A Broker’s Duty of Best Execution in the Nineteenth and Early Twentieth Centuries

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Introduction

Although a broker-dealer’s duty of best execution can now be located in federal common law, self-regulatory organization ("SRO") regulations, or state common law, the root of the doctrine is conventionally found in the third area, state law. In this view, the common law duty of best execution is a particular manifestation of a broker’s more general duties as an agent to its customers.1 The duty of best execution may be broadly characterized as a fiduciary one, or as a limited duty, due with respect only to a particular purchase or sale.2 Even in jurisdictions where a broker is not a fiduciary, however, courts require brokers, as agents, to give best execution to their customers.3

One well known treatise has summarized the common law duty of best execution as consisting of three things: "the duty to execute promptly; the duty to execute in an appropriate market; and the duty to obtain the best price."4 Different types of customers put differing

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1. See NORMAN POSER, BROKER-DEALER LAW & REGULATION § 2.03[A], at 2-56 (3d ed. 2001).
3. POSER, supra note 1, § 2.03[B], at 2-58.
4. Id. As one recent article characterizes the definitional issue,

Unlike pornography, which while difficult to define is known when it is seen, best execution is easily defined but is often unrecognizable. This reflects the difficulty that the term “best execution” does not connote a single execution attribute, such as price, but rather attaches to a vector of execution components. These certainly include the trade price, but they also involve the timing of trades, the trading mechanism used, the commission charged, and even the trading strategy employed.
emphases on the various components of best execution. First, one should distinguish between "informed and uninformed" trades, in other words, between trades by those who "trade in order to profit from private information relevant to the future return on a security" and trades by those "whose sales and purchases are prompted by the desire to consume or save."

Second, one should distinguish between traders based on the size of their trades. Large traders may be either informed or uninformed, although most small trades are uninformed or will be treated as such. A large institutional trader such as a mutual fund or pension fund may well be an uninformed trader. Informed trades have an impact on a security's price because of the implicit information conveyed by the trades themselves. In addition, the type of trader conveys information that impacts a security's price.

Both informed traders and uninformed large traders have incentives to conceal the size of their trades. Large orders are one signal that an informed trade is occurring. Another signal is the speed with which the trade must be made. Informed and large uninformed traders will seek executions from brokers that "reduce as much as possible the price impact of the customer's order."

An informed trader will care about the speed of execution and concealing both the trader's identity and the size of its order, in addition to the price. A large uninformed trader may seek a slower execution to signal to the market that the trades are being done by an uninformed trader. Finally, uninformed small traders will care above all else about the price they receive or pay.

Part of the puzzle that this article is unable to adequately address is the nature of trading prior to the 1930s. In other words, to what extent was the market made up by informed and uninformed customers and how did this change over time? The more uninformed customers there were, the more likely that price would have been the paramount concern.

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6. Id. at 828-29.

7. See id. at 828. Uninformed large traders also may pursue a strategy of identifying themselves as such in order to eliminate the price impact of their supposed information. They may also conceal the size of their trades both because of a concern about inferences about information drawn by other traders and the impact of the size of trade upon the market for the security being purchased. Id. at 828-29.

8. Id. at 831.
Some general information on the nature of customers is discussed in Part III, below, but the Author is unaware of any historical analysis of the clients of brokers during this period.

The concept of best execution has moved to center stage in current discussions of many widespread broker-dealer practices and market structure reforms. The most controversial of the proposed market structure reforms has been the Trade-Through Rule, which attracted over 700 comment letters to the SEC. The rule is designed to "require trading centers either to execute... orders at the best, immediately accessible prices or to route the orders to trading centers displaying such prices." The SEC's concern has been to encourage limit orders, which "typically establish the best prices for an NMS [National Market System] stock" and to ensure that market orders are "executed at the best prices." This article, however, does not examine the current debate. Rather, this article is concerned with the early common law history of the doctrine of best execution.

This article examines the development of the common law concept of best execution in order to explain why the doctrine has developed from the very simple injunction that a broker should act in good faith when executing its customers' orders, to a much more elaborate duty. The duty is now primarily embodied in federal law and requires a broker to be concerned with multiple aspects of how its customers' orders are executed. One of the significant differences between the state and federal duties of best execution is that, at least with respect to a breach of a broker's state law duty of loyalty, some states do not require a showing of the broker's intent to deceive (scienter in the federal scheme).


11. "A trade-through occurs when one trading center executes an order at a price that is inferior to the price of a protected quotation, often representing an investor limit order, displayed by another trading center." Id. at 77,426.

12. Id. at 77,430.

13. Id. at 77,427 n.9.

14. Id.

15. Compare Index Futures, 557 N.E.2d at 349-50 (under Illinois Law, "a breach of the fiduciary duty of loyalty owed to a principal by his or her agent" does not "require[] either actual dishonesty [or intent to deceive]" (quoting In re Estate of Neprozatis, 378 N.E.2d 1345, 1349 (Ill. App. Ct. 1978))) with Flickinger v. Harold C. Brown & Co., 947
This article started out very simply as an attempt by the Author to trace the common law roots of the duty of best execution. To the Author's amazement, there did not seem to be a common law basis beyond the vague formulation that a broker has a duty of good faith to its customer. The impact of this formulation on particular purchases and sales of securities, however, does not seem to have been explicitly litigated in the courts prior to the 1930s or to have been commented upon in any of the early treatises on brokers or the securities markets.

In examining this puzzle, a series of obvious questions about the structure of the securities markets must be answered. Perhaps the lack of an articulated duty of best execution arose from the inability to execute a particular securities transaction on multiple exchanges. Perhaps it was due to the inability to quickly communicate bid and offer prices on different financial exchanges for the same security. The fact that arbitrage between markets was a common nineteenth and early twentieth century phenomenon is the strongest argument against these market structure arguments. Ultimately, none of these market structure explanations are satisfying.

Another possible set of explanations arises from the dominant ideologies that shaped the viewpoint of the market participants. Insofar as society has moved from a view of the securities markets in which they are criticized as the equivalent of gambling casinos and as the locus of a money trust, to a view in which the securities markets are generally accepted, we can expect that criticism will become more focused on the particular problems of market mechanics, rather than overarching critiques.

The twentieth century growth of academic analysis of security trading, culminating in the various forms of the efficient market

F.2d 595, 599 (2d Cir. 1991) (applying New York law and holding that "[a]n action for breach of fiduciary duty... requires a showing of 'deceitful intent' on the part of the fiduciary" (quoting Horn v. 440 East 57th Co., 547 N.Y.S.2d 1, 5 (N.Y. App. Div. 1989))). Flickinger's reliance upon Horn has been criticized by Professor Poser, supra note 1, § 2.03[A], at 2-50 n.266.

