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SUPREME COURT FINDS THAT SECURITIES LAWS PREEMPT ANTITRUST LAWS IN IPO LITIGATION

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On June 18, 2007, the Supreme Court reversed the Court of Appeals for the Second Circuit's ruling in *Credit Suisse Securities v. Billing*, holding that the district court correctly dismissed complaints alleging certain investment banks violated various federal and state antitrust laws by the manner in which they operated syndicates to underwrite the initial public offerings (IPOs) of several hundred technology-related companies. *Credit Suisse Securities v. Billing*, (U.S. June 18, 2007) ("Slip Op."). The decision is significant because it conclusively sets forth the standard for deciding when federal securities laws implicitly preclude or preempt application of federal or state antitrust laws to conduct regulated by federal authorities. The Court held that, as a matter of law, there is implied preclusion where the securities laws and the antitrust complaint are "clearly incompatible" so that application of the antitrust laws would affect practices "squarely within the heartland of securities regulations," such as "financial market activity," that are subject to "active and ongoing" regulation by the appropriate federal authority. Slip Op. at 9-10, 19-20. Applying this standard, the Court concluded the securities laws precluded the plaintiffs' antitrust claims because (1) there was no dispute that the challenged conduct—the defendants' alleged activities in connection with the sale of newly issued securities—was adequately regulated; and (2) a serious conflict existed between the antitrust and securities regulatory regimes, such that application of the antitrust laws would pose "substantial risk of injury to the securities market." *Id*. at 18-20.

A. BACKGROUND

In *Credit Suisse*, putative classes of investors brought actions against several of the country's leading securities underwriting firms, alleging that the firms violated various federal and state antitrust laws by entering into illegal contracts with IPO purchasers that had the effect of artificially inflating the price of the securities in the aftermarket. Slip Op. at 3-4. In particular, the plaintiffs alleged the defendants conspired to violate the antitrust laws by requiring that, in exchange for receiving IPO allocations, investors must (1) place bids to purchase the newly issued securities in the aftermarket at prices above the IPO price, a practice known as "laddering"; (2) commit to purchase other less attractive securities, a practice called "tying"; and (3) pay excessive commissions on purchases of the issuers' shares in secondary public offerings. Slip Op. at 4.

The underwriters moved to dismiss the complaints on the ground that federal securities laws impliedly preclude application of the antitrust law to the alleged conduct. The United States District Court for the Southern District of New York agreed. Granting the motion to dismiss, the court held the Securities and Exchange Commission (SEC) through its "pervasive oversight" of the securities market, "either expressly permits" or "has the power to regulate the [alleged] conduct" *In re Initial Public Offering Antitrust Litig.*, 287 F. Supp. 2d 497, 523 (S.D.N.Y. 2003). Thus, the court concluded "a failure to find implied [antitrust] immunity would conflict with an overall regulatory scheme that empowers the [SEC] to allow conduct that the antitrust law would prohibit." *Id.*

On appeal, the Second Circuit reversed and remanded, holding that "the district court's decision goes too far" in finding implied immunity based on a potential conflict between the antitrust and securities laws. *Billing v. Credit Suisse*, 426 F.3d 130, 137 (2nd Cir. 2005). Even if a potential "conflict" exists, the Second Circuit held that any analysis of implied immunity requires "an inquiry into whether there is evidence of an implicit congressional intent to repeal the antitrust laws." *Credit Suisse*, 426 F.3d at 162. The Second Circuit concluded that there was no evidence of such intent. *First*, the relevant legislative history, the court held, provided no indication that Congress intended to provide antitrust immunity for the alleged conduct. *Id.* at 169. *Second*, the case was not one where the securities regime creates the potential for "irreconcilable mandates," since there was no showing the SEC "could compel the [alleged] anticompetitive conduct that the antitrust laws would prohibit." *Id. Third*, the defendants "fail[ed] to identify a single provision, phrase, or word within the securities laws that would be render[ed] nugatory by application of the antitrust laws." *Id. Finally*, in every case in which the Second Circuit or the Supreme Court had found implied antitrust immunity, the courts had done so following "SEC authorization" of the "specific anticompetitive behavior," and the agency had "never authorized" the conduct alleged by plaintiff. *Id.*

B. THE COURT'S OPINION

The Court began its analysis by reviewing its prior decisions regarding the relationship between the antitrust and federal securities laws. Those decisions, the Court noted, make clear that where regulatory statutes, such as the federal securities laws, "are silent in respect of the antitrust laws," any determination of whether they provide antitrust immunity necessarily requires an analysis of whether there is a "clear repugnancy" between the securities laws and the antitrust complaint or whether the two are "clearly incompatible." Slip Op. at 9-19. The Court held that together those decisions establish the following four factors as critical to a finding of whether there is sufficient incompatibility to warrant an implication of preclusion: "(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 law, if both applicable, would produce conflicting guidance, requirements, duties, privileges, or standards of conduct;" and (4) whether "the possible conflict affects practices that lie squarely within an area of financial market activity that the securities law seeks to regulate." *Id.* at 10.

Applying these principles, the Court concluded the first, second, and fourth factors were easily satisfied. *First*, the activities in question—the defendants' joint efforts as underwriters to promote and sell newly issued securities—were "central to the proper functioning of a well-regulated capital markets," and thus "lie at the very heart of the securities marketing enterprise." *Id*. at 10-11. *Second*, the challenged conduct was subject to regulatory authority, as "the law grants the SEC authority to supervise all of the activities in question." *Id*. at 11. *Third*, there was evidence that the SEC had exercised that authority by, among other things, defining in detail "what underwriters may and may not do and say" during the course of initial public offerings and by bringing enforcement "actions against underwriters who have violated [the applicable] regulations." *Id*. at 11.

