In the

Supreme Court of the United States

UNITED STATES)
)
Appellant,)
)
v.)
)
National Association Of) No. 73-1701
Securties Dealers, Inc., et al.,)
)

Washington, D. C.
March 17, 1975

Pages 1 thru 76

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Appellant, :
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v. : No. 73-1701
:
NATIONAL ASSOCIATION OF :
SECURITIES DEALERS, INC., et al., :
:
Appellees. :
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Washington, D. C.,

Monday, March 17, 1975.

The above-entitled matter came on for argument at 10:08 o'clock, a.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice

APPEARANCES:

GERALD P. NORTON, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C. 20530; on behalf of the Appellant.

LEE LOEVINGER, ESQ., Hogan & Hartson, 815 Connecticut Avenue, N. W., Washington, D. C. 20006; on behalf of the Appellees.

WALTER P. NORTH, ESQ., Senior Assistant General Counsel, Securities and Exchange Commission, Washington, D. C.; on behalf of SEC as amicus curiae

C O N T E N T S

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PROCEEDINGS

MR. CHIEF JUSTICE BURGER: We'll hear arguments first today in No. 73-1701, United States against the National Association of Securities Dealers.

Mr. Norton.

ORAL ARGUMENT OF GERALD P. NORTON, ESQ.,

ON BEHALF OF THE APPELLANT

MR. NORTON: Mr. Chief Justice, there's a chart I'll be using the course of the argument, which I'd like to have set up before I proceed.

MR. CHIEF JUSTICE BURGER: Very well. Is that reproduced in smaller form, too?

MR. NORTON: Yes, copies have been handed up to the Court.

QUESTION: That's this thing here?

MR. NORTON: That's right.

QUESTION: Very good.

QUESTION: What you just put on the easel, is that in the record, or is it just illustrative?

MR. NORTON: It's just illustrative.

Mr. Chief Justice and may it please the Court:

This case is on appeal from a judgment of the United States District Court for the District of Columbia, granting the defendants' motion to dismiss the government's complaint in a Sherman Act case.

The case involves interpretation of several provisions of the Investment Company Act of 1940, concerning mutual funds, and the relationship of that Act to the antitrust laws.

In reviewing the many briefs, we found some confusion in terminology and some misapprehension of the government's position in this case. We've tried to address some of those problems in the Reply Brief we filed last week, and we've also prepared this illustrative chart, which I think may help clarify some of the relationships that are involved in this case.

Basically, a mutual fund or an investment company is a company that invests shareholders' money in the stock of other companies.

This case involves the most common type of mutual fund, which is the open-end mutual fund. Its distinctive characteristics are that shares are always redeemable by the shareholder from the fund, at a proportional amount of the net asset value of the funds at the time of redemption.

Although they are not required to do so by law, the funds, most of them, are continually offering shares to the public. Some, however, have, for either short-term or long-term periods, stopped offering and are closed up, as they say.

There are two basic types of open-end mutual funds: the "load" funds and "no load" funds. "Load" refers to a sales charge that the purchaser pays at the time of purchase.

As a practical matter, the issues here involve only the load funds, and it is to those load, open-end mutual funds that I will be referring throughout.

In the initial distribution of mutual funds shares, we have the vertical alignment shown in the center of the chart. The mutual fund distributes its share to a single underwriter, known as the principal underwriter, pursuant to an underwriting contract.

Then the underwriter typically sells those shares to a large number of dealers through dealer contracts. We've only shown one in the chart for illustration, but there would be many of these in the ordinary scheme.

Then the contract dealer, as that dealer is known, sells the shares to the public, to investors.

The investor can then redeem directly from the fund or can also redeem by going through the dealer or the underwriter -- although we have not shown that here.

Now, this is called the primary distribution system, in the mutual fund industry.

There is also a secondary market in transactions involving mutual funds, as with any other securities.

Now, in the ordinary securities market, the secondary market is the one of most importance to investors, that is where issued shares are trade on the stock exchange.

A secondary market provides alternatives to the primary distribution system for an investor either wishing to buy or sell shares, in that the investor can purchase from either a contract dealer or another dealer or from an investor, either going through a broker or directly.

Because of the nature of the securities business, a securities firm will be acting in various capacities, depending on the transaction involved. The same firm can, at different times in different transactions, be a broker, meaning that it's acting as an agent in the purchase or sale of securities; whereas a dealer, meaning that it's acting as a principal for its own account, if it has a contract with respect to the shares involved, it would be a contract dealer. As to those shares for which it has no contract, it would be a non-contract dealer.

Now, although the chart here shows contract dealer, non-contract dealer, and broker as three separate categories, the same firm could be in all three of those categories as to different transactions.

The term "broker dealer" is used generically to refer to any firm in the securities business as either a broker or dealer.

Nearly all broker dealers are members of the defendant National Association of Securities Dealers. That is the only association that has been registered under the Maloney Act of 1938, which amended the Securities Exchange Act. That provides a measure of industry self-government subject to the oversight of the Securities Exchange Commission, under rules adopted by and reviewed by the Commission covering specified subjects.

None of the rules of the NASD are involved directly in this case.

Now, Section 22(d) of the Investment Company Act provides, in relevant part, that if a mutual fund is currently offering its shares to the public, then no principal underwriter and no dealer may sell shares of that fund to any person except another dealer underwriter or the fund, except that the public offering price described in the prospectus -- I'll return to that public offering price in a moment.

Also involved in this case is Section 22(f) of the Investment Company Act, which provides that no mutual fund may restrict the transferability or negotiability of its shares, except in conformity with statements made with respect thereto in its registration statement, and not in contravention of any rules prescribed by the Commission in the interest of the holders of all outstanding shares.

22(d) had no direct effect on the price of mutual fund shares, although 22 -- I'm sorry, 22(f) has no direct effect; 22(d) does, as I'll illustrate.

If the fund is currently offering its shares to the public, there's no dispute that the price to an investor, charged by a dealer, must be the public offering price described in the prospectus, whether that's a contract dealer or a non-contract dealer.

Now, that price is effectively the net asset value of the report, proportional amount of the net asset value of the fund, plus a sales load designated by the fund.

Typically, that is a maximum of 8.5 percent of the total amount paid.

Now, the price from the underwriter to the dealer is governed by the dealer contract, and that is typically the public offering price less a dealer discount, which, for 8.5 percent sales load would typically be 7 percent.

The price to the underwriter from the fund would be net asset value, meaning that the underwriter gets a net of the 1.5 percent difference between public offering price and its price to the dealer.

QUESTION: Is there no control on this load? No governmental control?

MR. NORTON: Oh, yes. There are other provisions of the Act which provide means of regulation of the sales load, other provisions of Section 22.

Now, there's also no dispute that the Act places no limitation on the price that one investor can charge another for shares of a fund. It's considered market price there.

As a practical matter, the range is likely to be between net asset value that the selling investor can get from the fund on redemption, and the public offering price that the buying investor could get the shares for from a dealer.

It's also no limitation on the price that an investor can get from a sale to a dealer.

Now, by its terms, 22(d) does not apply to sales by one dealer to another. This is the so-called inter-dealer market.

22(d) also does not impose any restriction, by its terms, on sales by a broker to anyone.

QUESTION: Is it clear that the language, the word "dealer" in 22(d) does not apply to a broker as well?

MR. NORTON: Well, those terms are separately defined and, as I've indicated, the same, any broker dealer is at various times a broker or a dealer.

So someone who is acting in a brokerage capacity would not be governed by 22(d),

QUESTION: So when you're describing the functions, those functions are descriptions contained in the statute itself?

MR. NORTON: They are in part contained in the statute and in part a description of the industry as it operates and as it has been characterized by the Commission, to which I will come in a moment.

Now, unlike the markets for other securities, the market for mutual funds is almost entirely the primary distribution system. There are no, really no secondary markets for mutual fund shares. There's a tiny interdealer market. There's no dealer market of sales to investors, and there's virtually no brokerage market.

Therefore, at present the investor has, as a practical matter, no choice but to buy at the public offering price and to sell at net asset value.

But the development of computer technology, the potential impact or importance of a brokerage market has been somewhat enhanced, in that it's possible to match, buy and sell orders in a broker age transaction in a way that has not always been so.

But secondary interdealer and brokerage markets have not developed because, in large part, they have been restrained by agreements, provisions in underwriting agreements and dealer agreements which effectively either fix the price at which such transactions must occur, thereby removing any competitive incentive, or precluse brokers, dealers and underwriters from engaging in them.

The validity of those agreements is what is at issue in this case.

Now, the case is here on motion to dismiss, so that the allegations of the complaint of course must be accepted as true and construed in the government's favor in determining whether there's any state of facts that the government might prove that would entitle it to any relief. Not necessarily the precise relief requested in the complaint but any relief.

And though there are some variations, the essence of counts two, four, six and eight is that underwriters and dealers have included in their dealer contracts various restrictive provisions which either require the dealers to act as dealers in their transactions, therefore subjecting themselves to the fixed price of 22(d); or, that if they do act as brokers, require that they maintain that fixed price, or preclude them from dealing with other broker dealers.

