The Legal and Legislative History of the Line of Commerce in Banking

Two decades ago the Department of Justice shocked the commercial banking industry by filing a civil antitrust action against the approved merger of the Philadelphia National Bank and the Girard Corn Exchange Bank, both of Philadelphia. Up until the filing of this suit in 1961, the bankers had felt they were immune from antitrust law, their confidence stemming from the language of the antitrust statutes and other statutes as well.

The **Philadelphia** case proved not to be an aberration, however, as the Justice Department has filed over 60 suits since then attacking various bank mergers. The possibility that bank mergers or acquisitions may result in antitrust violations has become very real, and as such the standards laid down by the Supreme Court and lesser courts need to be examined closely by merger applicants prior to entering into a merger.

The purpose of this analysis is to focus upon the concept of the relevant "line of commerce" as related to commercial banking, which is important for reasons of determining the effect the pending merger will have on competition in the particular geographical area. As will be seen, the original Supreme Court definition of the line of commerce as decided in the **Philadelphia** case has "weathered the storm" for the 20 years that have passed since. Due to some recent statutory developments and some recent District Court opinions, though, a change may be on the horizon.

Statutory History of Bank Antitrust Law

The line of commerce as related to commercial banking stems from Sections 1 and 2 of the Sherman Act of July 2, 1890. As stated in the Sherman Act:

> . . . Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade, or commerce, among the several states or foreign nations, is declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy shall be deemed guilty of a misdemeanor and, upon conviction thereof, shall be punished by a fine not exceeding $50,000 or by imprisonment not exceeding one year.[2]

Note that there is no analysis here of the line of commerce. Section 2 reads:

> . . . Any person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize, any part of the trade or commerce among the several states or with foreign nations, shall be deemed guilty of a misdemeanor and, on conviction thereof, shall be punished by a fine not exceeding $30,000 or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.[3]

Section 2 does not describe the definition of commerce, nor does it delineate what the relevant

product line would be for any possible violation. It was not specific as to whether there could be a multi-product or single product line of commerce. The 1950 amendments to Section 7 of the Clayton Act were far more specific. Clauses 1 and 2 of Section 7 stated:

> . . . No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital, and no corporation subject to the jurisdiction of the FTC shall acquire the whole or any part of the assets of another corporation engaged also in commerce where *in any line of commerce in any section of the country* the effect of such acquisition may be substantially to lessen competition.[4]

When the Cellar-Kefauver Amendment to Section 7 of the Clayton Act passed, neither commercial bankers nor regulatory authorities believed that Section 7 applied to commercial banks since commercial banking was not "commerce." As late as 1955, the antitrust division of the Department of Justice did not believe that commercial banking was affected by Section 7 for the same reason, and also because commercial bank mergers or consolidations were neither an asset acquisition nor a stock acquisition, but were in reality a hybrid.

The Bank Merger Act of 1960, which preceded commercial bank merger litigation, did not incorporate any of the more pervasive language of the amended Section 7 of the Clayton Act. The Bank Merger Act, which amended Section 18 of the Federal Deposit Insurance Act, reads, in relevant part, as follows:

> . . . In the case of a merger, consolidation, acquisition of assets, or assumption of liabilities, the appropriate agency shall also take into consideration the effect of the transaction on competition (including any tendency toward monopoly), and shall not approve the transaction unless after considering all such factors, it finds the transaction to be in the public interest.[5]

Commercial bankers and their trade associations felt that the omission of the relevant line of commerce clause from the Bank Merger Act of 1960 further insulated the banks from any Sherman or Clayton Act antitrust adjudication. Commercial bankers were shocked when less than 1½ years later the antitrust division of the Department of Justice filed a Clayton Section 7 (and Sherman Sections 1 and 2) action against the **Philadelphia National Bank-Girard Trust Corn Exchange Bank** merger.

Case History of Bank Antitrust Law

A. Philadelphia National Bank—The Single Product Doctrine

Judge Clary, speaking on behalf of the District Court for the Eastern District of Pennsylvania, dismissed the Department of Justice's antitrust suit against the **Philadelphia National Bank-Girard Trust Corn Exchange Bank** merger. He felt that Section 7, as amended, did not apply to commercial banking because the commercial banks were not under the FTC jurisdiction and because it was neither a pure stock nor pure asset acquisition.

