or "Am. Complaint" refers to the Consolidated Amended Class Action Complaint (Jan. 2, 2002).

charges that were not disclosed in the prospectuses. *Id.* ¶4. The alleged charges included "non-competitively determined commissions on the purchase and sale of other securities, purchases of an issuer's shares in follow-up or 'secondary' public offerings (for which the underwriters would earn underwriting discounts), [and] commitments to purchase other, less attractive securities." *Id.* ¶¶4, 6. Plaintiffs allege that defendants also agreed "to require that, in order to obtain IPO shares of a Class Security, customers had to place bids for and/or purchase quantities of such Class Security in the aftermarket at prices above the IPO price in order to systematically and significantly inflate the after-market prices of IPOs -- a practice known as 'laddering.'" *Id.* ¶¶4, 7.

Plaintiffs allege that defendants "abused the preexisting practice of combining into underwriting syndicates by implementing the unlawful agreement alleged . . . through such syndicates," Am. Complaint ¶5; that plaintiffs and other class members purchased IPO shares either from the underwriters or in the aftermarket, *id.* ¶13; and that they were injured "in that [they] paid the anticompetitive charges and inflated aftermarket prices caused by [defendants'] unlawful agreement," *Id.* ¶9. The Pfeiffer Complaint[2] alleges that the

[2]"Pfeiffer Complaint" refers to the Class Action Complaint of plaintiff Milton Pfeiffer (Dec. 12, 2001).

underwriter defendants and institutional investors engaged in "commercial bribery and other conduct in violation of Section 2(c) of the Robinson Patman Act, 15 U.S.C. section 13(c)," Pfeiffer Complaint ¶6, as "part of a course of conduct developed by the Underwriter Defendants to inflate the price of particular securities," *id.* ¶3.

Defendants moved to dismiss the complaints under Rule 12(b)(6), on the grounds that: (1) "the IPO allocation and commission practices challenged . . . are comprehensively regulated under the securities laws, and thus immune from antitrust scrutiny," D. Mem. at 1;[3] (2) "plaintiffs . . . lack antitrust standing," *id.* at 2; (3) "the Amended Complaint is devoid of any factual allegations" that would establish an antitrust conspiracy, *id.* at 3; and (4) "the Amended Complaint fails to allege a legally cognizable market," *id.* at 4.[4]

This Court requested the Securities Exchange Commission and the Antitrust Division of the United States Department of Justice to present their views on the implied immunity issue.

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[3]"D. Mem." refers to the Joint Memorandum of Law in Support of Defendants' Motion To Dismiss the Federal Law Claims in the Consolidated Amended Complaint (May 24, 2002).

[4]Defendants focus most of their attention on the Consolidated Amended Complaint. They also challenge the Pfeiffer complaint on the grounds of implied immunity and standing. *See* D. Mem. at 7-8, 62-70.

INTRODUCTION AND SUMMARY OF ARGUMENT

The United States expresses no view as to the merits of plaintiffs' claims that defendants have violated the federal antitrust laws. Section 1 of the Sherman Act focuses specifically on agreements that unreasonably restrain competition; the Robinson-Patman Act prohibits certain types of price discrimination. Neither is an all-purpose enforcement mechanism for attacking securities fraud or other illegal conduct.

Plaintiffs' complaints do not specify with precision the scope and nature of the alleged antitrust violations. Indeed, the Amended Complaint includes few specific facts in support of the conclusory allegations that defendants acted in concert and thereby restrained competition to plaintiffs' detriment. The United States takes no position as to whether the complaints are nonetheless sufficient to survive a motion to dismiss under Rule 12(b)(6) for failure to allege an antitrust offense or for lack of standing.

There is no basis at this point, however, for dismissing the complaints on the ground that regulation renders the alleged actions exempt from antitrust scrutiny as defendants claim. Because the Sherman Act implements a fundamental national policy favoring competition, a finding of implied immunity "can be justified only by a convincing showing of clear repugnancy between the

antitrust laws and the regulatory system." *National Gerimedical Hospital and Gerontology Center v. Blue Cross of Kansas City*, 452 U.S. 378, 388 (1981) (internal quotation omitted). In the absence of express or implicit authorization under the regulatory scheme for conduct alleged to violate the antitrust laws, there is no conflict and thus no clear repugnancy between the standards of the antitrust laws and federal securities regulation. The Amended Complaint and the Pfeiffer Complaint include allegations of conduct that the securities laws and SEC regulations clearly prohibit. Accordingly, whether or not defendants have *violated* the Sherman Act or the Robinson-Patman Act, the conduct alleged in the complaints is not *immune* from scrutiny under the antitrust laws.

