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Analyzing Antitrust Issues in Lending


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Although antitrust is rarely among issues practitioners who structure, document and enforce loans address, that field nevertheless does pose risks for lenders. Last month, for instance, a group of plaintiffs in a civil action against 16 banks embroiled in the ongoing LIBOR (London Interbank Offered Rate) controversy sought leave to file an amended complaint alleging that the banks conspired to rig LIBOR in violation of the Sherman Act,[1] and, in April, one of those banks agreed with the Department of Justice to pay a $150 million fine arising from a criminal LIBOR price-fixing violation of the Sherman Act.[2] These actions reflect what some say is a greater willingness by regulators, prosecutors and private parties to pursue antitrust violations in banking, after a more relaxed period of antitrust enforcement following the financial crisis.[3] The LIBOR imbroglio has been well-publicized, of course, but other lending activities potentially giving rise to antitrust exposure remain under the radar. Today, we examine some antitrust issues that lenders may face in conducting their lending business.[4]

Background

The Sherman Antitrust Act of 1890[5] and the Clayton Antitrust Act of 1914,[6] together with the case law thereunder and the rules and regulations promulgated by the DOJ and the Federal Trade Commission, form the main body of federal antitrust law in the United States. The Sherman Act generally prohibits contracts, combinations or conspiracies in unreasonable restraint of interstate commerce, and explicitly prohibits monopolization and attempted monopolization. The Clayton Act expands upon the Sherman Act by (a) enumerating several additional categories of prohibited behaviors, including price discrimination, exclusive dealing arrangements, predatory pricing and certain mergers, and (b) providing a private right of action for violations under both acts. Courts interpreting the acts have distinguished between two types of violation: *per se* and *Rule of Reason*. Per se violations are proven by their mere existence—simply engaging in the proscribed conduct is illegal, regardless of the perpetrator's motives or market power or the economic effects of its actions. The Rule of Reason, conversely, requires courts to consider those factors but to find a violation only where the behavior's anticompetitive effects outweigh the freedom to contract.[7] Notably, neither act distinguishes between enterprises in different industries; they apply to banks and other financial institutions as readily as to manufacturers or service companies. This makes sense, since the purpose of antitrust law—fostering competition—applies across industries. Moreover, §106 of the Bank Holding Company Act Amendments of 1970[8] places an additional layer of antitrust regulation on banks. As detailed below, §106 broadens certain antitrust restrictions on banks while narrowing others.

Civil and criminal penalties for antitrust violations are stiff. Successful civil plaintiffs may recover treble damages, including costs and attorney fees. Defendants can also face felony convictions (with up to 10 years in federal prison) and large fines (up to $1 million for individuals and $100 million for corporations).

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Anti-tying

One of the most common antitrust issues affecting lending is "tying." Tying occurs when a firm that controls the market for a desired product consents to supply that product only if the customer agrees to buy a different (and presumably undesired) product. The two products are thereby "tied." Microsoft famously was sued for tying Internet Explorer to its Windows operating system.[9] Sections 1 and 3 of the Sherman and Clayton acts, respectively, and §5 of the Federal Trade Commission Act, each generally bans tying arrangements, but §106 alters how those bans apply to banks.[10] That section presumes banks have market control and, therefore, unlike the Sherman Act, requires no proof of competitive injury; the mere existence of a conditional arrangement suffices to establish a violation, absent an applicable exemption. Section 106, however, also narrows the application of anti-tying provisions by offering several such exemptions. First, it exempts certain traditional services—namely loans, discounts, deposits, and trust services. Second, bank transactions with foreign entities are exempt. Third, restrictions necessary to protect the soundness of a loan are allowed, even if they are not

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usual.[11] This exemption has been used to require that a borrower, for example, hire or fire specified employees or management; allow the bank to control the business; or "assume the personal debt of its two sole stockholders and pay the interest on the personal loans of one of these individuals."[12] Nevertheless, although imposing such conditions might pass muster under federal antitrust law, doing so surely increases the degree of lender control over the borrower and therefore raises the specter of lender liability and equitable subordination. Thus, they should be undertaken, if at all, only after all potential risks have been weighed and mitigated.