Counts three, five and seven allege that mutual funds have engaged in -- entered into underwriting agreements containing provisions that either require the underwriters to impose these restrictive provisions in their dealer contracts or have imposed other restraints on the underwriter's ability to engage in competitive transactions.

Count one of the complaint alleges that NASD and its members, including underwriters and broker-dealers, hav combined to restrain the development of competitive secondary interdealer markets and brokerage markets through a variety of means.

Let me make it clear that when we talk about a secondary dealer market in the complaint and in this case we're talking about the market between dealers: contract dealer to a non-contract dealer; or an investor's sale to a dealer. We are not talking about a dealer's sale to an investor. There's some suggestion on the other side that that is the market we're trying to develop or redevelop in this case; that is not true.

As the complaint was later clarified, we are not challenging in the complaint any rules adopted by the NASD. It is asserted that those rules deal only with the primary distribution system and the complaint here is directed at the secondary markets.

None of these restrictions that we are challenging is required by any rule of the Commission or of any rule of the NASD.

Defendants acknowledge that they have the burden of establishing some implied exception to the antitrust laws, because there's no express exception, and they therefore must overcome the strong presumption against implied repeal of the antitrust laws.

In this effort, they contend that 22(d) was intended by Congress to eradicate secondary markets that had existed prior to 1940, and to require that all transactions in mutual fund shares be at the fixed prices.

They also claim that Congress intended section 22(f) to permit the funds, underwriters and dealers to make private arrangements which would restrict any other competition in this secondary market area that was not precluded by 22(d).

Building on these premises, the defendants claim that the entire distribution, sale, and redemption process of mutual fund sales, including secondary market transactions is covered by an implied immunity because of the exclusive jurisdiction, they say, of the Securities and Exchange Commission.

The district court agreed and granted their motion to dismiss.

I should note that the district court did not deal with any of the factual submissions made by the parties on various aspects of the case, and treated the motion as raising strictly legal questions, and the various factual issues are, of course, not before the court.

We don't believe that the language of section 22(d), with its plain inapplicability to interdealer transactions or to broker transactions, or the language of 22(f) will bear the weight of the defendants' argument as to its sweeping purpose and effect.

Our more limited reading of these sections is confirmed by their legislative history, and I think it's important to place the Act in context.

The defendants would have the Court think that the Act was enacted because mutual funds wanted protection from the secondary market competition, which they were troubled by. It's quite the contrary. The Act was thrust upon the industry as a response to revelation of a variety of abuses that had developed by funds in the 1920's and '30's.

In 1939 the SEC submitted to Congress a study, 3500-page study, the result of four years of intensive investigation, which revealed a wide variety of abuses by mutual funds. And the principal abuses are reflected in Congress's findings in section 1(b) of the Act. They involve such matters as inadequate disclosure to investors, discriminatory treatment of different classes of investors, favoritism of insiders, undue speculation.

They are all abuses of the mutual funds. There's not a single one that involves abuses by secondary market dealers. Which the other side would have the Court believe was the target of the Act.

Defendants' reference to the legislative history is rather dubious, because they can cite no single instance in which any person said that 22(d) or 22(f) was aimed at restricting the secondary market.

In the course of the vast investment company study, there is a half a page, a single paragraph, which we've quoted in its entirety at page 32 of our brief, which refers to what the industry, not the Commission, called a bootleg market. This was a market involving some secondary market dealers who would be buying at somewhat above the net asset value and selling at somewhat below the public offering price.

And as the report stated, they started a small price war.

QUESTION: Suppose the Securities and Exchange Commission had promulgated a rule under 22(f) that brokers -- or that funds should restrict the transferability of their shares, so that brokers as well as dealers couldn't sell to investors at anything less than the offering price. Would you -- I suppose your argument would be that that regulation would be, or that rule would be invalid.

MR. NORTON: Well, that hasn't been presented. On the face of it, I think that would go beyond the power the Commission has under 22(f). And, in any event, they have not done so.

It is clear that these restrictions are not the result of any rule that the Commission has promulgated.

QUESTION: Yes, but the argument is that -- the argument on the other side, I take it, among other things, is that the Commission would have power to do such a thing. And that the -- it's the Commission that has the exclusive power to --

MR. NORTON: Well --

QUESTION: -- to deal with this matter, and that the power of the Commission preempts the antitrust laws.

MR. NORTON: That is the argument. One problem with that argument is that the Commission, prior to this case, never exercised its authority under 22(f) in any respect.

QUESTION: Well, the Commission --

MR. NORTON: It never indicated in any way that it had the expansive view of its jurisdiction that the defendants, and to some extent the Commission now, now claim.

QUESTION: Well, the Commission is now asserting it, isn't it?

MR. NORTON: It's not saying that it could require the industry to impose these restrictive agreements, it's saying that it has some authority to regulate them, because it says these agreements may be treated as if they were restrictions on the transferability of the shares.

QUESTION: All right. Suppose the funds did impose this restriction and the Commission expressly approved it; expressly approved those restrictions, such as we've been talking about?

I would suggest the Commission says at least that that would preempt antitrust laws.

MR. NORTON: Well, I suspect that would be their position --

QUESTION: Well, it is here, isn't it?

MR. NORTON: Well, they haven't expressed the approval, so they can't really take that position.

But I think their position leans in that direction. But we would not agree, because that would present the different case referred to in Silver, as to which the Court has not given any definitive answer.

QUESTION: But they say they could do that, and if they could, that means that although the power is unexercised, the power is there and it should not be interfered with by antitrust prosecution.

MR. NORTON: Well, that's true. But of course this involves several problems. One is that they are trying to convert agency inaction into some evidence of affirmative approval, and that is something that there's no basis for here.

If the Commission had been exercising a broad jurisdiction under 22(f) and had been actually reviewing these agreements since 1940, and passing some kind of relevant judgment on them, they might have a stronger argument.

But the fact is that they were not, that these -- that the restrictive agreements are contained in underwriting and dealer contracts, not in registration statements. They are filed with those statements, but they are not reviewed in any way that is relevant to whether there should be antitrust immunity.

In fact, if you look at 22(f), the standard under 22(f) is extremely narrow. It's not a question of whether restrictions are in the public interest. The Commission is authorized to prescribe regulations in the interest of all holders of outstanding shares.

Now, that may or may not involve any competitive implications.

And this Court has never found implied immunity based on agency review or agency jurisdiction. And where the agency hasn't had to give some consideration to antitrust or competitive considerations. And there is no, nothing in the face of 22(f) that requires the Commission to do so.

Now, whether 22(f) might be construed to authorize that broad review is another matter, but it's perfectly clear that it has not been so construed and applied by the Commission since 1940.

QUESTION: Well, isn't one of your arguments that a secondary market would benefit the holders of these securities?

MR. NORTON: It would benefit the holders, but it would benefit people who were not yet holders.

QUESTION: Well, then, when this 22(f) says the Commission has to act in the interest of all the holders, wouldn't it have to take into consideration the fact, if you're right, that a secondary market would benefit some of the holders?

MR. NORTON: We would not argue that the Commission ought not to take competitive factors into consideration, but what we're saying is that this is a view of 22(f) which is novel, it has not been the way the Act, the section has been applied. So that the fact that the Commission has had all of these agreements filed with it, if that is the fact, and has taken no action, is of no significance, because the Commission has not been giving them any kind of review that is relevant. They have not been applying that standard in the past.

But let me just address 22(f) in terms of its legislative history.

The defendants would have -- they argue that 22(f) gave general validity to any restrictions in legislation statements endorsed by the fund that were not contrary to some explicit Commission rule.

Now, there is absolutely no support for that reading of 22(f) in the legislative history.

22(f) was intended to restrict the ability of funds to impose such restrictions by requiring that they be disclosed so that investors know that if they buy a mutual fund there may be some limitation on its transferability.

The funds involved in this case do not have limitations on their transferability. They're rully transferable under the same manner as any other security.

The restrictions here go to the distribution system, not to the transferability or negotiability of the fund. Those are technical terms used in a technical statute, and there is simply no basis for thinking that Congress would have used them to encompass a variety of contractual limitations, of which it had notice, and still use the narrow language.

But, anyway, the -- 22(f) stems from the Commission's intent to restrict the activities of the funds. It was not imposed or suggested by the funds as a means of enabling them to deal with a secondary market. Indeed, in the legislative history, they opposed 22(f). They now say it is their salvation, that they didn't want it; and it was adopted only as a result of the compromise between the Commission and the funds that led to the final Act.

Our position, and we think it is the only way that 22(f) can be read consistently with this Court's position to questions of implied repeal, is that 22(f), particularly where the Commission has taken no action, has no effect on the validity of restrictions that are within its terms under other federal or State laws.

If they were unlawful under some federal or State law prior to 1940, they would be unlawful after 1940. If they were not unlawful, then no effect. It left them where they stood.

All it did was impose additional requirements: a requirement of disclosure in the registration statement; and a requirement that they comply with any additional rules that the Commission might adopt.

