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Almost unnoticed at first, Section 106 of the 1970 Bank Holding Company Act Amendments establishes per se illegality for bank tie-in arrangements with broad ramifications for the banking industry.

Are All Bank Tie-Ins Illegal?

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Many Traditional banking practices involving tie-in arrangements of one sort or another are seldom questioned by bankers; however, they may give rise to private treble damage suits as a result of recent Congressional actions. Such time-honored practices as requiring compensating balances when making loans, utilizing negative covenants in loan agreements to control additional borrowing by customers, and the use of "equity kickers" in connection with mortgage lending may subject banks, bank holding companies, and subsidiaries of bank holding companies to liability in the future. To avoid this consequence, bankers may ultimately be required to institute elaborate customer disclaimer procedures or to restructure their pricing systems for bank services.

With the passage of the Bank Holding Company Act Amendments of 1970[1] late last year, bank holding company subsidiaries *may* have been permitted to operate "no-load" mutual funds, perform insurance functions in connection with services offered by other subsidiaries, provide bookkeeping or date processing services, and act as travel agents,[2] in addition to engaging in other less controversial activities. Recognizing that market forces alone could not effectively discipline these potentially far-ranging banking powers, Congress expanded antitrust remedies available to the Justice Department and private litigants.

Thus, Section 106 of the new law provides broad powers where anticompetitive tying arrangements are found to exist. This new provision has received little attention so far; however, it may well bring about substantial structural changes in the industry.

At the outset, it is important to note that while bank tie-in arrangements are numerous and take a variety of forms, their legitimacy is seldom challenged by even the most astute banking leaders. During the recent tight money period, few borrowers or bank officers questioned the right of banks to require compensating balances in conjunction with the granting of a loan. Even fewer questioned the right of a bank to impose restrictions on the ability of borrowers to obtain loans from other institutions while loans were outstanding with the bank in question.

Even though it is logical that few people would challenge the right of a bank to require customers to notify bank personnel before other loan obligations are incurred—in order to assure the soundness of bank loans—the imposition of other requirements often tests the limits of reasonable and legitimate business needs. In recent months, banks and other financial institutions have taken substantial equity positions in exchange for loans and have required loan applicants to be regular customers of the bank before extensions of credit were considered. These and other banking practices raise serious policy considerations and may subject bankers to extensive litigation in the years to come.

Banks, bank holding companies, as their subsidiaries may be required to devise procedure which will remove the appearance (as well as the possibility) that customers can be coerced into obtaining unwanted services or providing inducements to obtain bank credit. At the same time, precautions may have to be taken to remove the possibility of banks discriminating against nonbanking business rivals by denying the latter favorable access to bank credit and by granting this to bank affiliates; or by unfairly luring customers away from nonbanking business rivals by offering favorable access to bank credit, or by suggesting that continued access to bank credit is dependant on the use of affiliates' services.

Even though a bank or bank holding company has a separate travel department or regards its travel agency affiliate as an independent entity, bank officials will have to be wary of possible conflicts when a customer utilizes both loan services and travel services. Similarly, any combination of activities may give rise to litigation unless certain precautions have been taken to establish that the customer voluntarily agreed to utilize more than one available service.

SECTION 106

States briefly, Section 106 of the Bank Holding Company Act Amendments of 1970—the so-called anti-tying clause—prohibits a bank from extending credit, leasing or selling property, or furnishing any service on the condition or requirement that the customer obtain something else in the process; provide something else; or refrain from obtaining something else from a competitor of a bank. Thus, tie-ins—whether they be express or implied—are specifically prohibited by the new Act unless they fall within certain carefully delineated exemptions or the Federal Reserve Board grants an "exception" to the practices in question.

The Act states that the Attorney General is charged with enforcing Section 106; private litigants may bring treble damage suits under the section, as well as obtain injunctive relief; and existing antitrust laws are in no way affected by the presence of this section. A four-year statute of limitations begins running when the cause of action accrues; however, the statute is tolled while Federal enforcement action is pending—and for one year after that.

In short, Section 106 establishes *per se* illegality where bank tie-ins are involved. And it provides private litigants with the prospect of treble damage relief as an inducement to police this area of potential abuse.