16. See infra Part II.
17. See infra text accompanying notes 42-54.
18. See infra text accompanying notes 40-41.
19. In turn, this question generates a series of sub-issues involving the structure of financial markets in the nineteenth and early twentieth centuries. Could a particular security be listed on multiple exchanges? Could a broker be a member of multiple exchanges? Were clearance and settlement serious obstacles to trading in the age of paper certificates?
20. See infra text accompanying notes 65-69.
hypothesis, developed congruently with the focus on market mechanics. In a world where individuals cannot expect to consistently beat the market, transaction costs are a primary concern to investors. Best execution is ultimately about a type of transaction cost. Indeed, open the *Wall Street Journal* on almost any day and there will be a discussion of transaction costs in buying various types of securities. At least once in any given week there will be a discussion of transaction costs in buying various types of securities and mutual funds, and how these costs and fees affect performance.\(^1\)

This article suggests that the doctrine of best execution initially developed as a result of regulatory oversight by the SEC and then as a result of the development of the class action. Most losses due to a broker's failure to meet its best execution obligations would be relatively small, often pennies per share. No individual investor would have an incentive to pursue such small losses. Only a regulator or an attorney able to recover fees from a common fund would have the resources to pursue such a claim.

When one combines these economic and legal facts with the speculative orientation of nineteenth and early twentieth century investors, it is not surprising that best execution is a doctrine that awaited the birth of the SEC, more sophisticated theories about security markets and the pricing of securities, and the development of the class action suit.\(^2\)

This article suggests an approach to studying the doctrine of best execution.\(^3\) Professor James Fanto, who commented upon an earlier draft of this article at the Pace University School of Law’s Investor


\(^3\) The Author is working on a more definitive article on best execution in the nineteenth and early twentieth centuries.
Rights Symposium, suggested one general lesson of legal history that can be drawn from this preliminary work. Although we have all become legal realists, we sometimes forget the contingent nature of legal doctrine. As this article argues, the preconditions for the development of best execution as a legal doctrine existed in the late nineteenth century, but the doctrine only became prominent in the 1930s. As Professor Fanto wrote, this article provides an “example of how a legal right, which is now the subject of considerable debate, has a complex, somewhat contingent origin. That is, legal rights often appear not just when conditions permit, but when there is a spark or catalyst to bring them about . . .”

I. Market and Limit Orders

This article will discuss the duty of best execution, focusing on price, although price is not the only relevant factor. It is important to distinguish between the three basic types of orders: market orders, limit orders and stop orders. A market order directs a broker to buy at the lowest price or to sell at the highest price available in the market. A limit order directs a broker to purchase at a maximum price or to sell at a minimum price. A stop order directs a broker to place a market buy or sell order when the security reaches a specific price. Any of these orders could raise best execution issues as to the price at which the transaction is made, the market upon which the transaction is made or the speed with which the transaction is carried out.

The three basic orders have existed since at least the 1880s, although the meanings of the terms have shifted over time. What we currently call limit and stop orders were encompassed by the single term stop orders in the 1880s. It was unclear whether the broker had a duty to execute precisely at the price designated by the customer or below the designated price. The former would be a more restrictive form of a

25. There are a number of other instructions that can be combined with limit and stop orders. HOW THE STOCK MARKET WORKS 88-91 (John M. Dalton, ed., 2d ed. 1993).
26. Id. at 85-86.
27. Id. at 86.
28. Id. at 86-87.
30. Id. at 166-67.
modern stop order, while the latter would be a modern limit order.

In an 1872 case, the Pennsylvania Supreme Court dealt with whether difference trading in the context of a short sale was gambling.31 The editorial material prior to the actual opinion describes the transaction in some detail. The broker had sold 1000 shares at $165 a share and a second 1000 shares at $169 ¾ a share. The short sellers, a two person firm, then entered a written order to fix their loss, ordering the broker to "'[b]uy for my account, 2000 shares, New York Central, at 166; or, in event of that stock going against me, take the 2000 shares in at 175.'" The price of the stock rose, never hitting $166 after the short sales, and the broker covered at $174 ¾.32 The customers argued that the purchase to effect the cover should have not been made except at $175,33 while the broker argued that the purchase could be made at $175 or any price below.34 The trial judge took no position on the correct interpretation of the customers' order and a jury verdict was rendered for the broker. However, a leading contemporary treatise on stock brokers took the position that this was an incorrect result. "'[B]uying in' the stock at 174 ¾ might have been advantageous to" the broker's customers but "it was not in accordance with the stop order, which gave them the right to act only when the stock reached 175."35

32. Id.
33. The trial court judge's instructions to the jury were that:

if the contract of the plaintiffs [the broker] with the defendants [the customers] was an absolute one, that they were not to buy in the stock until it reached 175; and if they had no discretion in the premises whatever then of course, they had no right to buy it in at less price, and the plaintiffs' third point would be well taken; but is that a reasonable supposition?

Id. at *4.

34. The trial judge instructed the jury to consider whether the customers' position was correct:

Is that the contract which was entered into? Was it not rather that the plaintiffs... were not to let the stock go beyond 175 before buying it in, and is not that a reasonable interpretation of the written order. In view of what was plainly the interest of the defendants and of what occurred at the time?

Id.

35. DOS PASSOS, supra note 29, at 167. Dos Passos relied on the legal rule that a broker as an agent "must obey strictly his instructions, and it is no answer in his mouth to say that by disobeying them an advantage accrued to his principal." Id. (footnote omitted). Dos Passos posed the hypothetical of what should the result have been if the stock had "never reached 175, but, after selling at 174 ¾, it declined until it reached 166? Here would have been a loss to the Client from which it seems the Broker could not have escaped responsibility by showing a sale at 174 ¾." Id. (footnote omitted). But see WILLIAM W. COOK, A TREATISE ON THE LAW OF STOCK AND STOCKHOLDERS 438-39
Not all nineteenth century stop orders were so ambiguous. An instruction to a broker granting it discretion to sell "whenever my margin shall fall below five percent" was a type of stop order, but there were no limit order type restrictions in this stop order. In other words, the broker could sell at whatever the market price was when the margin had declined below five percent. This type of nineteenth century stop order is like a modern stop order.

A broker's duty to follow its customers' orders underlies all of these orders. This has been black letter law since the first treatises on the law of stockbrokers were written.

II. The Broker as Fiduciary

The primary principle articulated in the nineteenth century cases is the broker's general duty of good faith to its customer. A statement that a broker in buying or selling "is bound to act with diligence and prudence, and in entire good faith," is typical. (Limit orders were not yet recognized to have best execution ramifications.) Very little information appears in these cases on the actual mechanics of trading. The closest to an articulation of the duty of best execution is found in a series of cases that held that a broker may, absent instructions from its client, execute a sale or purchase upon any customary market for a particular security. Most of these cases, however, do not explicitly revolve around price differences among the markets in which the transaction might be carried out. Underlying this principle may be the unarticulated assumption that the best price for a particular security may be found on the market where it is customarily traded. This assumption comes closest to the surface in a New York Court of Appeals case, "Porter v. Wormser."

"Porter v. Wormser" involved a customer's attempt to rescind the sale of U.S. government bonds which had been carried out pursuant to a stop order (1887) (describing a stop order in modern terms).

