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Collusive Bidding in the Market for Corporate Control

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I. INTRODUCTION

After a brief hibernation, mega-mergers and corporate acquisitions have returned with a vengeance. Merger activity has risen dramatically in recent years, with activity increasing at record rates for each

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of the past four consecutive years.¹ In 1998, mergers and acquisitions resulted in \$2.4 trillion in announced activity.² The first three quarters of 1999 outpaced that rate, with \$2.2 trillion generated in the first three quarters alone.³ Unlike the mergers of the 1980s, which occurred more often as a result of leveraged buyouts of undervalued companies, the mergers and acquisitions of the 1990s have taken on a different flavor. Instead of attempting to capitalize on the cash flows of companies trading below their supposed market values, entities are uniting to achieve more efficient operations and provide a greater return as they court potential investors.⁴ The impetus behind the recent wave of corporate integration is premised on allowing companies to better compete in the world economy by achieving synergistic and competitive advantages over rivals.⁵ By contrast, leveraged-buyout firms accounted for only 10% of the hostile takeovers since 1994, down by half since the 1988-89 period.⁶ Strategic investors, normally those in a business related to that of the target, initiated the remaining takeovers. These strategic investors acquire their targets not only to achieve greater efficiencies in their own companies, but often to obtain the target company for relatively bargain rates. "[T]he prospect that strategic investors will produce a more competitive company has helped bring the 'takeover premium' down to 26% last year from 58% in 1988."⁷ Many of the recent mergers in which the acquiring company made a tender offer for the stock of the target company were effectuated consensually. Increasingly, such tender offers consist of the stock of the acquiring company coupled with cash or bonds, rather

1. See *A Busy Year in Business*, STAR TRIBUNE (Minneapolis), Dec. 31, 1998, at 1D.

2. See *id.*

3. See *Why this Merger Wave is Different*, BUS. WK., Oct. 18, 1999, at 234.

4. The volume of acquisitions and mergers in some industries has been spurred by the view that consolidation will increase efficiencies and expand markets. See, e.g., William Bulkeley, *CVS to Buy Arbor Drugs for \$1.48 Billion*, WALL ST. J., Feb. 10, 1998, at A3 (drugstores); Peter Elstrom et al., *A Cell Phone in Every Pocket?*, BUS. WK., Jan. 18, 1999, at 38 (telecommunications); Steven Lipin and Deborah Lohse, *AIG to Buy SunAmerica for \$18 Billion*, WALL ST. J., Aug. 20, 1998, at A3 (insurance); Elizabeth MacDonald, *Price-Coopers Deal Faces Hurdles before July Launch*, WALL ST. J., May 21, 1998, at B4 (accounting); Stephanie N. Mehta, *WorldCom Quietly Completes MCI Communications Purchase*, WALL ST. J., Sept. 15, 1998, at B6 (telecommunications); Robert O'Brien, *News of Wells Fargo-Norwest Pact Boosts Buying in Financial Shares*, WALL ST. J., June 9, 1998, at C4 (banking); Ron Winslow, *Aetna to Acquire Prudential Health Unit*, WALL ST. J., Dec. 11, 1998, at A3 (health insurance).

5. The current trend towards mergers differs from that of the past, being driven by forces including a desire to cut costs, shrink capacity, and gain access to new technologies, skills and workers, as well as to reduce competition and hike prices. See *Why this Merger Wave is Different*, *supra* note 3.

6. See Greg Ip, *With Dow 9000 Nearby, Stocks get Boost as Corporate America Tightens its Belt*, WALL ST. J., Mar. 23, 1998, at C1.

7. *Id.*

than the all-cash tender offers that characterized the era of mergers of the 1980s.⁸

However, the collective impact on individual shareholders who hold stock in a target company is often ignored in the broader context of business mergers and acquisitions. Notably, when several companies initially tender offers to shareholders of a target company, the price of the finite block of stock rises as a result of the competitive forces attempting to acquire it. This is what is often referred to as the "market for corporate control."⁹ When two or more entities vie for a finite block of stock of a target company, what are the qualitative and quantitative effects of the collusive transaction between potential buyers which reduce this market from several bidders to one? Specifically, what are the legal implications and economic effects of an agreement among potential buyers of stock in which suitors exit the bidding process in exchange for some sort of compensation thereby lowering the purchase price necessary to gain control of the corporation as a result of the diminished competition?¹⁰

The issue is not merely of academic interest, since several recent mergers have followed this pattern. For example, in a communications industry battle both Global Crossing and Qwest separately bid to acquire two companies: Frontier and U.S. West. Rather than engage in a bidding war, the rival suitors agreed to split the prizes, with Global Crossing getting Frontier while Qwest acquired U.S. West. Global Crossing received approximately half of an \$800 million "breakup fee" in relation to the U.S. West deal, in exchange for Qwest's promise not to continue to pursue Frontier.¹¹ In a similar exchange, rival suitors Bethlehem Steel and Allegheny Teledyne each attempted to acquire Lukens. Bethlehem succeeded in gaining Lukens only after agreeing to sell some assets to Allegheny.¹² Similarly, with both Comcast and

8. For example, see AT&T's acquisition of Teleport Communications in an exchange of stock. See Steven Lipin, *AT&T to buy Teleport for \$11.3 Billion*, WALL ST. J., Jan. 9, 1998, at A3.

9. *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 77 (1987); see also Edward B. Rock, *Antitrust and the Market for Corporate Control*, 77 CALIF. L. REV. 1365 (1989) (examining the role of antitrust laws in protecting the basic competitive processes within the market for corporate control).

10. Data on the rate of collusive conduct in the market for corporate acquisitions is difficult to obtain due to the widespread use of confidentially agreements. In practice, at least with friendly takeovers, target corporations often require that would-be acquirers agree not to contact other potential acquirers in exchange for access to non-public information concerning the takeover target. Interview with C. James Levin, J.D., M.M., O'Melveny & Myers, in Los Angeles, Cal. (Jan. 2, 1994).

11. See Rebecca Blumenstein, *Qwest Wins U.S. West for \$35 Billion*, WALL ST. J., July 19, 1999, at A3.

12. See Chris Adams, *Bethlehem Steel Wins Bidding War for Lukens, Agrees to Deal with Rival*, WALL ST. J., Jan. 29, 1998, at B6.

AT&T vying to acquire MediaOne, Comcast agreed to withdraw its offer after AT&T "gave" its cable systems in Baltimore and Washington, D.C. to Comcast.¹³ All of these examples involve one acquirer paying another to refrain from competitive bidding. This behavior, known as "bid rigging," is normally considered a *per se* violation of the Sherman Act.¹⁴ But while such cases are routinely prosecuted by the U.S. Justice Department, there is no history of such treatment in the market for corporate control.¹⁵

Part I of this article will examine the historical evolution of anti-trust laws, specifically as they have been applied to the market for corporate control. Part II will examine the current judicial opinions advanced which reject the application of antitrust laws to the market for corporate control, including the supposed nonapplicability of anti-trust laws to the sale of stock and the implied revocation of the anti-trust laws by virtue of the enactment of the Williams Act. Part III will address the inability of the Securities and Exchange Commission to regulate the market for corporate control via the Williams Act in that there is no inherent conflict between the Commission's disclosure requirements and the policy of antitrust laws. Part IV will analyze the quantitative economic effects of the diminution of competition in the market for corporate control and examine its aggregate effect on shareholders.

II. OVERVIEW OF ANTITRUST LAWS

A review of the development of antitrust law in the context of its concurrent application to other areas of federal law, especially securities regulation, provides the requisite foundation to determine whether the Sherman Act is applicable to the market for corporate control. The Sherman Act was enacted in 1890 to curb the abuses of unreasonable economic restraints imposed by entities endeavoring to limit trade through the restriction of competitive conditions.¹⁶ Section 1 of the Sherman Act provides: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal."¹⁷

A literal interpretation of the plain language of the Sherman Act would void all contracts because an agreement by two parties necessa-

13. See Leslie Cauley and Rebecca Blumenstein, *Comcast, in AT&T Accord, Abandons MediaOne Bid*, WALL ST. J., May 5, 1999, at A3.

14. See *United States v. Seville Indus. Mach. Corp.*, 696 F. Supp. 986, 989 (D.N.J. 1988).

15. See R. Preston McAfee *et al.*, *Collusive Bidding in Hostile Takeovers*, 2 J. OF ECON. & MANAGEMENT STRATEGY 449, 450 (1993).