ARGUMENT

I. Implied Antitrust Immunity Requires a "Convincing Showing of Clear Repugnancy" Between the Regulatory Scheme and the Application of the Antitrust Laws

As the Supreme Court said over twenty years ago: "claims of antitrust immunity in the context of various regulated industries" have been frequent, and "[t]he general principles applicable to such claims are well established." *National Gerimedical Hospital and Gerontology Center v. Blue Cross of Kansas City*, 452 U.S. 378, 388 (1981). Congress may exempt particular businesses or activities from the Sherman Act by an express provision in the regulatory statute.

Moreover, in some circumstances, statutes authorizing regulation by an administrative agency may imply Congressional intent that the federal antitrust laws not apply to certain regulated conduct. 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)), however, "'[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. Nat'l Ass'n of Sec. Dealers*, 422 U.S. 694, 719-20 (1975) ("*NASD*")); *accord, Northeastern Tel. Co. v. Am. Tel. & Tel. Co.*, 651 F.2d 76, 83 (2d Cir. 1981). The Second Circuit has consistently acknowledged and applied this fundamental principle. *E.g.*, *Strobl v. New York Mercantile Exchange,* 768 F.2d 22 (2d Cir. 1985); *Finnegan v. Campeau Corp.,* 915 F.2d 824 (2d Cir. 1990); *Law Offices of Curtis V. Trinko v. Bell Atlantic Corp.,* 294 F.3d 307 (2d Cir. 2002), *petition for cert. filed*, 71 U.S.L.W. 3352 (U.S. Nov. 1, 2002) (No. 02-682).[5] *See also Friedman v.*

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[5]Defendants' attempt to distinguish *Trinko* as involving the communications laws rather than the securities laws (Joint Reply Memorandum of Law in Support of Defendants' Motion To Dismiss the Federal Law Claims in the Consolidated Amended Complaint at 3-4 (Aug. 7, 2002) ("Reply")) is inapposite. The Second Circuit expressly relied on "basic principles" developed in cases involving immunity claims based on securities, banking, and electric power regulation. *See*

Solomon/Smith Barney, Inc., No. 01-7207, slip op. at 6 (2d Cir. Dec. 20, 2002).

Defendants nonetheless argue for antitrust immunity even in the absence of statutory or regulatory approval—express or implicit—for the alleged conduct. Indeed, they contend that antitrust immunity may be appropriate even when challenged conduct is expressly prohibited by regulatory authorities. *See* Reply at 6, 9. Defendants insist that conduct should be deemed immune "when either (i) Congress has granted the SEC direct authority over the challenged conduct, and the Commission has exercised this authority, or (ii) the conduct at issue is subject to a pervasive regulatory scheme." Reply at 1, *see* D. Mem. at 14-20. In their view, even the possibility that some "potential conflict . . . may arise as the Commission refines the regulatory framework," Reply at 2, is sufficient to immunize past conduct in the securities industry from the antitrust laws. Defendants' novel and expansive view of implied antitrust immunity cannot be

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Trinko, 294 F.3d at 324-28. Moreover, even before the 1996 Act, the courts consistently had held that telecommunications carriers, while subject to extensive federal and state regulation, do not receive implied antitrust immunity. *E.g., Northeastern Tel.,* 651 F.2d at 82-84. The specific antitrust savings clause in the Telecommunications Act of 1996 simply removed any plausible basis for contentions that Congress intended that Act to repeal (or expand) the antitrust laws as applied to conduct regulated under the Communications Act.

reconciled with the Supreme Court's insistence on "a convincing showing of clear repugnancy" between the standards of the antitrust laws and the regulatory scheme, *National Gerimedical*, 452 U.S. at 379.

A. A Broad Regulatory Scheme Does Not Automatically Displace the Antitrust Laws

The underwriting and sale to the public of newly issued securities are extensively regulated under the federal securities laws, but it does not follow that conduct related to this process is necessarily immune from the antitrust laws. As the courts have made clear, the existence of a regulatory scheme does not automatically establish the clear repugnancy between that scheme and application of the antitrust laws that is necessary to justify a finding of implied repeal. Rather, "'[r]epeal is to be regarded as implied only if necessary to make the [subsequent [regulatory] law] work, and even then only to the minimum extent necessary. This is the guiding principle to reconciliation of the two statutory schemes.'" *National Gerimedical*, 452 U.S. at 388 (quoting *Silver v. New York Stock Exchange*, 373 U.S. 341, 357 (1963)). *Accord*, *Northeastern Tel.*, 651 F.2d at 83 (no implied immunity unless "application of the antitrust laws would be incompatible with the regulatory framework, that is, [unless] immunity must be inferred to make the system work").

