presidential documents

Title 3—The President

EXECUTIVE ORDER 11838

Amending Executive Order No. 11491, as amended by Executive Orders 11616 and 11636, relating to Labor-Management Relations in the Federal Service

Correction

In FR Doc. 75–3781 appearing in the issue of Friday, February 7, 1975, on page 5743, the following corrections should be made to text on page 5746:

1. The word "decision" in the second line of paragraph (d) should be changed to read "procedure".

2. Paragraph 16 should be changed to read as follows:

"16. Section 21(b) is revoked."

rules and regulations

This section of the FEDERAL REGISTER contains regulatory documents having general applicability and legal effect most of which are keyed to and codified in the Code of Federal Regulations, which is published under 50 titles pursuant to 44 U.S.C. 1510.

The Code of Federal Regulations is sold by the Superintendent of Documents. Prices of new books are listed in the first FEDERAL REGISTER issue of each month.

Title 16—Commercial Practices

CHAPTER I—FEDERAL TRADE COMMISSION

[Docket C-2574]

PART 13—PROHIBITED TRADE PRACTICES, AND AFFIRMATIVE CORRECTIVE ACTIONS

Sharp Electronics Corp.

Subpart—Combining or cons‹iring: § 13.388 *To control allocations and solicitation of customers;* § 13.450 *To limit distribution or dealing to regular, established or acceptable channels or classes.* Subpart—Cutting off access to customers or market: § 13.560 *Interfering with distributive outlets.*

(Sec. 6, 38 Stat. 721; 15 U.S.C. 46. Interprets or applies sec. 5, 38 Stat. 719, as amended; 15 U.S.C. 45) [Cease and desist order, Sharp Electronics Corporation, Paramus, N.J., Docket C-2574, Oct. 9, 1974]

In the Matter of Sharp Electronics Corporation, a Corporation

Consent order requiring a Paramus, N.J., distributor of consumer and business electronic products, among other things to cease imposing territorial, customer and other anticompetitive restrictions on its dealers.

The order to cease and desist, including further order requiring report of compliance therewith, is as follows: [1]

It is ordered, That respondent Sharp Electronics Corporation, and its officers, agents, representatives, employees, successors and assigns, directly or through any corporate or other device, in connection with the advertising, merchandising, offering for sale and sale or distribution of electronic calculators, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from directly or indirectly:

1. Imposing or attempting to impose any limitations or restrictions respecting the territories in which electronic calculators may be sold by its dealers.

2. Attempting to enter into, entering into, continuing, maintaining, or enforcing and contract, combination, understanding or agreement to limit, allocate, or restrict the territory in which electronic calculators may be sold by its dealers.

3. Imposing or attempting to impose any limitations or restrictions respecting any contract, combination, understanding or agreement to limit, allocate or restrict the person or class of persons to whom electronic calculators may be sold by its dealers.

4. Attempting to enter into, entering into, continuing, maintaining, or enforcing any contract, combination, understanding or agreement to limit, allocate or restrict the person or class of persons to whom electronic calculators may be sold by its dealers.

5. Requiring or attempting to require for a period of five years from the date of this Order that its dealers without option, enter into any contract, combination, understanding or agreement establishing for the period of time during the warranty a mandatory fixed schedule for the division of any profit earned in the sale of an electronic calculator between the selling dealer and a dealer in whose territory the calculator is to be used and serviced.

6. Requiring or attempting to require for years subsequent to the period of five years from the date of this Order that its dealers without option, enter into any contract, combination, understanding or agreement where such mandatory fixed schedule has the effect of limiting, allocating or restricting the territory in which electronic calculators may be sold by its dealers.

Provided, That nothing in this Order shall prohibit respondent from:

(a) Engaging in any activity specifically rendered lawful by subsequent legislation enacted by the Congress of the United States or any rules or regulations promulgated pursuant to such legislation.

(b) Designating geographical areas within which a dealer may agree to devote his best efforts to the sale of electronic calculators (hereinafter "area of primary responsibility") as a condition of becoming a dealer or maintaining a dealership, provided that such dealers are told that said area is not exclusive and does not place a territorial restriction upon the sale of such equipment.

(c) Requiring or attempting to require as a condition of maintaining a dealership any dealer to undertake or cause others to undertake obligations of installation and warranty in connection with the use of any electronic calculators sold, leased or rented by such dealer or for which a dealer has accepted compensation for installation or warranty.

(d) Making available a program for use at the option of a dealer which provides, or contains provisions which provide, in all instances in which the selling dealer chooses not to undertake the obligations of installation or warranty, for a stated fixed schedule for the division of any profit between the selling dealer and a dealer in whose territory the calculator is to be used and serviced.

(e) Requiring, as a condition of maintaining a dealership, compliance with any program described in paragraph (d) voluntarily accepted by such dealer.

II

It is further ordered, That respondent shall within sixty (60) days after service upon it of this Order serve upon all of its franchised dealers a copy of this Order along with a copy of the attached letter (Attachment A) on respondent's official company stationery and signed by the president of respondent.

It is further ordered, That respondent shall forthwith distribute a copy of this Order to each of its subsidiaries and operating divisions.

IV

It is further ordered, That respondent notify the Federal Trade Commission at least thirty (30) days prior to any proposed change in the corporate respondent such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of this Order.

It is further ordered, That respondent shall within sixty (60) days after service upon it of this Order, file with the Commission a report in writing setting forth in detail the manner and form in which it has complied with this Order.

Decision and order issued by the Commission Oct. 9, 1974.

CHARLES A. TOBIN,
Secretary.

ATTACHMENT A

(Official Sharp Stationery)

(Date)

Dear: The Federal Trade Commission has entered into a Consent Order with Sharp Electronics Corporation which, among other things, prohibits Sharp Electronics Corporation from imposing or attempting to impose any limitations or restrictions respecting the territories in which, or class of persons to whom dealers may sell electronic calculators. Dealers are permitted to sell outside the confines of their assigned territories and to sell to any person or class of persons to whom they wish.

The Order prohibits as well, for a period of five years, any mandatory fixed schedule for the division of profit in the sale of electronic calculators between the selling dealer and the dealer in whose territory the calculator is to be used and serviced. For the period of time beyond five years, the Order prohibits mandatory fixed schedules with the effect of limiting, allocating or restricting the territory

[1] Copies of the complaint and decision and order filed with the original document.

in which electronic calculators may be sold by its dealers.

A copy of the Order is attached for your information.

Very truly yours,

President,
Sharp Electronics Corporation.

[FR Doc.75-4544 Filed 2-19-75;8:45 am]

Title 17—Commodity and Securities Exchanges

CHAPTER II—SECURITIES AND EXCHANGE COMMISSION

[Release 34-11203]

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

Fixing of Rates of Commission

The Securities and Exchange Commission, acting pursuant to the authority vested in it by the Securities Exchange Act of 1934,[1] and particularly sections 2, 6, 10, 11, 19 and 23 thereof,[2] has adopted Rule 19b-3. The rule will be effective as to the rates charged by members of national securities exchanges (exchanges) on transactions for persons other than members or associated members (public rates), and for clearance charges,[3] on May 1, 1975, the date originally proposed. As to floor brokerage rates, that is, rates charged to members or associated members except for clearance, the effective date will be May 1, 1976. The rule has otherwise been adopted substantially in the form proposed.[4] The Commission has determined not to adopt proposed Rule 10b-22.

The Commission's determination to defer the effective date of the rule as to floor brokerage rates is based essentially on the following considerations. In the first place, the Commission recognizes that the transition to competitive public rates will create problems of adjustment and accommodation for the exchanges and a deferral of the change as to floor brokerage rates may facilitate the ability of the exchanges to accomplish a smooth transition to the new environment. In addition, it appears that many exchange members did not fully appreciate until September 1974, following intra-member rate hearings, that the Commission's policy conclusions with respect to fixed commissions, which were announced on September 11, 1973, were applicable to floor brokerage rates and that, consequently, such members may not have had the benefit of the advance notice and time for planning with respect to floor brokerage rates which the September 11th notice was intended to provide. Finally, floor brokerage rates have considerably less impact on public investors than do public rates.[5]

The Commission's decision not to adopt Rule 10b-22 is based, in part, upon a consensus which developed at the 19b-3 Hearings.[6]

Rule 19b-3 essentially prohibits any exchange from adopting or retaining any rule that requires, or from otherwise requiring, its members to charge fixed rates of commission for transactions executed on or by the use of the facilities of such exchange after the applicable effective dates. Rule 19b-3 further requires each exchange after the applicable effective dates to provide in its rules that nothing therein shall be construed to require or authorize members to agree or arrange for the charging of fixed rates of commission. The rule would also relieve exchange members and their associated persons of any obligation to comply with rules prohibited by its basic provision, regardless of whether or not the exchange has amended such rules, and such rules could no longer be relied upon. This latter provision, among other things, provides for the contingency that some exchange may not have completed the necessary process of rule amendment by the applicable effective dates of the rule.

Rule 19b-3 is intended to reach all rules governing the fixing of rates of commission on exchange transactions. Thus, for example, in the case of the New York Stock Exchange (NYSE), the provisions of Article XV of the NYSE Constitution relating to floor brokerage could be retained after May 1, 1975; but such provisions may not be retained after May 1, 1976. In addition, other rules, such as NYSE Rules 391, 392, and 393, would have to be amended by exchanges to eliminate provisions intended to preserve the fixed commission rate structure in connection with distributions outside the normal pattern of exchange transactions. It should be noted that Rule 19b-3 covers any "rule of the exchange," which is defined as any provisions of the constitution, articles of incorporation, bylaws, or rules or instruments corresponding thereto, whatever the name, of the exchanges.

INTRODUCTION

In view of the importance of the issue of commission rates dealt with by the rule and the extensive consideration given to the subject over the past twelve years, not only by the Commission but by Congressional Committees, the Department of Justice, the Treasury Department, exchanges, various firms and organizations in the securities industry, investors and many independent economists, jurists and other scholars, the Commission believes it is appropriate to set forth the reasons for the rule and the relevant considerations in somewhat greater detail than is its usual practice in connection with the adoption of rules or than appears to be required by the Administrative Procedure Act.[7] At the same time, the voluminous materials on this subject which have been developed and considered since 1963 and the numerous questions with respect thereto which have received the Commission's attention make it impossible, if we are to keep this release within any reasonable compass, to do more than highlight those aspects of the matter which the Commission finds particularly significant. It is therefore impractical to undertake a detailed analysis of the large body of underlying facts which entered into the Commission's determination to adopt the rule.[8]

More particularly, although the Securities Industry Association raised a question at the 19b-3 Hearings with respect to the legal authority of the Commission to adopt any rule precluding the exchanges from having rules fixing rates of commission, and similar questions have been raised by others in the past, the Commission does not regard it as appropriate to set forth in this release the legal arguments in support of its authority to adopt the rule. In view of the broad regulatory and rulemaking authority over the securities markets and the securities exchanges, including the specific subject of commission rates, granted to the Commission by the Act, the Commission, after careful consideration of the legal issues, is satisfied that it has authority to adopt Rule 19b-3, if it makes, as it has done, the basic findings called for by the Act.

The Act was passed against the background of the stock market crash of 1929 and in the light of the extensive study and investigation by the Senate Committee on Banking and Commerce entitled "Stock Market Practices." It was consequently a basic, if not the basic,

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[1] 15 U.S.C. 78a et seq. (hereinafter cited as the Act).

[2] 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w.

[3] In its statement of May 29, 1974, at the Intra-Member Rate Hearings, the New York Stock Exchange concluded that fixed rates for clearance could be determined on a competitive basis at the same time as public rates were so determined. Statement of James J. Needham, In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4-171 (1974), Transcript at 4-5.

[4] Securities Exchange Act Release No. 11073 (Oct. 24, 1974), 39 FR 38396 (Oct. 31, 1974).

[5] Nothing in Rule 19b-3, however, requires exchanges to wait until May 1, 1976, to eliminate fixed floor brokerage rates, or for that matter, to wait until May 1, 1975, to eliminate fixed public rates.

[6] In the Matter of Proposal to Adopt Rules 19b-3 and 10b-22 Concerning the Fixing of Commission Rates by National Securities Exchanges, Securities and Exchange Commission File No. 4-176 (1974).

[7] Section 4(c) of the Administrative Procedure Act (5 U.S.C. 553(c)) provides that rules which are adopted shall incorporate "a concise general statement of their basis and purpose." It is our practice to include such a statement in the release announcing the adoption of a rule. This provision may be contrasted with Section 8(c) of that Act (5 U.S.C. 557(c)), which requires, in the case of adjudication, that the decision include a statement of "findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record."