Of course, the Commission has never adopted any such rules.

Let me just -- while we're on 22(f), the idea that the filing of a contract, as an exhibit to a registration statement, is the same as inclusion of it in the registration statement, is also unfounded here.

The registration statement is intended, with the prospectus that incorporates most of it, to inform investors. The exhibits and all of the technical matters that are filed with the Commission don't all get sent out to the investors. So that an investor might well buy a mutual fund on the basis of a prospectus saying its shares are fully transferable, and then find that there are contractual restrictions on who we can buy and sell to.

So, not only does 22(f) not validate any limitations, the type of restrictions here, contained in the contracts, are simply not within its terms.

Now, let me return to 22(d).

The defendants say that 22(d) intended to impose resale price maintenance on all transactions.

Again, there is not -- and to restrict the competition of the secondary market -- there is nothing in the legislative history that supports that purpose.

22(d) was first proposed by the industry as a means of dealing with insider trading. No reference to secondary market transactions.

It was then incorporated in a compromise measure that resulted in the revised bill that was then enacted without change. Again no reference to secondary markets. There is not a reference to secondary markets in the Committee Reports or in the debates. It was simply not a word in the pertinent legislative history that supports the defendants' attribution of purpose.

Now, we say that the language of 22(d) is perfectly clear. It does not apply to interdealer transactions, and it does not apply to brokerage transactions.

On this the Commission agrees with us and has explicitly taken the position in its amicus brief here that the district court was wrong to the extent that it read 22(d) as requiring resale price maintenance in all such transactions.

That has been the Commission's consistent view, and first announced contemporaneous with the enactment of the statute. It's entitled, of course, to the weight, the great weight that such interpretations normally receive.

Now, in mentioning the Commission's interpretation, and its reiteration of that interpretation in this brief, I think it fairly shows that the defendants' argument, based on certain legislative history concerning the 1970 amendments to the Investment Company Act, in which 22(d) was reenacted without any material change, and certain prior legislative proposals that were not enacted, simply is of no relevance to the question of what 22(d) means.

The Commission's interpretation has been consistent and has been unaffected, and the statements that the other side has relied upon in that legislative history, and we have addressed in our reply brief, simply did not deal with the precise questions before the Court in this case.

Now, one of the arguments that the defendants make in trying to say that 22(d) ought not be construed to permit a brokerage market to flourish is that such a market would be impractical.

Well, the major premise is obviously unacceptable because legality is not governed by practicability.

But even the question of practicability, we cannot accept the defendants' premise.

If such a market were so impractical, then why did they go to such elaborate lengths to preclude it through contractual agreements?

If it's so impractical, why has the Commission undertaken, in a 1974 report to which the parties have made great reference, to permit such a market to develop?

There is simply no basis for saying that this market cannot exist under 22(d) because it would be impractical.

QUESTION: Mr. Norton, has there been any congressional reaction to that '74 study?

MR. NORTON: I am not in a position to say.

Let me return to the Commission's role under 22(f), because that has a bearing on the question of immunity.

As I've indicated, the Commission, for 35 years, has not been playing an active role in reviewing these agreements that are filed with it under 22(f), and certainly has not been reviewing them with antitrust competitive principles in mind.

That, in itself, and the fact that there is no obligation on the Commission to consider competitive consequences, removes one of the essential conditions for a finding of a broad implied immunity.

As I said, this Court, to my knowledge, has never found such an immunity to exist where the agency did not have an obligation to review matters with some kind of comeptitive considérations as part of the mix of its regulatory factors.

QUESTION: If this has been going on for 35 years, why did the government wait so long to bring this suit?

MR. NORTON: Well, there is -- I think until the early Sixties it was less clear to everyone that these securities transactions were fully subject to the antitrust laws. And the practices were --

QUESTION: What happened in the early Sixties that made it more clear?

MR. NORTON: Well, there was the Silver case, for one, and there was also, with particular reference to the securities industry, in 1963 or so, a study which revealed a lot of the competitive problems of the industry. And this basically set in motion a lot of thinking in consideration of these problems.

In addition, as to the brokerage market, for example, as mentioned, as a practical matter, it may have required computer development before it became as feasible as it might be now.

Of course, we are seeking here injunctive relief only.

A further problem with the immunity argument of the other side is that there is really no Commission proceeding in which the allegations of the complaint and the conduct that is challenged in this case could be considered. I think it's highly significant that the Commission itself, while it supports the defendants as to Counts two through eight, and says that under its present reading of 22(f) all of those agreements come within its jurisdiction, it does not support them as to count one. It makes no claim that the allegations of count one are within its jurisdiction, and makes no claim that those allegations are covered by some kind of antitrust immunity.

QUESTION: Mr. Norton, would you summarize very briefly the essential difference between count one, what the government is driving at there, as contrasted with the practical consequences of what it is seeking in the other counts?

In other words, suppose you won on count one and lost on the others, and vice vera. What would the results be?

MR. NORTON: Well, I think it's hard to give a precise answer to that, because count one is a broad horizontal type of combination which has, as its focus the -- among other things, the development of these vertical arrangements which are challenged in counts two through eight. So they are somewhat interrelated.

QUESTION: Specifically what types of agreements would count one address that are different from the agreements addressed by the other counts?

MR. NORTON: Well, count one referred to other matters, such as discouraging people who -- a number of things to suppress the development of a secondary market, in addition to the contract. Such as discouraging people who might be interested in engaging in such a market, by saying, suggesting that it was not lawful. Or distributing information that mis-characterized the legality of such transactions.

But it's supplemental to --

QUESTION: Would information like that violate the antitrust laws if it were erroneous?

In other words, the brokers and dealers would have lawyers to advise them whether or not the NASD information was correct or not.

QUESTION: On problem in answering on count one is that we're here on a motion to dismiss. We don't have the facts. But there are some indications in the record that are suggestive. Government Exhibit 13, which is an interoffice memorandum for the Crosby Corporation in 1970, refers to the problem of dealers buying from the investors and selling again,not redeeming. And it addresses the question whether such restriction -- the dealer agreements should be amended to preclude those transactions.

And indicates an awareness that to do so would raise serious questions under the antitrust laws. And there is knowledge that going beyond the bounds of 22(d) presents serious antitrust questions. So that it's not as if they were babes in the woods.

Another exhibit, Government Exhibit 12 -- 13 is at page 276 of the Appendix, 12, the last page, at 266 -- which is another interoffice memorandum in 1950, talks about the importance of eliminating the competitive business, and knitting together, in a coordinated campaign, to cut down on competitive street markets.

We don't know what else there may be behind the face of the complaint. We haven't had discovery yet. So I just can't give you a definitive answer.

But the activities challenged in count one supplement and reinforce and give broader effect to the agreements challenged in counts two through eight.

Now, the test, of course, under Silver, on the question of immunity is whether immunity as to particular challenged transactions is necessary to make the regulatory

Act work, and even then immunity is implied only to the minimum extent necessary to do so, and there is no showing here that the kind of sweeping immunity for all kinds of restraints on secondary markets, that are comprehended by the complaint satisfy either of the Silver tests.

As I was beginning to say earlier, the Commission simply has no appropriate authority to review the kinds of activities that are challenged in the complaint. 22(d) provides it with no jurisdiction, it has no function under 22(d) except --

QUESTION: You agree, Mr. Norton, that 22(d) does oust the antitrust laws with respect to the primary market, but you don't --

MR. NORTON: Oh, yes.

QUESTION: -- but you don't attack, you don't say that the price, the resale price maintenance scheme, that the funds and the underwriters use, is illegal, I take it?

MR. NORTON: No. No. Obviously, if the statute requires someone to sell at a price fixed by his prior, we would --

QUESTION: When does that principal market end? When a particular share has been bought by an investor? Once he's purchased it the first time.

MR. NORTON: That's right.

QUESTION: And it's never been held by an investor before.

MR. NORTON: That's right.

QUESTION: Then you say the primary market is ended, and he should be able to sell that to another investor, either through a broker or directly.

MR. NORTON: Well, there's no question he can sell it --

QUESTION: Well, I know, but without any --

MR. NORTON: Yes.

QUESTION: -- without any interference from --

MR. NORTON: That's right; interference.

QUESTION: -- by the fund or the underwriter or a dealer, a contract dealer?

MR. NORTON: That's precisely right.

QUESTION: So it just isn't a question of -- well, you say that the primary market just can't reach out and keep investors from selling to another one at as low a price, even though the fund is continuously offering its new shares?

MR. NORTON: That's right.

Now, of course, if the fund suspends offering, as some do from time to time, then the whole resale price maintenance is out.

And let me point out, the agreements here don't limit their provisions to times when the fund is continuously offering.

That may be the norm, but that is not the condition set forth in the agreements.

QUESTION: Mr. Norton, I thought the funds did offer continuously, because they are obligated to buy back continuously.

MR. NORTON: Well, they generally do. There's no question about that. But they're not obliged to.

They are obliged, by law, to redeem them at any time; they're not obliged by law to continuously offer. And there are some -- some have been closed up for decades.

