THE INVESTMENT BANKERS' CASE—
INCLUDING A REPLY TO PROFESSOR STEFFEN

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THE so-called *Investment Bankers'* case is well worthy of study because, in reviewing the business and financial history of half a century, it provided a testing ground, not merely for our uniquely American system of trying major commerce cases according to formal court procedure, but also for methods and standards of business conduct which extend beyond finance and indeed throughout American trade and commerce. This was a "Big Case" *par excellence*.¹

THE COURT

Several factors combined to qualify Judge Medina to test the basic theory of antitrust law that great questions of commerce should be tried in open court. First, he had been a leader of the bar in practical every-day litigation, mostly commercial cases.² Second, in his short tenure as a Federal Judge he had gained unique familiarity with the federal law of conspiracy.³ And third,

†Member of the New York and Federal Bars. This is a reply, by invitation, to Professor Steffen's article, *The Investment Bankers' Case: Some Observations*, 64 YALE L.J. 169 (1954) (hereinafter cited as *Steffen*). Mr. Whitney participated on behalf of two of the defendant banking firms throughout the trial (1950-1953), as well as throughout the preliminary stages (1948-1950) of the case, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953).

1. There were 309 courtroom days and 25 days of hearing in chambers as well as a great number of days in pre-trial hearing (including 80 days of taking depositions); the stenographic trial transcript constituted 23,962 printed pages; there were 4,469 separate documents offered in evidence out of a stipulated total of 10,640; and in all there were printed in the course of the litigation approximately 100,000 pages of material. *United States v. Morgan*, 118 F. Supp. 621, 828 (S.D.N.Y. 1953).

2. The Judge, formerly an Associate Professor of Law at Columbia University, was the author of *MEDINA'S BOSTWICK* (1952), a book of New York procedural and substantive forms, and of a *NEW YORK CIVIL PRACTICE MANUAL* (1939). For almost two generations his lectures on New York procedural and substantive law have been the core of the young lawyer's preparation for the New York Bar examinations and, perhaps because his former students so frequently retained him, the number of appellate cases argued by Judge Medina in New York courts is probably several times that argued by any other practitioner. The author heard Judge Medina casually refer, in a speech before the New York County Lawyers' Association, to an incident that occurred during "my five hundredth argument before the Appellate Division, First Department."

3. Judge Medina was the district court judge in the Communist conspiracy case, *United States v. Dennis*, 341 U.S. 494 (1951), *affirming* 183 F.2d 201 (2d Cir. 1950).

he was not predisposed one way or the other by experience in the subject-matter of the case—financing on a national scale⁴—or in its special legal background—Sherman Act and antitrust cases generally.⁵ Throughout the early stages of the case the Judge was severe in restricting any interjections from defense counsel which seemed to him likely to interrupt the flow of presentation of the Government's opening speeches and evidence. The court's open criticism of the positions taken by Government counsel, which were daily reported in the financial columns of the press during the later stages of the trial, came only after the trial had progressed far enough for the court to have become familiar with the evidence.

Professor Steffen concludes his article with a statement that it constituted error for the court to permit defense counsel to make its extended opening statement, and that this alone could properly have been grounds for appeal to the Supreme Court. But the Government waived this ground of appeal, when Mr. Holmes Baldridge, Chief Counsel for the Government, and senior to Professor Steffen, opened his rebuttal argument on March 13, 1951:

"I might say that in my 12 years of antitrust litigation I have never been before a Court who was more eager to get all the facts in order to fully understand the basic issues before the introduction of evidence . . . And in this respect I think we will all agree that these openings have been unique. I earnestly hope that they will set a new pattern for a better understanding of the complicated factual, economic and legal problems which are involved in such cases. I want to say in addition that I would be less than candid if I did not admit that the defense openings have given the Government itself a better understanding of its own case; because who knows better than the defendants themselves the industry of which they are a part?"⁶

Besides assisting the court, the extended openings were in the interest of fairness to the defense. The Government had indicated its intention to make the case a purely documentary one, and had handed up four printed briefs containing a mass of material which the defense believed to include misstatements

4. He said, "with reference to these names—just as I indicated yesterday about Mr. Jesse Jones, of course I had heard the name 'Jesse Jones' but I did not know much about him . . . Now just assume, and you will be right 99 per cent of the time that I do not know these things, because I have been busy as a lawyer . . . I did not keep up with all these other things except in so far as they came up in some case that I had as a lawyer . . ." Transcript of Record, pp. 1075-76, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953).

5. Judge Medina opened the fifth day of the Government's opening speeches with a suggestion to Government counsel that they aid him with the law: "[T]his whole subject is one of which I am profoundly ignorant, not only the antitrust law, with which I have had absolutely no contact at all in my professional experience—well, when 'I say not at all' it is so small that it is almost negligible—and in economics there again I have no background in that subject, nor do I know anything about these banking practices." *Id.* at 359.

6. *Id.* at 4427.

of fact.⁷ The openings provided defense counsel an opportunity to reply. Furthermore, although during the Government's initial opening, defense counsel were forbidden to interrupt, another rule applied during defense counsel's opening. Government counsel were free, and indeed invited, to interrupt at any stage,⁸ a privilege of which they quite properly took frequent advantage.

Throughout the trial Judge Medina took the point of view that he wished to understand each statement that was made to him and to put before counsel each thought or viewpoint that occurred to him. Surely this is the way that a judge is supposed to try any difficult case, either of crime or tort. And a conspiracy in restraint of trade is both a crime and a tort. Its distinguishing feature is complexity: it frequently involves the history of an industry over a period of years, and therefore so much the more requires understanding by the Judge before the introduction of evidence.

In this case our most complex body of law was to be applied to what is probably our most complex form of business. When the two were brought into juxtaposition before a Judge unfamiliar with either, he had a choice of two courses. He could sit back and let documents pile up on his desk and let statements of fact flow across his consciousness, without attempting to read the one or check the other. Inevitably he would be bewildered and, from the defense point of view, subjected to a sort of pro-plaintiff brain washing. The other course would be to read each document when presented and to understand each oral statement as made. Those who object to Judge Medina's choice of the second course are simply objecting to a fair trial according to Anglo-American procedure. They are objecting to the whole system, imposed by the Sherman Act and other antitrust statutes, of trying antitrust cases in the court room according to the regular rules of procedure.

THE FUNCTION OF INVESTMENT BANKING

Turning from considerations of court and procedure to the substantive subject matter of the case, it is necessary to understand what is meant by "investment banker." In the first place, investment bankers are not bankers. Nor do they invest. The name is an historical misnomer. If banking be described as the business that banks characteristically do—receive deposits of public money—it is something that "investment bankers" are forbidden by the Glass-Steagall Act⁹ to do. What investment bankers do, at least so far as this case is concerned, is (a) to use their own limited capital, plus such borrowing power as that capital will support, to buy such portion of a long-term security issue as they can afford, and (b) to endeavor to resell it to investors as quickly as

7. The briefs consisted of four large printed volumes. One, of 81 pages, dealt with law. The second, of 458 pages, made innumerable statements of fact based on interpretation of exhibits not yet, of course, offered in evidence. This was supplemented by appendices containing 752 pages of tabular matter. Professor Steffen was not then among the Government counsel, thirteen of whom signed the briefs.

8. *Id.* at 39.

9. 48 STAT. 162 (1933), 12 U.S.C. cc. 2, 3, 6 (1952).

possible. They cannot themselves be investors, or their limited capital would be locked up and they would go out of business.

Long-term security issues (in the most usual case, stocks or bonds) provide merely one way of raising money at long term. Issuers (in the most usual case, corporations) are interested primarily in raising money, rather than the particular manner or form by which that result is accomplished. Consequently, investment bankers are not essential to the raising of money, even at long term. Commercial banks may lend on ten-year notes, for example, or insurance companies and other large aggregations of capital may buy whole issues for cash. Thus, suppose that a large corporation wishes to raise \$50,000,000 at long term; it can, and indeed today usually does, find one or more insurance companies in a position to buy the entire issue as an outright purchase and sale transaction.¹⁰ No investment banker has adequate capital for such a purpose. Indeed, the seventeen defendants were not even the investment bankers with the largest capital, and there were several hundred other firms in the business, many of very substantial capital.¹¹ Really, the seventeen defendants were merely the most competitive in the era that the Government was chiefly thinking about, 1934 to 1947.