[8] Securities Exchange Act Release No. 11073 of October 24, 1974, in which the Commission released the proposed rule for public comment, contained a list of some of the more important source materials relating to this subject, which mere list covered two and one-half printed pages. Reference thereto is hereby made.

purpose of this legislation to provide for regulation of the stock market and of transactions and practices relating thereto. It was intended that this regulation be comprehensive and complete. Indeed, the Congress so stated in the preamble of the Act which stated that it is "necessary to provide for regulation and control * * * and to impose requirements necessary to make such regulation and control reasonably complete and effective." This objective was approached in a variety of ways. The Commission was established to administer the Act; and exchanges are required to register with the Commission, are charged with the duty of self-regulation of their members and may become registered only if the Commission concludes, among other things, "that the rules of the exchange are just and adequate to insure fair dealing and to protect investors." In addition to statutory provisions regulating various trading practices and activities of members, section 19(b) of the Act supplements the initial authority of the Commission over exchange rules by authorizing it to alter or supplement the rules of an exchange with respect to various significant matters, including "the fixing of reasonable rates of commission, interest, listing and other charges." The standard for such action is that such alterations be "necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange." As the House Committee put it, this authority was intended to permit the Commission to effect changes in exchange rules "in any important matter * * * appropriate for the protection of investors or appropriate to insure fair dealing."[9]

In view of the complexity of the subject and of changing conditions, great reliance was placed upon broad rulemaking power so as to enable the Commission to respond flexibly to changing regulatory needs. In light of these considerations, the Commission believes that the express authority granted to it over the subject of commission which, as the Special Study[10] said, are "the lifeblood of the brokerage business today even as in 1792,"[11] encompasses the authority to accomplish necessary changes in those rules.

An extensive discussion of the history and interpretation of the Commission's rulemaking authority under the Act is found in Securities Exchange Act Release No. 9950 (Jan. 16, 1973), 38 FR 3902 (Feb. 8, 1973), to which reference is hereby made.

The remainder of this release consists of the following sections:

1. Summary of the evolution of exchange commission rates and of the Commission's consideration of them.
2. Reasons for the rule.
3. Comments on the rule.
4. Conclusion.
5. Text of the rule.

1. *Summary of the evolution of exchange commission rates and of the Commission's consideration of them.* The practice of fixing commission rates on stock exchanges in the United States is generally traced back to the so-called Buttonwood Tree Agreement of 1792, which provided:

> We, the Subscribers, Brokers for the Purchase and Sale of Public Stock, do hereby solemnly promise and pledge ourselves to each other, that we will not buy or sell from this day for any person whatsoever, any kind of Public Stock at a less rate than one-quarter percent Commission on the Specie value, and that we will give a preference to each other in our Negotiations. In Testimony whereof we have set our hands that 17th day of May, at New York, 1792.[12]

Although present exchange commission rate rules have become far more complex than this simple paragraph, the essentials are the same. The members undertake not to deal at a rate less than the fixed commission, that is, the public rate, and to give preference to each other, that is, the intra-member rates. The ancient lineage of exchange rate fixing, and the fact that it has persisted for over a century and a half without serious challenge, naturally provoke inquiry as to why it should be questioned now. The answer is that exchange commission rate fixing operates now in a far different environment than it did in earlier periods. During the period from 1792 to approximately the end of World War I, exchange commission rates were of little public importance. The general public was not involved to any significant extent in exchange trading in equity securities and there was some justification for regarding the stock exchanges as, in considerable measure, private clubs. While certain aspects of exchange operations gave rise to increasing public concern in the late years of the 19th Century and the opening years of the 20th Century, commission rates were not among them.

After the end of World War I, the public participated increasingly in exchange trading in equity securities and the stock market assumed unprecedented importance in the functioning of the economy. The disastrous events of 1929 demonstrated that the exchanges had not satisfactorily adapted to their new status as institutions with far reaching public responsibilities and led to the comprehensive Congressional investigations of the early 1930's. The evils and malpractices thus uncovered, in turn, gave rise to the movement for reform which culminated in the enactment of the Act in 1934 with its comprehensive scheme of governmental regulation. But attention was then focused primarily upon such obvious evils as corners, pools, manipulations, insider trading, and other fraudulent and deceptive practices which seriously injured investors. With respect to commission rates, there was some concern with the possible overcharging of unsophisticated investors, and with possible monopoly profits, and the Commission was given regulatory authority.

Between World War II and the early 1970's, the public flocked into the securities markets, and financial institutions increasingly participated in those markets. As a result of Congressional concern as to the adequacy of investor protection under these circumstances, two major studies were made under the auspices of the Commission. The first of these was the monumental Special Study, made essentially during the period from the end of 1961 to the middle of 1963, pursuant to Congressional direction embodied in an amendment to the Act. The second of these studies was the Institutional Investor Study,[13] made essentially in 1969 and 1970, pursuant to another amendment to the Act. The Special Study noted that during the 1952–1961 decade, the number of individual shareholders in America grew almost three times but that, despite this expansion, activity of individuals as a proportion of total NYSE share volume decreased from 57 percent in 1952 to 51.4 percent in 1961; during the same period, the Special Study observed, institutional activity rose from 24.6 percent in 1952 and 19 percent in 1953 to 26.2 percent of such volume in 1961.[14] The Institutional Investor Study noted a further decrease in the volume accounted for by the public to 33.4 percent at the end of 1969 and an increase in the institutional share during the same period of 42.4 percent.[15] The institutional share has continued to rise at least through 1971, the latest year for which the NYSE has made available a public transaction study.[16]

The Special Study included probably the first reasonably comprehensive analysis of the nature and structure of commission rates and their impact, together with the procedures and standards involved in setting and reviewing such rates. The Special Study did not, however, consider the question of fixed vs. competitive commissions. Nor did it believe that it was either "called upon or equipped" to study the level of commission rates or to express any view with respect to their reasonableness. Nevertheless, the Special Study did point out certain problems presented by the commission rate structure, some of which are still unresolved. These include the fact that the commission rate schedule covers a great variety of services performed by brokers in addition to the execution and

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[9] Report of House Committee on Interstate and Foreign Commerce on H.R. 9323, H.R. Rep. No. 1383, 73d Cong., 2d Sess. 15 (1934).

[10] Securities and Exchange Commission, "Report of Special Study of Securities Markets," H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963).

[11] 2 Special Study 295.

[12] Eames, "The New York Stock Exchange" 14 (1894).

[13] Securities and Exchange Commission, "Institutional Investor Study Report," H.R. Doc. No. 92-64, 92d Cong., 1st Sess. (1971).

[14] 2 Special Study 6.

[15] "Institutional Investor Study," Supp. Vol. 1 at 147.

[16] NYSE 1974 Fact Book 55.

clearance of transactions. That characteristic of the rate schedule has induced service competition rather than price competition and has resulted in complex and irrational distinctions between permissible ancillary services and prohibited rebates of the minimum commission. The Special Study also noted the prevalence of reciprocal arrangements and pointed out that the nature of the securities commission business is such that traditional principles of rate regulation can hardly be applied to it. In that connection, the Special Study said:

> It is important to reemphasize that, while the security commission business shares, with other businesses subject to rate regulation, the qualities of being "affected with the public interest" and of being limited to a standard of "reasonable" rates, the differences are perhaps more significant than the similarities, and the problem here is in many ways unique. Thus, the public utility normally possesses a franchise conferring upon it monopoly rights to furnish a service required by the public and also obligating it to furnish service to all who need it at reasonable prices. In contrast, though the auction market of the NYSE is a dominant unit in the structure of our capital markets, about 500 member firms compete with each other for the business of the public to be transacted on the NYSE within the confines of the same commission rate schedule. Moreover, they compete with other investment media for the public's savings, and the Exchange itself competes as a marketplace with other markets, both for the listing of issues to be traded and for transactions in listed issues also traded on other exchanges (dually traded securities) or in the over-the-counter market.
>
> There are other important economic differences. Public utilities generally are characterized by relatively high investment in fixed plant and equipment, while the security commission business is essentially a service business requiring relatively small capital investment but relatively high personnel costs. The income of utilities tends to be more stable than that of industry generally while that of the security commission business fluctuates much more widely. These differences make it clear that the problem of "reasonable" rate level can be solved by no simple transfer of principles evolved in the field of utility regulation to the security commission business.[17]

It was further pointed out that a basic dilemma was involved in the setting of commission rates. Traditionally, the rates have been set, at least in part, in terms of a commission per share. This means that with a per share commission the commission charge on a given number of shares of a low price stock is a far larger proportion of the amount invested than the commission on the same number of shares of a high priced stock. On the other hand, a commission schedule based on the dollar amount of the investment would produce a far higher commission on a given number of shares of a high priced stock than on a given number of shares of a low priced stock although the cost of executing the two orders would normally not be very different. In the context of a fixed rate structure, no satisfactory solution to this dilemma has yet been found.

The Special Study also pointed out that five commission rate increases occurred between the enactment of the Act and 1963, and that in connection with each, reference was made to generalized concepts of cost and profit but that the available data for the determination of these was entirely inadequate and that complex problems of allocation of costs existed as well as the even more difficult conceptual problem of giving content to the general standard of reasonableness in an industry to which traditional ratemaking concepts were largely inapplicable.

Over the years since the Special Study, strenuous efforts were made by the Commission and the exchanges to deal with the problems and to correct the defects pointed out. Thus, volume discounts were introduced, customer directed give-ups were abolished, income and expense data for member firms were substantially improved and efforts were made to develop principles for the allocation of costs and also to develop a ratemaking philosophy. It is fair to state, however, that the latter efforts have not been successful. The NYSE has acknowledged that it has not established a basis for allocating costs between the stock exchange commission business and other business done by member firms and has requested the Commission to pass upon recent proposals for rate increases upon the basis of the overall profitability of the securities industry and the impact of inflation upon various costs incurred by member firms. The exchanges and representatives of the brokerage industry acknowledged at the 19b-3 Hearings that they had not yet endeavored to develop and present a philosophy or a set of principles to be applied in ratemaking.

The Commission has held two major hearings with respect to rate structure since the Special Study. The first of these was the Rate Structure Hearings[18] commenced in early 1968. In those hearings, the question was, for the first time, directly raised as to whether rate fixing by exchanges should be replaced by competition. The Antitrust Division of the Department of Justice participated in those hearings in order to "raise questions concerning the relationship between * * * the Exchange Act and the public policy embraced in the Federal antitrust laws."[19] In the course of the hearings, the NYSE stated that it would retain economic consultants to develop a cost-based commission rate schedule. The Commission agreed to await completion of that study before resolving the basic question but, nevertheless, invited written submissions and oral presentations in preparation for the resolution of those issues. In response to the Commission's invitation, the Antitrust Division of the Department of Justice stated, in effect, that the Commission should develop a transitional program which would permit it to institute competitive commissions gradually, commencing with larger volume transactions.[20]

The NYSE study was thereafter accelerated and in February 1970 the NYSE presented to the Commission a study entitled "Reasonable Public Rates for Brokerage Commissions—A Report by National Economic Research Associates, Inc. to the Cost and Revenue Committee of the New York Stock Exchange."[21] The NYSE subsequently made clear, however, that its Board of Governors had not approved the proposed commission rate schedule set forth in the February NERA Report and that the February NERA Report was merely a study presented for discussion.[22]

The Commission reconvened hearings to analyze a new commission rate schedule proposed in June 1970 by the NYSE. The NYSE proposal departed from a cost-based schedule, such as that set forth in the February NERA Report, by limiting increases on small orders and decreases on large orders called for in the original study.[23]

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[17] 2 Special Study 328-329 (footnote omitted).

[18] In the Matter of the Commission Rate Structure of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4-144 (1968-1971).

