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ON BANKS, NONBANKS, AND OVERLAPPING MARKETS: A REASSESSMENT OF COMMERCIAL BANKING AS A LINE OF COMMERCE

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I. INTRODUCTION

Since the 1963 decision of *United States v. Philadelphia National Bank & Trust Co.*,[1] the Supreme Court has held that, pursuant to antitrust law, the "cluster" of commercial banking products is the relevant product market or line of commerce in bank merger litigation. This Article examines the validity of that rule and contrasts it with the theoretical approach taken by the Court in nonbanking

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1. 374 U.S. 321 (1963).

cases under section 1 of the Sherman Anti-Trust Act[2] and section 7 of the Clayton Act,[3] and with the rapidly evolving realities of the financial services industry. This two-pronged analysis leads to the conclusion that the Court established and has perpetuated the "cluster" rule for the sake of expediency. In the succeeding twenty years, legislated deregulation and competitive creativity have drastically altered conditions in the marketkplace to the degree that now there are virtually no significant legal or economic barriers to entry into product or geographical markets, and myriad nonbank providers of financial services offer reasonable substitutes for nearly all of the traditional commercial bank products that constitute the *Philadelphia* cluster.

II. THE NONFINANCIAL CASES

A credible antitrust policy must begin with the identification of producers (or potential producers) of products or services who compete for the favor of consumers. This requirement necessitates an economic investigation. While antitrust law in America is not motivated solely by economic considerations, an important purpose of antitrust law is the promotion of competition. Competition will encourage economic efficiency and, ultimately, will improve living standards.

In the major Sherman Act and Clayton Act decisions, the Supreme Court's discussions of the "relevant market"[4] have recognized the economic content of antitrust. In antitrust two markets must be defined: (1) the product market ("line of commerce") and (2) the geographic market ("section of the country").[5] Defining the geographic market without first establishing the relevant product in question is meaningless. This section will address the development of product market definition in the major nonfinancial antitrust cases before the Supreme Court during the modern age of antitrust.[6]

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2. Ch. 647, § 1, 26 Stat. 209 (1890) (codified as amended at 15 U.S.C. § 1 (1982)) [hereinafter cited as section 1].

3. Ch. 323, § 7, 38 Stat. 731 (1914) (codified as amended at 15 U.S.C. § 18 (1982)) [hereinafter cited as section 7].

4. *See* text accompanying notes 12-14 & 22-25 *infra*.

5. *See, e.g.,* Brown Shoe Co. v. United States, 370 U.S. 294, 324 (1962).

6. The modern age of antitrust began in 1950 with the enactment of the Celler-Kefauver Anti-Merger Act, ch. 1184, 64 Stat. 1125 (1950) (codified as amended at 15 U.S.C. §§ 18, 21) (1982)), which amended sections seven and eleven of the Clayton Act. The amendment was in part a response to the Sherman Act's ineffectiveness in dealing with mergers that do not result in a monopoly but which, arguably, substantially lessen competition. *See* Brown Shoe Co. v. United States, 370 U.S. 294, 318 n.33 (1962).

The two major nonfinancial cases decided by the Supreme Court are *United States v. E.I. Du Pont de Nemours & Co.*[7] and *Brown Shoe Co. v. United States.*[8] The court decided *Du Pont* under the Sherman Act, but decided *Brown Shoe* under the amended Clayton Act. In terms of product market definition, however, the standards of the Sherman and Clayton Acts are identical.[9]

In *Du Pont* the Government charged that the market for cellophane was being monopolized.[10] The defense contended that the cellophane market was not a market in isolation, but was only part of the market for flexible wrapping materials.[11] In *Du Pont* the Court gave judicial currency to the concepts of cross-elasticity of demand and product substitutability.

> Market delimitation is necessary . . . to determine whether an alleged monopolist violates § 2 [of the Sherman Act]. The ultimate consideration is whether the defendants control the price and competition in the market for such part of trade or commerce as they are charged with monopolizing. . . . Control in the above sense of the relevant market depends upon the availability of alternative commodities for buyers: *i.e.*, whether there is a *cross-elasticity of demand* between cellophane and the other wrappings. This interchangeability is largely gauged by the purchase of competing products for similar uses considering the price, characteristics and adaptability of the competing commodities.[12] . . . What is called for is an appraisal of the "cross-elasticity" of demand in the trade. . . . In considering what is the relevant market for determining the control of price and competition, no more definite rule can be declared than that commodities *reasonably interchangeable by consumers for the same purposes* make up that "part of the trade or commerce," monopolization of which may be illegal.[13]
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> . . . The "market" which one must study to determine when a producer has monopoly power will vary with the part of commerce under consideration. The tests are constant. *That market is composed of products that have reasonable interchangeability for the purposes for which they were produced—price, use and qualities considered.*[14]

Thus, the concept of cross-elasticity of demand is of utmost importance in antitrust analysis. This concept concerns the relationship between the price of one product and the quantity

7. 351 U.S. 377 (1956).
8. 370 U.S. 294 (1962).
9. *See* United States v. Grinnell Corp., 384 U.S. 563, 573 (1966).
10. 351 U.S. at 378.
11. *Id.* at 380.
12. 351 U.S. at 380-81 (emphasis added).
13. *Id.* at 394-95 (footnote and citation omitted) (emphasis added).
14. *Id.* at 404 (emphasis added). The Court previously noted cross-elasticity of demand in Times-Picayune Publishing Co. v. United States, 345 U.S. 594 (1953).

demanded of another product when other prices, income, and tastes are constant. The formula for cross-elasticity is:

$$\text{Eab} = \frac{\text{relative change in quantity of A}}{\text{relative change in price of B}}$$

Because all products have substitutes, a major goal of antitrust law is to identify these substitutes and their effectiveness in restraining the pricing decisions of competitors. The cross-elasticity of demand *defines* economic substitution. If Eab is large and positive, then Product A is a good substitute for Product B. Of course, if Eab is zero or negative, then the products most likely are not good substitutes for one another.[15]

The Supreme Court, however, will not estimate the cross-elasticity of demand. While theoretically precise, cross-elasticity is very difficult to measure empirically. It also is very difficult to determine the level of cross-elasticity below which products will not be considered close substitutes.

After assessing the cross-elasticity of demand in *Du Pont*, the Court found that "despite cellophane's advantages, it has to meet competition from other materials in every one of its uses. . . . Thus, cellophane shares the packaging market with others."[16] "We conclude that cellophane's interchangeability with the other materials mentioned suffices to make it a part of this flexible packaging material market."[17]

The Court's discussion of cross-elasticity of demand in *Du Pont* raises several issues. First, it was concerned about the price at which products are reasonably interchangeable. Recall that the *Du Pont* Court decided a monopolization charge under the Sherman Act. If a monopoly in fact existed, then the monopolist probably operated in the elastic end of the demand schedule; therefore, substitutes could be found at the monopolist's (high) price.[18] But, this substitutability would be a reflection of monopoly if cellophane prices were set so high that customers turned to other (inferior) wrappings.

Second, the *Du Pont* Court also was concerned about substitutability in use. It did not mention the substitutability of production facilities that might dampen the exercise of monopoly power. However, the Court corrected this omission in later cases,

15. Indeed, if Eab equals zero, the demand for Product A is independent of the price of Product B. If Eab is negative, the products are said to be complements.

16. 351 U.S. at 399.

17. *Id.* at 400. The other wrapping materials are noted in Appendix A to the opinion. *Id.* at 405. In total, cellophane accounted for approximately 22 percent of flexible wrapping material measured by wrapping surface. *Id.*

18. *See* J. HIRSHLEIFER, PRICE THEORY AND APPLICATIONS 276-80 (1976).

notably in *Brown Shoe* and *United States v. Aluminum Co. of America*[19] (*ALCOA*).

In *Brown Shoe*[20] the Court, for the first time, addressed the issue of relevant markets in merger cases under the amended Clayton Act. The Court again recognized the value of an economic evaluation and stressed an examination of particular markets:

> Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power, but only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger.[21]

Discussing the relevant markets, the Court stated:

> The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it. However, within this broad market, *well-defined submarkets* may exist which, in themselves, constitute product markets for antitrust purposes. . . . The boundaries of such a submarket may be determined by examining such *practical indicia* as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes and specialized vendors.[22]
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> . . . .
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> . . . [T]he boundaries of the relevant market must be drawn with sufficient breadth to include the competing products of the merging companies and to recognize competition where, in fact, competition exists.[23]

With respect to the merger in *Brown Shoe*, the Court concluded that markets of men's, women's, and children's shoes constituted relevant product markets.[24] The Court reached this determination by considering the following factors: "[a] These product lines are recognized by the public [as being separate]; [b] each line is manufactured in separate plants; [c] each has characteristics peculiar to itself rendering it generally noncompetitive with the others; [d] each is, of course, directed toward a distinct class of customers."[25]

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19. 377 U.S. 271 (1964).
20. *See* note 8 *supra*.
21. 370 U.S. at 322 n.38 (citations omitted).
22. *Id.* at 325 (footnotes and citations omitted) (emphasis added).
23. *Id.* at 326.
24. *Id.*
25. *Id.* at 326. Although the defendants argued for finer distinctions based on age/sex and price/quality distinctions, the Court decided that a finer division would be "impractical [and] unwarranted." *Id.* at 328.

Thus, the *Brown Shoe* Court fashioned "practical indicia" to determine product markets to operate in tandem with the cross-elasticity requirement of *Du Pont*. The concept of production substitutability, which the *Du Pont* Court ignored, found favor in Mr. Justice Harlan's comments:

> Because of this flexibility of manufacture, the product market with respect to the merger between Brown's manufacturing facilities and Kinney's retail outlets might more accurately be defined as the complete wearing-apparel shoe market, combining in one the three components which the District Court treated as separate lines of commerce. Such an analysis, taking into account the *interchangeability of production*, would seem a more realistic gauge of the possible anticompetitive effects in the shoe manufacturing industry of a merger between a shoe manufacturer and a retailer. . . . For if a manufacturer of women's shoes is able, albeit at some expense, to convert his plant to the production of men's shoes, the *possibility of such a shift should be considered in deciding whether the market for either men's shoes or women's shoes can be monopolized or whether a particular merger substantially lessens competition among either product.*[26]

The *Brown Shoe* Court expanded the groundwork laid by the *Du Pont* Court, but its method of determining the outer boundaries of a product market in which submarkets may exist raises substantial problems. One noted authority has observed that if a submarket is composed of sellers from which sellers of good substitutes have been eliminated, then market share statistics cannot have their ordinary significance.[27] Because the relevant criteria for defining the product market have already been addressed in determining the outer boundaries, any refinement of the product market or further division is arguably unsound from the standpoints of both economics and logic.

Two post-*Brown Shoe* Supreme Court decisions, *ALCOA*[28] and *United States v. General Dynamics Corp.*,[29] highlight the difficulties with the submarket approach. The majority opinion in *ALCOA* is symptomatic of the problem of the submarket approach. The majority, reversing the district court,[30] concluded that aluminum conductor and copper conductor were separable for the purpose of analyzing the competitive effects under the Clayton Act of the acquisition of Rome Cable Corporation by Alcoa.[31] Relying on the

26. *Id.* at 367 (Harlan, J., dissenting in part) (emphasis added).
27. *See* R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 129 (1976).
28. *See* note 19 *supra*.
29. 415 U.S. 486 (1974).
30. United States v. Aluminum Co. of America, 214 F. Supp. 50 (1963).
31. 377 U.S. at 277.

language of *Brown Shoe*, the Court determined that "aluminum conductor bare and insulated [constituted] a submarket and for purposes of § 7a 'line of commerce.' "[32]

The dissenting opinion, written by Justice Stewart, highlights the illogic of the submarket approach in this instance:

> [The] "practical indicia" to be considered in determining submarket boundaries express in practical terms the basic economic concept that markets are to be defined in terms of the close substitutability of either product (demand) or production facilities (supply), since it is ultimately the degree of substitutability that limits the exercise of market power, and it is only by delimiting the area of effective competition that an acquisition's competitive effects can be ascertained.[33]

Justice Stewart, supporting the district court's line of commerce analysis, concluded that insulated aluminum conductor had not been established as a line of commerce. Justice Stewart relied on several factors to support his conclusion: (a) the conductor industry did not differentiate between copper and aluminum insulated products; (b) copper and aluminum products were functionally interchangeable; and (c) no unique production facilities or specialized vendors for aluminum conductor products existed.[34] Justice Stewart was convinced that because the majority had concluded that the aluminum and copper markets were separable, they had improperly and arbitrarily excluded important copper elements. In other words, once the market was defined correctly, there was no need for submarkets because submarkets required the exclusion of good substitutes.