Established law thus requires that the courts apply both the antitrust and the regulatory statutes to the extent they do not conflict. The Supreme Court has consistently rejected claims for "a blanket exemption, despite a clear congressional finding that some substitution of regulation for competition was necessary." *National Gerimedical*, 452 U.S. 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). Similarly, in *Strobl v. New York Mercantile Exchange*, 768 F.2d 22, 27 (2d Cir. 1985), the Second Circuit expressly rejected the defendants' "over-simplified" argument "that *Silver* and *Gordon* can be read to say that when [an] activity is subject to the jurisdiction of some regulatory body, it is exempt from the antitrust laws." Rather, the question is whether there is "*conflict*[ ] between the antitrust laws and a regulatory scheme." *Id.* (emphasis in original). *See also Friedman*, slip op. at 6.

B. The Key Question Is Whether the Challenged Conduct Has Been Expressly or Implicitly Authorized Under the Regulatory Scheme

If neither Congress nor the regulatory agency has approved or authorized

the conduct at issue, explicitly or implicitly, neither the existence nor the exercise of regulatory authority with respect to that conduct creates conflict between the regulatory scheme and the antitrust laws. Rather, there is conflict warranting an implied exemption only when the antitrust laws "prohibit an action that a regulatory scheme permits." *Finnegan v. Campeau Corp.*, 915 F.2d 824, 828 (2d Cir. 1990) (citing *Strobl,* 768 F.2d at 27).

This authorization need not take the form of an explicit approval. Rather, conflict can also exist where the SEC "deliberately has chosen" not to exercise its authority to prohibit conduct. *Friedman*, slip op. at 9. Thus, in *Gordon v. New York Stock Exchange*, 422 U.S. 659 (1975), for example, the fixed commission rates at issue had been approved, at the time, by the SEC through actions "having an effect equivalent to that of a formal order," 422 U.S. at 690 n.13. In *NASD*, the Court found immunity for activities expressly authorized by statute, for regulated activities "*approved* by the SEC," and for an alleged conspiracy "to encourage . . . precisely the restriction that the SEC consistently has approved pursuant to [statute] for nearly 35 years." 422 U.S. at 733 (emphasis added). Similarly, in *Finnegan v. Campeau*, the Second Circuit found implied immunity for joint takeover bids "because the SEC has the power to regulate bidders' agreements under [the Williams Act] . . . *and has implicitly*

authorized them by requiring their disclosure . . . as part of a takeover battle." 915 F.2d at 831 (emphasis added). Similarly, the Second Circuit found immunity in *Friedman* where the SEC made a "deliberate and significant" decision to not prohibit the challenged conduct. *Friedman*, slip op. at 11-12.

Implied immunity does not extend beyond the conduct that Congress or the regulatory agency has expressly or implicitly approved. Even an express exemption for agency-approved conduct creates no implied immunity for conduct that has not been approved. *United States v. Borden Co.*, 308 U.S. 188, 197-201 (1939) (Sherman Act was repealed as to marketing agreements approved by the Secretary of Agriculture under the Agricultural Marketing Agreement Act of 1937, but not as to unapproved agreements); *Carnation*, 383 U.S. at 215-17 (price fixing agreements approved by the Federal Maritime Commission under the Shipping Act were exempt from the antitrust laws; unapproved agreements remained subject to the antitrust laws). More generally, implied immunity will not be based on agency authority to regulate a type of conduct if the regulator has not expressly or implicitly exercised its authority and authorized the conduct at issue. *E.g., Northeastern Tel.*, 651 F.2d at 84 (FCC had initially permitted the allegedly anticompetitive tariff conditions to take effect, but because it had never approved the tariff, "no conflict will arise between the Federal Communications

Act and the antitrust laws if we hold that [AT&T is] subject to antitrust liability for" those conditions).

Nor does application of the antitrust laws create a conflict if the regulatory agency has exercised its authority to *prohibit* the challenged conduct. Thus, the Second Circuit has squarely rejected the argument that "conduct specifically prohibited by the [applicable regulatory law] cannot be the basis for a treble damage award under the antitrust laws." *Strobl*, 768 F.2d at 24. Reading *Gordon*, *Silver,* 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 Second Circuit in *Strobl* found no antitrust immunity for conduct (price manipulation), prohibited under both the Commodity Exchange Act and the antitrust laws.[6]

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[6]The district court in *Stock Exchanges Options Trading Antitrust Litigation*, No. 99 Civ. 962 (RCC), 2001 WL 128325 (S.D.N.Y. Feb. 15, 2001), we submit, did not properly apply established law in dismissing the complaint on implied immunity grounds. The United States has filed a brief as *amicus curiae* urging reversal in the pending Second Circuit appeal. Brief Amicus Curiae of the United States Urging Reversal (July 20, 2001), *Stock Exchange Options Trading Antitrust Litigation*, No. 01-7371 (2d Cir.). The SEC also filed an amicus statement in the district court in the *Options* case expressing its view that the conduct at issue was prohibited by SEC regulations and therefore not immune from the antitrust laws. *See* Statement of the Securities and Exchange Commission, as Amicus Curiae, on the Issue of Implied Repeal of the Antitrust Laws at 5-6 (June 16, 2000).