[19] It is rather surprising that, although the exchanges have been engaged in a combination to fix commission prices both before and ever since the Sherman Act was passed in 1890, the first direct antitrust challenge to stock exchange rate fixing in the federal courts did not come until the Kaplan case in 1966. "Kaplan v. Lehman Bros.", 371 F. 2d 409 (7th Cir.), cert. denied, 389 U.S. 954 (1967). Perhaps this was, at first, attributable to the early idea that the commerce clause of the Constitution and the Sherman Act applied only to transactions in "commodities." See "Hopkins v. United States," 171 U.S. 578, 597-98 (1898); "United States v. Southeastern Underwriters Ass'n," 322 U.S. 533 (1944); "Atlantic Cleaners & Dyers v. United States," 286 U.S. 427 (1932). Since 1934, federal regulation under the Act has affected the application of the antitrust laws to stock exchange actions. See "Silver v. New York Stock Exchange," 373 U.S. 341 (1963). The status of stock exchange rules fixing commissions under the antitrust laws in view of the provisions of the Act is expected to be clarified by the Supreme Court in the near future unless mooted by enactment of legislation now pending in the 94th Congress. See "Gordon v. New York Stock Exchange," 498 F. 2d 1303 (2d Cir.), cert. granted, 95 Sup. Ct. 491 (1974).

[20] Rate Structure Hearings. Memorandum of the Department of Justice on the Fixed Minimum Commission Rate Structure, Jan. 17, 1969, at 194-195.

[21] Hereinafter cited as the February NERA Report.

[22] NYSE Special Membership Bulletin, February 12, 1970; NYSE Special Membership Bulletin, Feb. 19, 1970.

[23] The NYSE submitted in support of its proposal a revised study entitled "Stock Brokerage Commissions, the Development and Application of Standards of Reasonableness for Public Rates, a Report by National Economic Research Associates, Inc. to the Cost and Revenue Committee of the New York Stock Exchange" (July 1970) (hereinafter cited as the July NERA Report). The February NERA Report had proposed a 116.3 percent increase in the commission on an order involving 100 shares of stock selling at $10 per share; the NYSE proposal called for a 50 percent commission rate increase. For an order of 1,000 shares of a stock selling at $50 per share, the February NERA Report had proposed a 36.3 percent commission rate reduction; the NYSE proposal called for a 10 percent commission increase. For further comparisons, see Table XI-4 of the February NERA Report and Table XII-3 of the July NERA Report.

In October 1970, the Commission concluded that the data submitted in support of the NYSE proposal did not provide a complete answer to the problems of commission rate structure, but that it would not be in the public interest to leave the subject indefinitely in abeyance. Accordingly, while the Commission stated that it would not raise any objection if the proposed schedule were adopted with specified modifications and upon the understanding that specified steps would be taken to provide a better basis for the determination of commission rates, it also stated that it was of the opinion that fixed charges for portions of orders in excess of $100,000 were neither necessary nor appropriate. It further requested that a plan for reasonable economic access for non-member broker-dealers be presented.[24]

In March 1971, the Institutional Investor Study was transmitted to the Congress. That Study was basically an economic study conducted primarily by economists and it included an examination of the impact of institutional investment upon the securities markets. This aspect of the Institutional Investor Study is relevant to the question of commission rates since one of the principal problems with the commission rates was the generally unsuccessful effort to adapt them to the needs of both individual investors and large institutional investors. Upon the basis of the data and analysis of the Institutional Investor Study with respect to this matter, the Commission concluded, as stated in its letter of March 10, 1971, to the Congress in transmitting the Study:

> It is clear that the securities markets are changing in rapid and significant ways. There are a number of reasons for these changes; among the most important are the greatly increased volume of trading by institutions, the negotiated nature of many institutional transactions, the fixed minimum commission rates that stock exchanges impose on such transactions and technological advances in communications and data processing. The evolution of the securities markets has been, and may continue to be, affected and distorted by barriers to competition. Among the most significant of these are minimum commission rates and rules that insulate markets, market makers and broker-dealers from each other. The combination of fixed minimum commission rates and barriers to access have tended to cause institutions to choose market places, in part at least, for the purpose of reducing the commission they pay or taking advantage of opportunities to purchase various services with "soft" commission dollars by means of reciprocal practices. These appear to be the most important explanations for the accelerating growth of institutional trading on the regional stock exchanges and in the third market. Because the assembly of many block trades takes place primarily over the upstairs communications systems of broker-dealers rather than on the floor of any stock exchange, such transactions can be executed wherever the participants select, and markets have therefore been selected on the basis of these considerations.
>
> The fixed minimum stock exchange commission on large orders had led to the growth of complex reciprocal relationships between, on the one hand, institutions (particularly mutual fund managers and banks) and, on the other, broker-dealers. This has had the effect of making commission rates for institutions negotiable but limiting the extent to which the ultimate investor rather than the money manager has benefited from such negotiation. As noted earlier, these relationships tend to aggravate potential conflicts of interests, to be anti-competitive in nature and to impede the development of a central market system for securities trading. Elimination of fixed commission rates for institutional size transactions should go some distance toward dealing with these problems. The Commission will closely observe the extent to which competitive commission rates lead toward these results.[25]

In April 1971, at the direction of the Commission, exchanges provided that commissions on the portion of exchange orders involving $500,000 or more were to be competitively determined. In July 1971, the Commission reconvened its commission rate hearings to receive testimony and other relevant data concerning a proposed rate structure based in part on the methodology developed in the preceding year by the economic consultants engaged by the NYSE. The following September, the Commission advised the NYSE that it would not raise any objection to the new rate schedule if certain additional modifications to then prevailing commission-related practices were effected (including implementation of economic access for non-member brokers permitting discounts of up to 40 percent from the public rate).[26]

In not objecting to the NYSE's rate proposal the prior October, the Commission had specifically requested the presentation not later than May 31, 1971, of a uniform accounting system in order to evaluate the need for a fixed commission rate system.[27] In September 1971, the Commission recognized that the inability of the NYSE appropriately to allocate costs and revenues between brokerage and other activities engaged in by members had necessitated consideration of the proposal on the basis of the total financial experience of member firms. The Commission, therefore, extended until May 1, 1972, the period for submission of uniform reporting by member firms in order to permit evaluation of subsequent commission rate proposals.[28]

Beginning in October 1971, the Commission held the Hearings on Market Structure[29] and, on February 2, 1972, issued the Market Structure Statement,[30] which was based on those hearings as well as the earlier studies and hearings extending back over a decade.[31] The Market Structure Statement concluded that a reduction to $300,000 was called for in the breakpoint above which commission rates on exchange transactions should be competitively determined. In reaching that conclusion, however, the Market Structure Statement noted that the securities industry had operated under fixed commission rates for a very long time and that it would, therefore, be appropriate to measure the effect of competitive commissions carefully, on a step-by-step basis. The Commission recognized the possible risk of a precipitate movement toward competitive rates, but concluded that that did not rule out moving toward competitive rates, at least on large orders, at a measured, deliberate pace and that the Commission rate structure would ultimately be based upon the cost characteristics of the service being offered.[32] In response to the Commission's conclusions, the breakpoint on fixed commission rate schedules was lowered to $300,000 in April 1972.

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[24] Securities Exchange Act Release No. 9007 (Oct. 22, 1970). In the course of the 19b-3 Hearings, reference was made to that release as making the continuation of minimum commissions dependent on the adoption of a uniform system of accounts. While indicating that implementation of a uniform system of accounts, as well as uniform and adequate methods of cost allocation, was necessary to the continuance of a system of fixed rates for exchange transactions, that release also stated that fixed charges for portions of orders in excess of $100,000 were neither necessary nor appropriate. The inadequacies of the data submitted in support of the NYSE proposal were subsequently pointed out to the NYSE. See letter dated April 23, 1971, from Irving M. Pollack, Director, Division of Trading and Markets, to William C. Freund, NYSE Vice President and Economist. As indicated supra, p. 11, exchanges have not established a basis for allocating costs between stock exchange commissions and other business done by member firms. Furthermore, by the end of 1970 it appeared that the banning in 1968 of customer directed give-ups and the simultaneous introduction of the volume discount had not solved the regulatory problems of fixed commission rate schedules. See Address by Robert W. Haack before the Economic Club of New York, Nov. 17, 1970, quoted in The New York Times, Nov. 18 1970, at 76, col. 8. See also 4 Institutional Investor Study Report 2206.

[25] Institutional Investor Study, Summary Vol. at xxii. See supra n. 13.

[26] Securities Exchange Act Release No. 9351 (Sept. 24, 1971).

[27] See n. 24 supra.

[28] The Commission also indicated that it was continuing to study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000. *See* Securities Exchange Act Release No. 9148 (Apr. 14, 1971).

[29] In the Matter of the Structure, Operation and Regulation of the Securities Markets, Securities and Exchange Commission File No. 4-147 (1972).

[30] Securities and Exchange Commission, Statement on the Future Structure of the Securities Markets, 37 Fed. Reg. 5286 (Mar. 14, 1972).

[31] The Market Structure Statement expressed the unanimous view of the Commission as it was then constituted (Chairman Casey and Commissioners Owens, Needham, Herlong and Loomis), although Commissioner Owens took a different view with respect to restrictions on transactions by institutionally affiliated brokerage firms for their institutional affiliates.

[32] Market Structure Statement 16. The emphasis of the Market Structure Statement was on fostering free and open competition, not only with respect to commission rates but also competing market makers.

In May 1973, the NYSE proposed to increase commission rates; the Commission received comments on that proposal at a public hearing and, in September 1973, determined not to raise any objection to the proposed increases or to their continuation through March 31, 1974.[33] The Commission also indicated that it would act promptly to terminate the fixing of commission rates after April 30, 1975, if the exchanges did not, on their own initiative, adopt rule changes achieving that result.[34]

Subsequently, the NYSE proposed to provide for competitively determined commission rates on transactions involving less than $2,000. That proposal, as resubmitted in amended form by the NYSE to exclude intra-member rates (that is, rates paid by members to other members for floor brokerage and clearance), was adopted by the NYSE and other exchanges and became effective on April 1, 1974. In withdrawing its initial proposal, the NYSE Board of Directors stated that it did not believe it was necessary to amend the intra-member rate schedules as originally proposed in order to provide experimentation with competitive commission rates.[35] The Commission then held the Intra-Member Rate Hearings, at which the NYSE announced its willingness to abandon fixed intra-member commission rates for clearance.[36]

During the same period the Committees of the Congress having jurisdiction over securities regulation has also turned their attention to the issue of fixed vs. competitive rates. Both the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs and the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives initiated in 1971 a comprehensive examination of the securities industry. These studies were primarily occasioned by the operational and financial crisis in the securities industry in 1969 and 1970 which had led the Congress to enact the Securities Investor Protection Act of 1970.[37] That Act, in effect, provided government insurance for investors against loss resulting from the insolvency of broker-dealers and created a potential liability of the Treasury to cover such claims. The Committees felt that they should independently study the industry to examine the conditions which made such legislation necessary. Both Committees carefully studied the problems arising from fixed commissions. The recommendations of the Senate Subcommittee contained in its Report of February 4, 1972, with respect to commission rates were as follows:

> The related questions of stock exchange commission rates and exchange membership for institutions have been the subject of intensive hearings before the SEC for 3½ years. A review of the record of these proceedings and of the statements submitted to the Subcommittee itself on these questions reveals clearly that the present distortions and fragmentation of our securities markets cannot be effectively dealt with so long as the NYSE and other stock exchanges are permitted to fix the commissions that their members must charge, at least on large transactions. The industry expects, and is entitled to, a clear statement of government policy as to when and how the present restrictions will be removed. This requires the setting of a date certain for elimination of fixed rates on institutional-size transactions, which have resulted in the most serious distortions. This could best be achieved by eliminating fixed rates on orders in excess of $100,000. In addition, to provide the possibility of lower rates to small investors, brokerage firms, after appropriate filings with the SEC, should be permitted to charge lower fees for "unbundled" services than are required by the current fixed rate schedules for the full range of brokerage services.[38]

The House Committee in its recommendations went somewhat further, stating that:

> The Subcommittee finds that fixed minimum commission rates are not in the public interest. We have reviewed our own record, the relevant portions of the SEC's record and that of the Senate study. On the basis of that review the Subcommittee finds that the fixed minimum commission rate system should be replaced by one where commission rates are determined by the forces of competition. We find further that competitively determined rates should apply to all transactions regardless of size, and that a competitive commission rate system should be phased in without excessive delay.
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> The SEC has indicated that it will seek reduction of the level from $300,000 to $200,000 by April of 1973 and then to $100,000 by April of 1974. The New York Stock Exchange has proposed a slightly different timetable, and stated that it will review the level for competitively determined commission rates in October 1972. The Subcommittee has heard testimony that the difference in impact on the industry between a $500,000 breakpoint and a $300,000 breakpoint is minimal, and a number of witnesses indicated that a further reduction in the breakpoint may be warranted prior to the date scheduled by the SEC. The Subcommittee agrees. A further reduction in the breakpoint by the Exchange when it conducts its review in October is warranted. The SEC could then adjust its timetable accordingly. So long as reasonable progress along this road is being made, the Subcommittee will defer legislative action.
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> The Subcommittee agrees with the testimony of a large number of witnesses that there is no reason to freeze competitive rates at the $100,000 level. The Subcommittee finds no logical justification for competition on institutional size transactions while perpetuating rate fixing on transactions of small investors. If steps are not taken to continue to reduce the breakpoint below the $100,000 level until all fixed rates are abolished, the Subcommittee will introduce legislation to do so.
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> There has been much debate over the desirability of a fixed minimum commission rate system. But the Congress, the Department of Justice, and the SEC have determined that the public interest will best be served by replacing fixed prices with a competitive rate system. The debate should now end. If the securities industry expends as much energy in adjusting to a competitive system as it has in debating its wisdom, the Subcommittee is convinced that the industry will not only survive, but it will flourish.[39]