The Supreme Court, on June 17, 1963, reversed Judge Clary and remanded the case back to the District Court for redetermination of its potentially anti-competitive effects upon applicability of Section 7. The Supreme Court did agree with Judge Clary's determination that the relevant product line was commercial banking; the bundle of services or mutually interdependent services offered by commercial banking made commercial banking itself a unique line of commerce. As stated by the Supreme Court:

> . . . We have no difficulty in determining the 'line of commerce.' . . . We agree with the District court that the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term 'commercial banking,' composes a distinct line of

> commerce. Some commercial banking products or services are so distinctive that they are entirely free of effective competition from products or services of other financial institutions; the checking account is in this category. Others enjoy such cost advantages as to be insulated within a broad range from substitutes furnished by other institutions.[6]

Thus, the Supreme Court in its initial test accepted one major economic theory as to the operation of a commercial bank as a line of commerce.

Two theories have been available for a period of time; summarily they are stated as the bundle of goods, or mutually interdependent services single line of commerce theory, and the multiproduct department store of finance theory. The latter was the alternative rejected by Judge Clary's District Court and by the Supreme Court in 1963. Once the Supreme Court had determined the relevant line of commerce to be commercial banking, the resultant concentration ratios included commercial bank competition only, and other non-bank financial institutions were excluded from consideration.

B. Lexington, Continental, and Manufacturers-Hanover

On April 6, 1964, the Supreme Court ruled against a consummated merger of the **First National Bank & Trust Company** and the **Security Trust Co.**, both of Lexington, Kentucky. The merger, approved by the Comptroller of the Currency, had been attacked in 1961 by the Justice Department. After consummation by the parties, the Justice Department sued for divestiture under Section 1 of the Sherman Act.

This case is the only instance in which the Department of Justice sued and won under Section 1 of the Sherman Act, alleging restraint of trade in commercial banking and trust business. The Justice Department won both at the District Court and the Supreme Court levels against the banks. The line of commerce was in this particular case being stipulated as commercial banking for both Section 7 of the Clayton Act and Section 1 of the Sherman Act.

Two other major antitrust cases were filed in 1961, against the **Continental Illinois National Bank & Trust-City National Bank & Trust** merger in Chicago and the **Manufacturers Trust-Hanover Bank** litigation in New York. Continental Illinois National Bank and City National Bank & Trust of Chicago had received approval to merge in July 1961, but the Justice Department filed suit the following month against said merger on grounds of both Section 7 and Section 1. Again, commercial banking was defined as the single line of commerce, with emphasis being on demand deposits and business loans.

Almost simultaneously, the Justice Department moved against the combination of **Manufacturers Trust Company** and the **Hanover Bank** in New York City. This merger had been consummated, and, as in **Lexington**, the Justice Department demanded divestiture as the remedy for the anticompetitive combination. In that case, for the first time, the relevant line of commerce was altered. The Justice Department alleged, and the District Court agreed, that the relevant line of commerce was commercial banking, but that commercial banking was segregated into both wholesale and retail. This was important primarily for the relevant geographic market, to be discussed later. But it also revealed that there were at least different product lines within the unique single line of commerce.

In review, the first four cases filed were all won by the Justice Department. One other case not discussed above, the proposed merger of the **Calumet National Bank of Hammond** and **Mercantile National Bank of Hammond**, was abandoned after suit by the Justice Department. Thus, by 1966, the Justice Department had won five suits either in the courts or by the abandonment of the merger. Notice that all were horizontal market combinations, and the line of commerce was specifically tied to such combinations.

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C. Crocker-Anglo— The First Potential Competition Case

On October 8, 1963, the Department of Justice filed a suit against the combination of the **Crocker-Anglo National Bank** (San Francisco) and the **Citizens National Bank** (Los Angeles)[7] on Section 7 grounds, alleging the proposed combination would violate antitrust laws. The suit alleged that

the proposed merger would be potentially anticompetitive. At the time of the proposed merger, the two banks did little business in each other's service areas and had no branches located within each other's home office counties. In fact, Citizens National Bank had no offices in northern California, whereas Crocker-Anglo had branches only in the suburban counties surrounding Los Angeles.

The most relevant aspect of the **Crocker-Anglo National Bank** case was that the District Court found that the line of commerce was not only commercial banking but other types of financial institutions as well. The District Court enlarged the relevant product line to include savings and loan associations, commercial finance companies, Morris Plan banks, and insurance companies within the state of California. This permitted a decrease in the amount of concentration, and thus had some impact upon the competitive aspects of the case.

The decision in the **Crocker-Anglo** case was rendered in 1967, after passage of the Bank Merger Act of 1966. Thus, by the time the 1966 act was considered, all five cases reaching adjudication had utilized "commercial banking" as the definition of the line of commerce.