The Supreme Court also has underscored the importance of distinguishing between conduct approved under a regulatory scheme and conduct that violates regulatory norms. In *Ricci v. Chicago Mercantile Exchange,* 409 U.S. 289 (1972), the Court affirmed a stay of antitrust litigation pending administrative proceedings to determine whether the conduct at issue violated Chicago Mercantile Exchange rules, reasoning that *if* the conduct "was pursuant to a valid rule," antitrust immunity might be implied. *Id.* at 303. If the conduct was contrary to the rules, however, the basis for an immunity argument "disappears entirely," *id.* at 308, and "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 [Commodities Exchange] Commission are exclusive," *id.* at 304.

C. Immunity for Past Unapproved Conduct Is Not Required To Preserve Regulatory Flexibility

Defendants assert that the mere possibility of regulatory approval in the future warrants antitrust immunity for past conduct (*see* D. Mem. at 18, 38-40). But, as the Supreme Court has recognized, applying the antitrust laws to conduct that was not approved by the regulators when it occurred does not conflict or interfere with regulatory policy. If the agency (or Congress) changes regulatory

policy, subsequent conduct that is authorized under the new policy will be immune from the antitrust laws.[7] In *Carnation*, for example, the Court, drawing on *United States Navigation Co. v. Cunard Steamship Co.*, 284 U.S. 474 (1932), and *Far East Conference v. United States*, 342 U.S. 570 (1952), held that courts may "subject activities which are clearly unlawful under the Shipping Act to antitrust sanctions so long as the courts refrain from taking action which might interfere with the Commission's exercise of its lawful powers." 383 U.S. at 221. And, "[t]he award of treble damages for past and completed conduct which clearly violated the Shipping Act would certainly not interfere with any future action of the Commission." *Id.* at 222. Similarly, injunctive relief that is not "unconditional," *id.* at 221, would not interfere with future exercise of regulatory discretion.

Gordon v. New York Stock Exchange, 422 U.S. 659 (1975), is wholly consistent with these principles. There, the Court emphasized that the SEC had *approved* fixed commissions at the time the conduct at issue occurred, through

[7]As the SEC explained to the district court in the *Options* case, "'the Commission's regulatory authority to revisit the decision embodied in [the rule prohibiting the conduct at issue] continues, and . . . a different judgment about the desirability of competition in the future could compel a different result on the implied repeal issue.'" 2001 WL 128325 at *9 (quoting SEC Amicus Brief at 7).

actions whose effect was "equivalent to that of a formal order." 422 U.S. at 690 n.13. The SEC's subsequent decision to prohibit fixed commissions did not erase the preexisting conflict of standards as to the conduct for which treble damages were claimed, and a refusal to recognize immunity for conduct approved when it occurred "would render nugatory the legislative provision for regulatory agency supervision of exchange commission rates." *Id.* at 691. The Court had no occasion in *Gordon* to rule on conduct that was not approved when it occurred, and its emphasis on the SEC's prior approval of fixed commission rates negates any suggestion that the Court considered the mere possibility of future regulatory approval a sufficient reason to find antitrust immunity. *See Strobl,* 768 F.2d at 27. *See also Friedman*, slip op. at 11-12 (SEC made a "deliberate and significant" decision not to prohibit conduct).

II. Because the Complaints Allege Conduct Prohibited by the Securities Laws, They Should Not Be Dismissed on Implied Immunity Grounds Under Rule 12(b)(6)

A Rule 12(b)(6) motion must be denied unless "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957); *Gant v. Wallingford Bd. of Educ.*, 69 F.3d 669, 673 (2d Cir. 1995). In this case, the Amended Complaint and plaintiffs' response to the motion to dismiss are less

than clear as to who made the alleged agreement, what they agreed to do, what competition was restrained, and how the alleged competitive restraint operated to plaintiffs' detriment. Pfeiffer's complaint is similarly vague as to the "bribery" scheme he alleges. Whatever the merits of these complaints as a matter of antitrust law -- an issue on which the United States expresses no view -- they are based in part on alleged practices that the securities laws and SEC regulations prohibit. Thus the Rule 12(b)(6) motion should not be granted on *implied immunity* grounds.