The Fortner Case

The leading antitrust case pertaining to tie-in arrangements involving credit is *Fortner Enterprises, Inc. v. United States Steel Corp., et al.*[3] Fortner Enterprises claimed that, in order to obtain loans from United States Steel Homes Credit Corporation for the purchase and development of certain land, it had been required to agree—as a condition of the loans—to purchase prefabricated homes manufactured by another U.S. Steel subsidiary.

The U.S. Supreme Court held that an illegal tying arrangement could be found to exist if Fortner was required to take a "tied product"—as a condition of being allowed to purchase the "tying product"—namely, credit. While the Court remanded the case for further consideration on the issue of whether an illegal tying arrangement existed under the facts, the rule of law that credit could not be used by U.S. Steel (or, for that matter, any bank) to illegally tie other products was firmly established.

While the Court spoke in terms of *per se* illegality—that is, tying arrangements that are illegal in and of themselves, and which do not require any specific showing of unreasonable competitive effect—certain tests nevertheless had to be met. Tying arrangements, then, were only deemed to be unreasonable in and of themselves whenever a party had "sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product and a 'not insubstantial' amount of interstate commerce" was affected. According to the Court, a seller must be able to exert some power over some of the buyers in the market, even though the power need not be complete, and the total volume of sales tied must not be insubstantial.

The *Fortner* decision demonstrated that treble damages and injunctive relief could be obtained under the Sherman Act where anticompetitive tying involving credit was shown to exist. The expense of litigation and the difficulty of proof has, nevertheless, mitigated against effective and timely relief by private litigants.

By enacting Section 106, Congress recognized that the antitrust enforcement capabilities of the Justice Department were limited and that effective oversight by that department and by private litigants required additional remedies. Assistant Attorney General Richard W. McLaren stated:

> "While we believe that the antitrust laws are applicable in this area, a serious question remains as to the extent to which they can practically eliminate such practices in view of our limited enforcement resources. As a practical matter, many tie-in arrangements involving banks are so limited in their scope and involve such small amounts that they do not seem to justify the expensive and time-consuming efforts of full scale antitrust investigation."[4]

Mr. McLaren characterized Section 106 as "a most valuable supplement to existing remedies against anticompetitive tying arrangements."

The Brooke Anti-Tying Provision

Section 106 was sponsored by Senator Edward W. Brooke of Massachusetts and differs only slightly from an earlier legislative proposal, which he introduced during the Second Session of the 91st Congress.[5] Similarly, Section 106 differs only slightly from an anti-tying provision contained in the bank holding company bill proposed by the Nixon Administration.[6]

The original Brooke provision would have given the Federal Reserve Board full discretion to grant exceptions to the *per se* illegality requirements, while Section 106 goes beyond the original provision by statutorily delineating certain exemptions. Accordingly, bank tie-in arrangements involving so-called "traditional banking practices"—or specifically, "a loan, discount, deposit, or trust service"—are not considered to be *per se* illegal under Section 106. The Administration provision avoided any statutory delineation of exemptions for traditional banking practices. In addition, it did not cover individuals or banks that are not part of bank holding company arrangements, nor did it vest discretion with the Federal Reserve Board to grant exceptions to the *per se* illegality requirements.

Specifics of 106

Even though traditional banking practices are involved, a bank may nevertheless be liable. The exemptions involving loans, discounts, deposits, or trust services contained in Section 106 apply only where intra-bank tying is involved—that is, where the tying involves specific functions *within* a bank which have been traditionally tied together—and do not apply to extra-bank tying where tying exists between the bank and other holding company subsidiaries, or between these subsidiaries.

In order to remove a bank holding company or its subsidiaries from the provisions of Section 106, it must be shown that only the bank was involved; a traditional banking practice was being pursued; and that banking practice involved a loan, discount, deposit, or trust service. In the absence of specific guidelines from the Federal Reserve Board as to what constitutes a traditional banking practice involving the tying of a loan, discount, deposit, or trust service, banking ties are suspect under Section 106.

Despite the fact that one of the requirements for recovery under Section 106 has not been met, existing antitrust remedies are nevertheless available to both the Justice Department and private litigants. A suit may be brought under the Sherman Act or possibly under the Federal Trade Commission Act, even though recovery is not possible under the new anti-tying provision. In this respect, Congress expressly stated that it did not intend to remove traditional banking practices from normal antitrust scrutiny and that Section 106 was by no means an exclusive remedy.

