Economic Institutions and Value Survey: Legal Conflicts within the Banking Industry

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SURVEY

ECONOMIC INSTITUTIONS AND VALUE SURVEY: LEGAL CONFLICTS WITHIN THE BANKING INDUSTRY

CONTENTS

I. Introduction .................................................. 708

II. Conflicts Within the Federal Banking System ................. 708
   A. Conflicts Between the Federal Regulatory Agencies — Comptroller
      of the Currency v. Federal Reserve Board v. FDIC ............ 708
      1. Introduction .................................................... 708
      2. Corporate Savings Deposits ................................. 709
      3. Loans to Executive Officers ................................. 711
      4. Capital Notes and Debentures ............................... 713
      5. Undivided Profits as Capital ............................... 715
      6. Federal Funds Transactions ................................. 716
      7. Underwriting Revenue Bonds ............................... 718
      9. Purchase of Domestic Bank Stock ........................... 725
     10. Purchase of Foreign Bank Stock ............................ 727
     11. Bank Service Corporations ................................. 729
     12. Window Dressing ............................................ 731
     13. Unsubordinated Promissory Notes .......................... 734
     14. Securities Disclosure Regulations ........................ 736
     15. Absorption of Exchange Charges ........................... 738
   B. Competitive Effects of the Conflicts Between the Federal Regulatory
      Agencies — National Banks v. State Member Banks .......... 739

III. Conflicts Within the Dual Banking System — National Banks
     v. State Banks .................................................. 741
   A. Comptroller of the Currency v. the Dual Banking System 741
      1. Introduction .................................................... 741
      2. Purchase of the Stock of Travel Agencies and Mortgage
         Service Corporations ........................................ 741
      3. Provision of Insurance Services ............................. 743
      4. Leasing of Personal Property ............................... 745
      5. Stock Option Plan ............................................ 746
      6. Real Estate Loans ............................................ 746
      7. Pledge of Bank Shares ....................................... 748
      8. Interest Rates on Loans ..................................... 748
      9. Branch Banking ............................................... 751
     10. Appraisal of These Rulings ................................ 753
   B. Federal Law v. State Law .................................... 754
      1. Introduction .................................................... 754
      2. State Taxation ............................................... 755
      3. Venue Sanctuary of National Banks ......................... 757
      4. Usury .......................................................... 760
      5. Assessment of These Advantages ........................... 763

IV. The Possible Expansion of Federal Power: The Conflicts Engendered .......... 764
   A. Introduction .................................................... 764
   B. Expansion Through Substantive Change ........................ 764
1. Early Proposals .................................................. 764
3. The Effects on the Dual Banking System .......................... 768
C. Expansion Through Structural Change .................................. 769
   1. Introduction .................................................. 769
   2. Consolidation in the Federal Reserve System .................... 769
   3. Consolidation in the Treasury Department ....................... 771
   4. Consolidation in a Federal Banking Commission ................. 772
D. The Race of Laxity .................................................. 773

V. Federal Regulation of Anticompetitive Banking Practices —
   Conflicting Policies .................................................. 774
A. Introduction .................................................. 774
B. Bank Mergers .................................................. 777
   1. Supervision of Bank Mergers Prior to 1960 ....................... 777
   2. The Bank Merger Act of 1960 .................................. 780
   3. The Bank Merger Act of 1966 .................................. 786
      a. Introduction .................................................. 786
      b. The New Provisions ........................................... 787
         (1) Past Mergers .............................................. 787
         (2) Future Mergers — The New Standards ...................... 787
            (a) The Monopoly Standard ............................... 788
            (b) The Competitive Standard ............................ 788
                (i) The Product Market ............................... 788
                (ii) The Geographic Market ......................... 790
                (iii) The Mitigating Clause ......................... 790
         (3) Challenging Proposed Mergers ............................ 791
         (4) Operational Effectiveness ............................... 793
      c. The Future of the Bank Merger Act of 1966 ................... 797
C. Bank Holding Companies ........................................... 798
   1. The Bank Holding Company Act of 1956 .......................... 798
   2. The Bank Holding Company Act of 1966 .......................... 799
      a. The Registered Investment Company Exemption ............... 800
      b. One-Bank Holding Companies ................................. 801
      c. Long Term Trusts and Charitable Institutions .............. 802
      d. The Antitrust Provision .................................... 804

I. INTRODUCTION

In this survey, the Notre Dame Lawyer presents an analysis of selected legal
problems facing the banking industry today. Its purpose is twofold: to objec-
tively delineate the nature and extent of these problems, and to contribute in
some way to their solution.

II. CONFLICTS WITHIN THE FEDERAL BANKING SYSTEM

A. Conflicts Between the Federal Regulatory Agencies — Comptroller of the
   Currency v. Federal Reserve Board v. FDIC

1. Introduction
   There can be little doubt that the strength of the nation's commercial bank-
ing system has a major effect on the progress of the country's economy. As a
result, problems within that system can, and should, be a cause of concern to all, and not merely to those involved in the banking business. It is for this reason that the disputes that have arisen during the past few years between the Federal Reserve Board and the Comptroller of the Currency have received a great deal of publicity and attention, in some cases perhaps more than was deserved. The development of these disputes, however, should not be surprising, for it was an almost inevitable result of the very structure of the federal apparatus for bank supervision. Under the present supervisory system, national banks are subject primarily to the supervision of the Comptroller of the Currency as the administrator of the National Bank Act. But, since all national banks are also members of the Federal Reserve System, they are subject to a certain amount of supervision by the Federal Reserve Board, the administrative body of the Federal Reserve Act. This overlapping authority has frequently led to inconsistent regulatory policies, to such an extent that one prominent attorney regards the resulting confusion in the banking system as having reached "an all-time high." This confusion has been assailed as a "bureaucratic mess," a "hodgepodge," and the "tangled web of banking supervision." The disputes that have given rise to these appellations are the subject of the first part of this survey. The origins of these controversies will be analyzed and determinations made as to their present status. It is hoped that this will thereby pave the way for their solutions.

2. Corporate Savings Deposits

According to the provisions of the Federal Reserve Act, the Board of Governors of the Federal Reserve System is authorized to define the terms "demand deposits," "time deposits," and "savings deposits." Pursuant to this authority, the Board has defined a savings deposit to include funds deposited to the credit of a corporation operated primarily for religious, charitable, philanthropic, or other similar purposes, but not those deposited to the credit of a corporation operated for profit. A demand deposit has been defined to include every deposit that is not a time or savings deposit. The classification is of importance because federal banking law forbids the payment of interest on demand deposits by any bank that is a member of the Federal Reserve System. Member banks cannot, then, pay interest on funds deposited by profit-making corporations, unless these funds take the form of a "time deposit." And since time deposits are only avail-

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able in very substantial denominations, only large corporations are able to get a return on their idle funds from a member bank. This leads to the result that member banks are unable to attract most corporate accounts, since they naturally flow to those institutions that can accept corporate savings deposits, i.e., mutual savings banks and savings and loan associations.\textsuperscript{11} Primarily because of this discrimination between large and small corporations and between commercial banks and the other financial institutions, in December 1963, the then Comptroller of the Currency, James J. Saxon, issued an interpretation amending the Code of Federal Regulations. The interpretation declared that national banks can accept savings accounts from any class of depositor, including profit-making corporations.\textsuperscript{12} According to the Comptroller’s rationale, the authority possessed by the Board under the Federal Reserve Act to define time and savings deposits extends only to the terms of the deposit contract. There is nothing contained in the act that “would preclude, or would authorize a regulation which would preclude, the maintenance of such accounts by any class of depositor.”\textsuperscript{13} Thus, a national bank can, subject to certain limitations, “accept savings accounts without regard to whether the funds deposited are to the credit of one or more individuals, or of a corporation, association, or other organization, whether operated for profit or otherwise.”\textsuperscript{14}

The Board of Governors reacted quickly to the Comptroller’s new interpretation by issuing an interpretation of its own in which it reaffirmed its statutory authority to define time and savings deposits. It went on to flatly state that a deposit by a corporation operated for profit may not be classified by any member bank, including a national bank, as a savings deposit. Unless such a deposit comes within the definition of a “time deposit” it would constitute a demand deposit under Part 217 and payment of interest on such deposit by a national bank would violate the prohibition of the law against payment of interest on demand deposits.\textsuperscript{15}

To put force behind its interpretation, the Board further pointed out that failure of a bank to comply with the provisions of the Federal Reserve Act could lead to the imposition of severe penalties, since such failure constitutes grounds for instituting legal proceedings to close the bank, and since any director who participates in a violation of the act could be personally liable for any damages sustained by the bank, its shareholders, or any other persons as a result of the violation.\textsuperscript{16}

The Comptroller was not without comment on the Board’s new interpretation and soon thereafter wrote all national banks reaffirming his position regarding the Board’s authority to define the terms in question. He also asserted that the Board has no authority to impose any penalty for failure to comply with its unauthorized regulation; that the penalties of charter forfeiture and personal liability of directors cannot be applied to the enforcement of the invalid regu-

\textsuperscript{11} \textit{Pending Problem: Savings Accounts for Businesses}, Banking, April 1964, p. 122.
\textsuperscript{12} 12 C.F.R. § 7.8 (Supp. 1966).
\textsuperscript{13} \textit{Ibid.}
\textsuperscript{14} \textit{Ibid.}
\textsuperscript{15} 12 C.F.R. § 217.135(d) (Supp. 1966).
\textsuperscript{16} 12 C.F.R. § 217.135(e) (Supp. 1966).
lation; that these penalties can only be imposed as a result of a suit brought by the Comptroller; and that, under these circumstances, he would have an affirmative duty not to bring such a suit.\(^\text{17}\) He also sent a letter to the Chairman of the Senate Banking Committee stating that "national bank examination reports will not take exception to, note, or criticize actions which are in accordance with the Comptroller's interpretation of the national banking laws."\(^\text{18}\)

Valid arguments can certainly be made for both sides with regard to the advisability of permitting commercial banks to accept corporate savings accounts. In support of such permission, for example, it has been asserted that the acceptance of these accounts will enable member banks to compete more effectively with other financial institutions; will enable small businesses to receive a return on idle funds from commercial banks as well as from these other institutions; will help to improve community relations with small businesses; and will cause an inflow of deposits to these banks from new customers, which, despite a possible temporary decline in earnings due to the necessity of paying interest on savings deposits, should prove to have a favorable effect on the banks.\(^\text{19}\) On the other hand, it can be argued that corporate savings accounts will tend to increase operating costs, thereby causing a reduction in earnings (this reduction in turn making it harder for the banks to raise additional capital), and that the accounts will be more volatile than savings deposits held by individuals. They will be more like demand deposits than true savings deposits. This increased volatility will either require the bank to seek greater liquidity than would be required in the case of customary savings deposits or may induce the bank to permit riskier loans, thereby increasing its risk of loss.\(^\text{20}\)

This particular conflict surely does present serious problems for the bankers involved, who must either forgo the profits to be derived from these accounts or risk the penalties threatened by the Board, despite the Comptroller's assurances that these penalties will not be imposed. It is not surprising to find that the fear of sanctions has kept many bankers from accepting corporate savings accounts.\(^\text{21}\) Though motivated by fear, these bankers would seem to be following the proper course. In the light of the express statutory authority of the Board to define time and savings deposits, it is difficult to see the justification for the Comptroller's action in this area. His interpretation of the statute is without legal merit. Though the policy arguments in favor of permitting member banks to accept these deposits might very well outweigh the Board's arguments in opposition, the fact nevertheless remains that, under the law, the decision as to the acceptability of these deposits is the Board's, not the Comptroller's.\(^\text{22}\)

3. Loans to Executive Officers

The Federal Reserve Act prohibits any executive officer of a member bank

\(^{17}\) Bratter, *Index to Confusion*, Banking, March 1964, p. 57.

\(^{18}\) *Id.* at 119.

\(^{19}\) *Pending Problem: Savings Accounts for Businesses*, Banking, April 1964, p. 122.


\(^{22}\) The action of the Comptroller with regard to corporate savings accounts was also contrary to the recommendations made by his Advisory Committee. See *Advisory Committee on Banking, National Banks and the Future* 127 (1962).
from becoming indebted to any member bank of which he is an executive officer. However, with the prior approval of a majority of the entire board of directors, a member bank may extend credit to an executive officer thereof in an amount not to exceed $2,500. The same section of the act also authorizes the Board of Governors to define the term "executive officer," to determine what shall be deemed an indebtedness, and to prescribe any regulations necessary to effectuate the provisions of the section. Pursuant to this authorization, the Board issued its Regulation O, in which it defined an executive officer as

every officer of a member bank who participates or has authority to participate in the operating management of the bank or any branch thereof otherwise than in the capacity of a director of the bank, regardless of whether he has an official title or whether his title contains a designation of assistant and regardless of whether he is serving without salary or other compensation.

In December 1963, in response to a question from many national banks as to whether title alone determines if an individual is an executive officer, Comptroller Saxon issued his interpretation of the meaning of the term. He felt that, as contemplated by the Federal Reserve Act, an executive officer is any officer of a bank who, "by virtue of his position, has both voice in the formulation of the policy of the bank and responsibility for the implementation of such policy." According to his definition, just as with the Board’s, a person who acts solely as a director would not be considered an executive officer. Also, one whose sole responsibility is the administration of bank policy is eliminated from that category. In short, the basic theory behind the Comptroller’s interpretation is that “it is the responsibility of and function performed by the individual, and not his title, which determines whether he is an ‘executive officer.’” His definition led the Comptroller to conclude that ordinarily the president, principal vice-president, and cashier are executive officers, though officers with other titles who perform the same functions ordinarily performed by these three officers are also to be regarded as such. The Board, on the other hand,

assumed that the chairman of the board, the president, every vice president, the cashier, secretary, treasurer and trust officer of a member bank are executive officers, unless it is provided by resolution of the board of directors or the bank’s by-laws that any such officer is not authorized to participate in the operating management of the bank and he does not actually participate therein.

The reasoning behind the Comptroller’s interpretation was not complicated. He recognized the fact that banks, unlike most other businesses, often have a large number of employees who, for reasons such as additional prestige in dealing with the public, are executives in name only. In his opinion, a defini-

26 Ibid.
27 Ibid.
28 12 C.F.R. § 7.9(b) (Supp. 1966).
tion in any other terms than his own would deprive "many bank employees of
the opportunity of obtaining their home mortgage, automobile loan, and other
normal borrowing needs from the bank for which they work" and would deprive
"the bank of business from its employees who cannot influence their own loan
applications." This last point lends what Mr. Saxon regarded as realism to
his approach, for he pointed out that the true purpose of the applicable Federal
Reserve Act provision is to prevent individuals from influencing their own loan
applications. If an officer cannot exert this influence, the Comptroller felt
that he should not be subject to the borrowing limitation.

It has been asserted, quite legitimately when the definitions are considered
in the regulations issued by the Federal Reserve System. Though this might
well be true, it seems equally valid to hold that the Comptroller, by the issuance
of his own definition, implied that the Board's definition is improper. His defini-
tion showed that he intended to construe the term "more liberally" with respect
to loans by national banks to their officers than it was construed by the Board
with respect to such loans by state member banks. Here again, though the
Comptroller's formulation might be the more desirable, it is the Board and not
the Comptroller that has been given the power to define this particular term.
The Comptroller seemed to recognize this sub silentio during the 1965 hearings
on the consolidation of bank supervisory functions when he failed to answer the
charge that his ruling was contrary to the statute giving the power of definition
to the Board. Since the statute does confer this power upon the Board, the
pronouncement of the Comptroller was in excess of his authority.

4. Capital Notes and Debentures

Various provisions of the federal banking laws impose restrictions on banks
in terms of a percentage of "capital stock" and "surplus." The National Bank
Act, for instance, limits the total obligations to a national bank of any person,
partnership, or corporation to ten percent of the unimpaired capital stock of
the bank and ten percent of its unimpaired surplus fund. The Federal Reserve
Act contains like restrictions for member banks with respect to various other
transactions. The problem currently facing the banking industry is to decide
what constitutes "capital" for the purpose of applying these different limitations.
The Office of the Comptroller and the Federal Reserve Board are in sharp dis-
agreement over the matter.

30 *Hearings on Consolidation of Bank Examining and Supervisory Functions Before the
Subcommittee on Bank Supervision and Insurance of the House Committee on Banking and
Currency and the House Committee on Banking and Currency, 89th Cong., 1st Sess. 398
(1965) [hereinafter cited as 1965 Hearings on, Consolidation of Bank Supervisory Functions].
31 Id.
32 Id. at 398-99.
33 Id. at 399.
34 Hackley, supra note 3, at 617-18.
U.S.C.A. § 371c (Supp. 1966); 48 Stat. 184 (1933), as amended, 12
Traditionally, only common and preferred stock were regarded as “capital stock” for the purpose of these limitations. In recent years, however, many banks have been selling to the public “capital notes” or “capital debentures,” instruments which give their holder a creditor position rather than the “equity” ownership afforded by capital stock. This practice was given its initial impetus in 1962, when Comptroller Saxon liberalized the views of the Comptroller’s Office with regard to this matter and announced that he would permit the sale of these debentures. Such action was a radical break with the past, since the issuance of these instruments had for years been regarded as an unsound form of bank financing, primarily because of their association with the emergency conditions of the 1930’s. The immediate source of the present controversy arose in 1963 when the Comptroller ruled on the question of whether or not the proceeds of capital notes and debentures issued by national banks can be included in the total of unimpaired capital funds for the purpose of computing the loan limitation on these banks. His ruling held that

the proceeds of capital notes, capital debentures or other similar obligations issued by a National Bank, provided that such debentures, notes or other similar obligations are subordinate in right of payment to the prior payment in full of all deposit liabilities of the bank, may be included as part of the aggregate amount of unimpaired capital stock and unimpaired surplus funds for the purpose of the computation of the limit on loans to individual borrowers contained in 12 U.S.C. 84.

Since such subordinate notes and debentures have all the protective effect of capital and surplus with respect to the bank depositors, and since the legislative history of the lending restrictions indicates that the primary purpose of those restrictions is the protection of depositors, Comptroller Saxon felt that capital notes and debentures that stand in the same relationship to depositors as the traditionally recognized forms of capital and surplus should be included in the loan base.

The Board of Governors took exception to the Comptroller’s ruling and shortly thereafter issued a ruling of its own. According to the Board, “capital” excludes all debt instruments. As an evidence of debt, a note or debenture is of a different quality than stock, which evidences a proprietary interest in the assets of the bank. The Board also pointed out that the National Bank Act expressly provides that “capital,” when used in the laws relating to the capital of national banks, is limited to “the amount of unimpaired common stock plus

38 Hackley, supra note 3, at 602.
39 Ibid.
42 12 C.F.R. § 7.7 (Supp. 1966).
43 Ibid.
44 12 C.F.R. § 208.108(b) (Supp. 1966).
45 Ibid.
the amount of preferred stock outstanding and unimpaired . . . . Further, at least once in the past when Congress wished to permit notes and debentures to be considered capital, they deemed it advisable to specifically amend the Federal Reserve Act. The Board felt "these plain evidences of Congressional intent compel the conclusion that, for purposes of statutory limitations and requirements, 'capital' notes and debentures may not properly be regarded as part of either 'capital' or 'capital stock.'"

The Comptroller's original 1963 ruling did not involve a direct clash with the Board since it only related to the amount a national bank could lend to a single borrower, and the Board has no enforcement powers in this area. However, an expansion of his ruling later caused such a confrontation. Section 25A of the Federal Reserve Act limits the amount any member bank may lend to its affiliates, again in terms of a percentage of the bank's capital and surplus. Though the Board's statement clearly held that capital notes and debentures cannot be considered in determining the lending limits, the Comptroller subsequently extended his ruling to apply to loans made to affiliates of national banks as well as to other classes of borrowers.

During the 1965 hearings on the consolidation of bank supervisory functions, it was asserted that the Comptroller's action with regard to these capital notes and debentures is "not provided by law." In light of the statutory definition cited above, it seems that this charge is valid. The fact is that the inconsistent positions of the two agencies cause confusion in the banking industry. For this reason alone, if for no other, the conflict should be resolved. One possible solution could be a modification of a proposal by the American Bankers' Association whereby a statute would be passed clearly authorizing the Federal Reserve Board to define, for all member banks, the meaning of "capital" for the purpose of ascertaining their lending limits.

5. Undivided Profits as Capital

A problem related to the foregoing is the inclusion of undivided profits

54 There are both advantages and disadvantages associated with bank debenture financing generally. Those in favor of such financing argue the relatively low cost of borrowed capital. The interest payments on debentures are tax deductible, unlike dividend payments on common or preferred stock. In addition to being low, the cost of borrowed capital is also fixed. Thus any earnings in excess of the rate of interest paid by the bank will flow to stockholders, and earnings on bank stock will thereby be improved.

Those opposed to the issuance of debentures argue that bank management will be under pressure to earn more than the fixed rate on the debentures. The result will be deterioration in the quality of bank credit as credit requirements on loans and quality requirements on investment portfolios are lowered to obtain higher yields. Also, a sufficiently long period of relatively low interest rates could reduce bank earnings below the level necessary to meet the fixed costs of the borrowed capital and thereby make it harder for issuing banks to redeem or refund the debentures. Mock, Banks Find New Ways To Raise Capital, Banking, Nov. 1964, p. 60.
within capital and unimpaired surplus. According to the Comptroller, undivided profits constitute a capital account includable in the term "unimpaired surplus fund" as that term is used in the statutory provision relating to the lending limits of national banks as well as when used with respect to the other formulae affecting national banks, such as that determining their borrowing limits. 

"Unimpaired surplus fund" was held to include "all capital accounts (other than capital stock), derived from either paid-in capital funds or retained earnings, not subject to known charges, and which are considered interchangeable by resolution of the bank's board of directors." Apparently, the Comptroller felt that the category of undivided profits is "economically indistinguishable from that of capital and surplus." The reasoning behind the ruling on undivided profits is similar to that which gave rise to the Comptroller's ruling on capital notes and debentures; the former ruling, as the latter, conforms to the purpose of the lending limitations, i.e., the protection of depositors. For all accounts includable in "unimpaired surplus," including undivided profits, stand in the same relative position to deposits as does the surplus account.

The Federal Reserve Board, on the other hand, reached the opposite conclusion that "undivided profits do not constitute 'capital,' 'capital stock,' or 'surplus' for the purposes of provisions of the Federal Reserve Act . . . ." Again the Board pointed out that "capital," as defined in the National Bank Act, is limited to common and preferred stock and further asserted that a bank's surplus fund is more stable than its undivided profits account, a distinction that had been recognized by the United States Supreme Court. Finally, the Board indicated that the federal banking laws use the terms "undivided profits" and "surplus" with different meanings, so that certain provisions would be meaningless or their application impractical if undivided profits were regarded as part of a bank's "surplus" or "surplus fund." The Board's position was rightly supported by the staff of the House Committee on Banking and Currency in 1965 since it is the more reasonable view and is supported by the greater weight of authority.

6. Federal Funds Transactions

The fact that the federal banking statutes have created a number of limitations on the lending and borrowing powers of both national and state member banks necessitates an awareness of what is to be considered a loan or a borrowing. At the present time, there exists a conflict between the Comptroller's Office and the Federal Reserve Board on precisely this point. For the two agencies,
acting within their respective jurisdictions, disagree as to whether certain transfers in bank reserves are loans.65 The problem arises because of a practice, occurring more frequently in recent years, by which a member bank, temporarily short of reserves or in need of loanable funds, “buys” reserves from another member bank with excess reserves.66 This transaction ordinarily is in the form of a transfer from the “selling” bank’s account in the Federal Reserve Bank to the “buying” bank’s account for a specified fee and for a period of only one or two days. At the end of this period, the “buyer” retransfers the reserves involved from its account to that of the “seller.”67

Until 1963, the Comptroller’s Office considered these transactions in reserves to be loans on the part of the “selling” banks and borrowings by the “buying” banks.68 In that year, Comptroller Saxon ruled that they constitute not loans but purchases and sales of reserve funds and consequently do not “create on the part of the buyer an obligation subject to the lending limit or a borrowing subject to 12 U.S.C. 82 . . . .”69 In defense of his ruling, the Comptroller asserted that these transactions are really “trading in an established money market” and are recognized by the banking industry as such; that they constitute, in short, a “buying” of money for short-term use; and that his ruling is “consistent with custom and practice within the banking industry.”70 As to the charge that he was departing from the course of his predecessors, he argued that imposing a restriction merely because it had been done in the past was not a valid reason and that a “significant number” of state bank supervisors viewed the transactions in the same way he did.71

The Federal Reserve Board has adopted the position that “for purposes of provisions of law administered by the Board, a transaction in Federal funds involves a loan on the part of the ‘selling’ bank and a borrowing on the part of the ‘purchasing’ bank.”72 What is “bought” is money itself, the “repayment of which not earlier than the next day is the obligation assumed by the ‘buyer.’”73 As described by the Federal Reserve Bank of Chicago, these transactions are actually loans with a one-day maturity effected through a transfer of funds on the books of Federal Reserve Banks. They do not increase or decrease total member bank reserves, as could be the case if they were true sale transactions, but merely redistribute them.74

As indicated, the classification of federal funds transactions is important because of the various consequences involved. For example, if regarded as loans and borrowings, they would be subject to the statutory limit on lending and borrowing. Before Comptroller Saxon’s ruling, then, a national bank could

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65 Note, supra note 21, at 666.
67 Ibid.
68 Bratter, Should a Federal Funds Transaction Be a “Loan” or a “Sale”? , Banking, June 1966, p. 37.
70 1965 Hearings on Consolidation of Bank Supervisory Functions 382.
71 Ibid.
72 12 C.F.R. § 208.106(a) (Supp. 1966).
73 Bratter, Should a Federal Funds Transaction Be a “Loan” or a “Sale”? , Banking, June 1966, p. 37.
74 1965 Hearings on Consolidation of Bank Supervisory Functions 383.
not lend to another bank, in the form of federal funds, more than ten percent of its capital and surplus. National banks were at that time also disadvantaged in comparison to state member banks, which remain governed by state statutory authority as to lending limitations. Though the Comptroller's ruling freed national banks from most limitations, section 23A of the Federal Reserve Act still limits federal funds transactions between a member bank and its affiliates.

