UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, PLAINTIFF, v. ALEX. BROWN & SONS, INC. et al. DEFENDANTS.	Civil Action No. 96 CIV 5313 (RWS)

RESPONSE OF UNITED STATES TO PUBLIC COMMENTS

Pursuant to the Antitrust Procedures and Penalties Act ("Tunney Act"), 15 U.S.C. 16(b)-(h), the United States makes and files this response to the public comments received regarding the relief described in the proposed Stipulation and Order ("proposed order") that, if entered by the Court, would resolve this civil antitrust proceeding. The United States has carefully considered the comments received, and remains convinced that entry of the proposed order is in the public interest.

This response and the attached public comments have been submitted to the Federal Register for publication (see 15 U.S.C. 16(d)). Moreover, the United States has today certified to the Court that it has fulfilled the requirements of the Tunney Act in preparation for the entry of the proposed order. Upon a determination that the United States and the defendants have fulfilled the requirements of the Tunney Act and that entry of the proposed order would be in the public interest, the Court may enter the proposed order.

This action was initiated by the United States with the filing of a complaint on July 17, 1996. The complaint charges that the defendants -- all of whom are "market makers" in over-the-counter ("OTC") stocks quoted for public trading on Nasdaq,[1] had violated Section 1 of the Sherman Act, 15 U.S.C. 1, by engaging in a form of price fixing. The complaint alleges that the defendants and others adhered to and enforced a "quoting convention" that was designed to and did deter price competition among the defendants and other market makers in their trading of Nasdaq stocks with the general public. As a result of adherence to and enforcement of the "quoting convention" by the defendants, the United States believes investors incurred higher transaction costs to buy and sell Nasdaq stocks than they would have had the defendants not adhered to and enforced the "quoting convention."

Simultaneous with the filing of its complaint, the United States filed the proposed Stipulation and Order, signed by all the defendants, which, if entered by the Court, would terminate the litigation. In addition, on July 17, 1996, the United States filed its Competitive Impact Statement ("CIS"). 15 U.S.C. 16(b). Thereafter, the defendants filed statements identifying certain communications made on their behalf, as required by the Tunney Act. 15 U.S.C. 16(g). A summary of the terms of the proposed order and the CIS, and directions for the submission of written

[1] The term "Nasdaq" was originally an acronym for the "National Association of Securities Dealers Automated Quotation System." The automated quotation system is now operated by The Nasdaq Stock Market, Inc.

comments relating to the proposed order to the Department, were published in The Washington Post, a newspaper of general circulation in the District of Columbia, and in The New York Times, a newspaper of general circulation in the e Southern District of New York, beginning on July 29, 1996, and continuing on consecutive days through August 3, 1996, and on August 5, 1996.

The proposed order and the CIS were published in the Federal Register on August 2, 1996. 61 Fed. Reg. 40433-40451 (Aug. 2, 1996). The 60-day period public comment period began on August 3, 1996 and expired on October 2, 1996. In response to the solicitation of public comments, the United States received comments from three persons. These comments are attached as Exhibits 1-3.

In addition, the private plaintiffs in In re: Nasdaq Market-Makers Antitrust Litigation, 94 Civ. 3996 (RWS), M.D.L. No. 1023 (S.D.N.Y.), commented upon the proposed relief in the form of certain filings they made with the Court in connection with their pending motion to intervene in this case, namely (1) a memorandum in support of their motion to intervene and (2) a reply to the government's opposition to the motion. These papers are on file with the Court, and the relevant portions of them are attached as Exhibits 4-5.

I. BACKGROUND

The complaint and proposed order are the culmination of a major, two-year-long investigation by the Department of Justice into the trading activities of Nasdaq securities dealers. The Department's investigation began in the summer of 1994, shortly after the public disclosure of an economic study by Professors William Christie of Vanderbilt University and Paul Schultz of Ohio State University (the "Christie/Schultz study"). The Christie/Schultz study suggested that securities dealers on Nasdaq may have tacitly colluded to avoid odd-eighth price quotations on a substantial number of Nasdaq stocks, including some of the best known and most actively traded issues, such as Microsoft Corp., Amgen, Apple Computers, Inc., Intel Corp., and Cisco Systems, Inc. After the Christie/Schultz study had received wide-spread publicity, several class action lawsuits alleging antitrust violations were filed against the defendants and other Nasdaq market makers.[2]

During the course of its investigation, the Department reviewed thousands of pages of documents produced by the defendants and other market participants in response to more than 350 Civil Investigative Demands ("CIDs"). The Department reviewed hundreds of responses to interrogatories that were submitted by the defendants (and others) and took more than 225 depositions of individuals with knowledge of the trading

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[2] All of the private cases have been consolidated and assigned to this Court, M.D.L. 1023.

practices of Nasdaq market makers, including current and former officers and employees of the defendants and other Nasdaq market makers, as well as officials and committee members of the National Association of Securities Dealers, Inc. ("NASD"), the organization responsible for oversight of the Nasdaq market.

