1/7/2010 N.Y.L.J. 4, (col. 1)

New York Law Journal
Volume 243

Thursday, January 7, 2010

Outside Counsel

PRECLUSIVE EFFECT OF SECURITIES LAWS ON ANTITRUST ACTIONS

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In Credit Suisse Sec. (USA) LLC v. Billing,[FN1] the U.S. Supreme Court addressed the implied preclusive effect of the federal securities laws on antitrust laws and established a four-factor test to evaluate whether antitrust laws are ‘clearly incompatible‘ with federal securities laws, and thus precluded. Since Billing was decided, federal courts, including just recently the U.S. Court of Appeals for the Second Circuit, have applied Billing's four-factor test with varying results.

Preclusive effect has been found where the conduct in question involved short selling[FN2] and public offerings,[FN3] two areas that are heavily regulated and actively enforced by the U.S. Securities and Exchange Commission (SEC). By contrast, federal securities laws have been found to have no preclusive effect on antitrust laws in cases involving tender offers under the Williams Act of 1968[FN4] and private equity transactions,[FN5] two areas that involve little or no substantive SEC regulation of the conduct in question.

The 'Billing' Four-Factor Test

In Billing, the U.S. Supreme Court was asked to determine whether antitrust claims against the defendant underwriter firms were implicitly precluded by the federal securities laws notwithstanding that the language of the savings clause of the federal securities laws did not specifically address antitrust laws.[FN6] Adopting a four-factor test, Billing held that antitrust claims were implicitly precluded by federal securities laws where there was:

(1) an area of conduct squarely within the heartland of securities regulations; (2) clear and adequate SEC authority to regulate; (3) active and ongoing agency regulation; and (4) a serious conflict between the antitrust and regulatory regimes.[FN7]

Billing involved antitrust claims brought against underwriting firms that marketed and distributed newly issued and publicly offered securities purchased by the plaintiffs.[FN8] The buyers alleged that the underwriters unlawfully colluded to sell initial public offering (IPO) shares only to buyers who committed: (1) to buy additional shares of that security after the offering at escalating prices (a practice known as ‘laddering‘); (2) to pay unusually high commissions on subsequent security purchases from the underwriters; or (3) to purchase from the underwriters other less desirable securities (a practice known as ‘tying‘).

In light of the SEC's active and extensive regulation of the conduct in question, public offerings of stock, the Supreme Court found that the first three factors of its test were readily satisfied. The challenged practices rested squarely within an area of financial market activity that the securities laws seek to regulate, satisfying the first factor.[FN9] The securities laws endow the SEC with authority to supervise the conduct at issue, satisfying the second factor,[FN10] and the SEC has continuously exercised its legal authority to regulate public offerings by, for example, defining in detail ‘what underwriters may and may not do and say‘ while marketing the securities, satisfying the third factor.[FN11] Further, the SEC has repeatedly brought regulatory actions against underwriters who have violated SEC regulations.

The fourth factor required the court to conduct a complicated analysis of the risk that the securities and antitrust laws, if both applicable, would produce conflicting standards of conduct. Of particular concern to the Court was the danger that a court addressing antitrust claims but lacking the SEC's expertise would have trouble interpreting the ‘fine, complex, detailed line separat[ing] activity that the SEC permits or encourages [and which is immune from antitrust liability] from activity that the SEC forbid[s] (and which on respondents' theory should be open to antitrust attack),‘[FN12] particularly in those cases where ‘evidence tending to show unlawful antitrust activity and evidence tending to show lawful securities marketing activity may overlap, or prove identical.‘[FN13]

For example, ‘in respect to 'laddering’ the SEC forbids an underwriter to 'solicit customers prior to the completion of the distribution regarding whether or not what price and in what quantity they intend to place immediate aftermarket orders for IPO stock.'‘[FN14] Yet, the SEC encourages underwriters to ‘inquir[e] as to a customer's desired future position in the longer term... and the price or prices at which the customer might accumulate that position without reference to immediate aftermarket activity.‘[FN15] The court opined that the SEC was best positioned to distinguish lawful from unlawful conduct.

The court also noted that the remedies available under the antitrust laws (treble damages) were more severe than the remedies available to private litigants under the federal securities laws. Therefore, the potential misapplication of the antitrust laws posed a greater danger of chilling conduct that was permitted or encouraged under the securities laws than a misapplication of the securities laws would.[FN16]

The Supreme Court concluded that these concerns justified a finding that the antitrust claims were precluded by the federal securities laws.

Relevant Cases Post 'Billing'

In the cases that have addressed the federal securities-antitrust law compatibility question after Billing, the pivotal issue has been whether the two bodies of laws would produce conflicting results.

