MEMORANDUM

To: Section 106 Guide Public File

From: Mr. Van Der Weide

Date: June 24, 2004

Subject: Meeting with John Walker, Esq.

On January 30, 2004, representatives of the Federal Reserve System (Messrs. Mattingly, Alvarez, Fallon, Van Der Weide, Baer, and Hurwitz) met with John Walker, Esq. of the law firm Simpson Thatcher (representing Citigroup, JP Morgan Chase, Deutsche Bank, Bank of America, and UBS) to discuss the Board's proposed comprehensive interpretation of section 106 of the Bank Holding Company Act Amendments of 1970. Mr. Walker submitted the attached document, which served as the basis of the discussion at the meeting.

Attachment

SIMPSON THACHER & BARTLETT LLP

425 LEXINGTON AVENUE
NEW YORK, N.Y. 10017-3954
(212) 455-2000

FACSIMILE (212) 455-2502

DIRECT DIAL NUMBER
(212) 455-7365

E-MAIL ADDRESS
JWALKER@STBLAW.COM

January 14, 2004

J. Virgil Mattingly, Jr.
General Counsel
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Dear Virgil:

Since our meeting last April, there have been a number of developments relating to section 106, and my antitrust partner Ken Logan and I would like to meet with you again to further discuss section 106 and the Board's proposed interpretation and supervisory guidance regarding section 106. We will contact Bonnie to see if a meeting can be scheduled during the week of January 26.

In connection with the meeting, enclosed is a bullet-point presentation, which synthesizes the developments during 2003 relating to section 106 and sets out an analysis of section 106 that we believe evidences the fundamental misunderstanding of section 106 that was first set forth in the often cited and quoted Supplementary Views of Senator Edward Brooke. The bank group that we represent, Bank of America, Citigroup, Deutsche Bank, J.P. Morgan Chase, and UBS, believes that the analysis in the enclosed presentation is both compelling and correct and urges the Board, in adopting the final interpretation and supervisory guidance regarding section 106, not to be misled by (i) Senator Brooke's misunderstanding of the *per se* rule as it applies to tying arrangements and (ii) a line of cases that, while accepting Senator Brooke's Supplementary Views, do not rely on these Supplementary Views in their holdings. While Senator Brooke's Supplementary Views and this line of cases may appear to be formidable obstacles to adopting an approach to section 106 that reflects economic reality, the bank group believes that the analysis set out in the enclosed presentation shows that they are not formidable obstacles. We believe that the analysis that evidences the misunderstanding is itself very formidable.

The bank group strongly encourages the Board to fashion an interpretation of section 106 that is both correct and reflects economic reality.

Best wishes for the New Year.

Very truly yours,

/s/ *John*

John L. Walker

Enclosure

The historical interpretation of section 106 "disadvantages banks as competitors in markets in which banks and nonbanks compete" and is inconsistent with the "level playing field" policy underlying the Gramm-Leach-Bliley Act

- The Antitrust Division of the Department of Justice (sometimes referred to herein as the "Division") states in its comment letter (the "DOJ Letter") on the Board's proposed interpretation and supervisory guidance regarding section 106 (the "Proposed Interpretation" or the "Guide") that **"the Division is concerned that [section 106] disadvantages banks as competitors in markets in which banks and nonbanks compete, thus lessening competition and harming consumers."** DOJ Letter at 1; *see also id.* at 2 ("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.").

- In the Proposed Interpretation, the Board recognizes "the increasing importance of section 106 in the wake of the Gramm-Leach-Bliley Act." 68 Fed. Reg. 52025. **The intent of the Gramm-Leach-Bliley Act is to place financial institutions on the same "level playing field"** so that all financial institutions may engage in the same activities, either directly or through affiliates, and so that "everyone gets . . . the same rules, with no special advantages towards any party. . . ." Quoting Representative Bliley, 145 *Cong. Rec.* H11533 (daily ed. Nov. 4, 1999).

- It would be inconsistent with the "level playing field" policy underlying the Gramm-Leach-Bliley Act to conclude that a nonbank financial institution must have market power in the desired-product market for a tying arrangement to violate the *per se* prohibition of the general antitrust laws but that a bank does not have to have such market power for the exact same arrangement to violate the *per se* bank tying provisions.

- If banks have any advantages over nonbanks as a result of deposit insurance and access to the Discount Window, any such advantages would be relevant to the antitrust purposes of section 106 only if they provide banks with market power in the desired-product market.

The mixed-product arrangement as proposed is impractical and unworkable

- In the Proposed Interpretation, the Board concludes that mixed-product arrangements, whereby a bank conditions the grant of a loan to a customer on the requirement that the customer also choose to obtain one or more traditional bank products or non-traditional products, do not violate section 106 if the customer has a meaningful option to satisfy the condition solely through obtaining traditional bank products. 68 Fed. Reg. at 52030-31.

- For the reasons discussed in many of the comment letters on the Proposed Interpretation, this mixed-product arrangement as proposed is impractical and unworkable. *See, e.g.*, the comment letter of the New York Clearing House at 5-9.

- **A customer-by-customer analysis of "meaningful choice" would be highly burdensome, and it could create additional legal risk for banks.** First, it would be very difficult for a bank to obtain reliable information as to its customer's specific banking needs without requesting the information from the customer. The customer may not be inclined to provide the information and the very inquiry to the customer may involve the bank in a discussion of its product offerings that is not permitted under the Proposed Interpretation until after the bank's determination of its customer's needs. Moreover, the bank could be accused of imposing an illegal condition or requirement if it later declines to make a loan because it determines that the meaningful choice requirement cannot be satisfied with respect to that customer. Further, a customer-by-customer analysis could be subject to significant variations depending on the bank's assumptions with regard to both its customer and itself as to such variables as volume, price, timing, and profitability targets. As a result, **the bank's analysis easily could be subject to second-guessing and challenge**, thus increasing the bank's legal risk.

