Banking on 'Implied Immunity' From the Antitrust Laws

Suzanne E. Wachsstock and Joellen Valentine
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Several of the nation's leading investment banks, including Credit Suisse First Boston Corp., Goldman Sachs & Co., Lehman Brothers Inc., Merrill Lynch Inc., Morgan Stanley & Co. Inc., Salomon Smith Barney Inc., and J.P. Morgan Securities Inc., hope to duplicate the recent success of other defendants and avoid antitrust liability for their activities relating to the ill-fated dot-com IPO boom. Faced with a large, consolidated class action brought by purchasers in technology IPO offerings, the banks have asked a Manhattan federal district court to dismiss the lawsuit, claiming in part that they have "implied immunity" from the federal antitrust laws for the actions alleged.

In the case, *In Re Initial Public Offering Antitrust Litigation* ("*IPO Antitrust*"), the IPO purchasers sued the banks, which underwrote the IPOs and provided brokerage services. Plaintiffs allege a conspiracy to raise IPO prices, in large part through a process known as "laddering," in violation of the antitrust laws.

In February, the banks lost their motions to dismiss a parallel securities action -- *In re Public Offering Securities Litigation* -- pending before Judge Shira Scheindlin of the Southern District of New York. They are hoping not to meet a similar fate when Judge William H. Pauley III decides whether *IPO Antitrust* can proceed. In particular, the banks are pinning their hopes on two recent decisions from the 2nd U.S. Circuit Court of Appeals that granted antitrust immunity to defendants also accused of securities-related misdeeds -- decisions that arguably pushed the boundaries of the immunity doctrine.

A HIGH-STAKES PROPOSITION

Given both the current climate of skepticism about corporate integrity and evaporating high-tech IPO valuations, it is not surprising that investors are looking for multiple avenues to attack alleged stock-related wrongdoing. Whether the courts allow or prohibit parallel antitrust and securities law challenges to the same conduct has serious implications for both plaintiffs and defendants in securities actions -- and, indeed, for litigants involved in any number of other regulated industries. These implications range from the different pleading requirements at the initiation of these claims, to the divergent damages that may be available at the conclusion of antitrust and regulatory actions.

Recognizing the high stakes, several outside players have weighed in on the debate. On the court's invitation, both the Department of Justice and the Securities and Exchange Commission ("SEC") filed amicus briefs in December (the DOJ opposes immunity in this case, while the SEC supports it). In February, the office of New York Attorney General Eliot Spitzer filed an amicus letter -- a rare event at the trial court level -- siding with the IPO purchasers. Letter briefing by the parties has continued through January and February.

THE SECURITIES LAWS AND ANTITRUST: 'PLAINLY REPUGNANT' OR 'PERVASIVE SCHEME'?

The banks argue that the antitrust laws are simply inapplicable to conduct that the SEC has the authority to regulate, and over which it has "actively exercised" its authority to regulate. Since, they claim, the SEC *could* permit their alleged activities -- even if it has not done so to date -- they insist that aggrieved investors cannot use the antitrust laws to challenge their actions.

The banks' position rests on the doctrine of "implied immunity" or "implied repeal," first enunciated in the 1960s and 70s in three U.S. Supreme Court decisions, known as *Silver, Gordon* and *NASD*. Those decisions made clear that when an agency (such as the SEC) explicitly regulates the conduct challenged by plaintiffs in an antitrust suit and the agency's determination is "plainly repugnant" to the antitrust laws, the latter must give way. In particular, the court in each case emphasized the policy conflict between the securities and antitrust laws, noting that "the sole aim of antitrust legislation is to protect competition, whereas the SEC must consider, in addition, the economic health of the investors, the exchanges, and the securities industry." But the decisions also highlighted key limiting principles: Implied repeal of the antitrust laws is disfavored, and implied immunity should be found "only if necessary" and "to the minimum extent necessary."

In the final pages of its 38-page decision in *NASD*, however, the Supreme Court introduced a rather different notion -- that immunity is equally appropriate where a regulatory agency has authority over the

challenged activities through a "pervasive regulatory scheme," even if it has not yet actually regulated that conduct. It is the scope of this notion (the subject of a vigorous dissent in *NASD*) that has become the focal point for recent lower court decisions, including the *IPO Antitrust* litigation.

JUST WHAT IS 'PERVASIVE' ENOUGH?