Case law, of course, has not settled every anti-tying question for lenders, and a regulatory interpretation of §106 that the Federal Reserve Board (the Board) proposed in 2003 has never been finalized.[13] Among the issues the Board identified that remain unsettled are the tying implications of "over-the-counter" (OTC) derivatives. It is not unusual for banks to require that a customer hedge a portion of the loans made at a floating interest rate or in foreign currency via the purchase of a swap or other derivative product, nor is it unusual for a bank to require that the derivative be purchased from the bank. Although this latter condition has not been validated judicially or by regulatory guidance, several arguments support its propriety.

One could contend that no tying arrangement exists, maintaining that either (a) there is only one single product, e.g., a variable-rate loan plus an interest rate hedging derivative that together create one fixed-rate loan;[14] or (b) the loan and derivative form a single product market, for "the issue is not so much whether there are two separate products involved, but rather… 'whether…[lenders] have foreclosed the competition on the merits in the product market distinct from the market [for] the tied item.'"[15] One could also argue that tying loans and OTC derivatives is not anticompetitive because, in practice, a lender holding a blanket lien tends to be the only party willing to enter into a derivative contract with the borrower. In other words, even absent a tying arrangement, the borrower would be unable to purchase an unsecured derivative from a competing lender or may find it difficult or expensive to implement an intercreditor arrangement with a lender providing a secured derivative.

Additionally, OTC derivatives might fall within §106's "traditional banking practice" exemption. Courts have construed that exemption broadly to include not only the loan, discount, deposit or trust services §106 explicitly permits, but also any banking activity necessary to protect or enhance a borrower's creditworthiness (which is itself a separate exemption).[16] Indeed, the Board unofficially posited in its 2003 proposed interpretation that requiring borrowers to purchase interest rate swaps from their lender would not violate §106. The same logic ought to apply to other types of OTC derivatives, such as commodity swaps for mining companies.[17] Nevertheless, in the decade since the Board's interpretation, the OTC derivatives market has exploded and has been blamed for exacerbating the financial crisis. Accordingly, one can but guess whether the Board would still view tying OTC derivatives to loans as being permitted by §106.

> Collusion occurs when competitors collectively engage in one or more anticompetitive behaviors—such as price-fixing, group boycotting, dividing markets or allocating customers—that contravene antitrust laws.

This issue is even more unsettled in the context of loan syndications. Just as with single bank credits, it is not unusual for loan syndicates to require that a derivative be purchased from a member of the lending syndicate. Although §106 prohibits a bank's tying a loan to another product of that bank, its bank holding company or any other subsidiary of the bank holding company, the section is silent regarding tying between banks related only as syndicate members.[18] Prudence dictates that loan syndications be structured and administered with the same precautions as loans made by individual banks.

However derivatives may be viewed from a tying perspective, lenders should tread especially carefully when requiring the consumption of services, such as securities underwriting or insurance, that are patently *beyond* banking products. In *Adelphia Recovery Trust v. Bank of America*,[19] for example, the court characterized as a "clear violation of the anti-tying provisions" the bank's conditioning its issuance of a letter of credit on the borrower's agreeing to "market commercial paper through the lender's securities affiliate." To minimize exposure for tying violations, therefore, a lender should avoid requiring borrowers to purchase nonbanking products as a condition to extending credit and, if a lender does require the purchase of such nonbanking products, be clear it is doing so to reduce borrower credit risk, not merely to increase its own revenue.

Collusion

Collusion occurs when competitors collectively engage in one or more anticompetitive behaviors—such as price-fixing, group boycotting, dividing markets or allocating customers—that contravene antitrust laws. Competing lenders might agree to fix rates for certain types of credit or other bank products; to refuse to lend to certain customers; or each to solicit business only in separate geographic territories or only for different bank products. Such conduct can constitute a per se antitrust law violation and, obviously, is to be avoided.