The Department conducted numerous telephone and in-person interviews of current and former Nasdaq stock traders, Nasdaq investors, and others with relevant knowledge of the industry, and listened to approximately 4500 hours of audio tapes of telephone calls between stock traders employed by the defendants and other Nasdaq market makers. These audio tapes had been recorded by certain of the defendants (and other market makers) in the ordinary course of their business and were produced to the Department in response to its CIDs.

The Department also reviewed and analyzed substantial quantities of data relating to trading and quoting activity in Nasdaq stocks produced in computer-readable format by the NASD. These data included data showing all market maker quote changes on Nasdaq during a twenty-month period between December 1993 and July 1995, and for selected months thereafter, including March 1996. The Department also reviewed eighteen months of data reflecting actual trades in Nasdaq stocks. Finally, the Department reviewed numerous transcripts of depositions taken by the Securities and Exchange Commission ("SEC") in a concurrent inquiry into the operations and activities of the NASD and the Nasdaq market.

Based upon the evidence discovered during its investigation, the Department concluded that the defendants and others had been engaged for a number of years in anticompetitive conduct in violation of the Sherman Act, as alleged in the complaint. The Department challenged this conduct as violative of Section 1 of the Sherman Act. Entry of the proposed order would resolve the Department's competitive concerns regarding this conduct.

The complaint and proposed order address a mechanism by which the defendants coordinated their price quotes in certain Nasdaq stocks to increase the inside spread.[3] The central allegation of the complaint is that the defendants and others agreed to abide by a long-standing, essentially market-wide commitment to a two-part "quoting convention." This "quoting convention" dictates the price increments a market maker can use to adjust or "update" its bid and ask price quotes on the Nasdaq system. Under the first part of the quoting convention, if a market maker's dealer spread in a stock is 3/4 point (75 cents) or wider, the market maker is required to quote its bid and ask

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[3] Market makers must continuously quote the prices at which they are willing both to buy and sell individual stocks. The price an individual market maker quotes to buy a stock is known as its **"bid"** price. The price it quotes to sell a stock is known as its "offer" or **"ask"** price. (A market maker's bid price is always higher than its ask price.) The difference between a market maker's "bid" and "ask" is known as its **"dealer spread."** The Nasdaq computer screen collects and displays the bid and offer prices of all the market makers in each stock. The highest bid and the lowest offer from among the quotes of all the market makers in a stock are called the **"inside bid"** and the **"inside ask,"** or -- together -- the **"inside quotes."** The difference between the inside bid and the inside ask in a stock is called the **"inside spread."**

prices in even-eighth increments (*e.g.*, 1/4 (25 cents), 1/2 (50 cents), 3/4 (75 cents) or 4/4 ($1). (The minimum quote increment for Nasdaq stocks trading at a price of $10 or more is 1/8 point, *i.e.*, a much narrower increment than the 1/4 point increment dictated by the quoting convention when an individual dealer spread in a stock is 3/4 point or wider.) The quoting convention thus ensures that the inside spread in those stocks is maintained at 1/4 point (25 cents), or wider.

Under the second part of the quoting convention, market makers can quote bid and ask prices on Nasdaq in odd-eighth increments, *e.g.*, 1/8 (12.5 cents), 3/8 (37.5 cents), 5/8 (62.5 cents) or 7/8 (87.5 cents), only if they have a dealer spread of less than 3/4 point. This requirement deters market makers from quoting bid and ask prices in odd-eighth increments because a narrower dealer spread is likely to create a greater economic risk to the market maker in trading that stock. A market maker with a narrow dealer spread is more likely than a market maker with a wide dealer spread, other things equal, to be required to trade on the "wrong side" of the market.[4] When the difference

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[4] To trade on the "wrong side" of the market means to buy a stock when one would prefer to sell the stock, or *vice versa*. Being required to trade on the "wrong side" of the market is more likely to occur if a dealer has a narrow dealer spread, than if a dealer has a wide dealer spread. For example, if a market maker has a dealer spread of fifty cents -- say, 20 to 20-1/2 -- when the best bid in the market is 20, the market maker is presumably trying to buy the stock (because its bid is equal to the best bid in the market). If, however, the market moves up quickly, the market maker's 20-1/2 ask price could suddenly become the best ask price in the market, meaning that the market maker would be required to *sell* stock at that price. With a wider dealer spread -- say, 20 to 20-3/4 -- the possibility of this occurring is

between a market maker's bid and ask quotes is 1/2 rather than 3/4, a market maker may be called upon to buy (or sell) more stock than the trader wants, or buy stock when the market maker wants to sell (or *vice versa*).

In executing a market order on behalf of a retail customer, market makers historically bought from the customer at the inside bid, and sold to the customer at the inside ask. This execution by the market maker satisfied the retail broker's obligation of "best execution" for retail customers. Historically, large institutional customers have sometimes been able to negotiate prices that are better (higher bid prices and lower ask prices) than the inside spread, but the width of the inside spread influences many negotiations between market makers and their institutional customers.

Market makers thus have a significant interest in each others' price quotes because those quotes can either set each others' actual transaction prices or significantly affect those prices. This relationship creates an incentive for market makers to discourage bid and ask price competition that may have the effect of narrowing the inside spread.