37. DOS PASSOS, supra note 29, at 167 n.2.
38. Wicks, 62 N.Y. at 540.
40. DOS PASSOS, supra note 29, at 121.
42. 94 N.Y. 431 (1884).
order. The sales were carried out in mid-August while the customer was traveling in Europe, but the bonds had presumably recovered in price by the time the customer had returned to the United States. Such recovery would explain why the customer argued that the private sale of the bonds to dealers in government bonds was improper, and that a public sale on the New York Stock Exchange was required. The investor evidently did not argue, however, that a sale on the public market would have yielded a higher price.

It seems that the Porter court would have entertained an argument that the private sale was not fair on the grounds that the price was higher in the public market, but the court found that the private sales were at prices "as high" and, in some cases, "at a higher price than similar bonds bought at public sale." The specific holding, however, rested in part on the agent's discretion, "in the absence of special restrictions, [to] sell in any usual or ordinary way." The evidence had "shown that the bulk of sales of government bonds were made outside of the public board, at private sale, and [since] nothing [had] been shown to impeach the fairness of the sale in question, the fact that it was a private and not a public sale was not a ground of objection."

The clearest early articulation of what would become the duty of best execution occurs in an 1834 report by the New York State Assembly's Select Committee on Stock-Jobbing. The purpose of this brief report was to "inquire into the expediency of passing a law to regulate and license stock and exchange brokers, in the different cities of this State." The two page report focused on New York City, as there were no "similar abuses ... to be found ... in other cities of this State," and the secrecy of the transactions conducted on the New York

43. Id. at 442-46.
44. Id. at 441.
45. Id. at 447. The fact that there evidently were at least two markets for U.S. bonds and that there were differing prices is an important fact in understanding the nineteenth century securities markets.
46. Id.
47. Id. The Porter court cited cases involving the default of a purchaser of goods and the subsequent sale of the goods at a private sale. The decisions focused on the fact that the private sales were at "the full and fair value of the" goods. Pollen v. LeRoy, 30 N.Y. 549, 556 (1863); accord White v. Kearney, 2 La. Ann. 639, 641 (1847) ("[T]he sale made by the plaintiff, though not at auction, was at the fair market value.").
48. Report of the Select Committee on Stock-jobbing, N.Y. Assembly Doc. 339, 57th Sess. (Mar. 28, 1834) [hereinafter 1834 Report]. The report also considered regulating produce brokers but concluded that there were no "practices on the part of produce brokers which require to be prevented by legislative enactments." Id.
Stock Exchange and Board ("NYS&EB"), the predecessor to the New York Stock Exchange. At first, the NYS&EB released weekly price information, then daily, and by 1828, volume information was included.\textsuperscript{49} The intra-day pricing was not publicly released.\textsuperscript{50}

The secrecy allowed brokers in general, in the report's view, "to mislead and deceive their employers [principals] to a fearful and dangerous degree" and such secrecy "ought not to be permitted to any agent for another."\textsuperscript{51} One of the complaints contained in the report was essentially about best execution:

Whenever [the brokers] may have an order to execute, it cannot possibly be known to their principals, (the details of their proceedings being secret,) at what rate they have effected sales or purchases for them: And the means of deception in regard to their transactions being easy, they may report to the buyer that they have given the highest price, and to the seller that they could obtain only the lowest price; and as the variations in the nominal value of stocks are frequently great in the course of the same day, they pocket the profits arising out of the difference, without fear of detection.\textsuperscript{52}

There was no action taken by the New York legislature in response to the report, probably in part because of lobbying by the NYS&EB.\textsuperscript{53}

In addition to Porter and the 1834 New York Assembly report, there are some scattered general statements in the cases that "diligence as to time" and a purchase "at the best price obtainable" were duties arising from a broker's "ordinary fiduciary duties of good faith and due diligence in carrying out [the customer's] instructions."\textsuperscript{54} Finally, in New York in the nineteenth century, a broker could not sell its own shares in a company to its customer, even if "the brokers did better for their principal by selling him their own stock than they could have done by going into the open market."\textsuperscript{55} Although the rationale for this rule was not articulated, one concern might have been to guard against the possibility that a broker may purchase at one price and sell at a higher

\textsuperscript{49} Id.
\textsuperscript{50} See infra text accompanying notes 91-99.
\textsuperscript{51} 1834 Report, supra note 48.
\textsuperscript{52} Id. at 2.
\textsuperscript{54} Wahl v. Tracy, 121 N.W. 660, 661 (Wis. 1909). Wahl involved a purchase of securities made by a broker on margin when the securities should have been purchased outright, not a purchase at less than the best price. Id.
\textsuperscript{55} Taussig v. Hart, 58 N.Y. 425, 428 (1874).
price to its customer.\textsuperscript{56}

The underdeveloped state of the nineteenth and early twentieth century case law\textsuperscript{57} is striking when compared to the SEC’s confident assertion in the 1930s of the principle of best execution. What had been, on the whole, inarticulate and inchoate was asserted as a clear principle of law.

III. The Securities Markets in the Nineteenth and Early Twentieth Centuries

The lack of discussion of differing prices in different securities markets is puzzling in light of the existence of multiple securities markets that shared both listings and price information. One might think that the relative simplicity of securities products meant that there were few issues involving best execution. In fact, many of the future and derivative products with which we are familiar were already being actively traded, although not as widely and without the complicated mathematical models that are so prevalent currently.

Customers could purchase various put and call option contracts and engage in “difference trading” in which the customer was essentially gambling on price changes in underlying stocks without the customer or the broker ever purchasing the stocks.\textsuperscript{58} One current treatise compares

\begin{quote}
56. This is what appears to have happened in Thompson v. Meade, 7 T.L.R. 698 (Q.B.D. 1891), an English case that is cited in Wahl, 121 N.W. at 661. The broker purchased shares at 2 pounds 10 shillings and 2 pounds 11 shillings and sold them to its customer at 2 pounds 12 shillings 6 pence.

57. There is a body of adjudications, NYSE arbitrations, that the Author is in the process of researching for best execution cases. Professor Stuart Banner has done the pioneering work in this area. See Banner, supra note 53. His chapter on the self-regulatory functions of the NYSE includes an extensive discussion of the role of arbitration, which involved “any dispute relating to a contract made at the Board, including complaints made by non-members (usually clients of members) against members.” Id. at 273. Regrettably for this Article, Professor Banner is more concerned with describing the parameters of arbitration, the reasons for its growth and its effects than with describing the types of disputes themselves. He does write, however, that “[w]hen members breached their contracts, the most common reason was insolvency.” Id.

In a future article, the Author will address what types of disputes arose in NYSE arbitrations prior to the 1930s, including any best execution type claims.