In *General Dynamics* the Court adopted the viewpoint of the *ALCOA* minority. The issue in *General Dynamics* was whether the sale and production of coal constituted a line of commerce:

> As to the relevant product market, the [lower] court found that coal faced strong and direct competition from other sources of energy such as oil, natural gas, nuclear energy, and geothermal power which created a cross-elasticity of demand among those various fuels. As a result, it concluded that coal, by itself, was not a permissible product market and that the 'energy market' was the sole "line of commerce" in which anticompetitive effects could properly be canvassed.[35]

Although the majority seemed to sympathize with the lower court's conclusion that an "energy market" existed, the Court affirmed

32. *Id.*; *see* 370 U.S. at 324.
33. 377 U.S. at 283 (Stewart, J., dissenting).
34. *Id.* at 284 (Stewart, J., dissenting).
35. 415 U.S. at 491.

the lower court's judgment without expressly considering the line of commerce issue because it concluded that the Government had failed to demonstrate a lessening of competition in *any* market.[36]

The four dissenting Justices in *General Dynamics* concluded that "the existence of an energy market [was] not inconsistent with and [did] not negate the existence of a narrower coal market."[37] The dissent agreed with the "well-defined submarkets" rationale of *Brown Shoe*.[38] Furthermore, the dissenting Justices believed that inter-industry competition did not preclude the division of a broader market (energy) into a separate submarket (coal): "[W]hatever the existence of a § 7 energy market, coal constitutes an economically significant submarket for § 7 purposes."[39]

The Supreme Court in *Du Pont* sanctioned the use of cross-elasticity of demand in order to determine product markets even though the Court recognized the difficulty of precisely calculating cross-elasticity. Because of these measurement problems, the Court has, more or less, relied on indicators rather than on a direct measure of cross-elasticity. The *Brown Shoe* Court referred to these indicators of cross-elasticity as "practical indicia."[40] Gauging the cross-elasticity of demand through the indicators specified by the Court is fraught with problems because different indicators may point in different directions at any given time. Sorting through the morass of economic statistics is not a simple task. Nevertheless, courts must "hack through the jungle" as best they can.[41]

In addition to the previously discussed cases, there are several significant Supreme Court decisions concerning bank mergers and a number of lower court decisions relating to the product market in bank mergers. These cases raise the issue of whether the teachings in *Du Pont* and *Brown Shoe* have been applied in a logical fashion to the facts at hand, in other words, whether the courts have been perceptive in gauging cross-elasticities of demand in financial services. Unfortunately, the courts, especially the Supreme Court, are lost in the jungle; they rely on expediency rather than sound analysis.

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36. *Id.* at 510-11.
37. *Id.* at 514.
38. *Id* (citing Brown Shoe, 370 U.S. at 325).
39. *Id.* at 517 (Douglas, J., dissenting). United States v. Continental Can Co., 378 U.S. 441 (1964), is also of interest in this regard because it analyzes the effects of interindustry competition in the glass and metal container industries and concludes that the area of effective competition cuts across industry lines. Thus, metal and glass containers were viewed together as the line of commerce.
40. 370 U.S. at 325.
41. United States v. Times-Picayune Publishing Co., 345 U.S. at 621.

III. THE BANKING CASES

The *Philadelphia* decision represented the first occasion for the Supreme Court to apply the rules of product definition to the field of commercial banking. *Philadelphia* concerned a proposed merger between two Philadelphia banks; the Government alleged that this merger violated section 1 of the Sherman Act and section 7 of the Clayton Act.[42] The district court dismissed the action after trial.[43] On appeal, however, a five to three Supreme Court majority ruled that section 7 indeed applied to bank mergers and prohibited the resulting bank's control of thirty percent of the commercial banking business in the Philadelphia metropolitan area.

At the trial level the Government argued that about ten different products or services of commercial banks, each supplied not at all or at best "peripherally and imperfectly" by other sources, were the appropriate lines of commerce under section 7.[44] The defendant banks argued that effective substitutes for each of the delineated services, except demand deposits, were available from other suppliers and that the trial court should apply the *Du Pont* test of reasonable interchangeability.[45] The trial court refused to adopt the submarket approach and, reasoning that each of the product lines was an integral and dependent part of the whole, held that "commercial banking, viewed collectively, has sufficient peculiar characteristics which negate reasonable interchangeability."[46] Nevertheless, the district court dismissed the action on two grounds: first, the merger did not fall within the scope of section 7,[47] and second, even if it did, the merger would not substantially lessen competition or tend to create a monopoly in commercial banking in the relevant geographic area.[48]

Interestingly, the district court's product line definition was not at issue on appeal, yet the Supreme Court devoted a major portion of its opinion to a discussion of product line and upheld the lower court on this point. Justice Brennan, writing for the majority, based this finding on several overlapping reasons: (1) the perceived uniqueness of the commercial banking business; (2) public

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42. 374 U.S. at 323.
43. 201 F. Supp. 348 (E.D. Pa. 1962).
44. These included "commercial banking, commercial and industrial loans, installment lending to individuals, single payment loans to individuals, real estate loans, personal trusts, time deposits of partnerships and corporations, time and savings deposits, demand deposits, and IPC (Individual, Partnership and Corporation) demand deposits." *Id.* at 361.
45. *Id.*
46. *Id.* at 363.
47. *Id.* at 372.
48. *Id.*

policy; (3) the pervasive regulatory scheme, including legal barriers to entry; and (4) expediency.

The Court was particularly impressed by the exclusive power that commercial banks have to accept demand deposits—a service "so distinctive that [it is] entirely free of effective competition from products or services of other financial institutions . . . ."[49] Additionally, the Court noted the unique role that commercial banks play in the creation of money and maintenance of the nation's payments system.[50] A third factor separating commercial banks from other financial institutions was that the former were the chief suppliers of short-term business credit.[51] Finally, the Court observed that, unlike other product lines such as shoes and cellophane, concentration in banking accelerates concentration generally.[52]

This last item is related to the significant policy considerations that concerned the Court: "[T]he proper discharge of these [factors] is indispensible to a healthy national economy, as the role of bank failures in depression periods attests."[53] The historical role of commercial banks in supplying credit to small business was particularly significant because small business is the traditional linchpin of the United States' economy. The Court found a far greater public interest in the survival of competitors in the banking field[54] than in the survival of shoe manufacturing competitors because the vigor of the economy depends on the vigor of competition between banks: "If the number of banks in the locality is reduced, the vigor of competition for filling the marginal small business borrower's needs is likely to diminish."[55]

The public interest and economic history gave rise to a regulatory scheme in the banking industry that has been far more pervasive than any to which a shoe or cellophane manufacturer would be subject. This includes, *inter alia*, statutes and regulations designed to ensure safety and soundness that provide for periodic examinations and restrictions on entry, branching, and acquisition. Thus, in commercial banking there are legal barriers to entry, exit, and expansion that do not exist in commerce.

Finally, the Supreme Court did not examine submarkets in commercial banking. The lower court had rejected this approach because "carried to the logical extreme, [it] would result in many

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49. 374 U.S. at 356.
50. *Id.* at 326.
51. *Id.* at 327.
52. *Id.* at 370.
53. *Id.* at 327.
54. *Cf. Brown Shoe*, 370 U.S. at 320 (congressional concern underlying section 7 was protection of competition, not competitors).
55. 374 U.S. at 369.

additional so called lines of commerce."[56] The Supreme Court agreed with the district court and reiterated that the congressional intent is served by arresting anticompetitive tendencies in their incipiency[57] and is disserved by "permitting a too-broad economic investigation."[58] Moreover, the Court believed the simplified product market definition served the interest of sound business planning because the definition would enable business to "assess the legal consequences of a merger with some confidence,"[59] and because the definition would appeal to the courts' interest in "sound and practical judicial administration."[60]

After *Philadelphia* the district courts struggled to apply its lessons in a number of bank merger cases. Some courts uncritically or without elaboration accepted the commercial banking cluster as the outer limit of the line of commerce; others sought to restrict *Philadelphia* to its peculiar facts.

In *United States v. Manufacturers Hanover Trust Co.*,[61] the Government sued for divestiture after the merger of Manufacturers Trust Company, a retail-oriented bank,[62] and The Hanover Bank, a wholesale-oriented bank.[63] The district court cited *Philadelphia* for the proposition that in order to predict the competitive impact of a merger, there must be "a firm understanding of the structure of the relevant market . . . ."[64] The district court rejected the Government's contention that seven particular banking services should be treated as submarkets,[65] and adopted a slightly modified version of the *Philadelphia* cluster approach. The court concluded that "[h]owever tempting the easy course, exhausting the labor, complex, elusive and fragmentary the evidence, desirable simplified tests, or great the pressures for quick solution and mass production,"[66] it should scrutinize the peculiarities of commercial banking in New York City. After it did so, the court found that both wholesale and retail banking were "perfectly good lines of

56. 201 F. Supp. at 363.
57. 374 U.S. at 362 (citing Brown Shoe, 370 U.S. at 322).
58. *Id.* (citing Standard Oil Co. v. United States, 337 U.S. 293 (1949)).
59. 374 U.S. at 362.
60. *Id.*
61. 240 F. Supp. 867 (S.D.N.Y. 1965).
62. A retail-oriented bank serves the general public, primarily consumers and small businesses. *See* 240 F. Supp. at 894.
63. A wholesale-oriented bank primarily serves large corporate customers. *See id.*
64. *Id.* at 887 (quoting Philadelphia, 374 U.S. at 362).
65. These included demand deposits, commercial and industrial loans, single payment loans to individuals, loans to brokers and dealers to purchase and carry securities, loans to finance companies, bankers' acceptances, and personal and corporate trust services. 240 F. Supp. at 895 n.80.
66. *Id.* at 927 (citing Standard Oil Co. v. United States, 337 U.S. 293, 322 (1949)).

commerce"[67] and were within the bounds of *Philadelphia*. The court did not question the *Philadelphia* principle that nonbank competition is not to be considered.

In *United States v. Crocker-Anglo National Bank*,[68] the district court, relying on the language and legislative history of the Bank Merger Act of 1966 (hereinafter the BMA) rejected the *Philadelphia* principle.[69] The court concluded that the BMA compelled a broader test because it did not contain the phrase "in any line of commerce" and because the BMA's closest supporter, Senator Robertson, had stated:

> The banking agencies and the courts . . . are not permitted to select some single, perhaps minor aspect of the banks' business and to say that, because there is some lessening of competition in this element of the business, the overall effects of the merger—the increase in competition in the entire field of banking and in the broader field of financial institutions which may result from other aspects of the merger—are irrelevant and may not be considered.[70]

The court concluded that demand deposits—unique to banking—were just that kind of "minor aspect" to which the Senator referred.[71] The court also highlighted Congressman Ashley's comments: "commercial banks face intensive competition from other financial institutions—savings and loan associations, mutual savings banks, insurance companies, finance companies, and so forth. . . . To overlook any one of these aspects of competition . . . would be unrealistic and might well diminish, not increase, financial competition."[72] The evidence in the case supported a conclusion that nonbank financial competitors offered "effective economic substitutes"[73] for the legally unique demand deposit service of commercial banks. The court concluded that the cluster approach was the kind of impracticality the BMA sought to cure and rejected it.

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67. 240 F. Supp. at 898 (citing Philadelphia, 374 U.S. at 360 n.37).

68. 277 F. Supp. 133 (N.D. Cal. 1967).