Essentially, an "investment banking" firm is a combination of men of two different kinds—men with capital and men with a great deal of initiative and enterprise. Their primary business is to suggest to a corporate borrower a form of publicly issued security by which it can raise capital better than through a sale to insurance companies or to its own stockholders. Because the corporation wishes to be *assured* of the money, the investment banker's suggestion must carry with it an undertaking (a) to use his own capital to underwrite a portion of the issue and (b) to find among other "investment bankers" additional so-called "participants" in the underwriting in sufficient number to purchase in the aggregate the whole issue.

There are, of course, innumerable securities already issued and outstanding in the open market. Professor Steffen is right in saying that the case was not directly concerned with these. Yet what must be evident is that the price of comparable securities in the open market on any given day, or indeed from hour to hour during market hours, must govern the price at which a new security can be offered.

PRICE-COMPETITION AND PLAN-COMPETITION

The most frequently claimed achievement of compulsory "competitive bidding," bidding through publicly invited sealed bids for an already created "security," is that the borrower obtains a price perhaps one-half of one per

10. The data stipulated at the trial showed that of the dollar volume of bond financing in 1947-1949 for which submission to public sealed bidding was not required, less than fifteen percent was underwritten.

11. Finance, March 15, 1950 (the year that the trial commenced) showed only seven investment banking firms in the United States with over \$10,000,000 of capital of which two were defendants.

cent higher than he would have obtained if he had employed an investment banker to work with him in setting up and marketing the security. But stocks on the market fluctuate in the course of every day at least one-half of one per cent; anyone can turn to the newspapers or to the ticker tape and see prices constantly changing. The same is true, within a smaller percentage range, of bonds. It is the general market that controls absolutely the price at which a new issue can be offered. And it is far more important to the borrower that his new security be wisely prepared and its issuance properly timed than that he realize any particular percentage of the issue price—price being in the end determined by the market.

Indeed, if it were not more important to the corporation that the utmost skill and resourcefulness be devoted to preparation of the issue than that any particular price be paid for it, investment bankers would be out of business. An issue that is bought by an insurance company for cash need not qualify under the Securities Act, for it is not underwritten. The cost of registration and underwriting, both inherent in the function of investment banking, must be added to the price of a public issue. Thus, what the banker must do is, by his skill and ingenuity, to devise a better security which, he hopes, will command a price high enough to offset the added costs of underwriting and registration under the Securities Act. This is what Professor Steffen at one point calls "plan-competition" as distinct from "price-competition."

"Plan-competition" is the principal form of competition not merely by investment bankers against large aggregations of capital, but also by investment bankers against one another. That was proved by abundant examples in the Government's own documentary evidence and by depositions read at the trial. As a single example, in 1935 defendant Kuhn, Loeb & Co. took the leadership of Bethlehem Steel issues away from E.B. Smith & Co., predecessor of defendant Smith, Barney & Co., and the "claimed successor" of Guaranty Company, notwithstanding many years of "satisfactory" and "continuing relation" between Guaranty and Bethlehem. Kuhn, Loeb & Co. got the Bethlehem business because it was able to suggest a modification in the terms of a mortgage that enabled an issue of bonds, already largely prepared by the efforts of E.B. Smith, to be sold at a slightly higher price.¹² In effect, every case of "plan-competition" results in "price-competition": a different plan by definition provides a different security, which normally must command a different price, unless the changes happen to cancel out. What distinguishes "plan-competition" as such is that a corporation may prefer a better plan—better from the viewpoint of its special requirements, *e.g.*, to balance its capital structure—even at a slightly higher price.

Nor was it proved in the case that "price-competition" as such did not exist. In 1945, for example, a group of bankers, headed by defendants Kuhn, Loeb & Co. and Blyth & Co., Inc., was able at the last moment to take an issue of

12. Transcript of Record, pp. 7882, 8099, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953).

Pan-American Airways stock away from Atlas Corporation, which was working with defendant Lehman Brothers, on the sole ground that they asked a lower price for underwriting.¹³ There were many more examples.

"Plan-competition" was, in the jargon of the trial, competition as to what should constitute the "It," the security to be offered. There is an almost infinite variety of provisions which may be combined to constitute the "It." And what is the right combination may fluctuate from day to day with the market. An essential element of the service offered by the investment banker is to assist the issuer in answering such questions as: Shall the new security be a stock or a bond? If a stock, preferred or common? Must or shall it be offered to shareholders? If preferred, cumulative or noncumulative? Convertible? Redeemable? What dividend rate? How underwritten? How many shares? To be offered at what price below the market? If a bond, what interest rate? What maturity? Shall there be a sinking fund? If so, cumulative or not, and over how many years? Redeemable? If so, when and on what terms? Shall there be mortgage security? If so, what?

The answers to these questions are settled only in the prospectus and registration statement, and in the trust indenture, the amendments to the certificate of incorporation, and the other documents whose form cannot be final until the moment of registration. The Government's original notion seemed to be that the final security springs like Minerva from the head of Jove or rises like Aphrodite unclothed in all its beauty from the waves, to be then offered for sale to the highest bidder, or alternatively, if that is not so, that it ought to be so, and that Judge Medina ought by decree in a federal court to make it so. To this author this was and remains a wholly unrealistic view.

THE COMPLAINT

The theoretical nature of the Government's viewpoint is illustrated by the brilliant integration of the complaint, all of whose numerous paragraphs and subparagraphs neatly interrelate to describe an alleged conspiratorial industry, in which each segment meshes with the others as smoothly and harmoniously as the bones and tissues of the human body.¹⁴

The Conspiracy Charged

Part VI of the complaint was entitled "Offenses Charged" and included paragraphs 43-45. Professor Steffen describes paragraph 43 as *the* "charging paragraph," but there is nothing in the complaint to distinguish it in this

13. The two price offers appear in Gov't Exhibits 1520 and 1521, Transcript of Record, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953). For the full story see also Gov't Exhibits 1505-22 and Harrison, Ripley Exhibits 16-21, *ibid*.

14. A principal author of the complaint was Professor Steffen. Indeed, he reported it as one of his academic publications. See REPORT OF THE DEAN OF THE LAW SCHOOL FOR THE ACADEMIC YEAR 1947-1948 (Yale Univ. Bull., Ser. 44, No. 17) p. 58, "Bibliography of the Faculty 1947-48," at p. 64: "STEFFEN, ROSCOE TURNER . . . Complaint in *United States of America v. Henry S. Morgan, et al.*, in the District Court of the

respect from paragraphs 44 and 45. Paragraph 43 is a single sentence commencing with the phrase:

"Beginning in or about the year 1915 and continuing thereafter up to and including the date of the filing of this complaint, the defendants named herein, have engaged, knowingly and continuously, in a wrongful and unlawful conspiracy to restrain unreasonably and to monopolize the securities business of the United States . . . all in restraint and in monopolization of the interstate commerce described in this complaint, in violation of Sections 1 and 2 of . . . the Sherman Act"¹⁵

Professor Steffen maintains that the subsequent paragraphs alleged only the "means" by which the conspiracy charged in paragraph 43 was carried out. But paragraph 44, consistent with its being an integral part of the chapter entitled "Offenses Charged," did not confine itself to "means." Every subdivision of paragraph 44 is governed by a single introductory clause reading as follows:

"The conspiracy has *consisted* of a continuing *agreement* and *concert of action* among the defendants, the substantial *terms* of which have been that defendants:"¹⁶

Thus, paragraph 44 purported to be a description of what the conspiracy itself consisted of. The conspiracy was here said to consist of an agreement.¹⁷ And the paragraph was a recital, not of "means" only for carrying out the conspiracy, but of the very "terms" of the conspiracy.

Professor Steffen's quotation of paragraph 44 as though it constituted a recital only of "means" is a distortion of critical importance. It enables him

United States for the Southern District of New York, Civil Action No. 43-757, filed October 30, 1947. Washington, Government Printing Office, 1947, 56 pp. (With other.)"

15. Professor Steffen says "Judge Medina does not make an analysis of the several counts alleged in Paragraph 43 of the complaint." *Steffen*, p. 176. But there was in fact no division into counts. The division of a pleading into counts, when that will facilitate clarity, is the responsibility of the pleader. Fed. R. Civ. P. 10(b). When Professor Steffen wrote that "the two counts, charging first a conspiracy to restrain trade and secondly a conspiracy to monopolize, are simply run together and described as constituting one single offense," *Steffen*, pp. 176-77, he was criticizing not the Judge but the pleader.

