



From the Secretary of State

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Dear Martin

RESTRICTIVE TRADE PRACTICES ACT: STOCK EXCHANGE

My Secretary of State has seen your letter of 31st May. He is content for officials to discuss the options as the Chancellor suggests.

I am taking this opportunity to circulate the note inadvertently omitted from my Secretary of State's letter. Copies go to Tim Lankester (No 10), Andrew Duguid (Department of Industry), John Beverly (Bank), and Martin Vile (Cabinet Office).

Yours sincerely
John Symes

J M D Symes
Private Secretary

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CONFIDENTIAL

STOCK EXCHANGE: REQUEST FOR EXEMPTION FROM THE RESTRICTIVE
TRADE PRACTICES LEGISLATION

INTRODUCTION

The Stock Exchange applied to the last Government for exemption from the scope of the restrictive trade practices legislation, but were refused. The Director General of Fair Trading subsequently referred the Stock Exchange agreement to the Restrictive Practices Court on 9 February 1979 - and from that point has been in litigation with the Stock Exchange. The Stock Exchange has now applied again by means of Mr Goodison's letter of 8 May to be exempted and has asked to be able to put the Stock Exchange's case to Ministers in discussion and to discuss what alternative study would satisfy the Government.

BACKGROUND

2 The Restrictive Trade Practices (Services) Order 1976 brought within the scope of the legislation all commercial services except those already exempted in the Fair Trading Act 1973 and those which were already effectively controlled by Government or about which problems of jurisdiction arose.

3 When the scope of the Order was being discussed, the Stock Exchange and the Department of Trade argued for the exclusion of the Stock Exchange on the grounds that it was covered by the review then being carried out by the Department of Trade of supervision of the securities market, which might result in a measure of Government control. The Stock Exchange, however, did not press its case at that stage and Departments agreed not to exclude it because:



(a) it was not already subject to Government control, nor did it raise problems of jurisdiction;

(b) some of its practices were not different in kind to those practised by other bodies, such as the Clearing Banks, which had been accepted as registrable; and

(c) the proceedings in the Restrictive Practices Court would not duplicate the Department of Trade's review. If that review resulted in statutory backing for particular restrictions, these would automatically be exempted from the restrictive practices legislation.

In the event the Department of Trade's review did not result in new statutory controls.

REFERENCE PROCEDURE

4 The DGFT has a statutory duty to refer the whole agreement to the Court and to put before the Court all the material considerations he thinks are necessary for it to reach its decision. He has told the Stock Exchange which restrictions must be either abandoned or defended before the Court. The task of the Stock Exchange will be to convince the Court that these restrictions meet certain public interest tests. The particular restrictions identified are:

(a) brokers are not allowed to provide broking services except in accordance with specified minimum rates of commission;



(b) jobbers may not act as brokers; and

(c) brokers are not allowed to carry out deals with non-members or, directly, with other brokers - they must put all their deals through jobbers in the central market.

The so-called single capacity system, which prevents jobbers acting as brokers or brokers as jobbers, is thus brought into question.

THE REQUEST FOR EXEMPTION

5 The Stock Exchange's current request for exemption rests primarily on the grounds that:

(a) the Restrictive Practices Court is not an appropriate forum for examining the Stock Exchange's workings because it is not able to take a wide enough view of the benefits to the public that arise indirectly through its contribution to the efficient working of the economy;

(b) because the Restrictive Practices Court merely judges whether or not particular restrictions are against the public interest (and does not recommend alternatives) there could be an awkward delay should it strike down any part of the Stock Exchange agreement, before new rules were drawn up. The new rules may also be caught by the legislation. As a result, instability would be introduced to the financial market and there would be unforeseen consequences for the economy.



6 The first argument is therefore concerned with the definition of the public interest in the Act, and in particular whether the criterion in s.19(1)(b), which refers to benefits 'to the public as users of any services', would preclude the Court from considering wider indirect benefits to the public from having an effective and well regulated market. The Government themselves have an interest in such wider benefits being taken into account, if the Court is satisfied that the satisfactory running of the market does in fact depend on the restrictions being considered. In particular:

- (i) the Treasury attach great importance to having an active secondary market to enable the Government to fund its borrowing requirement and to implement its monetary policy;
- (ii) the Department of Industry similarly attach importance to an active secondary market in enabling companies to raise new capital on the primary market;
- (iii) Companies Division is responsible for the proper regulation of the securities market, and relies on a combination of statutory and self-regulatory control in which the authority of the Stock Exchange over its members, its rules and its disciplinary powers play an important part.