\end{quote}
post-Civil War securities markets with current markets and concludes "[t]ransactions bearing resemblance to the prohibited difference trading are now flourishing in the securities and commodities markets in various forms of derivative and hybrid instruments."\(^{59}\)

The phrase "the prohibitions on difference trading" refers to the debate in the second half of the nineteenth century on whether such trading was gambling and, therefore, illegal.\(^{60}\) Prior to the later statutes forbidding difference trading, there had been a small number of state statutes that, after 1792, restricted securities trading. The most notable was the Stock-Jobbing Act in New York. From 1792 to 1858, "contracts to sell shares of government debt or corporate stock one did not own on the contract date were void and hence unenforceable in the state's courts."\(^{61}\) This statutory regime provided a boost to arbitration before the Board of the NYSE, as arbitration was the only way such a contract could be enforced.\(^{62}\)

A. Stock Markets and Listings

The early 1800s saw the development of securities markets in New York, Boston, Philadelphia and other cities.\(^{63}\) The primary difference between the New York market and the others was that New York was a trading market that gradually developed a large retail market, while the other markets were primarily wholesale markets for raising capital.\(^{64}\) Over the course of "the nineteenth century approximately 250 different stock exchanges were formed in the United States, with all major centres of population coming to possess at least one," although most of these


60. BANNER, supra note 53, at 182-83. For a discussion of the legal situation in the United States on this issue as of 1887, see COOK, supra note 35, at 352-62; see also T. HENRY DEWEY, LEGISLATION AGAINST SPECULATION AND GAMBLING IN THE FORMS OF TRADE INCLUDING "FUTURES" "OPTIONS" AND "SHORT SALES" Preface (1905) (from 1886 to 1905, the number of states with statutes prohibiting certain forms of securities trading grew from four to twenty-three and the number of cases more than doubled).

61. BANNER, supra note 53, at 173-74.

62. Id. at 271-73. In addition to providing an adjudicative forum, the NYSE performed a regulatory function by adopting rules governing time bargains. Id. at 275-79.

63. WERNER & SMITH, supra note 58, at 44.

64. Id. at 44-45.
exchanges disappeared quickly. Stocks were cross listed on multiple exchanges. In fact, initially there were no listing requirements and "stock boards traded in whatever securities were available." It was not until the late 1850s that listing standards were elaborated.

The issues of listing on multiple exchanges and trading of securities on one exchange that are only listed upon another exchange are closely related. Such trading was a common practice in the nineteenth century and one that, of course, continues today. A good example of the trading of unlisted securities was the 1885 decision of the Consolidated Stock and Petroleum Exchange in New York City (the "CSE") to begin trading railroad stocks that were listed on the NYSE in the hope of taking business from the NYSE through lower commission rates and smaller minimum trade sizes. A current view of best execution would require brokers to use the CSE over the NYSE when possible. There is no evidence, however, of any cases involving this issue. In the twentieth century, the trading of securities listed on other exchanges flourished. By 1940, "[m]any of the securities which [were] listed on the NYSE [were] also traded on one or more of the seventeen regional exchanges."

66. Id. at 86.
67. Charles A. Cole, History of the Securities Business 19 (1963) (unpublished manuscript, available at the SEC library). In 1847, the NYSE required for listing only that a corporation be "regularly incorporated" and have its "books of transfer in" New York City. Id. (quoting 1847 rule).
68. Id.
69. MICHITE, supra note 65, at 198-99 (from 1885-1910, the NYSE had its own unlisted department for issuers, especially mining and manufacturing companies, without a NYSE listing).
70. DIVISION OF MARKET REGULATION, SEC, MARKET 2000: AN EXAMINATION OF CURRENT EQUITY MARKET DEVELOPMENTS II 8-9 ("In 1992, over 97% of the [five] regional stock exchanges' volume derived from issues" listed on the NYSE or Amex.).
72. MICHITE, supra note 65, at 204.
73. In re The Rules of the NYSE, 10 S.E.C. 270, 276 (1941). "On August 31, 1940, there were 249 dually traded issues on the Boston Exchange, 106 on the Chicago Exchange, 13 on the Cincinnati Exchange, 38 on the Cleveland Exchange, 408 on the Philadelphia Exchange and 64 on the Pittsburgh Exchange." Id. at 279. By "dually traded," the SEC meant that a security was either listed on both the NYSE and another
The trading on one exchange of securities listed on another should be distinguished from the trading on one exchange of securities not listed on any exchange, which this article will call "unlisted securities." Unlisted securities were traded from the beginnings of the American securities markets.\textsuperscript{74} In the late 1850s, unlisted securities could be traded upon the NYSE upon payment of a small fine.\textsuperscript{75} By the 1880s, trading of unlisted securities had become well established, in part because of trusts that "could not or would not supply the date required for listing."\textsuperscript{76} The practice declined in the years before WWI, only to be revived in the 1920s.\textsuperscript{77} The Securities Exchange Act of 1934 ended the trading of unlisted securities by allowing a national securities exchange to "extend unlisted trading privileges" to additional securities only if the security "is listed and registered on [another] national securities exchange."\textsuperscript{78}

Finally, there is trading of exchange listed securities off the exchange, either through dealers (over-the-counter) or directly between customers. One leading historian describes the situation involving the NYSE in the period from its founding to the Civil War and concludes "that considerable trading in the early New York securities markets occurred outside of the" NYSE.\textsuperscript{79} In part, this was driven by the desire of brokers to act as dealers so that they could make more than the "low uniform commissions" the NYSE allowed brokers.\textsuperscript{80} It was not until the early 1960s that members of the NYSE were forbidden to deal with non-exchange or listed on the NYSE and admitted to "unlisted trading privileges" on another exchange. \textit{Id.} at 271 n.3.

\textsuperscript{74} Cole, \textit{supra} note 67, at 19.

\textsuperscript{75} \textit{Id.}

\textsuperscript{76} \textit{Id.} at 20; CLARENCE W. BARRON & JOSEPH W. MARTIN, THE BOSTON STOCK EXCHANGE: WITH BRIEF SKETCHES OF PROMINENT BROKERS, BANKERS, BANKS AND MONEYED INSTITUTIONS OF BOSTON (1893) ("Within a few years capitalists have formed various so-called trusts, the stocks of which have become very active. These companies would not apply to the Stock Exchanges to have these stocks listed, and this led to the creation of an unlisted department in both New York and Boston, so that the members of these Exchanges could buy and sell these stocks under certain rules at their Exchange.").

\textsuperscript{77} Cole, \textit{supra} note 67, at 20.


\textsuperscript{79} WERNER & SMITH, \textit{supra} note 58, at 167-68. Professor Werner actually studied the stock register books of the Manhattan Company for 1836. The Manhattan Company was listed on the NYSE but the over-the-counter trading of its shares, as shown by its stock register book, was probably two to three times in volume as great as the trading on the NYSE. \textit{Id.} at 168-69.

\textsuperscript{80} \textit{Id.} at 168.
members as dealers, i.e., without collecting a commission. This prohibition arose from a changed interpretation by the NYSE of its Rule 394. Rule 394, later denominated Rule 390, was adopted in 1948 and was finally rescinded in 2000.