69. Pub. L. No. 89-356, 80 Stat. 7 (current version at 12 U.S.C. § 1828(c) (1982)). The BMA subjected bank mergers to prior approval by the Comptroller of the Currency, the Board of Governors of the Federal Reserve System or the Federal Deposit Insurance Corporation. Congress originally enacted it in 1960 in response to a loss of competition over the previous decade because a large number of banks had merged with other banks. The Sherman and Clayton Acts were thought to be inadequate to the task of regulating bank mergers. . . . " H.R. REP. NO. 1416, 86th Cong., 2d Sess., *reprinted in* 1960 U.S. CODE CONG. & AD. NEWS 1995, 1998.

70. 277 F. Supp. at 155.

71. *Id.* at 153-54 n.13.

72. *Id.* at 156.

73. *Id.* at 153 n.13.

Accordingly, in a lengthy discussion of the realities of the California market, the court examined and considered the services of a Morris Plan company,[74] savings and loan associations, the General Motors Acceptance Corporation, finance companies, credit unions, insurance companies, and even a governmental entity, the California Department of Veterans Affairs, Division of Farm and Home Purchases.[75] The ultimate decision in the case, however, rested on the absence of any adverse effect on actual or potential competition in banking.[76]

United States v. Third National Bank in Nashville[77] provided an opportunity for the Supreme Court to determine the effect of the BMA on the Court's holdings in *Philadelphia.* Without elaborating further, the Court assumed that commercial banking was the relevant product market and held that the BMA did not change the standards for determining whether a merger is anticompetitive, but rather, the BMA provided a "convenience and needs" analysis in mitigation of a merger's anticompetitive effects.[78]

The *Crocker* court was not the only court to voice dissatisfaction with the Supreme Court's product market definition in *Philadelphia.* In *United States v. Provident National Bank,*[79] two Philadelphia banks sought to merge. Despite the apparent benefits the merger would offer to the city, its banking, and its commerce, the district court reluctantly held that the merger would violate the antitrust laws "because of the quantitative (mechanical rules) approach to the question of antitrust violations declared as a policy by the Supreme Court . . . ."[80] In striking down the proposed merger, the court agreed with the *Crocker* court's analysis of the product market under the BMA and noted that even in the concentrated Philadelphia market the financial services industry had undergone profound changes since the Supreme Court rendered its landmark decision. Specifically, the statistics bore out that "it is no longer true that commercial banks enjoy a 'settled consumer preference' for the savings dollar."[81] The court found "*reasonable* interchangeability and meaningful competition for the savings dollar and mortgage loans" between commercial banks and thrift

74. Historically, a Morris Plan company, like an industrial bank, was a consumer-oriented institution that extended installment credit to consumers and accepted savings deposits or sold investment certificates.

75. *Id.* at 158-62.

76. *Id.* at 195-97.

77. 390 U.S. 171 (1968).

78. *Id.* at 177-78 (following United States v. First City Nat'l Bank of Houston, 386 U.S. 361 (1967)).

79. 280 F. Supp. 1(E.D. Pa. 1968).

80. *Id.* at 4.

81. *Id.* at 9 (quoting Philadelphia, 374 U.S. at 357).

institutions.[82] Therefore, the court concluded that thrifts must be included in the analysis, but rejected competition from insurance companies, finance companies, and the like as being too remote.[83] The *Provident* court felt that the uniqueness of the banking industry was precisely what made the *Philadelphia* approach simplistic.[84] It agreed that the *Crocker* court's approach and the *Manufacturers* court's wholesale/retail dichotomy more accurately reflected trade reality.[85]

The opinion in *United States v. First National Bank of Jackson*[86] represented yet another attempt by a federal district court to limit *Philadelphia* to "the *particular* facts and circumstances of that case."[87] In finding that the "trade realities" which made commercial banking the product in *Philadelphia* had changed significantly by the late 1960's,[88] the *Jackson* court was in full accord with the *Provident* and *Crocker* courts. The court characterized competition from thrift institutions as "*actual, fierce, direct* and *meaningful,*"[89] but like the *Provident* and *Crocker* courts, it hedged by noting that product line definition did not determine the result in the case.[90]

A district court in Idaho took a very different approach in *United States v. Idaho First National Bank*[91] and adopted the "many additional so-called lines of commerce" that the Supreme Court in *Philadelphia* thought were undesirable.[92] The district court reasoned that the previous cases were distinguishable on their facts; they dealt with banking practices in densely populated metropolitan areas, not with the rural character of Twin Falls and Idaho's "Magic Valley."[93] Accordingly, the court engaged in what it termed a "pragmatic facts-of-life analysis"[94] and took a pure submarket approach to defining the relevant product market. The court found that demand deposits are always an appropriate line of commerce, but even beyond that:

> [W]hen in a particular case banks in the relevant market area substantially compete with other financial concerns, as well as with each other, in providing product-services other than demand

82. 280 F. Supp. at 8 (emphasis in original).
83. *Id.* at 9.
84. *Id.* at 11.
85. *Id.* at 13.
86. 301 F. Supp. 1161 (S.D. Miss. 1969).
87. *Id.* at 1181 (emphasis in original).
88. *Id.* at 1180.
89. *Id.* (emphasis in original).
90. *Id.* at 1181.
91. 315 F. Supp. 261 (D. Idaho 1970).
92. *Id.* at 266. *See* Philadelphia, 374 U.S. at 363.
93. 315 F. Supp. at 265.
94. *Id.* at 268.

> deposits, there is cross-elasticity of demand for such product-services and each of the product-services in which banks so compete also constitutes an appropriate line of commerce . . . .[95]

The court recognized that commercial banks in the Twin Falls market area were subject to vigorous competition from myriad nonbank providers of financial services in a number of product categories, including "interest-bearing deposits, agricultural production loans, farm real estate loans, residential and commercial real estate loans, automobile and other consumer loans, and student loans."[96] Again a district court rejected the cluster rule, and again, although the court's opinion discloses little by way of statistical evidence, the line of commerce discussion was dictum.

The next court to grapple with this line of commerce issue was the district court in *United States v. First National Bank of Maryland*,[97] another action under section 7 and the BMA. This court also complained that it could not put blinders on and ignore the nonbank competition.[98] It observed that commercial banks in the relevant market area were in direct competition with thrifts and other financial institutions with respect to time deposits (but not demand deposits) and real estate, small business, and consumer loans.[99] Again, however, this court took pains to point out that whether or not the cluster of banking services was unbundled, the result in the instant case would be unaffected.[100]

Sparked primarily by the opinion in the *Crocker* case, the district courts for seven years paid homage to *Philadelphia*, but then ignored it. Instead, they applied the lessons from the antitrust decisions in the field of commerce and, scrutinizing the peculiarities of each individual market, drew a line of commerce inconsistent with the dictates of *Philadelphia*, but firmly grounded in the terms of the BMA and the changing realities of the financial services industry. The Supreme Court, however, attempted to bring a halt to the lower courts' refusal to apply *Philadelphia* with its 1970 opinion in *United States v. Phillipsburg National Bank & Trust Co.*[101]

In *Phillipsburg* two small banks in the small industrial town of Phillipsburg, New Jersey, sought to merge and secured the approval of the Comptroller of the Currency. The Justice Department sued to enjoin the merger as a violation of section 7.[102] The

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95. *Id.* at 267.
96. *Id.*
97. 310 F. Supp. 157 (D. Md. 1970).
98. *Id.* at 168.
99. *Id.*
100. *Id.*
101. 399 U.S. 350 (1970).
102. *Id.* at 352.

lower court pursued the kind of particularized product market analysis that marked *Crocker, Provident*, and others, but the Supreme Court ruled that this analysis was erroneous.[103] In an oddly short and unreasoned discussion of so significant an issue, the Court tenaciously clung to the principles it had enunciated in *Philadelphia*.

Setting forth the significant facts of the case, the Court noted that even though they offered them in proportions quite different from the proportions characteristic of large banks, both of the banks in question offered "the wide range of services and products available at commercial banks including, for instance, demand deposits, savings and time deposits, consumer loans, commercial and industrial loans, real estate mortgages, trust services, safe deposit boxes, and escrow services."[104] The proposed merger partners concentrated in real estate/mortgage loans, had relatively small proportions of demand to total deposits, and were generally oriented toward small depositors and borrowers.[105] These banks were more akin to thrifts than to large commercial banks.[106] Despite this distinction, however, the Supreme Court held that a submarket analysis was erroneous. The Court concluded that commercial banking still had an economic significance "well beyond the various products and services involved."[107] The Court did not mention the role of demand deposits—so crucial in *Philadelphia*—but found an overriding economic significance in the convenience of one-stop banking.[108] To support this finding, the Court pointed to the questionable notion that a customer without resources has a better chance of securing a loan on a handshake from a bank than from a finance company.[109]

Justice Harlan and Chief Justice Burger partially dissented from the majority and severely criticized the majority's convenient and simplistic reaffirmation of *Philadelphia*:

> The Court eschews all analysis of the *composition* of the products and services offered by appellee banks. . . . The Court thus manages to ignore completely the extent to which competition from savings and loan companies, mutual savings banks, and other financial institutions that are not commercial banks affect the market power of the appellee banks.[110]

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103. *Id.* at 353.
104. *Id.* at 354-56.
105. *Id.* at 356.
106. 306 F. Supp. 645, 648 (D.N.J. 1969).
107. 399 U.S. at 361.
108. *Id.*
109. *Id.*
110. *Id.* at 380 (emphasis in original) (Harlan, J., concurring in part and dissenting in part).

The dissenters attacked the cluster approach on three interrelated grounds. First, they agreed with the district court that the merging banks were more akin to thrifts, not the "big city commercial banks considered in *Philadelphia*,"[111] and that thrifts were more of a competitive force in this case.[112] Second, they claimed that an unbundling of the cluster with an examination of the concentration percentages for the major bank products would result in a more "discriminating conclusion" under the antitrust laws.[113] Third, they noted that a cluster approach would result in yet another example of an unreasoned numerical approach to applying the antitrust laws, namely, the quantitative, not qualitative, approach much criticized in other contexts.[114] Justice Harlan and Chief Justice Burger argued that even if the commercial banking cluster is the correct line of commerce,

> that does not excuse the majority's failure to consider the competitive realities of the case in appraising the *significance* of the concentration percentages thus calculated. . . . [T]he Court blithely assumes that percentages of the same order of magnitude represent the same degree of market power, irrespective of the amount of competition from neighboring markets.[115]

The next district court faced with the product market dilemma followed the established Supreme Court policy. In *United States v. First National Bancorporation*,[116] the trial court adopted the cluster as mandated by *Philadelphia* and justified this approach by pointing to the dearth of evidence in the case as proving the existence of nonbank competitors in the Greeley, Colorado, market.[117] The Government, however, advocated an alternative line of commerce, namely, correspondent banking, which was wholly within commercial banking (using *Manufacturers*).[118] Analyzing this issue, the trial court turned to the nonbanking *Du Pont* and *Brown Shoe* cases to support the theoretical possibility of banking submarkets, but found the evidence in the instant case inconclusive because the package of services termed "correspondent banking"

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111. *Id.* (Harlan, J., concurring in part and dissenting in part).

112. *Id.* (Harlan, J., concurring in part and dissenting in part).

113. *Id.* at 381 (Harlan, J., concurring in part and dissenting in part).

114. *Id.* at 374 (Harlan, J., concurring in part and dissenting in part). *See, e.g.,* United States v. Third Nat'l Bank in Nashville, 390 U.S. 171, 193 (1968) (Harlan, J., concurring in part and dissenting in part).

115. 399 U.S. at 381-82 (emphasis in original) (Harlan, J., concurring in part and dissenting in part).

116. 329 F. Supp. 1003 (D. Col. 1971). This case involved potential, not direct, competition, and arose under the Bank Merger Act of 1966.

117. 329 F. Supp. at 1012.