During oral argument in mid-January, U.S. District Judge William H. Pauley pushed the parties on several key questions, including whether any of the challenged activities had been permitted by the SEC and whether the SEC could, if it wanted to, permit any aspect of the alleged conduct. After reserving decision, Judge Pauley permitted additional briefing on the implied immunity issue.

In particular, the court is interested in the implications of two decisions, *Friedman v. Solomon/Smith Barney* (*"Friedman"*) and *In Re Stock Exchanges Options Trading Antitrust Litigation* ("*Options*"), decided in late 2002 and early 2003, that are the 2nd Circuit's most recent pronouncements on the scope of antitrust immunity. In these decisions, while still citing the Supreme Court's "clear repugnancy" language, the 2nd Circuit found immunity appropriate in "two narrowly-defined situations" -- "when an agency, acting pursuant to a specific Congressional directive, actively regulates the particular conduct challenged," or "when the regulatory scheme is so pervasive that Congress must be assumed to have forsworn the paradigm of competition." But just how "pervasive" is pervasive enough?

Both *Options* and *Friedman* dismissed the antitrust claims at issue, finding implied immunity on the basis of the SEC's continuing, active review of the challenged practices and the "potential for conflicts" between SEC authority and the antitrust laws, should the SEC decide in the future to regulate the alleged conduct. Central to both cases was the court's conclusion that allowing parallel antitrust and securities lawsuits to proceed could subject defendants to conflicting mandates -- even if that conflict might only arise at some future time. (Notably, the *Options* court rejected the SEC's own conclusion, in its amicus brief in that action, that this was an "unusual case" in which immunity was not necessary, because the Commission had actually prohibited the challenged conduct.)

Not surprisingly, the plaintiff investors in *IPO Antitrust* attempt to distinguish *Friedman* and *Options*. They argue that in this case, the SEC lacks the authority to permit the precise conduct they allege to violate the antitrust laws. Thus, they claim, there can be no conflict between the securities and the antitrust regimes. The defendants, by contrast, argue that the alleged conduct relating to IPO pricing is either expressly permissible under current SEC regulations, or is conduct that the Commission has actively investigated, and has specific authority to regulate.

THE IMPLICATIONS

The parties in the *IPO Antitrust* matter all recognize that immunity from the antitrust laws -- laws that Attorney General Spitzer's office described as "the most fundamental code of business conduct" -- is not to be lightly found. Indeed, in light of these central principles, the broad notions that now ground immunity, like "pervasive regulatory schemes" and "potential for conflict," must continue to be carefully defined and delimited, as the 2nd Circuit aimed to do in *Options* and *Friedman*. This caution is particularly warranted in the era of Sarbanes-Oxley, in which the SEC's regulatory authority continues to grow in response to ever-increasing evidence of wrongdoing in the securities arena.

Importantly, the issues central to this case are hardly limited to the securities realm. Claims of implied immunity routinely arise in the interface of antitrust law and a range of regulatory areas as diverse as health care, electric power and sports associations. Indeed, greater clarity about these issues may soon emerge from the Supreme Court itself, which has just agreed to hear a case involving the overlap between the antitrust laws and regulation in the telecommunication industry (*Trinko v. Bell Atlantic*).

But until that point, Judge Pauley, and other judges handling similar multi-front securities/antitrust actions, face both a challenge and an opportunity to more clearly define the scope of implied repeal. Such a ruling would, at a minimum, give some much needed certainty to investors, banks, and stock exchanges alike.

Suzanne Wachsstock *is counsel in the Stamford, Conn., office of Wiggin & Dana (www.wiggin.com), and a member of the firm's Antitrust and Trade Regulation and White-Collar Defense, Investigations & Corporate Compliance Practice Groups. Her practice focuses primarily on antitrust and commercial litigation, antitrust analysis of mergers, acquisitions and other forms of competitor collaborations, antitrust counseling regarding customer, supplier and competitor relationships, internal investigations and corporate compliance. She can be reached at 203-363-7601 or swachsstock@wiggin.com*.

Joellen Valentine *is an associate in the Stamford office of Wiggin & Dana. Her practice focuses primarily on white-collar defense, internal investigations and corporate compliance, antitrust and other complex litigation. She can be reached at 203 363-7626 or jvalentine@wiggin.com.*