16. See *Standard Oil Co. v. United States*, 221 U.S. 1, 58 (1911).

17. 15 U.S.C. § 1 (1997).

rily restrains trade by virtue of the contracting parties' exclusionary agreement.¹⁸ In order to avoid this unintended result,¹⁹ courts have inquired as to whether the restraint of trade "is unreasonably restrictive of competitive conditions."²⁰ This "Rule of Reason" test was first articulated by the Supreme Court in *Standard Oil v. United States*,²¹ and its application has been relatively unchanged throughout the last century.²² Congress has also chosen to statutorily exempt certain industries from antitrust liability even though their participants may form agreements and combinations that would otherwise unreasonably restrain trade.²³ An unreasonable restraint of trade may be found when either the contract itself or the surrounding circumstances "give rise to the inference or presumption that they had been entered into . . . with the intent to do wrong . . . and to limit the right of individuals, thus restraining the free flow of commerce and tending to bring about

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18. *See Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918). Justice Brandeis tempered the Court's analysis of the scope of antitrust laws by noting that "every agreement, concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. . ." *Id.* *See also* *United States v. Topco Associates*, 405 U.S. 596 (1972)(noting that a literal reading of the Sherman Act would preclude enforcement of all contracts).
 19. *See Topco*, 405 U.S. at 606. "The history underlying the formulation of the antitrust laws led this Court to conclude, however, that Congress did not intend to prohibit all contracts. . ." *Id.*
 20. *Standard Oil v. United States*, 221 U.S. 1, 58 (1911). It is this concept that comprises the essence of antitrust law enforcement. Prior to the enactment of the Sherman Act, many courts focused on whether the agreed price between two contracting parties itself was reasonable. *See id.* The Supreme Court explicitly rejected this type of judicial analysis because it fails to focus on the agreement's restraining effect on competition. *See United States v. Trans-Missouri Freight Assn.*, 166 U.S. 290, 330-39 (1897); *United States v. Addyston Pipe & Steel Co.*, 175 U.S. 211, 238 (1899).
 21. 221 U.S. 1 (1911).
 22. *Standard Oil* also removed the consideration of factors affecting a particular industry from the judicial analysis of whether an agreement violated the Sherman Act. *Id.* at 65. The Sherman Act does not confer courts the authority to exempt a particular industry or arrangement because of possible beneficial effects of a proposed transaction notwithstanding the fact that it would otherwise have constituted an unreasonable restraint of trade. *See id.* at 65. The Court was apparently concerned that lower courts might have been inclined to carve out exceptions to the preclusive effect of antitrust laws absent Congressional legislation. *See id.*
 23. *See, e.g.*, 15 U.S.C. §§ 1011-1013 (1995)(exempting certain insurance agreements from the preclusive effect of the Sherman Act); 15 U.S.C. § 1801 (1995)(exempting newspaper agreement from antitrust laws). One of the most famous antitrust exemptions that has not been statutorily accepted is that of professional baseball. *See Flood v. Kuhn*, 407 U.S. 258 (1972). Through the twentieth century, baseball has enjoyed the relatively unfettered ability to administer regulations including the geographic placement of professional baseball teams in a given area. *See id.* at 283. The Supreme Court was unwilling to abrogate baseball's non-statutory exemption from antitrust enforcement absent legislative action from Congress. *See id.*

. . . enhancement of prices.”²⁴ If the agreement is so plainly anticompetitive on its face that no further analysis of the particular industry is needed to ascertain the contract’s illegality, it fails the first test of the Rule of Reason and is illegal *per se*.²⁵ If the anticompetitive effects of the agreement are discerned only through an analysis of the circumstances unique to the particular business or industry, the history of the restraint and reasons underlying its imposition, the agreement fails the second test of the Rule of Reason and thus violates the Sherman Act.²⁶ The Court developed this test with the belief that the restraint of trade would shackle free competition and eventually force an increase in prices, which contravened the public policy advanced by the Sherman Act.²⁷ Thus, the test for whether an agreement violates antitrust laws focuses on whether the restraint of trade is simply subsumed within and fosters competition, or whether it suppresses and

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24. *Standard Oil*, 221 U.S. at 58. The Court fashioned this test based on its interpretation of the legislative intent and the public policy goal intended to be furthered through the enactment of the Sherman Act. The Sherman Act was not particularly clear on defining the circumstances that would constitute an illegal restraint of trade, so courts have applied the relatively unchanged judicial test promulgated in *Standard Oil*. See, e.g., *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 489 (1940)(noting that exceptions to the Sherman Act “were not stated in terms of precision or of crystal clarity and the Act itself did not define them. In consequence of the vagueness of its language . . . the courts should interpret its words in the light of its legislative history and of the particular evils at which the legislation was aimed.”); see also *Nat’l Society of Prof’l Engineers v. United States*, 435 U.S. 679, 691 (1978) (“In this respect the Rule of Reason has remained faithful to its origins.”); *Nash v. United States*, 229 U.S. 373, 378 (1913)(“[W]e can see no reason for reading into the Sherman Act more than we can find there”); *Appalachian Coals, Inc., v. United States*, 288 U.S. 344, 359-60 (1933)(“As a charter of freedom, the [Sherman] Act has a generality and adaptability comparable to that found to be desirable in constitutional provisions.”)
25. See *Nat’l Society of Prof’l Engineers*, 435 U.S. at 692; see also *Apex Hosiery*, 310 U.S. at 500 (“In thus grounding the ‘rule of reason’ upon . . . doctrines applicable to illegal restraints of trade the Court gave a content and meaning to the statute in harmony with its history and plainly indicated by its legislative purpose.”).
26. See *Nat’l Society of Prof’l Engineers*, 435 U.S. at 692. The Rule of Reason test is disjunctive in that an agreement violates antitrust laws if it is *either* illegal *per se*, or illegal by virtue of the circumstances surrounding the restraint. See *Standard Oil*, 221 U.S. at 58.
27. See *Standard Oil*, 221 U.S. at 58. The Court appeared to structure the Rule of Reason test to be consistent with the aims of the Sherman Act. Thus, the genesis of the test came from the Court’s analysis that antitrust laws were designed to prohibit or outlaw all contracts or combinations that unreasonably restricted competition. See *id.* An unreasonable restraint of trade could come from the literal content of the agreement, which is the first manner in which a court could invalidate an agreement pursuant to the Sherman Act. See *id.* In addition, a court also could strike down a contract if the circumstances surrounding the agreement showed that the parties intended to restrain trade and raise prices, rather than the “legitimate purpose of reasonably forwarding personal interest.” *Id.*

eviscerates free trade.²⁸ The Rule of Reason rejects any analysis that focuses solely on whether the price set by the competitors is reasonable.²⁹ The antitrust laws, after all, were designed to prevent unreasonable restraints of trade, not to set reasonable prices in the marketplace.³⁰

The jurisprudence interpreting the Sherman Act has been refined over the past century in the context of its application to alleged antitrust violations.³¹ However, the interplay of antitrust laws with other federal laws and regulations, particularly statutes governing corporate mergers and acquisitions, has received considerably less attention.

One of the seminal cases in which the Supreme Court explicitly addressed the coexistence of the viability of antitrust laws in the context of concurrent federal regulation was *Apex Hosiery Co. v. Leader*.³² In *Apex Hosiery*, the Supreme Court broadly delineated the application of the Sherman Act to restraints of trade involving labor unions, "which are so substantial as to affect market prices."³³ In the context of applying antitrust laws to a labor union governed by the rules of the National Labor Relations Act, *Apex Hosiery* expounded that the Sherman Act was designed to prevent restraints of trade that either had or were intended to manipulate prices in the market or would otherwise deprive purchasers or consumers of the benefits gained through free competition.³⁴ The thrust of the Supreme Court's analysis was a comparison of the respective aims of the National Labor Relations Act and the Sherman and Clayton Acts.³⁵ The dissent in *Apex Hosiery* noted that the National Labor Relations Act was designed to prevent the

28. See *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918).

29. See *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 235-38 (1899).

30. See *id.* Some arguments advanced in contravention to the Rule of Reason assert that the Sherman Act is designed to increase competition, and not to prevent restraints of trade. Relying on *Standard Oil's* analysis of the rationale underlying the enactment of the Sherman Act, "[t]he heart of our national economic policy long has been faith in the value of competition." *Standard Oil Co. v. Fed. Trade Comm'n*, 340 U.S. 231, 248 (1951).

