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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
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November 7,2003

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Comments On the Federal Reserve Bank's Interpretive and Compliance Guide to the Anti-Tying Restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970, Docket No. R-1159

Dear Ms. Johnson:

The United States Department of Justice Antitrust Division (the "Division") submits this letter in response to the August 25,2003 solicitation for public comments by the Board of Governors of the Federal Reserve System (the "Board") regarding its proposed interpretation and supervisory guidance (the "Guide") to the anti-tying restrictions of section 106 of the Bank Holding Company Act Amendments of 1970 (the "BHCA").

Section 106 broadly prohibits banks from requiring a customer to purchase a given product or service in order to qualify to purchase or receive a discount on some other product or service, a practice often called "tying." As discussed below, the prohibitions on tying within section 106 are much broader than those found in the federal antitrust laws. While the Guide brings section 106 closer to the scope of the federal antitrust laws by stating that it pertains only to coercive, not voluntary, tying, the Division is still concerned that the Guide's interpretation of section 106 may continue to prohibit some procompetitive practices, particularly multi-product discounting. Additionally, the Division is concerned that the section disadvantages banks as competitors in markets in which banks and nonbanks compete, thus lessening competition and harming consumers. The Division, therefore, recommends that the Guide interpret section 106 to be consistent with, and not broader than, the federal antitrust laws. In the event the Board determines that court precedent precludes such an interpretation, the Division recommends that the Board exercise its statutory right to expand the range of exemptions to section 106.

Section 106 and the Draft Interpretive Guide

In 1970, Congress enacted the BHCA. One stated purpose of the amendments was "to prohibit anticompetitive practices which require bank customers to accept or provide some other service or product or refrain from dealing with other parties in order to obtain the bank product or service they desire."[1] This prohibition of anticompetitive practices, referred to as the "anti-tying provision," is found in section 106(b)(1) of the BHCA, which provides that a "bank shall not in any manner extend credit, lease or sell property of any kind, or furnish any service, or fix or vary the consideration for any of the foregoing, on the condition or requirement . . . (A) that the customer shall obtain some additional credit, property, or service from such bank other than a loan, discount, deposit, or trust service; [or] (B) that the customer shall obtain some additional credit, property, or service from a bank holding company of such bank, or from any other subsidiary of such bank holding company. . . ."[2]

Not all tying arrangements violate section 106. Since the inception of the statute, banks have been allowed to impose certain types of tying arrangements on customers. Section 106 expressly permits a bank to condition the availability or price of a product or service to a customer on a requirement that the customer also obtain another traditional banking product, such as a loan, discount, deposits or trust service, from the bank. One stated purpose of this exception, as noted in the Guide, "was to allow banks and their customers to continue to negotiate their fee arrangements on the basis of the customer's entire banking relationship with the bank."[3] In addition to this exemption embodied in the statute, the Board may also "by regulation or order permit such exceptions to the foregoing prohibition . . . as it considers will not be contrary to the purposes of this chapter."[4] As envisioned by the statute, the Board has created some regulatory safe harbors for certain combined-balance discount packages, depending on their structure, and for foreign transactions.

The Guide clearly explains that voluntary ties, *i.e.,* those entered into freely or sought by a customer, are not violations of the statute. Likewise, it is noted in the Guide that cross-selling and cross-marketing the full array of products offered by the bank or its affiliates is an ordinary business practice, and not in itself a violation of section 106. The Guide acknowledges and retains the understanding that relationship banking is an important part of the business relationship. The Division believes it is very important that the Guide retains the clear understanding that only coercive ties forced on a customer by a bank, and not voluntary ties, may violate section 106.

The Division is still concerned, however, that, as interpreted by the Guide, section 106 may continue to restrict the ability of banks to bundle products at a discount depending on which products are bundled and which products are discounted. This restriction may negate or minimize

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[1] S. Rep. No. 91-1084, *reprinted in* 1970 U.S.C.C.A.N. 5519, *5535*.