- Banks should not be required to determine whether the customer may legally transfer its business to the bank, as the Proposed Interpretation appears to require. 68 Fed. Reg. at 52031 n.51. This could require a bank to review a customer's contracts with competitors of the bank to determine whether the customer may terminate the contracts. This is impractical from the bank's viewpoint, and **it is unlikely that a customer would allow a bank to review such contracts**.

- Even if a bank formed a "good faith belief" that its customer could meet the meaningful choice requirement, the Proposed Interpretation does not provide a safe harbor to protect the bank from liability if its customer (or a nonbank competitor of the bank) alleges that the bank engaged in impermissible tying. In fact, it appears from statements in the Proposed Interpretation that the burden might shift to banks to establish that no impermissible tying existed in a mixed-product arrangement. Banks could be subject to litigation by customers as to their analyses of customers' ability to satisfy the meaningful choice requirement, which could expose banks to treble damages and civil money penalties.

- The mixed-product arrangement is a verbal formulation that addresses the literal language of section 106; it is not a logical construct that is grounded in anti-competitive principles or considerations.

- The Antitrust Division concludes that while the exceptions in the Proposed Interpretation, including the exception for mixed-product arrangements, "are welcome, they are not enough in themselves to protect competition. . . ." DOJ Letter at 5.

Banking is a dynamic industry and Congress did not intend section 106 to be frozen in time

- Antitrust laws should be interpreted to reflect changing economic times. For example, the 19th century language of the Sherman Act is interpreted to apply to 21st century economic realities.

- This is certainly true for section 106 as well. The OCC White Paper cites numerous sources in the legislative history of section 106 for the proposition that "[b]anking is not a static form of activity" and that "Congress Intended Section 106(b) to Permit Banks to Evolve." OCC White Paper at 28. The OCC White Paper concludes: "The legislative history evinces Congress' understanding that banking is dynamic and banking practices evolve. **Congress did not intend section 106(b) to be frozen in time, just as Congress recognized banking is not static."** *Id.* at 31.

- The DOJ Letter recognizes that, in drafting the Proposed Interpretation, the Board "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." DOJ Letter at 4.

- The DOJ Letter states: "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."** DOJ Letter at 4.

<u>Today's financial services marketplace is quite different from the one that existed in 1970</u>

- **"The financial world today is quite different from the one that existed when section 106 was enacted. . . ."** Quoting DOJ Letter at 8. The DOJ Letter observes:

  > In the last three decades, . . . 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.**

  Id. at 6.

- The OCC White Paper notes that the Gramm-Leach-Bliley Act "removed most of the regulatory barriers to entry into investment banking by banking companies <u>and</u> investment banking companies' entry into banking." OCC White Paper at 7 (emphasis in original). The OCC White Paper states that "in 1995, bank loans accounted for about 10 percent of the outstanding liabilities of all nonfarm nonfinancial corporate businesses. . . . By 2002, the bank loan share had fallen to 7.2 percent." *Id.* at 8-9. The OCC White Paper further notes that "[t]he nonbank share of [Shared National Credits] *grew* from 7 percent in 2000 to 11.3 percent in 2003." *Id.* at 8 (emphasis in original).

  - The appendix to the letter dated August 13, 2002 from Board Chairman Greenspan and Comptroller Hawke to Congressman Dingell states (at page 4 of 7):

    We are aware that the combination of a deteriorating lending environment

> over the last several years, expanded powers under [the Gramm-Leach-Bliley Act], and cross-marketing practices of financial services in the banking industry, have prompted changes in lending and investment banking services by banking organizations. Deteriorating credit conditions and advances in credit risk management have prompted many large banking organizations to question the profitability of some traditional corporate loan products and borrowers that previously were considered low-risk.

The focus of section 106 was protection of small businesses and individual consumers

- The OCC White Paper states: "Throughout the hearing testimony are references to unfair practices that might harm or potentially harm **small independent businesses**, such as insurance agencies, **and individual consumers**." OCC White Paper at 21 n.60. The OCC White Paper (quoting from the Conference Report on the Bank Holding Company Act Amendments of 1970) further states: "The House conferees agreed to the Senate's anti-tying provision 'particularly because of the necessity for protecting small independent businessmen. . . .'" *Id.* at 21.

- In the DOJ Letter, the Antitrust Division states that "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**. . . ." DOJ Letter at 2-3; *see also id.* at 6 ("Generally, it appears that section 106 was designed to protect locally limited small business customers and individual consumers. . . ."); *id.* at 7 ("The case law supports the view that section 106 was intended as additional protection for small businesses and consumers.").

- In the view of the Antitrust Division, **syndicated loan borrowers "were not the customers that were intended to be protected by section 106."** DOJ Letter at 8.

Section 106 applies only to coercive tie-ins

- In the Proposed Interpretation, the Board concludes that the provisions of section 106 apply only to coercive tie-ins. The Board states: **"After carefully reviewing the language, legislative history and purposes of the statute, the Board believes that a violation may exist only if a bank *forces or coerces* a customer to obtain (or provide) the tied product as a condition to obtaining the customer's desired product."** 68 Fed. Reg. at 52029 n.36 (emphasis added); *see also id.* at 52028 and 52029. The Board cites numerous cases under the general antitrust laws to the effect that **"actual coercion" is an indispensable element of a tying violation under the general antitrust laws, and** the Board concluded that this actual coercion element **"also is embedded in section 106."** *Id.* at 52028.

