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

VIA E-MAIL

August 2, 2005

Mr. Scott G. Alvarez
General Counsel
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Scott:

This letter is submitted on behalf of Bank of America, Citigroup, Deutsche Bank, JPMorgan Chase & Co., and UBS (collectively, the "bank group") with respect to the proposed interpretation and supervisory guidance issued on August 25, 2003 by the Board regarding the anti-tying restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970 (such proposal, the "*Proposed Interpretation*"; such Section, "Section 106").

In a letter to the Board from the Antitrust Division of the United States Department of Justice dated November 7, 2003 (the "*DOJ Letter*"), the Antitrust Division recommended that (i) the Board interpret Section 106 to be consistent with, and not broader than, the general antitrust laws, and (ii) in the event the Board determines that court precedent precludes such an interpretation, the Board exercise its statutory authority to expand the range of exemptions to Section 106 and thereby limit the reach of Section 106 to those small businesses and consumers that were the original focus of the legislation. The bank group, in numerous submissions regarding the *Proposed Interpretation*, has strongly recommended that the Board either (i) adopt the recommendation of the Antitrust Division and interpret Section 106 to be consistent with, and not broader than, the general antitrust laws or (ii) exercise its statutory authority under Section 106 to create an exemption from the coverage of Section 106 for "large customers" as defined in the bank group's November 2004 submission regarding the *Proposed Interpretation*.

On June 27, 2005, the United States Supreme Court issued a decision, *National Cable & Telecommunications Association v. Brand X Internet Services*,[1] which fully supports the bank group's position that no court precedent precludes the Board from interpreting Section 106 to be consistent with, and not broader than, the general antitrust laws.

Under the general antitrust laws, a seller must have market power in the tying-product market for a tying arrangement to be illegal. In various meetings and discussions regarding the *Proposed Interpretation*, Board staff have stated to representatives of the bank group that the opinions of certain federal courts, which state that such market power is not required for a bank tying arrangement to violate Section 106, serve as precedent that precludes the Board from interpreting Section 106 in a manner that is

---

[1] 125 S.Ct. 2688 (2005) ("*Brand X*").

consistent with, and not broader than, the general antitrust laws, since such interpretation would require that a bank have such market power to violate Section 106.[2]

The concern expressed by Board staff has been that these federal court opinions, issued over the past 27 years, restrict the Board's ability at this time, almost 35 years after the enactment of Section 106, to make a reasoned interpretation of Section 106 that conflicts with these opinions. The Supreme Court's decision in *Brand X* definitively lays to rest such concern and makes clear that *none* of the cases cited by Board staff serves as precedent that precludes the Board from concluding in a rule-making that a bank must have market power in the tying-product market for a tying arrangement to violate Section 106.

In *Brand X*, the Federal Communications Commission (the "FCC") made a determination in a rule-making that was inconsistent with the past practice of the FCC and also was inconsistent with a prior decision of the Ninth Circuit Court of Appeals in a case that did not involve the review of an administrative proceeding and in which the FCC was not a party.[3] The Supreme Court, in overruling the Ninth Circuit Court of Appeals in *Brand*

---

2 In the paper entitled "*Economic Power and the Bank Tying Provisions*", which the bank group submitted to the Board on September 30, 2003 (the "*Economic Power Paper*"), the bank group analyzed in detail each case cited by Board staff as being precedential (*see* pages 58-72 of the *Economic Power Paper*). In most of these cases, the statement in the respective court's opinion that market power in the tying-product market is not required for a bank tying arrangement to violate Section 106 is unnecessary to the court's decision and therefore is *dicta*, which the Supreme Court has held has no precedential value. *See BE & K Construction Co. v. NLRB*, 536 U.S. 516, 528 (2002), quoting *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 513 U.S. 18, 24 (1994); *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44, 67 (1996); *Colgrove v. Battin*, 413 U.S. 149, 158 (1973).

3 *Brand X*, 125 S.Ct. at 2698-99.

