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NOTE

Informal Bargaining Process: An Analysis of the
SEC's Regulation of the New York
Stock Exchange

by

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Justice Department¹⁰⁶ and the regional exchanges¹⁰⁷ led the SEC to call for public hearings to explore commission rates and related problems.¹⁰⁸

Throughout the summer of 1968, and sporadically since, the SEC has collected more than 6,000 pages of testimony on the commission rate structure.¹⁰⁹ The testimony is weighted to reflect traditional SEC/NYSE bargaining concerns. Much testimony is by New York Stock Exchange officials.¹¹⁰ The SEC's presentation of witnesses is to a large extent aimed at exposing give-up procedures.¹¹¹ Aside from a scattering of Wall Street mavericks,¹¹² it was necessary for the Justice Department to get involved by presenting several economists to place in the record fundamental questioning of fixed commission rates.¹¹³ Use of private,

preliminary hearings allowed SEC officials to prepare their witnesses and to inform SEC cross-examiners¹¹⁴ so that the hearings could be used as an effective publicity device to push support for commission rate reform including implementation of a volume discount.¹¹⁵ Although the hearings proved inadequate as a record upon which to base a decision, as the SEC recognized by continuing private data collection,¹¹⁶ they made possible the expression of outside views and forced the Exchange publicly to defend its position.

Opening the commission rate structure to public scrutiny proved effective in late summer 1968 when the Exchange announced its intention to institute a volume discount and abolish give-ups.¹¹⁷ By letting the wind out of SEC sails, the Exchange seemed determined through minor reform to maintain the basic commission structure.¹¹⁸ The 1968 compromise was considered but an "interim solution," and the SEC and Exchange continued their private negotiations for the next three years.¹¹⁹ In early 1970, with several major brokerage houses filing for bankruptcy,¹²⁰ completely private, secret negotiations between SEC and Exchange officials led to approval of a surcharge on small transactions less than two weeks after the Exchange requested it.¹²¹ Public hearings were held before renewal of the original 60-day "emergency

114. Securities Exchange Act Release No. 8328 (June 5, 1968) at 2, setting up procedures for the hearings, asks persons wishing to testify to file a description of the evidence to be presented to facilitate scheduling and "if necessary arranging preliminary conferences with and between interested participants."

115. The SEC was aware of most of the practices about which it presented witnesses at the hearings; see Securities Exchange Act Release No. 8239 (Jan. 26, 1968). Pointed questioning by SEC staff members, see note 111 *supra*, elicited answers which bolstered the Commission's criticism of give-ups.

116. N.Y. Times, Sept. 1, 1970, at 47, col. 7.

117. N.Y. Times, June 28, 1968, at 57, col. 8. The cut in commission rates caused by the proposed volume discount amounted to an estimated \$200 million per year. Loomis, *They're Tearing Up Wall Street*, 80 FORTUNE, Aug. 1, 1969, at 88, 158.

118. N.Y. Times, June 30, 1968, § 3, at 1, col. 5; and Aug. 9, 1968, at 1, col. 1; 5 L. LOSS, SECURITIES REGULATION § 182 (Supp. 1969).

While the SEC was publicly pushing the Exchange through the hearings, it was also privately pressuring it through threats of 19(b) action unless the Exchange abolished give-ups and instituted a volume discount or negotiated rates for large trades, as described in Independent Broker-Dealers' Association v. SEC, Civil No. 22,252 (D.C. Cir. March 4, 1971), at 7-11.

119. Approval of the Exchange interim plan was given in a Cohen to Haack letter of Aug. 30, 1968. Securities Exchange Act Release No. 8399 (Aug. 30, 1968).