QUESTION: That would be a liquidation.

MR. NORTON: Not necessarily, no. They have good results, they may just have their shares traded in the secondary market. If they're doing well, people will trade there rather than redeem.

QUESTION: Returning to a question that Mr. Justice Marshall asked earlier, isn't the fundamental problem the estent of the load, and the SEC does have authority to regulate that?

MR. NORTON: They have authority to regulate that in the primary distribution system. It is tied with the resale -- the same scope as the resale price maintenance.

QUESTION: But if the load were fair, what would be the advantage of having the secondary, the free secondary market that you speak of?

MR. NORTON: Well, at present the investor has to pay the load whether or not the dealer performs any services. The sales load in mutual funds reflects the large selling expense, but if you've already bought a fund, you know about mutual funds, and you don't need to be sold on them; all you need is the mechanics to be taken care of --

QUESTION: But the percentage --

MR. NORTON: -- why should you have to pay full sales load when, if you could go to a broker you could buy the shares that somebody else down the street is trying to sell.

QUESTION: What is it, 8.5 percent?

MR. NORTON: Eight and a half percent. It's sizable.

QUESTION: But your problem is still -- this situation still exists, not perhaps to the same extent,even if there was no sales load. Because investors may want to sell, and other people may buy at less than the net asset value.

QUESTION: That's right.

MR. NORTON: That's right. It's not just the load, it's the --

QUESTION: Yes.

MR. NORTON: -- the freedom of option which is very basic in the competitive system.

The final consideration on the question of immunity is that it's essential that there be some conflict.

Now, there is no conflict here. There's certainly no conflict with anything the Commission has done in the past.

As to the future, the purpose of this suit is consistent with the Commission's proposals in its 1974 report. They want to end these contractual limitations, too. So there's no conflict there.

There's no conflict either with the Commission's proposals to permit funds to impose transfer fees and other measures. They are just not in conflict.

Now, going beyond that, the defendants suggest, well, there may be some possibility of conflict between something that the Court here might require and something that the Commission might require some day.

QUESTION: What is it -- but an investor can always redeem at net asset value, can't he?

MR. NORTON: That's right, but it's net asset value at the date of receipt by the fund. If he wants to get cash quickly, and at a more certain price, he may want to redeem on the secondary market.

QUESTION: But then he may have to pay a brokerage commission?

MR. NORTON: Well, it depends --

QUESTION: I mean, he doesn't know any other investor to --

MR. NORTON: Just talks with the dealer, and pays whatever the market price was.

If he goes to a broker, there would be a small commission.

But as to this remote possibility of some future conflict, of course the Court held in Silver and in Gulf States -- Otter Tail, rather, that that is not sufficient; you need an actual conflict.

In addition, we don't have a judgment here. The judgment, if and when it is entered, could take into account the possibility that the Commission might act differently in the future, and could accommodate the possibility of some overlap of jurisdiction.

So we believe that none of the conditions of implied immunity is satisfied here, and that the defendants' restraints are not justified and certainly not required by 22(d) or 22(f), and that the judgment of the district court should be reversed.

I'd like to reserve the balance of my time.

QUESTION: Well, I take it, Mr. Norton, you and the Solicitor General, or the Antitrust Division and the Solicitor General on the one hand and the SEC on the other couldn't settle their differences, in this case.

MR. NORTON: That would appear to be the situation.

QUESTION: But the SEC is here just as an amicus?

MR. NORTON: That's right.

MR. CHIEF JUSTICE BURGER: Mr. Norton, you've consumed all of your time.

Mr. Loevinger.

ORAL ARGUMENT OF LEE LOEVINGER, ESQ.,

ON BEHALF OF THE APPELLEES

MR. LOEVINGER: Mr. Chief Justice and may it please the Court:

In the first of the great antitrust cases in the securities industry, Judge Medina, back in 1953, observed: "the initial inquiry into any antitrust case must be in the character and background of the industry involved."

Now, Mr. Norton has sketched very nicely the character and the operation of mutual funds, with a few points I may take exception to; however, he has not undertaken to examine the character of the securities industry.

Now, although there's a limited record here, fortunately, all of the facts of significance are matters of public record. In 1963 there was a special study of the securities market, which has been referred to by this Court, cited in Silver and in Cartwright and in other cases, and therefore I have had reference to that as a source of available information. And my information concerning the market comes from that.

There are two basic types of markets.

First, the initial issue market for distribution of securities into public hands, which is usually handled through underwriters.

And the second, trading markets for continuous trading in outstanding securities. The special study says the uses and mechanisms of trading markets are substantially different from those of distribution markets.

The term "primary" is sometimes used to refer to the original issue market, and the term "secondary" to the secondary trading markets; and the terms are so used in this case.

There are, however, two types of trading markets, exchanges and over-the-counter markets.

The special study says that these are fundamentally similar in purpose and function, but substantially dissimilar in mechanics and practices.

In the exchange markets there is a physical congregation of buyers and sellers, represented by brokers, on the floor of the Exchanges, and actually at physical locations within the Exchanges.

There is continuous auction trading with buying and selling, and the price fluctuating according to supply and demand. Trades are executed quickly, often within minutes of the time the order is given. The market could function solely as a nexus for matching public orders to buy and sell, although there are dealers on the market to handle odd lots and perform various other functions.

The over-the-counter markets, in contrast, have no physical place of congregation. The special study says that such markets exist only as and to the extent that dealers elect to make them by standing ready to buy and sell for their own accounts. These dealers are market makers, and in the over-the-counter markets there is no mechanism for matching public orders, so that the market makers are the over-the-counter equivalent of the nexus between buyers and sellers provided by the Exchange floor.

There is also something called a third market which consists of stocks listed on an Exchange blotter sold over-the-counter; this exists almost exclusively to serve the needs of very large institutional investors, often trading tens of thousands of shares worth millions of dollars and occasionally these are broker transactions because there's enough involved so that they can go out and look for buyers or sellers to match the orders.

There has also been some discussion recently of a so-called electronic market, resulting, as Mr. Norton has said, from recent developments of computer technology and electronic communication, and it has made theoretically possible the combination of the New York Stock Exchange, the regional subsidiary exchanges, and possibly even of over-the-counter markets.

Whatever the merits or demerits of the so-called electronic market, they lie wholly in the future and are entirely theoretical, have nothing to do with this case because they never have existed, are not yet in existence.

Now, as Mr. Norton has said, there are various types of mutual funds of open-ended managment investment companies.

However, this case is concerned with only one type, open-end management investment companies engaged in continuous sale of their shares. We are not concerned with the so-called closed-end or with the closed-up funds.

Mr. Norton said that there may be occasions when an open-end company is closed up. That may very well be, but on those occasions the sales agreements to which he objects are no longer in effect. So those are completely out of the case.

In any event, all of the defendants here are open-end funds that have never been closed up, and so we are not concerned with any closed-up funds.

Mutual funds have been well analyzed and described in both the majority and dissenting opinions in the United States vs. Cartwright, so that this Court is presumably familiar with them as a means of providing a diversified investment portfolio and management service, mainly for small individuals and institutional investors. They have, as was said, the unique characteristics of being continuously offered through underwritings and primary distribution, and of being required to buy back any outstanding shares at any time at the net asset value.

Thus, the price of funds is not set as are the price of almost other securities by supply and demand. In the first place, the supply is practically unlimited, so there would be no limitation on that side of the equation. In the second place, the price depends upon the net asset value which is based on the market value of the underlying portfolio securities.

This is simply determined mathematically by a clerk in the office. There is no management discretion involved, it's a pure mathematical computation.

Furthermore, although the government talks about a restriction or restraint of competition here, there is vigorous competition between funds based on performance portfolio selection, type and nature of operation, and various other characteristics. There is vigorous interfund competition, and there is no contention to the contrary here.

QUESTION: But they don't -- they don't compete in terms of the load percentage, do they?

MR. LOEVINGER: Yes, they do, because some funds have higher loads, other funds have no loads, some funds have zero loads.

There is competition between funds -- between funds -- as to loads. The government is addressing its case solely to the fact that as to, within the organization of a single fund, the dealers engaged in the distribution of a single fund do not compete at the load. That's the whole government case here.

Now --

QUESTION: Well, do the load factors in your open fund vary? They are not all 7.5 percent --

MR. LOEVINGER: Indeed they are not; no, sir. They vary from a very low percentage to 8.5 percent. As a matter of fact, there is a pending NASD rule that sets a maximums of 8.5 percent with things scaled down according to variou contingencies. This has been given tentative approval by the SEC and will go into effect fairly shortly.

QUESTION: And you're say there are some with open-end -- investment companies with zero load?

MR. LOEVINGER: Yes, sir.

QUESTION: Open-end?

MR. LOEVINGER: There are no load funds on the market, and available.

QUESTION: I knew that there were closed-end no load funds.

MR. LOEVINGER: Well, there are open-end no load funds on the market.

QUESTION: Well, where is the -- how can --

MR. LOEVINGER: By standards, no load funds.