- The OCC White Paper concludes that "Section 106(b) Prohibits 'Coercive' Not Voluntary Tie-Ins." OCC White Paper at 18. The Paper states that "[a] primary concern of Congress was to prevent banks from using economic power to engage in *coercive* tie-ins." *Id.* (emphasis in original).

- In the DOJ Letter, the Antitrust Division states that "[t]he 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." DOJ Letter at 2.

Market power is a necessary condition for coercion

- The OCC White Paper states: **"Coercive ties . . . are premised on the bank's power to control the situation.** The anti-tying provisions were Congress' specific attempt to provide a safeguard against banks' 'misuse of economic power' through coercion or other abusive tactics." OCC White Paper at 19.

- The DOJ Letter states that "[t]ying arrangements are *per se* illegal under the federal antitrust laws only if the seller has sufficient market power to make anticompetitive effects highly likely." DOJ Letter at 4. In a footnote that accompanies such statement, the DOJ Letter quotes the following statement from the opinion of the United States Supreme Court in *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2, 16 (1984) (majority opinion): "*[P]er se* prohibition is appropriate if anti-competitive forcing is likely." It is clear from these statements that anti-competitive forcing -- coercion -- is premised on the existence of sufficient market power to make anti-competitive forcing likely.

- A memorandum submitted on behalf of the National Association of Insurance Agents that is included in the legislative history of section 106 defines a "tie-in" as "coercion through the use of power as a seller." *Bank Holding Company Act Amendments: Hearings on H.R. 6778 Before the House Comm. on Banking and Currency*, 91st Cong., 1st Sess. (1969) (the "*House Hearings*"), at 735 (included in May 1, 1969 proceedings).

- **In virtually every case under the general antitrust laws that the Board cites in the Proposed Interpretation to support its conclusion that proof of coercion is a required element of an illegal tying arrangement under section 106, coercion is explicitly linked to proof of the seller's market power in the desired-product market.** *See Thompson v. Multi-List, Inc.*; *Tic-X-Press, Inc. v. Omni Promotions Co.*; *Unijax, Inc. v. Champion Int'l, Inc.*; *Bob Maxfield, Inc. v. American Motors Corp.*; *Times-Picayune Publishing Co. v. United States*; *Datagate, Inc. v. Hewlett-Packard Co.*; *Response of Caroline, Inc. v. Leasco Response, Inc.*; *American Manufacturers Mut. Ins. Co. v. American Broadcasting-Paramount Theatres, Inc.*; *Capital Temporaries, Inc. v. Olsten Corporation*; *Northern Pacific Railway Co. v. United States*; *see also* Economic Power Paper at 49-56.

A tying arrangement can have anti-competitive consequences *only if* the seller has market power in the desired-product market

- The OCC White Paper concludes that **"Congress Intended [Section 106] to Prevent Anti-Competitive Consequences** Resulting From Improper Tying Arrangements" and that **"Banks Do Not Possess the Market Power [in the Commercial Loan Market] to Engage in Anti-Competitive Tying."** OCC White Paper at 21 and 7, respectively. The OCC White Paper states further that "[t]here is little evidence that banks have market power in the commercial loan market, especially for larger credits" and **"[t]he anti-competitive consequences that concerned Congress simply are not present in today's highly competitive commercial credit markets."** *Id.* at 7 and 24, respectively. The OCC White Paper further states that banks do not "appear to possess market power in lending to larger commercial customers that are the most likely targets for tying. **Pricing power** in this market **is a necessary condition for effective tying by banks."** *Id.* at 30. It necessarily follows from these conclusions in the OCC White Paper that a bank must have market power in the desired-product market to violate section 106.

- It is well established that **a tying arrangement can have anti-competitive consequences *only if* the seller has market power in the desired-product market.** "Without 'control or dominance over the tying product,' the seller could not use the tying product as 'an effectual weapon to pressure buyers into taking the tied item. . . .'" *Jefferson Parish Hospital*, 466 U.S. at 34 (concurring opinion); *see also id.* at 25 (majority opinion) ("Only if [buyers] are forced to purchase [seller's] services as a result of the [seller's] market power would the arrangement have anticompetitive consequences."); 10 Phillip E. Areeda *et al., Antitrust Law* ¶ 1734a, at 39 (1996) ("[T]he rationale for requiring proof of power over the tying product must be that no 'tie-in' can occur or cause any detrimental effect . . . without it."); *id.* at ¶ 1734b5, at 46 ("[P]ower is a precondition that must be satisfied before detriments, if any, can flow from an illegal tie."); *id.* at ¶ 1734d, at 54 ("[W]ithout power in the first [tying] market, no harm to competition in the tied market can occur."). Judge Frank Easterbrook, who sits on the Seventh Circuit Court of Appeals, has stated: **"Firms that lack [market] power cannot injure competition no matter how hard they try."** Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 20-21 (1984).

The historical interpretation of section 106 can inhibit competition

- The DOJ Letter states: "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**. . . ." DOJ Letter at 1.

    - The DOJ Letter states 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.**

DOJ Letter at 6. The DOJ Letter further states:

> **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.

Id. at 6.

- The DOJ Letter concludes: **"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. . . , and will continue to encourage competitive inequities in markets in which banks and nonbanks compete."** DOJ Letter at 8.