Current discussions of best execution often focus on the complexities of the securities markets as providing one explanation of why best execution is "a slippery and not comfortably determinate concept." As there are so many means by which a single order can be executed, "the idea of best available price [is turned] into a series of best available prices." Insofar as this is a fair characterization of the current securities markets, the same criticism would apply to the markets of the late nineteenth and early twentieth centuries, although the complexity has increased with the number of ways to execute an order. The indeterminacy of securities prices has been a consistent theme over time and does not help to explain why best execution did not become an issue until the 1930s. In fact, as the number of ways in which an order can be executed makes the concept of best execution indeterminate, one would expect the concept of best execution to have weakened rather than strengthened as it has in the past twenty years.

B. Price Information

Price information has been shared between securities markets since the founding of the Amsterdam and London markets in the late 1600s. The only thing that has changed is the density of the information and the speed with which it is disseminated. In 1867 the stock ticker was invented and by 1880 most brokers had telephone lines to trading floors. Although technology has certainly advanced since then, by the late 1880s there was no technological barrier to trading upon any market on which a security could be traded. The argument that "the past structure and technical capability of the securities markets" made it "difficult for a

82. Id. at 389-90.
83. Id. at 389.
86. Id. In turn, the "opacity and complexity" of the structure of the securities markets "creates a situation in which brokers can technically fulfill their legal duties while profiting themselves." Id.
broker to attempt a best price execution” or “difficult, if not impossible, for a broker or customer to determine whether best execution had been obtained” needs to be qualified.

The London and Amsterdam markets were well integrated in the early eighteenth century. “Shares of the great chartered joint-stock corporations in England were traded simultaneously on the stock exchanges of London and Amsterdam at least by the summer of 1723” and probably earlier. Although a well developed information exchange had developed between London and Amsterdam, with prices sent from London twice a week by 1720, each market seems to have acquired information simultaneously. “[T]he Amsterdam market was tracing much more closely the actual prices on the London market on the same trading day as in Amsterdam, rather than following with a lag of three days or more the prices reported from London.” The ability to arbitrage between the two markets, therefore, may have been limited.

A similar story unfolded from the very beginning of the American securities markets. In the 1790s, inter-market trading occurred between Philadelphia and Boston “whenever any price differential appeared” in prices of the stock of the first Bank of the United States. Before the telegraph, price information was exchanged by mail, either by publication in a newspaper or by private correspondence. Publicly

87. Lipton, Best Execution, supra note 22, at 470-71.
88. NEAL, supra note 59, at 141.
89. Id. at 37.
90. Id. at 43. A separate debate has developed over whether early security markets were efficient. Some economic historians have argued for the information efficiency of eighteenth century securities markets. NEAL, supra note 59, at 130-31; Paul Harrison, Similarities in the Distribution of Stock Market Price Changes Between the Eighteenth and Twentieth Centuries, 71 J. Bus. L. 55, 75-78 (1998). Other economic historians have expressed skepticism about whether the efficient market hypothesis, at least in its strong form, is valid for eighteenth century securities markets. Philip Mirowski, What Do Markets Do? Efficiency Tests of the 18th Century London Stock Market, in 24 EXPLORATIONS ECON. HIST. 107 (1987).
91. MICHIE, supra note 65, at 171.
92. WERNER & SMITH, supra note 58, at 31. Initially, the New York Stock and Exchange Board (NYS&EB), which was organized in February 1817 and was the predecessor to the NYSE, did not publish any price information. By November 1817, weekly information was published. Then daily price information was released and, by 1828, the NYS&EB was releasing volume information. Id. at 31, 219 n.25. Even prior to official action by the NYS&EB, weekly security prices “that were presumably furnished by one or more brokers” were published in newspapers. Id. at 219 n.25.
93. MICHIE, supra note 65, at 171-72. See also WERNER & SMITH, supra note 58, at 226 n.63. By 1831, the Federal government had created the world’s most advanced postal system, with 8,700 post masters manning a system that reached most inhabitants.
available prices were not intra-day prices, they were the prices as of a certain time. The lack of intra-day price information created numerous opportunities for brokers to act without the customer having any ability to effectively monitor the execution.\textsuperscript{94}

The situation changed dramatically with the invention of the telegraph in the 1840s and accelerated with the introduction of the ticker tape machine in 1867 and the telephone in the 1870s. Communication of price information that had taken two or three days by letter could now be accomplished in a minute and a half.\textsuperscript{95} Communication between brokers and customers was similarly accelerated.

As the ability to send price information quickly was transformed by the ticker tape, the amounts of price information increased as well. On the NYSE, continuous trading began after the Civil War. Prior to this change, securities "were called at intervals during the day, and such trading as resulted in them were [sic] supposed to occur, and usually did occur, only after the 'call' in each instance."\textsuperscript{96}

The ticker-tape machine "normally ran only two or three minutes behind the trading on the floor though in very active periods [the prices] could be as much as ten minutes behind."\textsuperscript{97} In theory, a customer now had the tools to effectively monitor a broker's execution on a minute by minute basis rather than the less precise daily basis. Now it was also possible for a broker to simultaneously follow developments in many geographically dispersed markets.\textsuperscript{98} It was even possible to stay in touch with the international securities markets by cable.\textsuperscript{99}

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\textsuperscript{94} PAUL STARR, THE CREATION OF THE MEDIA: POLITICAL ORIGINS OF MODERN COMMUNICATIONS 87-88 (2004). In addition, Congress granted newspapers "special discount rates and privileges," which led to the "postal service carry[ing] a prodigious volume of newspapers." \textit{Id.} at 88-90.

\textsuperscript{95} 1834 Report, \textit{supra} note 48.

\textsuperscript{96} MICHE, \textit{supra} note 65, at 171-73.

\textsuperscript{97} J. EDWARD MEEKER, THE WORK OF THE STOCK EXCHANGE 67 (1930).

\textsuperscript{98} \textit{Id.} at 174.

\textsuperscript{99} \textit{Id.} at 176. This monitoring was accomplished "[b]y maintaining a telephone line from the floor of the New York Stock Exchange to the broker's office, and thence a telegraph or telephone contact with a broker on another exchange." \textit{Id.}

\textsuperscript{99} THE FINANCIAL SYSTEM IN NINETEENTH-CENTURY BRITAIN 17-18 (Mary Poovey ed., 2003) ("By World War I, information could travel [by cable] from London to New York in only thirty seconds."). In the 1890s arbitrage between New York and London (or other European securities exchanges) was also conducted by cable. At that time, the roundtrip from New York to London and back took four minutes. FRANCIS L. EAMES, THE NEW YORK STOCK EXCHANGE 90 (Greenwood Press 1968) (1894).
C. Clearance and Settlement

Clearance is the process of comparing trading records on both sides of a trade to reconcile any differences, and settlement refers to the actual transfer of securities and money. Settlement changed greatly over the course of the nineteenth century. Until the Civil War, delivery of a security was effected by transferring it on the books of the issuer and certificates were not normally issued. The great increase in trading volume during the Civil War led to the transfer of the actual certificates with assignments indorsed in blank (now commonly called blank stock powers). There was no need to register a transfer on the books of an issuer except to ensure that dividends or interest were paid to the proper party.