120. See note 4 *supra*.

121. The approved surcharge of \$15 applied to orders of up to 1,000 shares, but was limited to not more than 50 per cent of the fixed commission. The letter from SEC Chairman Budge to Haack approving the surcharge included the stipulation: "The Commission . . . expects the exchanges will take all steps necessary to assure that full brokerage services to small investors are restored and that transaction size and other limitations on accounts of such investors which were imposed in the last year by a substantial portion of exchange membership will be removed." N.Y. Times, April 3, 1970, at 51, col. 6.

106. N.Y. Times, April 2, 1968, at 63, col. 5. The April 1, 1968 release of the COMMENTS OF THE U.S. DEPT. OF JUSTICE ON SEC RELEASE No. 8239, calling for negotiated commission rates on the Exchange, was considered "the worst blow of all" to Exchange hopes for maintaining the commission structure. Loomis, *Big Board, Big Volume, Big Trouble*, 77 FORTUNE, May 1968, at 146, 221. The Justice Department continued to play a major role in setting the tone for the commission rate structure dispute with its version of the evidence presented in the 1968 SEC hearings in JUSTICE DEPARTMENT, MEMORANDUM ON THE FIXED MINIMUM COMMISSION RATE STRUCTURE (Jan. 17, 1969). That memorandum found no justification for fixed commission rates to serve any purposes of the Exchange. Opposition to fixed rates was continued through the change in Presidential administration in JUSTICE DEPARTMENT, COMMENTS ON SEC RELEASE No. 8717 (Nov. 17, 1969) and JUSTICE DEPARTMENT, RESPONSE TO SEC RELEASE 8791 (March 20, 1970).

107. Midwest Stock Exchange President Michael Tobin denounced the "bilateral negotiations" between SEC and Exchange, Tobin to SEC letter, March 29, 1968, SEC b-10 file #S7-319-1-2 at the SEC in Washington.

108. Securities Exchange Act Release No. 8324 (May 28, 1968).

109. *SEC Rate Structure Investigation*, *supra* note 74.

110. *SEC Rate Structure Investigation*, *supra* note 74, at 23-137, 2540-807, 5162-417.

111. *SEC Rate Structure Investigation*, *supra* note 74, at 1372-403, 1420-54, 1601-23, 10-962, 1982-2050. With pointed questioning, the absurd justifications of give-ups were

plunged into the record. See the careful case being built up, through staff questioning,

of the amount a broker is willing to give up has no relation to the cost of his execution,

testimony of officials of Pershing & Co., at 144-207; and the case being built against a

mission that covers ancillary services whether or not the customer uses them,

testimony of William Donaldson of Donaldson, Lufkin & Jenrette, at 737-851. In question-

ing, officials of Fidelity Management and Research Co., at 1831-962, SEC Associate Director

of the Division of Trading and Markets Eugene Rotberg pushed especially hard to make

the Commission's point. After exposing a lie in Fidelity's testimony (at 1902), Rotberg led

witnesses through a description of give-ups made to foreign dealers to compensate

m for "information." Rotberg sarcastically asked the question he knew the witness

ld not answer: "Would you please tell us what information you thought Boettcher

getting from Hong Kong . . . Or Beirut, Lebanon?" at 1914. See similar questioning at

2-90, 1894-95, 2030-34.

12. *SEC Rate Structure Investigation*, *supra* note 74, testimony of M.A. Schapiro,

1904-4003, and testimony of Donald Weeden, at 1461-508, 4004-61.

13. Lionel Kestenbaum of the Antitrust Division of the Justice Department opened

Department's presentation of six witnesses at the SEC hearings: "The Department

evidenced that the Commission's evidentiary record on this issue would not be complete

out expert analysis and comment on the basic policy question and the Exchange's

economic argument." *SEC Rate Structure Investigation*, *supra* note 74, at 3527. To rebut

Exchange witnesses' arguments that fixed commission rates were necessary to maintain

long, central marketplace, the Justice Department presented economists Paul Samuel-

son at 3530-6222, William Baumol, at 3623-90, Henry Wallich, at 3757-805, and Harold

Seitz, at 3810-68.