Adherence to the quoting convention deterred the use of odd-eighth quotes in many stocks. This, in turn, tended to maintaine the inside spread in those stocks at no less than one quarter, or twenty-five cents. This artificial floor on the inside spread in those stocks raised transaction costs on Nasdaq. The proposed

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order, if entered by the Court, would prohibit the defendants from continuing to adhere to and enforce the quoting convention. In addition, it would establish mechanisms that would enable the Department to determine whether the defendants have, in fact, ceased their unlawful conduct and have complied with the terms of the proposed order designed to ensure against its repetition.

II. THE LEGAL STANDARD GOVERNING THE COURT'S PUBLIC INTEREST DETERMINATION

A. General Standard

When the United States proposes to settle a civil antitrust case with a consent judgment, the Tunney Act requires the district court to determine whether "the entry of such judgment is in the public interest." 15 U.S.C. 16(e).[5] The court is not, however, required "to determine whether the resulting array of rights and liabilities 'is one that will *best* serve society,' but only to confirm that the resulting settlement is 'within the *reaches* of the public interest.'" *United States v. Microsoft Corp.*, 56 F.3d 1448, 1460 (D.C. Cir. 1995) (emphasis in original); *accord*, *United States v. Western Elec. Co.*, 993 F.2d 1572, 1576 (D.C. Cir.), *cert. denied*, 114 S. Ct. 487 (1993); *see also* *United States v. Bechtel*, 648 F.2d 660, 666 (9th Cir.), *cert. denied*, 454 U.S. 1083 (1981); *United States v. Gillette*

[5] While not styled "consent judgment," the proposed order serves the same purpose. Violations of the proposed order are punishable as civil or criminal contempt. *See, e.g.*, *United States v. Schine*, 260 F.2d 552 (2d Cir. 1958), *cert. denied*, 358 U.S. 934 (1959); 18 U.S.C. 401; *see also* CIS at 3-4, 42, 49, 52.

Co., 406 F. Supp. 713, 716 (D. Mass. 1975). For this reason, a court should not refuse to enter an order terminating a civil antitrust case initiated by the United States "unless 'it has exceptional confidence that adverse antitrust consequences will result -- perhaps akin to the confidence that would justify a court in overturning the predictive judgments of an administrative agency.'" Microsoft, 56 F.3d at 1460 (quoting Western Electric, 993 F.2d at 1577). Congress did not intend the Tunney Act to lead to protracted hearings on the merits, and thereby undermine the incentives for defendants and the government to resolve civil antitrust cases through agreed-upon orders. S. Rep. No. 298, 93d Cong. 1st Sess. 3 (1973).

Tunney Act review is confined to the terms of the proposed relief and their adequacy as remedies for the violations alleged in the complaint. Microsoft, 56 F.3d at 1459.[6] Thus, in this case, the Court need decide only whether the proposed order is reasonably directed toward addressing the competitive concern raised by the quoting convention.

No third party has a right to demand that the proposed order be rejected or modified simply because a different order might better serve its private interests. Unless the proposed order

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[6] A district court exceeds its authority if it requires production of information concerning "the conclusions reached by the Government" with respect to the particular practices investigated but not charged in the complaint, and the areas addressed in settlement discussions, including "what, if any areas were bargained away and the reasons for their non-inclusion in the decree." Microsoft, 56 F.3d at 1455, 1459. To the extent that comments raise issues not charged in the complaint, those comments are irrelevant to the Court's review. Id. at 1460.

"will result in positive injury to third parties," a district court "should not reject an otherwise adequate remedy simply because a third party claims it could be better treated." Microsoft, 56 F.3d at 1461 n.9.[7]

The United States -- not any third party -- represents the public interest in government antitrust cases. See, e.g., Bechtel Corp., 648 F.2d at 660, 666; United States v. Associated Milk Producers, 534 F.2d 113, 117 (8th Cir.), cert. denied, 429 U.S. 940 (1976). The proposed order is intended to ensure that market makers do not collude through the mechanism of the quoting convention to increase transaction costs for investors in Nasdaq stocks. It is directed at private conduct illegal under the antitrust laws. It is not intended or designed -- nor could it be -- to make the Department the regulator of The Nasdaq Stock Market, Inc. or to change the structure of the Nasdaq Stock Market by, for example, requiring that market-maker quotes be posted anonymously on Nasdaq, as suggested by one commentor. Exhibit 1 [letter of Professor Junius Peake, dated July 26, 1996] at 2; see infra text at 14-15.

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[7] Cf. United States v. Associated Milk Producers, Inc., 534 F.2d 113, 116 n.3 (8th Cir.) ("The cases unanimously hold that a private litigant's desire for [the] prima facie effect [of a litigated government judgment] is not an interest entitling a private litigant to intervene in a government antitrust case."), cert. denied, 429 U.S. 940 (1976).