Subsequent to the Civil War, each trade on the NYSE was individually settled by 2:15 p.m. the next business day by the physical movement of stock certificates and checks from one broker to another. "As 2 o’clock approached, the streets of the financial district presented a curious spectacle. By common consent, the delivery boys were given the right of way. Running at top speed, their hands full of securities and checks, the boys were everywhere in evidence."

The next step was the development of the clearing house, which greatly simplified the process of clearing securities trades. The clearing houses simplified the number of separate movements of securities and checks between selling and buying brokers, and the absolute numbers of the former and amounts of the latter. The CSE created the first fully

101. THE NEW YORK STOCK EXCHANGE 446 (Edmund C. Stedman ed., 1905). Stedman dates the change to "[b]etween 1863 and 1864." Id.
102. EAMES, supra note 99, at 43-44.
103. JOSEPH E. HEDGES, COMMERCIAL BANKING AND THE STOCK MARKET BEFORE 1863, 97 (1938).
105. Id.
developed clearing house in 1886. The Philadelphia Stock Exchange set up a "crude" system at approximately the same time, and the NYSE adopted a clearing house a few years later, in 1892.

The clearing house allowed a broker to net out his obligations "as if his dealings had been with a single other member." The clearing house accomplished this by arbitrarily determining what particular broker was to deliver shares to another broker, so long as the first broker had the obligation to deliver and the second broker the obligation to receive the pertinent security. The delivering broker may have had no personal transaction with the broker assigned to him; that is a matter of no concern. The clearing-house deals with exchanges, not with bargains—with balances, not with persons; and so long as the entire list of deliveries due is assigned in correct proportion to the items in the list of receipts due, the clearing-house books balance and every broker will have received the stock to which he is entitled.

A similar system occurred with checks, except that there were two checks: a "check for the 'receive' and 'deliver' balances" was exchanged between the two brokers, with the value of the shares being calculated as of the close of the trading day. As the price was set arbitrarily, normally a "balance" check had to be delivered either by the broker to the clearing house or by the clearing house to the broker. By means of clearing houses, exchanges were able to greatly reduce the amount of capital required of brokers as well as the amount that brokers had to borrow.

One possible problem that the clearing house system presented to

107. S.A. Nelson, The Consolidated Stock Exchange of New York, Its History, Organization, Machinery and Methods 48 (1907) ("In this country, the distinction of first having adopted the clearing-house idea lies between the Philadelphia Stock Exchange and the Consolidated Stock Exchange of New York."); Noyes, supra note 106, at 259 ("The Philadelphia Stock Exchange had taken some steps in the same direction [as the CSE] . . . .").
110. Id. at 264.
111. Id. at 264-65.
112. Id. at 255. One report of the investigation of a single day's transactions for an unnamed broker, presumably a CSE member, found that, prior to the clearing house, the broker would have had to receive and deliver 18,700 shares, issue $649,741 in checks, and receive $607,456.66. After the clearing house, 1,700 shares were delivered, $67,700 in checks were issued and $25,415.66 in checks were received. Nelson, supra note 107, at 49-50.
the development of the theory of best execution was that, unlike the current situation in the United States securities markets, a clearing house only covered a single exchange and its members. The advantages of netting did not extend to nonmembers and, thus, practical concerns about delivering and receiving shares and checks might have made brokers hesitant about executing trades on exchanges of which they were not members.

It should be noted, however, that brokers who were members of one exchange had correspondence relations with brokers who were members of other exchanges and, increasingly by the end of the nineteenth century, brokers had memberships in multiple exchanges. In addition, there was a well developed market for borrowing shares, so concerns about delivery and receipt of stock certificates between markets should not have presented a great obstacle to the development of the concept of best execution. The pre-clearing house system of using an issuer’s books to settle trades would have made executions on markets located in cities where the issuer was not located more awkward than those in the same city. The correspondence relationship between brokers had been in existence since the very founding of the American securities markets. Finally, in both the pre- and post-clearing house eras, difference trading was a common practice. In difference trading, no transfers (either on the issuer’s books or by means of certificates and blank stock powers) were effected, thus settlement was made solely by cash payments.

D. Brokers and Their Customers

Another possible explanation for the late appearance of the doctrine of best execution is the nature of investing and the identity of the investors. Insofar as investing was done in local enterprises by purchases directly from the issuer, not through secondary markets, best execution would not have been a concern. Rather, the congruent legal issue would have been fraud involved in the selling of securities. By the middle of the nineteenth century, there was a well developed body of case law involving misrepresentations by issuers. Notions of fraud were also

113. Mooney, supra note 100, at 316-24.
114. See infra Part III.D.
115. STEDMAN, supra note 101, at 445-54.
116. MICHIE, supra note 65, at 171-72, 187.
117. See supra Part III.
applied to sellers and issuer's agents in the secondary market.\textsuperscript{119} Evidence certainly exists that most investing was done in local enterprises before the late nineteenth century.\textsuperscript{120} There is, however, no comparable evidence that securities were generally obtained directly from the issuer.

Perhaps investors were mainly institutions, wealthy individuals\textsuperscript{121} or foreigners. Institutions or wealthy investors might not have needed the protection of a doctrine like best execution, being able to protect themselves, and foreigners could not have afforded the costs of pursuing legal remedies.\textsuperscript{122} Although all three of these groups were present in the American securities markets by the early nineteenth century, "the mainstays of the early American securities markets were the . . . men of moderate means: tradespeople, merchants, and farmers."\textsuperscript{123} By the beginning of the twentieth century, the growth and capital needs of the large railroads and industrial enterprises had led to widely dispersed shareholdings. In 1913, the 76 "leading railroads" had approximately 500,000 shareholders and the 252 "principal industrial enterprises" had approximately 900,000 shareholders.\textsuperscript{124}

As the numbers and dispersion of shareholders increased, the mechanisms for reaching them expanded. The early twentieth century witnessed the growth of the regional and national brokerage firms that especially sought out the small investor. By World War I, almost all financial institutions that underwrote and distributed securities, which included "private and incorporated banks and trust companies," had both wholesale and retail arms.\textsuperscript{125} The turn of the century also saw the

\begin{itemize}
  \item \textsuperscript{119} \textit{Id.} at 239-42.
  \item \textsuperscript{120} \textsc{James L. Sturm}, \textsc{Investing in the United States 1798-1893: Upper Wealth-Holders in a Market Economy} 70-95 (1977).
  \item \textsuperscript{121} \textsc{James L. Sturm}, \textsc{Investing in the United States 1798-1893: Upper Wealth-Holders in a Market Economy} 70-95 (1977).
  \item \textsuperscript{122} \textsc{Edward Pesen}, \textsc{Riches, Class, and Power Before the Civil War} 67-68 (1973).
  \item \textsuperscript{123} \textsc{Professor John Coffee has argued that foreigners' importance to the American securities markets and their economic inability to pursue litigation in the United States help to explain American investment banks' practice of placing representatives on corporate boards in the late nineteenth and early twentieth centuries as proxies to protect foreign investors.} \textsc{John C. Coffee, Jr., The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control}, 111 \textsc{Yale L.J.} 1, 29-30 (2001).
  \item \textsuperscript{124} \textsc{Werner & Smith, supra note 58, at 62 (footnote omitted).}
  \item \textsuperscript{125} \textsc{Vincent P. Caruso, Investment Banking in America: A History} 108
\end{itemize}
development of five "wire houses" with national distribution systems, which "were essentially retail brokerage firms that handled the orders of small customers and were the predecessors to our modern broker-dealers." During the early twentieth century, the development of the wire houses continued apace.\textsuperscript{127}