<u>Section 106 should be interpreted consistent with, and not broader than, the federal antitrust laws</u>

- The DOJ Letter states: **"The Division, therefore, recommends that the Guide interpret section 106 to be consistent with, and not broader than, the federal antitrust laws."** DOJ Letter at 1; *see also id.* at 6 ("The Division recommends that section 106 should not be interpreted to prohibit conduct that the federal antitrust laws do not find anticompetitive.").

- The DOJ Letter concludes: "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 provides a more balanced approach to preserving competition and encouraging procompetitive practices that benefit all consumers." DOJ Letter at 8.

<u>**Case law precedent does not preclude the Board from adopting the recommendation of the Antitrust Division**</u>

- The DOJ Letter states that **"a more liberal interpretation of section 106 than currently proposed in the [Proposed Interpretation] would not undercut Congress' intent** . . . ." DOJ Letter at 3; *see also id.* at 6 ("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."); *id.* at 8 ("[A] more liberal interpretation of the section would not be inconsistent with the rationale that led Congress to adopt this provision.").

- The OCC White Paper describes court decisions regarding section 106 as being "somewhat inconsistent[]." OCC White Paper at 23. The OCC White Paper states: " Nevertheless, **the circuits all generally recognize that the Congressional intent was to prohibit certain types of tying practices that would 'lead to a lessening of competition or unfair competitive practices.'"** *Id.* at 23-24; *see also* S. Rep. No. 91-1080 (1970) (the "*Senate Report*"), at 17 (section 106 is designed "to prohibit anti-competitive practices"). **For bank tying practices to lead to a lessening of competition or unfair competitive practices, a tying bank must have market power in the desired-product market since "[a]bsent such power tying cannot conceivably have any adverse impact in the tied-product market"** (quoting *Jefferson Parish Hospital*, 466 U.S. at 37 (concurring opinion)). For this reason, the Supreme Court has concluded that a seller's market power in the desired-product market is "the essential characteristic of a invalid tying arrangement. . . ." *Id.* at 12 (majority opinion).

- **In the majority of the opinions of U.S. Courts of Appeals that state that a plaintiff in a section 106 case does not have to establish the market power of a bank in the desired-product market, such statements are *dicta*, which the Supreme Court views as having *no* precedential value.** *See Parsons Steel v. First Alabama Bank*; *Campbell v. Wells Fargo Bank, N.A.*; *Davis v. First National Bank of Westville*; *Amerifirst Properties, Inc. v. FDIC*; *Palermo v. First National Bank and Trust Company of Oklahoma City*; *S & N Equipment Company v. Casa Grande Cotton Finance Co.*; *Highland Capital, Inc. v. Franklin National Bank.* In only two of the opinions did such statements figure into the analysis that led to the outcome of the cases, and the analysis in these two opinions is so unreasonable and flawed, and stands in direct opposition to the analysis of the Board in the Proposed Interpretation and of the Antitrust Division in the DOJ Letter, that these opinions should not be accorded any precedential value. *See* Economic Power Paper at 58-72.

The "plain language" of section 106 does not preclude the Board from adopting the recommendation of the Antitrust Division

- This is no disagreement that section 106 is an antitrust law. **Antitrust laws should be interpreted and enforced in ways that make economic sense. Antitrust laws should not be interpreted in a manner that is hostile to economic efficiency. The role of antitrust regulators is to mold and guide the law. Antitrust laws are designed to evaluate conduct in light of continuing experience as to their effect on competition in evolving economic conditions.** This is particularly evident from the treatment of tying arrangements under the general antitrust laws. "The per se standards relating to tying arrangements . . . have undergone several reformulations throughout the judicial development of the antitrust laws. . . ." 4 *Kintner Federal Antitrust Law* § 32.57, at 95 (1984). Indeed, at the time section 106 was enacted, the status and interpretation of the *per se* rule under the general antitrust laws as it applied to tying arrangements had entered a period of such reformulation. Therefore, some of the confusion that arose under section 106 (*e.g.*, Senator Edward Brooke's Supplementary Views discussed below) can be viewed as a natural consequence of such period.

- The general antitrust laws regarding tying derive from the application of section 1 of the Sherman Act and section 3 of the Clayton Act. The Supreme Court has stated: "As a charter of [economic] freedom [to compete], **the [Sherman A]ct has a generality and adaptability comparable to that found to be desirable in constitutional provisions."** *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 359-60 (1933).

- Section 1 of the Sherman Act, section 3 of the Clayton Act, and section 106 are designed to prohibit agreements that restrain trade (*i.e.*, result in an anti-competitive practice) (i) in goods and services, including credit, by any person in the case of section 1 of the Sherman Act, (ii) in goods by any person in the case of section 3 of the Clayton Act, and (iii) in goods and services, including credit, by a bank in the case of section 106. Under section 1 of the Sherman Act, every agreement by a person that restrains trade in goods and services is illegal; under section 3 of the Clayton Act, a certain type of tying condition, agreement, or understanding by a person that restrains trade in goods is illegal "where the effect of . . . such condition, agreement, or understanding may be to substantially lessen competition[;]" and under section 106, every tying condition or requirement by a bank that restrains trade in goods and services is illegal.

- Read literally, the differences in the language of section 1 of the Sherman Act and section 3 of the Clayton Act are that (i) section 3 of the Clayton Act applies only to a certain type of tying condition, agreement, or understanding involving goods and section 1 of the Sherman Act applies to all contracts involving goods and services and (ii) section 3 of the Clayton Act applies where the effect of the arrangement may be to substantially lessen competition and section 1 of the Sherman Act does not include the "substantially lessen competition" language.