31. Even though the Rule of Reason has remained in effect for the better part of the last century, the Supreme Court has also articulated the standards in which courts interpret the Rule of Reason. The trier of fact must balance all circumstances in a case in deciding whether a restrictive arrangement should be struck down as an unreasonable restraint of trade. See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977). Courts need to differentiate whether the purported restraint "merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition." *Nat'l Society of Prof'l Engineers*, 435 U.S. 679, 691 (1978)(quoting *Continental T.V. Inc.*, 433 U.S. at 49 n.15).

32. 310 U.S. 469 (1940).

33. *Id.* at 500.

34. See *id.* at 493.

35. See *id.* at 501-13.

disruption of the shipment and delivery of goods through interstate commerce.³⁶ Thus, the National Labor Relations Act was applied to situations in which unfair labor practices interrupted or adversely effected interstate commerce.³⁷ The legislative purpose behind the enactment of the Sherman Act was to curb unreasonable restraints of trade resulting from illegal contracts, combinations or conspiracies.³⁸ The Court applied the Sherman Act after concluding that there was no conflict between the National Labor Relations Act and antitrust laws.³⁹ *Apex Hosiery* was one of the first and most prominent decisions to delineate the pattern for the Supreme Court's analysis of whether antitrust laws may be applied in the context of concurrent federal legislation or regulation. The *Apex Hosiery* Court expounded a very broad interpretation of the Sherman Act in concluding that labor unions were subject to antitrust laws notwithstanding the existence of the National Labor Relations Act.⁴⁰

Two decades after *Apex Hosiery*, the Supreme Court addressed the applicability of the Sherman Act within the context of mergers in *United States v. Philadelphia National Bank*.⁴¹ In *Philadelphia National Bank*, the Supreme Court affirmed the existence of antitrust laws in the context of the commercial banking industry.⁴² Philadelphia National Bank and Girard Trust Bank, the second and third largest banks in Philadelphia, approved a consolidation of the two entities.⁴³ The Attorney General challenged the consolidation on the basis that it would have an anticompetitive effect in the Philadelphia banking region.⁴⁴ The Court addressed the issue of whether antitrust laws were applicable in the context of bank mergers.⁴⁵ The Court prefaced its analysis by noting the applicability of antitrust laws to

36. See *id.* at 527 (Hughes, C.J., dissenting).

37. See *id.* at 527-28 (Hughes, C.J., dissenting); see also National Labor Relations Bd. v. Fruehauf Trailer Co., 301 U.S. 49 (1937)(applying the National Labor Relations Act to a manufacturer of commercial trailers); National Labor Relations Bd. v. Fainblatt, 306 U.S. 601, 606 (1939)(holding that the National Labor Relations Act has set no restrictions to the volume of interstate commerce that can be adjudicated by its terms).

38. See *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 527 (1940)(Hughes, C.J., dissenting)(quoting *Atlantic Cleaners & Dryers Inc. v. United States*, 286 U.S. 427, 435 (1932)).

39. *Apex Hosiery* at 528. "It would indeed be anomalous if, while employees are bound by the Labor Act . . . at the same time the direct and intentional obstruction or prevention of such shipments by the employers were not deemed to be a restraint of interstate commerce under the broad terms of the Sherman Act." *Id.*

40. See *id.* at 529. "[T]he Sherman Act does not except labor unions from its purview. . . ." *Id.*

41. 374 U.S. 321 (1963).

42. See *id.* at 372.

43. See *id.* at 330-31.

44. See *id.* at 333-34.

45. See *id.* at 323.

corporate acquisitions of stock and capital due to Congress's concern that the market of corporate control would lead to monopolistic concentrations.⁴⁶ Thus, Congress intended through the enactment of the Sherman Act, and the subsequent enactment of the Celler-Kefauver Antimerger Act of 1950, to broaden the reach of antitrust laws to apply to stock and asset acquisitions.⁴⁷ Congress had passed the Bank Merger Act in 1960, yet made no provision that would exempt banks from the scrutiny of antitrust laws.⁴⁸ In deciding that banks were subject to antitrust regulation notwithstanding concurrent legislation promulgated in the Bank Merger Act, the Court again focused on and concluded that the application of the Clayton Act would not frustrate or conflict with the Bank Merger Act.⁴⁹

Notably, the Court reiterated the rule that "[i]mmunity from the antitrust laws is not lightly implied" in the context of its application in the face of concurrent federal regulation.⁵⁰ The Court reasoned that had Congress wished to create a special exemption from the reach of antitrust law for the banking industry, it would have done so through legislation.⁵¹ The Court chose to focus on the lack of express intent by Congress that antitrust laws were not applicable in the arena of bank mergers.⁵² Instead, the Court articulated the test for whether antitrust causes of action were maintainable in the presence of other federal legislation when Congress is silent as to antitrust exemption. The Court stated that in the absence of a statutory exemption by Congress, antitrust laws were applicable unless there was a plain repugnancy between the antitrust and regulatory provisions.⁵³ In

46. *See id.* at 337-38.

47. *See id.* at 342. The Celler-Kefauver Antimerger Act was Congress' response to judicial holdings that found that mergers were outside the scope of the Clayton Act. *See, United States v. Celanese Corp. of America*, 91 F. Supp. 14 (S.D.N.Y. 1950); *see also* *Arrow-Hart & Hegeman Elec. Co. v. Federal Trade Comm'n*, 291 U.S. 587 (1934) (reasoning that the FTC did not have authority to obtain an order compelling enforcement with § 11 of the Clayton Act). As a response to the proliferation of mergers, Congress manifested a clear intent to bring consolidations and mergers within the ambit of antitrust laws. Congressman Celler, co-sponsor of the Celler-Kefauver Antimerger Act, stated that the bill was designed to "plug a loophole in the present antitrust laws. . . . It is time to stop, look, and listen and . . . halt . . . the merger movement that is going on in this country." 95 CONG. REC. 11,485 (1949). Consequently, Congress amended the Clayton Act to provide for an assets-acquisition provision to subject mergers to antitrust scrutiny. *See United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 340 (1963). "Congress primarily sought to bring mergers within § 7 and thereby close what it regarded as a loophole in the section." *Id.* at 341.

48. *Philadelphia Nat'l Bank*, 374 U.S. at 352.

49. *See id.* at 354.

50. *Id.* at 348.

51. *See id.* at 354.

52. *See id.* at 350-52. "[T]he legislative history of the Act seems clearly to refute any suggestion that applicability of the antitrust laws was to be affected." *Id.* at 352.

53. *See id.* at 350-51.

concluding that the merger violated antitrust laws, the Court reasoned that free competition operates within the ambit of governmental regulation of the banking industry, which included enforcing the anticompetitive remedy provided by antitrust laws, despite the protections afforded by the industry's stringent regulations.⁵⁴

III. SUPREME COURT PRECEDENT FOR APPLICATION OF ANTITRUST LAWS TO THE SALE OF STOCK

The application of antitrust laws to the sale of securities has been shaped by a trio of Supreme Court cases which delineated the applicable test for whether the Sherman and Clayton Acts⁵⁵ may be applied concurrently with SEC regulations and securities laws.

The seminal case analyzing the application of antitrust laws to securities regulations is *Silver v. New York Stock Exchange*.⁵⁶ The facts of *Silver* are relatively straightforward. The New York Stock Exchange directed all nonmember users of private wires connected to the Exchange to discontinue their connection to the Exchange's stock ticker service.⁵⁷ Silver's firm was not a member of the Exchange, and was therefore prohibited from using the wire connections to the Exchange.⁵⁸ The Exchange abruptly discontinued the use of private wires pursuant to its rules, and refused to offer Silver an explanation for its decision.⁵⁹ Since Silver was no longer able to quickly obtain stock quotes, his company lost customers stemming from the Exchange's decision to cut off all non-members from using private wires.⁶⁰ Silver's business greatly declined and eventually stopped functioning as an operating business organization.⁶¹ Silver sued the Exchange for violation of the Sherman Act because the members collectively refused to allow his business to continue using the private wire connections.⁶² The Supreme Court analyzed whether the Exchange was exempt from antitrust liability as a result of the enactment of the Securities and Exchange Act of 1934, which promulgated self-regulation of exchanges.⁶³

The Court prefaced its analysis by noting that, in the absence of the Securities and Exchange Act, the Exchange's removal of the wires would constitute a *per se* violation of the Sherman Act because it was

54. *See id.* at 372.

55. 15 U.S.C. § 12 (1994).

56. 373 U.S. 341 (1963).

57. *See id.* at 343-44.

58. *See id.*

59. *See id.* at 344.