118. *Id.* at 1010.

varied greatly from bank to bank.[119] Ultimately, the court did not need to commit itself because whether or not the commercial banking cluster or the correspondent banking submarket was the line of commerce, the proposed acquisition would not substantially lessen competition or tend to create a monopoly proscribed by section 7 of the Clayton Act.[120] An equally divided Supreme Court affirmed the judgment per curiam.[121]

A few months later, the district court in *United States v. Connecticut National Bank*[122] was unable to reconcile *Phillipsburg* with the economic reality in Connecticut or with the Supreme Court's nonbanking decisions. The court distinguished *Phillipsburg* on its facts: "[T]he Supreme Court's pronouncements in *Philadelphia* and *Phillipsburg* . . . were not intended to be ironclad, hard and fast rules which require a court to don blinders to block out the true competitive situation existing in every set of circumstances."[123] Instead, the court found support in the absence of the phrase "in any line of commerce" under the BMA, and in *United States v. Continental Can Co.*,[124] in which the Supreme Court held that complete identity between products and complete industry overlap need not be proven for section 7 to apply in a given case.[125]

In *Connecticut* the presidents of a savings bank and five commercial banks, the federal banking authorities, and the Connecticut State Banking Commission all agreed that savings banks were direct and formidable competitors of commercial banks.[126] Even the Government's expert witness testified that this competition had increased since the early 1960's.[127] The court observed that recent legislative developments evidenced a "national trend toward more equal powers" between banks and thrifts,[128] including the authorization of negotiable order of withdrawal (NOW) accounts[129] for thrifts.[130] Furthermore, the evidence elicited at trial disclosed the "cold, hard realities" that savings and commercial banks competed

119. *Id.* at 1017.
120. *Id.* at 1020.
121. 410 U.S. 577 (1973).
122. 362 F. Supp. 240 (D. Conn. 1973).
123. *Id.* at 280.
124. 378 U.S. 441 (1964).
125. 362 F. Supp. at 281.
126. *Id.* at 246.
127. *Id.* at 284.
128. *Id.* at 247.
129. A NOW account is a savings account (devised in 1970) on which a holder can write drafts similar to checks; therefore, the account is in effect an interest-bearing checking account. NOW accounts became available nationwide in January 1981.
130. 362 F. Supp. at 249.

meaningfully in at least five product lines: personal checking, real estate mortgages, personal loans, IPC deposits,[131] and commercial loans.[132] Accordingly, the court held that the lines of commerce had to include savings banks[133] and thus upheld the proposed bank merger.

On appeal, the Supreme Court struck down the trial court's conclusion about the correct line of commerce.[134] The majority opinion, not a model of consistency, at least plugged some of the gaps in *Phillipsburg*. Among other things, the Court took a point originally made by footnote in *United States v. Third National Bank in Nashville*[135] and for the first time directly held that the absence of any line of commerce language in the BMA did not alter the section 7 standards for product market definition.[136] It then held that the facts of banking in Connecticut did not disclose sufficient identity between savings and commercial banks to compel any finding other than commercial banking as the line of commerce.[137] To reach that result, the Court had to unbundle its own cluster.

Few would have argued under the Supreme Court decisions of the 1960's that commercial banks did not compete among themselves. In *Phillipsburg* the Supreme Court itself found that the line of commerce remained unchanged whether a bank made relatively few commercial loans (as did Phillipsburg National) or whether it had a relatively large commercial loan portfolio (as did Philadelphia National). The Court concluded that the critical issue was whether the banks in fact offered a cluster of products or services typical of commercial banks.[138] By 1973 savings banks in Connecticut essentially offered that cluster, but the Court did not feel they represented meaningful competition because they made relatively few short-term business loans.[139] In addition, the fact that savings banks did not offer credit cards, loans for securities purchases, trust services, investment services, computer and account services, and letters of credit, was considered significant even though commercial banks themselves may or may not have offered the complete range of typical commercial bank products.[140] Thus, the Supreme Court, in order to exclude savings banks from the

131. IPC is an acronym for deposits of individuals, partnerships, and corporations.
132. 362 F. Supp. at 280.
133. *Id.* at 281.
134. United States v. Connecticut Nat'l Bank, 418 U.S. 656 (1974).
135. 390 U.S. 171, 182 n.15 (1968).
136. 418 U.S. at 663.
137. *Id.* at 663-64.
138. 399 U.S. at 360.
139. 418 U.S. at 664-65.
140. *Id.* at 665.

equation, had to disregard the cluster and focus instead on submarkets.

Whether or not the Supreme Court made a sound judgment in determining that commercial banking was a distinct line of commerce in *Philadelphia, Phillipsburg,* and *Connecticut* is really beside the point. Events have evolved since these decisions to cast the continued acceptance of commercial banking as a distinct line of commerce into extreme doubt. Market forces and legislative and regulatory change have eroded the commercial banking cluster argument to the extent that only the strictest adherent to the principle of stare decisis is likely to conclude that commercial banking is relevant in an antitrust context. Fortunately, economic markets, unlike lower courts, are not bound by precedent.

IV. ANTITRUST ASYMMETRY

In *Phillipsburg* the Court, without explanation, concluded that "[s]ubmarkets . . . would be *clearly relevant*, for example, in analyzing the effect on competition of a merger between a commercial bank and another type of financial institution."[141] It is hard to fathom how the Court believed this conclusion could be consistent with its refusal to examine submarkets in a merger between a large diversified commercial bank and a bank having a loan portfolio more characteristic of a savings and loan association. Nonetheless, the courts and the regulatory authorities have seized on that bit of dictum as authority for submarket analysis in mergers or acquisitions between banks or bank holding companies and other nonbank financial services companies.

In *Fort Worth National Corp. v. Federal Savings and Loan Insurance Corp.*,[142] the plaintiff, a one-bank bank holding company, sought to acquire control of a savings and loan association. A major issue was whether the Federal Home Loan Bank Board, in disapproving the acquisition, had correctly defined the relevant product market. Fort Worth asserted that *Philadelphia* and *Phillipsburg* controlled and that only the cluster of commercial banking products was a correct line of commerce.[143] The Bank Board, however, found the acquisition unduly anticompetitive with respect to one product offered by both the acquirer and target association—savings deposits under 100,000 dollars.[144]

The Fifth Circuit agreed. Attempting to reconcile *Phillipsburg* with the general principles of antitrust law enunciated in the

141. 399 U.S. at 360 (emphasis added).
142. 469 F.2d 47 (5th Cir. 1972).
143. *Id.* at 59-60.
144. *Id.* at 59.

Supreme Court's nonbanking decisions, the court of appeals imputed more to the *Phillipsburg* dictum than perhaps was warranted: "[t]hus, where one of the merging firms offers less than the full line of commercial bank services, the relevant market is defined according to the particular services in which the firms actually compete."[145] Adopting the Supreme Court's reasoning in *Continental Can*, the court thought the relevant product market in the banking and savings and loan industries should be defined in terms of submarkets marked by the product's end use.[146]

The Board of Governors of the Federal Reserve System (the Board) similarly examined submarkets when it approved the acquisition of a consumer finance company by Patagonia Corporation, a bank holding company.[147] The Board's ruling rested on risk segmentation; no existing or potential competition between Patagonia's bank subsidiary and the acquiree would be eliminated because the latter catered to a higher risk customer unserved by commercial banks. The Board reasoned that finance companies and banks do not compete for the same class of borrowers.

The Board, however, would not have ruled that finance companies were shielded from bank competition in all respects simply because they alone served high-risk customers. This is evidenced by the Board's disapproval just a year later in *Bankers Trust New York Corp.*[148] of Bankers Trust's application to acquire a consumer and sales finance company. This acquisition would have eliminated existing competition between the acquiree and the applicant's commercial bank subsidiary. The Board noted that there were two product submarkets: 1) personal loans of up to 1,400 dollars and 2) all direct consumer installment loans. The Board observed that consumer finance companies were an alternative "source for personal loans, for loans to finance the purchase of automobiles and home improvements, and for other loans traditionally made by commercial banks."[149] The Board also noted other providers of these loans such as credit unions.[150]

When considering applications for nonbank acquisitions by bank holding companies, the Board, rather consistently, has acted in accord with the *Phillipsburg* dictum. In *American Fletcher Corp.*[151] it denied the acquisition of a savings and loan association for reasons unrelated to competition. It took note of a "discernable trend toward lessening distinctions between banks and savings and loan

145. *Id.* at 60.
146. *Id.*
147. Patagonia Corp., 58 FED. RES. BULL. 170 (1972).
148. 59 FED. RES. BULL. 694 (1973).
149. *Id.* at 695.
150. *Id.*
151. 60 FED. RES. BULL. 868 (1974).

associations."[152] Both banks and savings and loan associations traditionally engaged in financing the construction, sale, and purchase of housing and other types of real estate.

The bizarre result of *Philadelphia* and *Phillipsburg*, in short, was that other financial services firms were deemed not to compete with commercial banks, but commercial banks did compete with other financial services firms. The *Connecticut* decision, however, created a partial escape hatch:

> We do not say, and *Phillipsburg National Bank* . . . and *Philadelphia National Bank* . . . do not say, that in a case involving a merger of commercial banks a court may never consider savings banks and commercial banks as operating in the same line of commerce, no matter how similar their services and economic behavior. At some stage in the development of savings banks it will be unrealistic to distinguish them from commercial banks for purposes of the Clayton Act.[153]

Regardless of the escape hatch provided by *Connecticut*, it is now clear that the financial services industry has evolved so dramatically that it is unrealistic to distinguish between services of commercial banks and numerous other providers of financial services.

V. LEGISLATIVE AND REGULATORY DEVELOPMENTS

Prior to 1980 much of the legislation and regulation that applied to banks was a legacy of the early 1930's. The Banking Acts of 1933[154] and 1935[155] introduced a large array of restrictions on banking designed to shelter banks from excessive competition and from the errors and poor judgment of their own management. Legislation and regulation, however, are lagging indicators of marketplace events. By the late 1960's and throughout the 1970's, the more innovative managements of many financial institutions—both banking companies and firms whose main line of business was in other financial or nonfinancial industries—found numerous ways to exploit changing technological developments in transportation, information processing, and communications to satisfy market demands created by economic developments such as inflation and recent high levels of interest rates to their advantage. They offered new products and provided new delivery systems that were incongruent with the extant set of regulations. In some cases,

152. *Id.* at 869.
153. 418 U.S. at 666.
154. Banking Act of 1933, ch. 89, 48 Stat. 162 (codified throughout 12 U.S.C. ch. 2, 3 and 6 (1982)).
155. Banking Act of 1935, ch. 614, 49 Stat. 684 (codified throughout 12 U.S.C. ch. 1-6, 13 (1982); 11 U.S.C. § 101 (1982); 15 U.S.C. § 19 (1982)).

loopholes were closed by the banking regulatory agencies with a long and variable lag, while in other cases, legislation and regulation were amended to codify existing practices.[156]

Regulation in the 1970's could be characterized as a policy of accommodating competition and expansion as far as the current law would permit. Even so, regulation tended to lag developments in the financial markets, and much effort was spent simply bringing regulation into alignment with the situation de facto. The states played a leading role in the development of this new regulatory attitude. The 1970 origination of NOW accounts in Massachusetts, offered by mutual savings banks, proved to be a major step along the road toward deregulation.[157] Many of the subsequent administrative and legislative actions were taken in the 1970's, such as the enactment of federal legislation extending NOW account powers to banks, savings and loans, and mutual savings banks first in Massachusetts and New Hampshire, then to all the New England states, New York, and New Jersey, and finally nationwide;[158] the authorization of automated teller machines for national banks;[159] and the Federal Reserve's authorization of money market certificates in 1978[160] were merely incremental extensions of a policy trend already established.