III. ENTRY OF THE PROPOSED ORDER IS IN THE PUBLIC INTEREST

Entry of the proposed order is clearly within the reaches of the public interest under the standards articulated in Microsoft and other decided cases. If entered by the Court, the proposed order would prevent each of the defendant market makers, unless otherwise specifically permitted, in connection with their market-making activities in OTC stocks, from agreeing with any other market maker:

(1) to fix, raise, lower, or maintain quotes or prices for any Nasdaq security;

(2) to fix, increase, decrease, or maintain any dealer spread, inside spread, or the size of any quote increment (or any relationship between or among dealer spreads, inside spreads, or the size of any quote increment), for any Nasdaq security;

(3) to adhere to a quoting convention whereby Nasdaq securities with a three-quarter (3/4) point or greater dealer spread are quoted on Nasdaq in even-eighths and are updated in quarter-point (even-eighth) quote increments; and

(4) to adhere to any understanding or agreement (other than an agreement on one or a series of related trades) requiring a market maker to trade at its quotes on Nasdaq in quantities of shares greater than either the

Nasdaq minimum or the size actually displayed or otherwise communicated by that market;[8]

In addition, the proposed order, if entered by the Court, would bar each of the defendants from engaging in any harassment or intimidation of any other market maker because such market maker:

(1) decreased its dealer spread or the inside spread in any Nasdaq security;

(2) refused to trade at its quoted prices in quantities of shares greater than either the Nasdaq minimum or the size actually displayed or otherwise communicated by that market maker; or

(3) displayed a quantity of shares on Nasdaq greater than either the Nasdaq minimum or the size actually displayed or otherwise communicated by that market maker.

Finally, Section IV(8) of the proposed order, if entered by the Court, would bar each of the defendants from refusing, or threatening to refuse, to trade (or agreeing with or encouraging any other market maker to refuse to trade) with any market maker at the defendant's published Nasdaq quotes in amounts up to the published quotation size because such market maker decreased its dealer spread, decreased the inside spread in any Nasdaq

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[8] The reference to agreements "other than an agreement on one or a series of related trades" is intended to make clear that a market maker is not prohibited from agreeing to buy or sell a specific quantity of stock, and that agreeing to buy or sell a quantity of shares greater than the amount initially specified in a series of related trades also does not violate the proposed order.

security, or refused to trade at its quoted prices in a quantity of shares greater than either the Nasdaq minimum or the size actually displayed or otherwise communicated by that market maker.

Entry of the proposed order is in the public interest. The United States urges the the Court to enter the proposed order upon a determination that the United States and the defendants have satisfied the requirements of the Tunney Act.

IV. RESPONSE TO PUBLIC COMMENTS

As noted, this case has generated three formal comments. In addition, the private plaintiffs in In re: Nasdaq Market-Makers Antitrust Litigation, 94 Civ. 3996 (RWS), M.D.L. No. 1023 (S.D.N.Y.), commented upon the proposed relief in the form of certain filings they made with the Court in connection with their pending motion to intervene in this case, namely (1) a memorandum in support of their motion to intervene and (2) a reply to the government's opposition are on file with the Court. Our response to each of these comments is set forth below.

Comments of Professor Junius Peake

Professor Peake is Monfort Distinguished Professor of Finance at the University of Northern Colorado. He served as a member of the Board of Governors of the NASD. He is frequently quoted nationally and internationally in both print and electronic media. See Exhibit 1 at 1.

In his letter, Professor Peake expresses concern that the proposed order "will not necessarily deter retribution by firms which wish to keep spreads wider than might otherwise be the case under real competition." Id. at 2. Given his view that the proposed order will not deter retribution for spread-cutting, Professor Peake suggests that the appropriate remedy would be to require The Nasdaq Stock Market, Inc. to display market maker quotes anonymously. This would eliminate the possibility of retaliation by one market maker against another for violating the quoting convention or otherwise acting to narrow the spread in a stock for a simple and obvious reason: a firm inclined to "retaliate" in some way would not be able to identify the firm against which it should direct its retaliatory action. Id. at 3. In his letter, Professor Peake identifies some of the ways a market maker could -- despite the proposed order -- retaliate against a spread-cutter without violating the proposed order -- all of them a form of refusal to deal. Id. at 3.[9]

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[9] In addition to changing the way market-maker quotes are displayed on Nasdaq, Professor Peake would strengthen competition in market making by eliminating the practice of "preferencing." Exhibit 1 at 3. "Preferencing" occurs when a broker directs an order to a particular market maker. Pursuant to preferencing agreements, the market maker may pay the broker several cents per share for the order. The market maker then executes the order at the best price displayed *on Nasdaq*. Agreements that provide for payment for a steady flow of orders are called "payment-for-order-flow" agreements.

Under a "preferencing" arrangement, the price quoted by the market maker receiving the preferenced order for the stock in question is irrelevant. Although it will *execute* the order at the best price displayed on Nasdaq, the market maker receives the order without reference to its own quoted price in the stock. For this reason, many believe, preferencing arrangements diminish

The relief suggested by Professor Peake is not obtainable in this action. The Department's lawsuit charges a conspiracy among *market makers*. The Nasdaq Stock Market, Inc., which owns Nasdaq -- and, in turn, is owned by the NASD -- is not a defendant in this action, nor is the NASD.

Under the law, the NASD has the authority to organize the market and establish the rules governing its operation, subject to oversight by the SEC. See 15 U.S.C. §§ 78o.3 and 78s. The defendants, all market makers in Nasdaq stocks, are not in a position to implement structural changes in Nasdaq.