60. *See id.* at 345.

61. *See id.*

62. *See id.*

63. *See id.* at 347.

concerted effort by the member groups to deprive non-members of the ability to effectively trade through the market.⁶⁴ Thus, the Exchange's refusal to allow non-members access to the private wires effectively precluded competition and would constitute an unreasonable restraint of trade.⁶⁵ However, the Court was compelled, given the existence of SEC regulations, to examine the circumstances surrounding the restraint of trade and examine the policies, antitrust laws and SEC regulations in the context of this fact scenario.⁶⁶

The Court next analyzed whether the Sherman Act could be reconciled with the Securities and Exchange Act, or whether the self-regulation goals of securities regulations necessitated the nonapplicability of antitrust laws.⁶⁷ Thus, the focus of the Court's reasoning is not whether the self-regulating nature of the Securities and Exchange Act preempted application of antitrust laws, but rather whether the two acts could be reconciled and mutually applied.⁶⁸

Notably, the Court clearly articulated that Congress did not exempt the Securities Exchange Act from antitrust laws.⁶⁹ In light of express exemption from Congress, *Silver* emphasized the long-standing principle that implied revocation of antitrust laws to the field of security regulations are strongly disfavored.⁷⁰ *Silver* recognized the

64. *See id.* at 347. Thus, the Rule of Reason promulgated in *Standard Oil* would have prohibited the removal of the wires because it constituted an unreasonable restraint of trade on its face. *See* 221 U.S. 1, 58 (1911). *See also* *Fashion Originators' Guild of Am. Inc. v. Fed. Trade Comm'n*, 312 U.S. 457 (1941)(holding that garment manufacturers violated the Sherman Act by restricting the sale of unregistered textile, notwithstanding regulatory authority of Federal Trade Commission). Thus, the Court would, under ordinary business circumstances, hold these types of naked restraints of trade to be unreasonable on a *per se* basis. However, the presence of concurrent federal regulation provoked the alternative analysis of the Rule of Reason test, which focuses on the surrounding facts and circumstances of the restraint. *See Silver v. New York Stock Exch.*, 373 U.S. 341, 347-49 (1963).

65. *See Silver*, 373 U.S. at 364. Had the case not involved alternative federal regulation, the Court would have easily found the Board's act to be an unreasonable restraint of trade. *Id.* at 347. "The concerted action of the Exchange and its members here was, in simple terms, a group boycott depriving petitioners of a valuable service which they needed in order to compete. . . ." *Id.*

66. *See id.* at 349.

67. *See id.* at 349-51.

68. *See id.* at 360-61.

69. *See id.* at 357.

70. *See id.* The doctrine of implied revocation, which would impliedly exempt antitrust laws from application in a situation in which it conflicted with Securities Exchange Act, was promulgated in *United States v. Borden Co.*, 308 U.S. 188, 198 (1939). In such cases, repeal of antitrust laws would occur "only if necessary to make the Securities and Exchange Act work, and even then only then to the minimum extent necessary." *Silver*, 373 U.S. at 357. *See Borden*, 308 U.S. at 198 (1939)(refusing to impliedly repeal the Sherman Act in the context of concurrent application with federal Agricultural Act); *Georgia v. Pennsylvania R.R. Co.*, 324 U.S. 439, 457 (1945)(rejecting implicit revocation of Sherman Act by applying an-

unique interplay between antitrust laws and securities regulations by noting that "antitrust laws are peculiarly appropriate as a check upon anticompetitive acts of exchanges."⁷¹ The Court focused on the fact that Congress empowered the SEC with the regulatory authority to suggest and disapprove rules promulgated by various exchanges.⁷² However, the Court opined that the SEC does not maintain the jurisdictional authority to review enforcement of the rules stated in the Securities and Exchange Act.⁷³ Thus, the SEC, by virtue of its status as a regulatory agency, does not have the ability to apply antitrust laws to an exchange that engages in a unreasonable restraint of trade.⁷⁴ *Silver* noted that antitrust laws played a valid role in the context of securities regulations by insuring a competitive environment in the securities industry.⁷⁵ The Exchange's arbitrary and unfettered right to terminate *Silver's* wire connection, combined with the SEC's inability to compel the exchange to change its anticompetitive rules, displayed the need for some sort of review of the anticompetitive effects of the Exchange's rules.⁷⁶ The Court concluded that the Exchange had engaged in an unreasonable restraint of trade and failed to demonstrate how antitrust laws offended the goals of implementing the self-regulating provisions of the applicable securities laws.⁷⁷

Silver recognized that a broader application of antitrust laws served to ensure competitive freedom, even in the area of securities regulations in which there exist substantive laws and regulations governing stock transactions.⁷⁸ When antitrust laws do not obstruct the policy of the Securities and Exchange Act, they are fully applicable in instances where parties are engaged in unreasonable restraints of trade.⁷⁹ Stated another way, *Silver's* holding is not confined to whether securities regulations address a situation to which antitrust laws may be applicable, but whether there is a direct conflict in apply-

titrust laws to entities regulated by Interstate Commerce Commission); *California v. Federal Power Comm'n*, 369 U.S. 482, 485, 490 (1962)(rejecting implicit revocation of antitrust laws in context of Federal Power Commission's regulatory authority).

71. *Silver*, 373 U.S. at 360 ("Evidence of antitrust violations is plainly relevant in merger applications. . . ."); see *California v. Federal Power Comm'n*, 369 U.S. 482, 484 (1962)(citing *City of Pittsburgh v. Federal Power Comm'n*, 237 F.2d 741 (1956)).

72. See *Silver*, 373 U.S. at 357.

73. See *id.*

74. See *id.* at 358-59. The SEC's lack of enforcement power could lead to antitrust abuses by powerful regional exchanges which engage in unchecked, anticompetitive behavior in the absence of administrative or judicial authority which could enjoin unreasonable, anticompetitive activity. See *id.*

75. See *id.* at 359-60.

76. See *id.* at 361-62.

77. See *id.* at 365-67.

78. See *id.* at 362-63.

79. See *id.*

ing antitrust laws to situations which would offend the application of securities regulations.⁸⁰

Silver addressed the issue of the applicability of antitrust laws in the context of securities regulations when there is no conflict between the simultaneous application of both laws. The unanswered question was what situation would constitute a direct conflict between SEC regulations and antitrust violations. The Supreme Court addressed that issue twelve years later in *Gordon v. New York Stock Exchange, Inc.*⁸¹

In *Gordon*, the petitioner sued several stock exchanges challenging their agreements to set fixed commission rates as a violation of the Sherman Act.⁸² The exchanges argued that the SEC maintained supervisory authority over the disputed activities pursuant to the Securities and Exchange Act⁸³ and were therefore not subject to the preclusive effects of antitrust laws.⁸⁴ Pursuant to section 19(b)(9) of the Securities and Exchange Act, the SEC was given supervisory authority to fix reasonable rates of the various exchanges.⁸⁵ Pursuant to this statute, the SEC has direct authority to regulate and fix reasonable rates of commission.⁸⁶ Further, the SEC had maintained a history of actively regulating commission rates established pursuant to its regulatory power.⁸⁷ In applying the test articulated in *Silver*, the Court reasoned that antitrust laws directly conflicted with the SEC's regulatory authority in this particular instance.⁸⁸ Thus, the Court applied *Silver's* standard of antitrust analysis in the context of securities by stating that the implicit repeal of antitrust laws in the face of potentially conflicting securities laws was appropriate only in cases of "plain repugnancy between the antitrust and regulatory provisions."⁸⁹ In finding that the relevant SEC regulations on exchange commission rates could not be reconciled with antitrust laws, the Court reasoned that subjecting exchanges to antitrust standards, which are designed to protect competition, may conflict with the SEC's policy of safeguarding the economic health of the securities market.⁹⁰ While the Court characterized its holding as an exception to the rule promul-

80. *See id.* at 360-61.

81. 422 U.S. 659 (1975).

82. *See id.* at 660-61.

83. *See* 15 U.S.C. § 78s(b)(1994).

84. *See Gordon*, 422 U.S. at 661.

85. *See id.* at 666-67.

86. *See id.* at 685.

87. *See id.*

88. *See id.* at 685-86.

89. *Id.* at 682 (quoting *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 350-51 (1963)).