- Section 1 of the Sherman Act reads: "Every contract . . . in restraint of trade or commerce among the several States . . . is declared to be illegal. . . ." The Supreme Court has recognized that "the legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains." *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918). Consequently, **the Supreme Court has limited the scope of section 1 of the Sherman Act by reading into the statute a reasonableness standard**: section 1 of the Sherman Act prohibits only those restraints of trade that unreasonably restrain competition.

- It is important to note that when the Supreme Court first interpreted the substantive provisions of section 1 of the Sherman Act, the Court held that *all* contracts that in fact restrained trade, whether reasonably or unreasonably, were prohibited by section 1. *United States v. Trans-Missouri Freight Association*, 166 U.S. 290, 328 (1897). The Court refused to exempt reasonable restraints from the prohibition of section 1 in the face of "the plain and ordinary meaning" of the language of the Sherman Act. *Id.* at 340. In a vigorous dissent, Justice White stated:

> **[T]here is no canon of interpretation which requires that the letter be followed, when by so doing an unreasonable result is accomplished.** On the contrary, the rule is the other way, and exacts that the spirit which vivifies, and not the letter which killeth, is the proper guide by which to correctly interpret a statute.

Id. at 354. The Supreme Court reaffirmed its *Trans-Missouri* holding in *United States v. Joint-Traffic Association*, 171 U.S. 505 (1898). One year after becoming Chief Justice of the Supreme Court, Chief Justice White wrote a landmark opinion that concluded that only contracts in unreasonable restraint of trade violate section 1 of the Sherman Act. *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1 (1911).

- **Notwithstanding that section 3 of the Clayton Act, unlike section 1 of the Sherman Act, includes the "substantially lessen competition" language, the courts interpret section 1 of the Sherman Act and section 3 of the Clayton Act as applying a single substantive standard with respect to tying arrangements.** *See Fortner Enterprises v. United States Steel Corp.*, 394 U.S. 495, 521 (1969) ("*Fortner I*") (Fortas, J., dissenting, but not on this point) (In *Northern Pacific Railway Co. v. United States*, 356 U.S. 1 (1958), the Supreme Court "in effect, applied the same standards to tying arrangements under the Sherman Act as under the Clayton Act, on the theory that the anticompetitive effect of a tie-in was such as to make the difference in language in the two statutes immaterial."); *see also* 9 Phillip E. Areeda, *Antitrust Law* ¶ 1719b, at 254 (1991) ("Although their words differ, the two statutes apply a single substantive standard.").

- A tying arrangement is unlawful under section 1 of the Sherman Act if it is "unreasonable" and under section 3 of the Clayton Act "where the effect . . . may be to substantially lessen competition." A leading antitrust treatise states:

> [N]o difference in the criteria for illegality or the mode of analysis follows from the difference between the "unreasonable" formula of the Sherman Act and the "substantial lessening of competition" formula of the Clayton Act. **The relevant antitrust policy considerations are independent of the verbal formula used.**

2 Phillip E. Areeda *et al.*, *Antitrust Law* ¶ 301c, at 7 (2000). Accordingly, **"[t]he authority for identical substantive standards under the two statutes is well established with respect to Clayton Act §3 and Sherman Act §1."** *Id.* at 8.

- Section 3 of the Clayton Act was enacted in 1914 to specifically address certain tying arrangements because the Supreme Court had held in a 1912 decision that section 1 of the Sherman Act did not apply to a tying arrangement involving a patent. *See Henry v. A.B. Dick Co.*, 224 U.S. 1 (1912); *see also* 4 *Kintner Federal Antitrust Law* §18.5, at 16-17.

- The Supreme Court has interpreted the "substantially lessen competition" language

of section 3 of the Clayton Act to mean that section 3 "was not intended to reach every remote lessening of competition. . . ." *Standard Fashion Co. v. Magrane-Houston Co.*, 258 U.S. 346, 357 (1922). One framer and member of the Conference Committee of the bill that became the Clayton Act made it clear that **the word "substantially" in section 3 was drawn from a Supreme Court opinion under the Sherman Act that held that**, with respect to the liberty of a person to enter into contracts to carry on business as protected by the United States Constitution, **"the power of Congress to regulate interstate commerce [under the commerce clause of the Constitution] comprises the right to enact a law prohibiting the citizen from entering into those private contracts which directly and *substantially, and not merely indirectly, remotely, incidentally, and collaterally*, regulate to a greater or less degree commerce among the states."** *Addyston Pipe & Steel Co v. United States*, 175 U.S. 211, 229 (1899) (emphasis added), quoted in 51 *Cong. Rec.* 16318 (1914) (remarks of Rep. Floyd). In other words, **the constitutionally protected liberty of a person to enter into a contract can be limited by Congress under the commerce clause of the Constitution only if such contract substantially, and not merely remotely, incidentally or insignificantly, affects interstate commerce. Thus, a statutory prohibition on a tying contractual arrangement -- whether under section 3 of the Clayton Act, section 1 of the Sherman Act, or section 106 -- is constitutional if the statutory prohibition is violated only in those cases in which the effect of such arrangement substantially lessens competition in interstate commerce.**

- Under the antitrust laws, "the criterion to be used in judging the validity of a restraint on trade is its impact on competition." *NCAA v. Board of Regents*, 468 U.S. 85, 104 (1984). **The legislative history of section 3 of the Clayton Act makes clear that whether or not section 3 included the "substantially lessen competition" language, a court would necessarily read such language into the statute to determine whether an agreement impacted competition to the requisite degree to constitute a violation of the statute.** Senator Thomas Walsh, who introduced the tying provisions in the Clayton Act, stated:

> **If it [the word "substantially"] were out, the language would receive the same construction, because no court would find that competition was lessened unless it was "substantially" lessened.** The Sherman Act denounces all combinations in restraint of commerce, but no combination falls under the ban of the statute unless commerce is restrained to a "substantial" extent. De minimis non curat lex.