Prohibitions on fraud and manipulation in the sale of securities have been at the core of federal securities law since enactment of the Securities Act of 1933. Section 17(a) of the 1933 Act, 15 U.S.C. 77q(a), "the 'grandfather' of all the SEC fraud provisions," Louis Loss & Joel Seligman, Fundamentals of Securities Regulation 838 (4th ed. 2001), prohibits all forms of fraud, and untrue or misleading statements or omissions of material facts, in the offer or sale of any securities. Section 9(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78i(a), contains additional prohibitions on manipulation of prices for securities listed on a national securities exchange. Sections 9(a)(1)-(5) of the Exchange Act, 15 U.S.C. 78i(a)(1)-(5) prohibit a variety of transactions and techniques for the purpose of creating a false or misleading appearance of active trading, or for

the purpose of raising or depressing the price of a security to induce sales or purchases. Section 9(a)(6), 15 U.S.C. 78i(a)(6), outlaws "pegging, fixing, or stabilizing the price of [a listed] security in contravention of such rules and regulations as the Commission may prescribe."

Securities and Exchange Commission Regulation M, 17 C.F.R. 242, is among the most important of the regulations that implement the statutory prohibitions on fraud and manipulation in connection with an offering of securities. Regulation M specifically provides that it is unlawful (with certain limited exceptions) for underwriters "directly or indirectly, to bid for, purchase, or attempt to induce any person to bid for or purchase, a covered security during the applicable restricted period." Rule 101(a), 17 C.F.R. 242.101(a). Further, "[s]tabilizing is prohibited except for the purpose of preventing or retarding a decline in the market price of a security." Rule 104(b), 17 C.F.R. 242.104(b).

As the SEC staff has explained, the purpose of Regulation M is "to protect the integrity of the offering process by precluding activities that could artificially influence the market for the offered security." Division of Market Regulation, U.S. Securities and Exchange Comm'n, Staff Legal Bulletin No. 10, Prohibited Solicitations and "Tie-in" Agreements for Aftermarket Purchases ¶2 (August 25,

2000) ("Bulletin 10").[8] To that end, "solicitations or other inducements by distribution participants during the distribution to generate purchases in the aftermarket are prohibited until the distribution is completed." *Id.*

In Bulletin 10, the SEC staff addressed "complaints that, while participating in a distribution of securities, underwriters and broker-dealers have solicited their customers to make additional purchases of the offered security after trading in the security begins," and that "some underwriters have required their customers to agree to buy additional shares in the aftermarket as a condition to being allocated shares in the distribution (*i.e.*, 'tie-in' agreements)." Bulletin 10 ¶1. Reiterating the SEC's consistent view, the staff explained:

> Tie-in agreements are a particularly egregious form of solicited transaction prohibited by Regulation M. As far back as 1961, the Commission . . . said that such agreements may violate the anti-manipulative provisions of the Exchange Act, particularly Rule 10b-6 (which was replaced by Rules 101 and 102 of Regulation M) under the Exchange Act, and may violate other provisions of the federal securities laws.
>
> Solicitations and tie-in agreements for aftermarket purchases are manipulative because they undermine the integrity of the market as an independent pricing mechanism for the offered security. Solicitations for aftermarket purchases give purchasers in the offering

[8] Attached as Addendum A to this memorandum.

> the impression that there is a scarcity of the offered securities. This can stimulate demand and support the pricing of the offering. Moreover, traders in the aftermarket will not know that the aftermarket demand, which may appear to validate the offering price, has been stimulated by the distribution participants. Underwriters have an incentive to artificially influence aftermarket activity because they have underwritten the risk of the offering, and a poor aftermarket performance could result in reputational and subsequent financial loss.

Id. ¶2 (footnotes omitted). Accordingly, the staff cautioned underwriters that "solicitations and tie-in agreements for aftermarket purchases before a distribution is completed are manipulative sales practices prohibited by Rules 101 and 102 of Regulation M, and may violate other anti-fraud and anti-manipulation provisions of the federal securities laws." *Id*. ¶3 (footnote omitted).

In this case, plaintiffs contend that they are challenging the kind of solicitation and tie-in agreements that were the subject of Bulletin 10, as well as other fraudulent and manipulative practices prohibited by the securities laws and SEC regulations. *See* Am. Complaint ¶¶4, 6, 7; Pfeiffer Complaint ¶84;

Response at 25-32;[9] Pfeiffer Opp. at 5-6 and n.5.[10] There can be no basis for a contention -- and defendants do not argue -- that the SEC has expressly or implicitly approved tie-in requirements or agreements to impose them.[11] *Compare Friedman*, slip op. 9-12 (SEC had made deliberate decision not to prohibit practices). Accordingly, because antitrust scrutiny of these allegations would not conflict with or be repugnant to the regulatory scheme, the complaints should not be dismissed on *implied immunity* grounds under Rule 12(b)(6).