QUESTION: How can that economically be? Yes.

MR. LOEVINGER: That's a very good question, Mr. Justice, and that brings me to the next point which is that mutual funds are and have been, as found by the SEC, dependent upon their primary distribution system.

By the large, the demand for fund shares is the result of advertising and sales promotion efforts by the underwriters and the dealers.

Furthermore, for funds that do have loads and are thus dependent, continuous cash flow from their sales is necessary to provide the cash for redemption. Without such continuing sales, the funds would be forced to sell their portfolio of securities in order to meet the demands for redemption. This would tend to depress the markets and ultimately make the funds self liquidating.

This method of distribution, incidentally, is rather logical for mutual funds, because, as I've mentioned, trading markets exist to redistribute outstanding shares previously distributed by the issuer. For most securities this is, as Mr. Norton correctly said, the most important market.

However, since mutual funds are continuously being issued and repurchased by the issuer, there is no function for the secondary market to perform at all analogous to the secondary market trading function for other securities.

And, as noted in Cartwright, this method of distribution is now mandated by statute, and under the statutory scheme, the redemption of shares by funds is the market and the only market for investors.

Now, before 1940, when the Investment Company Act was passed, there was a secondary dealers market in mutual funds by non-contract dealers, which was referred to as the bootleg market.

QUESTION: Yes.

MR. LOEVINGER: Non-contract dealers would buy from stockholders at slightly below the net asset value and resell to investors at slightly below the public offering price. They could do this because they eliminated the underwriting fee which at that time was substantially higher than it is today.

There never has been, prior to 1940 or since then, a secondary brokerage market in mutual funds. This simply has been nonexistent, for two compelling reasons.

First, it has been functionally impractical, because there was simply no way for brokers to function in an over-the-counter market except on very large transactions where the brokerage commission would enable them to go out and search for buyers or sellers.

Incidentally, it's unethical for brokers to seek to get fund investors to sell their fund shares, because they're regarded as long-term investments.

Second is that it has been economically unprofitable because the brokerage commissions have always been less than the dealers' mark-ups on mutual funds.

Now, in 1935, Congress directed an extensive study of investment companies and after four years the SEC submitted it investment study to Congress, as a result of which Congress, in 1940, enacted the Investment lompany Act.

The congressional intent, contrary to the representations of the government, clearly was to restrain and inhibit the growth of a secondary trading market in mutual fund shares in order to maintain the primary distribution system and protect it against disruption.

Mr. Norton has suggested that there is no testimony to this effect. I suggest that the testimony of Mr. Schenker, the director of the Investment Trust Study, which can be found in the dealers' brief, which is the big red one, at page 31, specifically mentions the bootleg market. This was mentioned in the Investment Trust Study and there is, as we demonstrated at considerable length in our brief, a legislative background showing that in fact the suppression of the bootleg market was one of the purposes of the Investment Company Act.

QUESTION: Whatever became of the proposal that this problem be dealt with by forward pricing?

MR. LOEVINGER: That has been implemented by the SEC, it was implemented in 1969, Mr. Justice, by an SEC rule requiring forward pricing, which is now the present practice.

Therefore the problem of dilution resulting from forward pricing has been totally eliminated, and when Congress re-enacted Section 22(d) in 1970, it had no such problem before it; which again reinforces the same conclusion.

In any event, in the Investment Company Act there was ample provision for the regulation of mutual fund sales and distribution. 22(a) referred to the method of pricing, gave the NASD and the SEC the power to pass such rules.

22(b) gave the NASD and the SEC power to regulate mutual fund loads.

22(d) provided the mutual fund shares to be sold to investors only at a current public offering price, which, in effect, protected the sales load or sales marging against the price cutting of a secondary market; and 22(f) authorized restrictions on transferability and negotiability of fund shares which were fully disclosed to the Sec and not disapproved.

The SEC says in its brief that it was the intention of Congress to regulate, through section 22(f), restrictions on secondary market activities in mutual fund shares, and we fully agree with that position.

QUESTION: Well, I guess you will get to it, but you -- wholly aside from 22(f), I suppose you're saying that 22(d) or 22(d) and 22(f) together mean that the primary -- means that there is only supposed to be a primary market.

MR. LOEVINGER: They eliminated the secondary market, Mr. Justice.

QUESTION: Wholly aside from the power of the SEC?

MR. LOEVINGER: As a practical matter, yes, they did eliminate the secondary market.

Incidentally, the SEC --

QUESTION: Well, let's assume we disagreed with you on 22(d), that just by, on its face or in light of its legislative history, 22(d) standing alone didn't eliminate the secondary market, and then we are left with the argument that the powers of the SEC under 22(f) are sufficient to preempt the antitrust laws.

MR. LOEVINGER: Well, then, the --

QUESTION: Well, do you -- are you saying that 22(f) alone has that power?

MR. LOEVINGER: We needn't rest on that, sir. The --

QUESTION: I know you don't -- you needn't, but what if you have to? And what if we --

MR. LOEVINGER: Of course, as a practical matter, the powers of the SEC under 22(f) are perfectly adequate in this case. They answer the question asked by Mr. Justice Powell. As a practical matter, all of the restrictions the government is complaining about are in fact contained in the agreements, and if the SEC made regulations under 22(f), that would, as a practical matter, end the case.

However, there is ample authority under other sections. Under 22(b) there is an express antitrust exemption, for control of sales loads by the SEC and by the NASD. 22(d) sets the price, however, section 6(c) of the Investment Company Act gives the SEC full exemptive power, as the Department of Justice has often urged before the SEC. So that the SEC, and section 38 gives the SEC power to promulgate any rules and regulations it likes, to implement the other sections of the Act.

So the SEC has plenary power to control all of the matters that are in discussion here.

Furthermore, --

QUESTION: But it hasn't.

MR. LOEVINGER: -- the history --

QUESTION: But it hasn't. But it hasn't.

MR. LOEVINGER: Yes, it has, sir, to a large extent. In the 1974 report, as the SEC points out, all of these matters are discussed. There are proposals relating to every single thing the government has under discussion, and there are -- some of them have been -- some of them are in the form of tentative rules; others in the form of recommendations for no action, but they have all been thoroughly discussed, considered, and are the subject of either past or pending action by the SEC.

I submit, Mr. Justice, that history has in fact answered your question as to the effect of 22(d) and 22(f). There is a very active secondary dealer market up to the time of passage of the Investment Company Act in 1940. It has been estimated it was approximately as large, perhaps a trifle larger, than the primary distribution market.

Since 1940 the secondary market has disappeared except for what the SEC refers to as miniscule market, and which all parties agree amount to less than one-tenth of one percent of the total market; and that has been entirely the result of the passage of the Investment Company Act.

QUESTION: Well, of course, the government says part of the reason it's disappeared is because of the agreements among your clients.

MR. LOEVINGER: Those existed prior to 1940, Mr. Justice.

If it hadn't -- the only thing that changed in 1940 was the passage of the Investment Company Act. Consequently, it's the only thing to which we can attribute the disappearance of the secondary market.

Furthermore, the protests from the secondary market dealers which are in the record, largely as government exhibits, show that in fact these were -- that this was what the seconary market dealers saw as driving them out of business.

The reason for this is fairly simple, you see, because, as I explained, you have to understand the mechanism of the market. In the secondary markets, secondary trading markets, there are not brokers for transactions of this kind.

There are only dealers.

The government admits, both in its main and in its reply briefs, as I recall it's page 2 of their reply brief, that section 22(d) applies to all sales by all dealers, regardless of the capacity in which they're acting, or the market in which they're acting.

Since secondary market dealers cannot offer an investor any advantage in selling price, there is simply no function for the secondary market any more. Therefore, the Investment Company Act wiped out the secondary market in 1940, and it exists as a miniscule thing or a curiosity, I assume largely as a matter of convenience among dealers and for other peripheral things; but obviously not of any real importance.

QUESTION: Just to make it clear, let's assume that an investor has bought some shares in a mutual fund and he wants to get rid of it, let's assume he just sells to a dealer, and the dealer buys it for his own account. Now, if he does that, if he wants to sell to an investor, he must sell at the offering price?

MR. LOEVINGER: No, the -- oh, I'm sorry, if the dealer wants to sell; yes, sir.

QUESTION: Yes.

MR. LOEVINGER: The dealers must sell at the --

QUESTION: Even though an investor has previously held those shares?

MR. LOEVINGER: Yes, sir. That's conceded by the government.

QUESTION: Yes.

MR. LOEVINGER: No question about that.

QUESTION: Well, what if such an investor just wants to sell his shares to a fried and they say, Well, we'll just split the difference between the redemption cost and the offering price?

MR. LOEVINGER: It's perfectly proper, there's no law against it, no rule against it, no restriction against it; it's not involved in the case.

QUESTION: And if he goes through a broker it is involved, hunh?