Professor Steffen gives his view of the law in these terms: "Of course, there is no 'conspiracy' known to the law—integrated, over-all or otherwise—which comprises *both* 'monopoly' and 'restraint of trade.' " *Steffen*, p. 177. This is patent error. Section 1 of the Sherman Act condemns "conspiracy in restraint of trade," and section 2 condemns "conspiracy to monopolize." Innumerable cases have recognized that the same conspiracy can "comprise" both. As a single example, Mr. Justice Douglas in *United States v. Griffith*, 334 U.S. 100, 109 (1948), speaks of the defendants having "formed a conspiracy in violation of § 1 and § 2 of the Act."

16. Emphasis added. Professor Steffen repeatedly quotes from para. 44 and never once quotes this, its introductory clause, which governs the whole.

17. Professor Steffen consistently speaks of the conspiracy as if it consisted only of a "unity of purpose" or "a common plan or design," as distinct from the alleged actual "agreement." *Steffen*, p. 176. In fact, no agreement was ever proved or sought to be proved.

to advance the thesis that any one of these "means" could have been used by but one of the seventeen conspirators and still have been received in evidence against them all.¹⁸ But the activities of one co-conspirator are inadmissible as evidence of the "terms" of a conspiracy. The Government's case was that all of the defendant firms had consistently adhered to each of the alleged practices, that these practices must, therefore, have been not merely "means" but "terms" of a conspiracy, and that the court should infer from the fact of uniform adherence to such terms that they had been agreed upon.¹⁹ Accordingly, when the Government was unable to prove that the defendant firms did in fact adhere to them, no case was left.

Professor Steffen writes as if it were accepted that there *was* a conspiracy, and as if all that remained was to show just what the seventeen conspirators did. In his article, as throughout the trial, he has consistently used the phrase "the defendants" as though they were already a proved unit.²⁰ On this basis, the seventeen leading firms in almost any industry could be charged with conspiracy. What constitutes an "industry" is that those in it are more or less engaged in the same sort of activity. To say that simply because seventeen firms or seventeen persons are engaged in the same sort of activity, they must have a common plan and purpose—as the article consistently suggests—or a fortiori they must have been in a common agreement and concert of action—as the complaint charged—would be to condemn every one. The question in each case is whether the sort of activity that is in question is the nature of

18. "Pattern in a price-conspiracy case . . . is not essential, or even to be expected, at a 'means' level." *Steffen*, p. 185.

19. For example, on the sixth day of Mr. Baldrige's opening rebuttal for the Government, the Court summed up the Government's position: "adherence to these practices, such as traditional banker, historical position, and reciprocity . . . with knowledge of the fact that all the others were doing the same thing . . . is evidence from which I may draw an inference." "Mr. Baldrige: That is correct your Honor." Transcript of Record, p. 4901, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953).

20. For example, he speaks of syndicates managed by "the defendant bankers," of "their syndicates," of prices maintained "at defendants' sole discretion" and of prices stabilized "as defendants had thought best"; he says that "the seventeen defendant bankers . . . managed over seventy per cent of all issues" of a certain type, that they "managed security issues aggregating \$17,337,087,000," that "the defendants actually have developed their way of doing business" and that, regarding the alleged "traditional-banker way of doing business," it must have been the defendants who "planned it that way. Who else?" But the evidence related either to the whole industry or to a particular defendant independently. There are, therefore, two fallacies in Professor Steffen's assumptions: (1) that evidence of what the industry does is evidence that the defendants (seventeen of the several hundred bankers) forced it on the industry, and (2) that evidence of what one defendant did or said is evidence that the defendants as a group had agreed upon it. Judge Medina early spotted the fallacy of assuming conspiracy and ordered the plaintiff to refrain from referring to "the defendants" as a group until they were proved to be a group. Pre-Trial Order No. 3, para. C(2), *United States v. Morgan*, 11 F.R.D. 445, 451 (S.D.N.Y. 1951). But the court's order could not control articles written after the trial.

the business or is the result of an agreement among the defendants. There is not space here to review all of the twenty-eight different practices alleged in paragraph 44 to have been terms of the conspiracy. But we can discuss the same ones which received the principal attention both of Judge Medina and of Professor Steffen, and from them as examples show the fallacy in the latter's reasoning.

The Syndicate Method: A Charge of Conspiracy

The first practice alleged was that the defendants had agreed not to compete and had agreed to divide the merchandising of security issues among them "(1) By employing the syndicate method to merchandise the security issues so handled."²¹ As we have seen, the syndicate method is essential to the very existence of the industry. A corporation may wish to float a fifty million dollar bond issue. An insurance company with five or six billion dollars of capital and eleven or twelve billions of assets can buy the issue, or, at least, three or four insurance companies can join together to buy it. But it is impossible for the partners in a Wall Street banking firm, with a few million dollars capital, to buy the issue. It only becomes possible when they form a joint venture or syndicate with other firms so that in the aggregate they are capable of competing with the insurance companies. This has always been true, and must be true, of the investment banking business. To say, therefore, that the Government has proved a conspiracy because investment bankers "employed the syndicate method" is, to anyone familiar with the simple mathematics of finance, to say exactly nothing.

But Judge Medina gave to the Government full opportunity to prove the allegation that employment of the syndicate method was something that defendant bankers had conspired to do. And the author of the complaint intended to prove this, for he alleged in paragraph 27: "The modern syndicate method of distributing securities was invented by defendant banking firms and their predecessors in 1915 . . ."²² And he opened the whole subject of "Offenses Charged" by commencing the one sentence charge in paragraph 43 with the connected phrase: "Beginning in and about the year 1915 and continuing thereafter up to and including the date of the filing of this complaint, the defendants named herein have engaged . . ."²³

21. Complaint, para. 44(A)(1).

22. In his article Professor Steffen adheres to the argument, saying that "the syndicate is beautifully *contrived* as a safety valve to prevent any unseemly competitive explosion." Steffen, p. 173 (emphasis added). This is the same notion as that pleaded, *viz.*, that the syndicate "was *invented* by defendant banking firms." To poke fun at Judge Medina for investigating the question is hardly fair: "Who *invented* 'The Syndicate System' next becomes a question of great moment." Steffen, p. 178.

23. When Professor Steffen quotes his "charging paragraph," in the text, he omits its introductory lines relating to 1915, although it is quoted in full in footnote. Steffen, p. 172 n.21. But the court had to take the paragraph in the form Professor Steffen had written it as Government lawyer and not in the form in which he attempts to highlight it as critic after the event.

The "Triple Concept" Charge: A Charge of Conspiracy

Paragraph 44A went on to charge that among the "substantial terms" of the "continuing agreement and concert of action" constituting the "conspiracy" among the defendants was their agreement not to compete:

"(2) By recognizing and deferring to the claims of the defendant traditional bankers to manage and co-manage and control the merchandising of the securities of particular issuers."²⁴

"(3) By determining their respective participations and positions in buying groups in accordance with the concept of historical position."²⁵

"(4) By reciprocally exchanging participations in the buying groups which they manage."²⁶

This came to be known as the "triple concept" charge—"concept" because the Government soon realized the weakness of its evidence as proof of a "practice" and preferred to condemn a "concept." But thoughts are not yet illegal, and anyway "traditional banker" proved in fact not to have been a phrase in use in the industry.²⁷ Yet the Government from the beginning agreed that "traditional banker" was, of the three concepts, the one upon which the other two depended.²⁸ The suggestion was that whenever banker *B* found that banker *A* had managed a prior issue, *B* deferred to *A* and refused to compete for the management of a subsequent issue (*A* being called by the Government "the

24. Yet Professor Steffen says flatly, "The complaint, Paragraph 44A(2), does not charge that the defendants by 'joint action' conspired in advance to recognize and defer to certain of their number as the 'traditional' bankers for certain [sic] issuers." *Steffen*, p. 182. At another point he reduces para. 44A(2) to an allegation that defendant bankers "at times" recognize and defer to the claims of traditional bankers and proceeds to chide the Judge for having "with a great show of virtue" made his finding on the basis of what was actually pleaded—that it was a *term* of the conspiracy that defendants should thus "recognize and defer." *Steffen*, p. 183.