Widespread securities ownership and an active secondary market both had existed for decades before the administrative proceedings and cases of the 1930s in which the SEC began to develop the doctrine of best execution. Nothing in the nature of securities ownership would have presented an obstacle to the development of the doctrine.

\textbf{E. Arbitrage Between Markets}

The clearest evidence that best execution could have been a legal doctrine prior to the 1930s is the fact that arbitrage between American securities markets had been carried out from their earliest years. The first evidence of arbitrage occurs in the 1790-1792 economic boom and involves the New York and Philadelphia markets.\textsuperscript{128} Of course, an extremely limited range of securities were traded. In 1792 there were only three issues of federal bonds and two issues of bank stock that were traded on the NYSE\textsuperscript{129} but all of the mechanisms for effective arbitrage were in place.

An effective price discovery mechanism existed in New York, where prices were set initially by daily public auctions and then twice daily auctions starting in August 1791.\textsuperscript{130} The New York market was the most liquid and had an active group of traders, or "speculators" as they were called at the time.\textsuperscript{131} Communication difficulties meant, however,
that profits had to be at least 10% above and beyond expenses before arbitrage in these early markets was economically viable.\textsuperscript{132} Arbitrage did not lead, therefore, to substantially equal prices on different securities markets.\textsuperscript{133}

After the introduction of the telegraph, brokers who were members of one exchange initially set up relationships with brokers who were members of other exchanges. By the end of the nineteenth century, some brokers were becoming members of multiple exchanges and the arbitrage business was concentrated in these brokers.\textsuperscript{134} Differences in prices between typical securities traded on two or more markets in the United States dropped from 4.5% in the 1790s, to 0.19% in 1870, and to 0.125% in 1904.\textsuperscript{135} The same process occurred internationally, with price differentials dropping to 0.125% or 0.0625% (one-eighth and one-sixteenth, respectively).\textsuperscript{136}

As the NYSE had a fixed minimum commission of one-eighth percent when a member of the NYSE transacted business with a non-member,\textsuperscript{137} other exchanges were able, as communications improved, to take order flow away from the NYSE by adopting lower commissions.\textsuperscript{138} The NYSE took a number of measures in the last two decades of the nineteenth century to discourage arbitrage. The measures ranged from a series of litigations in which the NYSE attempted to restrict access to its price quotations by ticker tape to those parties of which it approved;\textsuperscript{139} to barring joint-account arbitrage where brokers “did not charge each other commission and shared the costs incurred, dividing any profits or losses

\textsuperscript{money is to be had in Your City.}

\textit{Id.}

\textsuperscript{132} Michie, supra note 65, at 171-72.

\textsuperscript{133} Id. at 172. Professor Michie cites the price of US Bank stock on February 25, 1792, as $117 in New York and $112 in Philadelphia. Id. Professor Werner, in contrast, writes that “[a]rbitrage between markets eliminated, or at least narrowed, differences in yield to investor and cost to issuers for issues that were traded nationally or internationally: primarily federal bonds and shares in the Bank of the United States.” Werner & Smith, supra note 58, at 226 n.63. It would be a useful project to examine how closely price quotations on the New York and other markets were correlated in the period prior to the introduction of the telegraph in the mid-1840s.

\textsuperscript{134} Michie, supra note 65, at 187.

\textsuperscript{135} Id.

\textsuperscript{136} Id. at 188.

\textsuperscript{137} W.C. Van Antwerp, The Stock Exchange from Within 278 (1913); Michie, supra note 65, at 199-200.

\textsuperscript{138} Michie, supra note 65, at 199-200.

\textsuperscript{139} Mulherin & Netter, supra note 71, at 605-17.
resulting;"\textsuperscript{140} to "bann[ing] the practice of dealing on differences in prices between exchanges;\textsuperscript{141} to, finally and most effectively in January of 1898, prohibiting "the sending of continuous quotations."\textsuperscript{142} As the ticker tape lagged a bit behind the real time trading on the NYSE, the prohibition on continuous quotation was fairly successful in limiting arbitrage, although it did not bring it to a complete halt.\textsuperscript{143}

Arbitrage also was conducted between the CSE and the Boston and Philadelphia Stock Exchanges into the first decade of the twentieth century.\textsuperscript{144} The profit per share, before the deduction of expenses, was "small-usually 1/8;" therefore, a broker had to conduct "many profitable" transactions in order to be successful.\textsuperscript{145} Arbitrage had started twenty-five years earlier with petroleum pipe-line shares that were traded on the petroleum exchanges of the CSE, Pittsburgh and Oil City.\textsuperscript{146}

The widespread existence of arbitrage opportunities between markets and the competition over commission rates between different securities markets certainly created an environment in which best execution claims could have been credibly brought. That there do not seem to be such claims made in the case law or discussed in the treatises suggests that this area of the law had not yet developed.

IV. Popular Writing on Investing

To compare Fred Schwed's \textit{Where Are the Customer's Yachts? Or a Good Hard Look at Wall Street}, first published in 1940, with Arthur Levitt's \textit{Take on the Street}, published in 2002, is to trace the development of the concept of best execution. Both books are addressed to customers of brokers and both have much sound advice. But where Schwed barely addresses best execution, Levitt spends considerable space on the doctrine.

Schwed's delightful volume was written at the end of his thirteen

\begin{itemize}
\item \textsuperscript{140} \textit{Michie, supra} note 65, at 201.
\item \textsuperscript{141} Id.
\item \textsuperscript{142} \textit{Id. Eames, supra} note 99, at 91, (providing the date of May 1894 for the withdrawal of "some of the facilities for sending instantaneous and continuous private quotations to other cities").
\item \textsuperscript{143} Id.
\item \textsuperscript{144} S.A. Nelson, \textit{supra} note 107, at 75-78. The trade was conducted by firms that had floor brokers in both cities and a dedicated telegraph wire between the floors of the two exchanges that was manned by operators who were visible to the floor brokers. The operators and floor brokers communicated by means of hand signals. \textit{Id.} at 76.
\item \textsuperscript{145} \textit{Id.} at 75.
\item \textsuperscript{146} \textit{Id.} at 77.
\end{itemize}
years as a broker on Wall Street. Although he covered topics such as the valuation of securities, mutual funds (or investment trusts as they were called then), short selling and options, he never discussed best execution. The closest he got is when he described a sale in 1928 of "twenty shares of Guarantee Trust Company stock at $760 a share at a moment when it could have been purchased anywhere else at $730."