Support can be found for both positions with regard to these transactions. Those in favor of the Comptroller's policy argue that they are specialized transfers between member banks ordinarily within two business days and, as such, do not involve the risks associated with longer loans. Furthermore, since the Board is informed of each transaction, it can move swiftly to protect bank stability should the transactions be used improperly. The American Bankers' Association, on the other hand, supports the Board's view of these transactions as loans subject to existing statutory limitations. The arguments in support of the Comptroller's position outweigh those opposed to it. That the transfer of these funds is generally only for one or two days, at a low fee, and for a limited purpose, shows that, though possibly not a true "sale," such a transfer is "clearly distinguishable" from an ordinary loan. It is an extremely secure transaction with only a negligible effect on the banks involved and should be treated differently from the usual loan. Once again a uniform view is desirable. The divergence of opinion causes confusion and bad feeling between the agencies and could give rise to inequitable competition between national and state member banks. One possible solution, which would at least result in uniformity, would be to place in the Board of Governors exclusive jurisdiction to define, with respect to all member banks, the nature of a transaction in federal funds.

7. Underwriting Revenue Bonds

Possibly the most publicized of the current controversies between the two agencies deals with the underwriting of revenue bonds. Under the terms of the National Bank Act, a national bank is not permitted to underwrite any issue of securities, with an exception that this restriction does not apply to "general obligations of any State or of any political subdivision thereof . . . ." The Federal Reserve Act subjects state member banks to the same limitations with respect to underwriting as are applicable to national banks under the National Bank Act. Problems arise in attempting to determine what constitutes a gen-

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75 Bratter, Should a Federal Funds Transaction Be a "Loan" or a "Sale"?, Banking, June 1966, p. 38.
77 Bratter, Should a Federal Funds Transaction Be a "Loan" or a "Sale"?, Banking, June 1966, p. 38.
78 Ibid.
79 Ibid.
81 Bratter, Should a Federal Funds Transaction Be a "Loan" or a "Sale"?, Banking, June 1966, p. 38.
82 1965 Hearings on Consolidation of Bank Supervisory Functions 189.
eral obligation for the purposes of these acts. Traditionally, it has been held that general obligations are bonds backed by the full faith and credit of a governmental body possessing general powers of taxation, including property taxation, while revenue bonds are obligations issued by a governmental entity that are not supported by general powers of taxation. Such an interpretation raised no problems until after World War II. Though revenue bond financing was almost unknown at the time the prohibition against underwriting was enacted, since the war, reliance by state and local governments on this method of financing, as opposed to general obligations, has increased. This increase eventually reached a level that enabled Comptroller Saxon to assert in 1965 that revenue bonds accounted for almost 40% of state and local government financing; were “invaluable” in helping state and local governments meet financial needs, and were often the only practical way for an overtaxed community to solve its problems on a financial basis that would be sound for both the community and the investor.

Partly because of such changing circumstances, rulings began to come out of the Office of the Comptroller that were inconsistent with past decisions. Thus, national banks were permitted to underwrite certain State of Washington bonds despite the fact that the state legislature had itself provided that they were not to be regarded as general obligations but were to be paid from certain motor vehicle excise taxes. This was allowed chiefly on the grounds of a Washington Supreme Court ruling that such bonds were issued upon the credit of the State and constituted debts of the State.

Despite the opposition of the Federal Reserve Board to the Comptroller’s ruling regarding the Washington bonds, the Comptroller soon afterwards went even further. Acting under the authority of the National Bank Act, in September 1963, he approved the underwriting of revenue bonds by issuing new investment securities regulations that redefine a general obligation to include an obligation backed by the full faith and credit of the obligor even though the obligor is a special authority without taxing power, a definition which frees national banks from most of their underwriting restrictions. In effect, purely revenue bonds can now be equated with general obligations and underwritten without regard to the statutory restrictions.

85 1965 Hearings on Consolidation of Bank Supervisory Functions 352.
90 12 C.F.R. § 208.105 (Supp. 1966). The Board, in addition to citing the Washington statute declaring these bonds not to be general obligations, cited a prior holding of the Comptroller’s Office indicating that securities, to be eligible for underwriting, must be supported by the general taxing power and not merely payable out of a particular source. Ibid.
92 1963 Hearings on Consolidation of Bank Supervisory Functions 352. These regulations provide:

(d) The term “political subdivision of any State” includes a county, city, town or other municipal corporation, a public authority, and generally any publicly owned entity which is an instrumentality of the State or of a municipal corporation.

(e) The phrase “general obligation of any State or of any political subdivision thereof” means an obligation supported by the full faith and credit of the obligor.
The Board has refused to acquiesce in the Comptroller's expanded concept of a general obligation and has affirmed the traditional definition as the controlling limitation on state member banks. Thus, an obligation underwritten by a state member bank must be supported either directly or indirectly by general powers of taxation, including property taxation. A variety of arguments have been put forth in support of the Board's position. Soon after the Comptroller's new regulations were proposed in June 1963, the Board itself wrote the Comptroller that it felt the federal banking laws do not authorize him to expand or contract the coverage of the underwriting powers conferred by the National Bank Act. The Board argued that existing law empowered him only to define "investment securities" and to prescribe "limitations and restrictions," but conferred no regulatory authority as to underwriting securities. The Board bluntly stated that the adoption of the regulations, "whether in the form of regulation or interpretation, would amount to an unauthorized attempt to change or to nullify congressional policy expressed in existing law." Further arguments in support of the Board's position are that the new regulations will create a conflict of interest between traditional bank trust functions and their underwriting functions, an evil against which the 1933 legislation ending securities underwriting by commercial banks was directed, and could very well do harm to the investment banking industry. The Governors' position found support with the Investment Bankers' Association. The underwriting of revenue bonds has also been criticized as imprudent, since many are not of bank investment quality and underwriting them would tend to discredit the entire banking community. Since this kind of underwriting is still speculative, it is argued it should be left in the hands of investment bankers rather than commercial bankers.

The reasons behind the Comptroller's new definition are legion. Noting the increasing reliance on revenue bonds in recent years, Mr. Saxon saw a duty owed to the financially hard-pressed states and municipalities. Believing that there was a lack of money at competitive rates for revenue bonds, he argued that ending restrictions on commercial banks with regard to revenue bond financing would increase the competition in an area presently dominated by investment banking institutions. This would lower the cost of the bonds for the issuers and thereby be of benefit to the public. The Comptroller did not feel that the entrance of commercial banks into this area would prove harmful to investment banks.

It includes an obligation payable from a special fund when the full faith and credit of a State or any political subdivision thereof is obligated for payments into the fund of amounts which will be sufficient to provide for all required payments in connection with the obligation. It implies an obligor possessing resources sufficient to justify faith and credit. 12 C.F.R. §§ 1.3(d)-(e) (Supp. 1966).

Hearings on Increased Flexibility for Financial Institutions Before the House Committee on Banking and Currency, 88th Cong., 1st Sess. 92 (1964) [hereinafter cited as Hearings on Increased Flexibility for Financial Institutions].


Id. at 126; Note, supra note 80, at 668.

Advisory Committee on Banking, National Banks and the Future 28-29 (1962).

Saxon Answers His Critics, Banking, June 1964, p. 132.

99 Hearings on Increased Flexibility for Financial Institutions 58.

100 Id. at 12.

101 Id. at 73.
in underwriting revenue bonds, others pointed out that the fear expressed in the debates on the 1933 amendments is no longer justified. The quality of present-day revenue bonds is often very high, sometimes higher than the quality of a municipality's general obligations, and it is argued that there are enough high-quality revenue bonds to permit commercial banks to participate in their underwriting.102 Also, national banks would be squeezed out of more and more financing of public improvements unless permitted to underwrite such obligations. As to the charge of a possible conflict of interest between the underwriting function and the investment and trust functions of banks on the grounds that banks underwriting securities would have an interest in selling them to depositors and correspondents, which interest would impair the ability of these banks to give disinterested advice, two points have been made. First, the increased knowledge about the issuer and the market that an underwriting bank would obtain would enhance its ability to give accurate investment advice. Second, since the business of providing correspondent services is highly competitive, the threat of losing correspondents and their deposits renders unrealistic the fear that an underwriting bank would recommend inferior securities to a customer merely because it had underwritten them.103 Furthermore, the Comptroller's Regulation 9 expressly forbids the use of fiduciary funds to purchase property or obligations from the bank,104 and this rule is strictly enforced irrespective of the intrinsic quality of the property or obligation involved.105 Finally, during the congressional hearings on consolidating the banking agencies, Comptroller Saxon asserted he could find no statute requiring a general obligation to be issued only by a political unit with general powers of taxation that are used to support the obligations. He argued that bonds adequately supported by substantial resources of a political unit should be eligible for underwriting.106

A settlement of this controversy is required in order to fulfill congressional intent that federally supervised banks be subject to the same rules and to put an end to the competitive disadvantage suffered by state member banks by reason of their exclusion from the revenue bond market, which national banks are permitted to take part in. The desire to improve the situation led the Federal Reserve Board to assert that corrective legislation was imperative and to recommend that Congress reaffirm existing law by adopting the Board's definition of a general obligation.107 Others suggested placing in the Comptroller's

102 ADVISORY COMMITTEE ON BANKING, op. cit. supra note 97, at 27.
106 1965 Hearings on Consolidation of Bank Supervisory Functions 398.

The Board defined general obligations as only obligations that are supported by an unconditional promise to pay, directly or indirectly, an aggregate amount which (together with any other funds available for the purpose) will suffice to discharge, when due, all interest on and principal of such obligations, which promise (1) is made by a governmental entity that possesses general powers of taxation, including property taxation, and (2) pledges or otherwise commits the full faith and credit of said promisor; said term does not include obligations not so supported that are to be repaid only from specified sources such as the income from designated facilities or the proceeds of designated taxes. HEARINGS ON INCREASED FLEXIBILITY FOR FINANCIAL INSTITUTIONS 1018.
Office exclusive jurisdiction over the determination of the types of bonds that can be underwritten by national banks. Such solutions as these, however, may well have become unnecessary in the light of a decision recently handed down by the United States District Court for the District of Columbia. The case in question involved an action brought against Comptroller Saxon by a group of investment bankers seeking an injunction to restrain him from authorizing national banks to underwrite and deal in obligations of states and political subdivisions where the obligations were not secured by the general power of taxation. It therefore involved the precise question of whether the phrase

"general obligations of any State or any political subdivision thereof" is limited to such obligations as are supported by the taxing power, or includes all obligations issued on the full faith and credit of a State or political subdivision, even if they are not sustained by the taxing power.

Recognizing that Congress did not intend the "fortuitous differentiation" whereby national banks are permitted to underwrite securities forbidden to state member banks, i.e., those issued by an entity without general powers of taxation, the court concluded that the origin of the Banking Act of 1933 conclusively demonstrated Congress’ unalterable intent to divorce commercial banks from the business of underwriting and dealing in securities. Congress had not deviated from that position since the passage of the act, allowing an exception only for certain limited types of governmental securities. Since there was no discernible basis for broadening that exception, which at the time of the passage of the act referred to what the Board presently considers a general obligation, and since the original objective of Congress should not be impaired except by later legislation, the court adopted the construction of the term "general obligations" which limited it to "those that are issued by a governmental entity endowed with the general taxing powers, and that are based on the full faith and credit of the issuing entity." The court thus approved the Federal Reserve Board’s position in this controversy. What effect this will have on the dispute remains to be seen.

8. Purchase of Stock of Operations Subsidiaries

Operations subsidiaries are “organizations designed to serve, in effect, as separately-incorporated departments of the bank, performing functions that the bank is empowered to perform directly.” Their ownership has caused yet another conflict between the Office of the Comptroller and the Federal Reserve Board. According to section 24 of the National Bank Act, except as thereafter provided or otherwise permitted by law, nothing contained therein “shall authorize the purchase by the [national banking] association for its own account of any shares of stock of any corporation.” Section 9 of the Federal Reserve

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108 1965 Hearings on Consolidation of Bank Supervisory Functions 189.
110 Id. at 248.
111 Id. at 252.
Act\textsuperscript{114} applies this same prohibition to state member banks. Until fairly recently, the view was generally accepted that banks were prohibited from purchasing \textit{any} corporate stock for their own account except where such purchase was permitted expressly or by clear implication in federal law.\textsuperscript{115}

The Federal Reserve Board has failed to make an exception to the preceding rule with regard to operations subsidiaries and persists in strictly applying it. When specifically faced with this question, the Board confirmed its prior position that the so-called "stock-purchase prohibition" forbids a state member from purchasing \textit{any} shares of corporate stock except as specifically permitted by federal law or as permitted by the concept of incidental powers necessary to carry on the business of banking.\textsuperscript{116} Where Congress desired to permit stock purchases, it made express provision, as in the case of purchasing the stock of Federal Reserve Banks, bank premises subsidiaries, safe deposit companies, and several others. In addition, the "incidental powers" of national banks have been held to include the power to purchase corporate stock where that action was a reasonable step in the collection of defaulted loans contracted in good faith.\textsuperscript{117} Beyond this, however, a bank's stock-purchase power is severely restricted. For the Board felt, as have prior Comptrollers, that the stock-purchase prohibition "was intended generally to prevent the purchase of the stock of corporations, including those created to perform functions that could be performed by the bank itself."\textsuperscript{118} To support its position, the Board noted that the "affiliate system," including a member bank's ownership of other corporations, was such a major banking problem of the 1930's that one objective of the Banking Act of 1933 was to separate national and state member banks as far as possible from affiliates of all kinds, a goal which the stock-purchase prohibition helped to accomplish.\textsuperscript{119} Furthermore, experience had shown the Board that there is a "significantly greater" likelihood of unsound practices, violations of law, and other developments contrary to the public interest where banks operate through subsidiary corporations. These practices result from the inevitable tendency of some banks to regard their subsidiaries as separate enterprises and to conduct the operations of these subsidiaries in a manner unsuitable for part of a banking enterprise, particularly by acting beyond the powers of the parent bank.\textsuperscript{120} Thus, the Board felt it reasonable to infer that Congress, aware of the past abuses of the affiliate system, thought the general welfare "would be benefited by limiting the authority of member banks to conduct their operations through separately-incorporated organizations."\textsuperscript{121}

Comptroller Saxon disagreed with the Board's reasoning as well as its

\begin{thebibliography}{121}
\bibitem{114} 48 Stat. 165 (1933), 12 U.S.C. \textsection 335 (1964).
\bibitem{115} Hackley, \textit{supra} note 66, at 608.
\bibitem{116} 52 \textit{Fed. Reserve Bull.} 1151 (1966). The question of what should be considered among the "incidental powers necessary to carry on the business of banking" has been hotly debated with regard to many of the disputes between these two agencies. For a comparison of opposing views, see Bratter, \textit{Comptroller's Rulings Aid National Banks}, Banking, July 1966, p. 48; 1965 \textit{Hearings on Consolidation of Bank Supervisory Functions} 375-76; Huck, \textit{What Is the Banking Business?}, 21 \textit{Bus. Law} 537 (Jan. 1966).
\bibitem{117} 52 \textit{Fed. Reserve Bull.} 1151 (1966).
\bibitem{118} \textit{Ibid.}
\bibitem{119} \textit{Ibid.} at 1152.
\bibitem{120} \textit{Ibid.}
\bibitem{121} \textit{Ibid.}
\end{thebibliography}
conclusion and adopted the position "that a national bank may directly or indirectly own an affiliated corporation and may carry on by means of such corporation any activity which the bank could legally carry on itself as an incident to the business of banking." He found the authority for allowing national banks to hold stock in these corporations in the provisions of the National Bank Act that endow national banks with such incidental powers as are necessary to carry on the business of banking. A national bank can, in short, purchase the stock of a corporation engaged in a business in which the bank itself can engage; this is such an incidental power. When faced with the stock-purchase prohibition, the Comptroller concluded that it is not a prohibition at all and that Congress could not have intended to generally circumscribe the authority of national banks to acquire and hold stock in any and all corporate subsidiaries. He rejected what he termed the "jaundiced attitude" of those who argued that the likelihood of unsound practice and violation of the law is greater when banks operate through subsidiary corporations and felt it "antediluvian" to contend that there is an inevitable tendency for banks to conduct the operations of their subsidiary corporations in a manner unsuited to the banking business. It was his opinion that care should be taken not to cripple national banks or disrupt their activities by unreasonably strict statutory construction. In his view, the powers of his office are adequate to insure compliance by subsidiaries with restrictions applicable to them and their parent banks.

In support of the Comptroller, it may also be contended that the purpose of the stock-purchase prohibition was simply to prohibit national banks from using their funds for "speculative" investments in corporate stocks and that it was not meant to prohibit stock purchases as a means of implementing the acknowledged powers of national banks, such as the operation of a subsidiary corporation to carry on a business in which a national bank may directly engage. The prohibition excepts not only stock purchases as "hereinafter provided" by Section 5136 of the Revised Statutes (i.e., stock of safe deposit companies) but purchases "otherwise permitted by law," and this exception, it is argued, covers purchases that are properly incident to the banking business as well as purchases of stock expressly sanctioned by specific provisions of federal statutes.

The desirability of his position can be seen in the additional options it would provide for national banks in structuring their businesses. National banks could use such subsidiaries as a means of controlling operation costs, improving effectiveness of supervision, decentralizing management decisions, or separating certain operations of a bank from others. It might also be argued, however, that

122 Bratter, Comptroller's Rulings Aid National Banks, Banking, July 1966, pp. 48-49.
124 For the Comptroller's interesting analysis of the stock-purchase prohibition, see id. at 11459.
125 Id. at 11460.
chases "hereinafter provided" indicates that it was not intended to exempt stock purchases that might otherwise fall within the "incidental" powers provision that appears earlier in that section.¹²⁸

Then, too, legal authorities have often stated that banks are organized to loan money and not to make permanent investments, however advisable such investments appear to the directors. When placed together for comparison, though, the view propounded by Comptroller Saxon in favor of stock purchase seems to be the more valid of the two, both from the legal standpoint and on the basis of policy considerations. The original purpose of the stock-purchase prohibition seems to have been to protect against speculative investment, as opposed to such investments as these. Also, it appears safe to regard the purchase of stock of operations subsidiaries as a necessary incident to the business of banking.

9. Purchase of Domestic Bank Stock

The conflict between the Federal Reserve Board and the Comptroller over the purchase of domestic bank stock is closely related to the one immediately preceding and involves the same stock-purchase prohibition there held applicable to both national and state member banks. Shortly after the enactment of the prohibition in 1933, the Federal Reserve Board ruled that a state member bank is not permitted to purchase the stock of another domestic bank.¹²⁹ Since that time the Board has not changed its position. As recently as last year it reaffirmed its original holding that such acquisitions, whether direct or indirect (as where the stock was purchased by a wholly owned subsidiary of the member bank), are not legally permissible.¹³⁰ It views the legislative history and judicial interpretation of the prohibition as indicating a congressional intent to prohibit both national and state member banks from acquiring for their own account the stock of other banks, either directly or through intermediary corporations. This prohibition applies to any voluntary acquisition of the stock of another bank, whether the consideration be cash or shares in the acquiring bank.¹³¹ The Board also feels that such acquisitions must be forbidden if observance of the federal laws on branching is to be assured. Both the National Bank Act and the Federal Reserve Act prohibit the establishment of branches except under certain conditions. These conditions are designed to permit national banks to operate additional offices only upon the prior approval of the Comptroller,¹³² while state member banks must first obtain the approval of the Board of Governors.¹³³ The argument is that

when one bank owns all or a majority of the stock of another, the offices and resources of the latter are a part of the banking organization owned by, and subject to the control of, the parent bank, despite the existence of separate corporate entities. Consequently, if such acquisition of stock were permissible, member banks could conduct banking operations through

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¹²⁸ Hackley, supra note 126, at 610.
¹²⁹ Id. at 612.
¹³¹ Ibid.
additional offices without obtaining supervisory approval, which would undermine an important regulatory purpose of the Federal statutes relating to multiple-office banking.\(^{134}\)

If one bank were allowed to acquire the stock of another, the former could easily circumvent public policy and accomplish indirectly what could not be accomplished directly, \(i.e.,\) ownership of banking offices in places where it was forbidden for the parent to conduct banking operations.\(^{135}\) For example, since there is no statutory requirement for the Comptroller’s approval of the purchase by a national bank of the stock of another bank, it would theoretically be possible for a national bank in one state to extend its operations to another state by acquiring the stock of a bank in that state, despite the Comptroller’s disapproval of the acquisition. This would be contrary to the traditional assumption that a bank can only have offices within its own state.\(^{136}\) A bank could thus effectively engage in interstate branching contrary to law.

Despite these arguments, the Comptroller has ruled that a national bank, with the approval of the Comptroller of the Currency, may acquire and hold voting stock of another bank directly or through an affiliate or subsidiary, in an amount constituting working control or more, for the purpose of facilitating its banking operations.\(^{137}\)

This ruling is in part based on the belief that the idea of what is properly incidental to banking has been expanded to such an extent that there is “sufficient recognition” that the acquisition by a national bank of the stock of another bank is within the corporate power of the acquiring bank.\(^{138}\) Refusing to rely on this foundation alone, the Comptroller also alleged statutory recognition of the stock-purchase power. Under the Bank Holding Company Act of 1956, a bank holding company is defined to be any company that meets certain conditions.\(^{139}\) “Company” is then defined to include any corporation or association other than a corporation of which the United States or any state owns a majority of the shares and other than any partnership.\(^{140}\) It therefore follows that a bank falls within the definition of “company” and by necessary implication can hold stock in another bank. Another section of the act provides that certain provisions of the act do not apply to shares acquired by a bank that is a bank holding company\(^{141}\) and thus also evidences the right of one bank to hold stock in another. The legislative history and judicial interpretations of the stock-purchase prohibition also influenced the Comptroller but led him to different

\(^{135}\) Ibid.
\(^{136}\) Hackley, supra note 126, at 614-15.
\(^{137}\) Comptroller of the Currency, Manual for National Banks \$ 7375, in 3 CCH Fed. Banking L. Rep. \$ 59877 (1966). For an interesting view of what can happen when a national bank tries to acquire such stock, see the discussion of Chase Manhattan’s attempt to acquire a majority of the stock of the Liberty National Bank and Trust Company of Buffalo in Hackley, supra note 126, at 613-14.
conclusions from those reached by the Federal Reserve Board. He felt they showed the statutory provisions dealing with stock investments to have no relevance to stock acquisitions that do not impair the bank depositor's position and are not for the purpose of investment in speculative, nonbanking business. If the acquisition is effected through an exchange of shares of stock, bank funds will not be expended and the depositor's position is in no way impaired.\textsuperscript{142}

Finally, he did not believe it could be seriously contended that each banking office of a subsidiary bank is a branch of the acquiring bank, thereby possibly causing a violation of branch banking policy. To so hold could very well make illegal all existing bank holding company organizations. If separate corporate existence were to be disregarded in the one-bank acquisition transaction, it would logically follow that it must be disregarded in the typical bank holding company organization. This would lead to the illogical result that the banking offices of each bank in a bank holding company organization would become branch offices of the bank that dominated and controlled the organization and would, therefore, be subject to the restrictions of the state branching laws.\textsuperscript{143} The better view, then, when one bank acquired a majority of the stock of another, was to continue to regard each as a separate corporate entity.