The Court then turned, and devoted the bulk of its analysis, to the third factor—whether application of both the securities and antitrust laws would produce conflicting guidance and standards. Concluding that conflict would result and threaten serious securities-related harm, the Court first noted that application of the antitrust laws to the defendant's purported illegal conduct would pose a difficult and "unusually serious legal line-drawing problem" regarding what the SEC permits or encourages," for which there must be "antitrust immunity," and what the agency "forbid[s]," which, under the plaintiffs' "theory, should be open to antitrust attack." *Id*. at 11-12. For example, the Court noted that as it pertains to "laddering," while the SEC forbids underwriters from gathering information from customers prior to the completion of the initial distribution about their "immediate after market orders for IPO stock," it permits, and in fact "encourages" underwriters to ask customer about their "desired future positions in the longer term" (three to six month), "and the price at which they might accumulate that position." Slip. Op. at 14 (citing 70 Fed. Reg. 19675-76). Given such fine distinctions between the legal and illegal, the Court concluded that it would be difficult for someone not familiar with accepted syndicate practices to distinguish with confidence underwriter conduct that the SEC forbids (insisting on the purchase of shares in the immediate aftermarket) from permissible conduct (determining whether to allocate shares to investors who will make additional purchases in the long run). *Id*.

The Court also noted the problem inherent in the fact that "evidence tending to show unlawful antitrust activity and evidence tending to show lawful securities marketing activity may overlap, or prove identical." Slip Op. at 14. For example, the Court pointed out that a conversation between an investor and an underwriter about how long an investor intends to hold his new shares and at what price might very well elicit comments concerning both the investors' short and longer term plans. Such comments might, as the plaintiffs contended, provide evidence of laddering, or as the defendant argued, provide evidence of a lawful effort to provide shares to those who will hold them for a longer period. *Id*. at 15.

Further, there was a high likelihood of inconsistent application of the law that might result from plaintiffs bringing lawsuits in courts throughout the country before judges and juries lacking the requisite expertise in securities and antitrust laws. Given the "nuanced nature of the evidentiary evaluation necessary to separate the permissible from the impermissible," the Court held that "it will prove difficult for those many" and different "nonexpert judges" and "nonexpert juries" to reach "consistent results." *Id*. at 16.

The Court ultimately concluded that these factors—the fine securities related line separating the permissible from the impermissible, the overlapping evidence from which reasonable but contradictory inference may be drawn, and the risk of inconsistent court results—mean that there is no practical way to limit antitrust suits so that they challenge only the kind of activities the plaintiffs alleged in their complaints. Instead, these factors suggest that antitrust courts are likely to make unusually serious mistakes, and the threat of such mistakes means that underwriters would not simply avoid conduct that the securities laws forbid but also a wide range of legitimate conduct that they fear could lead to antitrust lawsuits and treble damages. *Id.* at 17.

The Court conceded that this kind of problem applies to some degree to antitrust lawsuits affecting industries other than the securities markets. However, given the "role that joint conduct plays in respect to the marketing of IPOs along with the important role IPOs themselves play in relation to the effective functioning of the capital markets," the Court found the potential for costly mistakes "unusually likely" where antitrust lawsuits, like those brought by the plaintiffs, challenge "conduct at the core of the marketing of new securities." *Id.* Moreover, there was no need to risk such harm to the workings of the financial securities market, in view of the fact that the "SEC actively enforces the rules and regulations that forbid the conduct in question," and investors harmed by unlawful underwriters' practices may obtain relief under the securities laws. *Id.* at 18-17.

C. JUSTICE STEVENS' CONCURRENCE

Justice Stevens concurred in the judgment of the Court on the grounds that the challenged conduct was not unlawful.

Although the plaintiffs claimed that the underwriters had engaged in price fixing, Justice Stevens believed that their purported agreements on price and other terms of sale to initial investors "should be treated as procompetitive joint ventures" that did not run afoul of the prohibition against "conspiracies in restraint of trade within the meaning of § 1 of the Sherman Act." (Stevens, J., concurring) (Slip Op. at 1). He noted that after initial distributions, the prices of newly issued securities "are determined by competition among the multitude of other securities traded in a free market." *Id.* at 1. Thus, he concluded that it "is frivolous" to suggest that an underwriting syndicate can restrain trade in the aftermarket "by manipulating the terms of IPOs." *Id.* The Justice found it possible that the underwriting practices at issue may have allowed the defendants to "divert some of the benefits of the offerings from the [IPO] issuers to themselves," thereby breaching their "fiduciary obligations to their principals." *Id.* at 2. However, any resultant injury the issuers suffered did not constitute "'antitrust injury,' giving rise to a damages claim by investors." *Id.*

D. CONCLUSION

The *Credit Suisse* decision erects a substantial bar for private antitrust damages lawsuits premised on conduct that occurs in a highly regulated securities offering. In order to survive a motion to dismiss on the ground that the securities laws impliedly preclude their complaints, plaintiffs bringing such a suit may not simply argue that the language, structure, or legislative history of the federal securities statutes evinces no implied congressional grant of antitrust immunity. Nor may the plaintiffs simply argue, as the plaintiffs did and the Second Circuit held in *Credit Suisse*, that the SEC's failure to compel or authorize the alleged conduct is sufficient to defeat a claim of immunity. Rather, the plaintiffs must show that there exists no conflict between the securities laws and the antitrust complaint and that the challenged conduct is not subject to active and ongoing regulation by the SEC.

For more information regarding the Credit Suisse decision, please contact your Arnold & Porter attorney or:

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