In other words, both the Justice Department and private litigants have received a new weapon to add to their antitrust arsenals, while bankers must exercise a degree of caution heretofore unknown in dealing with customers. It should be noted that Section 106 prohibits not only express or overt tying, but also voluntary tying (or "tying effect:"), as well. The latter term is used to describe a situation where the economic effect of the arrangements is just as serious as overt tying.

For example, a customer may be induced to act in a certain manner because of his recognition of the bank's market power, rather than because of any overt coercion by the bank. Thus, a loan applicant might offer to place his insurance or travel business with a bank, hoping that this would improve his chances of obtaining a commercial or mortgage loan. To avoid possible liability, banks may be required to adequately inform customers of their right to obtain one service without obtaining others.

FUTURE DEVELOPMENTS

While some of the ramifications of Section 106 were considered by bankers when bank holding company legislation was before Congress, its full impact on the banking industry may not be known for some time to come. Ultimately, the courts may be called upon to define those traditional banking practices that involve the tying of loans, discounts, deposits, or trust services. Rather than subjecting themselves to the uncertainty of litigation, many banks my choose to curtail or eliminate questionable practices and restructure their pricing systems to reflect separate prices for various bank services. While most large banks can be expected to devise reasonable procedures in light of Federal Reserve guidelines and the applicable legislative history, many small banks will undoubtedly continue to adhere to traditional practices, even though the threat of litigation ensues.

Acquisition or retention by bank holding companies of interests in non-banking companies may also be affected where tying or the prospect of tying exists. The Federal Reserve Board recently recognized the risk of voluntary tying (or tying effect) when it issued proposed amendments to its bank holding company regulations earlier this year.[7] If these amendments are adopted, a bank holding company will be prohibited from retaining or acquiring an interest in a non-banking company if the latter engages in unlawful tying, either express or implied.

The practice effect of the Board's proposed regulation will be to limit the acquisition or retention of existing non-banking enterprises; activities commenced *de novo* will receive far less scrutiny. Inasmuch as voluntary tying is based on customer recognition of the bank's market power, the problem of curtailing abusive activities is particularly acute where the banking and non-banking enterprises are significant sellers of related products to the same customers in the same geographical areas. By establishing Congressional intent that bank holding company expansion is preferred in geographic areas where the bank itself does not operate since the risk of anticompetitive consequences is thereby substantially reduced.

The purpose of Section 106 is to eliminate anti-competitive practices which require bank customers to accept or provide some other service or product, or refrain form dealing with other parties in order to obtain the bank product or service they desire. Congress recognized that bank credit must be used fairly, and that the temptation to discriminate or secure reciprocal favors must not be indulged in when non-banking activities are involved. Section 106 may not only provide private litigants with rights of action in the event of abuse, it may curtail bank holding company expansion where the opportunity for abuse is thereby created.

Ultimately, the new anti-tying provision may also curtail the use of customer credit information by banks to the advantage of non-banking affiliates or where the effect would be to discriminate against non-banking rivals by unfairly luring customers away. Banks may be required to "unbundled" their services and give customers the choice of obtaining them elsewhere, without adversely affecting their remaining relations with the banks.

The full ramifications of Section 106 for the banking industry are still unknown. Legislative history surrounding this section is sparse and extensive litigation may ultimately ensue. At the very least, bankers will be required to review traditional banking practices in light of the new provision; this scrutiny alone may produce benefits to the public.

Even though it may not be said that all bank tie-in arrangements are illegal, it is fair to say that they are all suspect under the new law.

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[1] 84 Stat. 1760 (codified in scattered sections of 12, 15, 26 U.S.C.).
[2] It is uncertain at the time of publication whether bank holding company subsidiaries will be able to engage in any or all of the activities mentioned. The scope of permissible activities will be determined by the Federal Reserve Board although the matter may be settled finally in the courts.
[3] 394 U.W. 495 (1969).
[4] Letter from Richard W. McLaren to Edward W. Brooke, June 26, 1970, in S. Rep. No. 91-1084, 91st Cong., 2d Sess. 47-8 (1970).
[5] S. 3823, 91st Cong., 2d Sess., § 4 (1970).
[66] S. 1664, 91st Cong., 1st Sess., § 3 (1969).
[7] Proposed amends. To Fed. Res. Bd. Reg. Y § 222.4, 36 Fed. Reg. 1413 (1971).