10. Purchase of Foreign Bank Stock

Prior to July 1966, the Federal Reserve Act permitted national banks, subject to the approval of the Federal Reserve Board,\textsuperscript{144} to acquire \textit{indirectly} the stock of a foreign bank through subsidiary Edge Act or "agreement" corporations.\textsuperscript{145} In June 1964, the Comptroller attempted to expand the powers of national banks in this area by ruling that \textit{direct} acquisition of the stock of a foreign bank also involves a lawful exercise of the powers of a national bank. While not objecting to the indirect acquisition of such stock, he felt that direct acquisition is a "useful and practical" alternative to indirect acquisition and would result in more effective supervision, regulation, and examination of national banks involved in foreign banking and financing operations.\textsuperscript{146} Thus, national banks should be permitted to acquire and hold, directly as well as indirectly, stock in foreign banks as a means of conducting overseas operations. Such a
result had been suggested by the Comptroller’s Advisory Committee some two years previously.\textsuperscript{147}

Three weeks after the Comptroller’s ruling, the Federal Reserve Board expressed its disagreement. While recognizing that a member bank is permitted to acquire indirectly the stock of foreign banks through intermediate subsidiaries, it declared that direct acquisition of such stock was not permissible under the law as it then stood. The Board argued, as it had with respect to the other conflicts regarding stock purchase, that

state member banks are made subject by section 9 of the Federal Reserve Act (12 U.S.C. 335) to the same limitations and conditions with respect to the purchasing and holding of stock as are applicable in the case of national banks under section 5136 of the Revised Statutes (12 U.S.C. 24). Under the last-mentioned section, a national bank is prohibited from purchasing for its own account any shares of stock of any corporation except as provided in that section or “otherwise permitted by law.” There is no provision in section 5136 or any other provision of law permitting the purchase by national banks of stock of foreign banks.\textsuperscript{148}

In response to the Board’s statement, the Comptroller issued a press release indicating that his office was aware of the Board’s attitude with regard to this matter but found it without merit. He concluded he could “only assume that the Board was motivated by the desire to bar this office from the proper and essential exercise of its authority over the international operations of national banks.”\textsuperscript{149}

In issuing his ruling, the Comptroller once again relied on the National Bank Act provision that endows national banks with such incidental powers as are necessary to carry on the business of banking; he regarded the purchase of a foreign bank’s stock as such a power.\textsuperscript{150} The stock-purchase prohibition, he again asserted, does not preclude a bank from using corporate instrumentalities in carrying on the business of banking; and the Federal Reserve Act provisions providing for indirect investment in foreign banks are not to be regarded as precluding all other participation in international financial operations. Finally, he maintained that his finding that both direct and indirect stock holdings in foreign banks are proper means of conducting the overseas banking operations of national banks is an appropriate finding for his office to make. It is appropriate because the Office of the Comptroller is charged by the national banking laws with the execution of all federal laws relating to the organization, operation, regulation, and supervision of national banks, including the execution of the National Bank Act provision setting forth the corporate powers of national banks.\textsuperscript{151} It is therefore his responsibility to determine initially what financial operations come within the business of banking.\textsuperscript{152}

\textsuperscript{147} Advisory Committee on Banking, op. cit. supra note 97, at 133.
\textsuperscript{148} 12 C.F.R. § 208.112 (Supp. 1966).
\textsuperscript{149} Bratter, Is Acquisition of Foreign Bank Stock Permissible?, Banking, Sept. 1964, p. 52.
\textsuperscript{150} Id. at 53.
\textsuperscript{152} 1965 Hearings on Consolidation of Bank Supervisory Functions 386-87.
The Federal Reserve Board disagreed strongly with the Comptroller’s interpretation of his powers in this case, a disagreement that had substantial foundation since the Federal Reserve Act gives the Board exclusive authority over foreign and international operations of national banks.\footnote{153} The Comptroller’s position seemed to be another manifestation of his displeasure with a structure that separates the supervision of foreign banking operations from his office, especially since the clearly permissible indirect stock acquisitions were subject to the Board’s approval. Prior to July 1966, then, it might well have been argued that the Comptroller was guilty of disregarding congressional intent to give the Board supervisory jurisdiction over foreign banking operations. On July 1 of that year, however, Congress passed certain amendments to the Bank Holding Company Act of 1956 that may well have solved this problem. One of these amendments provides that a national banking association may apply to the Federal Reserve Board for permission to exercise, upon conditions prescribed by the Board, the power to acquire, directly or indirectly, stock in a bank organized under the law of a foreign country.\footnote{154} Thus, subject to the Board’s conditions, national banks are now statutorily permitted to acquire directly stock in foreign banks. It remains to be seen whether the Comptroller will acquiesce in the delegation to the Board of the responsibility for establishing the regulations for such acquisitions.

11. Bank Service Corporations

A bank service corporation is defined in the Bank Service Corporation Act\footnote{154A} as “a corporation organized to perform bank services for two or more banks, each of which owns part of the capital stock of such corporation, and at least one of which is subject to examination by a Federal supervisory agency.”\footnote{155} According to the act, any two or more banks are permitted to invest not more than ten percent of the paid-in and unimpaired capital and unimpaired surplus of each of them in such a bank service corporation.\footnote{156} This act was passed to fulfill a need acknowledged by all three banking supervisory agencies and clearly brought out at the hearings prior to its enactment. There, Chairman Martin of the Federal Reserve Board pointed out the great amount of data processing which modern banking entails and the corresponding need for efficiency possible only through automation. Because of the expense of automation, however, it is only available to the larger banks or to those banks having contracts with data-processing centers. Comptroller Saxon cited the high cost of automated equipment as a reason why many smaller banks desire to merge with larger ones.\footnote{157} In order to compete effectively with the larger banks, it is necessary for the smaller ones to do away with their old equipment.
techniques. This would be impossible in many cases without the availability of the bank service corporation.

It was in light of these circumstances that the bill was enacted. The conflict between the two agencies that has arisen over it is essentially one of policy, as opposed to a conflict of jurisdiction, and centers around section 5(a). That section provides:

No bank subject to examination by a Federal supervisory agency may cause to be performed, by contract or otherwise, any bank services for itself, whether on or off its premises, unless assurances satisfactory to the agency prescribed in subsection (b) of this section are furnished to such agency by both the bank and the party performing such services that the performance thereof will be subject to regulation and examination by such agency to the same extent as if such services were being performed by the bank itself on its own premises.\textsuperscript{158}

These assurances, depending upon the type of bank involved, are to be given to the Comptroller of the Currency, the Federal Reserve Board, or the Board of Directors of the FDIC.

This assurance provision was strongly opposed by the Comptroller at the hearings on the bill. It was his desire to have Congress deal with the problem of automation in the simplest way possible and not with a series of burdensome amendments. He felt that the proposed bill with the assurances provision carried "excessive regulation not needed for the purpose sought to be accomplished here, although that purpose we believe is desirable. . . . We do not believe that the amount of regulation sought can reasonably be justified."\textsuperscript{159} The Comptroller believed that his office already had enough power to prevent any abuses arising out of the bill, including the divulgence of confidential information, an abuse feared by the FDIC because these service corporations would be handling the data of several banks. He finally charged that the assurances provision would give his office control over even nonbanking corporations, which would tend to prevent corporations from making their services available to banks.\textsuperscript{160}

The FDIC had originally provided the impetus for the assurances provision. Arguing that the investments of banks would make up a large part of the capital of service corporations and that these corporations would handle confidential information of several banks, it felt that the supervisory agency should be in a position of immediate control in the event of the violation of any regulations.\textsuperscript{161} The Federal Reserve Board also favored enactment of the bill with the assurances provision. The Board felt that the provision did nothing more than make certain that there would be no "evasion of the necessary examination and supervisory powers by the simple expedient of transferring or farming out those functions to some other organization . . . ."\textsuperscript{162}

\textsuperscript{159} 1962 Hearing on Miscellaneous Bank Bills 40.
\textsuperscript{160} Id. at 53.
\textsuperscript{162} 1962 Hearing on Miscellaneous Bank Bills 63.
The substantial agreement between the Federal Reserve Board and the FDIC was manifested after the passage of the bill, when they issued basically the same regulations as to the form and time of submitting the assurances and as to dispensing with the assurances in case of emergency. The Comptroller, however, issued no formal regulations on the subject. At the present time, he requires that

when a national bank invests in a bank service corporation, the bank must obtain from said corporation a letter recognizing the right of the Comptroller to examine and regulate its activities. In the instance where a bank contracts for the performance of such services, rather than invests in a bank service corporation, the bank must obtain this letter from the supplier of said service.

Though the difference in requirements is not of great import, it is another instance of the inability of the Office of the Comptroller and the Federal Reserve Board to achieve agreement.

12. Window Dressing

Under federal law, all federally supervised banks are required to make four reports of condition annually upon dates selected by the Chairman of the Board of Directors of the FDIC, the Comptroller of the Currency, and the Chairman of the Board of Governors of the Federal Reserve System, or a majority thereof. In recent years, two of these reports have consistently been demanded as of the last business days in June and December while the other two have been demanded as of "surprise" dates. That two of the "call" dates are, in effect, predetermined has been asserted as the cause of "window dressing" in the bank reports, i.e., the "use of temporary non-business-purpose transactions to enable a bank to state a more favorable financial showing at a particular time than would normally be the case." Such window dressing not only enables a bank to display to the public a condition report presenting the bank more favorably than its normal condition warrants, but also can be used to hide the indebtedness of a bank. In an attempt to curtail the spreading practice of window dressing, in 1962 Comptroller Saxon was able to obtain a "surprise" report as of

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166 Hackley, supra note 126, at 630. A "surprise" call is issued by a bank supervisor to all banks under its supervision for a report as of a prior date. Unless the bank can anticipate the date of the call, the surprise call results in an accurate report of its normal condition. Hearing on "Window Dressing" in Bank Reports Before a Subcommittee of the House Committee on Government Operations, 89th Cong., 1st Sess. 3 (1963) [hereinafter cited as Hearing on "Window Dressing" in Bank Reports].

167 Gerber, Current Legal and Regulatory Developments, 1 NATIONAL BANKING REV. 425, 428 (1964). Some such transactions are the round robin exchange of interbank deposits; short-term reductions in borrowings; arrangements with large depositors to increase deposits temporarily; delayed processing of items presented for collection or of interoffice clearings in a branch system; very short-term loans to cooperating customers, the proceeds of which are credited to the customers' accounts on the statement date and repaid immediately afterwards. Hearing on "Window Dressing" in Bank Reports 7.
December 28 rather than as of December 31, the customary date. The results showed clearly how extensive the practice had become.\footnote{168} Since 1962, the other federal agencies have successfully restrained the Comptroller’s subsequent efforts to increase the number of surprise calls, and it is here that the basis of the conflict is found. The Comptroller regards the call reports as valuable supervisory tools, which provide his office with information necessary to assess the effect of regulatory policies on decisions of national banks and are helpful in deciding new policies and proposing new legislation.\footnote{169} It is the Comptroller’s opinion that “the legislative history of the call report laws clearly indicates a design to employ these reports as a supervisory device and on a surprise basis.”\footnote{170} This design is not being implemented because of the pre-determination of the June and December reporting dates, a default from sound supervision that has brought about and perpetuated the practice of window dressing.

The Federal Reserve Board disagrees with the fundamental basis of the Comptroller’s thesis, for it minimizes the significance of call reports. At the 1963 congressional hearings on window dressing, Governor Robertson emphasized that call reports originated at a time when the only depositors in commercial banks were people of substance and when there was no deposit insurance. Most bank customers at that time probably did read call reports to decide if a bank was safe. Today, on the other hand, few people rely on the reports because of the protection afforded by federal deposit insurance, and those who are interested in the condition of a bank are generally not fooled by window dressing but make allowances for it.\footnote{171} More importantly, however, the Board does not regard the call report as a significant supervisory instrument (for this purpose it looks to the bank examination report). Instead, it sees the condition report as serving one important purpose, one that hardly existed at the turn of the century. That purpose is to serve as the primary source of statistics for the banking industry. “In economic analysis and planning and particularly the formulation of monetary policy, reliable bank statistics are a principal tool.”\footnote{172} For this use, standardization of reporting dates is of great value. The Board argues that, if the dates are varied, even its own statisticians could not accurately measure movements in such basic items as deposits. Also, the accuracy of the actual data reported would be better under fixed-date reporting than under surprise calls. Since it is difficult for a bank to give an accurate condition report retroactively, most banks make estimates, which result in a margin of error. With fixed-date reporting, banks can arrange for accurate figures in advance.\footnote{173} This need for precisely comparable information from year to year in order to facilitate the formulation of monetary policy is held to outweigh any evils that might be caused by window dressing. The Comptroller, however, asserts that

\footnotesize{\begin{itemize}
  \item \footnote{169} Hearing on “Window Dressing” in Bank Reports 21.
  \item \footnote{170} Bratter, Call Dates and “Window Dressing,” Banking, Aug. 1963, p. 50.
  \item \footnote{171} Hearing on “Window Dressing” in Bank Reports 3-4.
  \item \footnote{172} Id. at 4.
  \item \footnote{173} Ibid.
\end{itemize}}
this need is not being met because of the impossibility of compensating for window dressing brought about by predetermined call dates.

The Board's attitude should not be interpreted as condoning window dressing. On the contrary, it agrees that the practice is undesirable and that every reasonable effort should be made to do away with it. For to the degree these efforts [at window dressing] succeed, they result in deceiving the public. And, to the degree they are recognized and discounted, they result in raising doubts as to the reliability of bank statements and of bankers' statements.174

It is also inequitable for one bank to publicize itself as larger than another when it actually is not. However, the Comptroller's surprise-call panacea does not appear to the Board to be the answer. For one thing, banks can publish additional condition reports whenever they desire. These highly publicized "dressed" reports would be much more likely to come to the attention of the public than the required call reports. The problem cannot be solved by governmental fiat without an excessive degree of regulation and control. Instead, the Board would rely on a program of "moral suasion" to curb the abuse, which would involve an attempt by the various federal agencies to convince bankers that the practice is "morally unworthy" and injurious to the public confidence.175 If the various agencies cooperated in requesting an end to window dressing, Governor Robertson feels that there would be an excellent chance of success. He indicates that there has never been a time when the different agencies showed "determined interest" in solving the same problem at the same time. If this were done, the resulting moral suasion would solve the problem.176 Cooperation is absolutely necessary, though, since without it, one class of banks could obtain a competitive advantage over the others; and once one bank began to window dress others would follow suit.

It has been suggested, however, and probably correctly, that the problem of window dressing is too great to be solved by moral suasion. Though the banking industry regards the practice as undesirable, it is impractical to expect bankers themselves to stamp it out. For almost inevitably some will continue to dress their reports, and the competitive advantage accruing will induce others

175 Hearing on "Window Dressing" in Bank Reports 7.
176 Id. at 8-9. The House Committee on Government Operations has also recommended a program of moral suasion. But in its report to the 88th Congress, it also made additional suggestions. The Committee recommended that the Federal bank supervisory agencies adopt uniform rules or regulations under which, commencing with the second call date in 1964: (a) Every bank shall be required (1) to include in every required and voluntary report and statement of condition a certification that no window dressing is contained therein, and (2) to file with its Federal supervisory agency as many copies of such reports and statements as such agency shall require. (b) Any supervisory agency which finds through bank examination or otherwise that contrary to such certification a bank has engaged in window dressing shall give public notice of its findings by publication of the name of the bank, the extent of the window dressing and other details thereof in the Federal Register and by press release; and shall refer the matter to the Attorney-General for possible prosecution under the false statements statutes. Gerber, Current Legal and Regulatory Developments, 1 NATIONAL BANKING REV. 425, 428 (1964).
to do likewise. Perhaps a better solution can be found in the suggestion of the Comptroller's Advisory Committee. The Committee proposed that condition reports be required only twice per year, as of the fixed dates of June 30 and December 31, but that the reports be revised to require the publication of average daily net deposits, loans, and investments for the preceding semiannual period. By this means, it is hoped to render the practice of calling on odd dates unnecessary, since the efforts at window dressing would be ineffective due to the use of figures.

13. Unsubordinated Promissory Notes

The use of the short-term promissory note as a means of obtaining additional funds for lending and other banking purposes was introduced by the First National Bank of Boston in September 1964 and was soon adopted by several other large banks. This new method of financing banking operations was supported by the Comptroller, who regarded the use of the instrument as within the corporate powers of a national bank and as a method of giving national banks “maximum access to one of the normal financing tools of the money market.” It was in 1963 that the present conflict in this area arose. In that year, the Comptroller, recognizing that this type of note, unlike capital notes and debentures, is not subordinated to the rights of depositors and other general creditors, ruled that the amount that banks could borrow by means of such a note is limited by the borrowing provisions of the National Bank Act. These provisions were to be an effective preventive against misuse of the new device. But freedom from the artificial restraints of the reserve requirements and interest rate ceilings of the Federal Reserve Board is vital to the effective use of the notes. The Comptroller therefore concluded that

of 12 U.S.C. 461, 462, and 1813 relating to reserves, interest limitations, of 12 U.S.C. 82, they cannot be considered deposits. Therefore, the ceiling on the payment of interest contained in Regulation Q, and the requirement for the maintenance of reserves contained in Regulation D, are inapplicable...

Although the use of the new instrument met with a cool reaction in some Federal Reserve circles, with Governor Robertson regarding this type of note as a “gimmick” that should be treated like the deposit it was, the Comptroller's decision was accepted by the Board. It agreed that

since such notes constitute borrowings, they are not subject, under present

177 Advisory Committee on Banking, National Banks and the Future 153 (1962).
178 Comptroller Saxon did recommend legislation similar to the Committee's suggestion while he was in office. Bratter, Call Dates and "Window Dressing," Banking, Aug. 1965, p. 50.
179 Bratter, Should Banks Be Allowed To Issue Promissory Notes?, Banking, Nov. 1963, p. 49.
180 Bratter, Should Bank Promissory Notes Be Subject to Regulations Q and D?, Banking, Dec. 1965, p. 52.
181 Bratter, Should Banks Be Allowed To Issue Promissory Notes?, Banking, Nov. 1965, p. 49.
182 Id. at 128.
183 Robertson, Meeting Changing Banking Problems Before a Crisis, 201 The Commercial and Financial Chronicle 752 (1965).
law and regulation, to the interest rate limitations or reserve requirements prescribed for deposits by the Board.

... . Borrowings of this type would, of course, be ... added to all other borrowings in the application of statutory or other limitations on the total amount of debt a bank may incur.\textsuperscript{184}

Problems arose in 1965, when the Comptroller partially reversed his prior position on the subject. He ruled that such promissory notes, issued in the regular course of business to obtain working funds for use in making loans and the performance of ordinary banking functions, represent liabilities of the nature \textit{excepted} from the provisions of 12 U.S.C. Such notes may, therefore, be issued \textit{without regard} to the limitations on indebtedness contained in that section.\textsuperscript{185} (Emphasis added.)

But, notwithstanding the provisions of Regulation Q and D issued by the Federal Reserve Board, it is the position of the Comptroller of the Currency that the proceeds of such notes do \textit{not} constitute deposits and that the provisions of 12 U.S.C. 461, 462, and 1813 relating to reserves, interest limitations, and deposit insurance are \textit{not} applicable.\textsuperscript{186} (Emphasis added.)

Thus, though the Comptroller did not change his position that these notes do not constitute deposits, he no longer regarded them as borrowings subject to the statutory borrowing limitations. At the same time, it seems clear that these notes do not fall within any of the expressly enumerated exceptions to the indebtedness limitation.\textsuperscript{187} The Comptroller's view that these notes are neither deposits nor borrowings seems logically indefensible.

As already noted, Governor Robertson regarded the promissory note as a "gimmick." Others pointed out that the unsecured note served a purpose identical to that of the certificate of deposit and appeared to be used to avoid compliance with the reserve requirements and interest rate ceilings of deposits while retaining the benefits afforded by them.\textsuperscript{188} To some this seemed much like the payment of interest on demand deposits (because of their short term and the occasional agreements whereby creditors could get their money back before maturity), which Congress had voted to abolish in 1933.\textsuperscript{189} Such attitudes led to the idea that, if the volume of promissory notes increased substantially, the Board might change its definition of deposits to include them, thereby rendering applicable the reserve requirements and interest rate ceilings. Such an idea was well founded, for in July 1965, under its authority to prevent evasions of section

\begin{footnotes}
\item[184] Bratter, \textit{Should Banks Be Allowed To Issue Promissory Notes?}, Banking, Nov. 1965, p. 128.
\item[186] Ibid.
\item[187] 1965 Hearings on Consolidation of Bank Supervisory Functions 409.
\item[188] Bratter, \textit{Should Banks Be Allowed To Issue Promissory Notes?}, Banking, Nov. 1965, p. 129.
\item[189] Id. at 130.
\end{footnotes}
19 of the Federal Reserve Act, the Board did take this action. Despite the opposition of the Comptroller to this regulation, in light of the use of these notes to evade regulations and the Board's authority to prevent such evasion, and in the light of the weaknesses in the Comptroller's position, the Board can be judged to have acted both wisely and properly.

14. Securities Disclosure Regulations

Although the majority of federal jurisdictional disputes we have seen deal with variant interpretations of a bank's external powers, the internal corporate structure also feels the effects of these conflicts. Disagreement regarding this area followed the 1964 amendments to the Securities and Exchange Act of 1934. The purpose of the amendments is to provide stockholders and prospective stockholders of companies selling securities over the counter with information about the companies. Companies having assets of at least 1 million dollars and at least 500 stockholders are subject to the act. According to an estimate of the Securities and Exchange Commission, some 600 United States banks representing 36% of all bank securities are brought under the act by the new provisions.

The amendments require public disclosure of information concerning the company's financial status, proxy solicitations, and insider trading. The amendments, however, contain a special provision regarding the regulation of bank securities. The regulation of bank securities is taken out of the hands of the SEC and instead is divided among the three federal bank supervisory agencies. The law provides that these agencies may develop their own rules and regulations for implementing the provisions of the act. The regulations adopted by the Federal Reserve and the Federal Deposit Insurance Corporation, pursuant to the new law, are virtually identical. They both outline specific regulations

191 The Board ruled:

(i) Deposits as including certain promissory notes. For the purposes of this part, the term "deposits" shall be deemed to include any promissory note, acknowledgment of advance, due bill, or similar instrument that is issued by a member bank principally as a means of obtaining funds to be used in its banking business, except any such instrument (1) that is issued to another bank, (2) that evidences an indebtedness arising from a transfer of assets that the bank is obligated to repurchase, or (3) that has an original maturity of more than 2 years and states expressly that it is subordinated to the claims of depositors. 31 Fed. Reg. 9103 (1966), amending 12 C.F.R. §§ 204.1, 217.1 (1963).


197 For a good analysis of the reasons behind the extension of the disclosure provisions to such over the counter issuers see the remarks of SEC commissioner Manuel F. Cohen, 109 Cong. Rec. 9310-13 (1963).

198 National banks are under the Comptroller, state member banks are under the Federal Reserve Board, and state nonmember insured banks must answer to the FDIC. 78 Stat. 569, 15 U.S.C. § 78l(i) (1964).

199 Ibid.
concerning the submission of financial statements and periodic reports. Rules have also been adopted with respect to proxy solicitations and insider trading.200 The Board and the FDIC appear to have made an effort to conform their regulations to those applied by the Securities and Exchange Commission to non-banking corporations.201

As might be expected, the regulations adopted by the Comptroller are somewhat less stringent. They deal briefly with stockholders reports, proxy solicitations, and ownership reports.202 They also require that registration statements and offering circulars be filed with his office.203 This filing regulation is the only one that is purported to be issued under the Securities Acts Amendments of 1964.204

The lenient regulations of the Comptroller were attacked by the House Committee on Banking and Currency as being "contrary to the intent of Congress as expressed in the Securities Acts Amendments of 1964" . . . .205 In rebuttal, Mr. Saxon took the position that the act recognizes the need for variance in security regulation when these regulations are to be applied to banks rather than to other types of business. It seems to be the view of the Comptroller that disclosure to investors may be of first importance where an ordinary corporation is involved, but in the case of a commercial bank the protection of investors is not as important as the protection of depositors. He also asserts that the Comptroller has the power to act independently of the other regulatory agencies in this area.206

Despite the validity of the Comptroller's opinion, it must be assumed that a purpose of the act is to provide the investing public with an informational common denominator from which they can make intelligent investment decisions.207

To the extent that regulations of the Comptroller differ from those of the Federal Reserve and FDIC, meaningful comparisons between the securities of different banks are difficult if not impossible, and consequently the purposes of the legislation have been defeated.208

Investors are certainly not the only parties affected in this conflict. It can be argued that the more strict regulations of the Federal Reserve Board and FDIC give national banks another competitive advantage over state insured banks and state member banks. The magnitude of the advantage is attested to by the conversion of the largest state member bank in Missouri to a national

201 There is one notable difference from the corresponding SEC rules in the Federal Reserve Board's Regulation F, however. The Board's regulation omits the SEC requirement that proposals submitted by corporate stockholders be included by bank management in proxy solicitations. See note, 41 N.Y.U.L. Rev. 451 (1966).
204 Ibid.
205 1965 Hearings on Consolidation of Bank Supervisory Functions 290.
206 Ibid. at 388.
charter, based in part on the bank's wishing to avoid the stringent disclosure regulations contemplated by the Federal Reserve Board. 208

All of the problems created by the new disclosure requirements cannot be traced to the jurisdictional conflict. Of more practical concern to the banks is the fact that the financial statements that they must submit under the various regulations are quite different from those required for the call reports. "Thus the banks are in a position of having to supply two materially different sets of financial statements as of the same date to the same federal agency to become a matter of public record." 209 This would appear to be an unnecessary burden on the banks, which burden might be eliminated if the forms required by the disclosure regulations and the call reports could follow the same format. 210

15. Absorption of Exchange Charges

Generally, relations between the Federal Reserve Board and the Federal Deposit Insurance Corporation have been harmonious. They do, however, share a disagreement, begun in 1934, that continues to trouble the banking industry. This conflict concerns the absorption of exchange charges.

An exchange charge is a fee exacted by some banks for the payment of checks drawn on them and presented through the mails. The payee bank is charged by the drawee bank. This charge could be passed on to the payee; but at this stage, a payee bank or its correspondent usually absorbs the charge. 211 The payee is thus credited with a greater amount than was actually collected by his bank from the drawee bank.

It is the contention of the Federal Reserve Board that this absorption of exchange charges is in fact an indirect payment of interest on the payee's deposit in violation of section 19 of the Federal Reserve Act, which forbids the direct or indirect payment of interest on demand deposits. 214

Banks supervised by the FDIC are bound by a similar statutory prohibition against the payment of interest on demand deposits. 215 However, the FDIC has taken the position that

the absorption of exchange charges by an insured nonmember bank in connection with its routine collection for its depositors of checks drawn

208  American Banker, Nov. 19, 1964, p. 1, col. 4, at 2, col. 1. It should be noted, however, that the regulations of the Federal Reserve Board did not become effective until Jan. 1, 1965, and that before the regulations were adopted a flurry of excitement was caused when it was rumored that the regulations of both the Federal Reserve Board and the FDIC would include the requirement of certified financial statements. 21 Bus. Law. 427 (1965).
210  Id. at 44.
211  Exchange charges are seldom absorbed by a bank for its individual customers, however. In the typical case the charge is absorbed by a city correspondent bank for a country bank, which maintains a compensating balance with the city correspondent. Hackley, Absorption of Bank Exchange Charges as a Payment of Interest, 40 Va. L. Rev. 603, 613 (1944).
212  The old meaning of "exchange charge" was more literal. It referred to the actual expense incurred by a bank in transferring funds or credit. The amount of the charge reflected the difference between the value of money in two different areas resulting from fluctuations in the supply and demand for money in those areas. See Spaehr, The Clearing and Collection of Checks 102 (1926).
on other banks cannot be considered a payment of interest, within the terms of the interest regulation of the Federal Deposit Insurance Corporation, in the absence of facts or circumstances establishing that the practice is resorted to as a device for the payment of interest.\textsuperscript{216}

It is significant to note that both the FDIC and the Federal Reserve agree as to the soundness of the usual judicial definition of interest, which is: "any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit."\textsuperscript{217} It is only when the agencies must apply this definition to the absorption of exchange charges that their views fail to coincide.