The Bank Merger Act of 1966

By 1966, the commercial banking industry had regrouped its forces and legislation passed through Congress amending the Bank Merger Act of 1960. The major import of the Bank Merger Act of 1966 was to strengthen "the competitive aspects" language of the 1960 act. Specifically, Section C(5) of Section 18 of the FDI Act was amended to read as follows:

> (A) any proposed merger transaction which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or
>
> (B) any other proposed merger transaction whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.[8]

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Careful reading of the revised Bank Merger Act of 1966, Section C(5), shows that there is no mention of any relevant line of commerce, whether phrased in the terminologies of Sections 1 and 2 of the Sherman Act or the stronger interpretation of the amended Section 7 of the Clayton Act. It is to be assumed that this was deliberate, not accidental, and was intended to alleviate the problem of the line of commerce being strictly interpreted to be commercial banking only.

Furthermore, the intent of the entire act was to bring the commercial banking industry out from underneath Sections 1 and 2 of the Sherman Act and Section 7 of the Clayton Act. The purpose was to replace them with primary jurisdiction by the regulatory authorities following the concepts and disciplines of the antitrust laws in general.

From the standpoint of the relevant line of commerce, however, it is important that the singular lack of attention to this particular ingredient has to be interpreted as being deliberate rather than a legislative oversight. That's especially important since the single product unique line of commerce doctrine had been firmly established by the previous litigation from 1961 to 1966.

Post-Bank Merger Act of 1966 Litigation

The major feature of the antitrust litigation from 1966 to 1970 was the number of banks that withdrew from previously approved mergers when sued by the Department of Justice. From 1966 to 1970, eight of the nine cases filed by the Department of Justice precipitated almost immediate withdrawals by the banks involved, although some preliminary litigation was carried on prior to abandonment by several of the litigants. For example, major cases in Houston, St. Louis, and Pennsylvania were abandoned after litigation was instituted by the Department of Justice.

The most interesting case during this period was the **Provident National Bank-Central Penn National Bank** merger. The Justice Department's original suit was dismissed by the District Court without trial. The Supreme Court, though, reversed the decision and remanded it back to the District Court in 1967. In 1968, the District Court found the merger unlawful and the banks did not appeal. In its ruling, the District Court extended the line of commerce to include not only commercial banking but also mutual savings banks within the Philadelphia area. This case, known familiarly as Philadelphia II, extended the commercial banking line of commerce in the same community where the original line of commerce was drawn.

Thus, by 1970, two lower court cases, in **Crocker-Anglo** and in **Provident**, had extended the line of commerce to be more than simply commercial banking. Furthermore, the regulatory authorities and bank applicants were utilizing lines of commerce beyond those of commercial banking in determining the competitive aspects of proposed mergers during the same period. The honeymoon, however, was short; the **Phillipsburg** case brought the commercial banking line of commerce back to a more strict standard.

A. Phillipsburg—Back to the Single Line of Commerce Test

On June 27, 1970, the Supreme Court reversed a District Court determination that the proposed merger between the **Phillipsburg National Bank and Trust Company** and the **Second National Bank of Phillipsburg** was not violative of the antitrust laws. The District Court, had dismissed the Justice Department's complaint, finding no violation of Section 7. The Supreme Court reversed the District Court on both the relevant line of commerce and relevant geographic market tests, thus remanding the case back for retrial on the needs and convenience issue. The Supreme Court stated that the District Court had erred in finding no violation of the antitrust clause because of erroneous use of their relevant line of commerce and relevant market area tests. The Supreme Court stated firmly and simply that the relevant product line for commercial banking was commercial banking. As the Court stated:

> . . . Indeed, competitive commercial banks, with their cluster of products and services, play a significant role in a small community unable to support a large variety of alternative financial institutions. If anything, it is even more true in the small towns.[9]

The District Court had relied upon the relevant product market being divided into sub-product markets due to the competition between the commercial banks and non-bank financial intermediaries. Furthermore, the District Court felt that the commercial banks operated more like savings institutions than like big city commercial banks. The Supreme Court rejected the contention stating:

> . . . The District Court erred. It is true, of course, that the relevant product market is determined by the nature of the commercial entities involved and by the nature of the competition that they face. . . . But sub-markets are not a basis for the disregard of a broader line of commerce that has economic significance.[10]

The Supreme Court again reiterated the **Philadelphia** standard that a clustering of services delimits commercial banking:

> The clustering of financial products and services in banks facilitates convenient access to them for all banking customers. . . . Moreover, if commercial banking were rejected as the line of commerce for banks with the same or similar ratios of business as those of the appellee banks, the effect would likely be to deny customers of small banks—and thus residents of many small towns—the antitrust protection to which they are no less entitled than customers of large city banks.[11]

Thus, after seven years of litigation, the lower court's attempts to expand the relevant line of commerce to include more than commercial

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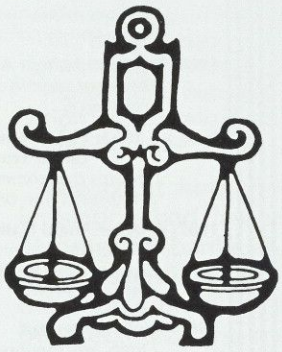
banking were foiled. The Supreme Court returned to its **Philadelphia National Bank** test of a single product cluster of services approach.

B. The Relevant Line of Commerce—The Potential Competition Cases, 1970-1976

Following **Phillipsburg**, two aspects of the relevant line of commerce doctrine are in evidence. The District Courts have continued to expand the relevant line of commerce to include non-bank financial institutions. For example, in the **First National Bank of Jackson-Bank of Greenwood**, Mississippi case, the relevant line of commerce was determined to be financial institutions, including commercial banks, cotton exchanges, and savings and loan associations.[12] Furthermore, in the **Idaho First National Bank of Boise-Fidelity National Bank, Twin Falls** case, Judge Bouldt also included as competitive financial institutions savings and loan associations, trust and savings banks, credit unions, the Production Credit Association, the Federal Land Bank, life insurance companies, and mortgage companies.[13]

Thus, in both the **Jackson** and **Idaho** cases, the District Court enlarged the relevant line of commerce to include other deposit and non-deposit financial intermediaries in addition to commercial banks. Potential competition cases have been characterized as market extension or product extension combinations rather than horizontal market combinations, as in the earlier actual competition cases. Both in the **Jackson** and **Idaho** cases, potential competition was alleged to be a market extension merger (acquisition), thus possibly (or probably) resulting in a violation of Section 7 of the Clayton Act.

Thus, not being a product extension merger, expansion of the relevant line of commerce by District Courts to include more than commercial banking was a significant change. In all fairness, though, it should be noted that the District Courts' actions preceded the **Phillipsburg** decision. Following the **Phillipsburg** case, the commercial banking line was restored in some lower court district cases. The prevalent behavioral pattern during 1970-1976 was abandonment of proposed mergers and acquisitions by either banks or holding companies.



C. The Two Supreme Court Cases—Marine Bancorporation and Connecticut

The first case to go to the Supreme Court under the potential competition theory was the **Greely** case; the *per curiam* opinion of the Supreme Court affirmed on a four-to-four vote the District Court's opinion that the proposed acquisition by a registered bank holding company was not a violation of Section 7 on potential competition grounds. By the time the Supreme Court heard the **Marine Bancorporation** and **Connecticut** cases in 1974, the Justice Department had lost all of its seven potential competition cases brought before the federal courts.

On June 17, 1974, the Supreme Court remanded the **Marine Bancorporation** and **Connecticut** cases back to the District Court for further adjudication, especially disintegrating the attempts by the Justice Department to utilize potential competition as a means of thwarting commercial bank acquisitions and/or mergers. Once again, the Court gave the green light to the single product line of commerce argument of the **Philadelphia National Bank** case 11 years previous.

In both the **Marine Bancorporation** and **Connecticut** cases, District Courts had expanded the line of commerce beyond commercial banking. In **Marine Bancorporation**, the line of commerce was increased to include savings and loan associations and mutual savings banks, and in the **Connecticut** case, mutual savings banks were

TRACING THE LINE OF COMMERCE

July 2, 1890: Sherman Act
Prohibits any trust or contract restraining trade.

1950: Clayton Act
Prohibits acquisition which would lessen competition in any line of commerce.

1960: The Bank Merger Act
Does not identify banking as a separate line of commerce.

June 17, 1963: Philadelphia National Bank — Girard Trust Corn Exchange Bank
Declares that commercial banking's cluster of products is a distinct line of commerce.

1967: Crocker-Anglo National Bank
Justice Department filed suit on grounds that a proposed merger would be potentially anti-competitive.

1966: Bank Merger Act
Omits any mention of banking as a separate line of commerce.

1970: Phillipsburg National Bank
Supreme Court reverses District Court and reaffirms banking as a separate line of commerce.

1974: Marine Bancorporation and Connecticut
Court rejects potential competition as a basis for blocking mergers and reaffirms single line of commerce rule.