There could clearly be damaging consequences for these policies if the Court decided that the wording of the Act debarred it from taking account of the wider benefits of this kind and then struck down the restrictions, and if it turned out, as the Stock Exchange contends, that the continuance of at least some of these restrictions was



necessary to the continuance of the wider benefits.

7 OFT have sought the views of their Counsel as to whether the Court would be able to interpret the public interest widely. He advised in consultation, on the papers before him, that a strict interpretation of s.19 must rule out some issues although others - notably the benefits of a regulated market and the assurance of a fair price to buyers and sellers of securities - would probably be covered. However, without considerable study of economic and legal factors he could not predict what attitude the Court would take after it had seen the pleadings and had heard economic evidence. OFT's view is that the Stock Exchange could prepare its pleadings as widely as it thinks necessary and could bring them before the Court.

8 At the time of the last application it was suggested to representatives of the Stock Exchange that they could take advantage of the possibility of seeking a ruling from the Court at an early stage in the proceedings. However, Stock Exchange's Leading Counsel took the view that it would not be in his client's interest to seek such a ruling before the main hearing. Since the Director General cannot himself seek a preliminary ruling on this without the co-operation of the Stock Exchange they have effectively foreclosed this route, and the Court will be able to consider the matter only at the stage of the main hearing.

9 The Stock Exchange's second argument is that the Court has no discretion to consider or recommend alternatives to the present restrictions, and that the abrupt striking down of the restrictions,



which they say are fundamental to the operation of the market, would cause a damaging period of uncertainty. The first part of this is true, and was recognised in 1976: it is not therefore a new factor. OFT question whether the ending of restrictions - which represent collective agreement to work in a certain way - would have an immediate effect. Established practices which such agreement underlines would be likely to continue for some time. It was the experience after Court rulings in good cases that changes came slowly. In any case the consequences of striking down particular restrictions would be a legitimate consideration to put before the Court, and the Court could be expected to take them into account in reaching its decision. If the Court was nevertheless minded to rule that any of the restrictions were contrary to the public interest, there would still be possibilities of gaining time in which to consider acceptable alternatives. The Court could be expected in that event to view sympathetically any reasonable proposal for avoiding undue disruption as a result of their ruling and the Director General would be prepared to agree to the delaying of the formal court ruling or of the making of orders restraining the parties from giving effect to the restrictions struck down by it or any other reasonable steps for this purpose. It would be open to the Stock Exchange to appeal to the Court of Appeal against the judgement of the Restrictive Practices Court on grounds of law. In that case it could apply for a stay of execution or of proceedings pending the hearing of the appeal, and the Court of Appeal could be expected to direct accordingly. There is therefore likely to be flexibility even at the point of decision as well as plenty of opportunity to consider alternatives if necessary during the long period before the hearing (late 1980 or more probably 1981). Variations can be made to the rules throughout this period and



OFT would be willing to discuss them without prejudice. There is no legal bar to such discussions.

CASE FOR EXEMPTION

10 The Stock Exchange is concerned about the trouble and expense to which it would be put during protracted Court proceedings (possibly extending into 1982), and that the uncertainty which would be engendered meanwhile might inhibit useful reforms which might otherwise take place. In the view of officials, the case for exemption turns largely on the situation which would arise if, at a late stage in the proceedings, the Court ruled that it could not take account of the wider arguments of concern to the Government in considering the public interest. A number of Government Departments are particularly concerned that such wider benefits should be taken into account. The Treasury (with its interest in funding the Government's borrowing requirement) and Department of Industry (with its interest in companies' ability to raise capital) attach great importance to having an active secondary market; and with its responsibility for the regulation of the securities market, the Department of Trade, recognises that The Stock Exchange's rules and disciplinary powers play a major role in the system of control. The risk that the Court would not be able to take these considerations into account is unquantifiable; if it becomes apparent in the course of the hearing that it could not do so, it would be awkward to withdraw a case which appeared to be going unfavourably to The Stock Exchange; and it would then be difficult to subject The Stock Exchange, after all the trouble and expense of the abortive hearing, to a second form of enquiry.