Following the completion of these Studies, legislation to implement the recommendations of the respective Committees was introduced in the Senate and in the House. The Senate bill passed the Senate but the House bill, although favorably reported by the Committee on Interstate and Foreign Commerce, was not acted upon in the 93d Congress. Similar legislation has been introduced in both Houses in the 94th Congress.[40]

2. *Reasons for the rule.* The basic reason for the Commission's decision to adopt Rule 19b–3 was the conclusion that, under present circumstances, the free play of competition can provide a level and structure of commission rates which will better serve the interests of the investing public, the securities markets, the securities industry, the national economy and the public interest than any system of price fixing which can reasonably be devised. Furthermore, the Commission concludes that there is no economic requirement for fixed rates of commission in the securities industry, as is evident from the practical experience of the over-the-counter market, where

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[33] On September 3, 1974, the NYSE proposed to increase rates again. As subsequently modified, the NYSE's proposal called for an increase of 8 percent on minimum rates of commission on transactions involving from $5,000 to $300,000. After receiving information with respect to the NYSE's proposal and holding a public hearing, the Commission determined not to invoke its jurisdiction to object to the NYSE's proposal. See Securities Exchange Act Release No. 11089 (Nov. 6, 1974), 39 FR 43250 (Dec. 11, 1974).

[34] Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 FR 27243 (Oct. 1, 1973). The NYSE Board of Directors had already adopted on the preceding March 1 a resolution calling for a combined program of legislation and regulation concurrently eliminating fixed commission rates on all orders and establishing the requirement that all trades of listed securities be made on national securities exchanges operating under similar rules and regulations.

[35] Securities Exchange Act Release No. 10669 (Mar. 6, 1974).

[36] In Securities Exchange Act Release No. 11019 (Sept. 18, 1974), 39 FR 35214 (Sept. 30, 1974), the Commission indicated that it had not been persuaded, on the basis of the data and views obtained at the public hearings on intra-member rates and otherwise, that its policy conclusions of September 11, 1973, should not also be applicable to intra-members rates.

[37] 15 U.S.C. 78aaa *et seq.* The Securities Investor Protection Corporation established by that Act is required to provide for the satisfaction of claims against a bankrupt broker, not exceeding $50,000 for each customer (subject to a limitation of $20,000 for claims for cash).

[38] Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the Senate Committee on Banking, Housing and Urban Affairs (For the Period Ended Feb. 4, 1972), 92d Cong., 2d Sess. (1972).

[39] Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, H.R. Doc. No. 92-1519, 92d Cong., 2d Sess. (1972).

[40] H.R. 10 and S. 249, 94th Cong., 1st Sess. (1975).

no such structure exists, as well as all of the data which has been accumulated concerning the nature and characteristics of the securities commission business.[41] Consequently, even if it were possible to devise a better scheme of fixed rates, the commitment of resources would not appear to be justified under present and foreseeable conditions in view of the strong probability that no such system would work as well as competition. The foregoing conclusions are consistent with the American tradition of reliance upon free competition to determine prices and allocate resources, as reflected by the public policy embodied in the antitrust laws. It should be emphasized, however, that the Commission's conclusions are not based upon any simplistic notion that competition is a "good thing" in all lines of endeavor, including a regulated industry, and that, therefore, competitive rates should be substituted regardless of experience and circumstances. Rather, this conclusion is based upon the entire experience of the Commission and the securities industry with fixed rates, particularly during the last decade and more, and the intensive studies which have been made of that subject by so many competent persons.

The existing commission rate structure has demonstrably worked badly during that period. It has led to distortions, evasions, conflicts of interest,[42] and inefficiencies, and has obstructed at every step the ability of the securities markets to adapt themselves to the demands of our time. It has impeded the evolution of a central market system and has fragmented the markets, impairing their ability to concentrate the flow of orders and to mobilize market-making resources necessary to provide depth and liquidity in a market increasingly affected by institutional participation. It has also, by its rigidity and delay, inhibited innovations in the rendering of brokerage services to the investing public and in the ability of the securities industry to adjust rapidly to the rapid fluctuations in the volume of trading and, therefore, in the demand for brokerage services. Some of these difficulties seem to be inherent in a fixed rate system as applied to a dynamic and rapidly changing industry.

When the Commission commenced its inquiry into the commission rate structures at the time of the Special Study, fixed commission rates were assumed by everyone, including the Commission, to be a normal and necessary feature of the exchange markets. It became more and more clear in the light of later experience that this was not the case. However, the virtues of the traditional system were staunchly defended throughout the Commission's hearings in 1968 and 1969 and in the hearings before Congressional Committees in 1971 and 1972. In contrast, at the 19b-3 Hearings, the existing system had few defenders. Those who opposed the proposed rule largely confined themselves to either asking for delay, or suggesting that the initiation of competitive commission rates should await a more prosperous period, or be deferred pending the taking of certain further steps toward a central market system, or the adoption of certain proposed safeguards for the auction market process.[43] A few witnesses suggested that some vaguely outlined better system of fixed commission rates should be developed. No one supported any extended continuation of the status quo at least with respect to public rates.

The foregoing does not reflect any judgment by the Commission that the fixed minimum commission rate always was bad or that it was, or now is, illegal, or that fixed commissions could never be appropriate in the future. Rather, it simply reflects a conclusion, based upon the Commission's experience and the abundant data alluded to earlier that, under the conditions now existing, fixed minimum commissions should terminate at the times specified in the rule. It is not possible to predict future developments or future conditions, and it is conceivable that unforeseen developments could require the Commission to reinstitute some form of fixed rates, although the Commission does not anticipate or believe that this will become necessary.

3. *Comments on the rule.* In addition to a number of comments urging prompt adoption of Proposed Rule 19b-3,[44] a number of comments were received either opposing its adoption or suggesting changes in timing to allow for other developments or to await improved economic conditions, or urging that other action be taken by the Commission in conjunction with its adoption. The principal arguments for permitting fixed minimum commission rates to continue were the contentions that the brokerage industry is subject to "destructive competition," that the fixed commission rate structure provides desirable subsidies which cause the securities markets to operate more efficiently and fairly and that the existence of a fixed commission rate, by encouraging membership on exchanges, is desirable to promote self-regulation.

The proposition that the brokerage industry, if subjected to competitive commission rates, would be susceptible to destructive competition was first elaborated in 1968; and it was again urged in opposition to Rule 19b-3. The economic prerequisites for the type of destructive competition postulated are, however, the existence of fixed costs constituting a high percentage of total costs and the availability of economies of scale applicable to a substantial percentage of an industry's aggregate production. Under those circumstances, it is argued that price competition, during periods of low

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[41] The securities commission business, of course, is not a natural monopoly or utility which requires fixed rates because price competition is impossible. It is, however, contended that the securities commission business is of so vulnerable a nature that it cannot survive price competition or, stated otherwise, that it is subject to "destructive competition." Certain reasons for rejecting that conclusion are discussed under the next heading in this release.

[42] The fixed rate structure tends to create conflicts of interest on the part of institutional investors who are usually engaged in managing investments on behalf of others, rather than investing their own money. In these cases, the institutional manager allocates the commission business among brokers but the beneficiaries, in effect, pay the commissions. Since brokers provide a great variety of services which are compensated by commissions, institutional managers are constantly tempted to direct the brokerage business of their beneficiaries to brokers who will provide services for the benefit of the manager. The problem is aggravated by the fact that under prevailing accounting practices and tax law, commissions are treated as part of the purchase price of securities bought, or as a deduction from the proceeds of securities sold, rather than being accounted for as expenses incurred in the management of the portfolio. Under these circumstances, investment managers may be inclined to seek services in exchange for brokerage since the cost of such services may be buried in the carrying value of the portfolio securities rather than charged to the beneficiaries as an expense of administration. The tendency of this situation to corrupt fiduciary relationships is not the least of the evils resulting from the present commission rate system. Even where no misconduct is present, the situation leads to inefficiency in the management of assets. The foregoing does not mean that fiduciaries may not utilize commissions on transactions for beneficiaries to obtain for their beneficiaries research and other valuable services. Certain aspects of this matter are discussed below in connection with the so-called "fiduciary question" raised by certain persons in connection with the proposed rule.

[43] See infra "Comments on the Rule."

[44] See, e.g., statements at 19b-3 Hearings by Representative William S. Stuckey, Jr., United States House of Representatives; James H. Lorie, Professor of Business Administration, University of Chicago; Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University; Marshall E. Blume, Professor of Finance, University of Pennsylvania; Donald Farrar, Professor of Finance, University of California, Los Angeles; Walter Werner, Professor of Law, Columbia University; Richard West, Dean, University of Oregon; David L. Ratner, Professor of Law, Cornell University; Robert Loeffler, Trustee, Equity Funding Corporation of America; James B. Halpern, of Arent, Fox Kintner, Plotkin and Kahn; Philip G. Conner, Executive Vice President of Conner, Redwine, Inc.; Mark M. Batatian, President, Prudential-American Securities, Inc.; Charles T. Bauer, Chairman, Committee of Investment Officers, American Insurance Association. Comments of the United States Department of Justice, Dec. 10, 1974.

In addition, a number of letters supporting prompt adoption of the rule were received subsequent to the 19b-3 Hearings. See, e.g., letters from Senator Harrison A. Williams, Jr., Chairman of the Senate Subcommittee on Securities (Dec. 16, 1974); Senator Phillip A. Hart, Chairman of the Senate Subcommittee on Anti-trust and Monopoly (Dec. 17, 1974); Representative John E. Moss, Chairman of the House Subcommittee on Commerce and Finance (Dec. 16, 1974); Representative Peter W. Rodino, Jr., Chairman of the House Subcommittee on Monopolies and Commercial Law (Dec. 18, 1974); and William R. Salomon, Salomon Brothers (Dec. 10, 1974).

demand and excess capacity, may be expected to drive prices down to marginal costs, which would be below average costs, resulting in losses for a large part of the industry. Eventually such conditions would result in a contraction of industry capacity to a level below that which is necessary to suppy the public need and an undue degree of concentration in the brokerage industry which would have adverse effects on the functioning of the securities markets.

The possibility of destructive competition in the brokerage industry has been, since 1968, subject to careful analysis by a number of independent economists.[45] These analyses demonstrate that the brokerage industry's fixed costs are not high in relation to its total costs even though fixed costs have sharply increased since 1968 and that there are no economies of scale which should lead to undue concentration with competitive commission rates. It has also been pointed out that, above a critical level necessary to provide modern electronic facilities by contract or otherwise, other forms of competition such as service competition could be expected eventually to have effects similar to those of price competition so that a fixed commission rate system, absent controls on the type and quantity of services, does not assure that there will not be increasing concentration in the brokerage industry.[46] Experience with competitive commission rates on large transactions since April 1971, and on small transactions since April 1974, has tended to bear out the analysis that the brokerage industry is not subject to destructive competition as postulated.

Coupled with the destructive competition argument has been an acknowledgment that any new fixed commissions would have to be based on costs with suggestions that the Commission develop the necessary analysis. To date the exchanges have not devised a system for allocating costs between stock exchange commission business and other business not involving fixed rates; furthermore, they have been reluctant to adopt schedules recommended on the basis of available cost data.[47] A number of brokerage firms have repeatedly indicated that it is impractical to allocate expenses so as to break down net income among such varied lines of business as securities commissions, underwriting and trading profits since substantially the same sales personnel and branch office facilities are engaged in the generation of all sources of revenues at any time, and it is not practicable to allocate to each revenue source its share of such joint expenses as personnel costs, occupancy and equipment costs, interest and communication costs.