[2] 12 U.S.C.§1972.

[3] *See* Guide at *16 (citing 116 Cong Rec S15708 (daily ed Sept 16, 1970)(Statement of Sen Bennett), see also* Senate Report at *5535*

[4] 12 U.S.C.§1972(1)

the benefits customers gain from multi-product discounts. The Division is also concerned that application of section 106 only to banks lessens competition in markets with bank and nonbank providers thus harming consumers. Finally, the Division's interpretation of the legislative history suggests that the focus of Congress in enacting section 106 was protection of small businesses or individual consumers from predatory business practices by a bank and that a more liberal interpretation of section 106 than currently proposed in the Guideline would not undercut Congress' intent and in certain circumstances would indeed increase competition and thereby benefit consumers.

The Interest and Experience of the U.S. Department of Justice

The Division is entrusted with enforcing the federal antitrust laws and works to promote free and unfettered competition in all sectors of the American economy. As part of its responsibilities to promote free competition, the Division has a special role under the banking statutes' to review all applications for bank mergers and report on the Competitive factors to either the Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Office of Thrift Supervision ("banking agencies"). For most bank mergers, the Division forwards its competitive factors report to the appropriate banking agencies, which are obligated to perform their own analysis of the proposed transaction. Working together, the Division and the banking agencies ensure healthy and vigorous competition in banking.

The United States Supreme Court has observed that "ultimately, competition will produce not only lower prices but also better goods and services. 'The heart of our national economic policy long has been faith in the value of competition."'[6] Competition benefits consumers not only of products offered by traditional manufacturing industries, but also of services offered by banks and other financial institutions. Restraining competition can force consumers to pay increased prices or to accept goods and services of poorer quality. Although tying arrangements can be anti-competitive, overly restrictive laws can also impede legitimate competition that benefits consumers. Our concern in these areas has led us to submit these comments.

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[5] The Bank Holding Company Act, 12 U.S.C.§§1842, 1849, the Bank Merger Act, 12 U.S.C.§1828(c), the Home Owners Loan Act 12 U.S.C.§1467a(e), and 12 U.S.C.§1821(n).

[6] *Nat'l Soc of Prof'l Eng'rs* v *United States*, 435 U S 679, 695 (1978) *(citing Standard Oil Co v FTC*, 340 U S 231, 248 (1950)); *accord FTC v Superior Court Trial Lawyers Ass'n*, 493 U S 411, 423 (1990)

Section 106 has the Potential to Chill Competition

In drafting the Guide, the Board was required to recognize and consider the precedent that to date has informed the interpretation of section 106. However, the Board also had to consider the degree to which banking has changed since section 106 was first adopted, and it is clear that the Board did just that in seeking to reduce the impact of the section's tying restrictions. The Division believes, however, that the Guide should go even further to reconcile section 106 with the commercial and economic realities that the Board has implicitly and explicitly recognized.

The courts have interpreted section 106 as imposing significantly more stringent prohibitions than the general prohibitions on tying found in the Sherman and Clayton Acts.[7] In fact, the U.S. courts have largely interpreted section 106 as a strict per se rule, that is, a rule for which a violation may be established by the act of tying itself, without the need to show that the targeted action is unreasonable. Per se interpretations of the antitrust laws have historically been limited to a relatively small group of practices that as noted by the Supreme Court, "because of their pernicious effect on competition and luck of any redeeming virtue are conclusively presumed to be *unreasonable*."[8] In circumstances where parties to an agreement have fixed prices, curtailed output, or divided a market, there are benefits in employing per se rules that draw bright lines between legal and illegal behavior. The federal antitrust laws, however, do not apply a strict per se rule to tying arrangements, as doing so may actually be harmful to competition. Tying arrangements are per se illegal under the federal antitrust laws only if the seller has sufficient market power to make anticompetitive effects highly likely.'