51 *Cong. Rec.* 16149 (1914) (remarks of Sen. Walsh). Conduct is proscribed by an antitrust statute only if it substantially lessens competition; otherwise, the statutory prohibition would be unconstitutional. **Just as the "substantially lessen competition" test has been read into the Sherman Act, such test must be read into section 106 for section 106 to be constitutional.** As discussed above, if a court found that a tying arrangement that did not substantially lessen competition in interstate commerce nevertheless violated section 1 of the Sherman Act, section 3 of the Clayton Act, or

section 106, such statutory provision would not be constitutional.

- Read literally, the only difference in the language of section 106 and the language of section 1 of the Sherman Act is that section 106 applies only to tying conditions or requirements and section 1 of the Sherman Act applies to all contracts. As discussed above, neither statute includes the "substantially lessen competition" language.

- Read literally, the only differences in the language of section 106 and the language of section 3 of the Clayton Act are that (i) section 106 applies to every tying condition or requirement by a bank involving goods and services and section 3 of the Clayton Act applies to a certain type of tying condition, agreement, or understanding by a person involving goods, and (ii) section 3 of the Clayton Act applies where the effect of the arrangement may be to substantially lessen competition and section 106 does not include the "substantially lessen competition" language. Thus, the language of section 106 (x) with respect to (i) is broader than the language of section 3 of the Clayton Act in that it covers all types of tying arrangements as opposed to only certain types of tying arrangements, is narrower than section 3 of the Clayton Act in that it applies only to banks and not any person, is broader than section 3 of the Clayton Act in that it applies to goods and services as opposed to only goods, and is arguably narrower than section 3 of the Clayton Act in that it covers only "conditions or requirements" as opposed to "conditions, agreements, or understandings" and (y) with respect to (ii) is broader than the language of section 3 of the Clayton Act in that section 106 does not include the "substantially lessen competition" language.

- The *all types* versus *only certain types* of tying arrangements difference in language, the *bank* versus *person* difference in language, and the *goods and services* versus *goods* difference in language are not of any importance to this discussion. Congress replaced the "condition, agreement, or understanding" language of section 3 of the Clayton Act with the "condition or requirement language" in section 106 to make clear that coercion is required for a bank tie-in to violate section 106. Since coercion and market power in the desired-product market are required for a tying arrangement to be illegal *per se* under section 3 of the Clayton Act, it would appear as an interpretive matter that the "condition, agreement, or understanding" language of the Clayton Act would have the same meaning as the "condition or requirement" language of section 106. Nevertheless, the intent of the amendment to replace the "condition, agreement, or understanding" language with the "condition or requirement" language was to use in section 106 as a literal matter narrower language that would make clear that coercion is required to violate the statutory provisions.

- As discussed above, the "substantially lessen competition" test must be read into section 106 for section 106 to be constitutional. Accordingly, as it relates to this discussion, the scope of the language of section 106 is no broader than the scope of the language of section 3 of the Clayton Act.

- The Supreme Court has held that the "substantially lessen competition" test will be

met by a showing that the seller had market power in the desired-product market. *See United Shoe Mach. Corp. v. United States*, 258 U.S. 451, 457-58 (1922) (a substantial lessening of competition will be presumed whenever the seller occupies a dominant position in the desired-product market); *International Business Machines Corp. v. United States*, 298 U.S. 131, 136 (1936) (the "substantially lessen competition" test was met since the seller controlled 81% of the desired-product market).

- **The language of section 106 (as it relates to this discussion) was drafted by the Antitrust Division and was intended to be "in general terms analogous to existing antitrust law."** 116 Cong. Rec. S15708 (daily ed. Sept. 16, 1970) (letter from Assistant Attorney General McLaren to the Chairman of the Senate Committee on Banking and Currency). **If Congress eliminated the market power requirement in section 106, then such provision would not be "in general terms analogous to existing antitrust law."**

- **At the time this statutory provision was proposed by the Antitrust Division on March 24, 1969,** it was not clear under the general antitrust laws whether "credit" could be a tying product because **"there was some doubt whether market power in the supply of money** -- which is entirely fungible -- **could support a tying charge."** *House Hearings* at 95 (Apr. 17, 1969 proceedings) (statement of Asst. Atty. Gen. McLaren).

- The ***Fortner I*** case, **decided** by the Supreme Court **on April 7, 1969, made it "clear beyond doubt" that credit could be a tying product**. *House Hearings* at 95 (quoting Assistant Attorney General McLaren).