Should the NASD or the SEC determine to regulate Nasdaq in the way suggested by Professor Peake, they have the authority to do so. In its 1975 amendments to the securities laws, Congress established

> a statutory scheme clearly granting the . . . [SEC] broad authority to oversee the implementation, operation, and regulation of the national market system and at the same time to (sic) charging it with the clear responsibility to assure that the system develops and operates in accordance with

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incentives for market makers who receive preferenced order flow to compete vigorously for orders on the basis of price. (Normally, a firm which lowers the price of a good can expect to experience increased sales of the good. If, in the case of a dealer in Nasdaq stocks, however, price improvement does not guarantee increased order flow, the dealer will have fewer incentives to price improve and will therefore do so less frequently.) The practice of preferencing, and especially payment-for-order-flow agreements, have been subject to considerable study and controversy. See, e.g., Market 2000: An Examination of Current Equity Market Developments, SEC Division of Market Regulation (January 1994). The SEC has not acted to prohibit payment-for-order-flow or other types of preferencing arrangments, and the complaint in this case did not allege that preferencing is an unreasonable restraint of trade.

Congressionally determined goals and objectives.

Sen. Rep. No. 75, 94th Cong., 1st Sess. at 8-9 (1975). These goals and objectives include ensuring that the securities markets (a) provide "economically efficient mechanisms for the execution of transactions" and (b) make available "information with respect to quotations for . . . securities." Id. at 8. Fair competition is another goal of the securities laws, but, in assuring fair competition, the SEC has been admonished by the Congress not "to compel elimination of differences between types of markets or types of firms that might be competition-enhancing." Id.

There has been debate in the academic literature for some time on the question of whether market makers should be required to post quotes anonymously on Nasdaq. Professor Peake has long advocated anonymity and other changes in Nasdaq. See Comments of Junius W. Peake and Morris Mendelson on SEC's Market 2000 Draft Release, SEC File # S7-18-92 (Nov. 3, 1992). As neither the NASD nor the SEC has acted to *require* anonymity on Nasdaq (a feature that, as Professor Peake notes, is available on Instinet), they have not made a judgment that having this feature *on Nasdaq* is necessary to the national market system. They are obviously free to revisit this question at any time.[10]

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[10] In a recent rulemaking (see 61 Fed. Reg. 48,290 (Sept. 12, 1996)), the SEC directed that market makers that accept limit orders must either execute those limit orders upon receipt or, if the customer limit order is priced better than the market maker's quote, display the limit order to the market in the market maker's quote. The Department submitted formal comments to the SEC strongly supporting the adoption of this rule proposal.

The proposed order will do much to decrease the likelihood that the defendants will endeavor to identify and punish spread cutters for behaving competitively. It proscribes the conduct identified in the Department's investigation as illegal. In making the "public interest" determination required by the Tunney Act, 15 U.S.C. 16(e), "the court's function is not to determine whether the resulting array of rights and liabilities is the one that will _best_ serve society, but only to confirm that the resulting settlement is within the _reaches_ of the public interest." _United States v. Microsoft Corp._, 56 F.3d 1448, 1460-61 (D.C. Cir. 1995) (emphasis in original) (internal quotations omitted). Under this standard, there is no doubt that the proposed relief is within the reaches of the public interest.

In addition, it contains terms that go a considerable distance in increasing the likelihood that recidivist behavior, if it occurs, will be identified. If entered by the Court, the proposed order will subject the defendants to punishment for civil or criminal contempt if they engage -- even unilaterally -- in any "harassment or intimidation of any other market maker" because such market maker:

> (1) "decreas[ed] its dealer spread or the inside spread in any Nasdaq security" (proposed order, IV(A)(5));
>
> (2) "refus[ed] to trade at its quoted prices in quantities of shares greater than either (1) the minimum size required by Nasdaq or NASD rules or (2) the size displayed or otherwise communicated by that market maker" (_id._, IV(A)(6)); or

> (3) "display[ed] a quantity of shares on Nasdaq in excess of the minimum size required by Nasdaq or NASD rules" (id., IV(A)(7)).

The proposed order also addresses the issue of refusals to deal specifically. Under the proposed order, each defendant is prohibited, directly or through any trade association, in connection with the activities of its OTC desk in making markets in Nasdaq securities, from:

> [r]efus[ing], or threaten[ing] to refuse to trade, (or agree[ing] with or encourag[ing] any other market maker to refuse to trade) with any market maker at defendant's published Nasdaq quotes in amounts up to the published quotation size because such market maker decreased its dealer spread, decreased the inside spread in any Nasdaq security, or refused to trade at its quoted prices in a quantity of shares greater than either (1) the minimum size required by Nasdaq or NASD rules or (2) the size displayed or otherwise communicated by that market maker.

Id., IV(A)(8).

Importantly, the proposed order would not merely prohibit the defendants from engaging in the conduct described, but would require each defendant to monitor and record up to 3.5% of its traders' conversations (without the traders having knowledge of the time when this recordation was occurring) *and to notify the Department* of any conversation which a defendant's Antitrust Compliance Officer "*believes may* violate" the order. Id., IV(C)(5) (emphasis added).