MR. LOEVINGER: There is some question as to whether or not 22(d) reaches the case of a broker who is not in fact a dealer, and acts only as a broker between two investors; but again that's a pure abstraction, it's the most exceptional case, it's something -- the only case that has ever come to light of that kind is the Oxford case, which involves the most extraordinary circumstances; perfectly, obviously, redolent of fraud, an overreaching on the part of a small firm that had two customers, and substantially only two customers, and it sold fund shares for one at the same time it bought the same fund shares for the other, and attempted to charge the full spread. And the SEC said you couldn't get away with it.

But there is nothing in there to indicate that it had ever acted as a dealer.

QUESTION: Well, let's assume that -- you may be right, that it hardly ever happens; but are you saying that the Act, 22(d) and 22(f) would exempt the NASD from any antitrust liability and the brokers, if they'll agreed, "Well, we will just never help an investor sell to another investor"?

MR. LOEVINGER: There's no charge that they have done this.

QUESTION: Well, but --

MR. LOEVINGER: The only charge is that the contract dealers --

QUESTION: Well, how about my question, though? Let's assume there was such an agreement. Is that exempted by the --

MR. LOEVINGER: I think it would be, sir. Because these are so -- there is such a pervasive system of regulation by the SEC, it is impossible to conceive of any practice that any of the dealers or brokers or underwriters could engage in here that is not subject to SEC control.

QUESTION: Well, I thought part of the government's case was that that NASD and the formal system was suppressing any kind of a development of a secondary market through brokers.

MR. LOEVINGER: There is a formal allegation to this effect, but in fact it has been largely abandoned. This formal allegation rests upon the assertion that NASD rules have this effect, but they have now retrated from that allegation and thereby substantially withdrawn their count one charges.

As a matter of fact, government Exhibits 12 and 13, that Mr. Norton referred to, are concerned exclusively with vertical restrictions and not horizontal restrictions.

QUESTION: Well, you're suggesting this is just a non-case.

MR. LOEVINGER: I believe that is precisely the instance, Mr. Justice.

QUESTION: Well, certainly Mr. Norton, in his response to Justice Powell's question, didn't indicate that the government had withdrawn count one.

MR. LOEVINGER: I know he didn't. But in fact they have, because all of the substantial allegations have been abandoned.

QUESTION: Well, how -- when you talk about someone withdrawing a portion of their case, I would assume you'd take their word rather than opposing counsel's, ordinarily.

MR. LOEVINGER: The government is very anxious to have the case reversed and to prevail, sir. But there is nothing left of count one after they have abandoned the charge that the NASD rules violate the antitrust laws.

The count one doesn't stand in the record simply on its bare -- in the first place, the things that they are talking about here, and in their brief, which refer to the refusal of broker-dealers to sell to secondary market dealers, don't appear in count one of the complaint, as it was drafted, filed, and appears in the record.

Count one refers primarily to NASD rules. When those have been abandoned, we are left to look --

QUESTION: Well, what do you point to to suggest that the government has abandoned its claims under count one?

MR. LOEVINGER: Its concession that the NASD rules are not under attack.

QUESTION: Where is that?

MR. LOEVINGER: The --

QUESTION: Is that just in the record, or is it in the brief --

MR. LOEVINGER: Yes, it's -- there is a letter from counsel in the Joint Appendix at page 327, it's set forth in the Jurisdictional Statement, page 26. It's repeated in the government brief at page 51. And Mr. Norton made the admission in oral argument here.

There is no attack upon NASD rules. It's perfectly clear at this point.

QUESTION: But they do say that there are agreements which had this effect of ousting any -- the development of any secondary market?

MR. LOEVINGER: Yes, sir; these are the agreements that are attacking counts two through eight.

Now, actually, the existence of agreements is required by Rule 26 of the NASD, which is of course not under attack. And the restrictions on the sales fund -- on the fund sales are, we maintain, plainly authorized by section 22(f).

So that, indeed, it does come down to the question of what is this case all about, and let me quote from the government brief, to suggest what the case may be about.

The government brief says, at page 9, that the secondary dealer market does not ordinarily produce any monetary advantage to a buying investor.

Furthermore, this leads to the conclusion, in the government brief at page 34, that "the prices in a competitive secondary market are not likely to differ substantially from the price established in the primary distribution chain."

Consequently, one is really entitled to ask: Why has the government brought, and why does it pursue this case?

And we believe that it is because it is dissatisfied with its efforts to get the SEC to act immediately to exempt or abolish section 22(d) and to get Congress to repeal 22(d).

There were three exhaustive studies presented to Congress, in 1962, '63, and '66 on the securities markets. There was four years of hearing, from 1967 through 1970; the Department of Justice contended that 22(d) should be repealed.

The SEC said: No, don't repeal 22(d) but impose a flat statutory maximum of 5 percent on sales loads.

Congress rejected both proposals, and in a legislative -- with a legislative history that is perfectly clear, that they were talking about the protection of the primary distribution system against any secondary trading markets. They re-enacted section 22(d) in full in 1970, with the full knowledge that since 1940 to 1970, the action of 22(d) and the Investment Company Act had in fact eliminated the secondary market.

This was fully explained, it was fully explored, there are numerous statements by Senators, Representatives, and witnesses before the Congress, during the period 1967 to 1970. So that we must look to the 1970 amendment of section 22(d) to see that Congress was fully aware that in enacting section 22(d) and the other provisions of the Investment Company Act, which were fully re-examined, it knew it was eliminating the secondary trading markets.

Furthermore, I think that if the Court will look at all the provisions of this extremely complicated and complex statute, coupled with the provisions of the Maloney Act, it will see that regardless of the technical construction that may be put on the specific terms of particular sections, that there can be no real quarrel with what the SEC states is the basis of its interest in this case, in his brief at 19, where it says the Investment Company Act of 1940 vests in the

Commission pervasive authority to regulate the process of distributing mutual fund shares in the role of retail price maintenance therein.

Furthermore, I call the Court's attention to the fact that the government has sought to file its brief in Gordon in this case as further elucidation of part of its position, and in the government's brief as amicus in Gordon, it says at page 35, it attempts to distinguish this case from the case of the Exchange, and it says in the Maloney Act Congress expressly incorporated antitrust principles and made it the duty of the SEC to enforce them as applied to associations of over-the-counter dealers, thus trying to strengthen its position in Gordon by pointing to the fact that here in fact there was an antitrust duty resting on the SEC.

Now, we submit that under the prevailing precedents of this Court, this complaint must be dismissed, and I think this is perfectly clear from the Pan American case and the Hughes Tool case.

In Pan American, the Court said the acts charged as antitrust violations are precise ingredients of the Court's authority, if the parts were to include independently with their construction the antitrust laws, the two regimes might collide. Dismissal of antitrust suits for an administrative remedy superseded the judicial one is the usual course.

In those cases, however, the CAB, which was the administrative agency that was involved, filed briefs on the side of the defendants and said it neither the competence nor the authority to control the acts alleged as antitrust violations.

Here, in contrast, the SEC is coming in and saying it has both the competence and the authority to control these matters.

Now, let me speak for just a minute about the diagram which is said to elucidate the government's position.

In the first place, it omits and distorts the time dimension. The vertical transactions are all virtually simultaneous transactions, whereas the horizontal and diagonal transactions take place at different times, and so are not comparable.

One firm cannot, contrary to Mr. Norton's assertion, be a contract dealer and a non-contract dealer at the same time with respect to the same fund. Though one firm may be a contract dealer as to one fund and a non-contract dealer as to another fund; but that's irrelevant. You can't be both a contract dealer and a non-contract dealer.

Second, since there is not and never has been a brokerage market, the drawing of this thing called broke over here is simply lines on a paper that doesn't correspond to any reality, for the same reason the transaction labeled Y is simply imaginary, because there isn't any such thing.

In the third place, the transaction marked by the sumbol X is not a secondary trading market transaction, it is clearly part of the primary distribution system. As part of the primary distribution system, the X transaction is subject to regulation by both the NASD and the SEC; both under section 22(f) and Rule 26 of the NASD.

The government brief indeed admits, at page 53, that section 22(d) permits the NASD and the Commission to regulate price and sales loads in connection with a primary distribution market.

And the SEC is addressing itself to the interdealer market.

Furthermore, transaction X is forbidden by Rule 26 of the NASD, which in effect provides that only contract dealers are entitled to discounts, and that they shall purchase only in order to fill investors' orders. Consequently, there is simply no economic incentive and no functional purpose served by transaction X.

Now, since transaction Y is imaginary and non-existent, and since transaction X is prohibited by rules which are not now attacked by the government, there is simply no transaction shown on this diagram which is restrained by any conduct of the defendants which is under attack in this lawsuit.

QUESTION: Well, you don't suggest that 22(d) or any other law makes it illegal for a broker to match -- to help an investor sell his shares to another one?

He doesn't violate the law, does he?

MR. LOEVINGER: This is disputable, Mr. Justice. As a matter of fact there is an argument made in --

QUESTION: Well, there's --

MR. LOEVINGER: -- the NASD brief to the effect that the term "dealer" is used in a generic sense.

QUESTION: Well, I'll put it to you this way. The Securities and Exchange Commission doesn't think that it's illegal for a broker to do this, does it?