25. Professor Steffen makes the point that the court found "that defendant bankers do make claims to 'historical position' and that, as managers, they do recognize such claims Also, that defendants . . . have denied participation . . . to many bankers who do not have historical position." *Steffen*, p. 186 (emphasis in original). But these were only findings that certain things happen. The complaint was different altogether, in alleging that the defendants conspired by agreement not to compete at all but rather to "determine their positions in buying groups in accordance with the concept of historical position."

26. Yet Professor Steffen says that the alleged conspiracy to control channels of distribution and to fix prices was "the *only* . . . conspiracy—charged in the complaint." *Steffen*, p. 172 (emphasis in original).

27. *United States v. Morgan*, 118 F. Supp. 621, 734 (S.D.N.Y. 1953).

28. See, e.g., Transcript of Record, pp. 4492-93, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953), Mr. Baldridge in opening: "Hence we submit that that direct exclusion of competitors by common adherence of the concepts of historical position and reciprocity was necessarily subsidiary to the understanding embodied in the traditional banker concept." Cf. Professor Steffen's entire omission of the traditional banker charge in his own opening summary, the 3rd paragraph of his article, *Steffen*, p. 170, and his attempt to dispose of all the "triple concept" allegations by calling them "merely the *a fortiori* parts of the case." *Steffen*, p. 174. But he later turns about and excoriates the Judge for making

traditional banker"); that *A* then invited into his syndicate those who had participated in the previous issue (according to what the Government called their "historical position"); and finally that those who participated in *A*'s syndicate "reciprocated" by inviting *A* into syndicates which they managed, thus blocking off competition.

In paragraph 44B, to which both the court and Professor Steffen have devoted considerable attention, the "traditional banker" concept reappeared. The paragraph alleged that one of the terms of the conspiracy by agreement among the defendants was: "to eliminate the competition of other investment bankers . . . (1) By establishing and maintaining relationships with issuers which give to and preserve for defendant banking firms domination and control over the merchandising of all issues of securities which emanate from such issuers." Judge Medina discerned that this was an essential element of the Government's case: if the bankers did not dominate and control the issuers, they would have difficulty in making effective their alleged conspiracy not to compete among themselves, for the issuers could simply go to other investment bankers outside the conspiracy, or to insurance companies. It was not "a straw man" that the court knocked down but an important element of the conspiracy.²⁹

In paragraph 45, the "traditional banker" theme was developed. Paragraph 45 contained numerous subparagraphs. But, like paragraph 44, they were governed by one introductory clause:

"During the period of time covered by this complaint, and for the purpose of *forming* and effectuating the conspiracy, the defendants, by agree-

an identical appraisal of the famous triple concept as possibly "mere dialectics." *Steffen*, p. 180.

A further example of this inconsistency is provided by Professor Steffen's treatment of twin paragraphs in the introductory portion of the complaint. Both para. 24 and para. 25 allege that the investment banker does not charge a fee but obtains his reward through merchandising security issues, para. 25 adding that this is sometimes consequent on his advice to and alleged control of the business affairs of an issuer. When Professor Steffen relies on this allegation he calls it the "core of the Government's case" *Steffen*, p. 173; but when Judge Medina deals with the identical allegation, Professor Steffen says that "the court now seized on this minor introductory allegation and inflated it into a *main charge* in the case." *Steffen*, p. 180.

29. Professor Steffen argues that "the monopoly aspects of the case" were separately alleged and that it is "there" that "the seventeen defendants are alleged to be arrayed against the industry." *Steffen*, p. 177. This finds no support in the complaint. One of the allegations of conspiracy to control issuers, complaint, para. 45A(10), was coupled with the allegation that defendants caused their partners to go on boards of directors. This was considered important by Government counsel, for, as Professor Steffen says, "The evidence before the court had largely to do with directorships . . ." *Steffen*, p. 181. He then attacks the court for its handling of that issue: "But the court said: 'No attempt was made to show the circumstances under which any of these men became directors,' as if that were material. And he [the court] went on to say that 'in many cases the men in question were invited by the management to come on the board,' and many were men 'of proven competence and judgment'—both matters not in controversy." *Steffen*, p. 181. If those matters were not in controversy, what was? Normal election of a banker as a director would by itself have no more significance than normal election of anyone else.

ment and concert of action, have done the things they agreed to do as hereinabove alleged, and, among others, the following acts and things:"³⁰

As with paragraph 44, therefore, this was an allegation of agreement—an agreement not merely on effectuating, but for the purpose of forming, the conspiracy. After a subparagraph A, "Defendants formulated and adopted, subsequently operated, and now operate pursuant to, among others, the following restrictive customs and practices:"³¹ there followed such allegations as the following:

"(1) Whenever an issuer agrees to permit one of the defendant banking firms to manage the merchandising of a security issue, the other defendant banking firms recognize this as establishing a continuing banker-client relationship and recognize such firm as the traditional banker for the issuer, exclusively entitled to act thereafter for the issuer in merchandising its future security issues. A defendant traditional banker's recognized exclusive relationships in this respect continue indefinitely and, upon dissolution or reorganization of an investment banking firm acting as traditional banker, the other defendant banking firms agree as to which defendant banking firm or firms, if any, they will thereafter recognize as successor or successors When one of the defendant banking firms is the traditional banker for an issuer, none of the other defendants will discuss or undertake the merchandising of new security issues for that issuer. Defendant banking firms observe an ethic not to compete and refuse to 'poach on each other's preserves.'

"(4) Once a defendant banking firm has been selected as an underwriter in a buying group formed to merchandise a security issue, it is recognized by the other defendant banking firms as having certain proprietary rights or historical position and is granted an opportunity to participate in every buying group thereafter formed to merchandise future security issues of the same issuer, and the extent of the participation and group position offered to such firm is usually the same"

30. Emphasis added.

31. In the light of the phrases "effectuating the conspiracy," "agreement and concert of action," "formulated and adopted," and the general tenor of the whole, Professor Steffen's statement that paragraph 45 deals only with the "restrictive customs and practices" has a hollow sound. *Steffen*, p. 182. Yet these and Professor Steffen's other abbreviated quotations are preceded by a sentence to the effect that the charges will be quoted in the article "as precisely alleged in the complaint." *Steffen*, p. 171. Professor Steffen goes on to belittle the Judge's work on this ten-page para. 45: "But the court seems never to have been able to get hold of the basic charge of the alleged conspiracy, and so he pursued each alleged 'means' to exhaustion as if it were charged as the nexus of the conspiracy. In this instance the court was able to reach over to Paragraph 45, dealing with 'restrictive customs and practices,' to lend credence to his point Of course, to anyone familiar with pleading, that is a funny place to go for a statement of the offenses charged." *Steffen*, p. 182-83. The fact is that Professor Steffen is repudiating his own complaint, for he says later, "The only 'concert of action' having any bite in it is that charged in Paragraph 43." *Steffen*, p. 183. If there was no "bite" in paragraph 45, or for that matter in paragraph 44, it may be right to say that the court ought to have ignored them. But if he had, the Government's case would have dissolved before it started.

On any fair reading of the English language, these were allegations that the defendants had agreed among themselves to do all these things, and to do them regularly.³² By the time of the closing speeches the Government was forced to concede that no such system operated, and they then made the "lesser charge" that a defendant competed with what was called "the traditional banker" only if he believed that the latter's relations with the issuer were not "satisfactory."³³ Quite apart from the fact that the Government did not prove even this lesser charge, it amounted in theory only to charging that individual defendant firms followed the practice of not going after competitive business unless they thought they had a chance of getting it.³⁴

"The Mosaic" and the Search for a "Unifying Element"

Judge Medina announced his program at the outset of the trial: "I am going to try my best to get the Government's position on all these things and rely on my own common sense when we get to the evidence later, to scrutinize it carefully and to do what you have to do in every other case."³⁵ It was on this basis that he received all the evidence, and considered what the Government called its mosaic, stone by stone, although in a memorandum at the conclusion of the opening speeches he had said that the unifying elements of the conspiracy still remain obscure.³⁶ He was seeking for some element from which he might infer that the defendant firms were in fact united in some common agreement or concert of action. Now, precisely because he sought to find some "unifying element" by which the allegation of conspiracy might be sustained, he is pilloried by the author of the original complaint.³⁷

32. Professor Steffen now waters these down into allegations "that many such banker-client relationships are recognized by defendant bankers as 'traditional,' " *Steffen*, p. 174 (emphasis added), and "that, by use of the 'historical position' concept, many syndicates have become more or less static from issue to issue," *Ibid.* (emphasis added).