The Department views these terms as a significant deterrent to repetition of the unlawful behavior. Further, the proposed order permits the Department to assure itself -- through review

of the tapes required to be created and real-time monitoring of trader conversations -- that the prohibitions of the proposed order are being obeyed. Id., IV(C)(6)-(8). But the Department does not have the ability to fashion relief in this case, or in any case, that can *guarantee* that the violation of the law the decree is intended to prevent from recurring will not recur. The possibility of evasion exists in every decree, and an absolute guaranty against violation is not -- and cannot be -- the *sine qua non* of the final order prohibiting defendants from engaging in specified conduct in the future.

The Department recognizes that retaliation could take a large number of different forms. But the proposed order can and does proscribe such retaliation, even though it does not, and could not, anticipate each possible form that such retaliation could take. Instead, the Department has identified broad but unambiguous categories of behavior -- harassment, intimidation, refusals to deal, or threats of refusals to deal -- and branded any behavior of that type, if directed at another market maker in response to that other market maker's specific pro-competitive acts, to be a violation of the proposed order.

Contrary to Professor Peake's suggestion (Exhibit 1 at 1), the relief that would be provided by the proposed order is not unnecessary and does not constitute an unwarranted burden upon the investing public or the country's corporate stock issuers. As shown, the proposed order would provide significant deterrence to repetition of the defendant's unlawful conspiracy. Under the

circumstances, the proposed settlement is clearly "'within the reaches of the public interest'" (Microsoft, 56 F.3d at 1460 (emphasis in original)), and ought to be entered by the Court.[11]

Comments of William Leighton

Mr. Leighton has bought and sold Nasdaq stocks, and claims to be "a person aggrieved and adversely affected by the proposed order." Exhibit 2 [letter of Sept. 9, 1996] at 1. He has written three letters to the Department, making a variety of objections to the proposed settlement. His primary objection is that the relief does not provide for the payment of damages to aggrieved persons, such as himself:

> The relief sought, which leaves the defendants in possession of the fruits of

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[11] Professor Peake notes that, despite long experience in the securities industry, including service on the NASD's Board of Governors, until the week before the Department's complaint and proposed settlement with the market maker defendants were filed, *he* had "never before heard of . . . [the quoting] convention." Exhibit 1 at 2. The Department's CIS points out that "[t]he effect of the quoting convention in maintaining wide spreads on Nasdaq was known . . . to employees and members of the industry's self-regulatory organization, the NASD; moreover, the NASD recognized the causal connection between widening spreads on Nasdaq and 'peer pressure' applied to keep spreads wide." CIS at 26. While Professor Peake may personally have been unaware of the quoting convention, the evidence described in the CIS establishes a solid basis for the Department's complaint and the relief obtained. It is unclear why or on what basis Professor Peake claims that "the 'quoting convention' is a convenient fiction." Id. If the suggestion is that it was "convenient" for the market makers to have falsely described a quoting convention in the deposition testimony when, in fact, none existed, he does not make clear why this would be true or how, as a practical matter, the defendants -- and, presumably, their lawyers -- might have colluded to paint a blatantly false picture of the actual evidence for the Department. It makes no sense for the Nasdaq securities traders who testified in the Department's investigation to coordinate their testimony and to claim that there was a quoting convention if there was not.

> their unjust enrichment, does not enable those injured and damaged by the actions of the "defendants" to recover their losses. There is no provision for disgorgement by the "defendants" of the enormous profits which they have realized and which have occasioned huge losses to the public.

Id. As the Department pointed out in its CIS -- and, as is the case with all of the Department's settlements in civil antitrust cases -- the relief obtained will neither advance or impair private plaintiffs' ability to bring damages cases.[12] The assertion by Mr. Leighton that he will be "adversely affected by the proposed order," however, is incorrect. Mr. Leighton is free to pursue a claim for damages against the Nasdaq market makers individually or as part of a class. See Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 130-31 (1969); United States v. Borden Co., 347 U.S. 514, 518 (1954). As the Supreme Court has emphasized, the "treble damages provision wielded by the private litigant is a chief tool in the antitrust enforcement scheme, posing a crucial deterrent to potential violators."

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[12] Section 4 of the Clayton Act, 15 U.S.C. § 15, provides that any person who has been injured as a result of conduct prohibited by the antitrust laws may bring suit in federal court to recover three times the damages suffered, as well as costs and reasonable attorneys' fees. Entry of the proposed Order will neither impair nor assist the bringing of such actions. Under the provisions of Section 5(a) of the Clayton Act, 15 U.S.C. § 16(a), the proposed Order has no *prima facie* effect in any subsequent lawsuits that may be brought against the defendants in this case.

CIS at 46.

Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 635 (1985).