X, held that the prior conflicting construction of the relevant statute by the Ninth Circuit Court of Appeals did not foreclose the FCC's subsequent interpretation of such statute because in its prior decision the court had not held the statute to be unambiguous. The Supreme Court stated: "Only a judicial precedent holding that the statute unambiguously forecloses the agency's interpretation, and therefore contains no gap for the agency to fill, displaces a conflicting agency construction."[4]

In *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*,[5] which the Supreme Court discussed at length in *Brand X*, the Supreme Court held that if a statute is ambiguous, and if the implementing agency's construction is reasonable, a federal court must defer to the agency's construction of the statute, even if the agency's reading differs from what the court believes is the best statutory interpretation.[6] Following *Chevron*, the Supreme Court reasoned in *Brand X*:

> *A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to Chevron deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion.* This principle follows from *Chevron* itself. *Chevron* established a "presumption that Congress, when it left ambiguity in a statute meant for implementation by an agency, understood that the ambiguity would be resolved, first and foremost, by the agency, and desired the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows." Yet allowing a judicial precedent to foreclose an agency from interpreting an ambiguous statute, as the Court of Appeals assumed it could, would allow a court's interpretation to

---

4 *Id.* at 2700.

5 467 U.S. 837 (1984) ("*Chevron*").

6 *Id.* at 843-44 and n.11; *Brand X*, 125 S.Ct. at 2699-2700.

> override an agency's. *Chevron's* premise is that it is for agencies, not courts, to fill statutory gaps.[7]

A contrary rule, the Supreme Court concluded, would produce anomalous results:

> It would mean that whether an agency's interpretation of an ambiguous statute is entitled to *Chevron* deference would turn on the order in which the interpretations issue: If the court's construction came first, its construction would prevail, whereas if the agency's came first, the agency's construction would command *Chevron* deference. Yet whether Congress has delegated to an agency the authority to interpret a statute does not depend on the order in which the judicial and administrative constructions occur. The Court of Appeals' rule, moreover, would "lead to the ossification of large portions of our statutory law," by precluding agencies from revising unwise judicial constructions of ambiguous statutes. Neither *Chevron* nor the doctrine of *stare decisis* requires these haphazard results.[8]

Accordingly, the Supreme Court held in *Brand X* that under the doctrine of *stare decisis* a court's prior interpretation of a statute trumps an agency's interpretation of the statute "only if the relevant court decision held the statute unambiguous."[9]

In none of the cases cited as precedent by Board staff did the court hold that its construction of Section 106 "follows from the unambiguous terms of the statute and thus leaves no room for agency discretion." Moreover, like the Court of Appeals decision that the Supreme Court held in *Brand X* did not have *stare decisis* effect, none of the cases cited by Board staff involved review of an administrative proceeding and none involved a

---

[7] *Id*. at 2700 (emphasis added; citations omitted).

[8] *Id.* at 2700-01 (citation omitted).

[9] *Id.* at 2701.

regulatory body charged with construing and enforcing Section 106[10] as a party to the litigation.

As the bank group discussed in its February 2, 2005 submission regarding the *Proposed Interpretation*,[11] Section 106 is hardly unambiguous; its provisions have been subject repeatedly to inconsistent or irreconcilable interpretations. For example, as discussed in detail in previous submissions of the bank group, two federal Courts of Appeal have concluded that market power in the tying-product market is required for a bank to violate Section 106 while other federal Courts of Appeal have concluded just the opposite.[12] A number of courts have stated that, while market power in the tying-product market is not required, a bank tying arrangement must be an "anti-competitive practice" to violate Section 106,[13] yet the Supreme Court has concluded that a tying arrangement can be an anti-competitive practice *only if* the seller has such market power.[14] The OCC has stated that

---

10 Namely, the Board, the Office of the Comptroller of the Currency (the "OCC") or the Federal Deposit Insurance Corporation (the "FDIC") under Section 8(b) of the Federal Deposit Insurance Act, as amended, or the Department of Justice under Section 106(c).

11 *See* Annex B to such submission, which summarizes the discussion in previous submissions regarding the *Proposed Interpretation*.

12 *See Economic Power Paper* at 58-59.

13 *Id.* at 72-76.

14 *Id.* at 13-17.

court decisions regarding Section 106 are "somewhat inconsistent."[15] Indeed, a Board economist has referred to Section 106 as a statute that has been "plagued" with confusion.[16]

Further, as the bank group has discussed in previous submissions regarding the *Proposed Interpretation*, Section 106 is an antitrust statute.[17] It is no clearer under Section 106 how a bank can improperly "condition" one product upon a customer taking another product, if the bank does not have the market power to impose and enforce its condition, than it is under Section 1 of the Sherman Act how a contract can improperly be "in restraint of trade", since all contracts are by their nature in restraint of trade.[18] Yet the Antitrust Division has had no difficulty reasonably interpreting the provisions of Section 1 of the Sherman Act.

---

15 *See* Office of the Comptroller of the Currency, International and Economic Affairs Department and Law Department, *Today's Credit Markets, Relationship Banking, and Tying* 23 (Sept. 2003).