MR. LOEVINGER: No, sir. The --

QUESTION: In fact they have a contrary opinion.

MR. LOEVINGER: If they have taken -- they have never made any ruling that a contract dealer can act as a broker. They have simply said that a securities firm, acting only in the capacity of a broker, may match investors, and sell orders.

QUESTION: That's right. So it's not illegal, in their opinion, for a broker to do that.

MR. LOEVINGER: But there is nothing charged in this suit that would prevent that. Because these are people who by definition are not subject to the restrictions of the sales agreements, and they are not subject to any inhibition in the NASD rules. There's just --

QUESTION: So you might have some problem if the complaint was alleged to charge that there was some interference with --

MR. LOEVINGER: If there were a different complaint, we might have a different complaint, Mr. Justice; but there is nothing in this complaint nor, may I point out also, that the government has filed an affidavit and 30 exhibits, taking 75 pages of the printed record, from pages 230 to 305, elucidating the charges in this complaint. There is no suggestion anywhere that anything that has been done in fact does suppress the independent brokerage market.

QUESTION: Well, I take it -- well, didn't the district court rule that section 22(d) or 22(d) and 22(f) together preempts or ousts the antitrust laws in this entire case?

MR. LOEVINGER: Yes, sir.

QUESTION: And that even if there was something aimed at brokers matching investors, the antitrust laws would still be irrelevant.

MR. LOEVINGER: As a matter of fact, we would take that position, because we think that under the decisions of this Court there is such a pervasive regulation of all these transactions by the SEC that under _TWA_ and _Pan American_ the Court would hold that the SEC has the authority and therefore these are not subject to the antitrust laws.

We think that in that respect the Court's decision is right. But whether or not there may or may not be some remote corner in which independent non-contract dealers --

QUESTION: But if somebody is interfering with brokers where they shouldn't be, it's up to the SEC not the antitrust laws, you're suggesting, to remedy the matter?

MR. LOEVINGER: Yes, sir. As a matter of fact, the SEC is in fact acting and studying those very matters. There isn't any question about it.

As a matter of fact, I think that in so far as this chart has any relevance to the present case, what it shows is: first, that the theoretical model of how the market operates, which is in the minds of the Department of Justice, government attorneys, simply doesn't correspond to reality; and second, that there simply is no place where the authority of the SEC and the jurisdiction and the application of the Investment Company Act and the Maloney Act don't apply.

In other words, that there is precisely that kind of pervasive authority which the Court has said, in both TWA and Pan Am, makes these things subject to administrative and not to antitrust regulations. And this is not a case where, as in Pan Am, there was potential conflict between the administrative and the judicial regimes.

This is a case in --

MR. CHIEF JUSTICE BURGER: Your time is up now, Mr. Loevinger.

MR. LOEVINGER: Yes, sir, I'm taking just a few minutes of Mr. North's time, with his permission.

This is a case in which there is actual collision, because the regulations that have been proposed by the SEC staff are completely incompatible with the remedy that is sought here by the Department of Justice.

As a matter of fact, the SEC staff seeks to establish a possibility for the existence, presumably under modern technology, of this alleged brokerage market. In which case, they say, that transaction Y, which is a brokerage transaction, could be subjected to a special charge to be payable to the underwriter in order to help support the distribution system.

Now, as I say, this is not a case of potential conflict, this is a case of actual conflict between the regulatory and the antitrust regimes. This Court has no choice, under its precedents, but to dismiss the complaint.

Thank you.

MR. CHIEF JUSTICE BURGER: Thank you, Mr. Loevinger.

Mr. North.

ORAL ARGUMENT OF WALTER P. NORTH, ESQ.,

ON BEHALF OF S.E.C. AS AMICUS CURIAE

MR. NORTH: Mr. Chief Justice, and may it please the Court:

The SEC is very thankful for this opportunity to participate in this argument. It isn't often that we and the Department of Justice disagree, and having done so in this instance and we not being parties to the case and they are, our only opportunity to be heard here is on an amicus basis, and we appreciate your allowing us to do so.

Having listened to nearly an hour and a half of argument by the appellant and the appellees, I see no need at this stage to try to recap the whole case.

I'm going to confine myself instead to making two or three specific points which I think are significant and emphasize and enlarge upon a little the way it was put by the other counsel.

I think the beginning of this case is to take a good hard look at the nature of the open-end mutual fund business.

Now, between the government counsel and counsel for the litigants, private litigants, you've had a rather full exposition of the way the market operates and quite a lot said about the legislative history. But I think the starting point is perhaps even back of that.

The mutual fund shares are not marketed in the way that General Motors stock is. You don't buy it on the market-place at auction. The mutual fund makes a continuous offering of its shares, which it has to do in order to meet the redemptions which the law requires it to meet.

In order to make continuous sales of mutual fund shares, there has to be a primary distribution system that will hopefully keep up their new sales parallel with if not in excess of their redemptions.

If you don't have that result, the fund is going to be forced into a gradual liquidation and eventually will have to go out of business.

I think that when you bear that in mind, it puts the importance of the primary distribution system that Congress has seen fit to try to protect in a much stronger light than you might otherwise consider it, and I think it's very important that we do take that into account.

Now, I'd like next to touch upon one aspect of the government's argument, which I think is highly technical and exults form over substance.

They say that the contracts that exist between the fund and the underwriter and, in turn, between the underwriter and the contract dealers are not sustainable under section 22(f) as being restrictions on transferability. They say apparently that you have to have something that's written on the face of the stock certificate or is expressed in some other way, but as long as these contracts are filed with the SEC, as they are and always have been since the 1940 Act was adopted, and as long as they are incorporated into the registration statement, I can see no basis for saying that they don't fully comply with section 22(f).

QUESTION: Even if the SEC doesn't even look at it?

MR. NORTH: Doesn't look at them, you say?

QUESTION: Yes.

MR. NORTH: Mr. Justice, I don't think that makes any difference one way or another.

QUESTION: Well, when did you start regulating on 22(f)? When did the SEC start regulating?

MR. NORTH: Well, it started, I would say, in 1941 when we first reviewed the NASD's initial rules that were adopted pursuant to this section of the statute.

QUESTION: You issued regulations?

MR. NORTH: We have not adopted any specific rule under 22(f) --

QUESTION: Until today, have you?

MR. NORTH: Well, I'm not even doing it today. As a matter of fact, we have exercised --

QUESTION: Well, you're telling me to ask another question: Do you ever expect to?

MR. NORTH: We have proposals right now that we're working on to go to Congress with, to change some of these things by statute rather than just by regulation of our own. And we in the meantime have specifically requested the NASD, just last November, to adopt a rule which would loosen up, to some extent, the right of others to participate in the market of mutual fund shares as distinguished from limiting it to the primary distribution that they now have.

But the Commission has exercised tacit surveillance in this whole area, all throughout the history of the Investment Company Act.

The only thing it hasn't done is to adopt a specific rule under 22(f), because it has never found occasion to take exception to the NASD's rules in this area, which it has carefully reviewed and kept track of. And commented upon from time to time.

Indeed, the Joint Appendix contains here some conferences between representatives of the Commission and the NASD which show that there was mutual consultation on the limits of these things, and on what should be done in these areas. So it seems to me that the important thing here is that the NASD and its members have consistently, since both before and after the 1940 Act, conducted a primary distribution system that was based upon contracts which contain these provisions, these contracts are on file with the Commission as a part of the registration statement, which is just what 22(f) says there should be.

QUESTION: Well, let me ask you this: You're suggesting that the SEC, by not disapproving any of these agreements, has in effect approved a contract between -- for example, between a contract dealer and an underwriter that the dealer will never act as a broker between two investors?

MR. NORTH: The Commission has approved the portion of that contract which --

QUESTION: No, let me just --

MR. NORTH: -- which you're mentioning.

QUESTION: Then your answer is yes?

MR. NORTH: Yes.

QUESTION: And that there are such agreements in existence where the people participating in the primary distribution system agree that they won't broker it?

MR. NORTH: That's right.

QUESTION: And the underwriter agrees with the mutual fund that his contract dealers won't broker.

MR. NORTH: That's right.

QUESTION: And you say that you've approved those agreements and therefore they're exempt from the antitrust laws?

MR. NORTH: I'm saying, Your Honor, that we haven't -- we haven't disapproved them. 22(f) permits --

QUESTION: Well then, a fortiori, if you'd approved them, you would say they would be exempt?

MR. NORTH: Yes, certainly.

QUESTION: Now, what's essential to the operation of the Act? Where do you find in the Act any authorization for approving or for exempting that kind of a contract from the antitrust laws?

Put your finger right on it in that Act, in section 22(d) or (f).

MR. NORTH: 22(d) -- 22(f) reads "No registered open-end company shall restrict the transferability ... of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement", which statements are not in contravention of any rule of the Commission.

QUESTION: Well, yes, you're just saying that under (f) the -- any kind of agreement known to man, as long as you

/sic/ don't approve it, is perfectly all right.