On the basis of its experience over the last six years with the problems of analyzing costs for a brokerage industry in many different lines of business, the Commission has concluded, as noted above, that commitment of resources would not be justified in view of the strong probability that no such system would work as well as competition.[48] The brokerage industry has demonstrated for a number of years that it can deal with price competition. Initially, such competition was confined to the use of the complex rebative practices which developed because the fixed commission rate structure was out of line with perceptions of cost. Since April 1971, competitive commission rates for large transactions have been given formal recognition in the rate structure, and since April 1974, competitive commission rates have been in effect for small transactions.

The second argument for retaining fixed commission rates is that they provide a number of subsidies which are beneficial to the operation of the securities markets.[49] Thus, it is said that large investors should pay commissions which are in excess of those justified by costs thereby enabling brokers to hold commission rates for small investors down to reasonable levels. The participation of small investors, which would be encouraged by lower commission rates would, it is asserted, enhance the orderliness and liquidity of the market for securities.

Many brokerage firms, however, concentrate on servicing large institutions while others concentrate on a retail business for small investors. Firms that do both a retail business and an institutional business have tended to treat the two as separate operations; each operation is in effect selling a different product and selling it to customers with fundamentally different needs. Brokerage firms are not obligated to do business at the request of the public and may decline, for example, to handle the accounts of small customers. Consequently, revenues derived from institutional business do not provide any rational, controllable subsidies to small investors.

It has also been argued that minimum commission rates, since they provide a relatively dependable stream of revenue to regional brokers, particularly small brokers, enable them to operate profitably. Their continued existence is said to be dependent on profits derived from fixed commission rates and to be important in order to maintain a nationwide distribution network for newly issued securities as well as to provide regional underwriting capabilities for local enterprises. While it may be argued that commission rates should be kept artificially high to sustain regional brokers in times of few underwritings so that they may be available when needed to distribute new offerings, underwriting is recognized as profitable business for a brokerage firm, there have always been adequate resources to devote, in light of the demand, to underwriting activities and many regional brokers appear confident of their ability to operate without minimum commission rates. Nevertheless, it is possible that some firms are not large enough to operate efficiently. To that extent there may be a continuation in the current pattern of consolidation of firms after the introdudction of competitive commissions.

It has also been argued that minimum floor brokerage commissions are desirable because they maintain excess capacity on exchange floors during slack periods in order to meet peak demands. There are not, however, concomitant obligations on exchanges or their members to maintain any particular level of floor brokerage capacity. Consequently, capacity is not maintained except to the extent that individual exchange members believe it desirable in order to meet expected demand.

With respect to market making by specialists, it is argued that floor brokerage income realized from high volume securities enables the specialist to make a better market in low volume securities. But it has never been possible, in view of exchanges and specialists, to measure the quality of markets with any degree of precision so as to determine that any incentive provided by minimum floor brokerage commissions is being used to provide better markets. It has consistently been acknowledged that the type of market maintained for a security is dependent upon its individual trading characteristics which may vary from time to time so that there is not any way to monitor the use by specialists of any incentive provided. Furthermore, the system of allocating and reallocating stocks to specialists has not been designed for the purpose of distributing floor brokerage among different specialists on any basis likely to make efficient use of the incentive. Secondly, securities listed on exchanges are required to meet listing criteria designed to provide reasonable likelihood of sufficient trading volume so that the exchange system will operate effectively.

The third argument for maintaining fixed commission rates is that they provide an incentive for membership on exchanges and that the exchange revenue derived from the orders executed on exchanges supports desirable self-regulation of the brokerage industry. The advent of competitive rates, it is argued,

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[45] See, e.g., Baxter, "NYSE Fixed Commission Rates": "A Private Cartel Goes Public", 22 Stanford L. Rev. 675 (1970); Friend and Blume, "Competitive Commissions on the New York Stock Exchange", 28 The Journal of Finance 795 (1973); Mann, "A Critique of the New York Stock Exchange's Report on the Economic Effects of Negotiated Commission Rates on the Brokerage Industry, the Market for Corporate Securities, and the Investing Public" Rate Structure Hearings (1969); West and Tinic, Minimum Commission Rates on New York Stock Exchange Transactions", 2 Bell Journal of Economic and Management Science 577 (1971).

[46] See Friend and Blume, supra, n. 43.

[47] See supra n. 22 and accompanying text.

[48] See supra "Reasons for the Rule."

[49] See, e.g., statements at Intra-Member Rate Hearings by representatives of the NYSE, the American Stock Exchange, and the Securities Industry Association; and statements at 19b-3 Hearings by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated and by representatives of the Association for the Preservation of the Auction Market, Inc., the NYSE, the American Stock Exchange, and the Securities Industry Association.

may lead to an exodus from exchanges of members which could effectively negotiate access to the exchange when necessary and would otherwise make separate markets off the exchanges.

Market making requires the commitment of capital so that, to the extent exchanges operate as efficient market places, brokers will be less likely to make the necessary investment to engage in their own market-making activities. With respect to the possible loss of membership in the case of brokers which prefer to negotiate access to exchange facilities, exchanges have authority to provide appropriate regulation for such transactions. Furthermore, exchanges may impose revenue charges to support their activities which, if not borne directly by brokers which negotiate access, will nevertheless be passed on indirectly to them through charges made by members. If transactions in listed securities take place off exchanges to a greater extent than is now the case, the associated self-regulatory costs will be shifted to a national securities association. Finally, developments of this kind are among the matters which may be monitored and dealt with if they arise, as discussed below.[50]

Representatives of several exchanges, as well as several other witnesses at the 19b–3 Hearings,[51] suggested that current economic conditions should lead to a postponement of the introduction of competitive commission rates. It is argued that the transition should be timed to a period of general prosperity so as to allow the securities industry a margin for error in making the necessary adjustments for competitive commission rates. There is not, however, any assurance of successfully predicting the general level of the economy, or of stock volume and stock prices. Furthermore, if a decision were to be made on the basis of predictions, after the decision became effective there could be a change in the trend of the economy, or of stock market volume and stock prices independent of the general state of the economy.

Similarly, there have been recent periods of high stock market volume and stock prices when it would have been unwise to introduce competitive commission rates; during the paperwork crunch in 1969 and 1970 there might have been substantial risks to investor protection, notwithstanding relatively high volume and prices for most of that period. Developments since 1970, such as implementation of the Securities Investor Protection Act,[52] revision of financial responsibility rules,[53] implementation of new rules with respect to custody of customer funds and securities[54] and improved surveillance procedures[55] have substantially reduced those risks.

On the other hand, some commentators suggested that there would be a better opportunity to observe adverse consequences, if any, and take action to correct them during a period of relative lack of activity in the industry. Finally it was suggested by others that there would be transitional problems of roughly the same magnitude whenever the transition took place and, therefore, no effort should be made to tie the transition to particular economic circumstances.[56]

The most important consideration is that the brokerage industry should be given, as it has been, a substantial period of time to plan for the transition rather than attempt to time the change precisely with respect to particular economic circumstances. That was the principle which motivated the Commission to announce, in September 1973, its policy conclusion that the fixing of commission rates should be terminated after April 30, 1975.

It was also urged that a number of other steps be implemented concurrently with or prior to the introduction of competitive commission rates. Suggestions included: (a) adoption of a best execution rule;[57] (b) development of a composite quotation system and improved nationwide clearance and depository system;[58] (c) possible safeguards to maintain viability of regional exchanges and third markets;[59] (d) preservation of the auction market by providing "equal regulation" for aspects of the securities business;[60] (e) alternation of other rules of exchanges which have anti-competitive aspects;[61] (f) prior action to lower costs on small transactions;[62] (g) prohibition of affiliated business;[63] (h) adoption of rules to resolve possible questions as to the scope of the term "investment adviser" under the Investment Advisers Act of 1940 and of the term "member" under the Act;[64] (i) action to clarify the "fiduciary" question;[65] and (j) institution of a monitoring system to assess the impact of competitive commission rates.[66]

Some of the suggestions are intended to have the effect of preserving the competitive position of exchanges; others are designed to remove competitive disadvantages which are believed to impede the ability of existing participants in the securities markets to compete effectively without fixed minimum commissions. Still other suggestions link anticipated developments in the efficient operation of the securities markets to the issue of competitive commission rates or anticipate problems with respect to the fair and orderly operation of securities markets.

With respect to adoption of a best execution rule, the Commission does not

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[50] Furthermore, with the advent of the consolidated tape, any broker choosing to make its own markets in listed securities would have to ensure appropriate reporting. See "Silver v. New York Stock Exchange," 373 U.S. 341, 356 (1963), with respect to regulation by exchanges of non-members.

[51] See, e.g., statements at 19b–3 Hearings by Sanford I. Weil, Chief Executive Officer, Shearson Hayden Stone, Inc.; James M. Roche, Public Director of the NYSE; and representatives of the American Stock Exchange, Midwest Stock Exchange and the Securities Industry Association.

[52] 15 U.S.C. 78aaa et seq. The Securities Investor Protection Corporation, established by the Securities Investor Protection Act, had by the end of 1973 placed 94 firms in liquidation. Securities Investor Protection Corporation, Third Annual Report 1973, at 1 (1974).

[53] Compare NYSE Rule 325 as in effect until 1970 with such rule as in effect subsequently.

[54] Rule 15c3–3 under the Securities Exchange Act of 1934, 17 C.F.R. 240.15c3–3.

[55] See Securities Investor Protection Corporation, Third Annual Report 1973, at 16–17 (1974).

[56] See, e.g., statements at 19b–3 Hearings by Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University, and Roger E. Birk, President, Merrill Lynch, Pierce, Fenner & Smith, Incorporated.

[57] See, e.g., statements at 19b–3 Hearings by Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University; Donald Farrar, Professor of Finance, University of California, Los Angeles; and representatives of the Boston Stock Exchange.

[58] See, e.g., statements at 19b–3 Hearings by Daniel J. Murphy, Senior Vice President, Shields Model Roland, Incorporated and by representatives of the Boston Stock Exchange, Midwest Stock Exchange and PBW Stock Exchange.

[59] See, e.g., statements at 19b–3 Hearings by Donald Farrar, Professor of Finance, University of California, Los Angeles; Mark Batatian, President, Prudential-American Securities, Inc.; and by representatives of the PBW Stock Exchange and the Investment Counsel Association of America.

[60] See, e.g., statements at 19b–3 Hearings by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated and by representatives of the Midwest Stock Exchange and the NYSE.

[61] See statement at 19b–3 Hearings by Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University.

[62] See, e.g., statements at 19b–3 Hearings by Mark Kaplan, President, Drexel Burnham & Co., Inc. and Thomas E. O'Hara, Chairman of the Board of Trustees of the National Association of Investment Clubs.

[63] See, e.g., statements at 19b–3 Hearings by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated and by representatives of the Midwest Stock Exchange.

[64] See, e.g., statements at 19b–3 Hearings by Roger E. Birk, President, Merrill Lynch, Pierce, Fenner & Smith, Incorporated and by representatives of the Midwest Stock Exchange.

[65] See, e.g., statements at 19b-3 Hearings by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; Haig Casparian, Vice President and General Counsel, William D. Witter, Inc.; Philip G. Conner, Executive Vice-President, Conner, Redwine Inc.; Roger E. Birk, President, Merrill Lynch, Pierce, Fenner & Smith, Incorporated; Daniel J. Murphy, Senior Vice President, Shields Model Roland, Incorporated; Mark Kaplan, President, Drexel Burnham & Co., Incorporated; Honorable Gerald L. Parsky, Assistant Secretary of the Treasury for Trade, Energy, and Financial Resources Policy Consideration; Marshall Blume, Professor of Finance, University of Pennsylvania; James H. Lorie, Professor of Business Administration, University of Chicago; Robert Loeffler, Trustee, Equity Funding Corporation of America; and by representatives of the Boston Stock Exchange, Midwest Stock Exchange, NYSE, American Insurance Association and Investment Counsel Association of America.

[66] See, e.g., statements at 19b–3 Hearings by representatives of the NYSE.

believe it necessary, solely because of the introduction of competitive commission rates, to formulate special principles to supplement existing standards as to the duty of loyalty and care owed by an agent to his principal under general principles of agency law, as currently supplemented by the provisions of the Act and the rules adopted thereunder. If, however, it should appear appropriate, after the introduction of competitive commissions and on the basis of experience with the evolution of the markets, to provide more particular rules, the Commission will consider doing so.