An attempt was made in 1943 to resolve the conflict when the Brown-Maybank Bill\textsuperscript{218} was introduced into Congress. The bill amended the existing legislation that governed the payment of interest by state member banks. It provided that the existing law "shall not be deemed to prohibit the absorption of exchange or collection charges by member banks."\textsuperscript{219} The bill won the approval of the House in 1944,\textsuperscript{220} but it met defeat in the Senate.\textsuperscript{221} Since that time Congress has repeatedly been requested to settle the dispute,\textsuperscript{222} but as yet no congressional action has been taken.\textsuperscript{223} Thus as the situation stands at present, insured nonmember state banks may solicit deposits by agreeing to absorb exchange charges, while a state member bank may not.

B. Competitive Effects of the Conflicts Between the Federal Regulatory Agencies — National Banks v. State Member Banks

As is manifest in the preceding discussion, these controversies among the federal supervisory agencies and their series of conflicting rulings have not been without effect upon the regulated banks. The federal laws were intended to be applied in an equal manner to all three classes of federally regulated banks: national, state member, and nonmember insured state banks. However, the rulings that the Comptroller has issued in order to regulate the operations of national banks pursuant to this legislation have been based upon more liberal readings of the controlling statutes than have been the rulings published by the Federal Reserve Board and the FDIC, and applied to their member banks. Consequently, the Comptroller's regulations have placed national banks in a more advantageous position in their competition with state banks.

\textsuperscript{216} Hearings on H.R. 3956 Before the House Committee on Banking and Currency, 78th Cong., 2d. Sess. 117 (1944).
\textsuperscript{217} Regulation Q, 12 C.F.R. § 217.2(a) (1963) (Federal Reserve); 12 C.F.R. § 329.2(a) (1963) (FDIC).
\textsuperscript{218} H.R. 3956, 78th Cong., 2d Sess. (1944).
\textsuperscript{219} Ibid.
\textsuperscript{220} 90 CONG. REc. 2170 (1944).
\textsuperscript{221} Id. at 2190.
\textsuperscript{222} Senate Banking and Currency Committee, 84th Cong., 2d Sess., Study of Banking Laws 200 (Comm. Print 1956).
\textsuperscript{223} In 1965 the Federal Reserve Board made the following recommendations: That legislation be enacted that would "require all insured banks to pay at 'par' all checks drawn upon them — that is, without deduction of an exchange charge." If such legislation is not enacted then the Board recommended in the alternative that "provisions of the Federal Reserve Act and the Federal Deposit Insurance Act with respect to the payment of interest on deposits by member and nonmember insured banks be amended to state expressly that absorption of exchange charges by such banks constitutes a payment of interest for the purposes of such provision." 52d ANN. REP. OF THE BD. OF GOVERNORS OF THE FED. RESERVE SYS. 240, 241 (1966).
By allowing national banks to include capital notes, capital debentures, and undivided profits in the computation of "capital and surplus" for the purpose of computing loan restrictions and reserve requirements, while state banks are not permitted to do so, the Comptroller has conferred a definite benefit on the national banks. Likewise, the classification of federal funds transactions as neither loans nor borrowings permits national banks to circumvent restrictions on the lending and borrowing powers of banks that do apply to state banks that are under the regulation of the Federal Reserve Board. The purchase of the stock of subsidiary corporations will allow national banks to expand their operations and to provide more flexibility in their organizational structure. The power to acquire stocks of domestic banks with the Comptroller's approval provides national banks with investment opportunities not available to state banks that are under the Federal Reserve Board's control. In sum, national banks now possess a definite edge in their competitive struggle with state banks for the banking business in this country.

Not all of the disputes between the Comptroller, the Federal Reserve, and the FDIC have significantly benefitted national banks in their contest with state banks. Some of the disputes, as the controversies over "window-dressing," assurances from bank service corporations, purchases of stock of foreign banks, and the definition of "executive officer," are rather inconsequential in their effect upon the competitive balance between the national and state banking systems. Other of the Comptroller's regulations that, if fully implemented, would have added significantly to the national banks' edge over state banks have not become generally operative. Underwriting revenue bonds, accepting corporate savings deposits, and issuing unsubordinated promissory notes would have afforded national banks even stronger weapons in their economic rivalry with state banks; but, fortunately for state banking interests, such activities have been stymied by the Federal Reserve Board.

Overall, the effectiveness of the Comptroller's policies has been seriously hampered by the questionableness of his authority in many of these matters. The major portion of the blame for the doubtful legality of his authorizations lies in the confused jurisdictional boundaries existing among the three federal banking supervisory agencies. Because of the uncertain status of these rulings, many national banks have been justifiably reluctant to implement them for fear of violating conflicting regulations of the other agencies. Thus, the competitive advantages that national banks now enjoy are not yet being exercised to their fullest potentialities. Before this competitive inequality becomes even greater, steps should be taken by Congress to ensure coordination between the federal supervisory agencies and to provide for equal application of federal laws to all federally regulated banks.
III CONFLICTS WITHIN THE DUAL BANKING SYSTEM — NATIONAL BANKS v. STATE BANKS

A. Comptroller of the Currency v. the Dual Banking System

1. Introduction

The application of more liberal interpretations of federal laws and regulations to national banks, which has resulted in the above-mentioned conflicts among the federal supervisory agencies, has benefited the national banks. In addition, national banks have been aided in their competition with state banks by rulings and directives from the Comptroller’s Office that have resulted in increased national banking powers. In areas of supervision clearly within the scope of the Comptroller’s authority over national banks, he has pursued a policy that adopts the most expansive view of national banking powers permissible under the federal statutes. He has achieved some degree of success in his attempt to instill more flexibility and energy in the national banking system by means of construing the statutory language in the manner most favorable to the national banks, arguing strongly on the basis of alleged congressional intent, and relying heavily upon the “implied powers” of national banks.

The goal of the Comptroller appears to be a reform of the entire banking industry which he is attempting to implement through the leadership of the national banking system. In his view, it is the obligation of the banking industry to be responsive to the needs of the economy and to provide the full range of banking facilities and services necessary for continued economic growth. Such a view inevitably leads to conflicts with some of the established traditions in the banking industry; but apparently, the Comptroller feels that this is a small price that must be paid if he is to provide the banking industry with the resources and responses necessary to meet the growing needs of the economy.

Undeterred by charges that he has exceeded his statutory authority, that his orders permit national banks to violate statutory restrictions, and that his actions have seriously threatened the continued existence of the dual banking system, the Comptroller has single-handedly pressed his campaign to enlarge the powers of national banks. The following are but a few of the many areas in which the Comptroller has expanded the scope of permissible activities for national banks.

2. Purchase of the Stock of Travel Agencies and Mortgage Service Corporations

In an attempt to provide greater organizational flexibility for national banks, the Comptroller has promulgated a ruling that authorizes national banks to purchase the stock of travel agencies and mortgage service corporations. See text accompanying footnotes 1-223.

225 See text accompanying footnotes 1-223.

A national bank may engage in activities which are a part of the business of banking or incidental thereto through a department of the bank or through a subsidiary corporation, the controlling stock of which is owned by the bank. For example, through a bank department or a subsidiary corporation, a national bank may issue credit cards, service mortgages, lease property, offer travel services, or operate a credit bureau.
This authorization has been challenged on the grounds not only that this power is not granted by law, but that it is prohibited by the seventh paragraph of 12 U.S.C. § 24, which severely restricts the purchase of corporate stock by a national bank. The Comptroller's response was that neither the provisions contained in that paragraph nor their purpose or legislative history prohibits, or in any way limits, the judicially recognized right of a national bank to exercise all such powers as are incidental to the business of banking, including the power to carry on certain activities which are a part of the business of banking through a subsidiary corporation.

He argued that servicing mortgage loans has "long been recognized as an essential part of the business of banking" and that providing travel services is the natural and necessary complement of long-standing banking services such as the issuance of travelers' letters of credit and travelers' checks, the making of loans to finance the costs of travel, the provision of custody accounts and safe deposit facilities, and the entire range of bank credits employed in international trade and investment.

The Comptroller attempted to justify his position by claiming that these travel and mortgage services are within the incidental powers of national banks. As incidental powers they may be exercised either directly through a department of the bank or "indirectly through a subsidiary corporation, the stock of which is owned by the bank."

In rebuttal, the House Banking Committee pointed to the often repeated holding that the "measure of powers of national banks is the statutory grant and powers not conferred by Congress are denied." The Comptroller's reliance on the "incidental powers" provision of section 24 in order to justify his authorization permitting national banks to purchase the stock of travel agencies.

and mortgage service corporations ignored another provision in that same paragraph. This provision states that "nothing contained herein shall authorize the purchase of the association for its own account of any shares of any corporation." The stand taken by the Comptroller becomes even more untenable when one considers that the power of national banks to purchase the stock of a safe deposit business is the result of express statutory authorization. If this power had already been within the incidental powers of the banking business, then according to the Comptroller's reasoning, no such specific authorization would have been necessary. Clearly, by making this specific exception to the general rule prohibiting stock purchases by national banks, Congress has demonstrated that it does not consider stock purchases to be among the incidental powers of the banking industry. The major exception to this general prohibition on the purchase of corporate stock that has been recognized by the courts, although not specially granted by statute, has been the ability of national banks to invest temporarily in other corporations for the purpose of diminishing or avoiding losses on outstanding loans to those corporations when such loss appears imminent.

In relying on the "incidental powers" provision of section 24 to the exclusion of the remaining provisions of that section, the Comptroller has violated a fundamental rule of statutory construction that specifies that when general and specific provisions are contained in the same statute, the specific provisions limit the general ones. The virtual absence of any judicial precedents supporting the Comptroller's expansive interpretation of the "incidental powers" clause in 12 U.S.C. § 24 (Seventh) strongly suggests that his viewpoint is fallacious. Regardless of the rationality or economic desirability of the Comptroller's position, it appears that his authorization of these corporate stock purchases is at variance with the clear meaning of the controlling legislation.

3. Provision of Insurance Services

In another easing of restrictions by the Comptroller, national banks have been given the authorization to act as insurance agents in communities of less than 5,000 population, irrespective of the size of the community in which the bank's home office is located, to act as agents in the sale of insurance incidental

233 Ibid.
234 Provided, That in carrying on the business commonly known as the safe-deposit business the association shall not invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15 per centum of the capital stock of the association actually paid in and unimpaired and 15 per centum of its unimpaired surplus. Id.
235 First Nat'l Bank v. National Exchange Bank, 92 U.S. 122 (1875); Birdsell Mfg. v. Anderson, 104 F.2d 340 (6th Cir. 1939) (recognizing the power to purchase and conduct a business for the purpose of avoiding a loss); Atherton v. Anderson, 86 F.2d 518 (1936), rev'd on other grounds, 292 U.S. 643 (1937); Norton Grocery Co. v. People's Nat'l Bank, 151 Va. 195, 144 S.E. 501 (1928) (bank may pledge its credit to save an imminent loss under a lawful contract); Commonwealth Trust Co. v. First-Second Nat'l Bank, 260 Pa. 223, 233, 103 Atl. 598, 600 (1918) (dictum).
to bank transactions, without regard to the community population;\textsuperscript{238} and to underwrite credit life insurance policies.\textsuperscript{239}

The ruling that any office of a national bank may act as an agent for any fire, life, or other insurance company if that office is located in a community having a population of less than 5,000, even though the principal office of that bank may be in a community with a population in excess of 5,000, has been challenged on the ground that its statutory source, 12 U.S.C. § 92, had been repealed in 1918. The Comptroller, while recognizing that "there is a disagreement among lawyers as to the \textit{technical} status of section 92 as having the force of law,"\textsuperscript{240} argued that "the Comptroller's Office, along with the other banking agencies and the banking industry generally, has always gone on the assumption that the provisions contained in 12 U.S.C. 92 remain as part of the law."\textsuperscript{241} In this contention, the Comptroller is strongly supported by at least one writer who says that: "In this respect, the Comptroller was clearly correct . . . . The provisions in question were omitted from the United States Code in 1952 (\textit{not} in 1918) by a careless codifier simply because of an inadvertently misplaced quotation mark . . . ."\textsuperscript{242}

The ruling that national banks may participate in insurance arrangements that are incidental to banking transactions was subjected to the same attack as that made upon the rulings allowing national banks to purchase corporate stocks. The Comptroller once again relied upon his expansive interpretation of the incidental powers clause of 12 U.S.C. § 24 (Seventh). "It is clear that the business of banking is advanced by financial and related services, and powers necessary to achieve and promote the fundamental purposes of banking must be regarded as powers incidental to those expressly granted . . . ."\textsuperscript{243} The most telling criticism of this view was simply stated by the House Banking Committee:

What he overlooks is that the conduct of a national bank is a very highly regulated business; and that by virtue of their subjection to so wide a range of governmental supervision national banks are not at liberty to deduce corporate authority with the same liberality as private commercial entities.\textsuperscript{244}

The Comptroller was once again unable to cite any judicial interpretations in support of his contentions, and his arguments based upon the concept of incidental powers are less than persuasive. It would seem only reasonable that an express congressional authorization would be required before national banks would be justified in invading the field of insurance — a move that the Comptroller's regulation directly portends.

A stronger argument can be made in support of the Comptroller's ruling

\textsuperscript{240} 1965 Hearings on Consolidation of Bank Supervisory Functions 391.
\textsuperscript{241} Ibid.
\textsuperscript{242} Hackley, supra note 207, at 778.
\textsuperscript{243} 1965 Hearings on Consolidation of Bank Supervisory Functions 392.
\textsuperscript{244} Ibid.
that permits a national bank to sell credit life insurance to a customer in order to
insure that the balance of the customer's loan held by that bank will be paid
in case of the customer's death. Such a debt cancellation policy seems to be a
justifiable means of self-protection for a national bank. The Comptroller contended:

The debt cancellation ruling is not intended as a means of enabling
national banks to invade the field of life insurance. Rather, it is a recogni-
tion of a national bank's right to protect itself against anticipated losses
in connection with its lending activities, through the establishment and
maintenance of appropriate reserves. 245

Even critics of the Comptroller recognized the validity of this argument and
they merely suggested that it might be more convenient and expeditious to
purchase a group life insurance policy covering all borrowers. 246

4. Leasing of Personal Property

In an unprecedented ruling the Comptroller authorized national banks to
become the owners and lessors of personal property purchased upon the specific
request of the customer and for his use. 247 This ruling came as the result of a
study of current national bank lease financing practices. It was found that the
lessor's economic function was of little significance to the bank in determining
whether to proceed with the financing transaction.

In these transactions a bank lent money to a lessor solely upon the credit
of a lessee for the purchase of property specifically requested by the lessee
for its immediate possession and use. The lessor acted solely as a holder
of title and as a nominal debtor. 248

In recognition of the obligation incumbent upon the banking industry to grow
and adapt to the changing needs of the economy, the Comptroller sought to
simplify and expedite lease financing by eliminating the unnecessary nominal
lessor, thus allowing national banks to directly lease tangible personality. The
Comptroller based his case upon the proposition that "the economic development
of the United States had brought this form of lease financing into the business
of banking."

However commendable one may deem the Comptroller's attempt to remove
the facade from current lease financing agreements, it has been asserted that
"the activity sanctioned by this Ruling would appear to be the least supportable

245 Id. at 393.
246 Id. at 394.
247 Comptroller of the Currency, Manual for National Banks, 3400, in 3 CCH
248 1965 Hearings on Consolidation of Bank Supervisory Functions 396.
249 Ibid.
of any that he has issued.\textsuperscript{250} Nowhere is such a venture into mercantile activity expressly granted by statute, nor can it be legitimately implied as incidental to the business of banking.\textsuperscript{251} The effects of this ruling would not only bring national banks into competition with existing businesses engaged in leasing, but would also open the door to national bank participation in numerous other commercial activities having little or no relation to the business of banking. "In short, all limitations against embarking upon unrelated mercantile activities would fall with the sanctioning of equipment leasing . . . ."\textsuperscript{252} The arguments offered by the Comptroller in support of his ruling fail to establish proper authority for such a radical departure from past practices. In view of the highly regulated nature of national banking powers, it would seem hardly sufficient to permit this radical extension of a national bank power to be effectuated by means of a mere ruling by the Comptroller.

5. Stock Option Plan

The Comptroller has ruled that national banks may offer stock options to their employees.\textsuperscript{253} The purpose of this ruling is to enable the banks to competitively recruit and retain competent personnel. Adoption of this form of incentive compensation was dictated by economic necessity, since other corporations have long employed such means of compensating their employees. The House Banking Committee, finding the Comptroller's ruling unobjectionable, stated:

\begin{quote}
Inasmuch as stock options relate to the internal management of national banking corporations and represent a form of compensation calculated to encourage the loyalty and to promote the initiative of employees, it would seem that the comptroller's authorization thereof, subject to the safeguard of stockholder approval stipulated in his regulations, probably can be held as not contravening any express provision of law applicable to such banks.\textsuperscript{254}
\end{quote}

A further presumption of validity of allowing stock options can be found in the holding that stockholders of a national bank have the incidental power to create a pension fund for the officers and employees.\textsuperscript{255} By analogy, this incidental power can easily be seen to apply to the creation of stock option plans.

6. Real Estate Loans

The Comptroller has ruled that when a national bank relies primarily on the general credit standing of the borrower in making a loan, the loan, though

\begin{itemize}
\item \textsuperscript{250} \textit{Ibid.}
\item \textsuperscript{251} By no accepted judicial interpretation of power allotted to national banks by 12 U.S.C. 24 can equipment leasing be viewed as an authorized activity of national banks. . . . [N]o precedents have been recorded which would support a national bank's venture into equipment leasing. \textit{Id.} at 396.
\item \textsuperscript{252} \textit{Id.} at 397.
\item \textsuperscript{253} \textit{COMPTROLLER OF THE CURRENCY, MANUAL FOR NATIONAL BANKS, \S 5015, in 3 CCH Fed. Banking L. Rep. \S 59813 (1966).}
\item \textsuperscript{254} \textit{1965 Hearings on Consolidation of Bank Supervisory Functions} 380-81.
\item \textsuperscript{255} \textit{Heinz v. National Bank of Commerce, 237 Fed. 942 (8th Cir. 1916).}
\end{itemize}
secured by real estate, is not a "real estate" loan and is not subject to the restrictions contained in 12 U.S.C. § 371. This section states that a loan secured by real estate within the meaning of this section shall be in the form of an obligation or obligations secured by a mortgage, trust deed, or other instrument upon real estate which shall constitute a first lien . . . .

According to the Comptroller, "the quoted language is obviously regulatory, not definitory." The mere fact that a real estate security interest is taken in a loan does not automatically make it a "real estate" loan.

Where a bank is primarily relying on [the] general credit standing of the borrower, guarantees, or security other than real estate the loan does not constitute a real estate loan within the meaning of 12 U.S.C. 371, although as a matter of prudent banking practice it may also be secured by real estate.

In making a personal loan that is entirely sound standing by itself, a bank may nevertheless take a real estate security interest merely as additional protection in the case of default. In the Comptroller's estimation, it would be patently unjust to classify this type of personal loan as a "real estate" loan within the meaning of 12 U.S.C. § 371. "Such a construction obviously defeated the remedial purpose of the section which was to require maximum protection for the bank."

In another disputed ruling concerning real estate loans, the Comptroller has said that real estate may be considered "improved" for loan purposes when its value has been enhanced by substantial and permanent improvements on other property in the immediate vicinity. This approach was attacked as being violative of the literal meaning of improved real estate — "land which at the given time is substantially enhanced in value by some probably durable structural improvement." The statute itself does not define "improved real estate," so its definition has always been the responsibility of the Comptroller's Office. In formulating his latest definition, the Comptroller has given recognition to the economic reality "that many changes may happen, both on and in the vicinity of the real estate such as affords all the protection to the lender that is contemplated by the statutory requirement that the real estate be improved."

While these two rulings may depart from prior policies of the Comptroller's Office, their underlying rationale suggests a purposeful effort on the part of the

258 1965 Hearings on Consolidation of Bank Supervisory Functions 399.
259 Id. at 399-400.
260 Id. at 400.
263 1965 Hearings on Consolidation of Bank Supervisory Functions 401.
Comptroller to update the regulations established by his office, thus harmonizing his rulings with the economic facts of life.

7. Pledge of Bank Shares

The Comptroller has promulgated a regulation that would permit national banks to require a borrower who holds shares of the bank to execute agreements (1) not to pledge the shares other than to the lending bank; (2) to pledge the shares to the bank at the bank's request when necessary to prevent loss; (3) to leave such shares in the bank's custody.264 These requirements have been challenged as violating the prohibition that "no association shall make any loan or discount on the security of the shares of its own capital stock . . . ."265 The Comptroller attempted to defend his ruling by maintaining that "none of the transactions described in that ruling constitute a pledge of bank stock as security."266 He pointed out that 12 U.S.C. § 83 allows national banks to accept their own shares as security in order to prevent a loss on an existing loan, and he insisted that each of the prescribed methods is merely a means of assuring the availability of the stock as security if a loss should appear imminent. He considered his regulations to be necessary if section 83 is to have any true protective value for national banks.267

The House Banking Committee claimed that such agreements are, in effect, pledges of stock in violation of 12 U.S.C. § 83, since they impose severe restraints on the transferability of the stock. The Committee relied upon the 1904 case of Third Nat'l Bank v. Buffalo German Ins. Co.,268 a case involving restrictions similar to those advocated by the Comptroller except that they were incorporated in the bylaws and stock certificates of the bank. These restrictions were held ultra vires. However, while asserting that these "liens" on the bank's own stock are unlawful, the courts have admitted that, after such agreements are executed and the stocks sold in accordance with the authorization, only the government can complain of a violation of section 83; and the former stockholder cannot void the subsequent sale by the national bank.269

It appears that the House Banking Committee has the weight of judicial precedent strongly in its favor. The regulation set out by the Comptroller seems to be little more than a clever device to enable national banks to engage in an activity that has been forbidden to them. Even though the Comptroller's position can be defended by arguments stressing the borrower's freedom of contract, it seems clear that fundamentally the regulation was designed merely to circumvent the clear prohibitions on stock pledges contained in section 83.

8. Interest Rates on Loans

In the interest of securing competitive equality for national banks, the

266 1965 Hearings on Consolidation of Bank Supervisory Functions 408.
267 Ibid.
268 193 U.S. 581 (1904).
Comptroller has ruled that national banks may charge the maximum rate of interest permitted by state law for any competing lending institution. This includes institutions licensed under the state small loans acts, subject only to those statutory limitations concerning the amount of the loan that may be made at a given interest rate. The Comptroller insisted that it was the clear congressional intent of 12 U.S.C. § 85 to leave national banks free to compete with state lending institutions. To hold that national banks must operate under more restrictive conditions that their state-chartered competitors would put them at a distinct disadvantage in the operations of the dual banking system. Without his provision, the Comptroller feared that national banks would be vulnerable to open discrimination at the hands of the state legislatures as to interest rates chargeable on loans.

Critics of this regulation argued that, instead of establishing equality between national and state banks, it has allowed national banks to obtain a competitive advantage over state banks. For example, under the small loans act of at least one state, the legislature has specifically excluded commercial banks from the act's coverage; but the Comptroller has said that such an exclusion does not apply to national banks. National banks may, therefore, charge the


A national bank may charge interest at the maximum rate permitted by state law to any competing state-chartered or licensed lending institution. If state law permits a higher interest rate on a specified class of loans, a national bank making such loans at such higher rate is subject only to the provisions of state law, relating to such class of loans that are material to the determination of [or] permitted to be charged by a state-licensed small loan company or morris plan bank, without being so licensed.

A national bank located in a state the law of which denies the defense of usury to a corporate borrower may charge a corporate borrower any rate of interest agreed upon by such borrower.


Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter. When no rate is fixed by the laws of the State, or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding 7 per centum, or 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run.

272 1965 Hearings on Consolidation of Bank Supervisory Functions 404:

To contend now ... that national banks are not free to compete with any competing State lending institutions is to ignore this clear congressional intent and thus to argue that national banks are required to operate and compete in a dual banking system under conditions that are more restrictive and less favorable than those applicable to State-chartered institutions. [Comptroller Saxon speaking.]


274 Letter from James J. Saxon, United States Comptroller of the Currency, to Jack G. Adams, Vice President of the Austin National Bank, Austin, Texas, Sept. 20, 1965. This letter did not constitute a regulation; it was an interpretation of an existing ruling. See Note, 44 Texas L. Rev. 547 (1966).

In a recent letter to a Texas banker, the United States Comptroller of the Currency stated that the attempt by the Texas Regulatory Loan Act (Small Loans
higher interest rate on small loans as provided for in the act, while state banks are not permitted to do so. The unfairness of this result clearly indicates how the purpose of 12 U.S.C. § 85, which is to insure equality of treatment for national banks in relation to state-chartered banking institutions, can be perverted to secure a competitive edge for national banks.

To further aggravate the problem, the interpretation advanced by the Comptroller is also broad enough to allow national banks to charge the higher credit union rates on larger loans, since credit unions do loan money and, thus, arguably are competing lending institutions. Such applications of the Comptroller’s ruling illustrate the unfair results that this policy would have for state banks, which remain subject to all of the restrictive provisions in the state laws setting the maximum rate of interest that may be charged. “These advantages will place national banks in a favorable competitive position with respect to consumer loans, thus enabling them to acquire more diverse loan portfolios than state banks, and to achieve greater operational stability.”

In this dispute the Comptroller is not without supporting authority. The leading case that served as precedent for his ruling is Tiffany v. National Bank. The Missouri legislature had attempted to restrict national and state banks to an interest rate of eight percent on loans while allowing individual lenders to charge ten percent. The Supreme Court, however, held that national banks can charge the highest rate of interest permitted by state law.