The pressures that gradually nudged the regulators toward a more accommodating stance continued unabated throughout this period. Foremost among these pressures were the higher and more volatile interest rates that first caused the deposit rate ceilings to bind and later led to progressively more severe bouts of disintermediation;[161] the related emergence of new, unregulated insitutions and instruments such as the money market mutual

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156. A considerable body of economic and finance literature summarizes this conflict or dialectic. *See, e.g.*, G. Kaufman, L. Mote, & H. Rosenblum, *The Future of Commercial Banks in the Financial Services Industry*, FINANCIAL SERVICES: THE CHANGING INSTITUTIONS AND GOVERNMENT POLICY (G. Benston ed. 1983); Kane, *Accelerating Inflation, Technological Innovation and the Decreasing Effectiveness of Banking Regulation*, J. OF FINANCE 355-67 (1981); Kaufman, Mote, & Rosenblum, *Implications of Deregulation for Product Lines and Geographical Markets of Financial Institutions*, J. OF BANK RESEARCH 8-21 (1983).

157. *See* Mass. Gen. Laws Ann. ch. 167, § 10 (West Supp. 1982).

158. Act of Aug. 16, 1973, Pub. L. No. 93-100, 87 Stat. 342; Act of Feb. 27, 1976, Pub. L. No. 94-222, 90 Stat. 197; Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, Tit. XIII, 92 Stat. 3641, 3712; Act of Dec. 28, 1979, Pub. L. No. 96-161, Tit. I, § 106, 93 Stat. 1233, 1235; Depository Institutions Deregulation and Monetary Control Act of 1980, Tit. III, § 303, 94 Stat. 132, 146 (codified at 12 U.S.C. § 1832 (1982)).

159. National Commission on Electronic Fund Transfers, Pub. L. No. 93-495, 88 Stat. 1508 (1974) (current version at 12 U.S.C. §§ 2401-08 (1982)).

160. 12 C.F.R. § 217.7 (1978).

161. Disintermediation is the shift of funds from financial intermediaries such as commercial banks, savings and loan associations, savings banks, and credit

fund;[162] and technological advances in the processes of collecting, storing, manipulating, and transmitting data that revolutionized cash management and greatly facilitated the introduction of regulation-induced innovations such as sweep accounts.[163]

The financial system is still digesting the legislative changes that have already occurred. Deregulation has virtually eliminated restrictions on prices paid and charged by depository institutions. Only the prohibition of interest on corporate demand deposits, which is already largely nullified by repurchase agreements,[164] improved cash management, and various devices for paying implicit interest and state usury laws remain to be eliminated. Geographic expansion is still restricted by the McFadden Act[165] and the Douglas Amendment to the Bank Holding Company Act,[166] but these restrictions have become less and less meaningful as banks have used nonbank subsidiaries of bank holding companies, loan production offices,[167] Edge Act corporations,[168] toll-free telephone numbers, brokered certificates of deposit, and other devices to serve customers over wide areas. Also, a number of states have liberalized their branching and holding company laws in recent decades; some states even allow out-of-state bank holding companies to open new banks or acquire existing banks within their boundaries.[169] The

unions directly to ultimate borrowers. Generally, this has occurred when financial intermediaries were prohibited from paying competitive market rates to attract funds.

162. An investment company may raise money by selling shares of stock and using the proceeds to buy money market (short-term) securities. Most are accessible via checking account.

163. A sweep account is a primary account that a bank links to a money market fund or some other second account which typically is subject to different regulations or a lower reserve requirement and bears a higher interest rate than the primary account. When the primary account balance exceeds a predetermined level, the excess funds are "swept" into the second account.

164. A repurchase agreement is a contract for the sale of securities in which the seller agrees to buy back the securities at an agreed upon price after a stated period of time. There is no interest rate ceiling on a repurchase agreement and if the underlying securities are U.S. Treasury securities, there is no reserve requirement.

165. 12 U.S.C. § 36 (1982) (setting the conditions on which a national bank may establish branches).

166. 12 U.S.C. § 1842(d) (1982) (limiting interstate acquisitions of banks by bank holding companies).

167. These are banking offices, usually established outside a bank's home state. Their function is to engage in corporate lending activities.

168. These corporations are nationally chartered and established pursuant to section 25(a) of the Federal Reserve Act, ch. 18, 41 Stat. 378 (1919) (current version at 12 U.S.C. §§ 611-32 (1982)) to assist banks in foreign trade financing. There are no geographic restrictions on the locations of Edge Act offices.

169. *See* Moulton, *Delaware Moves Toward Interstate Banking: A Look at the FCDA*, BUS. REV., July-Aug. 1983, at 17, 20-23. Prominent examples are South Dakota, Delaware, New York, most of the New England States, and Alaska.

Garn-St Germain Depository Institutions Act of 1982[170] has helped eliminate the remaining restrictions on prices and, to a lesser degree, geographic expansion. Product line restrictions remain, but are breaking down under the pressures applied by unregulated entrants into services formerly provided by specialized institutions[171] and by the recent legislation enlarging the asset powers of depository institutions. Entry, at least in a de facto sense, has become progressively easier, although only a few states have undertaken explicit legislative liberalization of depository institution chartering restrictions.

In short, the deregulation movement has made considerable progress in the financial services industry, but it is far from complete. One clear consequence of the steps taken toward deregulation is that financial institutions are now free to engage in a much broader range of financial activities. In the future, economic, rather than legal forces, including any complementarities[172] of either production or demand, can be expected to play a greater role in determining the extent to which institutions specialize in one or a few services or diversify into many.[173]

Although marketplace events lead regulatory and legislative change, it is necessary to assess the *legal* restrictions facing nonbank competitors according to the Supreme Court bank merger decisions. In *Connecticut* the Supreme Court was very much concerned with the authorized powers of the thrift institutions vis-a-vis commercial banks. Absent these limitations on the exercise of thrift powers, perhaps the Court would have reached a broader line of commerce determination.

Since the *Connecticut* decision, market pressures building in the financial system have compelled legislative change. The two most significant legislative changes affecting the competitiveness of thrifts have been the enactment of the Depository Institutions

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170. Pub. L. No. 97-320, 96 Stat. 1469 (codified throughout 12 U.S.C. (1982)) [hereinafter cited as Garn-St Germain].

171. *See* notes 194-264 *infra* and accompanying text for details of entry by nonbanking based firms into commercial banking product markets.

172. Two products complement each other when it is cheaper for one firm to produce both than it is for separate firms to produce each, as for example, when the two products share a common distribution system. Similarly, it may be cheaper for a consumer of two products to purchase both from one supplier than to purchase one each from separate suppliers.

173. There is considerable disagreement over the extent of economies of scope in the provision of financial services and the resulting degree of diversification or specialization that is optimal. *See, e.g.,* Kane, *Technological and Regulatory Forces in the Desegmentation of Financial Services Competition,* J. FINANCE (July 1984; Kaufman, Mote, & Rosenblum, *Consequences of Deregulation for Commercial Banking,* J. FINANCE (July 1984).

Deregulation and Monetary Control Act of 1980[174] and Garn-St Germain. These measures have significantly broadened the asset and liability powers of federally chartered thrifts. For purposes of the line of commerce, however, Garn-St Germain possesses far greater potential than the Monetary Control Act.

The Monetary Control Act authorizes all federally chartered savings and loan associations to offer NOW accounts; to invest up to twenty percent of assets in consumer loans, commercial real estate loans, commercial paper, and corporate debt securities; to issue credit cards and extend credit in connection therewith; and to apply for trust and fiduciary powers under restrictions and protections similar to those applicable to national banks. In addition to the expanded powers it grants to savings and loan associations, the Monetary Control Act authorizes federal mutual savings banks to invest up to five percent of assets in commercial loans and to accept demand deposits in connection with commercial, corporate, and business loan relationships.[175]

Through the Monetary Control Act, federally chartered thrifts have been able to offer individuals the convenience of "one-stop shopping" and, in effect, to become their "department store of finance." Nevertheless, the Monetary Control Act has done little to aid thrifts in serving the business customer, the class of customer that was so important to the Supreme Court's argument in *Connecticut*. Without expanded powers to make loans to commercial enterprises, thrifts were not likely to be viewed as full competitors of commercial banks under the antitrust laws.

Under Garn-St Germain the resemblance of federally chartered thrifts to commercial banks becomes even greater. Congress has enhanced the ability of thrifts to provide services to commercial enterprises in order to preserve the viability of thrifts. The Act increases the percentage of assets that may be invested in commercial real estate and consumer loans to forty percent and thirty percent, respectively. In addition, the Act permits thrifts to invest up to ten percent of capital and surplus in state and local securities and to invest up to ten percent of assets in personal property (leasing). Most important, however, the Act grants thrifts the authority to invest up to ten percent of assets in secured or unsecured commercial loans (pure commercial loans) and to offer demand deposits to business customers with whom the thrift has a business, corporate, commercial, or agricultural loan relationship.

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174. Pub. L. No. 96-221, 94 Stat. 132 (1980) (codified throughout 12 U.S.C. (1982)) [hereinafter cited as Monetary Control Act].

175. For a more comprehensive discussion of the Monetary Control Act, see Federal Reserve Bank of Chicago, *The Depository Institutions Deregulation and Monetary Control Act of 1980,* ECON. PERSPECTIVES, Sept.-Oct. 1980, at 3.

These expanded powers granted under Garn-St Germain[176] allow a federally chartered thrift to invest up to seventy-five percent of its assets in commercial investments.[177]

While commercial banks and thrifts may be different entities with different missions, the differences between them are not substantial from an antitrust perspective. A difficult issue is whether the new powers granted thrifts are enough to classify them as within the line of commerce of bank mergers. According to the Supreme Court's *Connecticut* rationale, the mere authority to offer expanded services does not compel thrift inclusion in the line of commerce. To warrant inclusion, thrifts must exercise their new powers to a meaningful degree.[178] However, one commentator has suggested that this requirement may be abandoned by the Court if thrifts have attained adequate power so that they offer a cluster of services substantially equivalent to the services offered by commercial banks.[179]

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176. An excellent review of the impact of Garn-St Germain appears in Federal Reserve Bank of Chicago, *The Garn-St Germain Depository Institutions Act of 1982,* ECON. PERSPECTIVES, March-April 1983, at 3.

177. Arguably, savings and loan associations and savings banks may be discouraged from utilizing these new powers because they may prefer to achieve certain tax benefits. Thrifts with over 72 percent of their assets in "qualifying assets" (primarily residential real estate) may deduct up to 40 percent of income as bad debt loss. This deduction is reduced as the holding of qualifying assets declines. However, as Baer points out, the tax barrier to asset diversification is not insurmountable. He concluded that the ability to hold tax-exempt securities will significantly increase the profitability of asset diversification, and thus render ineffective the tax provisions encouraging specialization in housing finance. Baer, *Thrift Dominance and Specialization in Housing Finance: The Role of Taxation,* 2 HOUSING FIN. REV. 366 (1983).

178. Kareken suggests that thrifts need not actually exercise new powers in order to exert a competitive influence in banking markets. Kareken, *Commercial Banks as a Line of Commerce: An Appraisal,* COMMERCIAL BANKING AS A LINE OF COMMERCE 16-17 (supplementary paper). Arguably, if thrifts exert a competitive effect in banking markets, then they should be included in the competitive analysis whether or not all expanded powers are exercised. In this sense, the mere threat of thrifts plays a significant role in restraining bank monopoly pricing. Of course, it is an empirical question whether the presence of thrifts restrains commercial bank pricing behavior. *See generally* Dunham & Guerin-Calvert, *How Quickly Can Thrifts Move into Commercial Lending?,* NEW ENGLAND ECON. REV., Nov.-Dec. 1983, at 42-54 (discussing growth, extent of commercial lending, and commercial lending capacity of thrifts).

179. Via, *Commercial Banking as the 'Line of Commerce' In Bank Amalgamations: A Reexamination,* 99 BANKING L. J. 326 (1982). In this vein, the Supreme Court indicates that in delineating a line of commerce "its contours must, as nearly as possible, conform to competitive reality. Where the area of effective competition cuts across industry lines, so must the relevant line of commerce . . ." United States v. Continental Can Co., 378 U.S. 441, 457 (1964). Thus, in *Continental Can,* the court held that because of the *interindustry* competition between glass and metal containers, it was necessary to treat as a relevant product market the combined glass and metal container industries, noting that for some end uses glass

In reality, a federal thrift might closely resemble a commercial bank, notwithstanding the percentage of asset limitations on commercial assets available for investment and the prohibition on offering demand deposits to individuals.[180] Table I reflects the degree to which mutual savings banks have exploited their new found powers since the mid-1970's. Although technically more limited, the powers granted thrifts under the Monetary Control Act and Garn-St Germain should be sufficient to include thrifts in the line of commerce within the confines of the *Connecticut* rationale.