33. *United States v. Morgan*, 118 F. Supp. 621, 736 (S.D.N.Y. 1953). See also Brief in Support of Plaintiff's Motion to Connect the Evidence, (April 15, 1953), pt. I *passim*, *United States v. Morgan*, *supra*, and the closing arguments for the Government, Transcript of Record, p. 20,143 *et seq.*, *United States v. Morgan*, *supra*.

34. This is where the Fifth Avenue versus Grand Street analogy came into play. Cf. *Steffen*, p. 190. The defense pointed out that although a cloak and suit man in the old days in Grand Street might have clutched at the sleeve of a customer entering a competitor's shop, even though the customer was satisfied with the competitor, there was no more reason why two investment banking firms, seeking the managership of an issue of the American Telephone and Telegraph Company, for example, should expect to succeed by clutched at the sleeve of the President of A.T. & T. than there was for Brooks Brothers or Tripler's to expect in that fashion to intercept customers whom they saw entering the shop of a competitor.

35. Transcript of Record, p. 38, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953). Indeed Professor Steffen's rigid insistence upon the paramountcy of the complaint would seem strange in the light of the policy of flexibility behind the Federal Rules of Civil Procedure, were it not that the Government did in fact adhere tenaciously throughout the trial to all the essential allegations of the complaint and made amendments to only a few clauses.

36. *United States v. Morgan*, 11 F.R.D. 445 (S.D.N.Y. 1951).

37. The court was not looking for a "mechanical" unifying element. He understood

At least Professor Steffen and this author can agree that "it is a commonplace that the presence or absence of conspiracy must be determined by an examination of all the circumstances."³⁸ That was precisely what Judge Medina did, and what Professor Steffen sedulously avoids doing. At practically no point in his entire article does Professor Steffen deal with the evidence. A characteristic way of his disposing of the evidence is found in the sentence immediately preceding the one last quoted about "all the circumstances." In that sentence there is reference to the allegations of "[1] common membership in the Investment Bankers Association, [2] the keeping of reciprocity records, or [3] the invention of the syndicate system."³⁹ Having named them, Professor Steffen says nothing about their merits. But let us consider the first two as samples—the third will be considered later.

In many antitrust cases against industries in which there are many small concerns and none really dominant, a trade association is found to have operated as a restraining or monopolizing conspiracy. In this case the Investment Bankers Association was named as a defendant, along with the seventeen firms, and a great deal of evidence was introduced against it. But after the evidence had shown on its face the innocence of the activities of that association, the Government voluntarily moved to dismiss it as a defendant.⁴⁰

Even more promising, from the Government's viewpoint, was the allegation that the defendants had agreed to exchange participations in the buying groups which they respectively managed and that they kept reciprocity records. From the moment he first heard this allegation Judge Medina identified it as one which, if proved, would make it very difficult for the defendants to escape an adverse judgment. The allegation was paragraph 45A(3):

"Defendant banking firms, in forming buying groups, select on a reciprocal basis, other defendant banking firms as underwriters. Over a period of time, the amount of gross spreads which one of such firms enables another to earn by selecting it for participation in buying groups is substantially equivalent (with due allowance for differentials in prestige and underwriting strength) to the amount of gross spreads it has earned in the same period of time as a participant in buying groups formed and managed by such other firm. Each defendant banking firm keeps a reciprocity record to show the business it has given to each of the other

perfectly the "mechanical" fallacy that Professor Steffen is still trying to pin upon him. See *United States v. Morgan*, 11 F.R.D. 445, 456 (S.D.N.Y. 1951). See also *Transcript of Record*, p. 4652, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953). But some "unifying element" was the essential ingredient of the Government case. Only as a proved combination could the defendants reach the position of dominance of an Aluminum Company, for example. The issues in *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945), *cf. Steffen*, p. 170, could not arise here until the combination had been proved.

38. *Steffen*, p. 175.

39. *Ibid.*

40. *Transcript of Record*, p. 10,775, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953).

defendant banking firms and the business it has received from each of such firms."

What happened to the charge that "each defendant banking firm keeps a reciprocity record" has become reduced even in Professor Steffen's article to statements "that some of the defendants *have* kept reciprocity records"⁴¹ and that "at least two witnesses testified on deposition . . . that their firms *do* award participations . . . on the basis, in part, of business received from other bankers or expected in the future."⁴² The collapse of proof was, of course, even more dramatic as it happened at the trial. An allegation that "each defendant banking firm keeps a reciprocity record" had dwindled before the outset of the trial to a statement made in the opening that eleven firms were found to have reciprocity records. No such records were introduced in evidence in respect of nine defendants, and no evidence of any kind was introduced on the subject in respect of seven of these. As to the remaining eight, the records introduced were shown in every case either to be not real reciprocity records at all or to have been kept solely for the information of the particular defendant, without regard to or knowledge of what any of the others were doing.⁴³ In no case were they records of reciprocity with other defendants, but always with other bankers generally.⁴⁴

A TEST CASE

The circumstantial evidence offered by the Government, in the absence of direct evidence of conspiratorial agreement,⁴⁵ was to consist in part of extensive stipulated statistical data,⁴⁶ and in part of documents from the files of the defendants. From these the Judge would be asked, at the conclusion of the evidence, to infer that the defendants had been participants in a conspiratorial agreement. The documents were to be the "stones" in the ultimate "mosaic," whose portrait of a conspiracy would be apparent to the Judge only after all the "stones" were in.

Meanwhile, however, there was the perfection of the beautifully articulated complaint, with its recital of the many "customs and practices" to which *all*

41. *Steffen*, p. 185 (emphasis in original).

42. *Steffen*, p. 185.

43. *United States v. Morgan*, 118 F. Supp. 621, 633 (S.D.N.Y. 1953).

44. Transcript of Record, p. 10,843, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953).

45. The Government's admission from the outset that it could not prove any agreement, except by inference, was made even though it had free access to all the files of all the defendants. *Id.* at 336.

46. All financing of the fifteen years, 1935-1949, was analyzed for the court and organized in tabular form, so that for every issue of stocks or bonds over \$1,000,000 the description of the issue, the type of transaction, number of underwriters, nature of underwriting, dollar amount, spread, and name of managing investment banker or bankers were immediately available. By common agreement between the parties the fifteen-year period seemed to break into five periods of three years each.

the defendants were alleged to have agreed and which *all* were alleged to have followed in practice. Of course, customs and practices as such could be, and until the contrary is proved in any case must be, presumed to be customs and practices inherent in the conduct of an industry. Proof even of universal adherence to customs or practices as such would, without more, in itself be proof only of the nature of the business. At most it might be shown that some of the customs and practices are "bad," and need to be further reformed by statute or by the SEC. But the Sherman Act is not concerned with what is "bad" unless it restrains or monopolizes. Accordingly, the pleader had not only alleged an agreement to follow particular customs and practices but, perhaps anticipating that the evidence might fail to prove this, had also alleged an agreement upon basic so-called "concepts" which, when agreed to, must in the natural course of business lead to "adherence" to the customs and practices.

At the opening of the trial the Government submitted a printed brief on the facts which purported to expound the theory of "adherence to concepts" by quoting from a great number of the documents. But both during the openings and during the introduction of evidence it became increasingly apparent that the documents reflected competition rather than agreement not to compete, and that the same competition was evidenced by the stipulated statistical data. As evidence of actual practice dwindled, Government counsel were forced to fall back on the theory of agreement upon mental concept. Whenever the Judge would point out that a particular document did not evidence any practice, they would reply that a particular phrase in the document evidenced at least adherence to some concept.

An example will illustrate the points. Assume that Mr. *A*, as president of bank affiliate *C*, had as manager handled the underwriting of a securities issue for corporation *X* in 1929 and that banking firm *B* had had a participation in the underwriting as a member of *C*'s syndicate. *C* bank was by the Glass-Steagall Act eliminated from the underwriting business in 1933. Mr. *A* then became a partner of investment banking firm *A*. In 1935 corporation *X* proposes to make an additional issue of securities. *A* goes to *X* and seeks to handle the underwriting, and in so doing, Mr. *A* says to the president of *X* words to this effect: "Tom, (or Dick or Harry, as the case may be) you and I worked hard together in 1929. Ever since that time I have been in constant touch with you. I know as much as any banker could know about *X* corporation. I have now joined *A* so *A* is the *successor* of *C*. I can do a better job for you than anyone who is unfamiliar with your affairs." *X* then entrusts *A* with the preparation of the issue.