The only mode of guarding against such contingencies [state discrimination against national banks] was that which, we think, Congress adopted. It was to allow to National [banking] associations the rate allowed by the State to natural persons generally, and a higher rate, if State banks of issue were authorized to charge a higher rate.

The Court referred to the banks as “national favorites” and went on to explain that, in light of their purpose, which was to provide a national currency, it could not have been the intention of Congress “to expose them to the hazard of unfriendly legislation by States, or to ruinous competition with State banks.”

The support for the Comptroller’s stand that was provided by this case is seriously weakened by the clearly “dated” nature of the Court’s views. The Court in this 1873 case, indicated that it believed state banks were soon to be extinct. “[M]uch has been done to insure their [referring to national banks] taking the place of State banks. The latter have been substantially taxed out of existence.” Operating from such a premise, the Court’s willingness to

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276 Id. at 549.
277 85 U.S. (18 Wall.) 409 (1874).
278 Id. at 413.
279 Ibid.
280 Ibid.
show favoritism toward national banks is more easily understood; but correspondingly, the value of this case as authority for the Comptroller's ruling is thereby diminished.

An objective evaluation of the above competing contentions leads to a rejection of the proposition that national banks should be allowed to charge the highest permissible rate of interest in the state. The purpose of section 85 was to secure to national banks equal treatment with state banks; it was not designed to place national banks in a position superior to their state counterparts. The competition envisaged between the national and state banking systems was to be in the areas of performance of services and operating efficiency—not in the area of obtaining statutory advantages. It seems unduly beneficial to national banks to allow them to charge an interest rate in excess of that which state banks are permitted to exact for the same type of loan. Since the Comptroller's regulation will lead to such an injustice, this policy of "reverse discrimination" against state banks should be abandoned.

9. Branch Banking

In addition to the regulations and interpretations already noted, the Comptroller has relaxed restrictions in many other areas under his supervision. His liberality in granting new national bank charters,288 his substantial enlargement of trust powers of national banks,289 and his highly controverted policy in approving branches of national banks290 are but a few of the most noteworthy of the relaxed practices indulged in by the Comptroller.

In all of these actions the Comptroller has encountered general opposition and criticism, but none nearly as strong as that which has arisen over his branch banking policy. The Comptroller's authorization is contained in 12 U.S.C. § 36:

(c) A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches:
(1) Within the limits of the city, town, or village in which said association is situated, if such establishment and operation are at the time expressly authorized to State banks by the law of the State in question; and (2) at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the State on State banks.284

In granting approvals of branch applications under this section, the Comptroller has taken the position that restrictions in state laws other than as to permissible locations are not applicable to national banks.285 In support of this

view, it can be said that some of the more technical limitations in state branching laws appear to be little more than veiled attempts to protect local monopolies and to restrain effective competition.\textsuperscript{286} However, the Comptroller's goal is much larger than the mere elimination of local banking monopolies. "He is concerned with the broad problem of growth in the national economy and, more particularly, with insuring the existence of adequate banking facilities to promote, rather than to retard, national growth."\textsuperscript{287} Thus, his branching policy is designed to provide banking facilities in areas of recent population growth and to stimulate competition in the banking industry. Also, it has been asserted that bank expansion through branching increases the mobility of capital and bank credit and stabilizes the financial structure of banks.\textsuperscript{288}

In a recent decision involving Utah's branch banking law, the United States Supreme Court considered the arguments put forward by the Comptroller and ruled against his position. In \textit{First Nat'l Bank v. Walker Bank & Trust Co.},\textsuperscript{289} the Court held that all the restrictions of state branch banking laws are applicable to national banks.\textsuperscript{290} This ruling should serve to end much of the present controversy over branching since it is a clear repudiation of the Comptroller's view.

It is the view of some that restrictive state laws and the admmeasuring of national bank power by these laws have grown to the point where they may be said to impair the efficiency of the federal government in promoting economic development. On such grounds, Congress, exercising its valid, implied powers, would be justified in granting national banks the ability to branch irrespective of state laws.\textsuperscript{291}

In sharp disagreement with this proposal, state banking interests contend that the states are in a better position to determine the nature and extent of local banking needs and this function should be left to their legislatures.\textsuperscript{292}

In this policy dispute, it is the Comptroller's position that the "national" interest

\textsuperscript{286} See examples of these highly complicated branching restrictions in Note, 38 \textsc{Notre Dame Lawyer} 315, 320-23 (1963); Note, 71 \textsc{Yale L.J.} 502, 509-16 (1962).
\textsuperscript{287} Note, 16 \textsc{Stan. L. Rev.} 983 (1964).
\textsuperscript{288} Even where new unit banks would fulfill the need, at least two economic factors make expansion through branching the preferable alternative. Branch banking increases the mobility of capital or credit, permitting a shifting of funds from branches with excess deposits to branches where demand for additional credit exists and thus promoting the optimum use of money. Secondly, stability of banking is increased since banks having branches can achieve a greater diversification of loan risks. \textit{Id.} at 984.
\textsuperscript{289} 385 \textsc{U.S.} 252 (1966).
\textsuperscript{290} The Comptroller argued that Utah's statute "expressly authorizes" state banks to have branches in their home municipalities. He maintains that the restriction, in the subsequent paragraph of the statute limiting branching solely to the taking over of an existing bank, is not applicable to national banks. . . . The Comptroller also contends that the \textit{[National Bank] Act} supersedes state law only as to "whether" and "where" branches may be located and not the "method" by which this is effected. We believe that where a State allows branching only by taking over an existing bank, it expresses as much "whether" and "where" a branch may be located as does a prohibition or a limitation to the home office municipality. As to the restriction being a "method," we have concluded that since it is part and parcel of Utah's policy, it was absorbed by the provisions of § 36 (c)(1) and (2), regardless of the tag placed upon it. \textit{Id.} at 261-62.
\textsuperscript{291} Note, 38 \textsc{Notre Dame Lawyer} 315, 325-26 (1963).
\textsuperscript{292} \textit{Hearings on Conflict of Federal and State Banking Laws Before the House Committee on Banking and Currency, 88th Cong., 1st Sess. 7} (1963).
in promoting economic growth outweigh "local concerns"; and, consequently, the policies of national banks should be determined primarily upon the basis of this overriding national interest. The solution to this controversy requires a policy determination that only Congress has authority to make. Under existing congressional enactments, the *First Nat'l Bank v. Walker Bank & Trust Co.* case clearly points out that state laws currently set the standards for branching for both state and national banks.

10. *Appraisal of These Rulings*

It is very difficult to assess, with any degree of accuracy, the exact effect that these liberal policies pursued by the Comptroller will have upon the competitive balance between national and state banks. Any such appraisal is valid only in general terms, because as one writer has stated, "[T]here are bewildering variations with respect to the powers and operations of state banks." Each of the fifty states has its own banking law that varies in countless ways from the banking laws of all other states. For the banks of any particular state, the competitive effect of expanded national bank powers depends upon the relative strictness of the limitations contained in the laws of that state. In some matters, as the leasing of personal property and charging the highest permissible interest rates, the Comptroller's policies have clearly tended to give the national banks a decided advantage in comparison to state banks. Other rulings, however, such as the allowance of stock option plans and the pledge of the bank's own stock on loans, have been rather inconsequential to the dual banking equilibrium. The policy of the Comptroller in liberally approving branches for national banks in circumstances where state banks were not permitted to branch had placed the national banks in a decidedly superior competitive position over state banks; however, this policy has now been rejected by the Supreme Court.

Although a precise evaluation of each ruling is virtually impossible, it is possible to appraise the cumulative effect of the Comptroller's overall policy as it has been manifested through his lenient regulations. In pursuing his goal of providing adequate bank capabilities in order to ensure continued economic growth, the Comptroller has sought to expand the powers of national banks to the outermost limits of their statutory grants. In doing so, an imbalance in favor of national banks over state banks has definitely been established. (As indicated above, in more than a few instances, it seems apparent that the Comptroller's liberalizing authorizations have violated the controlling federal legislation.) These more lenient regulations for the national banking system reflect the general attitude of the Comptroller's Office, which seeks to instill within the banking industry as a whole the flexibility needed to cope with new problems and an openness to accept new solutions for old problems. Despite this initiative from the national banking system, there is still a reluctance on the part of the states to change their banking laws to permit state banks to engage in certain activities that the Comptroller has authorized for national banks. These con-

293 *Id.* at 278-79.
295 See note 290 *supra*.
Conflicting attitudes toward "change" provide the real basis for the imbalance presently existing in the dual banking system. It is the "open" attitude on the part of the Comptroller, more than any of his specific rulings, that has placed national banks in a competitive position superior to that of their slow-to-change state counterparts.

The present disadvantageous position of state banks need not be permanent. The organization of the dual banking system will tend to force remedial action by the states. It is one of the assets of our dual banking system that banks chartered under one system may switch their charter to the other system if the restrictions under their original system become relatively more burdensome. If one system begins losing banks to the other, this is a signal that the system must take steps to eliminate the competitive disparities. In this manner, each system acts as a check upon the other to ensure continual modernization of their respective regulatory schemes. At the present time the signal has been given, for the state banking system is losing banks to the national system. Thus, the state banking system must either seek remedial congressional action that would compel the Comptroller to conform his regulations to the strict letter of the existing federal banking laws or seek to provide a liberalization of controlling restrictions through modernization of the state banking laws. Failure to do so will lead to a continued deterioration of the state banking system. The warning has been given, the next step is up to the states.

B. Federal Law v. State Law

1. Introduction

It is a well-established principle that national banks are not subject to any state law that would interfere with the purpose of their creation, impair their efficiency as a federal agency, discriminate against national banks, or conflict with the laws of the United States. This privilege flows from the status of national banks as "instrumentalities" of the federal government. While undoubtedly valid at the time when the national banking system was established, this privileged status is open to question today.

The national banks were created to promulgate a national currency and to implement the government's fiscal policy. In pursuing these goals, the national banks were validly operating as instrumentalities of the government. But over

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296 From 1960 through 1965, 118 state banks switched to national charters, while only 40 national banks converted to state charters. Admittedly, the national system's net gain of 78 banks in this six-year period does not indicate a mass exodus from the state system, but it does reflect a distinct trend that possesses serious implications for the state banking system. Even more significant than the number of banks changing to national charters is the size of these banks. The 118 newly converted national banks had assets totaling $16.5 billion, while the 40 banks leaving the national system had assets valued at only $396 million. These figures clearly indicate a disturbing movement of the largest state banks into the national system. [Jan.-Sept. 1966] 2 N.Y. ADV. COMM. OF COMMERCIAL BANK SUPERVISION REP. 3 n.3.


the years, as the governmental functions of national banks have been gradually diminished,\textsuperscript{299} these banks have expanded their operations to include the full range of banking activities; and now their business is almost indistinguishable from that of private banking institutions. While competing with state banks in nearly all areas of the banking business and performing little more in the way of governmental services than do the state-chartered banks that are members of the Federal Reserve System, nonetheless, national banks enjoy immunity from certain state laws and regulations that are binding upon state banks. Other than their federally granted charters, it would appear that national banks can claim little in the way of justification for their continuing classification as instrumentalities of the federal government.

2. \textit{State Taxation}

One area in which national banks benefit from their status as instrumentalities of the federal government is that of state taxation. Although national banks are not completely immune from paying state taxes, Congress has restricted the methods by which they may be taxed.\textsuperscript{300}

National banks are not merely private moneyed institutions but agencies of the United States created under its laws to promote its fiscal policies; and hence the banks, their property and their shares cannot be taxed under state authority except as Congress consents and then only in conformity with the restrictions attached to its consent.\textsuperscript{301}

This doctrine originated in \textit{McCulloch v. Maryland};\textsuperscript{302} and despite some convincing criticism,\textsuperscript{303} it is now too well settled, by virtue of judicial reiteration, to be successfully overturned.\textsuperscript{304}

Nevertheless, it can be pointed out, without examining the desirability of this doctrine, that the reason given in support of it is less than convincing. The rationale has been concisely stated by Mr. Justice Marshall: "That the power to tax involves the power to destroy . . . [can] not be denied . . . If the states may tax one instrument, employed by the government in the execution of its powers, they may tax any and every other instrument."\textsuperscript{305}

Admittedly, action by a nation within the scope of its powers constitutes

\textsuperscript{299} The Federal Reserve Act took away from national banks the responsibility for managing the monetary and fiscal policies of the government. 38 Stat. 251 (1913) (codified as amended in scattered sections of 12 U.S.C.).

\textsuperscript{300} 44 Stat. 223 (1926), 12 U.S.C. § 548 (1964):

The legislature of each State may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares of national banking associations located within its limits. The several States may (1) tax said shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such associations on their net income, or (4) according to or measured by their net income . . . .


\textsuperscript{302} 17 U.S. (4 Wheat.) 316 (1819).


\textsuperscript{304} Note, 1961 U. ILL. L.F. 717, 719-20.

\textsuperscript{305} \textit{McCulloch v. Maryland}, 17 U.S. (4 Wheat.) 316, 431-32 (1819).
governmental action, but this does not preclude the possibility that some of this governmental action may also be business activity.

The fact that the nation may do only what it may do does not mean that none of the things that it may do can be business activity. The fact that the scope of national action is restricted by a written constitution in no way prevents a ruling that when the United States elects "to support a governmental activity through the conduct of a business comparable in all essentials to those usually conducted by private owners," [Allen v. Regents of the University System of Georgia, 304 U.S. 439, 451 (1938)] such business is not thereby withdrawn from state taxation. Marshall's lumping of all national activity into the single category of "governmental" can be rebuked somewhat after the fashion of Mr. Justice Frankfurter's characterization of his statement that the power to tax is the power to destroy. It was a "flourish of rhetoric," a "seductive cliche," and "a free use of absolutes." [Graves v. New York ex rel. O'Keefe, 306 U.S. 466, 489 (1939) (concurring opinion).]

In light of the predominately business nature of national banks today, there seems to be even less of an argument for continuing their exemption from state taxation. However, any hopes of overturning this exemption are premature, for the privileged status of national banks is still too firmly established.

Since it appears unlikely that national banks will soon be made subject to the general taxing powers of the states, it would be advisable for the states to review their policies on taxing national banks and to revise the policies, if necessary, in order to ensure that national banks will pay their just share of the tax burden within each state. Great care must be taken, however, to coordinate these taxing policies with the permissive federal legislation. Section 548 of Title 12 of the United States Code sets out the four alternative procedures by which states may tax the national banks located within their boundaries: (1) a tax on bank shares; (2) a tax on the income of bank shares; (3) a tax on the bank's net income; (4) a tax according to or measured by the bank's net income. As a further restriction on state taxing power over national banks, two other limitations are imposed: (1) only one of these methods of taxation may be employed at a given time; (2) the tax cannot discriminate against national banks.

This latter restriction, in conjunction with the former, has produced some inequalities that have placed a greater tax burden on state banks. It appears quite evident "that the various restrictions it [section 548] places on the permitted methods of taxation are designed to prohibit only those systems of state taxation which discriminate... against national banking associations or their shareholders as a class." In practice, however, the restrictions have led to a disadvantage for state banks. "In most states, corporations are subject to one principal tax and one or more of lesser fiscal importance." Since national banks can be made

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subject, at most, only to the principal tax and only at a rate not exceeding that charged to other moneyed capital, the tax burden on state banks is necessarily greater because of the secondary taxes.

Despite the availability of a tax on the net income of national banks, some states have not adopted this more profitable method of taxation. In at least one state, because of the existence at the local level of a bank share tax, the state was prevented from imposing a tax on the income of national banks. In order for a state to impose its principal corporate tax upon national banks it may be necessary to repeal existing legislation that was enacted when a property tax based on the value of the bank stock was the only permissible method open to the states for taxing national banks. Then the state could adopt a tax provision that conforms to either method (3) or (4) of section 548, permitting a tax on the net income of national banks. This enactment would be a major step towards equalizing the tax burden of national banks with that already imposed upon state banks.

It can be seen that the privileged status of national banks as instrumentalties of the federal government, despite congressional permission for four restricted methods of state taxation, has generally resulted in a smaller tax burden for national banks, affording them a competitive edge over state banks.

3. Venue Sanctuary of National Banks

Section 94 of Title 12 of the United States Code reads:

Actions and proceedings against any association under this chapter may be had in any district or Territorial court of the United States held within the district in which such association may be established, or in any State, county, or municipal court in the county or city in which said association is located having jurisdiction in similar cases. (Emphasis added.)

Courts have generally interpreted this venue provision of the National Bank Act as requiring that suits against a national bank be brought in the county or district in which that bank is "established." "This provision has been phrased variously as the place of location, the principal place of business, the location

310 The term "moneyed capital" has been described as money employed in a business whose object is to make profit by investing in securities by way of loan, discount, or otherwise, which from time to time are reduced again to money and reinvested. See Mercantile Nat'l Bank v. Shields, 59 Fed. 952 (C.C.N.D. Ohio 1894).
311 Howell, supra note 309, at 280.
313 The suggested remedy for this situation is quite simple, even though its adoption would most assuredly present political problems in some of the states. The first step would be to repeal all supplementary state and local taxes on banks except property taxes on real estate. Then an excise tax, measured by net income from all sources, could be imposed on banks. This could be accomplished for national banks by simply inserting a clause referring to method numbered (4) authorized by the Act of March 25, 1926 amending section 5219 of the Revised Statutes of the United States. A rate could then be determined which would absorb on the average approximately the same percentage of net income as do the combined state and local taxes of the income of nonfinancial corporations. This rate could be included in the statutes or computed annually . . . . Howell, supra note 90, at 281-82.
of the principal office, and the charter location." As these variations of "established" indicate, the construction given to this statute has been a highly restricted one that permits suit against a national bank only in that single county or district where the bank has its main office. In the 1963 case of Mercantile Nat'l Bank v. Langdeau, the Supreme Court reaffirmed its adherence to this principle in reaching the conclusion "that national banks may be sued only in those state courts in the county where the banks are located.

This view has been attacked convincingly on the ground that the history and policy of the National Bank Act do not support this "venue sanctuary" accorded national banks. Moreover, it has been argued that the harsh consequences of this doctrine in denying litigants a forum or imposing unnecessary inconvenience upon parties suing a national bank were certainly not contemplated or intended by Congress when it enacted this provision.

In the early case of Manufacturers' Nat'l Bank v. Baack, the position was taken that a national bank was "located" or "established" at the place named in its organization certificate and was subject to suit only in that location. At the time of this decision, 1871, there was little, if any, branch banking by national banks and this interpretation worked to no one's disadvantage. Under the unit-banking practices of the day, nearly all of the business transacted by a bank took place in the locality where the office was located. With the advent of branch banking in this century, however, national banks began to transact business outside the county or district of their original charter. In effect, they became "established" in locations other than their charter location. Courts, however, did not accept such an interpretation. In the 1936 case of Leonardi v. Chase Nat'l Bank, the principle was once again upheld that a national bank was "established" only at the location designated in its charter; and therefore,

317 Id. at 561.
318 Scheflin & Dixon, supra note 315, at 765-74.
319 Mr. Justice Black, concurring in the remand of the case to the state court, but totally disagreeing with the Court's interpretation of § 94 in Michigan Nat'l Bank v. Robertson, 372 U.S. 591 (1963), argued:

Now, under this Court's holding, these people in Nebraska who allege that their contracts were usurious under Nebraska law must, unless the bank be held to have waived statutory venue, go all the way to Michigan to try to vindicate their rights against the bank. This harsh result is held to be compelled by a provision of the Act of June 3, 1864, c. 106, § 30, 13 Stat. 108, now codified in 12 U.S.C. § 94. I do not know of a single Act Congress has passed in a century which clearly and explicitly denies a person in one State the privilege of filing suit in his own State against an out-of-state company where service can be obtained and where the suit arises out of a transaction within the State. And I am not willing to find such a congressional purpose in § 94. I realized that this Court did hold several weeks ago in Mercantile Nat'l Bank v. Langdeau, 371 U.S. 555, that this statute requires a suit in a state court against a national bank to be brought in the county where the bank is located. Langdeau merely required that the plaintiff sue in one county of the State rather than in another. Formal logic strictly applied might call for expansion of that holding to cover the different factual situation here. But that would require a plaintiff to go to another State hundreds of miles from home to bring suit for a wrong done him in a transaction in his own State, a result which I cannot believe Congress intended. Id. at 595.

321 81 F.2d 19 (2d Cir. 1936), cert. denied, 298 U.S. 677 (1936).
its venue was restricted to that site. The only generally accepted exception to this rule has been in cases involving local actions. In *Casey v. Adams*, the Supreme Court held that section 94 applied only to transitory actions. Local actions involving national banks are subject to the ordinary rules of law affecting local affairs.

In the *Langdeau* case, it should be noted that there appears to be a certain amount of reluctance on the part of the Court to wholeheartedly embrace the traditional restrictive doctrine. After conceding that its ruling could be applied so as to prevent a litigant from joining two national banks in the same action in the state courts if they are located in different counties or in the federal courts if they are located in different districts, the Court lamely pointed out that “aside from not being presented by these cases, such a situation is a matter for Congress to consider.” Apparently, the Court felt itself bound to follow the strong weight of judicial precedent on the matter and then turn to Congress for any relief from its harsh applications.

It is submitted that the Supreme Court in *Langdeau* could have remedied the situation with the means already at its disposal. By expanding the definition of “established” in section 94 to include all those locations within the state where a national bank is transacting its general business, the Court still could have reconciled its ruling with the language and purpose of section 94, while at the same time enlarging the scope of that provision to meet the demands of a banking industry in which national banks engage in state-wide branching and thus transact general business in more than one county or district.

In choosing to follow precedent in the face of radical changes in the organization of the banking industry, the Court appears to have closed its eyes to the seemingly wider interpretation of “established” adopted by Congress. By its adoption of branch banking legislation for national banks, Congress implicitly recognized the fact that national banks may now be “established” in more than one place for the purpose of carrying on their general business.

Although, as the court said in *Leonardi*, a reading of the branch banking amendments and section 8 did not “require” a national bank to be “established” in more than one place, the amendments, considered together with the legislative history and changed factual basis, indicate strongly that, as a national bank’s general business could now be conducted in more than

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322 102 U.S. 66 (1880).
323 The term [transitory action] is used in contradistinction to “local action,” and is a personal action, the cause of which might have arisen in one place or county as well as in another; one that may be brought in any county; an action which seeks nothing more than the recovery of money or personality, whether it sounds in contract or in tort, and which is generally founded on the violation of rights which, in contemplation of law, have no locality. Chappell v. Fidelity & Deposit Co., 194 S.C. 124, 129, 9 S.E.2d 592, 593-94 (1940).
324 The distinction between local and transitory actions is as old as actions themselves, and no one has ever supposed that laws which prescribed generally where one should be sued, included such suits as were local in their character, either by statute or the common law, unless it was expressly so declared. Local actions are in the nature of suits in rem, and are to be prosecuted where the thing on which they are founded is situated. *Casey v. Adams*, 102 U.S. 66, 67-68 (1880).
one location, Congress intended that a national bank could be “established” in places other than its charter location.\textsuperscript{227}

Subsequent decisions have generally been content to repeat the traditional holding of \textit{Leonardi} without attempting to ascertain the validity of its rationale.\textsuperscript{228} In \textit{Langdeau}, the Court did consider the issue more directly, but it did not venture to lay down a definitive ruling on a national bank’s “location” for venue purposes.

In a recent law review article, two writers have advanced the proposition that

a national bank may be viewed as “located” or “established” for venue purposes not only in the judicial district (state or federal) in which its principal office or banking house is located, but also in other judicial districts in which it maintains branches for conducting general business.\textsuperscript{229}

Quite clearly, this view\textsuperscript{229} is more reasonable and more closely related to economic reality than the narrow interpretation of “established” that the Supreme Court chose to adhere to in \textit{Langdeau}. At this time, however, the decision in \textit{Langdeau}, restricting suits against national banks to only the single county or district in which the bank is located, represents the current state of the law.

4. \textit{Usury}

Section 85 of Title 12 of the United States Code\textsuperscript{231} authorizes a national bank to charge interest on loans or discounts at a rate equal to the maximum rate permitted by the laws of the state in which it is located.\textsuperscript{232} Section 86,\textsuperscript{233} however, sets out the only penalties which may be assessed against national banks that contract or collect interest at a rate in excess of that permitted by law.

\textsuperscript{227} Scheflin & Dixon, \textit{supra} note 315, at 770.
\textsuperscript{229} Scheflin & Dixon, \textit{supra} note 315, at 771-72.
\textsuperscript{230} This view was followed in a recent New York Supreme Court case, Gregor J. Schaefer Sons v. Watson, 49 Misc. 2d 265, 267 N.Y.S.2d 252 (Sup. Ct.), \textit{rev'd} 26 App. Div. 2d 659, 272 N.Y.S.2d 790 (1966), where the court said:

Moreover, in the opinion of this Court the provisions of Title 12, § 94, United States Code do not warrant an interpretation that a national bank having branch offices in the different counties may be sued only in the county in which it has its main office. Defendant bank maintains a number of offices in Suffolk County and conducts general business at such offices. It is therefore located in Suffolk County. \textit{Id.} 267 N.Y.S.2d at 252-53. In reversing this holding, however, the Appellate Division of the New York Supreme Court chose to follow the traditional interpretation of § 94.
\textsuperscript{231} \textit{Rev. Stat.} § 5179 (1875), as amended, 12 U.S.C. § 85 (1964). For the relevant text of this section, see note 271 \textit{supra}.
\textsuperscript{232} For a table showing the maximum rates of interest in the 50 states, see 3 \textit{CCH} \textit{Fed. Banking L. Rep.} ¶ 59005. While some states impose a maximum rate as low as 6%, other states set no statutory maximum for interest rates.