Although it clarifies categories of exceptions to the strict per se rule, the Guide retains the per *se* interpretation of section 106, even in instances where the conduct could be procompetitive. In fact, the Guide specifically finds that market power and anticompetitive effects are not necessary for a tying or bundling practice to be a violation of section 106.[10] The primary difference between section 106 and the broader antitrust restrictions on tying is that the former generally has been interpreted by the courts as requiring a showing of neither market power nor anticompetitive effects

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[7] *See, e.g., Dibidale of Louisiana, Inc. v. American Bank & Trust Company, New Orleans,* 916 F.2d *300,* 305 (5th Cir. 1990) ("the anti-tying provisions [of section 106] were intended to regulate conditional transactions in the extension of credit by banks more stringently than had the Supreme Court under the general antitrust statutes").

'*Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

[9] *Jefferson Purish Hospital District No. 2 v. Hyde*, 466 U.S. *2,* 14-16 (1984). The Court stated that "...as a threshold matter there must be a substantial potential for impact on competition to justify *per se* condenmation...[o]nce this threshold is surmounted, *per se* prohibition is appropriate if anticompetitive forcing is likely." *Id.* at 16. *See, e.g.,* ABA Antitrust Law Developments at 179 (5th ed. 2002). ("[A) tying arrangement may still be unlawful under the rule of reason.'')

[10] The Guide compares the required elements for a general antitrust prohibition on tying to the requirements for a section 106 violation. Guide at 7-9. The former include market power in the tying good market and anticompetitive effects, along with a requirement that the arrangement affect a "not insubstantial" amount of interstate commerce. *Id.* According to the Guide, none of these elements are required in finding a section 106 violation. *Id.* at 8.

(though there is some disagreement in the courts regarding the latter"), while prosecution under the antitrust laws effectively requires both of these elements.

A significant problem with a strict *per se* interpretation of section 106 is that, even given the ability to carve out exceptions to the statute, it is very difficult, if not impossible, to anticipate all efficient ties and bundles of bank products that might merit an exception. Tying and bundling strategies encompass a wide range of firm behavior and can be either pro or anticompetitive Consumers are harmed when efficient ties of banking products are not exempted from the statute, because they are denied the opportunity to purchase more affordable and desirable product mixes.

As interpreted by the Guide, section 106 still prohibits practices that could well be pro-competitive, and the Division is concerned about the section's potential to limit multi-product discounting. Firms may have a natural, non-strategic incentive to offer multi-product package discounts. For example, a firm might have the incentive to offer package discounts if a package creates economies of scale or scope in production, similar to the incentive of a firm to offer a volume discount on a single product, which would be allowed under section 106. Such discounts give firms the appropriate incentives to find and pass along reductions in cost from jointly supplying particular combinations of goods and services. If a bank does not have market power, such discounts can only benefit consumers, and even if a bank *does* have market power, such discounting is often procompetitive. Yet, if the tied product is a "non-traditional" good, the practice would violate the literal wording of section 106 unless one of a small number of additional exceptions is satisfied. Such a prohibition on package discounts can easily dampen one pervasive element of price cornpetition.

As noted earlier, the Guide has defined exceptions to section 106 that allow limited package discounts. For instance, any kind of tying or discounting is allowed if the tied good is a "traditional banking product" as defined by the Federal Reserve, or if the customer has the option of buying either a traditional or non-traditional banking product to obtain the desired good or obtain a discount on the desired good. Also, the Guide emphasizes that to be declared illegal under section 106, ties and bundles must be shown to have been "forced on the customer by the bank."[12] While these exceptions are welcome, they are not enough in themselves to protect competition, because they do not cover all possible procompetitive tying and bundling arrangements. For example, a bank offering a new low-cost and low-price bundle of services welcomed by most customers could still be considered a violation of section 106 if some customers, who only want to buy one product in the bundle, protest that they are being coerced into paying a higher price for the individual product because they choose not to buy the bundled non-traditional banking product. Concern over committing such a violation of Section 106 can discourage bank efficiency, as banks may not offer the most efficient bundle of services for fear that some customers will feel coerced into taking the