Now suppose that the partners of investment banking firm *B* meet, and its partners say to each other: "Shall we compete for this issue? We don't know the president of *X*. And Mr. *A* has intimate knowledge of *X*'s affairs. He has had a *continuing relation* as financial *adviser* of *X*, and that relation is still *satisfactory* to *X*. *X* is a *client* of Mr. *A* and is treating his new firm, *A*, as the *successor* of *C* and therefore as *its banker*. But we were in the

syndicate that *C* organized to handle *X*'s underwriting in 1929, so let's not waste our time trying to compete with *A* for the management of this new issue. Rather let's go to *A* and point out our *historical position* in the old syndicate and *claim* an equal or better participating share in *A*'s new syndicate. Perhaps we may later *reciprocate* by offering to *A* a participation in one or more of our syndicates."

The italicized phrases embrace substantially all of the allegedly wicked thoughts or "concepts." The Government's position was that they are so inherently unusual, abnormal, and noncompetitive, that the fact that *B* held them would in itself be proof that *B* must have conspired with *A*. The defendants' position was, first, that it was extraordinary to observe how often the evidence showed that in just such a situation *B* never entertained such thoughts at all; second, that even when *B* did entertain such thoughts, it was extraordinary how often related and connecting documents showed that *B* went ahead and competed anyway; third, that the fact of competition was further proved by the stipulated statistical data, which showed how frequently *B* had succeeded in getting the business away from *A*; and fourth, that even if *B* had such thoughts and acted on them, it was a natural and normal business decision, and was not in itself any evidence of conspiracy.

Defendants' first three arguments turned, of course, on the evidence. This is reviewed in some detail in the court's opinion and is substantially ignored in Professor Steffen's article. Suffice it to say that on the court's findings the defendants prevailed on the stipulated facts, and the fourth argument need never have been made. But it was extensively debated at the trial, and Professor Steffen still denies its validity.⁴⁷

In a competitive economy *in the real world* men on the two sides of a trade are necessarily in a *continuing relation* with each other. It is only in the simplest transactions that price is the only competitive factor. In all other business relationships, the phrases alleged to have been used by the investment bankers are common coin. In any trade the man who had previous and *satisfactory relations* with the customer will refer to himself as *the supplier* (cf., "the banker"⁴⁸) of that customer. His position as supplier, having

47. See, e.g., his statement that "the bare fact that anyone should even make a claim to 'successorship' in a truly competitive industry is surely unusual." *Steffen*, p. 184. Of course, the essence of competition in every industry is that people make every sort of claim, and a frequent one is the claim to be the true and only "successor" to some firm which has had the customer's business before. Professor Steffen adds his usual statement that "no 'conspiracy' on successorships was ever charged." *Steffen*, p. 184. Not merely is this belied by the complaint, paras. 45A(1) and (4), but when the Government summed up at the conclusion of the case, the conspiracy on "successorships" was made the first and principal cornerstone of the whole charge. Brief in Support of Plaintiff's Motion to Connect the Evidence (April 15, 1953), pt. II, p. 24 *et seq.* United States v. Morgan, 118 F. Supp. 621 (S.D.N.Y. 1953). See also closing arguments for the Government, Transcript of Record, p. 20,143 *et seq.*, United States v. Morgan, *supra*.

48. Of the "concepts" criticized by the Government, "traditional banker" did not come from industry sources. See United States v. Morgan, 118 F. Supp. 621, 734 (S.D.N.Y.

existed in the past, is by definition *historical*. His business relations, like his human relations, such as invitations to dinner, are normally on the basis of *reciprocity*. If he changes from one firm to another, he is sure to tell his old customers that the new firm is the *successor* to the old. To retain his customer's good will, he *advises* him, and seeks to establish a *continuing relation* of the same sort that a lawyer hopes to have with a *client*. His customer is one who has followed the custom of dealing with him—has given him its "custom." The suggestion that these words were badges of evil, and that their use was evidence of a "code" or an "ethic" in itself evil, was a revolutionary suggestion, and one that sought to substitute, by judicial fiat, a governmentally regulated public auction economy for a normal private enterprise economy.

With the collapse, on the evidence at the trial, of the claims of an actual conspiracy, Government counsel were forced into Professor Steffen's alternative position—the one that has significance for all trade and commerce, not merely investment banking—that the use of these phrases was in itself inconsistent with a competitive economy. The argument meant nothing less than that an industry cannot be competitive unless its participants are forbidden to have personal relations with their customers, lest that give them an undue competitive advantage. And this position explains Professor Steffen's enthusiasm for the so-called competitive bidding system.⁴⁹ "Competitive bidding" was proved at the trial to have been rarely resorted to in practice by any corporate borrower,⁵⁰ although it has been imposed upon railway bonds and upon the largest public utilities by decisions of federal, and some state, regulatory commissions.⁵¹ "Competitive bidding" is nothing more nor less than compulsory public auction, the article for sale being knocked down to the highest sealed bid. It eliminates plan-competition because the borrower sets up his own proposed security. And it reduces competition exclusively to price-competition. At the trial and in his article Professor Steffen (unlike any of the other Government counsel who also conducted the trial) has

1953). A phrase that had found some currency in the industry was "the banker"—that *A* is "X's banker."

49. "[T]he evidence dealt with the heart of the case." *Steffen*, p. 189.

50. The statistical evidence, for example, showed that only 4 out of 2,183 industrial bond issues had been sold by public sealed bidding over the period of 15 years from 1935 to 1949. Of 2,945 industrial stock issues, one had been sold in that fashion.

51. Less harm can be done by stereotyping the bonds of these industries than the bonds of active industrials or shares of stock. Yet the SEC and ICC are sometimes called upon to provide would-be issuers with an exemption from the competitive bidding requirement. The system compels preoccupation with the single factor of initial price, the bids frequently differing only by 1/100th or 1/1000th of a per cent. Not unnaturally, as Judge Medina pointed out, the result has been to eliminate from management in this theoretically competitive field all except the few largest and most expert firms. See *United States v. Morgan*, 118 F. Supp. 621, 822-23 (S.D.N.Y. 1953). It is not surprising that only two investment banking firms in the United States favored the position that was taken under the academic influences prevailing on the SEC and ICC when these rules were adopted in 1941 and 1944, respectively.

been ready to jettison all of the alleged charges of restraint of competition so long as he can hold to the charge that the defendants had refrained from "price-competition." This is because he considers that any competitive effort other than bidding on price is not true competition at all, from which it follows that anyone who holds any of the cited "concepts" must be engaged in an unlawful restraint of trade.⁵²

Professor Steffen conceives that he requires only one more "charge": that the investment bankers have formed syndicates. Says he, a syndicate necessarily "stifles competition in channels of distribution."⁵³ But here he is up against the fact that if there were no syndicates, the investment banking business would not exist at all. Large corporations could then only be financed by public money, because no private person or group of persons has enough. But public money has been barred by statute from underwriting. Consequently, the underwriting of large issues, which can only be done through syndicates, must disappear. To attack the syndicate method, as Professor Steffen does, is to attack the institution of underwriting as such, and to maintain that security issues should only be sold outright to those who can afford to buy them—to depositories of public money, such as banks and insurance companies—unless a syndicate be formed for the sole purpose of bidding at a public auction in competition with depositories of public moneys.

The complaint did contain a prayer:

52. Once again Professor Steffen returns to the statement that on this issue "no conspiracy was ever charged . . ." *Steffen*, p. 188. In fact the complaint, para. 44C, alleged that the conspiracy included an agreement "to prevent, restrain, minimize, and discredit the use of competitive bidding . . ."

53. *Steffen*, p. 173. That he is attacking the syndicate method *as such* is further shown in his answer to the Judge's finding that the 1,300 syndicate agreements in evidence were infinitely varied: uniformity was not in issue, for the charge was not that the defendants "ever agreed . . . to write 'uniform' syndicate agreements." *Steffen*, p. 179. If "uniformity" was not in issue, what was in issue but the use of the syndicate agreement as such? That his attack is on the syndicate itself is further confirmed by the statement that "it is wholly immaterial that some other bank or bankers may also have had a part in developing the system." *Ibid.*

Indeed, Professor Steffen goes so far as to suggest that the 1,300 syndicate agreements offered in evidence had been written by the defendants all working together. He says of their differences: "It may, in fact, have been more effective to tailor each agreement differently, as to minor matters, to serve the alleged common purpose of eliminating price-competition." *Ibid.* This statement, at least, seems to merit the adjective which at one point he applies to Judge Medina—"intemperate." It amounts to a suggestion that for a generation the principal investment banking firms have worked in unison over their agreements in order to introduce enough variations to mislead some future antitrust prosecutor and court.