1980: New Jersey and Utah
District Courts consider thrifts in bank merger cases.

considered as competitive substitutes and alternatives to commercial banks. In the **Connecticut** case, one reason for reversal by the Supreme Court was the District Court's erroneous drawing of the relevant line of commerce.[14]

Thus, after 18 years of litigation, the Supreme Court has held fast to the relevant line of commerce being that of commercial banking. It has resisted pressures placed upon it by the regulatory agencies, the lower courts, merger applicants, and academia in general. All have pushed for expanding the relevant line of commerce from a single product unique line of clusters of services to a multi-product mutually independent bundle of services.

However, since there has been no litigation in this area at the Supreme Court level for a number of years, and there have been some relatively recent case law and statutory developments in the banking industry, we may see some changes in the standard.

Recent Legal and Legislative Developments

Certain developments that have taken place on both the legal and legislative fronts may signal that a change is forthcoming in the definition of the relevant line of commerce. It is becoming increasingly apparent that the legal distinctions that existed among the various financial institutions at the time of the **Philadelphia** decision no longer conform to reality. This has been a result of both a conscious effort on the part of the federal government, and of private competitive forces.

The most important statutory development has been the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980. That act greatly increased the powers of federally chartered thrifts, and at the same time narrowed the distinctions between the thrifts and the commercial banks. One major provision calls for the phase-out and elimination of the limitations on deposit interest rates eliminating the existing differentials that thrifts may pay over the commercial bank rate. The act also permits all depository institutions to offer NOW accounts to individuals, which will accelerate the trend of depository institution de-specialization.

Further, the "cluster of services" that the **Philadelphia** court attributed to commercial banking is becoming increasingly permissible for thrifts. Federally chartered thrifts may exercise trust and fiduciary services, issue stock, and offer credit card services. All thrifts may employ remote service units similar to those utilized by commercial banks. Further, federally chartered mutual savings banks may now hold up to 5 percent of their assets in commercial, corporate or business loans - a lending power previously denied them. Finally, the uniform reserve requirements imposed on all depository institutions by the 1980 act will also reduce distinctions among them.

Federal courts have begun to take note of the changes in the depository institution industry. In some districts at least, the courts are starting to reassess the **Philadelphia** standard as it applies to new economic realities. In two major instances recently, District Courts considered the impact of the thrifts in cases involving commercial bank mergers.

In the first case, decided in 1980, the Justice Department brought suit to enjoin the proposed merger of two of New Jersey banks. First National State Bank of Central Jersey and the First National Bank of South Jersey. Violation of the Clayton Act was charged, and the Justice Department's basis was that the merger would substantially lessen both actual and potential competition. The District Court of New Jersey affirmed the Comptroller's approval of the merger, however. Although the court did in the end utilize commercial banking as the relevant line of commerce, its decision apparently was influenced by the presence of thrifts in the area. The defendants had introduced substantial evidence showing the scope and impact of all banking alternatives in the area to prove that competition would not be affected, and the court remarked in agreement:

> The overwhelming weight of the evidence establishes that each of the markets is competitive. This ultimate finding stems from numerous subsidiary findings regarding the reliability of concentration ratios as evidence of the competitiveness of markets, the historical trend toward deconcentration in the relevant geographic markets, competition from the thrifts, . . .(etc.)[15]

The court further recognized that the 1980 legislation had lessened distinctions between commercial banks and thrifts. The presence of these essentially similar institutions resulted in the court's finding that competition would not be affected by the merger.

The second instance involved the 1980 merger of Zions First National Bank and the First National Bank of Logan, both of Utah. There the Justice Department claimed that the merger would lessen potential competition. As in the **New Jersey** case, the defendants presented evidence of non-bank alternatives that would absorb any possible anti-competitive effect that the merger could create. And as its **New Jersey** counterpart had done, the District Court of Utah considered the thrifts in its ruling:

> All of these enterprises have an offer of some kind that affects this commercial banking market. And that is just as much a part of the factual backdrop in which these commercial banks compete as is the population or the number of commercial banks.[16]

The court proceeded to approve the merger, thus keeping intact the Justice Department's string of defeats in the area of potential competition.

Although both the **New Jersey** and the **Utah** courts have specifically retained the **Philadelphia** definition of the relevant line of commerce, there is no denying that the standard is again under attack. The potential success of this trend is enhanced by the legislative and private market developments of late. At present, no cases are pending at the Supreme Court level, however, so it will be some time before the issue is resolved.

—Douglas V. Austin