The United States does not address whether the Amended Complaint and the Pfeiffer Complaint should be dismissed on *other* grounds under Rule

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[9]"Response" refers to Plaintiffs' Corrected Response to Defendants' Motion To Dismiss the Federal Antitrust Claims (July 24, 2002).

[10]"Pfeiffer Opp." refers to the Memorandum on Behalf of Plaintiff Pfeiffer in Opposition to Defendants' Motion to Dismiss the Robinson-Patman Claim Under Section 2(c) (July 8, 2002).

[11]Although the SEC regulations do not specifically address *agreements* among underwriters to engage in prohibited solicitations and tie-ins for aftermarket purchases, the securities law prohibitions do not depend on whether such practices are implemented by individual underwriters, through a syndicate, or pursuant to an industry-wide agreement.

Section 5(c) of the 1933 Act, 15 U.S.C. 77e(c), also prohibits a sale or offer to sell securities unless a registration statement has been filed. *See* Loss and Seligman, *supra*, at 82-84. Alleged requirements that customers purchase stock in any IPO for which a registration statement has not yet been filed would violate this prohibition as well.

12(b)(6). If the complaints are not dismissed, of course, plaintiffs will have the burden of proving the alleged antitrust violations. It is unclear at this point what evidence they intend to adduce in support of their generalized assertions. The Amended Complaint alleges that "defendants continuously communicated and worked together as co-underwriters and members of underwriting syndicates," Am. Complaint ¶45, and that they "abused the preexisting practice of combining into underwriting syndicates by implementing the unlawful agreement alleged . . . through such syndicates," *id.* ¶5. Many of the factual allegations of the Amended Complaint as to the "making and implementation of defendants' unlawful agreement," *id.* ¶¶44-64, appear merely to describe accepted practices of syndicated underwriters that are approved by the SEC and would not violate the antitrust laws, *see United States v. Morgan*, 118 F.Supp. 621, 691 (S.D.N.Y. 1953); *Friedman v. Solomon/Smith Barney, Inc.*, No. 98 Civ. 5990 (NRB), 2000 WL 1804719 (S.D.N.Y. Dec. 8, 2000), *aff'd,* No. 01-7207 (2d Cir. Dec. 20, 2002).[12] Nonetheless, plaintiffs maintain that while "the

[12]Mere evidence that the defendants had an opportunity to conspire while engaging in legal activities will not meet plaintiffs' burden of proof at trial or defeat a defense motion for summary judgment. *See, e.g., United States v. Taubman*, 297 F.3d 161, 166 (2d Cir. 2002) (antitrust conspiracy may not be inferred from mere fact of meetings between persons engaged in competing businesses); *Schwimmer v. Sony Corp. of America*, 677 F.2d 946, 953 (2d Cir.

[Amended] Complaint describes the 'syndicate system,'" it "does not challenge its propriety." Response at 3.

The United States expresses no view as to the merits of plaintiffs' antitrust complaints. Antitrust suits are not a proper vehicle for advancing complaints about violations of the securities laws under another label. To pursue an antitrust claim, plaintiffs are obliged to plead and prove that defendants' committed conduct meets the standards of the Sherman Act. We submit, however, that the complaints should not be dismissed on implied immunity grounds under Rule 12(b)(6) merely because regulated conduct is involved.

1982) ("'mere showing of close relations or frequent meetings between the alleged conspirators'" would be "insufficient as a matter of law to warrant the inference of a conspiracy") (quoting *Oreck v. Whirlpool Corp.*, 639 F.2d 75, 79 (2d Cir. 1980)).

CONCLUSION

The Court should not dismiss the complaints on implied immunity grounds under Rule 12(b)(6).

Respectfully submitted.

R. HEWITT PATE
Acting Assistant Attorney General

CATHERINE G. O'SULLIVAN

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NANCY C. GARRISON (NG4640)
GEORGE S. BARANKO
Attorneys
Antitrust Division
U.S. Department of Justice
601 D Street NW
Washington, DC 20530
(202) 514-1531

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Addendum A

Division of Market Regulation, U.S. Securities and Exchange Comm'n, Staff Legal Bulletin No. 10, Prohibited Solicitations and "Tie-in" Agreements for Aftermarket Purchases (August 25, 2000) ("Bulletin 10")

U.S. Securities and Exchange Commission

Division of Market Regulation: Staff Legal Bulletin No. 10

Prohibited Solicitations and "Tie-in" Agreements for Aftermarket Purchases

Action: Publication of Division of Market Regulation Staff Legal Bulletin.