The taking, receiving, reserving, or charging a rate of interest greater than is allowed by section 85 of this title, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. In the case the greater rate of interest has been paid, the person by whom it has been paid, or his legal representative, may recover back, in an action in the nature of an action of debt, twice the amount of the interest thus paid from the association taking or receiving the same: \textit{Provided}, That such action is commenced within two years from the time the usurious transaction occurred.
It is clear under section 85 that it is federal law that has established the interest rates that may be charged by each national bank, "although it is measured in each instance by the laws of the state in which it is engaged in business." Likewise, in determining whether the interest charged on a particular loan is usurious, the court must decide the issue according to the laws of the state in which the loan was made.

As already discussed, the national banks have been authorized by the Comptroller to charge the highest rate of interest that competing lending institutions in the state may exact. This ruling has permitted national banks to charge the higher interest rates on small loans permitted under the various small loans acts that have been enacted in most states. Thus, state banks have been placed in a less favorable competitive position in those states that have attempted to exclude all commercial banks from coverage of their small loans act. Under the guise of providing equal treatment for national banks, the Comptroller's ruling has had the effect of securing an unwarranted advantage over state banks in a very important segment of the banking business — consumer loans. If such ruling becomes generally effective, the states will be faced with the anomalous situation of being compelled to reform their banking laws to permit state banks to charge the same interest rate as national banks or else witness the continued switching of charters by state banks.

A provision in section 85 reads:

When no rate is fixed by the laws of the State, or Territory, or District, the bank may take ... a rate not exceeding 7 per centum, or 1 per centum in excess of the discount rate on ninety-day commercial paper in effect ... in the Federal reserve district where the bank is located, whichever may be greater . . . .

In spite of this provision, the courts continue to treat national banks as "national favorites" and strain to stretch the language of section 85 to permit a reading that national banks may charge as much as a state bank where there is no maximum rate for state banks set by law. For example, the court in Hiatt v. San Francisco Nat'l Bank, faced with a California law that did not set a maximum rate for state banks, was guided by another provision in section 85: "Any association may . . . charge . . . interest at the rate allowed by the laws of the State . . . where the bank is located . . . ." The court held that this wording "should be construed as meaning that a national association located in a particular state may charge as much interest as may be legally charged by the state's

335 Schumacher v. Lawrence, 108 F.2d 576, 577 (6th Cir. 1940).
336 See text accompanying notes 270-80 supra.
338 See text accompanying note 273 supra.
339 See text accompanying note 276 supra.
340 See note 296 supra.
342 361 F.2d 504 (9th Cir. 1966).
banks under the state's existing laws.\textsuperscript{343} Since no specific maximum rate was set by statute, the court interpreted this as meaning, in effect, that California had "fixed the rates for state banks . . . as without limitation except such as may be established by agreement between the banks of the . . . states and those who borrow from them."\textsuperscript{344} By means of this reasoning, the national bank was allowed to charge the agreed-upon rate of interest, although it exceeded the "7 per centum, or 1 per centum in excess of the discount rate on ninety-day commercial paper." The court, in reaching its conclusion, said:

Considering the federal statute in its entirety, we clearly see a congressional intent that the competitive opportunities of a national bank operating in a certain state should not be impeded by congressional limitations on interest charges which are more restrictive than state limitations imposed upon the state's banks.\textsuperscript{345}

Although federal law adopts those state laws that establish the maximum interest rates that may be charged, section 86 sets up its own exclusive penalties for usurious practices by national banks.

A careful reading of Section 86 discloses that this section provides for two situations: first, where the usurious interest has not been actually paid by the borrower, but has been contracted for and is incorporated in the face value of the evidence of the indebtedness; and secondly, where the usurious interest has in fact been paid by the borrower.\textsuperscript{346}

In the first case, the penalty prescribed is a forfeiture of all the interest on the obligation. When the second situation arises, that is, the usurious interest has already been collected, the victim of the usury may recover back double the amount of the usurious interest paid.\textsuperscript{347} It has been uniformly held that these federal penalties preempt any state penalties when a national bank engages in usurious practices.\textsuperscript{348}

In the states that impose more severe penalties for usury by state lending institutions,\textsuperscript{349} this preemption by section 86 will favor national banks by allowing them to escape with a lesser penalty than their state counterparts. A clear example of this advantage is shown in \textit{Coral Gables First Nat'l Bank v. Constructors of Florida}.\textsuperscript{350} In that case, a national and a state-chartered bank participated in a loan that was found to be usurious. Under Florida law,\textsuperscript{351} the penalty prescribed for usury is a forfeiture of both principal and interest. The

\textsuperscript{343} Id. at 507.
\textsuperscript{344} Ibid. \textit{Accord,} Daggs v. Phoenix Nat'l Bank, 177 U.S. 549, 555 (1900).
\textsuperscript{345} Hiatt v. San Francisco Nat'l Bank, 361 F.2d 504, 506-07 (9th Cir. 1966).
\textsuperscript{346} Morris, supra note 334, at 856.
\textsuperscript{349} For a listing of the penalties applicable to violations of the usury laws of the 50 states, see 3 \textit{CCH} \textit{FED. BANKING L. REP.} ¶ 59005.
\textsuperscript{351} \textit{Fla. STAT. ANN.} § 687.07 (1966).
court held that the entire amount of the interest due was properly forfeited as to both parties, but that the portion of the principal due to the national bank was not properly forfeited since federal law provides the exclusive penalty for usurious practices by national banks, which, in this case, was the forfeiture of only the interest. 352

While this disparity is not likely to cause any significant change in the overall competitive positions of state and national banks, it does illustrate another instance in which the banking laws of this country can tend to favor national banks.

5. Assessment of These Advantages

As has been shown in the areas of taxation, venue, and usury, national banks possess some advantages over state banks. These benefits accrue to national banks by reason of federal regulatory legislation. These inequalities, however, are not of themselves fatal to the dual banking system. States could adjust their regulatory legislation to place their state-chartered banks in as favorable a position as that of national banks. However, few state legislatures have modernized their banking regulations and consequently these national bank advantages remain.

When these advantages of national banks resulting from their more favorable statutory regulation are added to the other advantages that national banks are enjoying due to the more lenient rulings of the Comptroller, it is quite evident that the competitive balance in the dual banking system has swung decidedly in favor of national banks. Although strict equality in the dual banking system may never be attainable, nor even necessarily desirable, 353 significant imbalance between its state and national components must be avoided if this dual system is to remain viable. Further prolongation of this competitive inequality could continue to prove injurious to individual state banks and could continue to cause the loss of state banks to the national system. 354

As suggested before, 355 the states might be able to eliminate or mitigate the inequalities resulting from the Comptroller's liberal regulations by making a concerted effort to obtain congressional action that would set narrow limits on the Comptroller's freedom of interpretation. However, this policy could not be utilized successfully in the case of the statutory advantages that are enjoyed by national banks. In this instance, where the federal laws themselves, not the rulings of the Comptroller, give national banks a superior competitive position, it appears that the states have little choice but to modernize their own banking laws so that the powers of the state banks will once again compare favorably with those of the national banks.

354 See note 296 supra.
355 See text following note 296 supra.
IV. THE POSSIBLE EXPANSION OF FEDERAL POWER: THE CONFLICTS ENGENDERED

A. Introduction

The problems spawned within the federal bank regulatory machinery have been examined. Also examined have been the problems arising from the banking industry's dual regulation by the federal and state governments. The competitive differences between state banks and national banks are in some instances the result of differences between the laws governing national banks and those governing state banks. To the extent that this is true, changes by individual states in their banking laws will alleviate some of the competitive advantages enjoyed by national banks. National banks have certain built-in advantages, however, that cannot be eradicated by the action of the states (e.g., exemption from state taxation). In these areas, and in the areas where the problem is conflict between the federal agencies themselves, a reform in the structure of federal law is required.

An examination of recent changes and proposals for change on the federal level reveals two movements designed to improve bank supervision and regulation. One movement favors the expansion of federal power over banking. The other represents an effort to change the structure of the federal regulatory power. These two movements seem to be related in subtle ways; but before examining this relationship, it may be helpful to examine each area separately.

B. Expansion Through Substantive Change

1. Early Proposals

"The regulation of banking may be more intensive than the regulation of any other industry, and it is the oldest system of economic regulation." Early in our nation's history the bank was seen as an effective instrument of federal monetary authority, and regulation was directed primarily towards increasing this effectiveness. In the present century, federal power has been extended to protect the bank depositor and the investor in bank securities. Today federal regulation and supervision of banking cover nearly every banking function and are the primary concern of three major governmental agencies. (See table on facing page.) Despite this fact, there are many who feel that banking

356 See text accompanying notes 1-223 supra.
357 See text accompanying notes 224-355 supra.
360 A specie-paying bank, with an overwhelming capital and the whole aid of the government deposits, presented the only resource to which the government could resort, to restore that power over the currency of the country, which the framers of the constitution evidently intended to give to congress alone. Ouburn v. Bank of the United States, 22 U.S. (9 Wheat.) 728, 873 (1824) (dissenting opinion of Johnson, J.). This view presages the later views of the Court concerning congressional monetary functions.
### Distribution of Powers Among Supervisory Authorities

<table>
<thead>
<tr>
<th>Powers Concerning—</th>
<th>National Banks</th>
<th>State Member Banks</th>
<th>State Nonmember Insured Banks</th>
<th>State Nonmember Noninsured Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuance of charters</td>
<td>CC</td>
<td>State</td>
<td>State</td>
<td>State</td>
</tr>
<tr>
<td>Mergers, with national banks surviving</td>
<td>CC</td>
<td>State</td>
<td>State, FDIC</td>
<td>State</td>
</tr>
<tr>
<td>Mergers, with state banks surviving</td>
<td>State</td>
<td>State</td>
<td>State</td>
<td>State</td>
</tr>
<tr>
<td>Assumption of liabilities of uninsured bank</td>
<td>FDIC</td>
<td>FDIC</td>
<td>FDIC</td>
<td>FDIC</td>
</tr>
<tr>
<td>Acquisition of control of, by bank holding company</td>
<td>FR</td>
<td>FR</td>
<td>FR, State</td>
<td>FR, State</td>
</tr>
<tr>
<td>Establishing branches</td>
<td>CC</td>
<td>State</td>
<td>State</td>
<td>State</td>
</tr>
<tr>
<td>Relocation of bank or branch</td>
<td>CC</td>
<td>State</td>
<td>State, FDIC</td>
<td>State</td>
</tr>
<tr>
<td>Admission to Federal Reserve System</td>
<td>CC</td>
<td>FR</td>
<td>FDIC</td>
<td>FDIC</td>
</tr>
<tr>
<td>Admission to deposit insurance system</td>
<td>CC</td>
<td>FR</td>
<td>FDIC</td>
<td>FDIC</td>
</tr>
<tr>
<td>Exercise of trust powers</td>
<td>CC</td>
<td>State</td>
<td>State</td>
<td>State</td>
</tr>
<tr>
<td>Management of common trust funds</td>
<td>CC</td>
<td>CC</td>
<td>CC</td>
<td>CC</td>
</tr>
<tr>
<td>Examinations</td>
<td>CC, (FDIC)</td>
<td>State</td>
<td>State</td>
<td>State</td>
</tr>
<tr>
<td>Reports of condition</td>
<td>CC</td>
<td>State</td>
<td>State, FDIC</td>
<td>State</td>
</tr>
<tr>
<td>Required reserves</td>
<td>FR</td>
<td>State</td>
<td>State</td>
<td>State</td>
</tr>
<tr>
<td>Loan regulations</td>
<td>CC, FR</td>
<td>State</td>
<td>State</td>
<td>State</td>
</tr>
<tr>
<td>Investment regulations</td>
<td>CC</td>
<td>State</td>
<td>State</td>
<td>State</td>
</tr>
<tr>
<td>Interest payments on time deposits</td>
<td>FR</td>
<td>State</td>
<td>State, FDIC</td>
<td>State</td>
</tr>
<tr>
<td>Margin requirements on security loans</td>
<td>FR</td>
<td>FR</td>
<td>FR</td>
<td>FR</td>
</tr>
</tbody>
</table>

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*a* Abbreviations used: "CC" for the Comptroller of the Currency; "FR" for the Board of Governors and other officials of the Federal Reserve System; "FDIC" for the Federal Deposit Insurance Corporation; and "State" for the state supervisory authorities. Parentheses indicate that powers are not usually exercised.

*b* In loan and investment regulation, the powers of CC and FR are chiefly in separate areas, although there is some overlapping.

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is not as responsive to the public will as it should be\(^{363}\) and that a real expansion of federal power is called for. Such proposals are not new, however. As early as 1933, it was urged that our dual banking regulation be abolished and that we adopt unified banking control under federal supervision.\(^{364}\) Modern proposals for expansion of federal power have tended to be narrower in scope than those proposed immediately following the depression. In 1963, a committee on financial institutions recommended to President Kennedy that all commercial banks be subject to the same reserve requirements that now are applied only to members of the Federal Reserve System.\(^{365}\) A modification of the committee's proposal was suggested in the 1965 Annual Report of the Board of Governors of the Federal Reserve System. The board recommended legislation that would authorize the Board to fix reserve requirements on a graduated basis according to the amount of deposits and that would make such requirements applicable to all insured banks. At the same time, it is recommended that all banks subject to such requirements should be afforded access to Federal Reserve discount facilities.\(^{366}\) (Emphasis added.)

In 1965 Senator Robertson of Virginia introduced a bill that would make non-member insured state banks subject to many restrictions now imposed on member banks only. These restrictions concern loans to affiliates, loans to executive officers, and the proper relation between bank directors and the management of securities companies.\(^{367}\)

The latest example of congressional expansion of federal regulatory power is the Financial Institutions Supervisory Act of 1966\(^{368}\)

2. The Financial Institutions Supervisory Act of 1966

Recent bank failures, which were the result of improper practices and what has been described as the infiltration of financial institutions by "unscrupulous operators,"\(^{369}\) prompted the enactment of the Financial Institutions Supervisory Act of 1966.\(^{370}\)

Title II of the act deals with the regulation of commercial banks. The principal provisions of this section provide for the issuing of temporary\(^{371}\) and


\(^{364}\) 19 Fed. Reserve Bull. 166 (1933).

\(^{365}\) 1963 Comm. on Financial Institutions Rep. to the President of the United States 9.


\(^{371}\) Temporary orders will be issued if insolvency is imminent, if there is a substantial dissipation of assets, or any time the interests of depositors or savings account holders would be put in jeopardy. 80 Stat. ——, 12 U.S.C.A. § 1818(c)(1) (Supp. 1966). The temporary
permanent cease and desist orders by federal regulatory agencies whenever an institution under their jurisdiction has violated a law, rule, regulation, or charter, or any other written condition or agreement. The orders will also issue where a bank has engaged in unsound or unsafe practices, or where the agency has reasonable cause to believe that such a practice may be committed. The bill also authorizes the removal of bank officers and directors. These removal orders can be issued (1) where the directors or officers violate a regulation or a final cease and desist order or engage in unsound banking practices, and (2) this violation or practice has caused, or may cause, substantial financial loss to depositors or holders of savings accounts, and (3) such violation involves personal dishonesty. It should be noted that this removal power may operate against a bank director or officer who causes financial loss to another insured "business institution"; this is considered to be evidence of his "personal dishonesty and unfitness to participate in the conduct of the affairs of such insured bank." In addition, if a director or officer is indicted or charged with a felony involving dishonesty or breach of trust, he may be suspended. If he is convicted, he may be removed. Court injunctions may be obtained to force obedience to any cease and desist, suspension, or removal order. Title II divides the jurisdiction with respect to the issuance of these orders between the three federal regulatory agencies. The Federal Deposit Insurance Corporation has the power to issue orders to insured nonmember state banks. The Federal Reserve Board has the power to issue orders with respect to state member banks. When the orders issue to directors or officers of national banks (except for routine suspensions and removals based on charges of dishonesty) they must be issued by the Federal Reserve Board, with the proviso that in such cases the Comptroller is made a member of the Board of Governors and is allowed to vote on the order. This special removal and suspension procedure, which limits the Comptroller's power, reflects congressional reluctance to give the power to issue the orders to only one man.

At the time these measures were being discussed, it was felt by some state banking groups that the act would give too much discretionary power to the federal agency involved and would ignore the state supervisory power, thus confusing further the "already confused supervisory picture." As a compromise to state banking agencies, the act provides that the appropriate state supervisory authority must be given notice of the federal agency's intent to institute cease and desist, suspension, or removal proceedings (other than ones based on felony charges or convictions). The state authority is to be given an appropriate time to take its own corrective measures, and only after the state agency has failed to act within the time specified may the federal order can be stayed by the district court on application filed within 10 days. 80 Stat. 12 U.S.C.A. § 1818(c)(2) (Supp. 1966). 372 80 Stat. 12 U.S.C.A. § 1818(b) (Supp. 1966). 373 80 Stat. 12 U.S.C.A. § 1818(e)(1) (Supp. 1966). 374 80 Stat. 12 U.S.C.A. § 1818(e)(3) (Supp. 1966). 375 80 Stat. 12 U.S.C.A. § 1818(g)(1) (Supp. 1966). 376 80 Stat. 12 U.S.C.A. § 1818(e)(7) (Supp. 1966). 377 112 Cong. Rec. 19221 (daily ed. Aug. 19, 1966). 378 Hearings on the Financial Institutions Supervisory and Insurance Act of 1966, at 131.
agency begin proceedings. To make the regulatory scheme more palatable, the act provides that the maximum amount of deposit insurable shall be raised from $10,000 to $15,000.

The act represents a substantial increase in the federal banking agencies’ control over state chartered banks. Indeed, “the thrust of the bill is directed at State-chartered institutions.”

3. The Effects on the Dual Banking System

One of the dual banking system’s most ardent defenders is the National Association of Supervisors of State Banks (NASSB). It is their feeling that federal regulation of state banking is only justified when it is exercised in “those narrow instances where it is related to a legitimate aim of the Federal Government.” It is further contended by the association that duplication of state supervisory functions is not a proper goal of the federal government unless “it can be shown that the states do not adequately use the power they now possess.”

The state supervisors, however, do believe that their power is adequately used.

The arguments that favor a contraction of federal regulation are usually based on the propositions that the dual banking system is of value to the banking community and that too much federal power will stifle that system. The value of the dual system is discussed by Mr. James F. Bell, General Counsel for the NASSB:

Without such a two-way street, there would not be the competitive spirit between the two segments which has resulted in a restraint on the part of both segments in their regulatory activities, thereby resulting in less Government regulation than is found in many foreign banking systems. This same competitive spirit has also created the necessary interplay to lead each segment to try to adopt the most effective and modern banking regulation procedures found in the other.

Although the dual banking system is too ingrained in our financial community to be easily abolished and may in fact be the impetus for continued growth within the banking industry, it must be seriously doubted that a contraction of federal regulation would inure to the general benefit of the banking industry and banking public. It seems obvious that such a contraction would further accentuate competitive inequalities between the different classes of banks. For example, relinquishment of

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384 See also [Jan.-Sept. 1966] 2 N.Y. ADVISORY CMM. ON COMMERCIAL BANK SUPERVISION REP. 4.
federal regulation over branches and mergers of state member and non-member insured banks could result in substantial disadvantages for state banks in relation to national banks.\textsuperscript{387}

Even if a contraction of federal authority would prove beneficial, it is doubtful that the states could handle the extra burden. Even the president of the National Association of Supervisors of State Banks has admitted that less than two-thirds of the existing state agencies could handle such responsibility.\textsuperscript{388}

While some advocate the restriction of federal regulation, in practice, federal power over banking is a growing power. The reason for this is demonstrated by the Financial Institutions Supervisory Act: the protection of the depositor and investor is the protection of the general public. Although a state-dominated system of supervision may develop a competitive spirit among the regulatory agencies, it does not guarantee the security of a nation’s depositors. Though some believe that even the federal agencies are not as responsive as they might be to the public will,\textsuperscript{389} it seems that intelligent supervision at the national level is wiser than allowing fifty states to set fifty different standards as to what is sound banking practice.

C. Expansion Through Structural Change

1. Introduction

The present conflicts among the three federal banking agencies indicate that a major problem facing federal regulatory power is the structure of the regulatory system.\textsuperscript{390} The conflicts between the Comptroller and the Federal Reserve Board have led to confusion within the banking industry and have lowered the prestige and effectiveness of both federal agencies. Attempts at separately resolving each conflict through specific remedial legislation have met with failure,\textsuperscript{391} as have attempts at coordination.\textsuperscript{392} The only way in which such differences may be finally resolved seems to lie in the consolidation of federal bank regulatory authority in a single agency. If consolidation is the answer, the obvious question is in which agency should the power be consolidated. Three agencies or departments have been seriously considered: (1) the Federal Reserve Board; (2) the Treasury Department; (3) a new Federal Banking Commission.

2. Consolidation in the Federal Reserve System

In 1919, six years after the enactment of the Federal Reserve Act, Con-

\textsuperscript{388} N.Y. Times, Oct. 27, 1964, p. 53, cols. 6-7.
\textsuperscript{389} Patman, \textit{supra} note 363.
\textsuperscript{390} See 1963 \textit{Hearings on Federal Banking Commission} 168.
\textsuperscript{391} Two examples of such attempted legislation are: H.R. 3956, 78 Cong., 2d Sess. (1944), which was intended to settle the dispute between the Federal Reserve and the FDIC regarding the absorption of exchange charges (see text accompanying notes 212-23 \textit{supra}); H.R. 5845, 88 Cong., 1st Sess. (1963), which was intended to resolve the dispute between the Comptroller and the Federal Reserve regarding investments in revenue bonds by commercial banks.
\textsuperscript{392} One such attempt at coordination can be found in the letters of Secretary of the Treasury Dillon to the heads of the three federal banking agencies. \textit{1965 Hearings on Consolidation of Bank Supervisory Functions} 354.
gress saw two bills introduced that would have eliminated the office of the Comptroller of the Currency and would have transferred his functions to the Board of Governors of the Federal Reserve System. These bills were prompted by the dissatisfaction of some members of Congress with the conduct of the Comptroller. A similar bill was introduced in 1921 prompted by the fact that some state banks had become members of the Federal Reserve System when the Comptroller had allowed the state banks to obtain national charters after the banks had previously been refused membership by the Federal Reserve.

In 1949 a task force for the investigation of regulatory commissions, under the Hoover commission, urged that all federal regulatory functions be consolidated in the Federal Reserve Board. The reasons given by the task force in support of the plan were (1) that the Federal Reserve would be the organization best able to regulate bank practices without adversely affecting the country's monetary policies, since the Board already is the agency responsible for developing and implementing these policies, and (2) that the System's regional banks constituted a national framework for the delegation of supervisory authority.

With the recent interest in consolidation, the Federal Reserve has again come under consideration. Former Federal Reserve Board Governor Abbott L. Mills suggested in 1963 that if Congress decided to consolidate the supervisory power, the agency that could most appropriately handle the resulting power would be the Federal Reserve. In a statement before the Subcommittee on Bank Supervision and Insurance, Governor Mills explained: "[T]he Federal Reserve System suggests itself as the one most appropriate, in that its responsibilities in the field of monetary and credit policy already demand a close relationship with its Nation's commercial banks."

Those who oppose consolidation in the Federal Reserve argue that the burden of supervisory authority would interfere with the Board's monetary functions. In the opinion of Governor J. L. Robertson of the Board:

The Federal Reserve could function as a central bank at least equally well, in my judgment, better, if it were to devote its full time to the formulation and execution of monetary policy and were not engaged in bank supervision at all.

Former Comptroller Saxon echoed this view when he advocated one central banking agency — "not the Federal Reserve Board" — to exercise "all non-monetary Federal authority over all State-chartered banks."

As has been seen, this argument is turned around by those who favor consolidation in the Federal Reserve Board. They argue that the supervisory authority, rather than burdening the monetary controls, actually makes the con-
trols more usable in the sense that the makers of monetary policy have close contact with the practical world of commercial banking via the supervisory functions. The President of the American Bankers Association, Mr. William F. Kelly, suggested the position of his organization on the subject of consolidation:

Without attempts to judge this complex issue, we would at least raise the question as to whether sufficient consideration has been given the fact that supervision exercised by the Federal Reserve banks gives the System direct and intimate contact with the commercial banking system and thereby keeps open important avenues of communication not otherwise available. Monetary policy decisions are of such far-reaching importance to the economy that it is essential that their purposes and consequences be thoroughly understood by the commercial banks.

Another reason for favoring consolidation in the Federal Reserve Board is that, because its monetary and supervisory controls are exercised over both national and state banks, it is least likely to favor one class of bank over another.

The Board has been accused of another bias, however, which if true would seem to reflect on its supervisory capabilities, at least from the public's standpoint. Chairman Wright Patman of the House Banking and Currency Committee has accused the Board of being the autocratic tool of the banking community and "well beyond the reach of the people and their elected Representatives." If the general public has a major stake in proper bank supervision at the federal level, as it seems they have, then the supervisory agency should in some sense be responsive to Congress. Board Chairman Martin has argued that a certain degree of isolation is needed to protect the Federal Reserve System from political control, but he maintains that the board is basically a public agency. He has defined it as "independent within the government, not independent of the government.

Mr. Patman's view of the nature of the Federal Reserve Board is not shared by everyone, however, as testified to by the support from outside the banking community for coordination within the Board.