Collusive agreements need not be expressed or specific to be illegal. A meat-packing industry case found illegal price-fixing in a trade association member's statement that "wholesale meat prices were 'low,' resale prices were 'high,' and they should keep it that way." Moreover, a party's being a mere passive witness to that kind of statement can implicate it; in the meat-packing case, the government alleged an "implied agreement" among all present.[20]

Historically, the concerted action by a group of lenders to collect the loans has not violated antitrust restrictions on group boycotts.[21] In *CompuCredit Holdings v. Akanthos Capital Management*,[22] however, the 11th Circuit faced a case involving coordinated behavior by a different type of creditor group: bondholders. There, CompuCredit had begun a tender offer for its outstanding bonds, a large majority of which were held by a group of hedge funds. CompuCredit accused those holders of conducting an illegal boycott by collectively refusing to tender, the theory being that the bondholders' coordination was an improper attempt to raise the bond price. The creditors won when the court below dismissed the case and an en banc Circuit Court panel affirmed. However, the panel did not rule on the merits of the antitrust claim and half the panel judges voted to remand the case to the district court to hear the antitrust issue. Consequently, the specter exists that borrowers in the future will raise collusion defenses when creditors coordinate to collect debts.[23]

Trade associations are legal but are not shielded from antitrust laws; illegal dealings among competitors violate the law even if done through a trade association. The antitrust risk of trade associations arises especially in meetings of those groups and the discussions, formal and informal, that those *meetings* foster. Indeed, scholars have suggested that "association meetings are probably the single most dangerous point of the operation of a business from an antitrust viewpoint."[24]

One area for concern is exchanging price or other sensitive business data among competitors within a trade association. Any data exchange or statistical reporting that includes current prices, or information that identifies data from individual competitors, can raise antitrust issues if it encourages more uniform prices than otherwise would exist. However, information reporting cost or data other than price, and historical data rather than current or future data, generally is less likely to raise antitrust concerns. Dissemination of aggregated data managed by an independent third party also raises fewer antitrust concerns.[25]

As with the other potential antitrust issues, many of those arising from trade meetings are inadvertent, due largely to the law's ability to ensnare both loose and implied agreements. Lenders can avoid inadvertent anticompetitive behavior at these meetings by, among other things:[26]

• establishing a reputation for unwillingness to participate in anticompetitive discussions (silence is not enough);

• consulting with counsel after any troubling conversations, in case corrective action is necessary; and

• not discussing current or future prices or rates; profit levels or credit terms; costs; allocation, division or "rationalization" of markets or customers; or boycotts or agreements not to deal with competitors, customers or suppliers.

Finally, we note the Noerr-Pennington Doctrine. Based on two Supreme Court cases,[27] the doctrine provides that competitors, including banks, do not incur antitrust liability simply by advocating jointly for anticompetitive laws. Nevertheless, those competitors cannot immunize their anticompetitive actions merely by subsequently requesting legislative approval of such actions.[28]

Debt Investments in Competitors

Lenders often finance themselves by borrowing from other lenders. Antitrust issues should be considered whenever one lender extends credit to a competitor, especially a smaller bank or finance company. Due diligence and loan administration by the creditor could arm it with confidential information that, if exploited for its own marketing purposes, could undercut the borrowing financial institution's ability to compete against the lending financial institution. Accordingly, loans to and debt investments in competitors should expressly prohibit the exchange of certain types of confidential information about the borrowing financial institution's customers that the lending financial institution could use to reduce competition unfairly.[29]

Antitrust's Changing Environment

Practitioners should recognize that the antitrust landscape is changing in ways that may increase lender liability. After a period of mild enforcement during the financial crisis, DOJ has stated that it intends to increase enforcement activity and has targeted banking as an industry that will receive heightened antitrust scrutiny. Additionally, DOJ is straying from its traditional role of focusing on anticompetitive bank mergers and acquisitions, making room for the prosecution of other anticompetitive behavior, such as tying and price-fixing.[30] Moreover, regulators have developed expertise in the banking industry through past investigations, including the LIBOR controversy, increasing their ability to pursue future lending-related antitrust violations.

Conclusion

Although antitrust is hardly the first thing one thinks of when engaging in commercial lending, that business is susceptible to antitrust law violations in various ways. Lending officers and their counsel need to be sufficiently familiar with the conduct that antitrust law proscribes that they can avoid perpetrating it, even inadvertently or by acquiescence. The treble damages and criminal penalties that can be imposed for violations are too costly to countenance ignorance of the law.