11 The Restrictive Practices Court, when it rules against a particular restriction, is not in a position to give advice on an acceptable alternative. Although it would be possible (perhaps with the aid of new legislation following the review of Competition policy) to delay the striking down of any restriction until alternative arrangements can be brought into force, there is a possibility that during the transitional period the market might be partially unregulated, a prospect ^{about} which the Department as supervisory authority would be very concerned.

12 Ministers may also consider that there could be some political embarrassment if proceedings are allowed to take their course. It would be open to the Stock Exchange, in arguing before the Court that its restrictions were necessary in the wider public interest, to call as witnesses officials of the Treasury, the Department of Trade, the Bank of England or the Government Broker. Although these officials would be appearing merely as expert witnesses, they might be misrepresented as taking the side of the Stock Exchange. This problem might, however, be avoided if the OFT were to call the official witnesses.

CASE AGAINST EXEMPTION

13 The main grounds for reluctance to grant exemption are that:

- (a) amendment to the Services Order would require an Affirmative Resolution in both Houses and there could be political embarrassment for the Government (which could be accused either of abandoning the policy enshrined in the Fair Trading Act 1973



or of being selective in the support for stronger competition powers generally).

(b) the Stock Exchange's arguments do not show that there has been a change in circumstances since the Order itself was considered in 1975; nor do they establish convincingly that proceedings before the Court are inappropriate, even if they are not ideal;

(c) that no adequate argument has been put forward that, contrary to OFT's view, all the wider benefits the Stock Exchange want to plead are dependent on the continuance of the restrictions on the level of commissions and against dual capacity;

(d) although the Stock Exchange is unique in some respects (jobbing falls outside the scope of the legislation) it could be difficult to draw a line between the Stock Exchange and other bodies which would be eager to seek similar exemption from the Order, with the result that the current application of the legislation to services would be seriously undermined;

(e) exemption at this stage might be seen as interfering with judicial proceedings already before the Court;

(f) there are difficulties over alternative forms of enquiry.

ALTERNATIVE ENQUIRY

14. We understand that the Stock Exchange accept that if they are exempted from the Restrictive Practices Court it could only be on condition that they went through an equally searching investigation in some more appropriate forum.



15. The nature of such an investigation would require some thought
- (a) the obvious alternative to the Restrictive Practices Court would be an enquiry by the Monopolies and Mergers Commission, and this would fit well with the Government's intention to develop the Commission as the mainstay of its prices and competition policy. There may, however, be technical legal problems about making a formal legal reference to the Monopolies Commission under statutory powers;
 - (b) the Monopolies and Mergers Commission and their staff might perhaps be asked to carry out the enquiry, although not under statutory powers. There are no precedents for using the Commission in this way;
 - (c) a departmental enquiry could be held by officials of this Department (possibly with others). This would be difficult for the Department to undertake and even if the report was published it would risk being regarded as a whitewash job in comparison with a strong objective external enquiry;
 - (d) an ad hoc body could be set up - a Committee or possibly a Royal Commission. However this might look odd, given that two bodies are already operative in the same field, (the Monopolies Commission and Sir Harold Wilson's Committee on the Functioning of the Financial Institutions);



(e) Sir Harold Wilson's CFFI could be asked to consider the Stock Exchange restrictions and deal with them in its report. The Committee is expected to report by the end of the year. Its terms of reference are broad, and it is already interesting itself in the organisation and regulation of the institutions. Sir Harold Wilson's recent letter to the Secretary of State is somewhat ambiguous but implies that he might not be averse to an invitation to deal with the issues otherwise before the Court.

16. An advantage of any of these courses is that it would be possible to frame the terms of reference to put beyond doubt that the enquiry was to look at the Stock Exchange restrictions in the broad, taking account of the wider public interest as well as the effect of the restrictions on competition. However, there are two limitations to most of the alternatives, one more serious than the other. One is that an ad hoc Committee would have no powers to call for witnesses or papers. This should not be a problem: if the Stock Exchange want an alternative enquiry, they should be prepared to undertake to co-operate fully with it. A more serious weakness is that the Government would have no power to enforce any recommendations. Unless the Stock Exchange adopted them voluntarily, legislation would be required.

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