The line of commerce in bank mergers should not be limited to thrifts and commercial banks. Competition must be recognized when, in fact, competition exists.[181] Thus, an appraisal of competition afforded by nonbank, nondepository organizations is necessary and it must go beyond the cluster approach of the Supreme Court because that approach is wanting.

TABLE I

Percent of Mutual Savings Banks Offering Selected Services*

Services	1974	1978	1980*	1981	1982
Automated Teller Services	2.9%	17.2%	23.8%	32.4%	38.4%
Business Loans	n.a.	n.a.	n.a.	39.5	53.8
Checking Accounts	6.5	47.6	47.7	55.6	72.2
Credit Cards	3.8	38.6	63.1	53.1**	62.3**
NOW Accounts (interest-bearing)	29.2	66.1	80.8	92.4	92.0
Personal Loans	64.4	67.2	69.8	71.7	94.8
Second Mortgage Loans	n.a.	n.a.	n.a.	71.4	79.7
Total Number of Savings Banks	480	466	463	448	424

*Small changes in the percentage of mutual savings banks that offer the various services should be interpreted carefully because they are due largely from changes in the number of mutual savings banks rather than from changes in the number that offer the services.

**MasterCard and Visa issuers actually increased about 10 percentage points from 1980 to 1982, but a sharp decrease in American Express Gold card issuers pull these overall percentages down.

SOURCE: *National Fact Book of Savings Banks*, various issues, National Association of Mutual Savings Banks.

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and metal containers did not and could not compete. Indeed, complete industry overlap need not be shown. *Id.*

180. This prohibition is more illusory than real since NOW accounts function as demand accounts for all practical purposes.

181. *See* 370 U.S. at 326.

VI. CONSIDERATION OF NONBANKS

In many respects, commercial banks operate much like industrial firms; they purchase resources (obtain labor and capital), produce a product (loans of various types, services of various kinds), and price the product according to regulation and competition.[182] Banks operate in many product markets and in many geographic areas; they exploit profitable opportunities as they arise.[183] Yet, the Supreme Court has chosen, and to a large extent the banking agencies have acquiesced, to view commercial banking as a line of commerce because it believes that the *conglomeration* of the various products and services offered by commercial banks somehow sets them apart from other financial institutions.

Philadelphia and the later Supreme Court cluster decisions hinge on the presumptive ability of banks to provide unique products, products not unique but supported by cost advantages, and products that, though neither unique nor supported by cost advantages, are nonetheless preferred by customers to products offered by other financial organizations. In some manner, each product of commercial banks is dependent upon the other product(s). However, the Court has not offered proof of this contention nor have any convincing studies been made available since *Philadelphia* to support the argument. Without proof of significant complementarities, the cluster approach is arbitrary.

Indeed, the weight of the statistical evidence indicates that commercial banks are not unique, single product firms, and that good, if not perfect, substitutes exist for virtually every commercial bank product and service.[184] Recent surveys of small businesses, the customer class that was so important to the line of commerce determination in *Connecticut*, suggest that small businesses view commercial banks as only one of a number of sources of banking

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182. *See* L. SPELLMAN, THE DEPOSITORY FIRM AND INDUSTRY: THEORY, HISTORY, AND REGULATION 51-54 (1982).

183. *See* Shull, *Commercial Banks as Multiple-Product Price-Discriminating Firms*, BANKING & MONETARY STUDIES 351, 355-56, (D. Carson ed. 1963).

184. Lewis J. Spellman found that commercial banks and thrifts are fierce competitors for savings deposits. Spellman, *Competition for Savings Deposits in the U.S.: 1936-1966*, 10 J. FIN. & QUANTITATIVE ANALYSIS 567, 569-71 (1975). He also found that commercial bank entry significantly reduces the profitability of savings and loan markets, Spellman, *Commercial Banks and the Profits of Savings and Loan Markets*, 12 J. BANK RESEARCH 32, 35-36 (1981). *See also* Gilbert & Murphy, *Competition Between Thrift Institutions and Commercial Banks: An Examination of the Evidence*, 2 J. BANK RESEARCH 8 (1971) (finding increased competition between commercial banks and thrift institutions for savings-type liabilities); Yesley, *Defining the Product Market in Commercial Banking*, ECON. REV., June-July 1972, at 17 (contrasting the narrow market and broad market concepts).

services.[185]

There can be advantages inuring to commercial banks through the joint production and joint consumption of products. However, nonbanks have advantages of this type through the various products they produce. It has not been demonstrated how significant the supposed advantages are to commercial banks vis-a-vis their nonbank competitors. To demonstrate these advantages would require an examination of individual product lines.

The financial services industry has been subject to rapid technological changes. These changes, coupled with the sharp reduction in barriers to entry, have caused the industry to undergo significant structural transformation. As a result, the traditional product market boundaries have failed to characterize accurately the degree of product substitutability.

The Department of Justice merger guidelines reflect the need to capture this dynamic element of economic markets in product market definition.[186] The guidelines seek to prevent the creation or exercise of market power, defined as the ability to maintain price above the competitive level for a significant period of time.[187] In terms of product definition, the Department of Justice will establish a provisional market that includes the products of the merging firms and the products that the merging firms' customers view as good substitutes at prevailing prices.[188] Next, the Department will hypothesize a small but significant non-transitory price increase.[189] The pertinent question in expanding the provisional market is whether a significant percentage of buyers already in that market would likely shift to other products.[190] According to these guidelines, if this customer shift is likely, then the provisional market has been too narrowly defined and the market will be expanded to include those products to which customers would shift. As a first approximation, the Justice Department will hypothesize a five percent price increase and ask how many buyers would be likely to shift to other products within one year.[191] The Department of Justice assesses related products that significantly constrain the ability of the merging firms to exercise market power in this manner. In reaching its assessment of substitutability, the

185. *See, e.g.,* Andrews & Eisemann, *Who Finances Small Business Circa 1980?,* STUDIES OF SMALL BUSINESS FINANCE (Nov., 1981); Watro, *Financial Services and Small Businesses,* ECON. COMMENTARY, Jan. 11, 1982, at 1 [hereinafter cited as Watro].

186. *U.S. Dept. of Justice and Federal Trade Commission Merger Guidelines - 1982,* TRADE REG. REP. (CCH) No. 546 Extra Ed. (June 16, 1982).

187. *Id.* at 12-13.

188. *Id.* at 15.

189. *Id.* at 16.

190. *Id.*

191. *Id.*

Justice Department recognizes a number of factors, including evidence of: (a) buyers' perceptions; (b) usage, design, and physical composition of the product; (c) price movements over time; and (d) sellers' perceptions.[192]

Even when the line of commerce is reasonably well established and the merging firms are shown to have large market shares, other characteristics of the market may hinder the exercise of market power. Potential competition is a powerful force restraining monopoly pricing. If entry barriers are low, it is doubtful whether market power will be exercised for a sustained period of time. In terms of commercial bank products, the significant legal and technological barriers to competition have been eliminated. Significant entry of nonbank firms into the various products and services traditionally offered by commercial banks suggests that the barriers to competition in these markets are not high, or at least not insurmountable by a large number of nonbank firms, many of which operate on a national basis.

Whether or not merger will permit the resulting entity to exercise significant power over prices and competitors, actual or potential, is an antitrust issue that remains. To assume that the cluster approach allows for this evaluation is pure illusion. This point may best be illustrated by a hypothetical example. Suppose that Bank A and Bank B plan to merge. Under the cluster approach, a geographic market will be established in which the two parties are the only competing commercial banks. For the purpose of the example, assume that Bank A is a full service bank, offering products one through five and that Bank B produces only products one, two, and three. Although Bank B does not produce the full range of services provided by a full service bank, the Supreme Court, nonetheless, considers it a full service bank.[193] Assume that for each product one through five there are one hundred nonbank competitors providing more or less perfect substitutes in the geographic area designated as the relevant geographic market. The merger of Bank A and Bank B may not result in the merged bank having an economic monopoly. Clearly, the merged bank will have a monopoly in bank charters in the area, but what power has it over the price of any product? Will it be able to exclude existing nonbank competitors from providing substitute products or keep other nonbank competitors from invading its geographic area? An accurate assessment of the competitive effects of commercial bank mergers must be based on a product-by-product analysis.

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192. *Id.* at 17.
193. *See* 399 U.S. at 359-60.

VII. BANKS AND NONBANKS: OVERLAPPING MARKETS

The mergers in 1981 between Prudential Life Insurance and Bache, between American Express and Shearson, and between Sears and both Dean Witter and Coldwell-Banker generated a great deal of publicity for financial conglomerates. Sears' establishment of financial centers in a number of its retail stores further stimulated the public imagination, as did the acquisition by a number of commercial firms of consumer or nonbank banks.[194] In addition to enabling financial conglomerates to engage in activities not permitted to bank holding companies, these acquisitions allowed parent firms to raise funds by offering federally insured deposits. These deposits complemented other nonbank products, particularly since the financial conglomerates have been able to introduce money market deposit accounts that compete with money market funds. To date, Prudential-Bache, Fidelity, Merrill Lynch, Dreyfus, Gulf & Western, and many other companies have planned for, organized, and acquired nonbank banks.

The interest of nonbanking firms in banking activities is not, however, new. Nonbanking entities have long performed lending services to businesses and to households, as well as other financial services.[195] For example, Sears provided retail credit as early as 1910.[196] Sears has been a major supplier of insurance services since it organized Allstate Insurance in 1931.[197] In 1961 and 1962, Sears expanded Allstate Insurance by purchasing two savings and loan associations in California and renaming them Allstate Savings and Loan.[198] Other nonbanking firms have provided financial services for a comparable period. General Motors (GM) began its financing operations in 1919;[199] Ford began in 1928.[200] General Electric (GE) formed its credit subsidiary to finance the purchase of refrigerators and other appliances in 1932, diversified into many

194. These are institutions with commercial bank charters, but that either do not make business loans or do not accept demand deposits. Thus, they avoid the necessity of obtaining prior approval from the Federal Reserve under Section 2(c) of the Bank Holding Company Act of 1956 (current version at 12 U.S.C. § 1841(c) (1982)), which defines a bank as an institution that engages in both of those activities.

195. *See generally* H. Rosenblum & D. Siegel, *Competition in Financial Services: The Impact of Nonbank Entry* (May 1983) (Federal Reserve Bank of Chicago Staff Study 83-1) (analyzing competition between nonbanking based firms and commercial banks) [hereinafter cited as Rosenblum & Siegel].

196. *Id.* at B4-3.

197. *Id.*

198. *Id.*

199. *Id.* at B1-6.

200. *Id.* at B1-4.

types of business financing in the 1960's,[201] and by 1982 financed 13.1 billion dollars in loans, virtually none of which was related to the financing of GE products.[202]

Roughly a decade ago Cleveland Christophe[203] documented the positions of eleven nonbanking firms in the consumer lending areas traditionally thought to be the domain of commercial banks and consumer finance companies. Many of these firms, companies such as Sears, GM, and GE, had earnings from their financial service activities that rivaled the earnings of the nation's leading bank holding companies.[204] Moreover, in 1972, the dollar amount of the combined consumer installment loans held by three manufacturers (GM, Ford, and GE) was almost double the dollar amount held by three leading retailers (Sears, Montgomery Ward, and J.C. Penney) and almost triple the dollar amount held by the three largest bank holding companies (BankAmerica, Citicorp, and Chase Manhattan).[205]

The Federal Reserve Bank of Chicago has recently published several studies that have updated and extended past studies of the extent of overlap between commercial banks and nondeposit firms in consumer and business lending and in the generation of deposit-like liabilities.[206] These studies examined over thirty nonbanking companies and compared them with the top fifteen bank holding companies and the consolidated commercial banking system. One of the principal findings was that in 1982, a group of thirty-two selected companies had one or more product lines that overlapped with commercial bank products; furthermore, each of these firms had a significant regional or nationwide presence in one or more banking services.[207]

Nonbanking firms for many years have offered products that compete with commercial banks. However, this trend began in the late 1960's rather than the early 1980's as is so often assumed.