- **Given that before the *Fortner I* decision it was not clear that credit could be a tying product at all, it would not make sense that the Antitrust Division would propose *ab initio* that credit tying arrangements be subject to a *per se* rule that is stricter than the *per se* rule that is applicable to tying arrangements under the general antitrust laws.**

- Under the *per se* rule against tying, "if the defendant is found to have market power [in the desired-product market], the plaintiff is, in theory, relieved of proving actual harm to competition. . . ." *Town Sound and Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 477 (3d Cir.), *cert. denied*, 506 U.S. 868 (1992). Unlike other conduct that is subject to the *per se* rule (*e.g.*, naked price-fixing), **the Supreme Court has historically subjected tying arrangements to the *per se* rule only if the seller had market power in the desired-product market**. One court has stated that the use of the term "*per se*" as applied to tying arrangements "is confusing . . . because it insists on an inquiry into market power as a predicate to 'per se' illegality." *Roy B. Taylor Sales, Inc. v. Hollymatic Corp.*, 28 F.3d 1379, 1382 (5th Cir. 1994), *cert. denied*, 513 U.S. 1103 (1995). **"In the case of tying arrangements, the probability that the anticompetitive effects are greater than their procompetitive effects in all or almost all circumstances is not sufficiently high to warrant per se condemnation unless the supplier has market power in the tying market."** ABA Section of Antitrust Law, *Antitrust Law Developments* 58 (5th ed. 2002). **Proof of anti-competitive effect is not required with respect to tying arrangements under the *per se* rule of the general antitrust laws and section 106 because proof of market power is required.**

- **A tying arrangement that is an *anti-competitive practice* (*i.e.*, an arrangement that substantially, and not merely remotely, incidentally or insignificantly, affects interstate commerce) will be subject to the *per se* rule only if the probability that the *anti-competitive effects* of the arrangement are greater than the pro-competitive effects of the arrangement in all or almost all circumstances.** If the *per se* rule is applied, an anti-competitive practice will be unlawful without any showing of specific adverse effects on competition.

- **Senator Brooke's often cited and quoted Supplementary Views** that bank tying arrangements are unlawful under section 106 "without any showing of specific adverse effects on competition or other restraints of trade and without any showing of some degree of bank dominance or control over the tying product or service" (*Senate Report* at 45) **fail to recognize that under the *per se* rule for tying arrangements it** is **appropriate to eliminate the showing of specific anti-competitive effects or other restraints of trade *only if* a bank has dominance or control (*i.e.*, market power) over the tying product or service**. Certainly the Antitrust Division understood this fundamental principle of antitrust law when it drafted and introduced the language that was ultimately enacted as section 106.

- This conclusion is borne out in a letter addressed to Senator Brooke from Assistant Attorney General McLaren that is included at the end of Senator Brooke's Supplementary Views:

> The proposed new section . . . would make tie-in arrangements unlawful, **thereby eliminating the burden of proving specific adverse impacts on competition or restraints of trade**. In so doing, the proposed new section would go beyond the *Fortner* decision, which did not go so far as to hold tie-ins involving credit illegal per se.

Senate Report at 48; *see also One-Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1211, S. 1664, S. 3823, and H.R. 6778 Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. (1970) (the "*Senate Hearings*"), at 260 (letter dated June 8, 1970), where Mr. McLaren stated that "[b]oth S. 3823 [the Brooke Bill] and S. 1664 [the Administration Bill] would make such tie-ins illegal regardless of any showing of adverse impact on competitiveness or other restraint of trade." Mr. McLaren clearly meant that **credit tie-ins are to be analyzed under the *per se* rule for tying arrangements, which does not require proof of specific adverse effects or impacts on competition or restraints of trade but *does* require proof of market power in the market for the desired product or service**. With such market power, such a tie-in would substantially affect interstate commerce and thus would constitute an anti-competitive practice that is required to violate section 106.

- The Board, at an early stage of the legislative history of section 106, and others believed that a showing of anti-competitive effect would be required under section 3 of the Clayton Act -- because of the "substantially lessen competition" language of section 3 -- as well as under the provisions of Section 22(a)(1)(A) of the first version of H.R. 6778 (the "Patman Bill"), which applied to tying transactions "whose effect may be to substantially lessen competition. . . ." *See, e.g., House Hearings* at 200 (Apr. 18, 1969 proceedings), where Board Chairman Martin stated: "We prefer the language of H.R. 6778 [the Patman Bill] to that of H.R. 9385 [the Administration Bill, which did not include the "substantially lessen competition" language] on this point, since H.R. 6778 would retain the traditional tests of anticompetitive effects. . . ." As discussed above, it is important to understand that the "substantially lessen competition" language of section 3 of the Clayton Act is relevant only with respect to whether a tying arrangement is an anti-competitive practice and that "the traditional tests of anticompetitive effects" are relevant only with respect to whether the tying arrangement is subject to the *per se* rule (*i.e.*, if a tying arrangement is subject to the *per se* rule, proof of anti-competitive effects is not required). Since section 106 subjects bank tying arrangements that are anti-competitive practices to the *per se* test, the showing of anti-competitive effects is not a requirement under section 106. This conclusion is confirmed in Assistant Attorney General McLaren's written response to questions from the Chairman of the House Committee on Banking and Currency in which he stated that the "injury to competition" (*i.e.*, the anti-competitive effect) criteria "are not essential elements to an antitrust case against a tie-in" since tying arrangements are subject to the *per se* test. *House Hearings* at 487 (included in April 24, 1969 proceedings). **Just as the showing of anti-competitive effects is not a requirement under section 106, the Board recognizes in the Proposed Interpretation that the showing of anti-competitive effects is not a requirement under the *per se* test of section 3 of the Clayton Act or of section 1 of the Sherman Act.** 68 Fed. Reg. at 52027 n.20.

- **Notwithstanding that a showing of anti-competitive effects is not a requirement under section 106 (because section 106 is subject to the *per se* test), a bank tying arrangement must be an anti-competitive practice, which requires, in order for section 106 to be constitutional, that the arrangement substantially, and not merely remotely, incidentally or insignificantly, affects interstate commerce.** As discussed above, the Supreme Court has concluded that a tying arrangement will have such substantial effect if the seller has market power in the desired-product market.