90. *See id.* at 688-89.

gated in *Silver*,⁹¹ it devoted the majority of its analysis to the active role that the SEC had taken in making sure that commission rates were adequately regulated.⁹² Thus, just as the *Silver* Court was troubled by the SEC's inability to enforce certain exchange rules, the *Gordon* Court's holding appeared similarly influenced by the protections offered to investors by virtue of the SEC's proactive approach toward establishing commission rates. In both cases, the level of SEC attention to the perceived anticompetitive problem heavily influenced the Court's decision to allow or disallow the application of antitrust laws in the face of concurrent SEC regulation.

Despite its holding, *Gordon* is significant for the advocacy of antitrust laws to securities transactions in two respects. First, *Gordon* cemented *Silver's* rule that antitrust laws were applicable in the field of securities, notwithstanding the regulatory power of the SEC, to the extent that they are not plainly repugnant toward the SEC's regulatory power. Thus, the analysis focuses on whether the two acts contradict rather than merely overlap each other. Even if antitrust laws are plainly repugnant toward implementation of SEC regulations, antitrust laws yield only to the minimal extent necessary to implement the Securities and Exchange Act. Second, *Gordon* appreciated that the determination of whether antitrust laws were plainly repugnant to SEC regulations was completely dependent on the unique facts and circumstances of each case.⁹³ Thus, rather than articulate narrow standards for determining which situations were appropriate for the coexistence of antitrust laws and which situations necessitated their implied revocation, *Gordon* affirmed the responsibility of the judiciary, and not the administrative agencies, for making these factual determinations.⁹⁴ Given the SEC's apparent enforcement power⁹⁵ over this aspect of the Securities and Exchange Act and its long and arduous history of consistent regulation of exchange commission rates, the Court seemed less bothered by the possible anticompetitive aspects of

91. *See id.* at 685. "[T]he case presently at bar is . . . that 'different case' to which the Court in *Silver* referred." *Gordon*, 422 U.S. at 685.

92. *See id.* The Court noted that the SEC "has been engaged in deep and serious study of the commission rate practices of the exchanges and of their members, and has required major changes in those practices." *Id.* at 690.

93. *See id.* at 685 (stating that *Gordon* was a "different case" from the general rule set forth in *Silver*).

94. *See id.* at 686. The decision of whether to allow the regulatory agency to operate free of antitrust legislation or whether to apply antitrust laws is to be decided by the courts. *See Ricci v. Chicago Mercantile Exch.*, 409 U.S. 289, 306-08 (1973).

95. The Court seemed swayed by the fact that the legislative history of section 19(b) indicated that the SEC could "compel adoption of those changes it felt were necessary to insure fair dealing and protection of the public." *Gordon*, 422 U.S. at 667. The Court also seemed satisfied of the SEC's ability to enforce compliance with its regulation of this rule given its historical performance and activity in this area over the last 40 years. *See id.*, at 663-91.

the exchange and felt confident that the SEC could rectify any anticompetitive rate established by an exchange.⁹⁶ *Gordon* left open the possibility of applying antitrust laws to other issues in which the SEC has regulatory power, and in fact reiterates *Silver's* presumptive application of antitrust law in situations except when they are plainly repugnant to SEC regulations.

The third landmark Supreme Court case involving the interplay between antitrust laws and security regulations occurred in *United States v. National Association of Securities Dealers, Inc.*⁹⁷ *Securities Dealers* was decided in the same year as *Gordon* and determined whether mutual fund companies were exempt from antitrust liability.⁹⁸ Like *Gordon*, a divided *Securities Dealers* Court had to interpret the SEC's enforcement power over a provision of the Securities and Exchange Act.⁹⁹ Section 22(d) of the Investment Company Act of 1940 prohibited dealers from selling mutual fund shares to any person except another dealer, a principal underwriter, or the issuer.¹⁰⁰ Much of the Court's reasoning came from its analysis of the legislative history and purpose of the Investment Company Act. The Court found that the statutory language contained in section 22(d) did not exempt broker-dealers selling mutual funds in the capacity as brokers from antitrust scrutiny.¹⁰¹ The Court reasoned that the statutory authority of section 22(d) was not sufficiently broad to extend to dealers acting as statutory brokers.¹⁰² Further, the court reasoned that the application of antitrust rules was reconcilable with the goals of the Investment Company Act and were, therefore, fully applicable to the case at bar.¹⁰³ However, the Court refused to apply antitrust laws to an agreement between members of the National Association of Security Dealers to regulate dealer and brokerage markets for the sale of mutual funds.¹⁰⁴ As in *Gordon*, the Court felt that the SEC was properly charged with regulating the Association's rules and had maintained a vigorous and continuous presence in the field of monitoring rules within the purview of its regulatory authority.¹⁰⁵ However, as the dissenting Justices noted, the Court never addressed the issue as to

96. *See id.* at 663-91.

97. 422 U.S. 694 (1975).

98. *See id.* at 697.

99. *See id.* at 694.

100. *See* 15 U.S.C. §80a-22(d)(1994).

101. *See Securities Dealers*, 422 U.S. at 720.

102. *See id.*

103. *See id.*

104. *See id.* at 734-35.

105. *See id.* at 734. The four dissenting Justices were not so convinced. Justice White opined that in the absence of clear immunization or exemption from antitrust laws, private business agreements are subject to antitrust scrutiny notwithstanding the fact that another regulatory agency has the authority to regulate the conduct in question. *See id.* at 737-38 (White, J., dissenting).

whether antitrust laws were plainly repugnant to the SEC's effectuation of the rules and standards within its authority.¹⁰⁶ The Court did briefly note that the application of antitrust laws would subject individuals to "duplicative and inconsistent standards,"¹⁰⁷ but its analysis was largely devoid of any explanation for why antitrust laws were irreconcilably offensive to the SEC's duties under the relevant federal legislation.¹⁰⁸

IV. THE CURRENT TEST: DISCERNING COMMON THEMES IN *SILVER, GORDON AND SECURITIES DEALERS*

How are *Silver, Gordon, Securities Dealers* and their progeny able to be reconciled? Despite the Supreme Court's divergent holdings, several common threads may be gleaned through its analysis. First, antitrust laws are applicable to areas under the purview of the SEC if they are not plainly repugnant to the effectuation of the particular SEC enforcement policy. While the Court and subsequent federal opinions have not laid a consistent foundation for what would constitute plain repugnancy, it tends to focus on whether SEC regulations would subject defendants to inconsistent standards if antitrust laws are applied.

Thus, based on the Supreme Court's prior holdings, application of antitrust laws to the market for corporate control would not be plainly repugnant to the SEC's regulatory authority which is concerned only with disclosure. However, the Supreme Court's reasoning is more multilayered. In each of the three cases in which antitrust laws either were or were not applicable, the Court expressed an opinion, supported by extensive legislative history, determining whether the SEC had done an adequate job in enforcing its regulations and curbing the anticompetitive evils confronted in the facts before the Court.¹⁰⁹ When the Court expressed satisfaction that the SEC was adequately policing anticompetitive agreements or combinations within the purview of its regulatory authority, it has consistently found antitrust laws to conflict with the effectuation of some SEC policy.¹¹⁰ In instances in which the SEC had not acted affirmatively to curb anticompetitive abuses, the Court has been quick to apply antitrust law to the facts before it.¹¹¹ In fact, the SEC's authority to control the manipulation of tender offers is quite limited by the Securities and Exchange

106. See *id.* at 735-36 (White, J., dissenting).

107. *Id.* at 735.

108. See *id.*

109. See *Gordon v. New York Stock Exch.*, 422 U.S. 659 (1975); *United States v. National Ass'n of Securities Dealers, Inc.*, 422 U.S. 694 (1975); *Silver v. New York Stock Exch.*, 373 U.S. 341 (1963).

110. See *Gordon*, 422 U.S. 659; *Securities Dealers*, 422 U.S. 694.

111. See *Silver*, 373 U.S. 341.

Act.¹¹² Thus, the situation in the market for corporate control more closely resembles the fact scenario in *Silver*, in which the Supreme Court refused to enjoin the application of antitrust laws while loudly expressing its uneasiness over the SEC's impotence to enforce its rules.

The nexus between the Supreme Court's constant focus on the SEC's performance of curbing antitrust violations within its regulatory environment is striking because applying the Court's own test, it should not matter whether the SEC has chosen to act in a given situation.¹¹³ If the SEC has the regulatory authority to supervise a given activity and a stated policy which would conflict with antitrust laws, of what relevance is the SEC's historical track record of supervision in the field? Either antitrust laws are applicable or they are not, but the SEC's advocacy in a given area should not be a relevant factor in deciding whether antitrust laws can coexist with SEC regulation.