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201. *Id.* at B1-5.

202. H. Rosenblum & C. Pavel, *Financial Services in Transition: The Effects of Nonbank Competitors*, at B-4, Table 4 (January 1984) (Federal Reserve Bank of Chicago Staff Memorandum 84-1) [hereinafter cited as Rosenblum & Pavel]. An abbreviated version of this paper will be published in the HANDBOOK OF BANKING STRATEGY (R. Aspinwall & R. Eisenbeis ed. 1984).

203. C.A. CHRISTOPHE, COMPETITION IN FINANCIAL SERVICES (1974) [hereinafter cited as CHRISTOPHE].

204. *Id.* at 8.

205. *Id.* at 7.

206. *See* Rosenblum & Pavel, *supra* note 202; Rosenblum & Siegel, *supra* note 195, at B1-5; Rosenblum, Siegel, & Pavel, *Banks and Nonbanks: A Run for the Money*, ECON. PERSPECTIVES, May-June 1983, at 3.

207. *See generally* Rosenblum & Pavel, *supra* note 202 (analyzing the competition between thirty-two nonfinancial institutions and depository institutions).

In 1962 only two nonbanking firms, GM and Sears, were significant financiers, with earnings from financial services of 40.9 million and 50.4 million dollars, respectively.[208] By 1972, Christophe was able to identify ten companies whose financial services earnings were comparable to the financial services earnings of many of the leading banks and bank holding companies at that time.[209] In 1972 the net earnings from financial activities of these ten nonbanking firms totaled 662.2 million dollars, six times greater than a decade earlier.[210] In 1982 the earnings of these ten companies from their financial activities totaled 2.36 billion dollars, more than three and one half times the 1972 total and a considerably greater gain than could be accounted for by inflation alone.[211] In contrast, the nation's fifteen largest bank holding companies had combined earnings of 3.15 billion dollars in 1982.[212] Indeed, in 1982 it took the seven largest bank holding companies, ranked by earnings, to equal the financial services earnings of the ten companies identified by Christophe.[213]

The composition of earnings from financial services is different for banks, bank holding companies, and nonbanking firms. For example, until 1982 the insurance activities of Sears dominated its financial services earnings.[214] Nonetheless, examining those companies with 1982 financial services earnings in excess of 200 million dollars is helpful. Of the seventeen firms in this category, nine are bank holding companies. Of the top eleven, however, only three are bank holding companies. Moreover, the eight nonbanking companies had total 1982 earnings from financial services of 5.53 billion dollars compared with 3.1 billion dollars for the nine bank holding companies.[215]

Perhaps the best way to examine the impact of nonbank entry upon banks is to look at what has happened to competition in individual product lines. Presently, at least thirty-two nonbank companies have made significant competitive thrusts into various segments of consumer or business credit or into deposit markets. This number is likely to increase in the future.

A. Consumer Credit

Among the fifteen largest lenders in consumer installment and revolving credit in 1982, only five were bank holding companies;

208. CHRISTOPHE, *supra* note 203, at 10, Table III.
209. *Id.*
210. *Id.*
211. Rosenblum & Pavel, *supra* note 202, at B-2, Table 2.
212. *Id.* at 12.
213. *Id.*
214. *Id.* at 12-13.
215. *Id.* at B-3, Table 3.

within the top eight firms, only two were bank holding companies.[216] At the end of 1982 the top ten nonbanking consumer installment lenders had 86.7 billion dollars of these loans outstanding, exactly double that held by the ten largest bank holding companies in this lending category.[217]

"In the narrower field of auto loans commercial banks have maintained their positions as the leading lending group, but they have lost significant ground over the last few years to the captive finance affiliates of the auto manufacturers."[218] While commercial banks as a group had the largest market share in the auto lending product line with forty-six percent of the market at the end of 1982, this share had fallen by fifteen percentage points from the peak reached only four years earlier.[219] Over this same 1978-82 period the share of auto loans held by the captive finance companies of GM, Ford, and Chrysler increased by thirteen percentage points to thirty-four percent of the market.[220] In 1982 GMAC held 33.5 billion dollars of auto loans, more than one-fourth of all auto loans outstanding and almost double its share of the total market just three years earlier.[221]

"By way of comparison, Bank of America was the largest auto lender among commercial banks with 2.1 billion dollars of auto loans at year-end 1982, about 2.3 times the total of the second largest bank in auto loans but a mere one-sixteenth the total held by GMAC."[222] Bank of America's auto loans are confined almost totally to California, but GMAC lends throughout the United States. Nevertheless, GMAC's market position as measured by loans outstanding is enormous.

At the end of 1982, the domestic consolidated Call Reports[223] of the top twenty-five commercial banks in auto loans reported that those banks had 10.5 billion dollars of these loans on their books, and the Call Reports of the top 100 banks reported that they had 18.1 billion dollars.[224] As mentioned above, GMAC alone held 33.5 billion dollars, one and six-tenths times the amount held by the largest 100 commercial banking auto lenders. Ford Motor Credit held 9.3 billion dollars, about the same amount that the nineteen largest commercial banking auto lenders held.[225]

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216. *Id.* at B-6, Table 6.
217. *Id.*
218. *Id.* at 15-16.
219. *Id.* at B-7, Table 7.
220. *Id.*
221. *Id.*
222. *Id.* at 16.
223. The Call Reports are periodic reports of financial condition filed by banks with banking regulatory authorities.
224. *Id.*
225. The auto captive finance companies have a different profit orientation

While special circumstances in the automobile market during the 1978-82 period may have propelled the shift in the market share of auto loans toward the auto captive finance companies[226] and away from banks, there were similar trends of market share changes in total consumer lending. Over the last several years automobile-related credit has averaged between thirty-seven and thirty-eight percent of total consumer installment credit. In 1978 commercial banks issued fifty-five percent of net new installment debt (new loans written less paydowns of existing loans) to households; finance companies accounted for only twenty-two percent of this debt.[227] In 1981 these relative shares reversed themselves; commercial banks issued only three percent of the net new consumer installment debt that year while finance companies accounted for seventy-two percent.[228] Not all of this increased finance company share, however, was used to finance auto loans. Many noncaptive, consumer finance companies moved away from small, unsecured cash loans to making second mortgage loans; they held at least 13 billion dollars of second mortgage debt at the end of 1981.[229] In 1982 commercial banks bounced back in new consumer lending and increased their market share to thirty-three percent in spite of a poor showing in auto loans.[230]

The correlations[231] of movements of changes in credit extended by various institutional lenders are evidence that there has been a fundamental change in the competitive character of the market for consumer credit in recent years. Between 1945 and 1977 the correlation between the net annual changes in consumer installment credit at finance companies and commercial banks was 0.75; that is, increases in these loans at banks tended to be accompanied by increases at finance companies, and vice versa.[232] The correlation coefficient fell to 0.27 for the period from 1978 to 1982.[233] The

than their competitors. The use of a captive finance company gives auto manufacturers an added degree of pricing and marketing freedom not enjoyed by the competition. Indeed a captive finance company could, in theory, lose money on every loan it makes provided its parent made up for these losses in added sales volume at higher average prices.

226. A captive finance company is a subsidiary that finances the purchase of the parent company's products. GMAC and Ford Motor Credit are examples.

227. Rosenblum & Pavel, *supra* note 202, at 21.

228. *Id.*

229. C. Luckett, *Recent Developments in the Mortgage and Consumer Credit Markets,* 68 FED. RES. BULL. 281, 286 (1982).

230. Rosenblum & Pavel, *supra* note 202, at 21.

231. A correlation coefficient measures the relationship between two variables. At one extreme, a correlation coefficient of +1 means the two variables are perfectly, positively related. At the other extreme, a coefficient of -1 means the two variables are perfectly, negatively related. A coefficient of zero means there is no relationship between the two variables.

232. Rosenblum & Pavel, *supra* note 202, at 22.

233. *Id.*

change in the correlation coefficient for net changes in auto loans was even more dramatic; the coefficient fell from 0.68 during the period from 1945 to 1977 to -0.52 during the period from 1978 to 1982.[234] The latter period clearly was not representative of the long-term trend.

Thus, it is clear that consumer loan markets are very fluid in the sense that the share of *new* loans written by any single group of lenders can change dramatically as economic conditions change. Households seem to be willing to shift from one institutional supplier to another in response to noticeable differences in price or service. In a deregulated world, old habits may be shortlived.

B. Credit Cards

In 1972 Sears clearly led both Master Charge and National BankAmericard in the credit card business.[235] At that time Sears' 18.5 million active accounts were almost double the accounts of its two bank card rivals, each of which had about ten million active accounts.[236] Moreover, Sears was the leader in charge volume and account balances at that time.[237]

By 1981 Visa had become the undisputed leader in charge volume, a very important measure of business activity in this product line because the income generated from merchants' discount fees is proportional to its charge volume. With United States charge volume of 29.3 billion dollars during the June 1980-81 period, Visa's volume nearly tripled the volume of Sears; in 1972 Sears' volume was forty-three percent greater than Visa's.[238] Visa's and MasterCard's leading positions were augmented further in 1982.[239]

The success of Visa and MasterCard vis-a-vis Sears does not necessarily imply a victory for banks over a nonbank competitor because neither Visa nor MasterCard is a bank. They are cooperative organizations that license a product to their members. The original members were banks, but recently institutions other than banks have become members. According to Visa's 1981 Annual Report, during 1981 "311 institutions joined Visa U.S.A. as proprietary members and another 571 joined as agent members. Many were thrift institutions—318 savings and loan associations,

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234. *Id.* at 21-22.

235. As mentioned previously, Sears' lead in 1972 should have been expected; Sears began offering retail credit in 1910 while the two bank cards did not come into existence until the early 1960's. But since their inception, the bank cards have been very successful.

236. CHRISTOPHE, at *supra* note 203, at 6, Chart II.

237. *Id.*

238. Rosenblum & Pavel, *supra* note 202, at 22-23.

239. *Id.*

28 mutual savings banks, and 98 credit unions—who [chose] Visa as the vehicle for exercising the new consumer payment powers granted to them by Congress."[240] Some of Visa's growth in the last few years is attributable to the popularity of Merrill Lynch's Cash Management Account,[241] which includes a Visa card.[242]

On a consolidated banking system basis, banks have surpassed Sears, American Express, and other nonbank issuers of credit cards such as department stores and petroleum companies. Nonetheless, the two leading credit cards (as measured by customer account receivables) are Sears and American Express, whose combined credit card receivables are approximately equal to those of the ten largest commercial banks in the credit card business.[243] The three largest bank credit card issuers together are approximately equal to Sears, and the volume of receivables falls off sharply as the number of included card issuers is increased.

C. *Business Loans*

Commercial banks are an important source of credit to all businesses, large and small. Banks have the largest share of outstanding commercial and industrial (C&I) loans in the United States.[244] The fifteen largest bank holding companies held 155.5 billion dollars of domestic C&I loans at the end of 1982, more than triple the total held by the thirty-two nonbank companies studied by Rosenblum and Pavel.[245] Nevertheless, the importance of nonbank lenders should not be underestimated. Large nonbank firms raise funds from banks and capital markets and use these funds to provide loans to many smaller businesses. For smaller businesses, trade credit is the most widely used source of credit, both in terms of the percentage of firms utilizing it as a credit source[246] and in

240. VISA INTERNATIONAL 1981 ANNUAL REPORT 15.

241. This is a brokerage margin account, created by Merrill Lynch, which automatically sweeps idle funds into a money market fund and allows the investor to borrow against the account's assets. Accounts of this type are usually accessible through checks or debit cards.