More efficient and wider dissemination of quotations as well as full implementation of the consolidated tape now in a trial phase, continue, in the Commission's judgment, to be appropriate in the context of the development of a central market system. In the view of the Commission the essence of the central market system is an interconnected system of communication. But the development of such a system or further improvements in the nationwide clearance and depository systems are not preconditions to the introduction of competitive commission rates; rather, competitive commissions may, as suggested by some,[67] speed progress in their development.

While regional exchanges have been innovative and resourceful in developing new techniques and services for their members, some of them have also been vehicles for the evasion of minimum commissions. At least one regional exchange has indicated its confidence that it will be a viable marketplace without minimum commissions,[68] and the Commission does not believe it appropriate to afford special safeguards to regional exchanges solely to protect them against the effects of competitive commissions rather than for reasons relating to a desirable market structure. Similarly, to the extent that the third market has in effect existed because of the exchange umbrella of the minimum commission rate structure, the Commission does not therefore conclude that special protections are appropriate for the third market to further the objectives of the Act.

Suggestions for "equal regulation" for all aspects of the securities business came specifically from the NYSE. The NYSE would, among other things, require all trading in listed securities to be exposed to the auction market provided by any exchange[69] and would limit contact between dealers in listed securities and their customers as is currently done for specialists by NYSE and American Stock Exchange rules. The NYSE and American Stock Exchange rules retricting specialists from certain classes of customers have their regulatory foundation on the specialist's control of the limit order book from which he derives substantial income acting as an agent for other brokers. Similar circumstances do not exist for third market dealers. Nevertheless, without such provisions it is suggested that the third market will expand to the detriment of the exchanges and the auction market they provide.

Other commentators have suggested that it is more reasonable to argue that minimum commission rates have had more to do with fostering the development of the third market than to argue that competitive rates will make the third market more important.[70] Since the effect of proposals to restrict third market dealers would be to put the third market out of business and consequently give exchanges a monopoly on trading in listed securities, such action would not appear to be appropriate without persuasive evidence based on experience with competitive commission rates that the objectives of the Act would thereby be promoted.

Alteration of other rules of exchanges which have anticompetitive effects was also suggested by commentators particularly concerned that regional exchanges might not survive in an environment of competitive commission rates. One commentator suggested requiring the NYSE to allow anyone to become a specialist in order to develop a system of competitive specialists on the NYSE. That suggestion is based on assumptions about future developments in the markets for listed securities as a consequence of introducing competitive commission rates; those developments may not come to pass and the Commission does not believe it necessary to take specific action in advance of any experience with actual developments.

With respect to small transactions, it may not be possible to reduce costs without changes in the manner in which securities transactions are effected; certain kinds of costs do not vary with the amount involved in a transaction and must be incurred. To the extent, however, that better cost controls and improved procedures for processing transactions, including the elimination or immobilization of stock certificates, can be developed, their development will be speeded by the introduction of competitive commission rates and impeded by retention of a minimum commission rate system in which rates are automatically increased to pay for increasing costs.

It was also urged that, prior to implementation of a system of competitive commission rates, any handling of affiliated business by exchange members should be prohibited outright in place of the current provisions of Rule 19b-2[71] which require that 80 percent of an exchange member's business not be affiliated business. In adopting Rule 19b-2 the Commission recognized that it should gain some administrative experience in its operation and impact so that it might reassess its position should harmful, unforeseen consequences arise. The current formulation provides flexibility to respond to any fundamental changes attributable to operation under competitive commission rates, which will greatly reduce the significance of the so-called "institutional membership" problem.

The fiduciary question referred to above, arises out of the expectation by many observers that institutional portfolio managers, who purchase a very large part of all brokerage services, may believe themselves compelled, after the introduction of competitive commission rates, to seek the lowest available commission rate. It is believed that institutions would so act out of fear of lawsuits alleging breach of fiduciary duty if they used their beneficiaries' funds to pay more than the lowest available commission rate. Paying the lowest available commission rate would, it is argued, protect the institutional portfolio manager from liability. Fiduciaries, however, purchase other services for their beneficiaries without believing themselves compelled to seek the lowest possible cost; rather they appropriately "consider the full range and quality" of the services which accrue to their beneficiaries and "need not solicit competitive bids."[72]

In this connection, it has been suggested that fiduciaries might feel compelled to pay commissions which were so low as to make it impossible for brokers to supply research which is urgently needed by these fiduciaries and their beneficiaries. The Commission does not believe that this will occur to any material extent since fiduciaries are entitled to exercise their judgment as to what is in the interest of their beneficiaries and, in any event, the cost of research does not appear to be so large a part of the expense incurred by brokerage firms as to make it impossible for them to supply it in reasonable quantity if their customers de-

[67] See statement at 19b-3 Hearings by James H. Lorie, Professor of Business Administration, University of Chicago.

[68] See statement at 19b-3 Hearings by representatives of the Midwest Stock Exchange.

[69] The Midwest Stock Exchange suggested requiring all trading of listed securities to be done on exchanges if exchange memberships dropped. Currently NYSE rules provide in a number of situations that a member need not take even its own transactions in listed securities to an exchange floor. See NYSE rules relating to secondary distributions.

[70] See, e.g., statements at 19b-3 Hearings by James H. Lorie, Professor of Business Administration, University of Chicago and Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University.

[71] 17 CFR 240.19b-2.

[72] *Cf.* Securities Exchange Act Release No. 9598 (May 9, 1972), 37 FR 9988 (May 18, 1972).

sire it.[73] While there may be some period of adjustment for fiduciaries after the introduction of competitive commission rates for all transactions, experience has to some extent already built up in arriving at commissions on the portion of orders over $300,000, which have most frequently involved fiduciaries. That experience should eventually be capable of general application.

Questions relating to the definition of investment adviser under the Investment Advisers Act of 1940 may require analysis based on experience with competitive commission rates. The questions raised relating to the scope of the definition of member under the Act are not basically new, but were not considered to require specific action in connection with the introduction of access provisions for nonmember brokers. The Commission, as indicated below, is, however, prepared to consider further specific proposals with respect to those questions as well as the fiduciary question and other suggestions made at the 19b-3 Hearings.

The Commission was also requested to undertake a monitoring system to assess the impact of competitive commissions. The Commission proposes to take steps to provide appropriate increased monitoring of the activities of brokers and their financial condition and operations as well as possible shifts in patterns of trading for some period subsequent to May 1, 1975, in order to assure that the objectives of the Act, including the protection of investors and the maintenance of fair and orderly markets, are upheld during any transitional phase. Such monitoring may include collection of additional financial data as well as programs of staff interviews to evaluate changing conditions. In that connection the Commission will welcome specific suggestions for the types of activities on which monitoring efforts should be focused. In addition, the Commission will consider whether or not any rulemaking or other action would be appropriate to clarify the application of the definition of member in order to assist exchanges in performing their self-regulatory role and will consider questions as to incentives to exchange membership and problems for fiduciaries anticipated by some commentators. As to the fiduciary question the Commission will, of course, also submit comments on provisions in pending legislation.[74] Any such action, if appropriate, could be taken prior to May 1, 1975, in order to facilitate the transition.

[73] Member firms' 1973 NYSE Income and Expense reports (which include an estimate of research expense covering all research activities wherever performed) show that, of the 235 firms carrying public customer accounts, 4 estimated research expense as 25 percent or more of total expense, 12 as more than 15 percent, and 26 firms as more than 10 percent. The aggregate research expense of these 26 firms was $20 million out of a total of $109 million for all 235 carrying firms. There were 180 firms for which research expense was estimated to account for less than 5 percent of total expense; but the research expenditures of these firms accounted for 65 percent of the total for all carrying firms.

[74] H.R. 10 and S. 249, 94th Cong., 1st Sess. (1975).

Stated differently, certain persons suggested that the introduction of competitive rates would have undesirable and unintended consequences, in part because of the changes which it would create in the economic incentives and choices of member firms. The Commission believes that these concerns appear exaggerated. In any event, however, the possibility of such undesirable consequences does not provide an adequate basis for deferring competitive rates, since there are other ways in which these problems can be dealt with. The monitoring efforts which the Commission intends to undertake will enable it to be alert to developments and to position itself to take prompt corrective action if undesirable consequences develop before, or after, May 1, 1975. Thus, for example, if it should appear that member firms are proposing to leave the exchanges in order to execute customers' transactions by making markets off the exchange, various steps could be taken to restrict this practice to the extent necessary or appropriate in the public interest or for the protection of investors.

In that connection, the Commission intends shortly to announce procedures by which any interested person may offer suggestions concerning appropriate methods to deal with any problems that might emerge. It should be noted, however, that proposals which appear on their face to be anticompetitive can hardly be acted upon in the absence of experience under competitive rates which demonstrates that they are, nevertheless, necessary or appropriate.

4. *Conclusion.* After a long and careful consideration of the policy questions raised by the existence of the fixed commission rate structures on national securities exchanges, the Commission has concluded that the adoption of Securities Exchange Act Rule 19b-3, precluding exchanges from fixing the rates of commission their members must charge, is necessary or appropriate for the protection of investors, to assure fair dealing in securities traded in upon such exchanges and to insure the fair administration of such exchanges, and, accordingly, hereby adopts Rule 19b-3.

5. *The Text of the Rule.* Section 240.19b-3 reads as follows:

§ 240.19b-3 Prohibiting fixing of rates of commission by exchanges.

(a) No national securities exchange ("exchange") shall adopt or retain any rule of the exchange that requires, or shall otherwise, directly or indirectly, require its members, or any person associated with its members, to charge any person any fixed rate of commission for transactions effected on, or effected by the use of the facilities of, such exchange.

(b) Each exchange shall provide in its rules of the exchange that nothing therein or in its practices shall be construed to require or authorize its members, or any person associated with its members, to agree or arrange, directly or indirectly, for the charging of fixed rates of commission for transactions effected on, or effected by the use of the facilities of, such exchange.

(c) No member of any exchange, or person associated with any member, shall be required to comply with, or may rely on, the provisions of any rule of the exchange covered by paragraph (a) of this section.

(d) As used in this rule, the term "rule of the exchange" refers to any provision of the constitution, articles of incorporation, bylaws or rules or instruments corresponding thereto, whatever the name, of the exchange, and the term "floor brokerage commissions" refers to commissions applicable to the execution of transactions for members or associate members of an exchange but does not include commissions for clearance services or commissions for a combination of floor brokerage and clearance services.

(e) The provisions of this rule shall become effective on May 1, 1975, except as to any rule of the exchange relating to floor brokerage commissions as to which the provisions of this rule shall become effective on May 1, 1976.

(Secs. 2, 6, 10, 11, 19, 23; 48 Stat. 881, 885, 891, 898, 901; as amended; secs. 8, 49 Stat. 1379, 75 Stat. 465, 82 Stat. 453 (15 U.S.C. 78b, 78f, 78j, 78k, 78s, 78w))

By the Commission.

[SEAL] GEORGE A. FITZSIMMONS, *Secretary.*

JANUARY 23, 1975.

[FR Doc.75-4609 Filed 2-19-75;8:45 am]

Title 21—Food and Drugs

CHAPTER I—FOOD AND DRUG ADMINISTRATION, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

SUBCHAPTER A—GENERAL

PART 2—ADMINISTRATIVE FUNCTIONS, PRACTICES, AND PROCEDURES

Subpart H—Delegations of Authority

AMENDMENT REGARDING ENFORCEMENT ACTIVITIES

The Commissioner of Food and Drugs is amending "Part 2—Administrative Functions, Practices, and Procedures" (21 CFR Part 2) to provide for revised delegations of authority to inspect establishments of manufacturers of biological products under section 351 of the Public Health Service Act. A reorganization of the Bureau of Biologics (39 FR 18702) made revision of the delegation necessary.

Further redelegation of the authority redelegated hereby is not authorized. Authority redelegated hereby to a position by title may be exercised by a person officially designated to serve in such position in an acting capacity or on a temporary basis, unless prohibited by a restriction written into the document designating him as "acting" or unless not legally permissible.

Therefore, pursuant to provisions of the Federal Food, Drug, and Cosmetic Act (sec. 701(a), 52 Stat. 1055; 21 U.S.C. 371(a)) and under authority delegated to the Commissioner (21 CFR 2.120), Part 2 is amended in § 2.121 by revising paragraph (p) (7) to read as follows:

§ 2.121 Redelegations of authority from the Commissioner to other officers of the Administration.