Date: August 25, 2000.

Summary: This staff legal bulletin (bulletin) sets forth the views of the Division of Market Regulation (Division), reminding underwriters, broker-dealers, and any other person who is participating in a distribution of securities (distribution participants), that they are prohibited from soliciting or requiring their customers to make aftermarket purchases until the distribution is completed.

Supplementary Information: The statements in this bulletin represent the views of the Division's staff. This bulletin is not a rule, regulation, or statement of the Securities and Exchange Commission (Commission). Further, the Commission has neither approved nor disapproved its content.

Contact Persons: For further information, please contact: James Brigagliano, Assistant Director, or Joan Collopy, Special Counsel, in the Office of Trading Practices, Division of Market Regulation, at (202) 942-0772.

1. Solicitations and "Tie-in" Agreements for Aftermarket Purchases

Recently, the Division has become aware of complaints that, while participating in a distribution of securities, underwriters and broker-dealers have solicited their customers to make additional purchases of the offered security after trading in the security begins. Moreover, some underwriters have required their customers to agree to buy additional shares in the aftermarket as a condition to being allocated shares in the distribution (*i.e.*, "tie-in" agreements). These practices are prohibited by Rules 101 and 102 of Regulation M,[1] and may violate other anti-fraud and anti-manipulation provisions of the federal securities laws.[2]

2. Regulation M Prohibits Solicitations and "Tie-in" Agreements

One of the principal purposes of the federal securities laws is to protect the integrity of the process for offering securities to the public. As an anti-manipulation regulation, Regulation M is intended to protect the integrity of the offering process by precluding activities that could artificially influence the market for the offered security. In particular,

Regulation M prohibits distribution participants from "directly or indirectly . . . attempt[ing] to induce any person to bid for or purchase" any security that is the subject of a distribution otherwise than in the distribution.[3] Thus, solicitations or other inducements by distribution participants during the distribution to generate purchases in the aftermarket are prohibited until the distribution is completed.[4]

Tie-in agreements are a particularly egregious form of solicited transaction prohibited by Regulation M. As far back as 1961, the Commission addressed reports that certain dealers participating in distributions of new issues had been making allotments to their customers only if such customers agreed to make some comparable purchase in the open market after the issue was initially sold.[5] The Commission said that such agreements may violate the anti-manipulative provisions of the Exchange Act, particularly Rule 10b-6 (which was replaced by Rules 101 and 102 of Regulation M) under the Exchange Act, and may violate other provisions of the federal securities laws.[6]

Solicitations and tie-in agreements for aftermarket purchases are manipulative because they undermine the integrity of the market as an independent pricing mechanism for the offered security.[7] Solicitations for aftermarket purchases give purchasers in the offering the impression that there is a scarcity of the offered securities.[8] This can stimulate demand and support the pricing of the offering. Moreover, traders in the aftermarket will not know that the aftermarket demand, which may appear to validate the offering price, has been stimulated by the distribution participants. Underwriters have an incentive to artificially influence aftermarket activity because they have underwritten the risk of the offering, and a poor aftermarket performance could result in reputational and subsequent financial loss.[9]

3. Conclusion

For these reasons, the Division reminds distribution participants that solicitations and tie-in agreements for aftermarket purchases before a distribution is completed are manipulative sales practices prohibited by Rules 101 and 102 of Regulation M,[10] and may violate other anti-fraud and anti-manipulation provisions of the federal securities laws.

Footnotes

1 17 CFR 242.101 and 242.102. Regulation M applies to a "distribution" of securities, which is defined in 17 CFR 242.100 to mean any offering of securities that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods. This bulletin does not address any other securities laws issues that solicitations and tie-in agreements may raise.

2 *See* Securities Exchange Act Release No. 6536 (April 24, 1961). The Commission also has held that tie-ins are fraudulent devices that

violate Section 17(a) of the Securities Act of 1933 (Securities Act) and Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), and Rule 10b-5 under the Exchange Act, because they facilitate material omissions in connection with the offer or sale of securities. *See, e.g.*, *Richard D. Demaio*, Initial Decision Release No. 37 (August 4, 1993), Securities Exchange Release No. 33062 (October 15, 1993) (final release) (purchasers of IPO units also required to buy common stock in the immediate aftermarket).

"Purchase" is defined in Section 3 of the Exchange Act to include a contract to purchase, so an accepted solicitation and a tie-in agreement are prohibited purchases even though they are executed later (*i.e.*, when aftermarket trading begins). 15 USC 78c (a) (13).