1. Proposed Second Consolidated Amended Complaint at 1–2, *In re LIBOR-Based Financial Instruments Antitrust Litigation*, 11-MD-2262 (S.D.N.Y. May 17, 2013).
2. Deferred Prosecution Agreement at 1, *United States v. Royal Bank of Scotland* (D. Conn. April 12, 2013).
3. D. Myles, "Antitrust Compliance Warning for US Banks," Int'l Fin'l L. Rev. (Feb. 12, 2013).
4. A discussion of anticompetitive mergers and acquisitions of financial institutions is beyond the scope of this article.
5. 15 U.S.C. §§1-7.
6. Id. §§12-27.
7. *Standard Oil of New Jersey v. United States*, 221 U.S. 1 (1911).
8. 12 U.S.C. §§1971-78.
9. Complaint at 21-24, *United States v. Microsoft*, No. 98-1232 (D.D.C. May 18, 1998).
10. Section 331 of the Garn-St. Germain Depository Institutions Act of 1982, codified in various sections of 12 U.S.C., applies similarly to federal savings and loan associations.
11. *Parsons Steel v. First Ala. Bank of Montgomery*, 679 F.2d 242 (11th Cir. 1982) ("[I]t is not sufficient in order to establish a violation of the Act to show simply that a particular method of protecting against default is not commonly used").
12. 9 E. Kintner & J. Bauer, Federal Antitrust Law §68.6 and cases cited therein.
13. Anti-Tying Restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970, Board of Governors of the Federal Reserve System, Docket No. OP-1158 (proposed Aug. 25, 2003) (never finalized).
14. C. Johnson, "Banking, Antitrust, and Derivatives: Untying the Antitying Restrictions," 49 Buff. L. Rev. 1, 3 (2001).
15. 2 G. Blanchard, Lender Liability: Law, Practice & Prevention §15:10.
16. C. Johnson, supra note 14, at 46.
17. G. Kalbaugh, "Including Derivatives Providers in Intercreditor Arrangements," 44 UCC L.J. 409, 428-29 (2012).
18. 12 U.S.C. §1972(1) (2013).
19. 646 F. Supp. 2d 489 (S.D.N.Y. 2009).
20. Trade Associations-Antitrust Risks, in Executive Legal Summary No. 129 (W. Hancock ed., 2000).
21. *United Airlines v. U.S. Bank*, 406 F.3d 918 (7th Cir. 2005) ("Competition comes at the time loans are made; cooperation in an effort to collect as much as possible of the amounts due under competitively determined contracts is not the sort of activity with which the antitrust laws are concerned.").
22. 661 F.3d 1312 (11th Cir. 2011), cert. denied, __U.S.__ (May 28, 2013)..
23. E. Ganz, LSTA Amicus Brief Update, LSTA Loan Market Chronicle, 2013, at 16-17.
24. Materials on Antitrust Compliance 1.002 (W. Hancock ed., 2d ed. 2003).
25. See "An FTC Guide to the Antitrust Laws," at 14, available at www.ftc.gov/bc/antitrust/factsheets/antitrustlawsguide.pdf.
26. Trade Associations-Antitrust Risks, supra note 20.
27. *E. R.R. Presidents Conference v. Noerr Motor Freight*, 365 U.S. 127 (1961); *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).
28. *Allied Tube & Conduit v. Indian Head*, 486 U.S. 492, 499 (1988).
29. H. Kaiser, "Debt Investments in Competitors Under the Federal Antitrust Laws," 9 Fordham J. Corp. & Fin. L. 605, 605-06 (2004).
30. Statement of W.J. Baer, Assistant Att'y Gen., Antitrust Div. Hearing on "Oversight of the Enforcement of the Antitrust Laws" before the Subcomm. on Antitrust, Competition, Policy and Consumer Rights, Comm. on the Judiciary, U.S. Senate (April 16, 2013), available at http://www.justice.gov/atr/public/testimony/295840.pdf; Peter Lattman, William Baer Confirmed as Justice Department Antitrust Chief, The New York Times (Dec. 30, 2012).