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[11] *See, e.g., AmeriFirst Properties, Inc.* v. *FDIC, 880* F.2d 821,826 (5th Cir. 1989) ("Based on the legislative history of the BHCA . . . and on case authority, we conclude that [plaintiff] does not have to make a showing of anticompetitive effects in order to state a tying claim under the BHCA."); *compare, Davis* v. *First National Bank of Westville*, 868 F.2d 206, 208 (7th Cir. 1989) ("[E]ven under this 'relaxed' per se approach to banking tie-ins, a plaintiff seeking relief under section 1972 must still complain of a practice that is anticompetitive. . . . If not . . . section 1972 would prohibit banks from devising particular methods for protecting themselves against default and could . . . have the undesirable effect of discouraging banks from granting extensions of credit. . . ") (internal quotations omitted).

[12] Guide at 12.

product and may pursue litigation. It is true that the Board does have the ability to carve out further new exceptions, but this would be a costly and time-consuming process, and every new exception brings with it a host of new interpretation questions.

The Division is also concerned that, as interpreted by the Guide, section 106 prohibits a bank from meeting competition from non-bank providers of the same service or product. Section 106 has the potential to put banks at a disadvantage when competing with non-banks, because the section's restrictions apply only to banks and not to the other institutions with which the banks may be competing. Any restrictions on banks that are not also imposed on non-banks can inhibit competition in areas where the two intersect. In "non-traditional" banking areas in which banks and non-banks compete, *e.g.*, investment banking services, the competitive benefit offered by banks may be reduced because the banks are not able to competitively respond to multi-product bundles and discounts offered by non-banks. Consumers are harmed when banks cannot respond to competitive tying and bundling of products offered by non-banks.

Further limiting the restrictions imposed by section 106 would also not be inconsistent with the Congressional concerns that led to the provision being enacted in the first place. In passing section 106, Congress was evidently concerned that banks, which often had monopoly power over credit in local markets, would use tying to extend this power into new markets in which the banks did not have monopoly power, thus prompting the section's distinction between "traditional" and "non-traditional" bank products. In the last three decades, however, the repeal of prohibitions on interstate banking has tended to erode banks' monopoly power in "traditional" products. With the growth of interstate banking, many local markets are more competitive and legislatively imposed barriers to entry have been lessened. Whatever the initial merits of the restriction on tying, section 106 has probably outlived its usefulness as a way to protect competition in the banking sector.

Sector-specific prohibitions raise definitional issues and can raise unanticipated complications when Competition spans several sectors. The narrower restrictions on tying encompassed in the Sherman and Clayton Acts, in contrast, apply with equal force across all segments of the economy. For this reason, robust enforcement of the general antitrust prohibitions on tying provides a more balanced approach to sector-specific prohibitions when it comes to protecting competition.

Section 106 Should be Limited in its Application to Individual Consumers and Small Business Customers

The Division recommends that section 106 should not be interpreted to prohibit conduct that the federal antitrust laws do not find anticompetitive. Failing that, at a minimum, the section should be limited to ties involving small businesses and individual consumers. Generally, it appears that section 106 was designed to protect locally limited small business customers and individual consumers from being forced to buy products they did not want (often credit insurance) in order to obtain products they did want (loans) from banks with monopoly power in local markets. The House Managers indicated their concern about the market power of banks, stating:

> Committees of Congress have in recent years been seriously concerned about the basic dangers of monopoly power often enjoyed by banks in local markets. Such power rests on a number of

> considerations, including regulatory policy, scarcity of alternatives, and the difficulties that borrowers tend to have in shopping around for credit or finding alternative funding services. . . . In addition, even without affirmative action or coercion by the bank or holding company, the mere existence of market power may influence potential customers of the bank to choose to deal with other holding company affiliates in order to increase the chances of obtaining credit on favorable terms from the bank.[13] (Emphasis added.)
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> The House Conferees agreed to this provision, particularly because of the necessity of protecting small independent businessmen from unfair and predatory business practices of banks, bank holding companies and subsidiaries thereof.[14] (Emphasis added.)