MR. NORTH: We're saying that restrictions on transferability of the shares of an issuer are unobjectionable from the standpoint of the antitrust laws if, as long as they are contained in the --

QUESTION: Are you suggesting that it could say -- that the stock could have on it, and have enforcible, that one investor couldn't sell to another?

MR. NORTH: No.

QUESTION: Well, why wouldn't you? As long as you didn't disapprove it.

QUESTION: If it's in the registration statement and if it's not disapproved by the SEC, I think your answer would be yes under 22(f).

MR. NORTH: Maybe I didn't understand the question. I'm sorry.

QUESTION: Well, you would say that such a restriction on a sale from one investor to another would be not only -- certainly there wouldn't be anything wrong with that, as long as you didn't disapprove it?

QUESTION: And as long as it was in the registration papers.

QUESTION: Yes.

MR. NORTH: That's undoubtedly so. But I'm not at all sure but what we wouldn't disapprove it if they went that far.

In other words, I think that Congress has vested the authority in the Commission to do that.

QUESTION: All right. You're suggesting then that the SEC would interpret the Act to exclude that kind of a restriction?

MR. NORTH: I think we would say --

QUESTION: So there are restrictions which the Act wouldn't permit you to approve?

MR. NORTH: The Act permits us to approve only ones that we feel are in the best interest of the shareholders and the investing public.

QUESTION: That's all I want to know.

MR. NORTH: And that's exactly where we think the authority in this area lies, as against lying in the hands of an antitrust court, which wants to do the ruling for the Commission in this area.

QUESTION: Very well.

QUESTION: Mr. North.

MR. NORTH: Yes, Your Honor?

QUESTION: In the Commission's letter of November 22nd to the NASD, you framed a request that certain changes be accomplished.

Let's assume for the moment that the NASD said, No, we don't agree with the Commission, we're not going to make those changes. In your opinion, does the Commission have authority, under 22(f) or any other section of the Act, to require compliance?

MR. NORTH: I think the Commission has adequate authority to require compliance. We're sending that letter to the NASD to give them the first opportunity to move in this area, if they see fit to do so. And I'm not at all sure but what the Commission, if the NASD did not see fit to do so, wouldn't either compel them to do it or enact a rule of its own to that same effect.

QUESTION: And you'd enact such a rule under 22(f)?

MR. NORTH: Under that or under 6(c) or under 38, there are several sections of the Act that give the Commission rule-making authority that I think would cover this kind of a situation.

There are sometimes situations that we don't think our rule-making authority covers. We're working right now on a draft of some legislation we're going to submit to Congress to give us powers in some of these respects. And someone asked the question earlier in the argument as to whether or not we had any reaction from Congress as a result of the report that was submitted last November, some 130-40 pages long.

The answer is that the committees of the Congress are still waiting for us to send over a draft or actual bills that do incorporate or implement some of these suggestions that are made in this report.

So the Commission is actively studying this whole situation, has some ideas of its own to indicate that maybe this system, as it is now, isn't perfect and maybe it needs some changes; maybe it needs some relaxing.

But they want to go about it in a cautious, judicious manner and not just chop it off by an antitrust court decree that says the whole primary distribution system no longer needs any protection. Which is, I think, virtually where you might end up if you had an antitrust court decision in favor of the government in this case.

Incidentally, I would like -- I see my time is nearly up -- I would like to close by referring to a paragraph from this Commission report that we sent over to Congress just last November.

On the very last page of the government's, the Department of Justice, reply brief, they quote what they say is a sentence out of this report.

Incidentally, this report is a report by the staff to the Commission, it isn't the Commission's own report at all. They say the Commission has made this observation, and they say we made this observation in a related context.

Here is what they say we said to the Congress in that report, and as far as it goes -- I don't say it's inaccurate; it's word for word the way our report reads.

It says that "an exaggerated fear of disorderly distribution should not be permitted to form a pretext for avoiding the interoduction of price competition which, while perhaps difficult and even unprofitable for particular funds and their underwriters, and certain dealers, would be to the benefit of investors and the mutual fund industry generally."

Now, the thing that the government's brief does not do is include the first word of that sentence, which was "however"; it's a "However" sentence. And a "however" sentence, by its very nature, assumes that you're distinguishing something that just went before.

Here is the sentence before the "however" sentence, which they quote without the "however":

"There is of course a necessity to avoid disruption of the fund distribution system:" and then it goes on, "however" and then they say this.

QUESTION: Mr. North, if that's a staff report, what action has the Commission taken upon that report as of now?

MR. NORTH: They have transmitted it to the Congress, they are working now on a draft of some legislation to implement parts of it, we have --

QUESTION: Did the Commission send any report of its own to Congress?

MR. NORTH: There is an extensive letter of transmittal, signed by the Chairman of the Commission, and authorized by the whole Commission, some eight pages in length, single-spaced, stating the Commission's own reaction, and sustaining some of the recommendations of the staff.

QUESTION: So it took the Commission 35 years to get to the point of getting to this bill; right?

MR. NORTH: Well, no, there have been proposals up in a number of other Congresses. There were proposals --

QUESTION: Not initiated by the Commission; initiated by Congress -- by the Department of Justice?

MR. NORTH: Oh, no. The Commission in 1967 and against in 1969 had proposals before the Congress, including some modifications of this section 22, the very section we're talking about.

QUESTION: Granting all of that, but am I still -- I still want an answer: Has the Commission done anything in the realm of regulation on 22?

MR. NORTH: 22(f) -- not, no, they've never adopted a formal rule.

I would suggest one other thing, then I'll be through, that this quotation that I just read is in a portion of the Commission's report which is recommending legislative proposals. And yet they say we made that statement in a related context.

I would say this is just the opposite context. The context of what you think the law is in a lawsuit is one thing; the context of what you want when you go to Congress to get the change in the law is quite a different thing.

Thank you very much.

MR. CHIEF JUSTICE BURGER: Thank you.

Mr. Norton, we enlarged your friend's time by about four minutes; you may have four minutes for rebuttal.

REBUTTAL ARGUMENT OF GERALD P. NORTON, ESQ.,

ON BEHALF OF THE APPELLANT

MR. NORTON: I appreciate that.

I'd like to address one comment by Mr. Loevinger. He said that these contracts had been in existence before and after the Investment Company Act; that the only thing that happened was the enactment of that Act.

Well, it is true that the Investment Company Study shows that there were such contractual restrictions prior to 1940. It did not indicate that they had become widespread in virtually the norm, the way they are now. This is indeed part of count one.

Count one says that they have combined to restrain the development of secondary markets; and one of the ways in which they have done it is to induce the funds and underwriters to include these restrictive provisions in their vertical agreements.

So that we don't have a record, first of all, on what existed prior to 1940, but it is inaccurate to suggest that there is nothing since then that is important.

We certainly do not withdraw -- we have not withdrawn or abandoned count one in any way. What we have done is clarified one single allegation of count one which could have been viewed as challenging rules adopted by the NASD. We've made it clear that that is not part of count one.

The balance of count one, which is at page 9 of the Appendix, stands fully in effect.

Now, with respect to 22(f), the Commission has considered that they have done nothing under 22(f), as we have indicated, but they also indicated that they thought that they could act with reference to not only protection of outstanding shareholders, but protection --

QUESTION: Well, does the rules of NASD purport to recommend or authorize or forbid a dealer to act as a broker?

MR. NORTON: NASD rules? No.

QUESTION: Well, but I take it then, that part of your cause of action is that dealers do agree not to act as brokers --

MR. NORTON: That's right.

QUESTION: -- and you attack that idea.

MR. NORTON: That's right.

And the complaint is not limited to brokerage markets involving contract dealers. Count one is unqualified.

QUESTION: I understand.

MR. NORTON: Now, 22(f) does not, as Mr. North indicated, refer in terms to the protection of the investing public who are not already shareholders.

Now, another provision that should be borne in mind in considering 22(f) is section 50 of the Act, which provides that nothing in the Act affects the jurisdiction of any agency or officer of the United States or any State with respect to any purchase, security or transaction, except in the possible extent of any conflict with something in the Act.

Now, there is no conflict with anything in the antitrust law and 22(f) standing alone.

So we have the statute supporting us in that regard.

I should suppose also that the mere fact that a registration statement discloses a merger, for example, that would tend to violate the antitrust laws, would not mean that that merger is immune. That is contrary to the facts of life and the way this Court has applied the antitrust laws in words..

Similarly, if the restriction on transferability precluded the sale to a black person; that would be a violation of the federal Civil Rights laws. It may be unlikely, but with current activities in the investment world, various things may seem more likely than we would like. Probably not be exempted in the Civil Rights Act, just because it was disclosed in the registration statement.

The Commission's requirements that prospectuses of the shareholders indicate that the fact that the document has been reviewed by the Commission does not constitute approval of it, it is not any guarantee of the adequacy or the accuracy of any representations therein.

As an example of that, in government Exhibit 8, on page 254, the standard legend which denies any notion that the Commission action in reviewing these statements is an approval.

Thank you.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

[Whereupon, at 11:48 o'clock, a.m., the case in the above-entitled matter was submitted.]

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