16 *See* Direct Testimony of Paul R. Schweitzer, Board Economist, before James V. Mattingly and Carl V. Howard, Board Counsel, in *Formal Hearing in the Matter of the Application by Citicorp to Engage in Certain Data Processing and Electronic Funds Transfer Activities Through a Subsidiary to be Known as Citishare Corporation* 1 (Oct. 13, 1981). In this testimony, Mr. Schweitzer stated: "Involuntary [coercive] tie-ins that are cognizable under the Bank Holding Company Act [Amendments] thus *can only exist if the supplier has* very great *market power* in a product market within a specific geographic area." *Id.* at 4 (emphasis added). This testimony is discussed in the Letter dated March 30, 2004 to J. Virgil Mattingly, Jr., from the bank group (the "Letter dated March 30, 2004") at n.67.

17 *See Economic Power Paper* at 22-24; Letter dated March 30, 2004 at 18-21.

18 The Supreme Court has stated: "One problem presented by the language of § 1 of the Sherman Act is that it cannot mean what it says. [R]ead literally, § 1 would outlaw the entire body of private contract law. . . ." *National Society of Professional Engineers v. United States*, 435 U.S. 679, 687-88 (1978).

Antitrust laws, including Section 106, are designed to be interpreted and applied to conduct in light of continuing experience as to their effect on competition in evolving economic conditions. Thus, by their very nature the provisions of antitrust laws are open to interpretation. Over the more than 110 years of federal antitrust practice and jurisprudence, the antitrust regulatory bodies and the courts have frequently shifted, sometimes quite dramatically, their interpretation of statutory language which itself has never changed. For example, the 19th century language of the Sherman Act is interpreted by the Antitrust Division and the courts to apply to 21st century economic realities. The Supreme Court has stated that the Sherman Act "has a generality and adaptability compared to that found to be desirable in constitutional provisions."[19] "The result is a statute whose meaning has evolved over the years".[20] It is the role of antitrust regulatory bodies -- including, in the case of Section 106, the Board, the OCC and the FDIC with respect to the institutions subject to their respective jurisdictions, as well as the Department of Justice -- to mold and guide antitrust laws.

As the Supreme Court concluded in *Chevron*, if a statute is ambiguous -- *Section 106 undoubtedly is ambiguous* -- a court is required to accept an agency's construction of the statute if that construction is reasonable.[21] For the reasons discussed

---

[19] *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 359-60 (1933).

[20] Quoting 1 Phillip E. Areeda *et al.*, *Antitrust Law* ¶ 104f, at 94 (2000).

[21] *Chevron*, 467 U.S. at 843-44 and n.11; *Brand X*, 125 S.Ct. at 2699 ("If a statute is ambiguous, and if the implementing agency's construction is reasonable, *Chevron* requires a federal court to accept the agency's construction of the statute, even if the agency's reading differs from what the court believes is the best statutory interpretation.").

extensively in the submissions of the bank group regarding the *Proposed Interpretation*, it would be imminently reasonable for the Board to interpret Section 106 to require that a bank must have market power in the tying-product market for a tying arrangement to violate Section 106. The Supreme Court has long recognized that market power in the tying-product market is "*the essential characteristic*" of an invalid tying arrangement.[22] An authoritative antitrust treatise states that "the rationale for requiring proof of [market] power over the tying product must be that no 'tie-in' can occur or cause any detrimental effect . . . without it."[23] Judge Frank Easterbrook of the Seventh Circuit Court of Appeals, who is a noted antitrust scholar, has observed: "Firms that lack [market] power cannot injure competition no matter how hard they try."[24]

As stated above, a number of courts have concluded that a bank tying arrangement must be an "anti-competitive practice" to violate Section 106.[25] As a logical matter, this conclusion *necessarily* requires a finding that a bank has market power in the tying-product market since it is well established that "[o]nly if [buyers] are forced to

---

22 *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2, 12 (1984) (emphasis added).

23 10 Phillip E. Areeda *et al.*, *Antitrust Law* ¶ 1734a, at 39 (1996).

24 Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 20-21 (1984).