The case law supports the view that section 106 was intended as additional protection for small businesses and consumers.[15] With section 106 in place, banks were limited in their ability to use the leverage they have in a banking relationship with a customer in order to gain a competitive advantage in a non-banking product.

When the Amendments were being considered in 1970, the Division supported the broader definition of tying under the BHCA in large part because of the overall concern with the inherent market power of banks. Then-Assistant Attorney General McLaren was concerned with the fact that most of the banking tie-ins involved small businesses or individual consumers and small amounts of money. He questioned whether Division resources would be best used in investigating these types of claims, and saw the proposed strict *per se* rule as an appropriate way to balance the harm of tying against the cost of monitoring and investigating these types of claims. The Division believed that any cost or reduction in social benefit to individual consumers by having section 106 in place could be outweighed by the overall benefit to consumers at large and by preservation of Division resources.[16]

Section 106, however, is not limited to small customers, but encompasses all customers, regardless of size or the product being purchased. This is a particular concern in syndicated lending, the area that has engendered most recent questions about tying. Syndicated lending is a national

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[13] Conf. Rep. No. 1747, 91st Cong., 2nd Sess., *reprinted in* 1970 U.S.C.C.A.N. 5561, 5575-5576 (Statement of Patman, Barrett, Sullivan and Reuss, Managers on the Part of the House).

[14] *Id.* at 5580.

[15] *See, e g* , *Dibidale,* 916 F 2d 300 (small building business being iequired to use bank's choice of general contractor in order to obtain construction loan would be a violation of section 106); *see also, Sharkey v Security Bunk & Trust Co* , 651 F Supp. 1231 (bank's requirement that customer purchase real estate from the bank as a condition to obtaining a loan was a violation of section 106)

[16] Mr. McLaren stated: "As a practical matter, many tie-in arrangements involving banks are so limited in their scope or involve such small amounts that they do not seem to justify the expense and time-consuming efforts of full-scale antitrust investigation...enactment of this proposed section would provide a most valuable supplement to the existing remedies against anticompetitive tying arrangements." STREP. No. 91-1084, 91" Cong., 2nd Sess., reprinted in 1970 U.S.C.C.A.N. 5519, 5560-5561.

market with a substantial number of bank and non-bank competitors. Further, borrowers in this market are large corporations with well-trained and sophisticated staff fully capable of negotiating favorable terms. The syndicated loan market is the largest capital market in the world, with over $1 trillion of annual volume. We see no evidence that large borrowers such as syndicated loan borrowers need additional assistance beyond the antitrust laws to protect themselves from anti-Competitive tying. Such firms are much less likely to be victims of anti-competitive ties than small business customers or individual consumers, and were not the customers that were intended to be protected by section 106. Consequently, if the Board determines that section 106 must remain broader that the antitrust laws, the section's reach should be limited to those small businesses and consumers that were the original focus of the legislation.

Conclusion

The Division is concerned that the Board's proposed interpretation of section 106, while permitting a broader use of tying in the banking industry, will continue to prohibit procompetitive practices such as multi-product discounting, and will continue to encourage competitive inequities in markets in which banks and nonbanks compete. The financial world today is quite different from the one that existed when section 106 was enacted, and a more liberal interpretation of the section would not be inconsistent with the rationale that led Congress to adopt this provision. The Division therefore recommends that the Board's interpretation of section 106 be modified to track as closely as possible the standards embodied in existing federal antitrust laws, which provide a more balanced approach to preserving competition and encouraging procompetitive practices that benefit all consumers.

The Division appreciates the opportunity to present its views and would be pleased to address any questions or comments regarding the above.

Sincerely yours,

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United States Department of Justice
Antitrust Division