3. Consolidation in the Treasury Department

In 1965, Mr. Patman introduced his own bill that would consolidate federal regulatory and supervisory authority in the Treasury Department. This approach is consistent with his belief that the Federal Reserve, as an independent agency, is the tool of the banking community and unresponsive to the public will. By consolidating these powers in the Treasury Department, regulation would be taken out of the hands of agencies dominated by bankers

401 Id. at 270.
402 Patman, supra note 363, at 314.
405 In 1963, the President of the United States Chamber of Commerce recommended that the Federal Reserve Board be given the authority to charter and regulate national banks. N.Y. Times, Oct. 4, 1963, p. 48, cols. 6-7.
407 Patman, supra note 363, at 314.
and would be concentrated in the chief financial officer of the Government, who is under the direct control of the President. The proposal would also eliminate the need for any new federal agency. The office of Comptroller of the Currency would be abolished by the Patman Bill. The Comptroller's present functions, as well as the functions of the FDIC, would be transferred to the Secretary of the Treasury. The FDIC would still exist, but only as a subdivision of the Treasury Department, since the Secretary would absorb the functions of the FDIC's Board of Directors. All the supervisory functions of the Federal Reserve Board would also be given to the Secretary, leaving the Board with its monetary functions only. The Secretary of the Treasury would be able to distribute the regulatory power in any manner throughout the agencies and officers of the Department.\textsuperscript{408}

The bill would certainly end the destructive fragmentation of federal authority, and for this reason it received some support from those who viewed any consolidation arrangement as an improvement over the present situation.\textsuperscript{409} The Patman bill met with strong opposition, however, from many quarters. The American Bankers Association condemned it as contrary to "the basic rationale of a dual banking system."\textsuperscript{410} The bill was also opposed by the Chairman of the FDIC\textsuperscript{411} and the Comptroller of the Currency.\textsuperscript{412}

The Patman bill would centralize regulatory authority in one individual, which would enable more decisive action without the cumbersome deliberations of a body like the Federal Reserve Board. However, it would seem that the deliberations of a board or commission would develop sounder policies and make wiser decisions than would an individual administrator. "The wisdom of this principle has been recognized by Congress again and again, in the establishment of the independent regulatory agencies that characterize 20th-century government."\textsuperscript{413}

4. Consolidation in a Federal Banking Commission

Perhaps the perfect compromise between the two proposals already discussed would be the creation of a new federal supervisory agency as proposed by a Federal Reserve Board Governor, J. L. Robertson. The new agency would not be burdened with monetary decisions, which was the major criticism of consolidation in the Federal Reserve; and it would be an independent agency free from executive domination and one man control, which were "defects" in the Patman bill.

Governor Robertson recommends that all bank examination and supervisory functions be vested in a new Federal Banking Commission composed of five members. The Office of the Comptroller and the FDIC would be abolished; and the Federal Reserve would be stripped of its supervisory authority, remaining

\textsuperscript{408} See 1965 Hearings on Consolidation of Federal Bank Supervisory Functions 69.
\textsuperscript{409} Governor Robertson of the Federal Reserve Board offered some support for the Patman bill, although he preferred the idea of a new Federal Banking Commission. 1965 Hearings on Consolidation of Federal Bank Supervisory Functions 87.
\textsuperscript{410} Id. at 182.
\textsuperscript{411} Id. at 210-15.
\textsuperscript{412} Id. at 235-36.
\textsuperscript{413} Id. at 85.
an instrument for the formation of monetary policy only. The commission would have two separate departments. One department, under a Director of Bank Examinations, would examine national banks and have authority to examine state member and nonmember insured banks as well. The other department would handle the deposit insurance functions of the FDIC and would be under the supervision of a Director of Insurance.414

In 1963 Congressman Multer introduced a bill415 that was based on Governor Robertson's proposals. The same arguments used against the Patman proposal were levied against the proposed commission. Bankers themselves were in the forefront of the opposition. They claimed that the new commission would violate the "plan" of Congress to keep the control of banking decentralized. Speaking for the American Bankers Association, the President, Mr. Archie K. Davis, argued that "Congress recognized that the advantages of dual supervision would be lost if all Federal supervision were lodged in one place."416

It seems obvious that the duplication of functions and the present triple standard in federal bank regulation are undesirable and may well have put our banking system in a dangerous position. Yet whenever the obvious answer of consolidation is urged, the bankers themselves rise to defend the present confusion. But does consolidation really mean the expansion of federal power? Is there any connection between direct expansion in federal power such as the Financial Institutions Supervisory Act and the weakness in the tripartite enforcement structure?

D. The Race of Laxity

On May 8, 1963, Governor Robertson spoke before the House Subcommittee on Bank Supervision and Insurance in support of his new Federal Banking Commission. He felt a major benefit of his proposal was that it

would do away with a dangerous tendency toward a "race of laxity" in bank supervision that will lead, at an accelerating rate, to deterioration of the standards of sound banking which it is a function of bank supervision to maintain.417 (Emphasis added.)

This race of laxity results from the attempts of each agency to eliminate the competitive disadvantages of the banks under its supervision. Those who benefit from this laxity oppose consolidation, fearing that it would result in an expansion of regulation. Logically, however, consolidation of federal power does not have to mean expansion of federal power. The General Counsel for the Federal Reserve Board, Mr. Howard H. Hackley, believes that consolidation proposals

would not in any respect change the substantive requirements of federal law; they would change only the structure of federal bank supervision. They would not extend to state banks any provision of federal law not

414 See id. at 81-110; 1963 Hearings on Federal Banking Commission 174-81.
416 1965 Hearings on Consolidation of Bank Supervisory Functions 183.
417 1963 Hearings on Federal Banking Commission 177.
now applicable to such banks. The fear that the mere establishment of a single agency would lead to encroachment on the powers of the states and thus imperil the dual banking system appears to have no logical foundation.\[418\]

Although the fear that consolidation means an expansion of power might not have any logical foundation, it may have a practical one. Although state banking agencies oppose any increase in substantive federal power\[419\] (e.g., the Financial Institutions Supervisory Act of 1966), they oppose with equal vigor any plan that would permit enforcement of the present law to the limits of the statutory language.\[420\] Given the present situation, each agency is reluctant to fully utilize its supervisory power where this would result in competitive disadvantages for the banks under its regulation. If all power to regulate were in one agency, that agency could fully enforce its supervisory controls, because it would have no fear that such enforcement would cripple one class of federally supervised banks to the advantage of another class.

Power over banking, then, can be visualized as substantive power — the letter of the law — and effective power — the way that law is interpreted and the extent to which it is enforced. Consolidation may very well expand the effective power of the federal government over banking, and this seems to be at the root of the banking community's reluctance to consolidate. However, it seems that, as a reaction to the laxity in the enforcement of the present supervisory power, some legislative steps will be taken. If bankers generally are not willing to support a reorganization of federal power in such a way as to permit stricter enforcement of existing federal law, Congress may enact stiffer supervisory measures in an effort to expand substantive federal power. Consolidation would seem to be the more preferable solution. As Governor Robertson has stated:

It would end much friction and conflict among banks and bank supervisors. It would eliminate wasteful duplication and overlapping among agencies. It would abolish the present triple standard and enable the banking industry to operate under a single, consistent set of rules, as far as federal supervision is concerned. It would do away with a dangerous tendency toward a "race of laxity" in bank supervision that will lead, at an accelerating rate, to deterioration of the standards of sound banking which it is the function of bank supervision to maintain.\[421\]

V. Federal Regulation of Anticompetitive Banking Practices — Conflicting Policies

A. Introduction

The eighty-ninth Congress will be remembered by those in the banking profession for two noteworthy acts of legislation: the 1966 amendments to both the Bank Merger Act of 1960\[422\] and the Bank Holding Company Act of 1956.\[423\] Both acts represent attempts to resolve problems left unresolved, and to some

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\[418\] Hackley, supra note 387, at 817.
\[420\] 1965 Hearings on Consolidation of Bank Supervisory Functions 120.
\[421\] 1963 Hearings on Federal Banking Commission 177.
\[422\] 74 Stat. 129 (1960).
extent actually initiated, by previous congressional legislation in this area. The problem to be discussed is caused by a basic lack of consensus as to what is the genus "banking" as an economic activity. This in turn causes a lack of consensus regarding the type and extent of regulation to which banking should be subject. At one pole, with former Senator Robertson as spokesman, are those who believe that the banking industry should not be subject to sections 1 or 2 of the Sherman Act or section 7 of the Clayton Act because, through comprehensive regulation by the three federal banking agencies and the fifty state banking agencies, the banking industry has taken on the nature of a public utility— it has become a unique economic pursuit. The reason for banking's uniqueness, it is claimed, lies in its importance to our economy. It is the very basis of our economy because it creates the resources and provides the means by which most commerce within the country is transacted. Because of this important function of the banking industry, it differs from industries traditionally subject to the philosophy of "success to the efficient, failure to the inefficient" and, therefore, subject to the antitrust laws. Such a philosophy in the field of banking would produce far-reaching effects detrimental to the public interest. Because the freewheeling competition of unregulated industry does not exist in the highly regulated banking industry, it is argued that the antitrust laws, created as the guardians of economic opportunity within unregulated industry, should not apply to the banking industry.

At the other pole stand the proponents of strict application of antitrust law

427 According to the Director of the Department of Banking and Economic Research in the Office of the Comptroller of the Currency, this regulation should be a factor in determining the applicability of the antitrust laws to the banking industry.

Public policy with respect to banking may clearly be distinguished from that applied to the unregulated industries, and the distinctions are relevant to the proper applicability of antitrust concepts to the banking industry. Entry into banking is restricted, bank expansion is controlled, and the competition of banks for the "raw materials" of their operations, the services which they offer, and the prices which they charge for those services, are in greater or less degree publicly regulated or supervised. These basic decisions, which are left largely to private entrepreneurs in the unregulated industries, represent the critically essential means through which the competitive forces are expressed. There is no more fundamental sense in which an industry could be said to be unique with respect to the applicability of the competitive concepts embodied in our antitrust laws. Abramson, The Philadelphia National Bank Case: A Reply, in STUDIES IN BANKING COMPETITION AND THE BANKING STRUCTURE 39 (The Administrator of National Banks ed. 1966).

431 Berle, supra note 430, at 592; Harfield, Legal Restraints on Expanding Banking Facilities, Competition and the Public Interest, 14 BUS. LAW. 1016, 1021 (1959).
432 KRONSTEIN, MILLER & DOMMER, MAJOR AMERICAN ANTITRUST LAWS 295 (1965). The Office of the Comptroller of the Currency believes that "competitive forces are purposefully restricted in order to safeguard the viability of the banking system, and an effort to apply conventional antitrust principles in these circumstances is almost certain to conflict with bank regulatory objectives." A Statement of Policy, in (The Administrator of National Banks ed.), op. cit. supra note 427, at 401, 408.

One commentator believes that much of the supervision and regulation over banking today has as its purpose the actual elimination of competition—the antithesis of the anti-
to the banking industry. This faction also bases its reasoning on the importance of banking in our economy, but fails to be swayed by the arguments of uniqueness and comprehensive regulation. The reason for their viewpoint was clearly stated by former Attorney General Katzenbach:

The proper discharge of banking functions is indispensable to a healthy national economy. Access to credit on competitive terms is critical to the survival and growth of commercial and industrial enterprises. Unduly high banking charges, or abnormal disparity between the rates at which large and small borrowers can obtain funds will inhibit industrial growth and prevent the emerging of innovating competitors. Undue concentration in banking can lead to inflated charges and discriminatory rates. It may fairly be said that, because of the central role of banks in relation to other businesses, the traditional antitrust goal of prevention of undue concentration is as important in banking as in any other field.

I say this in full recognition of the fact that banks are, to some extent, formally regulated. Extensive governmental supervision of banking exists primarily to prevent financially unsound practices. This regulation, however, is far less comprehensive than the regulation of public utilities, for example, which warrants displacement of the antitrust laws. . . . In the absence of such comprehensive regulation, the protection of the antitrust laws . . . in banking must be retained.433

Those who would apply antitrust law to banking attempt to distinguish the industry from public utilities by arguing that the essential characteristic of a public utility — “the presence of some feature which makes competition clearly impossible or at least extremely wasteful”434 — is not present. Thus, they conclude, banking may be unique, but no more so than all other industries, inter se.435 This attitude reached its ascendancy in United States v. Philadelphia Nat’l Bank,436 where the Supreme Court applied the strict standard of section 7 trust laws. As examples he cites requirements for specified reserves, limitations on interest rates, and control over the cost and availability of bank credit. See, Seely, Banks and Antitrust, 21 Bus. Law. 917 (1966).

A historical basis for antitrust exemption also exists. McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819), held, inter alia, that Congress had the power to regulate banking. This power was founded upon the necessary and proper clause, id. at 421-24, rather than the commerce clause, which is the basis for federal jurisdiction under the antitrust laws. Addyson Pipe & Steel Co. v. United States, 175 U.S. 211 (1899). Reinforcement for this position came in Nathan v. Louisiana, 49 U.S. (8 How.) 73 (1850), where the Court determined that use of money in buying and selling bills of exchange does not constitute engaging in commerce, but merely “supplying an instrument of commerce.” Id. at 81. This line of reasoning, however, was severely shaken in United States v. South-Eastern Underwriters Ass’n, 322 U.S. 533 (1944), wherein the Court determined that writing a contract of insurance, previously considered non-commercial, is engaging in “commerce.” See Berle, supra note 430, at 590. The question is moot today in the light of Transamerica Corp. v. Board of Governors, 206 F.2d 163 (3d Cir.), cert. denied, 346 U.S. 901 (1953) and United States v. Philadelphia Nat’l Bank, 201 F. Supp. 348 (1962), rev’d, 374 U.S. 321 (1963), where federal antitrust law was held applicable to commercial banking as “commerce.” Even after these decisions, however, Congress continues to deal with banking as a specialized field. Examples of this special treatment are cited in Legislation, 20 Vand. L. Rev. 200, 201-04 (1966).

433 Hearings on S. 1698 Before the Subcommittee on Domestic Finance of the House Committee on Banking and Currency, 89th Cong., 1st Sess. 170-71 (1965) [hereinafter cited as House Hearings on S. 1698].
434 House Hearings on S. 1698, at 1048.
435 Id. at 966.
of the Clayton Act to a proposed bank merger without considering applicable statutory mitigating factors promulgated specifically for the banking industry.

The failure to sufficiently define the nature of banking for purposes of effective regulation is shown by attempts to pacify, to some extent, both extremes by calling banking a "quasi-public utility" and suggesting that it be regulated in the same manner as "quasi-utilities and monopolies." Further attempts to satisfy both factions through compromise legislation have resulted in vague standards which only worsen the problem, since these standards must be jointly interpreted and enforced by the very factions holding the opposing views. Thus, there is a lack of "consensus as to direction," even though all the regulatory laws have the same objective of promoting safe, efficient banking service.

The result of this chaos has been a failure to resolve the real problem: the "demonstrable public need, and perhaps . . . demand, for increased banking capacity and increased accessibility of banking services." Despite past failures, Congress has again attempted to satisfy this basic public need through the process of redefinition and reclassification manifested by the amendments to the Bank Merger and Bank Holding Company Acts. The probable success or failure of this effort will be explored in the following sections.

B. Bank Mergers

Although it has been generally accepted for almost 150 years that banking is vested with a public interest due to its close relationship with the country's fiscal policies, federal regulation of concentration within the industry has been by and large "incomplete and confusing." The need for supervision over national bank mergers was recommended as early as 1913, but federal regulation in this area was almost nonexistent until recent years.

1. Supervision of Bank Mergers Prior to 1960

The futility of attempting to apply the original Clayton Act to bank mergers was recognized as early as 1913, but federal regulation in this area was almost nonexistent until recent years.

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No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.


440 "[M]uch of the trouble in applying the antitrust laws and related legislation generates from the failure of legislators to meet the issues squarely by clear statements of purpose and by laws clearly drawn to meet the issues." Carter, Commercial Banking and the Antitrust Laws, 11 Antitrust Bull. 141, 189 (1966).


442 Kronstein, Miller & Dommer, op. cit. supra note 432, at 294.

443 Harfield, supra note 431, at 1025.

444 For the sake of brevity, the term "merger" will be used hereinafter to include not only technical mergers, but also consolidations and transactions where one institution acquires the assets of another and assumes its liabilities.


448 Act of Oct. 15, 1914, ch. 323, § 7, 38 Stat. 751:

No corporation engaged in commerce shall acquire, directly or indirectly, the whole
mergers stemmed from the fact that mergers were not accomplished by acquiring the "stock or share capital" of another bank, but by the acquisition of its assets, a procedure not regulated by the Act. A second reason for believing that the Clayton Act could not reach bank mergers was that banking was not considered "commerce," thereby constitutionally exempting it from the Act's purview. The same constitutional exemption also protected bank mergers from the reach of the Sherman Act. A final reason for assuming that the Clayton Act would have no effect upon bank mergers was that, while section 11 vests exclusive enforcement authority in the "Federal Reserve Board where applicable to banks," the Board appeared to be "uninterested in utilizing this authority."

Attempts to control bank mergers by means other than the antitrust laws proved equally as futile. The National Bank Consolidation Act of 1918 requires prior approval by the Comptroller of the Currency before a consolidation can be effected between two or more national banks or between a state and national bank under the charter of the national bank, or before effectuation of a merger of a state bank into a national bank. Section 18(c) of the Federal Deposit Insurance Act required prior approval by the Federal Deposit Insurance Corporation before, inter alia, an insured bank could merge with a noninsured bank. It further required that no two or more banks could merge if their aggregate capital stock would decrease because of the merger, without prior written consent of the proper supervisory agency. That agency would be the Comptroller of the Currency, the Federal Reserve Board, or the Federal Deposit Insurance Corporation; depending upon whether the resulting bank was, respectively, a national or district bank, a state member bank, or a non-member insured state bank. In neither the National Bank Consolidation Act nor the Federal Deposit Insurance Act, however, did Congress provide the federal banking agencies with any standards to be applied in judging the proposed merger's effect upon banking concentration. Consequently, this factor was not one of their considerations.

or any part of the stock or other share capital of another corporation . . . where the effect of such acquisition may be to substantially lessen competition . . . or to restrain such commerce in any section or community, or tend to create a monopoly of any line of commerce.

449 Although part of the merger transaction will involve acquisition and cancellation of the acquired bank's stock, and subsequent reissuing of the acquiring bank's stock to the equity holders of the acquired bank, this procedure was considered an integral part of the merger transaction, and not an acquisition of "stock or share capital" subject to the Clayton Act. Accord, Arrow-Hart & Hegeman Elec. Co. v. FTC, 291 U.S. 587 (1934).

450 Sherman Act § 1, 26 Stat. 209 (1890), as amended, 15 U.S.C. § 1 (1964), provides:

Every contract, combination in the form of trust or otherwise, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal . . . .


Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor . . . .


454 Ch. 967, § 18(c), 64 Stat. 892 (1950).

455 A district bank is one chartered under federal law to do business within the District of Columbia.
As a result of this almost unlimited freedom, between 1940 and 1950, 774 banks disappeared through absorption, consolidation, or merger.456 This concentration was largely responsible for the fact that by 1951 "1½ per cent of the banks had over 54 per cent of the total assets of all American banks . . . [and] the hundred largest banks controlled 48 per cent of the deposits of all commercial banks . . ."457 The widespread use of the merger device has been attributed to: (1) a desire to avoid the limitation on the lending power of a national bank, restricting the amount of unsecured loans outstanding to ten percent of its capital stock and surplus;458 (2) the lower operating costs and higher profits that accompany growth in size;459 (3) the lack of sufficient depth in management within the smaller banks;460 (4) meeting the expanding credit needs of an expanding industrial economy;461 (5) meeting the competition of other financial institutions;462 (6) providing for "diversification in deposits, investments and services."463

Concentration by merger and consolidation between 1940 and 1950 was not limited to the banking industry. In 1950 Congress was shocked to learn that as early as 1946 "one-tenth of one percent of the total number of all American corporations . . . owned 49 percent of the assets of all American corporations . . ."464 This concentration was attributed in part to a loophole in section 7 of the Clayton Act, which, as originally enacted,465 covered stock acquisitions but not asset acquisitions. To close this loophole, Congress in 1950 enacted the Celler-Kefauver Amendment to section 7. The pertinent part of the amendment states, "[N]o corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation . . . where the effect of the acquisition may substantially lessen competition or tend to create a monopoly. The Senate Report stated that the purpose of the amendment was to prevent corporations from acquiring another corporation by means of the acquisition of its assets, where under the present law it is prohibited from acquiring the stock of said corporation. Since the acquisition of stock is significant chiefly because it is likely to result in control of the under-

457 Klebaner, supra note 447, at 288.
460 Senate Hearings on S. 1698, at 59-60.
462 Ibid.
lying assets, failure to prohibit direct purchase of the same assets has been inconsistent and paradoxical as to the over-all effect of existing law.\textsuperscript{407}

As noted, before 1950 commercial banks desiring to merge had three lines of defense against attack under the antitrust laws: (1) the Clayton Act did not cover asset acquisitions; (2) banking was not "commerce"; (3) sole authority to enforce the Clayton Act against banks rested with the less than militant Federal Reserve Board. The Celler-Kefauver Amendment, however, marked the beginning of the end for banking's antitrust immunity. Though it proscribes anticompetitive asset acquisitions only where the acquiring corporation is subject to the jurisdiction of the Federal Trade Commission — which banks are not — it nonetheless demonstrated to the banking industry that merger by means of asset acquisition is not inherently sacrosanct. The second defense, that banking is not "commerce" and thereby not subject to the antitrust laws, was destroyed in 1953 by \textit{Transamerica v. Board of Governors},\textsuperscript{468} when the Third Circuit applied the Clayton Act to a bank holding company. By the late 1950s, therefore, the basis for believing bank mergers to be outside the purview of the antitrust laws was considerably narrowed. The lines of defense had narrowed to two: (1) the Celler-Kefauver Amendment to section 7 of the Clayton Act did not cover banks; (2) the Federal Reserve Board still retained exclusive authority to apply the Clayton Act against banks.

Though the defenses were diminishing, the merger trend continued. Between 1950 and 1958, 1,258 commercial banks disappeared as a result of absorption, consolidation, or merger.\textsuperscript{469} In 1955, "the largest single merger in American banking history," resulting in the Chase Manhattan Bank, was effected without the need for federal approval.\textsuperscript{470} So ineffective was federal legislation controlling bank mergers, that between 1955 and 1960 federal approval was not required for mergers involving over 10 billion dollars of resources.\textsuperscript{471} Some Senators believed that even in the limited situations where approval by one of the federal banking agencies was required before the merger could be effected,\textsuperscript{472} the record of agency disapprovals was disappointingly low.\textsuperscript{473} Discontent with the situation grew\textsuperscript{474} to the extent that by the end of the decade Congress was determined to enact legislation that would effectively avert the trend toward banking monopoly.

2. \textit{The Bank Merger Act of 1960}

The Bank Merger Act of 1960\textsuperscript{475} was born of controversy.\textsuperscript{476} The Depart-
ment of Justice had recommended legislation that would apply section 7 of the Clayton Act to bank mergers;\textsuperscript{477} the federal banking agencies, however, desired that they be vested with the power to review proposed mergers on the basis of anticompetitive and monopolistic factors.\textsuperscript{478} Neither faction was completely successful, for the Bank Merger Act of 1960 was a compromise that attempted to combine the expertise of the banking agencies\textsuperscript{479} with the antitrust experience of the Department of Justice.\textsuperscript{480} The act, in an effort "to provide for control of all mergers\textsuperscript{481} by asset acquisition by banks under the jurisdiction of the Federal banking agencies,"\textsuperscript{482} prohibited mergers where the resulting bank was a national or district bank, a state member bank of the Federal Reserve System, or an insured nonmember bank, unless prior approval was obtained, respectively, from the Comptroller of the Currency, the Federal Reserve Board, or the Federal Deposit Insurance Corporation. The granting or denial of approval by these agencies was to be based upon "uniform and clear standards . . . ."\textsuperscript{483} There were two classes of standards: the banking factors and the competitive factor. The banking factors were

the financial history and condition of each of the banks involved, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served, and whether or not its corporate powers are consistent with the purposes of this Act.\textsuperscript{484}

These six banking factors were taken from section 6 of the Federal Deposit Insurance Act.\textsuperscript{485} The Senate report noted that "these are the usual banking factors which these three regulatory agencies are accustomed to review and consider."\textsuperscript{486} Though these factors might have been familiar, the fact that the familiarity was obtained through their use as criteria in approving federal deposit insurance applications — something quite unlike bank mergers — was not mentioned in the legislative history. The act also directed the agencies to take into account the competitive factor, i.e., "the effect of the transaction on competition (including any tendency toward monopoly)."\textsuperscript{487} The agency with jurisdiction over a particular merger was to request reports on the competitive factor from the other two banking agencies and the Attorney General in order to insure uniformity and to

\begin{itemize}
  \item avoid a situation where one Federal agency is "tough" about mergers and another one is "easy," where there might be an inducement to arrange
\end{itemize}

\textsuperscript{477} Ibid.
\textsuperscript{480} The Act's coverage extended to all banks insured by the Federal Deposit Insurance Corporation which included 95% of all banks in the United States, holding 97% of the country's total banking assets. H.R. Rep. No. 1416, 86th Cong., 2d Sess. 5 (1960).
\textsuperscript{482} Ibid.
\textsuperscript{483} 74 Stat. 129 (1960).
\textsuperscript{486} 74 Stat. 129 (1960).
mergers so as to result in the kind of bank where approval could be easily obtained.\footnote{488}

It is clear, however, that these reports were to be purely advisory. They in no way bound the responsible agency or affected its exclusive jurisdiction.\footnote{489} In rendering its decision, the agency was to consider all seven factors together, without giving controlling weight to any of them,\footnote{490} and was not to approve the merger unless it found it to be in the public interest. The "public interest" was interpreted to mean merely a finding, after all seven factors had been equally weighed, of some positive benefit to be derived from the merger.\footnote{491} The agency's decision was to be a "balanced judgment."\footnote{492}

The Senate report noted that the banking factors were essential, but that they alone would not suffice, since they gave insufficient weight to the merger's effect upon competition.\footnote{493} On the other hand, the rule of section 7 of the Clayton Act, including the Celler-Kefauver Amendment, was regarded as too strict to be applied to bank mergers, since by its terms, absolute weight is given to the merger's effect upon competition;\footnote{494} no other factors can be considered regardless of their beneficial effect. Use of the Clayton Act standard in the Bank Merger Act was also deemed undesirable due to a fear that the legislative history of the Bank Merger Act, combined with subsequent judicial decisions that would interpret the Clayton Act standard as applied under the Bank Merger Act, could weaken section 7 of the Clayton Act to the extent that it would lose its effectiveness when used to attack mergers in unregulated industries where strict application is desired.\footnote{495} Although the House Committee was convinced of the basic soundness of the Senate's approach,\footnote{496} the committee reported:

We are concerned ... with some indications that under the Senate bill a merger could be approved even though it "unduly" lessened competition. While this result presumably was not intended, ... doubts on this score should obviously be removed. We are convinced, also, that approval of a merger should depend on a positive showing of some benefit to be derived from it. ... We ... reject the philosophy that doubts are to be resolved in favor of bank mergers, ... [and] feel [that] the burden should be on the proponents of a merger to show that it is in the public interest, if it is to be approved.\footnote{497}

In neither committee report, however, was there any question that a merger

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\footnotetext{490} S. REP. No. 196, 86th Cong., 1st Sess. 21, 22 (1959).
\footnotetext{491} H.R. REP. No. 1416, 86th Cong., 2d Sess. 11-12 (1960); see Senate Hearings on S. 1698, at 302.
\footnotetext{493} Ibid.
\footnotetext{494} Ibid.
\footnotetext{495} Id. at 20-21.
\footnotetext{496} H.R. REP. No. 1416, 86th Cong., 2d Sess. 11 (1960).
\footnotetext{497} Id. at 10-11.
could be found to be in the public interest though it did in fact lessen competition.\textsuperscript{498}

Other provisions of the Bank Merger Act required the federal banking agencies to apprise Congress annually of the pertinent facts of each merger approved during the previous year\textsuperscript{499} and required publication of notice of proposed mergers, except in certain emergency situations, in order to allow interested citizens to express their views.