25 *See Doe v. Norwest Bank Minnesota, N.A.*, 107 F.3d 1297, 1305 (8th Cir. 1997); *Palermo v. First National Bank and Trust Co. of Oklahoma City*, 894 F.2d 363, 368 (10th Cir. 1990); *Davis v. First National Bank of Westville*, 868 F.2d 206, 208 (7th Cir.), *cert. denied*, 493 U.S. 816 (1989). *See also* S. Rep. No. 91-1084 (1970), at 17 (Section 106 was intended "only to prohibit anticompetitive practices").

purchase [seller's] services as a result of the [seller's] market power would the arrangement have anticompetitive consequences."[26]

Prior to the issuance of the court opinions that Board staff view as being precedential, the Board made the following statement in three separate orders: "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."[27] This statement is consistent with the statement that the Board made to Congress in 1970, during the legislative process that led to the enactment of Section 106, that the bank tying legislation would not materially alter the then-existing general antitrust laws, which required then and continue to require that the seller have market power in the tying-product market.[28] The Board has also 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."[29]

A Board Staff Study, which was submitted by the Board to the Senate Committee on Banking, Housing and Urban Affairs in 1979, includes a section on "The

---

[26] *Jefferson Parish Hospital*, 466 U.S. at 25.

[27] *Barnett Banks, Inc.*, 61 Fed. Res. Bull. 678, 684 (1975); *Barnett Banks of Florida, Inc. and The Chase Manhattan Corp.*, 61 Fed. Res. Bull. 686, 691 (1975); *Pan American Bancshares,* 61 Fed. Res. Bull. 693, 699 (1975).

[28] *See 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. at 136-37 (1970) (letter dated June 1, 1970); *id.* at 148-49 (May 17, 1970 proceedings). *See also Economic Power Paper* at 34-35.

[29] 55 Fed. Reg. 47741, 47742 (Nov. 15, 1990).

Concepts of Tying and the Necessary Market Conditions."[30] The bank group entirely agrees with the analysis in that section, the most pertinent parts of which are set out below:

> Various types of tying arrangements may exist depending upon the kind and degree of pressure exerted upon the customer by the supplier. At the one extreme are explicit, contractual tying arrangements in which the supplier, *through the exercise of monopoly power, is able to coerce* the customer to formally agree to tie the purchase of one good to the purchase of another. *Such coercive contractual arrangements are* <u>*per*</u> <u>*se*</u> *illegal under Section 3 of the Clayton Act, Section 1 of the Sherman Antitrust Act, and Section 106 of the Bank Holding Company Act as amended*.
>
> * * *
>
> At the other extreme, a joint purchase can be made that is purely voluntary, and no pressure to tie is exerted by the supplier or is perceived by the purchaser.
>
> * * *
>
> Between the two extremes of coercive contractual tied sales and purely voluntary joint purchases, a wide variety of tied sales may occur. They may range from a situation that is characterized by strong "implicit" pressure by the supplier on the customer to make the tied purchase to a mere perception on the part of the buyer that it might be to his advantage to make the joint purchase. *The degree to which these pressures are exerted successfully, or are perceived by the buyer, depends importantly on the market power of the supplier.*
>
> *Whenever a degree of implicit pressure exists, a joint purchase is no longer purely voluntary because a consumer's decision is influenced or constrained to some extent by the presence of market power in the tying market.* <u>For purposes of this study, all joint purchases made in response to such pressures are defined as involuntary tie-ins</u>.[31]

These statements of the Board and Board staff are consistent with the view expressed by the Antitrust Division during the legislative process that led to the enactment

---

[30] Robert A. Eisenbeis and Paul R. Schweitzer, *Tie-ins Between the Granting of Credit and Sale of Insurance by Bank Holding Companies and Other Lenders* (1978) (the "*Staff Study*"). The *Staff Study* is discussed in the Letter dated March 30, 2004 at n.67.

[31] *Staff Study* at 8-11 (emphasis added; footnotes omitted; underscoring in original).

of Section 106. Assistant Attorney General Richard McLaren, the head of the Antitrust Division in 1970, stated that the bank tying legislation "is in general terms *analogous to existing antitrust law*".[32] Section 106 would not in general terms be analogous to the then existing (or currently existing) antitrust law if market power -- the essential characteristic of an illegal tying arrangement under the antitrust law -- were not required under Section 106.

The conclusion that a bank must have such market power is supported by a complete and careful reading and analysis of the legislative history of Section 106, which, as discussed in detail in the *Economic Power Paper*,[33] evidences the following correct interpretation of Section 106: Section 106, an antitrust statute, imposes on bank tie-ins the *per se* rule that is applied to tying arrangements under the general antitrust laws.[34] Thus, once an arrangement is found to be a tie-in, which requires a finding that a bank has market power in the tying-product market, the tie-in is then treated as a *per se* violation such that the effect of such an arrangement is deemed to be anti-competitive without further proof. While a plaintiff in a Section 106 case is not required to prove that the tie-in resulted in a

---

32 116 *Cong. Rec.* S15708 (daily ed. Sept. 16, 1970) (emphasis added).