Thus, without stating so explicitly, the Supreme Court has demonstrated a pattern of examining the SEC's regulatory and enforcement performance in a given area in connection with determining whether an antitrust cause of action is maintainable. The SEC's complete unwillingness, either because it does not possess a statutory basis or out of simple reluctance to regulate the manipulation of prices in the market for corporate control, would militate in favor of applying antitrust laws to unreasonable restraints of trade in that context.

V. DOES THE SALE OF STOCK FALL WITHIN THE PURVIEW OF "TRADE OR COMMERCE" UNDER THE SHERMAN ACT?

Some courts have refused to apply antitrust laws to securities transactions because the sale of stock is "not an item of goods."¹¹⁴ Taking their cue from the Supreme Court's dicta in *Apex Hosiery*, several courts have reasoned that since the sale of securities was not a good or service, antitrust laws were inapplicable.

In *Kalmanovitz v. G. Heileman Brewing Co.*,¹¹⁵ the Third Circuit expressly held that the sale of stock did not constitute a good or service and was therefore not covered by the Sherman Act.¹¹⁶ In concluding that an antitrust cause of action was not maintainable, the court reasoned that other federal security laws would "stand guard over the excesses endemic to corporate takeovers."¹¹⁷ Other courts have similarly reasoned that the market for corporate control is not

112. *See id.*

113. *See* Standard Oil Co. v. United States, 221 U.S. 1, 58(1911).

114. *See infra* notes 115-127 and accompanying text.

115. 769 F.2d 152 (3rd Cir. 1985).

116. *See id.* at 156.

117. *Id.*

subject to the application of antitrust laws because securities are neither goods nor services.¹¹⁸

On a preliminary note, it is important to note that section 1 of the Sherman Act is devoid of any reference to "goods and services." Rather, it prohibits "[e]very contract, combination . . . or conspiracy in restraint of *trade or commerce*."¹¹⁹ The singular authority that the sale of stock is neither a good nor a service is derived from the Supreme Court's determination that any alleged unreasonable restraint of trade must involve "commercial competition in the marketing of goods or services."¹²⁰ Thus, *Kalmanovitz* and other courts have interpreted the Supreme Court's limitation on the Sherman Act's application to only goods and services to exclude the sale of stock because it does not comport with either category. This interpretation of the applicability of the Sherman Act to the sale of stock is misconstrued for several reasons.

First, as stated above, the plain language of the Sherman Act contains no mention of goods or services, but rather, speaks more broadly to "trade or commerce."¹²¹ Reliance on the specialized analysis of the Sherman Act in *Apex Hosiery Co. v. Leader*, which was decided in the context of segregating labor unions from mainstream commerce, is misplaced.¹²² In fact, the correlative footnote qualifying *Apex Hosiery's* "goods and services" limitation clearly states that the Sherman Act was meant to curb abusive restraints of trade in the broad area of business competition.¹²³ Second, the Supreme Court has considered several cases in which antitrust laws were applied to intangible property.¹²⁴ If the Sherman Act's construction of "goods and services" were as narrow as *Kalmanovitz* suggests, the Supreme Court would never reach the larger issue with which it has grappled so extensively: the

118. See *Bucher v. Shumway*, 452 F. Supp. 1288, 1290-91 (S.D.N.Y. 1978)(holding that securities are neither goods nor services).

119. 15 U.S.C. § 1 (1994) (emphasis added).

120. *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 495 (1940). The source for this confusion stems from the Supreme Court's explanation of the policy underlying the Sherman Act in *Apex Hosiery*. In rationalizing that the Sherman Act was designed to prevent someone from "rais[ing] prices or otherwise controll[ing] the market to the detriment of purchasers or consumers of goods and services," courts have assumed that antitrust laws are not applicable to the sale of stock because it does not fit their particularized definition of "good or service." *Id.* at 493.

121. 15 U.S.C. § 1(1994).

122. See *Apex Hosiery*, 310 U.S. 469.

123. *Id.* at 493 n.15. "The history of the Sherman Act . . . is emphatic in its support for the conclusion that 'business competition' was the problem considered and that the act was designed to prevent restraints of trade which had a significant effect on such competition." *Id.*

124. See, e.g., *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963)(applying antitrust laws to bank mergers).

coexistence of antitrust laws with other federal regulations.¹²⁵ Further, the Supreme Court stated that entities should not be exempted from liability under antitrust laws just because they may deal "in the intangibles of credit and services rather than in the manufacture or sale of tangible commodities."¹²⁶ Other Supreme Court cases have made clear that antitrust laws were applicable to agreements which purported to restrain the price of commodities, which further strains the context and application of *Apex Hosiery's* demarcation of the Sherman Act's limits.¹²⁷

Finally, courts concluding that antitrust laws are outside the reach of the sale of stock have done so without reasoning why securities are not goods.¹²⁸ A good may be defined restrictively, or it may "include every species of personal property."¹²⁹ Many courts have recognized the defectiveness of various arguments in favor of excluding the sale of stock from reaches of the Sherman Act and have refused to exempt these sales from the scope of antitrust laws on such grounds.¹³⁰

VI. THE IMPLIED REVOCATION OF THE SHERMAN ACT IN THE MARKET FOR CORPORATE CONTROL BY THE WILLIAMS ACT

The final argument frequently asserted for the proposition that antitrust laws are not enforceable in transactions involving the sale of stock is that the Sherman Act has been impliedly repealed in cases involving the application of the Williams Act.

The Williams Act was enacted in 1968 to provide shareholders who are offered a cash tender offer for the ownership of their stock with information and disclosure about the intentions and qualifications of the offeror.¹³¹ Due to the increasing occurrences of cash tender offers,

125. See, e.g., *Gordon v. New York Stock Exch.*, 422 U.S. 659 (1975); *United States v. National Ass'n of Securities Dealers, Inc.*, 422 U.S. 694 (1975); *Philadelphia Nat'l Bank*, 374 U.S. 321; *Silver v. New York Stock Exch.*, 373 U.S. 341 (1963).

126. *Philadelphia Nat'l Bank*, 374 U.S. 368.

127. See *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

128. See *Kalmanovitz v. G. Heileman Brewing Co.*, 769 F.2d 152, 156 (3rd Cir. 1985). The court concluded that the sale of stock did not constitute a good, stating that the sale of stock in the context of a takeover battle does not fall within *Apex Hosiery's* definition of "good." *Id.* *Kalmanovitz* seemed swayed by the fact that "other laws" would protect the abuses of corporate takeovers. *Id.* at 157-58.

129. BLACK'S LAW DICTIONARY 822, 6th ed. (1990); see also *Bozant v. Bank of New York*, 156 F.2d 787, 790 (2nd Cir. 1946)(holding that "preparing, executing or validating bonds, shares of stock, commercial paper . . . [or] bills of lading" constitutes the production of goods).

130. See *Rothberg v. National Banner Corp.*, 259 F. Supp. 414 (E.D. Pa. 1966); *Finnegan v. Campeau Corp.*, 915 F.2d 824, 827 (2nd Cir. 1990).

131. See *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49 (1975); see also S. REP. NO. 550-2 (1967)(outlining the decisions confronting shareholders in the face of a tender offer).

Congress enacted the Williams Act to compel disclosure of the "background and identity" of the offeror, the source and quantity of funds used to purchase the stock, the offeror's holdings in the target, and the offeror's plans *vis a vis* the target corporation's business or structure.¹³² Thus, the offering party must disclose adequate information to both the target corporation and the SEC in order for investors to gauge whether acceptance or rejection of the tender offer is in their best respective interests.¹³³ The Williams Act also governs rules surrounding cash tender offers that afford shareholders certain protections, such as the ability to withdraw their shares for a period of time following the commencement of the tender offer.¹³⁴ Further, the Williams Act specified that the offeror must match any increase in its original tender offer paid to subsequent shareholders to those shareholders who had previously tendered their stock before the price increase.¹³⁵ The Williams Act also prohibits untrue and misleading statements of fact or engaging in any "fraudulent, deceptive, or manipulative acts or practices" in connection with tender offers.¹³⁶

Thus, the Williams Act was designed to protect against three evils: nondisclosure by tender offerors of adequate information enabling a shareholder to make a reasonable decision to sell or keep his stock, offeror overreaching in connection with tender offers, and fraudulent and misleading statements. As discussed below, none of these policies are inconsistent or plainly repugnant to the application of antitrust laws because the Williams Act was designed to further a different policy than that of the Sherman Act.