- Regardless of whether conduct is analyzed under the *per se* test or the rule of reason, the purpose of both approaches "is to decide the restraint's competitive significance." Quoting *Wilk v. American Med. Ass'n*, 895 F.2 352, 358 (7th Cir.), *cert. denied*, 496 U.S. 927 (1990); *see also NCAA v. Board of Regents*, 468 U.S. at 103 ("Both *per se* rules and the Rule of Reason are employed 'to form a judgment about the competitive significance of the restraint.'"). **A tying arrangement cannot have any "competitive significance" unless a seller has market power in the desired-product market. To read the**

"letter" of section 106 to prohibit bank tying arrangements that cannot have any competitive significance would not make economic sense and would be hostile to economic efficiency. Indeed, such a reading would raise serious constitutional questions. As Chief Justice White stated, "there is no canon of interpretation which requires that the letter be followed, when by doing so an unreasonable result is accomplished." The proper interpretive guide in such case is the "spirit which vivifies, and not the letter which killeth." For the reasons discussed above, the "letter" of section 106 does not preclude the Board from adopting the recommendation of the Antitrust Division.

The recommendation of the Antitrust Division is consistent with previous Board positions

- It is very clear that the Board did not believe in 1970 that the bank tying legislation would materially alter in the bank context the then-existing antitrust laws. In a written response to questions submitted to the Board by Senator Brooke, Board Vice Chairman Robertson, on behalf of the Board, stated:

> **The Board understands that under present antitrust laws, [coercive tying] practices [by a bank] are prohibited where the bank has sufficient market power to force tie-ins on unwilling customers. . . .** While the Board has no objection to provisions [in the bank tie-in legislation] explicitly prohibiting banks from engaging in coercive tying practices, **we do not believe such provisions would materially alter existing law.**

Senate Hearings at 136-37 (emphasis added) (letter dated June 1, 1970). In this connection, Board Chairman Burns stated:

> . . . I believe that tie-ins are definitely illegal now.
>
> **I don't see that much would be accomplished by adding a provision with respect to tie-ins.** However, I also see no objection to it.

Id. at 148-49 (May 17, 1970 proceedings). **If the bank tying legislation eliminated in the bank context the well-established, "essential"** (quoting *Jefferson Parish Hospital*, 466 U.S. at 12 (majority opinion)) **requirement under the antitrust laws that the seller of the desired product must have market power in the desired-product market, then the legislation would have materially altered in the bank context the then-existing antitrust laws.**

- These statements made by the Board to Congress are consistent with the following statement made by the Board in 1975 in each of three orders approving applications to engage in certain insurance agency activities: "It is clear that coerced tying is forbidden by § 106. . . . **[T]he record indicates that the market power required for the successful practice of tying does not appear to be present.**" *Barnett Banks, Inc.*, 61 Fed. Res. Bull. 678, 684 (1975); *Barnett Banks of Florida, Inc. and The Chase*

Manhattan Corporation, 61 Fed. Res. Bull. 686, 691 (1975); *Pan American Bancshares*, 61 Fed. Res. Bull. 693, 699 (1975).

- In analyzing the danger of voluntary tie-ins in the context of applications under section 4(c)(8) of the Bank Holding Company Act, the premise of the Board's analysis is that in the absence of significant market power in the desired-product market there can be no danger of voluntary tie-ins. *See, e.g., J.P. Morgan & Co., Inc.*, 68 Fed. Res. Bull. 514, 517 (1982) ("[V]oluntary tying can only take place when a firm possesses significant market power."); *Citicorp*, 67 Fed. Res. Bull. 443, 445-46 (1981); *Mercantile Bancorporation*, 66 Fed. Res. Bull. 799, 800 (1980); *The Alabama Financial Group, Inc.*, 60 Fed. Res. Bull. 596, 602-603 (1974). Both voluntary tying and coercive tying can only take place when a firm possesses significant market power, and there is no reasonable basis for such market power to be a necessary element in the voluntary tie-in analysis under section 4(c)(8) but not to be a necessary element in the coercive tie-in analysis under section 106.

- It is also instructive to note that when the Board has exempted certain transactions from the coverage of section 106, "the Board has considered it appropriate to analyze the competitiveness of the relevant . . . market" to determine whether the exemption would not be contrary to "the purpose [of section 106] of preventing anticompetitive practices." 55 Fed. Reg. 47741, 47742 (Nov. 15, 1990). In this connection, the Board has stated: **"In the Board's view, unless it would be likely that the seller's market power in the . . . market for the tying product is high enough to force a customer to also purchase on uncompetitive terms a . . . service in the tied product market, a [tying] arrangement would not appear to produce anticompetitive effects."** *Id.* The Board stated further: **"[T]he Board believes that market analyses for . . . tying products would be relevant to the Board's determination of whether those tying products would result in anticompetitive practices and thus would be inconsistent with the purposes of section 106."** *Id.* at 47742-43.

Making case-by-case or specific exceptions is not the best way forward

- The DOJ Letter states 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."** DOJ Letter at 5. The DOJ Letter further states: "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.**" *Id.* at 6.

Conclusion: the Board should, as the Antitrust Division recommends, interpret section 106 to prohibit only conduct that is anti-competitive under the general antitrust laws

- Based on the above discussion, **the Board should adopt the recommendation of the Antitrust Division and interpret section 106 to prohibit only conduct that is anti-competitive under the general antitrust laws**. By interpreting section 106 to be consistent with, and not broader than, the general antitrust laws, as the Antitrust Division strongly recommends, banks would be able to compete with nonbank financial institutions on the "level playing field" that Congress intended to create with the passage over four years ago of the Gramm-Leach-Bliley Act.