As the Court knows, there is a consolidated, class-action lawsuit pending in this district in which private plaintiffs claiming to have suffered antitrust injury as a result of a price-fixing conspiracy among Nasdaq market makers are seeking monetary damages. The United States has no authority to litigate on behalf of private plaintiffs for the purpose of recovering damages for injuries allegedly sustained as the result of an antitrust conspiracy.[13]

Mr. Leighton also objects to the entry of the proposed order because of alleged legal deficiencies in the action. For example, he suggests that the Department's complaint "does not state a claim upon which relief could be granted because there is no Case or Controversy present in the constitutional sense." Exhibit 2 [letter of Aug. 7, 1996] at 1. Mr. Leighton's assertion of a lack of any Case or Controversy is based upon the defendants' consent to the entry of the proposed order before having been sued -- in other words, to the negotiated settlement. Id.; see also id. [letter of Sept. 9, 1996] at 3.

A Case or Controversy exists here because the United States and the market maker defendants have adverse interests (see Muskrat v. United States, 219 U.S. 346, 361 (1911)) and because

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[13] The defendants, in agreeing to entry of the proposed order, have not admitted the truth of any of the allegations in the government's complaint. Entry of the proposed order will not constitute evidence against or an admission by any defendant with respect to any allegation in the complaint.

the United States seeks to enjoin the defendants from engaging in certain specific conduct in the future and to impose upon them certain requirements designed to ensure that they do not continue to engage in the conduct identified in the complaint as unlawful. The fact that the United States and the defendants have reached a settlement, that, if approved by the Court, would resolve the issue, does not moot the controversy between them. See, e.g., Havens Realty Corp. v. Coleman, 455 U.S. 363, 371 n.10 (1982); Coopers & Lybrand v. Livesay, 437 U.S. 463, 465 n.3 (1978); Dacanay v. Mendoza, 573 F.2d 1075, 1078 (9th Cir. 1978).

Civil antitrust cases brought by the government are, more frequently than not, resolved via consent decrees. Indeed, in enacting the Tunney Act, the Congress recognized that such cases would often be resolved by consent orders. See 15 U.S.C. 16 (passim); 51 Cong. Rec. 15,824-25 (noting Congress' interest in encouraging capitulation in government antitrust suits, and providing that no *prima facie* effect would flow from such decrees entered before any testimony was taken) (1914); United States v. Blue Chip Stamp Co., 272 F.Supp. 432, 440 (C.D. Cal. 1967) (the legality of the consent decree procedure is "beyond question") (quoting Sam Fox Pub. Co. v. United States, 366 U.S. 683, 689 (1961)).

Mr. Leighton also suggests that the United States is not a "real party in interest" here -- and therefore not a proper plaintiff -- because it is "members of the public [not the government qua government] who buy or sell securities on the

NASDAQ and who have suffered, and may continue to suffer, damages as a result of the alleged conduct." Id. The United States is a proper party to bring an injunctive action under Section 1 of the Sherman Act. 15 U.S.C. § 4; United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290, 309-10 (1897).[14] See also supra text at 22-23. Mr. Leighton's comments do not state a sound basis upon which to reject the proposed order.

Comments of Joel Steinberg

Mr. Steinberg is a plaintiff in a lawsuit against Goldman, Sachs & Company. He has communicated with the Department on five occasions in connection with this matter. Exhibit 3. Mr. Steinberg's central objection to the proposed order is that it does not require that any parties injured as a result of the conduct alleged in the complaint be compensated. Id. [letter of August 15, 1996] at 1. Mr. Steinberg further complains that the Department did not proceed criminally against the market makers

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[14] Mr. Leighton makes other technical, legal objections to the case, the primary one being that "it does not appear that the complaint has been served on the 'defendants.'" Id. [letter of Sept. 9, 1996]at 2. Citing Fed. R. Civ. P. 4, Mr. Leighton claims that deficiency would enable a defendant later to "dismiss the attorney who has signed the stipulation and claim the Court's lack of jurisdiction over its person." Id. The defendants in this case have expressly waived service of summons, acknowledged receipt of the complaint, consented to in personam jurisdiction and entered their general appearance in the action. Stipulation and Order (filed Aug. 5, 1996). It is clear on this record that defendants have been adequately notified of the government's case and have acceded to the jurisdiction of the Court. See Precision Etchings & Findings v. LGP Gem, LTD., 152 F.R.D. 433,436 (D.R.I. 1993); A.L.T. Corp. v Small Business Admin., 801 F.2d 1451, 1458-59 (5th Cir. 1986); Wright & Miller, Federal Practice and Procedure: Civil 2d § 1062 (1987).

under the antitrust laws. Id. [letter of August 15, 1996] at 1; id. [letter of August 18, 1996] at 1.

The Department exercised its prosecutorial discretion not to pursue a criminal case against the defendant market makers based upon the quoting convention because the evidence did not meet the criteria the Department has historically required in order to proceed criminally. See Antitrust Division Manual at III-12 (2d ed. 1987). As earlier noted, the Department has no authority to seek to recover damages for third parties possibly injured by the conduct alleged in the complaint. Furthermore, to the extent that Mr. Steinberg's comments raise issues not alleged in the complaint, they are outside the scope of a Tunney Act review. Microsoft, 56 F.3d at 1448, 1459, 1463; see also ABA Antitrust Section, Annual Review of 1995 Antitrust Law Developments at 171-72 (1996).