In *Finnegan v. Campeau Corp.*,¹³⁷ the Second Circuit refused to apply antitrust laws to a collusive takeover agreement between two bidders of a target company on the grounds that the Sherman Act conflicted with the policy of the Williams Act.¹³⁸ A shareholder of the target company challenged the agreement, which reduced the purchase price for the target company, as violative of antitrust laws.¹³⁹ The court held that Congress had impliedly revoked the application of antitrust laws to securities transactions because they irreconcilably conflicted with the Williams Act.¹⁴⁰ The court reasoned

132. See 15 U.S.C. § 78m(d)(1)(A)(1994).

133. The Williams Act was intended to close existing loopholes in federal securities regulation. The Securities and Exchange Act regulated corporate takeover attempts by proxy solicitation, but did not provide disclosure requirements for cash tender offers. See 15 U.S.C. § 78 (1994); *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 22 (1976).

134. See 15 U.S.C. § 78n(d)(5)(1994).

135. See U.S.C. § 78n(d)(7)(1994).

136. 15 U.S.C. § 78n(e)(1994).

137. 915 F.2d 824 (2nd Cir. 1990).

138. See *id.* at 832.

139. See *id.* at 825.

140. See *id.* at 832.

that antitrust laws were impliedly repealed because their application would disrupt the SEC's regulatory power over agreements that are "fraudulent, deceptive, or manipulative."¹⁴¹ *Finnegan* reasoned that the Williams Act provided shareholders with the remedy of disclosure, and this remedy conflicted with the Sherman Act.¹⁴²

Finnegan misapplies the Supreme Court's "plain repugnancy" analysis by concluding that the remedy afforded under the Williams Act, disclosure, so conflicts with the Sherman Act that antitrust laws may not be applied. *Finnegan* further asserts that the SEC has the authority to protect target shareholders from collusive bidding among potential buyers because the Commission can prevent acts and practices that involve material misrepresentation and disclosure.¹⁴³ However, this remedy is of little comfort to the shareholder who, having received disclosure of the proposed transaction pursuant to the Williams Act, is powerless to halt the collusive bidding between large shareholders to increase the market price of the company's stock and thereby induce one bidder to opt out pursuant to an agreement with the other winning stockholder.

It is important to note that Congress has never statutorily exempted the Williams Act from antitrust application, nor does the legislative history evince any intent to do so. Thus, any argument that the Sherman Act would be impliedly repealed in its application to the Williams Act would be because the former's operation is plainly repugnant to the effectuation of the Williams Act.¹⁴⁴ The SEC is constrained from affecting antitrust laws pursuant to the terms of the Exchange Act. 15 U.S.C. § 78s(f) prohibits the SEC from expanding its interpretation of securities laws when it imposes "a burden on competition not necessary or appropriate in furtherance of the purposes of the [Exchange Act]."¹⁴⁵ This statutory limitation opens the door to the concurrent application of antitrust and securities laws when the two are not diametrically opposed to each another. Stated another way, the SEC's authority to preempt the application of antitrust laws is limited both by statute and by the Supreme Court's "plain repugnancy" test.

The SEC's limitations are not surprising when one compares the underlying policy of the Williams Act to antitrust laws. The case of collusion between two bidders designed to increase the sales price of stock so one of them may take the company over is more often premised on an entrepreneurial motivation to control the market, rather than a fraudulent, deceptive or manipulative animus.

141. *Id.* at 831 (quoting 15 U.S.C. § 78n(e)).

142. *See id.* at 830-31.

143. *See id.*

144. *See United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 350-51(1963).

145. 15 U.S.C. § 78s(f)(1994).

Although the SEC may regulate manipulative acts and practices, the Supreme Court has stated that Section 14(e) is designed only to address disclosure, and that courts are strictly mandated to interpret the term "manipulative" only as it pertains to disclosure, and not to the fairness of the tender offer.¹⁴⁶ Thus, the manipulation of the sale price of stock by two rival bidders seeking corporate control is not within the purview of the SEC's regulatory authority except to the extent that such manipulation involves a lack of disclosure. For example, in common instances of collusive agreements for corporate control, the acquiring company wants to take over the target company, presumably to run it, sell off its assets, or increase the company's going concern value and sell it at a future date. The losing bidder is motivated to increase the price that he would otherwise receive for his stock, plus whatever the acquiring company is willing to offer in order to prevent further escalation of the company's stock price, thereby making it more expensive to obtain a controlling interest in the target company. This scenario has nothing to do with disclosure issues or procedural rules governing tender offers, which are the two areas covered under the Williams Act. Rather, the above hypothetical contemplates that two rival bidders would agree, either tacitly or expressly, to fix a price for the target. There are no issues pertaining to disclosure or tender offers that would offend the application of the Williams Act. Rather, the issue is the ability of two entities to fix the purchase price for a corporate takeover.

The reason for the incompatibility between the SEC's regulatory authority over securities and the Sherman Act is easy to comprehend in light of the genesis of the legislation of each body of substantive law. Antitrust laws were designed to curtail unreasonable restraints of trade. They arose as a response to monolithic companies that controlled their particular industry as a result of their ability to predatorily price and otherwise restrict trade by setting high barriers of entry which precluded startup companies from asserting any meaningful challenge to the monopolist's dominance.¹⁴⁷ Antitrust laws were also developed to prevent unreasonable vertical and horizontal restraints of trade by entities that possessed enough market power to dictate and manipulate the scope of competition. The majority of the Supreme Court cases surveyed resolving antitrust disputes do not analyze the fraudulent intent or lack of disclosure surrounding an unreasonable restraint of trade. Rather, the focus is on whether the restraint of trade is unreasonable, either on a *per se* basis or in light of the various

146. See *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 8-12 (1985).

147. The Sherman Act was "enacted in an era of 'trusts' and of 'combinations' of business and of capital organized and directed to control of the market by suppression of competition in the marketing of goods and services." *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 492-93 (1939).

circumstances surrounding the restraint.¹⁴⁸ Parties who, devoid of any fraudulent intent, engage in an unreasonable restraint of trade in order to gain a competitive economic advantage violate the Sherman Act as much as they would if their intent were deceitful or misleading.¹⁴⁹ In either case, the unreasonableness of the restraint of trade is the evil which the Sherman Act attempts to correct, not the protection of the marketplace from fraud.

By contrast, curbing excessive restraints of trade and monopolistic businesses was never the intent of the securities regulations. Even a cursory view of the implemented securities regulations show that disclosure and the prevention of fraud are the SEC's major objectives. The primary regulatory concern of the SEC is to prevent fraudulent or deceptive practices in the market for corporate control. Thus, the SEC was neither empowered nor inclined to assert regulatory authority over companies which engage in predatory pricing or otherwise unreasonably restrain trade. The SEC has chosen to instead concentrate on disclosure and the prevention of fraudulent and deceptive practices governing securities transactions. This was the policy behind creation of the Securities and Exchange Act of 1934, the Williams Act, and the establishment of the SEC as the supervising regulatory authority in the securities industry.

Thus, the conclusion that the Williams Act's remedy of disclosure effectively precludes the application of antitrust laws is erroneous. There is no plain repugnancy from allowing the plaintiff to assert claims for relief pursuant to the Sherman Act and the SEC's power which, in this case, is limited to situations involving non-disclosure, deception, fraud and manipulation. *Finnegan's* argument that application of antitrust laws "would discourage potential bidders from making a tender offer"¹⁵⁰ again misses the point that the application of the Sherman Act is not plainly repugnant to the SEC's regulatory authority to compel disclosure. It is therefore anomalous to compare the respective policies of the Sherman Act and the SEC's regulations because each policy is aimed at preventing a different, yet not incompatible, economic problem.

VII. ECONOMIC ANALYSIS

In an earlier work¹⁵¹, we developed a mathematical theory of collusive bidding in hostile takeovers. This model highlights several important features of such collusive bidding. In particular, the model considers (1) the effort to find a suitable takeover target, (2) the exter-

148. See, e.g., *Standard Oil Co. v. United States*, 221 U.S. 1, 58 (1911).

149. See *American Society of Mechanical Engineers, Inc., v. Hydrolevel Corp.*, 456 U.S. 556, 573-74 (1982).

150. *Finnegan v. Campeau Corp.*, 915 F.2d 824, 831 (1990).

