CASE NOTE:

The *Credit Suisse* Decision and U.S. Financial Markets

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by

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A recent U.S. Supreme Court decision could help bolster America's standing as a competitive location for capital formation. Or at the very least, the decision has forestalled the onslaught of plaintiff antitrust claims against Wall Street's IPO underwriting process.

In a 7-1 vote, the U.S. Supreme Court held in *Credit Suisse Securities (USA) LLC v. Billing* that the securities laws implicitly precluded application of the antitrust laws to the practice of tying the sale of IPO shares to the sale of less desirable shares in the aftermarket and "laddering" the sales of such shares.

In the case, a group of investment banks – including Goldman Sachs, Merrill Lynch, Morgan Stanley, Citigroup, J.P. Morgan, and others – petitioned the Court to reverse the Second Circuit Court of Appeals and grant implied antitrust immunity to their IPO underwriting process, which investors complained violated the Sherman Act. The respondent investors argued that a horizontal conspiracy was entered into among the investment banks to create pools of orders to drive up the price of less attractive shares in the aftermarket. Tie-ins – between allocation of shares in the IPO and purchases of stock in the aftermarket – and laddering agreements both made this possible.

The investors brought a class action suit in U.S. District Court, Southern District of New York. The District Court ruled in favor of the banks and dismissed the case on the grounds that the pervasive regulation of the sale of securities by the Securities and Exchange Commission (SEC) immunized the banks from antitrust liability. The Second Circuit Court of Appeals reversed and reinstated the complaint against the investment banks.

Much was at stake in the Supreme Court's decision. If the Court decided in favor of the investors, investment banks could suddenly be subjected to an onslaught of antitrust litigation, including treble damages under Section 4 of the Clayton Act. The immediate impact on the U.S. economy would have been apparent: the cost of capital

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formation could increase and the appeal of the U.S. as a location for new start-up companies could have been significantly diminished. Companies seeking capital could have structured their IPOs in London, Hong Kong, or Frankfurt and avoided the problem entirely.

The legal question posed to the Court concerned whether there is an incompatibility between the antitrust claims and the federal securities law. In determining that there was, the Court relied on a line of cases beginning with *Silver v. New York Stock Exchange*,[1] and concluded with *Gordon v. New York Stock Exchange*.[2]

The *Gordon* case involved a challenge to stockbroker commissions on grounds that they were set through price fixing and therefore violated the Sherman Act. In reaching the conclusion that the securities laws implicitly precluded the application of the antitrust laws, the *Gordon* Court established that: securities laws gave the SEC power over fixing commissions; the SEC had assumed a continuing role regarding the setting of the commissions; and, without antitrust immunity, the exchanges and members would be subject to conflicting standards.

While the Court did not explicitly immunize the banks' conduct from antitrust liability, it did come very close. Drawing from *Gordon*, the Court in *Credit Suisse* required the following for avoiding the antitrust laws: the existence of authority to regulate the activities in question; evidence that the SEC exercises that authority; a risk that if the securities and antitrust laws were both applicable, they would produce a conflict; and the conflict would affect financial market activity that securities laws seek to regulate.

The Court concluded that the alleged antitrust conduct constituted an essential ingredient for an underwriting or capital-raising campaign for the issuing company. This conclusion was in agreement with the SEC's Amicus Brief filed in the District Court. Interestingly, before its submission to the Court, the SEC modified its view and joined with the Solicitor General and the Antitrust Division of the Department of Justice to file an Amicus Brief to the Court supporting the position that preclusion was inappropriate in this case. Despite the SEC's support for the Solicitor General's position, the Court dismissed the Solicitor General's proposed solution.

Drawing the line between permissible and impermissible conduct was a determination the Court decided was best left to the SEC. It made note of the need for consistent and competent results in assessing these practices and decided that securities experts were highly preferred over judges and juries in antitrust cases. In addition, Justice Breyer underlined the fact that Congress, in an effort to weed out unmeritorious securities lawsuits, had tightened the procedural requirements for bringing securities claims. "To permit an antitrust lawsuit risks circumventing these requirements by permitting plaintiffs to dress what is essentially a securities complaint in antitrust clothing."

[1] 373 U.S. 341 (1963).
[2] 422 U.S. 659 (1975).

Convinced of the importance of ensuring that the SEC was the final arbiter of disputes involving the IPO underwriting process, the Court's decision will prohibit claims brought forth under the Clayton Act.

Arriving at a practical solution was critical, because ultimately the issue was not what is best for the investment banks but what is best for the United States. W. R. Hambrecht & Co., which was not a defendant in this case but submitted an Amicus Brief, argued in favor of dismissing the investors' claims against the investment banks and brought the Open IPO Auction process, a concept it has pioneered, to the attention of the Court. Such auctions are totally in compliance with antitrust laws because they allow the market to set the pricing of securities of issuing companies.

In order to stay competitive in the global economy, the United States cannot afford to make it more difficult to raise capital here than in our competitors' cities. It seems evident that the Court did not wish to contribute to harming the financial markets. Carving out an exception to the antitrust laws for IPO underwriting was a far easier undertaking.