Comments of the Private Plaintiffs

The plaintiffs in In re: Nasdaq Market-Makers Antitrust Litigation, 94 Civ. 3996 (RWS), M.D.L. No. 1023 (S.D.N.Y.), a private, class-action civil case to recover damages under the antitrust laws for injuries allegedly sustained by persons who bought or sold Nasdaq stocks that were subject to an alleged price-fixing conspiracy among Nasdaq market makers, commented upon the proposed order in briefs filed in connection with their motion to intervene in the instant action. See Exhibit 4 (Excerpts from Memorandum of Plaintiffs in the *In re: Nasdaq Market-Makers Antitrust Litigation* to Intervene or to Appeal as

Amicus Curiae (filed Aug. 28, 1996); Exhibit 5 (Excerpts from Reply Memorandum in Support of Motion of Plaintiffs in the *In re: Nasdaq Market-Makers Antitrust Litigation* to Intervene or to Appeal as *Amicus Curiae* (filed Oct. 14, 1996)).

Plaintiffs object to the provision of the proposed order that would limit use of the audio tapes to be created under it. Paragraphs IV(C)(2)-(6) of the proposed order, if entered by the Court, would require that defendants randomly monitor and tape record not less than 3.5% of their Nasdaq trader telephone conversations (up to a maximum of 70 hours per week). It would also require that they identify and produce any tapes containing conversations that may violate the proposed order and furnish the tape of any such conversation to the Antitrust Division within ten business days of its recordation. Further, paragraph IV(C)(6) specifically provides:

> Tapes made pursuant to this stipulation and order shall not be subject to civil process except for process issued by the Antitrust Division, the SEC, the NASD, or any other self-regulatory organization, as defined in Section 3(a)(26) of the Securities Exchange Act of 1934, as amended.

Plaintiffs ask "the Court [to] reject this provision, or clarify that, by entering the Consent Decree, the Court does not bind any non-party to the Consent Decree. . . ." Exhibit 4 at 30.

In reaching the tentative settlement of this case, the defendants agreed, at the government's insistence, to conduct random taping of their traders' conversations. In negotiating this unusually strict requirement, the government agreed to the

term in the proposed order that would limit the use to which the tapes could be put.[15] Since the tapes would not even be created but for the proposed order, the Court should accept the provision in the proposed order preventing their use in private litigation. See In re LTV Securities Litigation, 89 F.R.D. 595, 617-22 (N.D. Tex. 1981) (denying disclosure of documents prepared by Special Officer appointed, in accordance with provisions of a consent decree, to investigate and report on defendant's accounting and auditing practices).

Contrary to the facts in Ex Parte Uppercu, 239 U.S. 435, 440 (1915), and Olympic Refining Co. v. Carter, 332 F.2d 260, 265

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[15] The disclosure and admissibility limitations of the proposed order apply only to tape recordings created pursuant to the proposed order. To the extent that defendants record trader conversations for their own purposes, such recordings would not be subject to the provision of paragraph IV(C)(6) limiting the disclosure and admissibility of recordings "made pursuant to" the proposed order. See also proposed order, paragraph IV(C)(8) ([u]pon request of the Antitrust Division, a defendant must "immediately identify all tape recordings *made pursuant to . . . [the proposed] order* that are in its possession or control . . ." (emphasis added). Further, as the proposed order requires that a defendant "record *(and listen to)* not less than three and one-half percent (3.5%) of the total number of trader hours of such defendant" (paragraph IV(C)(4)) -- and to report potential violations to the Antitrust Division (paragraph IV(C)(5)) -- a defendant would have great difficultly "over claiming" recordings not created pursuant to the proposed order. If a recording was not actually "listened to" by the defendant's Antitrust Compliance Officer (or his staff) and a report of potential violations made to the Antitrust Division, the recording would not qualify as having been made pursuant to the proposed order. The Department intends to ensure that each defendant is capable of identifying immediately all tape recordings made pursuant to the proposed order, and may insist that the defendants provide a schedule of the recordings to be made in advance of their creation. See proposed order, paragraph IV(C)(8); see also paragraph IV(C)(3). In this way, it will be clear what recordings have been made pursuant to the order and should be in the firm's inventory.

(9th Cir. 1964), both cases cited by plaintiffs in their motion to intervene, the proposed order does not withhold from the public or from parties to litigation information that that would otherwise be available to them. Unless the proposed order is entered, the audio tapes will not be created. Should the tapes be subpoeaned in future litigation, the enforceability of this provision can be litigated at that time by parties with standing to press the issue.

Meanwhile, the Department plans, if the Court enters the proposed order, to monitor the tapes carefully and, if evidence of new or continuing violations comes to light, take appropriate enforcement action. In addition, should violations of the securities laws be indicated, the Department will refer such evidence to the SEC, the NASD, or both.

CONCLUSION

Entry of the proposed order is in the public interest. The United States has today certified compliance with the Tunney Act. The Court should enter the proposed order as submitted.

Dated: October xx, 1996
Washington, D.C.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Hays Gorey, Jr., hereby certify that on October xx, 1996, I caused to be served a true and correct copy of the foregoing Response to Public Comments by first-class mail, postage prepaid, upon:

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