3 Rule 101 of Regulation M applies specifically to underwriters, prospective underwriters, brokers, dealers, or other persons who have agreed to participate or are participating in a distribution of securities. Rule 102 applies to issuers, selling security holders, or any affiliated purchaser of such persons.

4 *See, e.g.*, *SEC v. Wexler*, Securities Exchange Act Release No. 13225 (April 22, 1992), Securities Exchange Release No. 14489 (September 21, 1995); *P.N. MacIntyre & Co., Inc.*, Securities Exchange Act Release No. 10694 (March 20, 1974); *S.E.C. v. Burns*, 816 F.2d 471, 476-77 (9 th Cir. 1987).

5 Securities Exchange Act Release No. 6536 (April 24, 1961).

6 *Id.* In 1974 and 1975, the Commission proposed Rule 10b-20 to ban tie-in agreements (including those discussed in this Bulletin) in connection with an offering of securities. *See* Securities Exchange Release No. 10636 (February 11, 1974), 39 FR 7806, and Securities Exchange Release No. 11328 (April 2, 1975), 40 FR 16090. Among other things, the proposed rule would have explicitly prohibited broker-dealers (and others) from (explicitly or implicitly) demanding from their customers any payment or consideration (including a requirement to purchase other securities) in addition to the announced offering price of the offered security. This would include, for example, conditioning an allocation of shares in a "hot issue" (for which demand exceeds supply) on an agreement to buy shares in another offering or in the aftermarket of another offering, for which there may be a lack of demand. The proposal was withdrawn in 1988, in part due to the passage of time since proposing, and because the Commission concluded that such agreements may be reached under the existing anti-fraud and anti-manipulation provisions of the federal securities laws. *See* Securities Exchange Release No. 26182 (October 14, 1988), 53 FR 41206. *See also C. James Padgett*, 52 SEC 1257 (1997), *aff'd sub. nom*, *Sullivan v. SEC*, 159 F.3d 637 (D.C.Cir. 1998). In *Padgett*, the IPO purchasers were obligated to sell their shares back to the firm at the beginning of aftermarket trading. The Commission determined that this agreement created a materially false impression of the extent of aftermarket activity. As such, the tie-in agreement operated as a fraud upon the market and defrauded aftermarket purchasers in violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act, and Rule 10b-5 under the Exchange Act.

7 Regulation M applies to distributions of securities with an existing trading market and to IPOs.

8 In *Padgett*, *supra* note 6, the Commission noted that tie-in agreements also can increase a firm's control over the supply of a security by ensuring that IPO purchasers will sell their IPO shares back to the firm rather than to the firm's competitors. Control over the supply of the security increases a firm's ability to control the security's price (*i.e.*, such control would enable the firm to artificially inflate both the repurchase and resale prices, creating the appearance of active interest in the issue). In a competitive market, an increased supply of the security could reasonably be expected to lower the security's price.

Tie-in agreements that require purchasers in the distribution to sell their shares back to the firm also raise concerns whether the firm has actually completed its participation in the distribution. The provisions of Regulation M continue to apply until all of the shares have come to rest in the hands of investors. *See* Securities Exchange Act Release No. 38067 (December 20, 1996), 62 FR 520.

9 *See Walk-In Medical Centers, Inc. v. Breuer Capital Corp.*, 818 F.2d 260 (2d Cir. 1987).

10 While Rules 101 and 102 contain exceptions for certain activities and types of securities, it is highly unlikely that any of those exceptions would apply to the offerings discussed in this bulletin.

http://www.sec.gov/interps/legal/slbmr10.htm

CERTIFICATE OF SERVICE

I, Nancy C. Garrison, certify that on this 20th day of December 2002, copies of the Memorandum of the United States as Amicus Curiae were served by Federal Express next day delivery, and by fax, on counsel for the parties:

Robert B. McCaw
WILMER, CUTLER & PICKERING
399 Park Avenue
New York, NY 10022
(212) 230-8800
(212) 719-4677 (fax)
Counsel for Defendants

Christopher Lovell
LOVELL STEWART HALEBIAN LLP
500 Fifth Avenue
New York, NY 10110
(212) 608-1900
(212) 230-8888 (fax)
Counsel for Plaintiffs

Russel H. Beatie
BEATIE AND OSBORN LLP
521 Fifth Avenue, 34th Floor
New York, NY 10175
(212) 888-9000
(212) 888-9664 (fax)
Counsel for Pfeiffer Plaintiffs

and by hand delivery, and by electronic mail, to counsel for amicus curiae

Securities and Exchange Commission:

Mark Pennington
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549-0606
(202) 942-0928
(202) 942-9625 (fax)

____

NANCY C. GARRISON (NG4640)