* * * * *

(p) * * *

(7) The Director, Deputy Director, and Associate Director of the Bureau of Biologics and the Director of the Division of Compliance of that Bureau may authorize, pursuant to section 351(c) of the Public Health Service Act (42 U.S.C. 262 (c)), any officer, agent, or employee to enter and inspect any establishment which is subject to the provisions of section 351 of the act (42 U.S.C. 262).

* * * * *

Effective date. This order shall be effective February 20, 1975.

(Sec. 701(a), 52 Stat. 1055; 21 U.S.C. 371(a).)

Dated: February 13, 1975.

SAM D. FINE,
Associate Commissioner for Compliance.

[FR Doc.75-4591 Filed 2-19-75;8:45 am]

SUBCHAPTER B—FOOD AND FOOD PRODUCTS

PART 121—FOOD ADDITIVES

Subpart C—Food Additives Permitted in Feed and Drinking Water of Animals or for the Treatment of Food-Producing Animals

LIGNIN SULFONATE FROM SISAL

The Commissioner of Food and Drugs has evaluated the data in a petition (MF-3515) filed by the Dexter Corp., 1 Elm St., Windsor Locks, CT 06096, and other relevant material, and concludes that the food additive regulations (21 CFR Part 121) should be amended, as set forth below, to provide for the safe use of lignin sulfonate derived from sisal (*Agave sisalana*) as a permitted ingredient in animal feed.

Therefore, pursuant to provisions of the Federal Food, Drug, and Cosmetic Act (sec. 409(c)(1), 72 Stat. 1786; 21 U.S.C. 348(c)(1)), and under authority delegated to the Commissioner (21 CFR 2.120), § 121.234 is amended in paragraph (a) by adding the words "or of sisal (*Agave sisalana*)" after the words "or of abaca (*Musa textilis*)." As revised, paragraph (a) reads as follows:

§ 121.234 Lignin sulfonates.

* * * * *

(a) For the purpose of this section, the food additive is either one, or a combination of, the ammonium, calcium, magnesium, or sodium salts of the extract of spent sulfite liquor derived from the sulfite digestion of wood or of abaca (*Musa textilis*) or of sisal (*Agave sisalana*) in either a liquid form moisture not to exceed 50 percent by weight) or dry form (moisture not to exceed 6 percent by weight).

* * * * *

Any person who will be adversely affected by the foregoing order may at any time on or before March 24, 1975 file with the Hearing Clerk, Food and Drug Administration, Rm. 4-65, 5600 Fishers Lane, Rockville, MD 20852, written objections thereto. Objections shall show wherein the person filing will be adversely affected by the order, specify with particularity the provisions of the order deemed objectionable, and state the grounds for the objections. If a hearing is requested, the objections shall state the issues for the hearing, shall be supported by grounds factually and legally sufficient to justify the relief sought, and shall include a detailed description and analysis of the factual information intended to be presented in support of the objections in the event that a hearing is held. Six copies of all documents shall be filed. Received objections may be seen in the above office during working hours, Monday through Friday.

Effective date. This order shall become effective February 20, 1975.

(Sec. 409(c)(1), 72 Stat. 1786; 21 U.S.C. 348(c)(1))

Dated: February 13, 1975.

SAM D. FINE,
Associate Commissioner for Compliance.

[FR Doc.75-4592 Filed 2-19-75;8:45 am]

Title 29—Labor

CHAPTER V—WAGE AND HOUR DIVISION, DEPARTMENT OF LABOR

PART 516—RECORDS TO BE KEPT BY EMPLOYERS

PART 552—APPLICATION OF THE FAIR LABOR STANDARDS ACT TO DOMESTIC SERVICE

Extension to Domestic Service Employees

The Fair Labor Standards Act of 1938 (52 Stat. 1060, as amended, 29 U.S.C. 201 et seq.), as amended by the Fair Labor Standards Amendments of 1974 (Pub. L. 93-259, 88 Stat. 55), extends with certain exceptions the Act's minimum wage, overtime, equal pay, and recordkeeping provisions to domestic service employees. In order to implement the 1974 Amendments, a proposed change in the recordkeeping requirements of 29 CFR Part 516 and and a new proposed 29 CFR Part 552 concerning domestic service employment were published in the FEDERAL REGISTER on October 1, 1974 (39 FR 35382). Subpart A of 29 CFR Part 552 defined and delimited the terms "domestic service employee," "employee employed on a casual basis in domestic service employment to provide babysitting services," and "employment to provide companionship services for individuals who (because of age or infirmity) are unable to care for themselves." Subpart B set out statements of general policy and interpretation concerning the application of the Fair Labor Standards Act to domestic service employees. Interested persons were invited to submit written comments, suggestions, data or arguments concerning the proposal to the Administrator of the Wage and Hour Division, U.S. Department of Labor, in Washington, D.C. on or before November 4, 1974.

In response to the October proposal, comments were received from individuals, law firms, social service groups (both public and private), employers of working mothers, the Women's Bureau of the U.S. Department of Labor, the AFL-CIO, public welfare departments of State and local governments, and business firms providing domestic service workers. Most of the comments were from working mothers and their employers who expressed great concern over the impact which the Amendments and the proposed regulations would have upon those working mothers who employ full-time babysitters. The Wage and Hour Division is mindful of the special problems of working mothers, but the text of the statute and the legislative history of the 1974 Amendments do not permit the Secretary of Labor or the Administrator of the Wage and Hour Division to extend the exemption which Congress provided for those who perform babysitting services on a casual basis to individuals who care for children as their regular, full-time employment.

Based upon the other comments, I have made several minor changes in proposed Part 552. These include the addition of "nurses" to the list of employees who fall within the term "domestic service employment" (§ 552.3); removing the examples from the definition of "casual basis" as it applies to babysitting services (§ 552.5) and inserting them in § 552.104; and deleting the 8-hour a week limitation on the amount of nonexempt work which may be performed by individuals engaged in rendering companionship services (§ 552.6). Also, a sentence was added to § 552.100(b) to make it clear that employers cannot credit against wages for the cost of uniforms and their care if they require that the uniforms be worn. The more detailed description in § 552.100(d) for determining the actual cost of furnishing lodging has been omitted and employers are referred instead to the applicable regulations and rulings contained in 29 CFR 531. Section 552.101(b) has been amended to make clear that employees engaged in maintaining businesses conducted in a home are not "domestic service employees." A paragraph (c) has been added to § 552.101 to deal with the method of determining hours of work for non-live-in domestic service employees. The recordkeeping requirements for live-in domestic service employees have been simplified by the addition of paragraph (b) to § 552.102 which permits the employee's hours to be established by an agreement rather than by the maintenance of precise hourly records where there is an agreement between the parties which schedules the employee's hours of work and that agreement is regularly followed. Other clarifying changes were made in § 552.110.

The one major change in Part 552 is in § 552.109 which deals with "third party employment." This section as originally proposed would not have allowed the section 13(a)(15) or the section 13(b)(21) exemption for employees who, although providing companionship or live-in domestic services, are employed by an employer or agency other than the family or household using their services. On further consideration, I have concluded that these exemptions can be available to such third party employers since they apply to "any employee" engaged "in" the enumerated services. This interpretation is more consistent with the statutory language and prior practices concerning other similarly worded exemptions.

Therefore, with the changes and additions indicated above, the proposed amendments to 29 CFR Part 516, and the new 29 CFR Part 552, are adopted, to become effective February 20, 1975 in their final form which reads as follows:

1. Part 516 is amended by adding the following section:

§ 516.34 Domestic service employees.

(a) With respect to any person employed as a domestic service employee who is not exempt under section 13(a)(15) of the Act, the employer of such person shall maintain and preserve records containing for each such person the following:

(1) Name in full;

(2) Social security number;

(3) Address in full, including zip code;

(4) Total hours worked each week by such employee for the employer;

(5) Total cash wages paid each week to such employee by the employer;

(6) Weekly sums claimed by the employer for board, lodging or other facilities; and

(7) Extra pay for weekly hours worked in excess of 40 by such employee for the employer.

(b) No particular form of records is required, so long as the above information is recorded and the record is maintained and preserved for a period of 3 years.

(c) Where an employee works on a fixed schedule, the employer may maintain the schedule of daily and weekly hours the employee normally works, and (1) indicate by check mark, statement or other method that such hours were actually worked, and (2) when more or less than the scheduled hours are worked, show the exact number of hours worked.

(Sec. 11(c), 52 Stat. 1060, as amended (29 U.S.C. 211 (c)))

2. Part 552 is added. Its title, table of contents and Subparts A and B read as follows.

Subpart A—General Regulations

Subpart B—Interpretations

AUTHORITY: Section 13(a)(15) of the Fair Labor Standards Act, as amended (29 U.S.C. 213(a)(15), 88 Stat. 62; sec. 29(b) of the Fair Labor Standards Amendments of 1974 (Pub. L. 93-259, 88 Stat. 76).

Subpart A—General Regulations

§ 552.1 Terms used in regulations.

(a) "Administrator" means the Administrator of the Wage and Hour Division, U.S. Department of Labor, or the Administrator's authorized representative.

(b) "Act" means the Fair Labor Standards Act of 1938, as amended.

§ 552.2 Purpose and scope.

(a) This part provides necessary rules for the application of the Act to domestic service employment in accordance with the following amendments made by the Fair Labor Standards Amendments of 1974, 88 Stat. 55, et seq.

(b) Section 2(a) of the Act finds that the "employment of persons in domestic service in households affects commerce." Section 6(f) extends minimum wage protection under section 6(b) to employees employed as domestic service employees under either of the following circumstances: (1) If the employee's compensation for such services from his employer would constitute wages under section 209 (g) of Title II of the Social Security Act, that is, if the compensation paid in cash during a calendar quarter totaled $50 or more, or (2) if the employee was employed in such domestic service work by one or more employers for more than 8 hours in the aggregate in any workweek. Section 7(1) extends generally the protection of the overtime provisions of section 7(a) to such domestic service employees. Section 13(a)(15) provides both a minimum wage and overtime exemption for "employees employed on a casual basis in domestic service employment to provide babysitting services" and for domestic service employees employed "to provide companionship services for individuals who (because of age or infirmity) are unable to care for themselves." Section 13(b)(21) provides an overtime exemption for domestic service employees who reside in the household in which they are employed.

(c) The definitions required by section 13(a)(15) are contained in §§ 552.3, 552.4, 552.5 and 552.6.

§ 552.3 Domestic service employment.

As used in section 13(a)(15) of the Act, the term "domestic service employment" refers to services of a household nature performed by an employee in or about a private home (permanent or temporary) of the person by whom he or she is employed. The term includes employees such as cooks, waiters, butlers, valets, maids, housekeepers, governesses, nurses, janitors, laundresses, caretakers, handymen, gardeners, footmen, grooms, and chauffeurs of automobiles for family use. It also includes babysitters employed on other than a casual basis. This listing is illustrative and not exhaustive.

§ 552.4 Babysitting services.

As used in section 13(a)(15) of the Act, the term "babysitting services" shall mean the custodial care and protection, during any part of the 24-hour day, of infants or children in or about the private home in which the infants or young children reside. The term "babysitting services" does not include services relating to the care and protection of infants or children which are performed by trained personnel, such as registered, vocational, or practical nurses. While such trained personnel do not qualify as baby sitters, this fact does not remove them from the category of a covered domestic service employee when employed in or about a private household.

§ 552.5 Casual basis.

As used in section 13(a)(15) of the Act, the term "casual basis," when applied to babysitting services, shall mean employment which is irregular or intermittent, and which is not performed by an individual whose vocation is babysitting. Casual babysitting services may include the performance of some household work not related to caring for the children: *Provided, however*, That such work is incidental, i.e., does not exceed 20 percent of the total hours worked on the particular babysitting assignment.

§ 552.6 Companionship services for the aged or infirm.

As used in section 13(a)(15) of the Act, the term "companionship services" shall mean those services which provide fellowship, care, and protection for a person who, because of advanced age or physical or mental infirmity, cannot care for his or her own needs. Such services may include household work related to the care of the aged or infirm person such as meal preparation, bed making, washing of clothes, and other similar services. They may also include the performance of general household work; *Provided however*, That such work is incidental, i.e., does not exceed 20 percent of the total weekly hours worked. The term "companionship services" does not include services relating to the care and protection of the aged or infirm which require and are performed by trained personnel, such as a registered or practical nurse. While such trained personnel do not qualify as companions, this fact does not remove them from the category of covered domestic service employees when employed in or about a private household.

§ 552.7 Petition for amendment of regulations.

