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Legal

The Supreme Court And The Tech Bubble

Brian Wingfield, 03.27.07, 6:00 AM ET

WASHINGTON, D.C. - Many of the excesses of the tech bubble in the late 1990s and 2000 will be relived on Tuesday before the U.S. Supreme Court.

The case deals with alleged Wall Street corruption and conspiracy in that long-ago period of surging IPOs and fast money. But this time, the outcome could have far-reaching implications for investment banks and the extent to which they are regulated now and into the future.

Credit Suisse Securities, et al. v. Glen Billing, et al. is essentially a showdown between a class-action group of investors and 16 powerful companies that underwrite securities, including JPMorgan Chase, Lehman Brothers and Goldman Sachs. The investment banks argue that heavy regulations from the U.S. Securities and Exchange Commission provide them with immunity from antitrust laws when they cooperate in setting prices for a stock's initial public offering.

But after a host of allegations that the banks and their preferred customers conspired to drive up post-IPO prices for some 900 tech stocks, the investor group sued, arguing that the companies should not be immune from antitrust liability. In 2005, a federal appeals court agreed with the investors. The banks are now seeking to overturn that decision.

The court will likely issue its decision on the case sometime in June, but several signs indicate that the justices will send the case back to the lower court. First, the Supreme Court would not have agreed to hear the case if it were completely satisfied with the appeals court's decision. Second, a highly influential friend-of-the-court brief filed by the solicitor general on behalf of the U.S. government says the appeals court erred when it decided the case.

If the justices were to rule the other way--in favor of the investors--there is concern that Wall Street could be over-regulated and more antitrust cases will be filed against securities firms, which could discourage competition and perhaps send capital elsewhere.

"There's a real danger that if you start increasing the number of antitrust cases, you increase the cost of raising capital in this country," says Richard Samp, chief counsel at the Washington Legal Foundation, a public interest law firm.

But when the SEC's regulations were written, lawmakers and regulators didn't envision the so-called "laddering" scandal of the late 1990s. The premise of the alleged conspiracy was relatively simple: hedge funds and other preferred customers of underwriting firms agreed to buy IPO shares as well as the stock's shares in the resale market. The collusion would have the effect of causing artificially high stock prices, allowing the preferred clients and the investment banks to cash out.

The court is not considering whether this type of behavior is legal (it's not), but rather whether manipulation of the

securities markets is subject to antitrust laws.

The American Antitrust Institute (AAI), a pro-competition think tank in Washington, believes the SEC's heavy regulation of investment banks should necessarily allow firms to be exempt from antitrust liability.

"This seems to be a situation that deviates from the path and opens up the path for more claims of antitrust exemption, even where the regulator has not exercised all of the power it might potentially exercise," says Albert Foer, AAI's president.

According to Foer, the fact that the court has agreed to hear the case doesn't necessarily mean the justices will overturn the lower court's ruling. "It's possible that they want to use the opportunity to clarify what they meant" in a previous case, he says.

If the U.S. government's brief in the current case is any indication, Foer could very well be right. In deciding that the investment banks were not protected by antitrust immunity, the appeals court should have been more specific in what is covered under this immunity, the solicitor general said. At the same time, the government also argued that the decision leading to the appeals court's case "was likewise in error and gives too little weight to the antitrust laws and their fundamental policy of competition."

Government briefs tend to carry significant weight because federal officials are responsible for enforcing the laws themselves. Thus, if the government's brief is any indication, the Supreme Court will send the decision back to the lower court for clarification.

"The court has become so active on antitrust matters, it's almost as if they're saying, 'Look, folks, we let this field of law develop in our absence, and now we're going to come back and take another look at … the range of antitrust issues,' " says Foer.