When the customer called to complain, the Texas broker told him that "you-all don't appreciate what the policy of this firm is. This-heah firm selects investments for its clients not on a basis of Price, but of Value!"

Fifty-two years later, Levitt spent considerable space explicitly discussing best execution issues. In fact, best execution is one of the themes that ties his book together.

He describes payment for order flow and internalization, spreads on Instinet versus Nasdaq, the "SOES bandits" and the demand for faster executions that led to the electronic communication networks such as Island and Archipelago; order-handling rules; fragmentation of markets; SEC rules governing disclosure by brokers of execution

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147. FRED SCHWED, JR., WHERE ARE THE CUSTOMERS' YACHTS? OR A GOOD HARD LOOK AT WALL STREET 4 (John Wiley & Sons 1995) (1940). The title is taken from an illuminating joke that Schwed retells:

Once in the dear dead days beyond recall, an out-of-town visitor was being shown the wonders of the New York financial district. When the party arrived at the Battery, one of his guides indicated some handsome ships riding at anchor. He said, "Look, those are the bankers' and brokers' yachts."

"Where are the customers' yachts?" asked the naïve visitor.
— Ancient story

148. Id. It would be anachronistic to expect Schwed to use the term "best execution." But one could expect him to discuss the relative costs of executing trades on different markets.

149. Id. at 186. It is unclear whether this is an apocryphal story.

150. Id. at 187. There are four other occasions where Schwed hinted at best execution-type issues. Id. at 144 ("disappointing [option] executions on the floor"), 199 (characterizing the spread of an eighth as "stealing"), 204-05 (describing bribery of low level brokerage employees to direct "commission business to other brokers"), 207 (referring again to "an honest broker stealing his customary eighth").

151. ARTHUR LEVITT, TAKE ON THE STREET: WHAT WALL STREET AND CORPORATE AMERICA DON'T WANT YOU TO KNOW, WHAT YOU CAN DO TO FIGHT BACK 29-31 (2002).

152. Id. at 185.
153. Id. at 188.
154. Id. at 190.
practices;\textsuperscript{155} decimalization;\textsuperscript{156} and execution quality and what the customer can do about it.\textsuperscript{157}

How can we account for this change? One of the crucial intellectual changes in the intervening 60 years was the development of the capital-asset pricing model and the related efficient market hypothesis in all of its various forms: weak, intermediate and strong.\textsuperscript{158} One of the consequences of accepting a version of the efficient market theory is that minimizing transaction costs becomes a crucial issue. If it is not possible to beat the market, then transaction costs just detract from what an investor would otherwise earn.\textsuperscript{159}

In addition, American attitudes toward securities trading underwent a considerable change in the first half of the nineteenth century.

The anti-market thought inherited from eighteenth-century England, and reformulated in the United States after the crash of 1792, remained fixed in American culture through the middle of the nineteenth century. In the view of many observers, securities trading was inordinately deceitful, it was a non-productive activity diverting time and money from more useful pursuits, and it corroded the nation’s political structure. As the composition of the market shifted over the first half of the century, however, and as conventional objects of concern changed over the same period, the last argument—the fear of the market’s political effects—underwent slow but unmistakable transformations.\textsuperscript{160}

The biggest change was in the growth of support for the securities markets and even for speculation. “By the middle of the century, there was a substantial body of opinion holding that stock speculation actually \textit{added} to the national wealth.”\textsuperscript{161} Sometimes commentators were willing to condone “useful” speculation, e.g., speculation that led to canals being built, but not speculation that was “wasteful,” e.g., speculations that “make the variation of prices more irregular, and force them to

\begin{itemize}
\item \textsuperscript{155} Id. at 194.
\item \textsuperscript{156} Id. at 195-96.
\item \textsuperscript{157} Id. at 199-203.
\item \textsuperscript{158} See generally BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET (1990).
\item \textsuperscript{159} Id. at 306 (“As someone who believes largely in the efficient market theory, I advocate a buy-and-hold strategy. Doing very little trading minimizes both transaction charges and taxes.”).
\item \textsuperscript{160} BANNER, supra note 53, at 198. The political argument moved from an eighteenth century republican critique of political corruption to a nineteenth century conception of class interests. Id. at 215.
\item \textsuperscript{161} Id. at 217.
\end{itemize}
wider extremes.""162

V. Conclusion

This article concludes before the doctrine of best execution had really emerged. The story of best execution subsequent to the 1920s is one of the SEC's confident announcement of the doctrine in the 1930s as though it were well-established. The development of class actions in the 1960s is another important step in the doctrine's development.163 Without a mechanism for the aggregation of individually small claims, there would have been little incentive for attorneys to pursue such claims. The story of the development of class actions is also the story of members of ethnic and religious groups that were excluded from the traditional legal profession creating their own plaintiffs' securities bar and, in the process, helping to revolutionize securities law.164

In a later article, this Author will explore the development of the doctrine of best execution under auspices of the SEC and the prodding of the plaintiffs' securities bar. It is a rich story, with many highlights. On the SEC's side, the story starts in the 1930s with the SEC's first regulatory actions with regard to brokers. Each time since then that the SEC has considered broad reform of the securities markets, it has revisited the issue of best execution. The high points, of course, are the 1960s and early 1970s as the National Market System was developed165 and the current debates over the Trade-Through Rule. The securities

162. Id. at 220-21 (quoting WILLARD PHILLIPS, A MANUAL OF POLITICAL ECONOMY 50-51 (1828)).


164. The role of the plaintiffs' securities bar was suggested to me by Professor James A. Fanto of Brooklyn Law School. Professor Mitchell has written a suggestive article on this topic. See Lawrence E. Mitchell, Gentleman's Agreement: The Antisemitic Origins of Restrictions on Stockholder Litigation, GWU Law School, Public Law Research Paper No. 44, available at http://ssrn.com/abstract_id=321680 (last visited Dec. 12, 2005). Professor Mitchell is concerned with tracing the anti-semitic origins of New York's statute allowing a corporation that is sued derivatively to require the plaintiff to post a bond and if the plaintiff does not own a certain amount in value or percentage of outstanding stock. Id. at 1. He ascribes the passage of this restriction to the annoyance that the WASP corporate bar and its WASP clients felt at having to deal with a plaintiff shareholders' derivative suit bar that was largely Jewish. Id. at 42-46.

165. The result was not always a clear victory for the best execution doctrine. See SELIGMAN, supra note 81, at 338-39 (criticizing the SEC's 1963 special study of Securities Markets for not at least studying "the mechanisms by which market-maker competition could be increased" in order to encourage lower costs for individual investors).
class action story is also interesting in that the doctrine of best execution, at least in its pure form, was a relatively late arrival to the party.