Any person wishing a revision of any of the terms of the foregoing regulations may submit in writing to the Administrator a petition setting forth the changes desired, the reasons for proposing the specified changes, and his or her interest in the matter. No particular form of petition is required. If, upon inspection of the petition, the Administrator believes that reasonable cause for amendment of the regulations is set forth, the Administrator will either schedule a hearing with due notice to interested parties, or will make other provision for affording interested parties an opportunity to present their views, either in support of or in opposition to the proposed changes.

Subpart B—Interpretations

§ 552.99 Basis for coverage of domestic service employees.

Congress in section 2(a) of the Act specifically found that the employment of persons in domestic service in households affects commerce. In the legislative history it was pointed out that employees in domestic service employment handle goods such as soaps, mops, detergents, and vacuum cleaners that have moved in or were produced for interstate commerce and also that they free members of the household to themselves engage in activities in interstate commerce (S. Rep. 93-690, pages 21-22). The Senate Committee on Labor and Public Welfare "took note of the expanded use of the interstate commerce clause by the Supreme Court in numerous recent cases (particularly "Katzenbach v. McClung", 379 U.S. 294 (1964))," and concluded "that coverage of domestic employees is a vital step in the direction of ensuring that all workers affecting interstate commerce are protected by the Fair Labor Standards Act" (S. Rep. 93-690, pp. 21-22).

§ 552.100 Application of minimum wage and overtime provisions.

(a)(1) Domestic service employees must receive for employment in any household a minimum wage of $1.90 an hour effective May 1, 1974, not less than $2.00 an hour during the year beginning January 1, 1975, not less than $2.20 an hour during the year beginning January 1, 1976, and not less than $2.30 an hour after December 31, 1976.

(2) In addition, domestic service employees who work more than 40 hours in any one workweek for the same employer must be paid overtime compensation at a rate not less than one and one-half times the employee's regular rate of pay for such excess hours, unless the employee is one who resides in the employer's household. In the case of employees who reside in the household where they are employed, section 13(b)(21) of the Act provides an overtime, but not a minimum wage, exemption. See § 552.102.

(b) In meeting the wage responsibilities imposed by the Act, employers may take appropriate credit for the reasonable cost or fair value, as determined by the Administrator, of food, lodging and other facilities customarily furnished to the employee by the employer such as drugs, cosmetics, drycleaning, etc. See S. Rep. 93-690, p. 19, and section 3(m) of the Act. Credit may be taken for the reasonable cost or fair value of these facilities only when the employee's acceptance of them is voluntary and uncoerced. See regulations, Part 531. Where uniforms are required by the employer, the cost of the uniforms and their care may not be included in such credit.

(c) For enforcement purposes, the Administrator will accept a credit taken by the employer of $0.75 for breakfast (if furnished), $1.00 for lunch (if furnished), and $1.25 for dinner (if furnished), which meal credits do not exceed $3.00 a day. Nothing herein shall prevent employers from crediting themselves with the actual cost or fair value of furnishing meals, as determined in accordance with Part 531 of this chapter, if such cost or fair value is different from the meal credits specified above: *Provided, however,* That employers keep, maintain and preserve (for a period of 3 years) the records on which they rely to justify such different cost figures.

(d) In the case of lodging furnished to live-in domestic service employees, the Administrator will accept a credit taken by the employer of $15 a week. Nothing herein shall prevent employers from crediting themselves with the actual cost or fair value of furnishing lodging, as determined in accordance with Part 531 of this chapter, if such cost or fair value is different from the amount specified above, provided however, that employers keep, maintain, and preserve (for a period of 3 years) the records on which they rely to justify such different cost figures. In determining reasonable cost or fair value, the regulations and rulings in 29 CFR 531 are applicable.

§ 552.101 Domestic service employment.

(a) The definition of "domestic service employment" contained in § 552.3 is derived from the regulations issued under the Social Security Act (20 CFR 404.1027(j)) and from "the generally accepted meaning" of the term. Accordingly, the term includes persons who are frequently referred to as "private household workers." See S. Rep. 93-690, p. 20. The domestic service must be performed in or about the private home of the employer whether that home is a fixed place of abode or a temporary dwelling as in the case of an individual or family travelling on vacation. A separate and distinct dwelling maintained by an individual or a family in an apartment house, condominium or hotel may constitute a private home.

(b) Employees employed in dwelling places which are primarily rooming or boarding houses are not considered domestic service employees. The places where they work are not private homes but commercial or business establishments. Likewise, employees employed in connection with a business or professional service which is conducted in a home (such as a real estate, doctor's, dentist's or lawyer's office) are not domestic service employees.

(c) In determining the total hours worked, the employer must include all time the employee is required to be on the premises or on duty, and all time the employee is suffered or permitted to work. Special rules for live-in domestic service employees are set forth in § 552.102.

§ 552.102 Live-in domestic service employees.

(a) Domestic service employees who reside in the household where they are employed are entitled to the same minimum wage as domestic service employees who work by the day. However, section 13(b)(21) provides an exemption from the Act's overtime requirements for domestic service employees who reside in the household where employed. But this exemption does not excuse the employer from paying the live-in worker at the applicable minimum wage rate for all hours worked. In determining the number of hours worked by a live-in worker, the employee and the employer may exclude, by agreement between themselves, the amount of sleeping time, meal time and other periods of complete freedom from all duties when the employee may either leave the premises or stay on the premises for purely personal pursuits. For periods of free time (other than those relating to meals and sleeping) to be excluded from hours worked, the periods must be of sufficient duration to enable the employee to make effective use of the time. If the sleeping time, meal periods or other periods of free time are interrupted by a call to duty, the interruption must be counted as hours worked. See regulations Part 785, § 785.23.

(b) Where there is a reasonable agreement, as indicated in (a) above, it may be used to establish the employee's hours of work in lieu of maintaining precise records of the hours actually worked. The employer shall keep a copy of the agreement and indicate that the employee's work time generally coincides with the agreement. If it is found by the parties that there is a significant deviation from the initial agreement, a separate record should be kept for that period or a new agreement should be reached that reflects the actual facts.

§ 552.103 Babysitting services in general.

The term "babysitting services" is defined in § 552.4. Babysitting is a form of domestic service, and babysitters other than those working on a casual basis are entitled to the same benefits under the Act as other domestic service employees.

§ 552.104 Babysitting services performed on a casual basis.

(a) Employees performing babysitting services on a casual basis, as defined in § 552.5 are excluded from the minimum wage and overtime provisions of the Act. The rationale for this exclusion is that such persons are usually not dependent upon the income from rendering such services for their livelihood. Such services are often provided by (1) teenagers during non-school hours or for a short period after completing high school but prior to entering other employment as a vocation, or (2) older persons whose main source of livelihood is from other means.

(b) Employment in babysitting services would usually be on a "casual basis," whether performed for one or more employees, if such employment by all such employers does not exceed 20 hours per week in the aggregate. Employment in excess of these hours may still be on a "casual basis" if the excessive hours of employment are without regularity or are for irregular or intermittent periods. Employment in babysitting services shall also be deemed to be on a "casual basis" (regardless of the number of weekly hours worked by the babysitter) in the case of individuals whose vocations are not domestic service who accompany families for a vacation period to take care of the children if the duration of such employment does not exceed 6 weeks.

(c) If the individual performing babysitting services on a "casual" basis devotes more than 20 percent of his or her time to household work during a babysitting assignment, the exemption for "babysitting services on a casual basis" does not apply during that assignment and the individual must be paid in accordance with the Act's minimum wage and overtime requirements. This does not affect the application of the exemption for previous or subsequent babysitting assignments where the 20 percent tolerance is not exceeded.

(d) Individuals who engage in babysitting as a full-time occupation are not employed on a "casual basis."

§ 552.105 Individuals performing babysitting services in their own homes.

(a) It is clear from the legislative history that the Act's new coverage of domestic service employees is limited to those persons who perform such services in or about the private household of the employer. Accordingly, if such services are performed away from the employer's permanent or temporary household, there is no coverage under sections 6(f) and 7(l) of the Act. A typical example would be an individual who cares for the children of others in her own home. This type of operation, however, could, depending on the particular facts, qualify as a preschool or day care center and thus be covered under section 3(s)(4) of the Act in which case the person providing the service would be required to comply with the applicable provisions of the Act.

(b) An individual in a local neighborhood who takes four or five children into his or her home, which is operated as a day care home, and who does not have more than 1 employee or whose only employees are members of that individual's immediate family is not covered by the Fair Labor Standards Act.

§ 552.106 Companionship services for the aged or infirm.

The term "companionship services for the aged or infirm" is defined in § 552.6. Persons who provide care and protection for babies and young children, who are not physically or mentally infirm, are considered babysitters, not companions. The companion must perform the services with respect to the aged or infirm persons and not generally to other persons. The "casual" limitation does not apply to companion services.

§ 552.107 Yard maintenance workers.

Persons who mow lawns and perform other yard work in a neighborhood community generally provide their own equipment, set their own work schedule and occasionally hire other individuals. Such persons will be recognized as independent contractors who are not covered by the Act as domestic service employees. On the other hand, gardeners and yardmen employed primarily by one household are not usually independent contractors.

§ 552.108 Child labor provisions.

Congress made no change in section 12 as regards domestic service employees. Accordingly, the child labor provisions of the Act do not apply unless the underaged minor (a) is individually engaged in commerce or in the production of goods for commerce, or (b) is employed by an enterprise meeting the coverage tests of sections 3(r) and 3(s)(1) of the Act, or (3) is employed in or about a home where work in the production of goods for commerce is performed.

§ 552.109 Third party employment.

(a) Employees who are engaged in providing companionship services, as defined in § 552.6, and who are employed by an employer or agency other than the family or household using their services, are exempt from the Act's minimum wage and overtime pay requirements by virtue of section 13(a)(15). Assigning such an employee to more than one household or family in the same workweek would not defeat the exemption for that workweek, provided that the services rendered during each assignment come within the definition of companionship services.

(b) Employees who are engaged in providing babysitting services and who are employed by an employer or agency other than the family or household using their services are not employed on a "casual basis" for purposes of the section 13(a)(15) exemption. Such employees are engaged in this occupation as a vocation.

(c) Live-in domestic service employees who are employed by an employer or agency other than the family or household using their services are exempt from the Act's overtime requirements by virtue of section 13(b)(21). This exemption, however, will not apply where the employee works only temporarily for any one family or household, since that employee would not be "residing" on the premises of such family or household.

§ 552.110 Recordkeeping requirements.

(a) The general recordkeeping regulations are found in Part 516 of this chapter and they require that every employer having covered domestic service employees shall keep records which show for each such employee (1) name in full, (2) social security number, (3) address in full, including zip code, (4) total hours worked each week by the employee for the employer, (5) total cash wages paid each week to the employee by the employer, (6) weekly sums claimed by the employer for board, lodging or other facilities, and (7) extra pay for weekly hours worked in excess of 40 by the employee for the employer. No particular form of records is required, so long as the above information is recorded and the record is maintained and preserved for a period of 3 years.

(b) In the case of an employee who resides on the premises, records of the actual hours worked are not required. Instead, the employer may maintain a copy of the agreement referred to in § 552.102. The more limited recordkeeping requirement provided by this subsection does not apply to third party employers. No records are required for casual babysitters.

(c) Where a domestic service employee works on a fixed schedule, the employer may use a schedule of daily and weekly hours that the employee normally works, and either the employer or the employee may (1) indicate by check marks, statement or other method that such hours were actually worked, and (2) when more or less than the scheduled hours are worked, show the exact number of hours worked.

(d) The employer may require the domestic service employee to record the hours worked and submit such record to the employer.

Signed at Washington, D.C., this 12th day of February, 1975.

BETTY SOUTHARD MURPHY,
Administrator, Wage and Hour Division, U.S. Department of Labor.

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Title 32—National Defense

CHAPTER VII—DEPARTMENT OF THE AIR FORCE

SUBCHAPTER B—SALES AND SERVICES

PART 812—USER CHARGES

Cost Determination Factors

These amendments expand and revise the factors used in determining costs for services and change the criteria for determining charges for lease or sale of Federally-owned resources or property.

Part 812, Subchapter B of Chapter VI of title 32 of the Code of Federal Regulations is amended as follows:

1. Section 812.3 is amended by revising paragraph (b)(1) and adding (b)(10) and (11) to read as follows:

§ 812.3 Establishing fees and determining costs for special services.

* * * * *

(b) * * *

(1) Gross civilian salaries. (Include an amount to cover annual leave, sick leave and holiday entitlements, and the Air Force contributions for life insurance,