242. Some of the comparisons between the success of the Visa, Sears, and other credit cards may be overdrawn. Over the period of analysis, one could not use a Visa card in Sears nor could a Sears card have been used outside a Sears store. What is being observed is a derived demand for credit based on the relative demand for goods sold by Sears versus goods sold by merchants or other outlets that accept Visa or MasterCard. Similarly, the American Express green card is perceived by many of its users as a "travel and entertainment" card rather than a credit card since the full amount of the purchase is due and payable when the customer receives his or her bill from American Express.

243. Rosenblum & Pavel, *supra* note 202, at B-11, Table 10b.

244. *Id.* at 25.

245. *Id.* at B-12, Table 11.

246. *Watro, supra* note 185, at 4, Table 3.

dollar volume.[247] Admittedly, trade credit is an imperfect substitute for bank credit because it cannot be used to pay other creditors or meet employee payrolls; nevertheless, its importance cannot be ignored.[248] In spite of modest recent gains by others, banks and bank holding companies still are the leaders in commercial lending. Among the top ten commercial and industrial lenders, nine are bank holding companies.[249]

Banks are an important source of funds for commercial mortgages, but so are insurance companies. In fact, life insurance companies overshadow banks and bank holding companies in commercial mortgage lending. This fact is not unexpected given the long-term nature of insurance companies' liabilities. In 1982 the top fifteen life insurance companies had roughly 88 billion dollars in commercial mortgages, 62.2 billion dollars more than the fifteen largest bank holding companies and sixty-seven percent of the commercial mortgages held by the domestic offices of all insured commercial banks.[250] Indeed, the four insurance companies studied by Rosenblum and Pavel, Prudential, Aetna Life & Casualty, Equitable Life Assurance, and American General Corp., had 36.4 billion dollars of commercial mortgages outstanding at the end of 1982, compared with 26.5 billion dollars of worldwide commercial mortgages held by the fifteen largest bank holding companies.[251] The three largest insurance companies in commercial mortgage lending, Prudential, Aetna, and Equitable, had more commercial mortgage loans outstanding at the end of 1982 than did the twenty-one largest banks in commercial mortgage lending, which include four mutual savings banks.[252]

Commercial banks do not dominate in lease financing either. With 15.9 billion dollars of lease receivables, the fifteen industrial-based companies studied by Rosenblum and Pavel engaged in more lease financing than did the fifteen largest bank holding companies, and more than did the nation's more than 14,000 insured commercial banks.[253] However, eight of the top fifteen lessors were associated with bank holding companies.[254]

247. Eisemann, *Empirical Evidence on Sources of Business Finance,* THE FUTURE OF THE FINANCIAL SERVICES INDUSTRY 77, 83, Table 2 (1981) (Conference Proceedings).

248. That the range of alternative financing sources for small businesses has increased is corroborated by more recent studies. *See, e.g.,* Andrews & Eisemann, *supra* note 191; THE INTERAGENCY TASK FORCE ON SMALL BUSINESS FINANCE, A REPORT TO CONGRESS, STUDIES OF SMALL BUSINESS FINANCE, (Feb., 1982).

249. Rosenblum & Pavel, *supra* note 202, at B-13, Table 12a.

250. *Id.* at B-12, Table 11.

251. *Id.* at 26.

252. *Id.*

253. *Id.* at B-12, Table 11.

254. *Id.* at B-15, Table 13.

Nonbank companies compete with banks in other ways as well. For example, Commercial Credit Corporation (a subsidiary of Control Data), Merrill Lynch, and ITT are now approved lenders for the Small Business Administration. This approval has opened a new area of competition between nonbank companies and banks because prior to January 1980, SBA lending was the sole province of commercial banks.[255]

D. Deposits

Substitutes for bank deposits have been around as long as there has been a reasonably efficient secondary market for government and private securities. Treasury bills, repurchase agreements with banks or government bond dealers, and large negotiable CD's are (imperfect) substitutes for bank deposits, including demand deposits. A comparatively recent substitute, money market mutual funds (MMF's), grew from only a few billion dollars in assets in 1975 to over 230 billion dollars of assets by December 1982 when MMF assets reached their peak[256] just prior to the introduction of the Money Market Deposit Account[257] permitted by Garn-St Germain.

Ten of the nonbanking companies included in the Rosenblum and Pavel sample accounted for about forty-six percent of all MMF assets in 1982 and 1983.[258] To the extent that MMF's provide reasonably attractive substitutes for commercial bank deposits, the combined deposit size of these ten companies at the end of 1982 ranked about halfway between the deposit sizes of BankAmerica and Citicorp, the nation's two largest bank holding companies in deposits.[259] Merrill Lynch, with MMF assets of 50.4 billion dollars as of December 1, 1982, was roughly comparable in size with Manufacturers Hanover and Chase Manhattan, which had worldwide deposits of 43.8 billion and 56.9 billion dollars, respectively, at the end of 1982.[260]

In the last two or three years competition for deposits has taken new forms. Alliances that would have been termed unholy not long ago are commonplace now. Merrill Lynch has marketed, through

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255. *Id.* at 27.

256. *Id.* at 28.

257. The Money Market Deposit Account was authorized in late 1982 and was designed to be directly competitive with MMF's. It can be offered by all depository institutions to all depositors. It requires a minimum balance of $2,500, pays money market rates, and allows for six transfers per month (only three by draft); however, the account has no restrictions on withdrawals. *See* 12 U.S.C. § 3503 (1982).

258. Rosenblum & Pavel, *supra* note 202, at B-13, Table 12a.

259. *Id.* at 28.

260. *Id.*

its nationwide network of some 475 offices, All Savers Certificates[261] and other retail time deposits for Bank of America, Crocker National Bank, and several savings and loan associations in Florida, Washington, and other parts of the country.[262] Merrill Lynch, the same company that once had over 50 billion dollars of MMF assets that purportedly competed with bank and thrift deposits, also maintains a secondary market for retail CD's issued by banks and savings and loan associations. In addition, Merrill Lynch, by acting as a broker in the placement of retail CD's issued by many banks and thrifts, has given banks and thrifts a nationwide reach. Merrill Lynch is not alone in this regard, but is joined by several companies who compete directly with banks in some product lines. These include Sears/Dean Witter, Shearson/American Express, and E. F. Hutton. Together these four companies operate more than 1,300 offices throughout the United States. Even in rural locations where these companies have no physical office facilities, they are no farther than a newspaper, radio, TV, or magazine advertisement and a telephone call away. Thanks to Merrill Lynch, Sears/Dean Witter, and Bache, City Federal Savings and Loan of Elizabeth, New Jersey, now competes toe-to-toe on a nationwide basis with Bank of America for retail CD's.[263]

The importance of the cooperative affiliations between brokers and depository institutions should not be underestimated, for it

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261. A savings instrument created by Section 301 of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 301, 95 Stat. 173, 267 (codified at 26 U.S.C. § 128 (1982)). The major benefit of the certificate was that up to $1000 of interest income was exempt from federal income tax.

262. Rosenblum & Pavel, *supra* note 202, at 29-30.

263. *Id.* at 30 and B-18, Table 16.

However, more recent developments will likely reduce the use of brokered deposits to some extent. Because of the abuses of brokered deposits by a few "troubled" banks and thrifts, the Federal Deposit Insurance Corporation (FDIC) and the Federal Home Loan Bank Board, as operating head of the Federal Savings and Loan Insurance Corporation, adopted final regulations on brokered deposits in March 1984, in an effort to reduce the risks that brokered deposits pose for the federal deposit insurance system. Effective October 1, 1984, these regulations limit insurance coverage of funds placed by or through a deposit broker to one hundred thousand dollars per broker per insured institution. Also, in April 1984, the FDIC banned the use of brokered deposits by banks in financial trouble.

On June 20, 1984, a federal judge overturned the brokered-deposit limitation, thereby restoring temporarily the extended geographic reach of depository institutions wishing to raise funds by this mechanism. (*Wall Street Journal*, Jun. 21, 1984.) Prior to this court ruling, banks and S&Ls managed to find ways to circumvent the restrictions on brokered deposits, for example, by advertising nationally or by hiring the brokers as full-time employees. Irrespective of the legislative and legal battles that will be fought on this issue, ways will be found to extend the geographic outreach of depository institutions beyond their local service area.

may represent one of the most significant reductions in entry barriers into the financial services business. No longer is the deposit and loan growth of a de novo bank or thrift constrained by its ability to generate deposits from its local customers. To the extent that it has profitable lending opportunities, a new depository institution can engage in liability management through the sale of brokered, insured *retail* deposits by paying above the going market rate. The availability of federal deposit insurance should make depositors virtually indifferent to the type of institution with which they will deal. It is now conceivable that a de novo bank or thrift could develop a billion dollar deposit base within a year or two of its opening. Furthermore, under current law the ability to own one (and only one) savings and loan association is not constrained by the line of commerce engaged in by the parent company or one of its affiliates. Thus, a nonbank firm can establish a de novo savings and loan association or buy an existing one and gain a significant presence in financial services in a very short time by selling insured retail deposits on a national scale through brokers. Because of the expanded range of lending powers granted to thrifts by Garn-St Germain, a de novo savings and loan association could, in a very short time, resemble a large, long-established commercial bank, especially if it were to receive outside capital infusions from a well-heeled parent.

The market for funds in denominations greater than 100,000 dollars has been national since Citibank devised the negotiable certificate of deposit in 1961. The same is true for the market for large repurchase agreements. Bank-related commercial paper, also sold in a national market, amounted to 34.5 billion dollars at the end of 1982.[264] What was true a decade ago for wholesale deposit markets has now become true at the retail level—the market for deposits (and their close substitutes) is national in scope.

VIII. CONCLUSION

The commercial banking cluster is a fiction created by the Supreme Court premised on the alleged uniqueness of commercial banks. The cluster rule comports with neither the traditional principles of product market analysis as enunciated in *Du Pont, Brown Shoe*, and other relevant Supreme Court decisions, nor with the reality of competition faced by commercial banks from nonbank financial institutions. Theoretically, courts should unbundle the cluster and examine the anticompetitive effects on a product-by-product basis.

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264. *Id.* at 31.

The product-based approach recommended here not only rests in the mainstream of antitrust analysis as demonstrated by the discussion of the nonfinancial cases, but also makes logical sense because of the continuing evolution of the financial services industry. Evidence indicates that a variety of financial services firms vigorously compete with commercial banks for depositors and borrowers. For nearly every commercial bank product, reasonable substitutes are available from other suppliers. The absence of a commercial bank charter does not prevent nonbank firms from engaging in the business of banking. The uniqueness of commercial banks has no content in an antitrust context. The cluster rule, relying as it does on uniqueness, should be deposited in the judicial dustbin.

This is not to suggest, however, that a product-by-product analysis would make antitrust decisions any easier; it will not. But, then again, expediency has its price. If we are concerned about possible anticompetitive consequences, that is, if the antitrust laws are to be taken seriously, the antitrust analysis must be applied with scrupulous logic.

Market shares and concentration measures, the stuff of which antitrust decisions are made, are of dubious significance under the cluster rule. A product-by-product analysis overcomes this problem by permitting the identification of all competitors, bank and nonbank. Furthermore, it allows for an informed discussion of potential competitors relative to various markets. A question of paramount importance in any discussion of the competitive consequences of a merger is whether potential competitors face significant barriers to entry. Unfortunately, this question cannot be answered under the cluster rule. That is, the effect of potential competition in restraining the exercise of market power of firms cannot be assessed. At least one commentator has noted that "the condition for competition is many potential rivals, not necessarily many existing rivals."[265]

Because of these problems with relying on the cluster rule, and in order to extend the traditional principles of antitrust to bank mergers, the cluster approach should be discarded in favor of a product-by-product analysis. As time passes and technology continues its rapid evolution, the cluster approach will lead to merger decisions inimical to the public interest. It is impossible to speculate on whether a product-based approach will yield fewer or more mergers in commercial banking. However, it is clear that the cluster approach is simply inappropriate and needs to be scrapped.

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265. G. STIGLER, THE ORGANIZATION OF INDUSTRY 19 (1968).