In In re Short Sale Antitrust Litigation[FN17] (Short Sale) the plaintiffs (Short Sellers) alleged that they paid artificially inflated and unjustified fees to their stock brokers (Seller's Broker) in connection with the borrowing of securities in short sale securities transactions as a result of Seller's Brokers' conspiracy[FN18] Short Sellers alleged that in order to effectuate the conspiracy, Seller's Brokers communicated daily regarding which securities to classify as ‘hard-to-borrow‘ and what minimum borrowing rates to assign for those securities.

Further, Short Sellers claimed that because the defendants represented both Short Sellers and those purchasing the subject securities, they conspired not to enforce delivery of shorted securities, resulting in multiple failures-to-deliver being issued to the Short Sellers. The District Court dismissed the action holding that the federal antitrust claims were preempted by federal securities laws. Dismissal was recently affirmed on appeal.[FN19]

Applying the four Billings factors, the Second Circuit in Short Sales acknowledged that the outcome of its preclusion analysis would differ depending ‘on the level of particularity or generality at which each Billing [factor] is evaluated.‘[FN20] The court provided useful guidance on the application of the Billing factors, explaining that although ‘the fourth consideration—detection of a serious conflict—is evaluated at the level of the alleged anticompetitive conduct,‘ the first three factors are ‘evaluated at the level most useful to the court in achieving the overarching goal of avoiding conflict between the securities and antitrust regimes.‘[FN21]

The court focused on the ‘underlying market activity‘—short selling—to hold that this activity ‘is 'an area of conduct squarely within the heartland of securities regulation,’‘ and thus satisfied the first Billing factor.[FN22] As for the second and third factors, the court noted that while there was no specific regulation addressing borrowing fees, it was enough that the SEC possessed regulatory authority over the underlying market activity and the alleged anti-competitive conduct, ‘has the authority to regulate prime brokers in short selling [and] the borrowing fees charged by the prime brokers,‘[FN23] and actively regulates short sales as evidenced by its adoption and enforcement of Regulations SHO and a recent SEC roundtable.[FN24]

The fourth Billing factor—compatibility of the two bodies of law—required an analysis of the ‘impact that antitrust liability may have on arrangements for borrowing fees.‘ The Second Circuit concluded that the existence of both actual and potential conflicts that could harm the efficient functioning of the short selling market, and the possibility that the SEC might act on its authority to regulate the borrowing fees, warranted preclusion.[FN25] The court warned that the fact that neither body of law permits the collusive fixing of borrowing fees—the conduct complained of—is ‘not decisive.‘[FN26]

Further defining the parameters of preemption of antitrust laws by the federal securities laws, two district courts have declined to find preemption where SEC oversight over the transactions at issue is either nonexistent or limited to disclosure requirements. In Dahl v. Bain Capital Partners, LLC the court held that private equity leverage buyouts are inherently private in nature, and are ‘untouched by the securities laws.‘[FN27] In Pennsylvania Avenue Funds v. Borey the court found that insufficient evidence had been presented to support a ruling that the SEC's regulatory power over tender offers was so pervasive and actively enforced as to preclude application of the antitrust laws.[FN28]

In Dahi, shareholders of publicly-traded companies brought an action alleging an antitrust conspiracy carried out by the defendant private equity firms (‘PE Firms‘) that brought these companies private through leveraged buyouts (‘LBOs ‘). The plaintiffs alleged that the PE Firms conspired to pay less than fair value for the target companies' shareholders of the true value of their shares, by, inter alia, (1) submitting sham bids, (2) agreeing not to submit bids, (3) granting management certain incentives, and (4) including ‘losing‘ bidders in the final transaction.[FN29]

The Dahl court held that the antitrust claims were not preempted because ‘[p]rivate equity LBOs do not lie within the area of the financial market that the securities laws seek to regulate as their private, as opposed to public, nature leaves them untouched by the securities laws.‘[FN30] Moreover, PE Firms are exempt from regulation under the Investment Company Act, and their partners and employees are exempt from registration under the lnvestment Advisor Act, which reinforces the notion of their private nature. SEC filings required to be made by the target companies in conjunction with an LBO were deemed too insubstantial to support the conclusion that the SEC supervised the activity in question.[FN31]

In Pennsylvania Avenue Funds v. Borey, the court found that the reporting requirements associated with a tender offer do not empower the SEC to regulate the ‘Substantive Fairness‘ of tender offers. In Borey, the plaintiff sought to represent a class of investors in Watch-Guard Technologies Incorporated (Watch-Guard), a publicly traded corporation taken private via a tender offer and merger. The conduct at issue concerned the actions of two groups of entities which the court referred to as ‘FP‘ and ‘Vector.‘