151. See McAfee, *supra* note 15.

nality created when a rival realizes, from an opening bid, that the target exists, and (3) the effect on share prices of the takeover attempt and the possible collusion by the bidders thereafter.¹⁵²

The timing posited in the model is as follows. First, one firm opens the bidding and starts the process.¹⁵³ This is commonly known as putting the target "into play," with the ultimate expectation that the target will be acquired by someone. Second, the market reacts rationally to the news of the first bid, often outbidding the initial offer on the expectation that the final price will exceed the opening bid.¹⁵⁴ (The model generates the rational market response, set by arbitrage.) Third, another potential suitor considers the target.¹⁵⁵ This suitor is "awakened" by the initial offer, as if the first firm pointed out the value of the target to the world.¹⁵⁶ The awakened potential bidder can decide to outbid the going market price or not. Fourth, if a new bidder does enter the fray, a cartel may form.¹⁵⁷ We suppose that the likelihood of a cartel forming is a number α .¹⁵⁸ The parameter α is intended to capture the financial incentives of forming a cartel along with the problems (negotiation, trust, suspicion, personality conflicts, etc.) that might hinder the cartel's formation. To consider the effect of the policy of making such cartels illegal, we consider the effect of a decrease in α . Finally, if a cartel does form, it is efficient about the takeover (assigning the assets to the efficient holder) and splits the proceeds, which generally involves a cash transfer from one of the bidders to the other, i.e. a payoff to drop out of the bidding. If no cartel forms, the bidding continues until only one firm is left standing.

This sequence of events seems to capture the salient aspect of takeover cartels. In particular, it recognizes the market response to the initial bid, and to a bid by a rival. It permits the initial bid to be submitted artificially high as a means of deterring a rival from entering the fray. Finally, it allows for the policy experiment of changing the likelihood of a cartel. The effect of making cartel bidding illegal is tantamount to a decrease in α .

This model bifurcates into two models, depending on the process that generates the initial takeover bid. In one version of the model, the initial bid is a consequence of a fortuitous observation or chance happening. That is, the takeover is initiated when a firm realizes, as a byproduct of what it was doing anyway, that the target represents value beyond the stock price. In this case, any proceeds from the take-

152. *See id.* at 457-66.

153. *See id.* at 458.

154. *See id.*

155. *See id.*

156. *See id.* at 459.

157. *See id.*

158. *See id.*

over are windfall gains, and a change in the law on cartels will not affect the rate of takeovers. In the second model, the initial bid comes about by a search process, with firms searching for undervalued firms. In this case, a reduction in α will tend to reduce the gains to searching for targets, thus reducing the search intensity and reducing the likelihood that the assets are bid up.

A large number of observations follow from the model. First, the initial price of the target will exceed the value of the assets in the current use, because the stock price should reflect the value of the assets in the alternative use of a takeover, weighted by the likelihood that such a takeover occurs. An initial offer has two major external effects. First, it may wake a second firm up, thereby increasing value to the second firm and to shareholders. Second, it puts the firm into play, ruling out later suitors that don't currently exist. The second effect is rather subtle and an example may serve to illustrate the issue. The value of railroads fell dramatically in the 1960s. Some railroads were disassembled and the railbed sold. Sale of railroads at that time may have eliminated a railroad. Today, however, railroads have a value that was not as important in the 1960s, ownership of the right of way. In particular, rural railroads are useful for laying fiber optic cable. Urban railroads are useful for light rail transportation. Neither of these applications was apparent in the 1960s; sales at that time would not reflect potential future uses. The premium of the share value over the value of the current use offers a deterrent to those who might put the assets to a low-value use; thereby holding out for a high-value use. It is important to realize that this premium serves a socially useful purpose: if the share price is too low, then the asset may be put to an inefficiently low-value use. Similarly, were the share price to be too high, efficient uses will be missed.

The opening bid by a suitor must exceed the current price, which acts as a screen to prevent low-value takeovers. Moreover, the first bidder will generally offer a premium over the going stock price. This premium deters the subsequent bidder from entering the fray, by signaling the first bidder's commitment to the takeover. This premium was emphasized in the work of Fishman.¹⁵⁹ The key insight is that the firm signals how high it will go by its opening bid, which induces a large opening bid by high-value bidders.¹⁶⁰ Low-value bidders will offer more modest bids, hoping that the second bidder doesn't value the firm very much.¹⁶¹

The market reacts to the opening bid in a rational manner. In the case of perfect collusion ($\alpha=1$), the market price is just the opening bid.

159. Michael J. Fishman, *A Theory of Pre-emptive Takeover Bidding*, 19 R. AND J. OF ECONOMICS 88 (1988).

160. *Id.*

161. *Id.*

No subsequent bidders are deterred because any bidder can bid the going price, hoping to be paid to go away. Generally the size of the market reaction to an opening bid increases as the likelihood of collusion, α , falls.

When is collusive bidding a good thing for existing shareholders? Collusive bidding has two significant impacts. First, it tends to reduce the price paid to shareholders, given that a takeover has already started, because it eliminates the competition. Second, collusive bidding tends to increase the rewards to finding undervalued firms, by reducing the free-rider problem associated with subsequent bidders, who may get the target without doing the work of searching.

In the case when initial bids are the result of an accident, an idiosyncratic event, the second effect is absent, because there is no need to reward searching. Thus, for windfall occurrences, existing shareholders benefit from a prohibition of collusive bidding. In the second model, where a competitive search process generates the discovery of undervalued assets, exactly the opposite is true: the free-rider problem dominates the analysis, because the first effect vanishes. The rewards for searching for targets are set to the cost of searching, and any attempt to reduce those rewards by reducing the ability to collude is felt in a reduction in searching; there are no profits to be squeezed out of the initial bidder. Consequently, the first effect vanishes, and only the second effect, collusion speeding the arrival of a bidder, remains.

This analysis provides starkly different predictions depending on the process generating the initial takeover. When the initial bidder is created by an investment and there is a competitive market generating those investments, collusion is a good thing for shareholders, because it speeds up the takeover without changing the proceeds of the takeover. Nevertheless, once the takeover process has started, existing shareholders would like to prohibit collusion. Collusion benefits shareholders generally, by increasing the effort spent in finding undervalued firms, but once that effort is spent, the owners of any particular firm would like to prohibit collusion by the suitors. In contrast, when the bids are determined by a random process unaffected by the possibility of collusion, collusion does not speed up the takeover, but does reduce the payments to bidders, thereby driving down the *ex ante* share price. In this case, shareholders are opposed to collusion, even *ex ante*.

When the process generating bids is competitive, everyone in the model agrees that the policy of permitting collusion is a good thing. In contrast, when the process generating the initial bid is random and not determined by suitor effort, the shareholders would like collusion to be prohibited. But is the social interest maximizing the present value of the gains from trade? This turns out to depend on how much

discounting there is relative to the speed of arrival of potential suitors. The reasoning is fairly subtle. Recall that the initial share price will cause the rejection of potential suitors whose value is less than the initial price; collusion helps to determine which deals are consummated by affecting the initial share price. If interest rates are low, the social cost of rejecting an existing suitor is low, because another will come along relatively quickly. In this case, share prices should be high, which requires low collusion. In contrast, when discounting is high there is a great cost of a rejected offer, so the initial stock price needs to be low, and collusion is an instrument to lower the stock price. The difference between shareholder incentives and the gains from trade arise because of windfalls captured by the second bidder, whose profits are not reflected either in the stock price or the returns to searching for targets. Because of these profits, the socially optimal level of collusion is always at least as large as that maximizing the shareholder value.

VIII. CONCLUSION

The economic model, then, is a less than wholehearted embrace of the basic premise of the antitrust laws, i.e. that collusive bidding always reduces the price paid to the seller. Instead, we conclude that the effect of collusive bidding is mixed depending upon the point at which the collusion occurs. Collusion coming at the time of the initial bid speeds the rate of the takeover without reducing the shareholder's proceeds. By contrast, collusion occurring after the takeover process has begun reduces the price paid to shareholders.

The economic consequences of collusion in the market for corporate control falls short of an endorsement of the founding premise of the antitrust laws, i.e. that collusive bidding is always harmful to the seller. The results affirm, however, that once the takeover process has occurred, collusion is harmful to the shareholder since it (1) decreases the price paid and (2) diverts a portion of the price to someone other than the shareholder/seller.

It is curious, then, that while collusive bidding is prosecuted in any other arena, it is tacitly permitted in the market for corporate control. This gap in enforcement is attributable to the resistance of the courts to apply antitrust laws to the sale of securities combined with the inapplicability of the securities laws to non-fraudulent collusive bidding. In the frenzied mergers and acquisitions market, this promises to be a boon for acquirers and a loss for shareholders.