Likewise meaningless is Professor Steffen's point that in almost every syndicate operation which the court considered "from one to fifteen or more of the defendants" took part. The 1,300 agreements offered in evidence necessarily were made by syndicates in which defendants took part. Since the defendants were seventeen of the more important firms in the business it was inevitable that "one to fifteen or more" of them took part.

"2. That as to any particular security issuer each of the defendant banking firms be required to elect to function either exclusively as a financial adviser to such issuer or exclusively as a purchaser in competition with others for resale of the securities put out by such issuer . . ."

Passing the question whether the second alternative meant that the individual firm should not act in a syndicate with others, there are three fatal defects in this prayer. The first two are of a "legal" character, the third practical.

First, to divide an existing industry into two functions, and to require each firm to choose one or the other, is essentially a legislative, not a judicial task. Congress had so acted in requiring, by the Glass-Steagall Act, a division between the function of receiving deposits and the function of underwriting. The two functions of advising and merchandising (if they are two) have been combined throughout the history of the investment banking business. For a judge to order the business made over in a form considered better by him would be little short of judicial tyranny. This is not to say that he lacks constitutional authority to do it, if the defendants had been extreme in their violation of antitrust law. But it would be an extreme measure.

Second, separation of the two functions, would be an inequitable measure because it would put the defendants at an enormous disadvantage compared to their competitors—indeed, would in the author's opinion have put them out of business. If non-defendant *A* had worked for months or even years, as is frequently the case, in developing with issuer *X* the plan for *X*'s new security issue, ex-defendant *B* would not be in a position to compete on equal terms with *A* in offering a price for *X*'s security. Nor could *B* earn its way acting only as adviser, for its non-defendant competitors would have the decisive advantage of being able to make good their advice by underwriting the resultant issue.

Third, it would be impractical. As we have seen, issuers do not like the separation. The only real business is the buying and selling business, and the advisory does not exist separately but only as part of the general service to the issuer. Plan-competition is not only to give the best advice but also to give the best service over-all in creating the issue and placing it. The founders of Morgan, Stanley & Co. first considered forming an advising firm, to be called Ewing & Co., but soon concluded that it was an impractical idea which issuers would not welcome. Experience with the refusal of issuers to offer issues at so-called competitive bidding, unless ordered by a Government commission to do so, has confirmed their decision.

HISTORY OF INVESTMENT BANKING

It may be asked how the Government came to commence a case that was so utterly demolished as this one, or how the case could have lasted so long. In the author's opinion it is unfair to ascribe the former to naïveté on the part of Government counsel, although doubtless some was shown and some

persists,⁵⁴ or the latter to the extreme lengths to which the court went in the effort to find some substance in the Government's case, although the Judge is now criticized for having done so. The real reason for both, in the author's opinion, is that earlier generations of bankers did use phraseology which indicated a belief in some sort of a code or ethic not to compete,⁵⁵ and that Government counsel wholly failed to appreciate, until confronted by statistical data at the trial, that a revolution has occurred in investment banking since that time. There was extensive evidence of all the history, and great detail for the fifteen years preceding trial, 1935-1949. But three periods should suffice to illustrate the essential points: (1) the period before the legislation of 1933-1934, the Glass-Steagall Act, the Securities Act and the Securities Exchange Act; (2) the period immediately after those statutes, 1934-1937; and (3) the last period for which full statistics were available at the trial, 1947-1949.

Before 1933

The complaint reflected the traditionally critical conception of the investment banking business as it existed before 1933.⁵⁶ Undoubtedly bankers then professed not to compete⁵⁷ and, in the atmosphere of the times, what Judge Medina has called "dignity and mystery" were prime assets of private bankers. However, no reform had been recommended to Congress in respect to investment banking as such, even after the Pujo Investigation in 1913. In fact, that Committee had regarded the commercial banking aspects of

54. Professor Steffen says that "each of the defendants has long done business by getting himself named as banker . . . for one or many issuers." *Steffen*, p. 173. Surely the purpose of business is to get one's self business, and the antitrust question is not whether one gets business, but whether he gets it by entering into a conspiracy with his potential competitors.

55. That conception of banking ethics exists in England today. Paradoxically, England was held up to the court by the Government as a model. Yet in England not merely is the buying end of the business continued in the old "traditional" form, but "other people's money" is used to underwrite.

56. The attitude is evidenced by the popular book *BRANDEIS, OTHER PEOPLE'S MONEY* (1932), a summary of the disclosures of the Pujo Investigation of 1913. The complaint bears a striking resemblance to Brandeis' description, but the distinguishing feature of present-day investment banking is precisely that it is prohibited by law from using "other people's money."

57. To anyone, however, who has read of the way in which J. P. Morgan & Co. took James J. Hill's railroad business away from Kuhn, Loeb, see *ADLER, JACOB H. SCHIFF—HIS LIFE AND LETTERS*, 83-92 (1929), and took the American Telephone & Telegraph Company business away from Speyer and Lee Higginson, see Gov't Exhibits 821-34, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953); Transcript of Record, pp. 12263-80, *United States v. Morgan*, *supra*, the theory that bankers did not compete, even before World War I, raises a smile of skepticism. The stipulated evidence of pre-1933 issues, showed constant competitive shifting of business from one banker or group of bankers to another. See Pre-Securities Act Issuer Summary Sheets, Transcript of Record *United States v. Morgan*, *supra*.

its investigation as more important.⁵⁸ Neither the Wilson administration nor the Republican administrations that followed it seemed to consider investment banking in need of legislative reform. Nor did anyone conceive that the sale of securities was open to federal regulation under the commerce clause.

Distribution by the normal syndicate in the 1920's differed little from that of pre-World War I. On a large issue there were often several successive syndicates. The first syndicate, the "Purchase Group" would sell to a "Banking Group," which in turn would sell to an "Underwriting Group," and that in turn to a "Selling Group." Each "group" or "syndicate" normally imposed a joint and several obligation on all the members.⁵⁹

Effect of the Legislation of 1933-1934

The disastrous fall in values brought their house down on the bankers' heads, and out of the successive congressional investigations which featured the years 1931-1934 there emerged three principal statutes: the Glass-Steagall Act,⁶⁰ separating the function of receiving and employing deposits of public money from the "investment banking" function; the Securities Act,⁶¹ primarily regulating the original issue of securities; and the subsequent, interlocking Securities Exchange Act,⁶² primarily regulating the stock exchanges and securities already issued.

In a real sense, investment banking has since that day been controlled by legislation, particularly as to form and methods of syndication and distribution. The Acts of 1933 and 1934 so greatly increased the banker's liability that they could no longer underwrite each other by assuming joint and several liability for the whole issue. The syndicates came to impose only several liability for the amount of each firm's commitment. And the number of syndicates were reduced normally to two, one to underwrite and one to sell. Furthermore, by removing the major supply of capital, public deposits, from availability for underwriting, on the ground that underwriting was too risky for public money to be used in it, the Glass-Steagall Act reduced the capital of the largest underwriting firms from the \$100,000,000 which had been in the hands of such firms as J. P. Morgan & Co., National City, and Chase Securities Co. in the 1920's to a few million dollars.

What seems to have been overlooked, however, was that underwriting remained just as risky for those who engaged their own capital in it. The result was paradoxical. On the eve of a great expansion of the nation's

58. Indeed, the investigation resulted in the adoption of the Federal Reserve System.

59. A large number of syndicate agreements from 1908 on were introduced into evidence. Transcript of Record, p. 13,620, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953). The history of syndicate agreements in this country runs back at least to the period of the Civil War. *Id.* at 13,613.

60. 48 STAT. 162 (1933), 12 U.S.C. cc. 2, 3, 6 (1952).

61. 48 STAT. 74 (1933), 15 U.S.C. § 77a (1952).