FP and Vector initially submitted competing bids for the company; during the course of the bidding process, however, Vector and FP allegedly conspired to rig the bidding, such that Vector would stop pursuing WatchGuard and stand aside while FP made a lower bid, which WatchGuard's board accepted. Subsequently, Vector announced an agreement to fund half of FP's acquisition of WatchGuard in exchange for a 50 percent interest in WatchGuard after the acquisition.[FN32]

The defendants in Borey in favor of preemption of the antitrust laws based on the SEC's sweeping authority to regulate the disclosure of bidding agreements such as that between FP and Vector.[FN33] The court disagreed and distinguished the authority to require disclosures from the authority to regulate conduct. It pointed to the underlying premise of the Williams Act of 1968, which sets forth the reporting requirements for tender offers, that ‘the marketplace, not the SEC, govern[s] the substantial of a tender offer.‘[FN34]

Emphasizing Billing's holding that ‘preclusion depends on showing SEC regulatory authority and enforcement over 'all of the activities' that a plaintiff challenges as anticompetitive,‘[FN35] the court in Borey stated that ‘[d]efendants have not convinced the court either that the SEC possesses authority over the anticompetitive conduct that Plaintiff alleges, or that it has exercised that authority.‘[FN36] It concluded that ‘[i]f the SEC's power is limited to requiring disclosure, then the agency's exercise of that power does not conflict with antitrust law, under which disclosure is neither a remedy for anti-competitive conduct nor a defense to the imposition of liability.‘[FN37]

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FN1. 551 U.S. 264(2007).

FN2. See In re Short Sale Antitrust Litig., 527 F.Supp.2d 253 (SDNY 2007) [‘Short Sale‘].

FN3.See Dahl v. Bain Capital Partners, LLC, 589 F.Supp.2d 112 (D.Mass. 2008); Pennsylvania Avenue Funds v. Borey, 569 F.Supp.2d 1126, 1130-32 (W.D. Wash. 2008)

FN4.Borey, 569 F.Supp.2d at 1126.

FN5.Dahl, 589 F.Supp.2d at 112.

FN6. Billing, 551 U.S. at 270.

FN7.Id. at 285. Billing marks the first time that the Supreme Court expressly required the affected practice to lie squarely within an area of financial market activity that the securities laws seek to regulate.

FN8. Id. at 267.

FN9. Id. at 276 (the Court found the underwriters' efforts to promote and sell IPOs were ‘central to the proper functioning of a well-regulated capital market‘ and ‘lie at the very heart of the securities marketing enterprise‘).

FN10. Id. at 276.

FN11. Id. at 277.

FN12. Id. at 279.

FN13. Id. at 281.

FN14. Id. at 279 (quoting 70 Fed. Reg. 19675-19676 (emphasis deleted); 17 CFR §§242. 100-242. 105).

FN15. Id. (quoting 70 Fed. Reg. 19676). Similarly, with respect to the buyers' typing allegation, the SEC expressly prohibits and under-writer ‘from demanding...an offer from their customers of any payment or other consideration...in addition to the security's stated consideration.‘ 15 Yet, the SEC permits a firm to ‘allocat[e] IPO shares to a customer because the customer has separately retained the firm for other services, when the customer has not paid excessive compensation in relation to those services.‘ Id. (quoting 69 Fed Reg. 75785 n.108 (2004)).

FN16. See id. at 282.

FN17. 527 F.Supp. 2d 253 (SDNY 2007), aff'd 2009 WL 4350035 (2d Cir. Dec. 3, 2009.

FN18. Id. at 256.

FN19. In re Short Sate Litigation, 2009 WL 4350035, at 8.

FN20. Id at 1.

FN21. Id.

FN22. Id.at 3 (quoting Billing, 551 U.S. at 285).

FN23. Id at 4.

FN24. Id at 5.

FN25. Id at 8.

FN26. Id.

FN27. Dahl, 589 F.Supp.2d at 116.

FN28. 569 F.Supp.2d at 1130-32.

FN29. Dahl, 589 F.Supp.2d at 114.

FN30. Id. at 116.

FN31. Id. at 116-117.

FN32. Id. at 1128-29.

FN33. Id. at 1130 (citing 17 CFT §§240.14d-100, 240.14a-101).

FN34. Id. at 1131.

FN35. Id. (quoting Billings, 551 U.S. at 276-77).

FN36. Id. at 1132.

FN37. Id. at 1130. In so holding the court distinguished Finnegon a Campeau Corp., 915 F.2d 824 (2d Cir. 1990), a factually similar case, as a pre-Billing case that did not sufficiently place its emphasis on the existence of ‘SEC regulations that must 'define[] in detail’ what conduct [is] permissible [and] action by the SEC and private litigants to enforce those regulations.‘ Borey, 569 F.Supp. 2d at 1131-32.

1/7/2010 NYLJ 4, (col. 1)

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