33 *Economic Power Paper* at 24-45.

34 It is important to note that at the time bank tying legislation was first introduced in Congress, there was doubt under the general antitrust laws as to whether "credit" could be a tying "product". This issue was resolved during the legislative process when the Supreme Court held in *Fortner Enterprises v. United States Steel Corp.*, 394 U.S. 495, 508-09 (1969), that credit could be a tying product. One of the earliest bank tying bills was prepared by the Antitrust Division as the "Administration Bill" and was introduced in Congress just a few weeks before the *Fortner* decision was issued. Shortly after the decision was issued, the head of the Antitrust Division stated to the House Committee on Banking and Currency that as a result of the *Fortner* decision the "need for such a provision may have been reduced" and such provision was not "essential". *See Economic Power Paper* at 27-32.

specific anti-competitive effect, the plaintiff is required to prove that the bank had market power in the tying-product market. Since, as the Supreme Court has recognized, a tie-in cannot result in an anti-competitive practice that lessens competition unless the seller has market power in the market for the tying product, it follows that to prove a violation of Section 106 the plaintiff is required to prove that the bank had market power in the market for the tying product in order for the tie-in to constitute an anti-competitive practice that lessens competition and therefore is unlawful under Section 106.

Just as the market power requirement has been read into the general antitrust laws by the Antitrust Division and the courts as a matter of economic logic, commercial necessity and common sense, it is entirely reasonable for the Board to read the market power requirement into Section 106. There is no doubt that such an interpretation of Section 106 by the Board would satisfy the reasonableness standard of *Chevron*.

Accordingly, pursuant to the Supreme Court's holdings in *Brand X* and *Chevron*, the bank group concludes that no case serves as precedent that precludes the Board from construing Section 106, as recommended by the Antitrust Division and the bank group, to require that a bank have market power in the tying-product market for a tying arrangement to violate Section 106, thereby interpreting Section 106 to be consistent with, and not broader than, the general antitrust laws.

The bank group believes that the Board should adopt this conclusion in a *final rule* issued pursuant to the record accompanying the *Proposed Interpretation*. The bank group believes that the record in this matter is more than sufficiently developed to support a final rule interpreting Section 106 to be consistent with, and not broader than, the general antitrust laws. Publishing a proposed rule or interpretation to this effect for comment would not serve any purpose and would only impose additional delay. Further delay in adopting such a final rule "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."[35] Such a final rule would, in the words of the Antitrust Division, "provide a more balanced approach to preserving competition and encouraging procompetitive practices that benefit all consumers."[36]

The process should not be drawn out any longer since, as the Antitrust Division has recognized, Section 106, even as interpreted in the *Proposed Interpretation,* "prohibits a bank from meeting competition from non-bank providers of the same service or product."[37] For far too long, Section 106 has been interpreted in a manner that disadvantages banks relative to their nonbank competitors and "lessens competition in markets with bank and nonbank providers thus harming consumers."[38] The bank group believes that the time is now for the Board to interpret the provisions of Section 106 in a manner that makes economic sense and is not hostile to economic efficiency. It is a widely recognized truism that a tying arrangement cannot have any anti-competitive consequence unless a seller has market power in the tying-product market. The prohibition of a tying arrangement in the absence of such market power is antithetical to antitrust principles.

---

35 Quoting the *DOJ Letter* at 8.

36 *DOJ Letter* at 8.

37 *DOJ Letter* at 6.

38 Quoting the *DOJ Letter* at 2.

The bank group hopes that the above discussion fully addresses the Board staff's expressed view that court precedent precludes the Board from construing Section 106 to be consistent with, and not broader than, the general antitrust laws. If it has not, or if Board staff are not persuaded by, or have questions with respect to, the bank group's previous submissions regarding the *Proposed Interpretation*, then representatives of the bank group would propose to meet with Board staff. Given the passage of time since the *Proposed Interpretation* was issued almost two years ago and since the last submission of the bank group regarding the *Proposed Interpretation* almost six months ago, such a meeting may be useful in any event. We will contact you in the near future to discuss whether such a meeting should be scheduled.

Sincerely,

/s/ *John L. Walker*

John L. Walker

cc: Kieran J. Fallon
Mark E. Van Der Weide
Andrew S. Baer
Robin Prager
Ron Borzekowski
Kenneth P. Brevoort
Joyce Hansen
Ivan Hurwitz

Jennifer J. Johnson
Secretary of the Board
Re: Docket No. OP-1158