62. 48 STAT. 895 (1934), 15 U.S.C. § 78a (1952).

economy with its need for ever greater long-term financing, the funds available for underwriting were enormously reduced. Business was confined to private firms, where men put up their own capital or raised it from friends, and to small corporations where a limited number of shareholders were prepared expressly to invest in the speculative investment banking business.⁶³ Each defendant firm had its own peculiar make-up, and each was dissimilar from the others.⁶⁴

The new era of financing began with the passage of the Securities Exchange Act of 1934. A golden harvest was anticipated by the firms left in the industry, as a result of the elimination of their competitor, the great commercial bank. Accordingly, their efforts were principally directed toward re-establishing old contacts. This was particularly true of the firms whose members included the former officers of the banks or bank affiliates which had been operative in the 1920's, and which therefore claimed to be successors.⁶⁵

Many of the new firms during the 1934-1937 period took on overly-large commitments for their small capital and were over-extended at the time of the sudden sharp recession in the summer of 1937. As a result, the capital of some of the firms became frozen, and the capital of substantially all was impaired. A period of travail and readjustment occurred after 1937. It eventuated in a radical reduction in the size of the commitment by each firm in a syndicate, thereby increasing the number of firms in each syndicate, and had an incidentally devastating effect on "historical position." There were lean years after 1937, intensified by the war, but even more by the dominating influence of other legislation dating from the depression period. The successive Income Tax Acts, commencing with 1932, substituted life insurance companies for the individual investor as the prime source of long-term investment capital.

It was unfortunate that the TNEC investigation⁶⁶ came just after this period, for the examination of a group of the more conservative of the in-

63. Of the defendant firms, ten were partnerships and seven corporations; but of the latter only one or two had a fairly wide public holding of shares.

64. See *United States v. Morgan*, 118 F. Supp. 621, 655-80 (S.D.N.Y. 1953).

65. Outstanding were: Harriman, Ripley & Co., then known as Brown Bros. Harriman & Co., in which leading former officers of National City Company had joined with former partners of Brown Bros. and of W. A. Harriman & Co.; Blyth & Co., which had been joined by Mr. Charles Mitchell, formerly the head of the National City Company; E. B. Smith & Co., formerly a small firm but which had been joined by a number of former officers of Guaranty Company; and First Boston Corporation, which had been joined by a number of former partners and officers of Harris Forbes & Co. and of Chase Securities Corporation.

66. Professor Steffen expresses satisfaction with the conduct of the TNEC inquiry because "witnesses were treated courteously" and "were permitted to answer questions fully and in their own way," with counsel "present" although not permitted to take part. *Steffen*, p. 169-70. These would appear to be the minimum requirements in a free country but they, of course, provide no guaranty of truth comparable to a trial where both sides are heard equally. The present writer is concerned at Professor Steffen's apparent

vestment bankers undoubtedly provided Government attorneys ten years later with the background of their thinking—a background that proved to be misleading in the light of the revolutionary changes which were then just beginning to be felt in the industry, but which found no place in the TNEC inquiry.⁶⁷

1947-1949

This third period, 1947-1949, was the one with which the court was, of course, to be primarily concerned in determining whether there should be a decree against the defendants in a case the trial of which began in November 1950 and terminated in May 1953. An equity decree looks to the cure of existing abuses, and evidence as to the past is useful only as it casts light on the present and future. Yet, strangely enough, the bulk of the exhibits upon which the Government particularly relied came from the period of 1934-1937. What the Government apparently did not realize until it was disclosed by the stipulated statistical evidence was that, whatever may have been its competitive condition in the period 1934-1937, the business was revolutionized thereafter.

The decisive feature of this second revolution was that it was a revolution in the standards of competition. Investment bankers no longer competed primarily against each other, but now had to compete against the great aggregations of capital, such as the insurance companies, which were free from the securities legislation because they could buy issues outright without underwriting. This forced investment bankers into a struggle for survival, in which they could only operate on a slender margin of profit because they had always to compete with people who were immune from the expenses of registration.

At the distributing end it has become customary to have only one syndicate of underwriters. Today, with profit margins ever narrowing, the second, or selling, syndicate is rarely formed. But the underwriting syndicate remains, as an essential element of the system under which firms with small capital can band together to compete with large aggregations of capital. An even more profound change was felt at the buying end of the business, however.

The Government's case dealt almost exclusively with the classic form of financing through investment bankers—known as the "negotiated underwritten" form, the negotiation, of course, being between the issuer and the one or more investment bankers who, together with the issuer, work out the varied details of the issue and then agree with the issuer on a price. This method

assumption that the recent investigations cited in *Steffen*, p. 170 n.7, have established what he calls "post-1952 standards." Does he mean that witnesses are no longer to be treated courteously or to answer questions fully?

67. The TNEC did not of course have access to such evidence; yet the TNEC made no recommendation against the investment bankers, and as Judge Medina pointed out, no TNEC monograph was written in regard to the investment banking evidence. *United States v. Morgan*, 118 F. Supp. 621, 733 (S.D.N.Y. 1953).

of negotiation accounted in the 1935-1937 period for over eighty per cent of the dollar volume of bond financing and in 1947-1949 for less than twenty per cent.⁶⁸ Since Government counsel normally spoke as if this were almost the only form of financing, and persistently offered documentary evidence dating from 1935 and 1936, the court, not unnaturally, became progressively disillusioned. It became increasingly apparent that Government counsel were living in the past and that the past had little connection with the present.

Again, dollar volume of private placements, requiring no underwriting and consequently no registration under the Securities Act, increased nearly eight times from 1935-1937 to 1947-1949—from \$958 million to \$7,613 million. And public sealed bidding, so-called "competitive bidding," almost all of which was pursuant to federal or state order for railroad bonds and public utilities, further narrowed the "negotiated underwritten" business by increasing from \$143 million in 1935-1937 to \$5,434 million in 1947-1949. Primary importance was attached by the Government to railroad issues. Yet, there was not a single negotiated underwritten railroad issue in any one of the years 1947-1949, and only four such between 1942 and 1949.⁶⁹ In industrial bond financing the emergence of the insurance company resulted in a dollar volume of private placements in 1947-1949 six times that of negotiated underwritings. In 1935-1937 negotiated underwritings had been four times the amount of private placements. The shift was, therefore, in the proportion of twenty-four to one. These and innumerable other figures attested to the revolution in financing.

But the investment bankers did not go out of business. They developed new activities in order to survive. They made themselves useful to issuers and insurance companies in working out the terms of private placements so that by 1947-1949 approximately one-half of all private placements called for the help of investment bankers in a purely agency or service capacity, for a fee. They continued, of course, to handle "negotiated underwritten" financing, and to compete with one another for the privilege of doing so; but they were always compelled also to compete with the now dominant non-underwritten private placement.

As a class the bankers were particularly ingenious in the development of forms of financing by stock issues. Equity financing has always been considered on the whole more healthy than debt financing. Making this field particularly their own, investment bankers handled in 1947-1949 a total of 357 stock issues, so that eighty per cent of all negotiated underwritten issues were issues of stock. This suggests the basic contribution of the investment banker to modern financing: dealing closely with the corporation with respect

68. The relevant statistical data was all in the stipulated Issue Registers, Transcript of Record, *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953), from which tables and charts were prepared by both sides.

69. Yet the only two concrete events mentioned by Professor Steffen involved railroad issues. *Steffen*, p. 189.

to shares of its own ownership and providing service in setting up and placing these shares. From the much larger field of bond debt financing the old underwritten negotiated method has been largely crowded out—in the rail and public utility fields largely by Government-imposed public sealed bidding, and in all fields by the ease with which the great aggregations of capital, such as insurance companies, can buy the entire issue with immunity from Securities Act registration.

Against such facts, ignored in Professor Steffen's article, the Government's case, with its persistent reminiscence of the history of railroad bond financings of twenty to fifty years before, and its stale air of old Pujo, Pecora, and TNEC controversies and slogans, simply evaporated.⁷⁰

70. It is not right to close this reply without a word of protest to the language that Professor Steffen has permitted himself in attacking a court, for having decided against his side of a case, and the Department of Justice, for rejecting his recommendation for appeal. If Judge Medina did err, at least the errors were not "gross" or "flagrant" or "funny," *Steffen*, pp. 187, 193; nor did he "openly flout" the decided cases, *Steffen*, p. 194. Of Judge Barnes he says that he was, for reasons that "would seem to be faintly tinged with politics," *Steffen*, p. 170 n.12, conniving at violation of law, for the decision not to appeal had "no rational basis," *Steffen*, p. 194, and Judge Barnes "must have understood that, as a precedent, the case would greatly encourage the defendant bankers in their noncompetitive ways of doing business." *Steffen*, p. 193.