If any one purpose can be gleaned from the legislative history of the Bank Merger Act of 1960, it is the congressional intent to achieve control over bank mergers — indeed to make them more difficult\textsuperscript{500} — through the implementation of uniform standards, including a consideration of the proposed merger’s effect upon competition.\textsuperscript{501} Effecution of this purpose, however, depended upon a good faith effort on the part of the federal banking agencies to heed the intent of Congress.\textsuperscript{502} Whether the agencies made this effort is questionable. Between May 1960 and December 1963, the agencies approved over 95 per cent of the merger applications, although 70 per cent of them had been criticized by the Department of Justice as violating the Bank Merger Act’s competitive factor.\textsuperscript{503} Although these statistics have been interpreted by some as evidence of agency disregard for congressional intent, others have noted that the advisory reports on the competitive factor should not be judged as an opinion on the desirability of the merger as a whole, since they fail to take into account the six banking factors.\textsuperscript{504} The fact remains, however, that the act proved ineffective in achieving its goal of making bank mergers more difficult.\textsuperscript{505} This ineffectiveness might well be traced back to Congress itself; for uniform regulation is quite difficult to achieve where three agencies, each subject to different laws, attempt to apply “standards” that “are commonly passive legal and descriptive considerations or at most conditioning factors which would influence the decision only indirectly.”\textsuperscript{506}

The continued trend toward banking concentration led the Department

\textsuperscript{498} Id. at 10; S. Rep. No. 196, 86th Cong., 1st Sess. 19-20 (1959).
\textsuperscript{499} This report was to include the names and resources of the banks involved, the reasons why the agency approved the merger, and a summary of the Attorney General's report in each case where one had been submitted.
\textsuperscript{500} Senate Hearings on S. 1698, at 182.
\textsuperscript{502} Senate Hearings on S. 1698, at 298.
\textsuperscript{503} House Hearings on S. 1698, at 3. The Federal Reserve Board approved 117 applications and denied 15; the Comptroller of the Currency approved 329 and denied 11; and the Federal Deposit Insurance Corporation approved 127 and denied 2. Senate Hearings on S. 1698, at 16.

If the merger involves two competing banks, and their competition is more than insignificant, the [Justice] Department typically looks no further .... But the antitrust inquiry of the agencies is more penetrating. Going beyond the question of what quantum of competition will be lost as a result of the merger, they focus on the vigor of remaining competition — the variety of alternative sources for bank services and credit — in an effort to forecast the effect of the transaction in the market as a whole. Waxberg & Robinson, \textit{Chaos in Federal Regulation of Bank Mergers: A Need for Legislative Revision}, 82 \textit{Banking L.J.} 377, 381 (1965).

(Footnotes omitted.)
\textsuperscript{505} Senate Hearings on S. 1698, at 182.
\textsuperscript{506} House Hearings on S. 1698, at 1051.
of Justice to urge again\footnote{See text accompanying note 477 supra.} that section 7 of the Clayton Act should be extended to bank mergers accomplished by asset acquisition. As a means of testing its proposition, the Department of Justice chose to attack the approved but unconsummated merger of Philadelphia National Bank and Girard Trust Corn Exchange Bank.

Before its contention could be successfully maintained, however, there had to be an initial determination as to whether the Bank Merger Act had superseded the Clayton Act's applicability to bank mergers. The Supreme Court, in United States v. Philadelphia Nat'l Bank,\footnote{374 U.S. 321 (1963).} ruled that the Clayton Act had not been superseded and allowed the action to proceed solely under section 7. In doing so it stated that

the legislative history of the [Bank Merger] Act seems clearly to refute any suggestion that applicability of the antitrust laws was to be affected. Both the House and Senate Committee Reports stated that the Act would not affect in any way the applicability of the antitrust laws to bank acquisitions. . . .

It should be unnecessary to add that in holding as we do that the Bank Merger Act of 1960 does not preclude application of § 7 of the Clayton Act to bank mergers, we deprive the latter statute of none of its intended force. Congress plainly did not intend the 1960 Act to extinguish other sources of federal restraint of bank acquisitions having anticompetitive effects.\footnote{Id. at 342.}

This initial obstacle having been overcome, the Court, in a decision that rocked both Congress and the banking industry, accepted the position of the Department of Justice and thus extended the scope of section 7 to bank mergers accomplished by asset acquisition. In reaching its decision, the Court reasoned that the Celler-Kefauver Amendment gave the Clayton Act

a reach which would bring the entire range of corporate amalgamations, from pure stock acquisitions to pure asset acquisitions, within the scope of § 7. Thus, the stock-acquisition and assets-acquisition provisions, \textit{read together}, reach mergers, which fit neither category perfectly but lie somewhere between the two ends of the spectrum. . . . So construed, the specific exemption for acquiring corporations not subject to the FTC's jurisdiction excludes from the coverage of § 7 only assets acquisitions by such corporations when not accomplished by merger.\footnote{Id. at 336 n.13.}
Justice Harlan, dissenting, believed that the majority opinion left the Bank Merger Act "almost completely nullified." To look only to the Clayton Act with its single standard — the merger's effect upon competition — was to ignore recent congressional intent, as evidenced by the Bank Merger Act of 1960, that other factors be considered. Not only did the majority fail to consider the six banking factors, but they reversed the roles of the Attorney General and the banking agencies. Now the agencies would retain only an "initial veto", for if the agency's decision is not satisfactory, a § 7 suit may be commenced immediately. One year later, in United States v. First Nat'l Bank & Trust Co., the Court finished what it had begun in Philadelphia. It held section 1 of the Sherman Act applicable to a bank consolidation and thereby effectively construed the Bank Merger Act of 1960 out of existence.

The open conflict between the federal bank regulatory agencies and the Attorney General that culminated in the judicial legislation of the Supreme Court, left banks in a "never-never land" of merger confusion. Not only was holder dissenting from a merger has the right to receive the appraised value of his shares whereas no shareholder has a comparable right in an acquisition of stock. Furthermore the corporate existence of a merged company is terminated by a merger, but remains unaffected by an acquisition of stock. Both positions, we think, have merit; a merger fits neither category neatly. Since the literal terms of § 7 thus do not dispose of our question, we must determine whether a congressional design to embrace bank mergers is revealed in the history of the statute. The question appears to be one of first impression; we have been directed to no previous case in which a merger or consolidation was challenged under § 7 of the Clayton Act, as amended, where the acquiring corporation was not subject to the FTC's jurisdiction.

When it was first enacted in 1914, § 7 referred only to corporate acquisitions of stock and share capital; it was silent as to assets acquisitions and as to mergers and consolidations. It is true that the omission may not have been an oversight. Congress' principal concern was with the activities of holding companies, and specifically with the practice whereby corporations secretly acquired control of their competitors by purchasing the stock of those companies. Although assets acquisitions and mergers were known forms of corporate amalgamations at the time, their no less dangerously anticompetitive effects may not have been fully apparent to the Congress. Still, the statutory language, read in the light of the overriding congressional purpose to control corporate concentrations tending to monopoly, lent itself to a construction whereby § 7 would have reached at least mergers and consolidations.

But the courts found mergers to be beyond the reach of § 7, even when the merger technique had supplanted stock acquisitions as the prevalent mode of corporate amalgamation. As a result, § 7 become largely a dead letter. It was against this background that Congress in 1950 amended § 7 to include an assets-acquisition provision. The legislative history is silent on the specific questions why the amendment made no explicit reference to mergers, why assets acquisitions by corporations not subject to FTC jurisdiction were not included, and what these omissions signify. Nevertheless, the basic congressional design clearly emerges and from that design the answers to these questions may be inferred.

Congress primarily sought to bring mergers within § 7 and thereby close what it regarded as a loophole in the section. But, in addition, it sought to reach transactions such as that involved in Columbia Steel, which was a simple purchase of assets and not a merger. Id. at 336-42. (Footnotes omitted.)

511 Id. at 384 (dissenting opinion).
512 Id. at 385 (dissenting opinion).
513 Id. at 384-85 (dissenting opinion).
515 Seeley, Banks and Antitrust, 21 Bus. Law. 917, 923 (1966). In United States v. Manufacturers Hanover Trust Co., 240 F. Supp. 867 (S.D.N.Y. 1965), the third case to be decided under the Bank Merger Act of 1960, the district court found the merger of two New York banks to violate both § 7 of the Clayton Act and § 1 of the Sherman Act.
there a doctrinal clash on the question of what constitutes the anticompetitive
effects of a merger, but Congress had condoned this conflict by prescribing that
the banking agencies assess the merger under the liberal standards of the Bank
Merger Act, while at the same time allowing the Department of Justice to make
its assessment under strict antitrust standards.

3. The Bank Merger Act of 1966

a. Introduction

In an attempt to remove the uncertainty and confusion surrounding bank
mergers, Congress amended the Bank Merger Act in February 1966. The
amended act\textsuperscript{517} has two basic purposes. As a “specific repeal of two Supreme
Court decisions,”\textsuperscript{518} its primary purpose, according to Representative Ashley, is
“to assure that the courts will never again dismiss as irrelevant the question of
the need of a community for the services which a proposed merger may pro-
vide.”\textsuperscript{518} The act also attempts to effect a workable compromise in bank merger
regulation between the banking agencies and the Department of Justice.\textsuperscript{520}

Certain provisions of the original Bank Merger Act have been retained.
Prior written approval of the Federal Deposit Insurance Corporation is required
before an insured bank may merge with a noninsured bank or institution. Before
insured banks may merge, prior written approval is required from the Com-
roller of the Currency, the Federal Reserve Board, or the Federal Deposit In-
surance Corporation, depending upon whether the resulting bank is, respectively,
a national or district bank, a state member bank, or a nonmember insured bank.
The responsible agency is required to publish notice of the proposed merger and
deciding the case the court was of the opinion that the Bank Merger Act was “impotent.”
Id. at 880.

The Court's decisions in Philadelphia and Lexington were both surprising and frustrating
to Government officials. The Chief of Staff of the Senate Committee on Banking and
Currency stated that
every responsible official of the Government, from 1950 to 1960, who took a
position on the subject, took the position that . . . section 7 of the Clayton Act
would not apply to bank mergers. This applies to Congressman Celler and Senator
Kefauver, the authors of the Celler-Kefauver amendment of 1950, and to every
other Senator and Representative who spoke on the subject, and to every repre-
sentative of the Department of Justice, as well as representatives of the Federal
Reserve Board, Federal Trade Commission, and other agencies. No statements to
the effect that section 7 of the Clayton Act would or should apply to the Bank
Merger Act have been found up to the filing of the complaint in the Philadelphia
case . . . . Senate Hearings on S. 1698, at 329.

516 Senate Hearings on S. 1698, at 97.
518 112 Cong. Rec. 2538 (daily ed. Feb. 9, 1966) (the Philadelphia and Lexington de-
cisions).
519 112 Cong. Rec. 2339 (daily ed. Feb. 8, 1966). Senator Robertson stated:
It is not often that Congress finds it necessary and desirable to reverse a deci-
sion of the Supreme Court. It is necessary and desirable in this instance because
the consequences of the Court's erroneous opinions and decisions are so serious and
because the error is so clear. The legislative history of this specific repeal of two
Supreme Court decisions and one district court decision, and the clearer and more
specific standards set forth in this bill should convince the courts that the Congress
does not intend that mergers in the banking field should be measured solely by the
antitrust considerations which are applied in other industries.
to request reports on the competitive factor from the other two agencies and the Attorney General, unless immediate approval of the merger is necessary to prevent the probable failure of one of the banks. Finally, as in the original act, the agencies are required to annually inform Congress of the mergers that they have approved during the previous year.


(1) Past Mergers

By section 2(a) of the 1966 amendment, all bank mergers that were consummated prior to the Supreme Court’s decision in *Philadelphia* are made exempt from antitrust prosecution except under section 2 of the Sherman Act. This was done in an effort to lift a cloud of uncertainty from consummated mergers; to redress alleged inequitable application of the antitrust laws to mergers consummated at a time when the state of the law may have been uncertain; and to avoid the difficulties of unscrambling a merged bank.

Though over 2,000 bank mergers were permanently protected by this provision, Attorney General Katzenbach believed it unnecessary, since “past mergers against which no action was taken will remain undisturbed.” He viewed this provision as a mere “private bill” for the relief of a small number of politically powerful banks, whose recent mergers were either subject to pending antitrust litigation or had been ruled illegal subsequent to the Supreme Court’s decision in *Philadelphia*. His view of this provision as a private bill seems to be sound. The banks seeking inclusion of this exemption in the act argued that demerger and divestiture of assets would be unconscionable. However, they seem to have planned this defense far in advance. These same banks brought the possibility of ultimate divestiture upon themselves when, with knowledge that divestiture would be decreed if the Government’s cases against their mergers were successful, they nonetheless either accelerated the merger in order to effect it before a preliminary injunction could be granted or argued against granting the preliminary injunction after suit was brought. In either case, if the injunction had been obtained, a subsequent divestiture would have been unnecessary.

(2) Future Mergers—The New Standards

In the 1966 amendment the antitrust aspect of bank mergers is stated more definitively and receives more emphasis than in previous legislation.

521 The decision was rendered on June 17, 1963.
522 *House Hearings on S. 1698*, at 172.
524 *House Hearings on S. 1698*, at 173.
525 *Id.* at 170.
526 *Id.* at 174.
527 *Id.* at 173; H.R. REP. No. 1221, 89th Cong., 2d Sess. 31-32 (1966).
(a) The Monopoly Standard
Paragraph 5(A) of the Bank Merger Act of 1966 prohibits the responsible agency from approving

any proposed merger transaction which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States . . . .

This standard, clearly the same as that embodied in section 2 of the Sherman Act, was present in the 1960 act only by implication. Its emphasis is clear. A bank merger that would violate section 2 of the Sherman Act may not be approved under any circumstances.

(b) The Competitive Standard

Paragraph 5(B) is the focal point of the 1966 amendment. It prohibits the responsible banking agency from approving

any . . . proposed merger transaction whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

This paragraph "intentionally" embodies the antitrust language found in section 1 of the Sherman Act and section 7 of the Clayton Act, in order to emphasize the fact that all the principles established through these acts' long histories "are carried forward unchanged by this . . . legislation." According to the established principles of antitrust law, the competitive aspects of a merger are measured by its effects upon a "relevant market." This relevant market, in turn, is composed of a product market—a "line of commerce"—and a geographic market—an area where both competitors operate so as to afford the public alternatives in their choice of goods or services.

(i) The Product Market
A product market, or line of commerce, can be defined as specific goods or services that differ from other goods or services to such an extent that the consumer or user will believe the other goods or services to be "distinctly inferior substitutes." The less inclusive the line of commerce is found to be, the greater will be the potential monopoly power,
should the suppliers of the line of commerce merge or consolidate. In Philadelphia, the district court held commercial banking to be the relevant line of commerce. Its finding was later accepted by the Supreme Court. This determination is significant because in assessing the competitive effect of the bank merger the Court discounted the relevancy of any competition that might have existed between the banks and other financial institutions. The Court justified its finding on three grounds: (1) some commercial bank services, such as the checking account, are so unique that they face no effective nonbank competition; (2) loan services are effectively insulated from nonbank competition since potential competitors must borrow much of their capital from commercial banks, and consequently must charge higher rates than are charged by the banks from which they borrow; (3) although certain bank services freely compete with those offered by other financial institutions, users of these services have a preference for dealing with banks.

Whether the 1966 amendment will effect a change in judicial determinations of the relevant line of commerce in future bank merger litigation is unclear. In its determination that commercial banking was the product market in Philadelphia, the Court was guided by the language of the Clayton Act that expressly mentions "line of commerce." In paragraph 5(B), however, this phrase is absent. Senator Robertson believed that the phrase was omitted as an indication that the competitive effect of commercial bank mergers should no longer be assessed solely in the light of competition between banks, but that the competition of other financial institutions should also be considered. The benefit of Senator Robertson's interpretation is questionable. If services rendered by other financial institutions were to be considered in determining the competitive effect of a proposed merger, the result might be a differentiation of some or all of the over seventy separate banking services into separate lines of commerce. This would emphasize the merger's anticompetitive effect, rather than minimize it. This result is possible because of the extensive powers possessed by commercial banks. Since no other financial institution is authorized to provide the broad range of services that are provided by commercial banks, in order to determine the total effect the merger will have on the concentration of all the services which the commercial bank provides, the commercial banking product market might be differentiated into respective submarkets in order to correspond with the particular service rendered by each class of competing financial institution. Thus the separate lines of commerce would arise. Therefore it seems that Senator Robertson's interpretation could produce exactly the opposite result from that intended.

If Senator Robertson's interpretation is not accepted, it would seem that, by this omission, Congress has merely given the Supreme Court a carte blanche

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532 Ibid.
535 Id. at 356-57.
to determine, on a case by case basis, the relevant product market in future bank merger litigation. However, noting the congressional intent that paragraph 5(B) is to be interpreted in the light of established antitrust principles, it seems likely that the relevant product market established by the Supreme Court in Philadelphia will not be altered.

(ii) The Geographic Market

Section 7 of the Clayton Act proscribes mergers that have substantial anticompetitive effects "in any line of commerce in any section of the country." As noted above, however, paragraph 5(B) of the 1966 amendment deletes the phrase "in any line of commerce," and directs attention only to the merger's anticompetitive effects in "any section of the country."

In applying section 7 to the proposed merger in Philadelphia, the Court defined the geographic market as the geographical limits "where, within the area of competitive overlap, the effect of the merger on competition will be direct and immediate." Working with this definition in an effort to find "some fair intermediate delineation" that would avoid the extremes of either a very large or very small market, the Court decided that the relevant geographic market was the four-county area where the banks' offices were located, even though they competed in a multistate regional market as well.

Whether the deletion of the words "in any line of commerce" from the 1966 amendment will liberalize the Philadelphia approach to determining the relevant geographic market is as uncertain as its effect upon determining the relevant product market. The legislative history gives no reason why the words were deleted. Senator Robertson, the only legislator expressing an opinion on the matter, thought the deletion was intended to liberalize the Philadelphia approach by permitting assessment of the overall competitive effect of the merger. This would involve balancing the anticompetitive effect in a local market—where the bank does most of its retail business—with the precompetitive effect in a regional market—where the bank services large industrial clients. Whether the Supreme Court will follow Senator Robertson's interpretation, in the absence of a more definite expression of congressional intent, is questionable.

(iii) The Mitigating Clause

Though a proposed merger would violate the antitrust standards of paragraph 5(B), the agency and the courts are allowed to approve it if they find its anticompetitive effects "are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served." This clause is a revision of the "archaic and inappropriate phraseology" that was used in the "banking factors" clause of the original Bank Merger Act. The words "clearly outweighed" emphasize that the competitive factor of the merger is to be given primary consideration, unlike the

539 Id. at 361.
540 Id. at 359.
approach of the 1960 act, which required a mere balancing of the banking factors against the competitive factor.\textsuperscript{543} According to Representative Patman, "clearly outweighed" means outweighed by the preponderance of the evidence,\textsuperscript{544} with the proponents of the merger carrying the burden of proof.\textsuperscript{545} "The convenience and needs of the community to be served" is now the only factor that may be weighed against the anticompetitive effects of the merger.\textsuperscript{546} The major question, then, is the meaning of this phrase. One interpretation leaves the relevant community largely undefined, dependent only upon the regional or even world-wide areas where the banks transact their business.\textsuperscript{547} Another interpretation, finding that borrowers of limited size are usually restricted to a specific locale in securing banking services, is that the "maintenance of competition in a local market is of overriding significance."\textsuperscript{548} No clear meaning of "the convenience and needs of the community to be served" can be found in the legislative history. In fact, one of the Representatives said the phrase was "as vague and undefined a standard as any group of men could possibly dream up.\textsuperscript{549}

(3) \textbf{Challenging Proposed Mergers}

In an effort to tighten the control over banking concentration, paragraph 6 of the 1966 amendment requires the responsible agency to notify the Attorney General immediately after approving a proposed merger. Except in certain emergency situations,\textsuperscript{550} the merger cannot be consummated until thirty days after the date of agency approval. Paragraph 7(A) provides that any antitrust action brought by the Attorney General against the approved merger must be initiated prior to the earliest time that consummation of the merger would be allowed under paragraph 6, \textit{i.e.}, before the thirty days have elapsed. Commencement of an action results in an automatic injunction, prohibiting effectuation of the merger pending subsequent judicial approval. It is important to note that the statute of limitations in paragraph 7(A) is not all-inclusive. It applies only to the merger per se and does "not... immunize banks created by such mergers from future attacks... for later conduct which might violate the antitrust laws."\textsuperscript{551} The time restriction placed upon Justice Department action challenging proposed mergers was engendered by a desire to protect consummated mergers

\textsuperscript{544} \textit{Id.} at 2334.
\textsuperscript{545} \textit{Id.} at 2333-34.
\textsuperscript{549} H.R. Rep. No. 1221, 89th Cong., 2d Sess. 27 (1966) (remarks of Representative Gonzalez). Representative Weltner stated: "It cannot be argued that this new language will clarify the bank merger situation. The contrary is true; and if this bill becomes law, we must await years of litigation to know what we are actually legislating." \textit{Id.} at 29.
\textsuperscript{550} Paragraph 6 provides:

\textit{If the agency has found that it must act immediately to prevent the probable failure of one of the banks involved and reports on the competitive factor have been dispensed with, the transaction may be consummated immediately upon approval by the agency. If the agency has advised the Attorney General and the other two banking agencies of the existence of an emergency requiring expeditious action and has requested reports on the competitive factors within ten days, the transaction may not be consummated before the fifth calendar day after the date of approval by the agency. . . .}

\textsuperscript{551} \textit{House Hearings on S. 1698}, at 494.
from a "sword of Damocles" that could have theoretically struck them months or even years after consummation, thereby necessitating demerger, "which is worse than unscrambling an egg." The thirty-day period was believed to be a "brief but reasonable" time during which the Attorney General could determine whether or not to bring an action. It has been argued, however, that the provision could cause a flood of litigation. The Attorney General, faced with this short period in which to make his determination, might, as a defensive measure, bring action against many more proposed mergers than would be brought if a prescriptive period did not exist. The fear has been expressed that this could substantially disrupt the entire banking industry, due to the act's automatic injunction provision. Judging from past procedure this fear seems unwarranted. The Department of Justice, even in the absence of a statute of limitations, has always initiated suit within days after the banking agencies have approved proposed mergers.

Should the proposed merger be challenged, paragraph 7(A) provides for de novo judicial review of all the issues. In the interest of uniformity, paragraph 7(B) directs the court to judge the proposed merger under the identical standards that the agencies are required to apply under paragraph 5. In its review, the court is directed to "independently make a judgment as to whether the merger should be approved" on the basis of the evidence presented, without giving special consideration to the banking agency's determination of the issues. Under the standards of paragraph 5, it seems as though the court would be required not only to decide questions of law—the antitrust issues—but also economic questions—the relevant market; it would then have to finally weigh these factors to reach its conclusion. In the words of the Supreme Court in Philadelphia, "a value choice of such magnitude is beyond the ordinary limits of judicial competence . . . ." This possible difficulty, although considered in Congress, was summarily dismissed without discussion. It was, however, to create jurisdictional problems in subsequent litigation.

Paragraph 7(D) gives the federal banking agency that has approved the

552 Senate Hearings on S. 1698, at 177.
553 House Hearings on S. 1698, at 1044-45.
554 Id. at 173.
555 The purpose of this provision was stated during the hearings:

"In a field as complex as merger policy — and more generally antitrust policy — there is room for differences of opinion. However, any one agency is likely — if only for reasons of administrative convenience — to develop set views with respect to such policy. Where a bank regulatory agency and the Department of Justice differ on a given merger case, the appropriate final arbiter must be the courts — which provide a forum for the presentation of opposing views. Id. at 520.
557 Ibid.
559 Representative Widnall stated:

"Finally, I wish to comment briefly on the charge that courts will not be able to effectively assess the banking standards in judicial review of a merger. This is a subjective admission of deficiency either on the part of the courts or on the banking agencies. Wherever directed, it is not worthy of acceptance. If the courts can accept legal evidence about banking from the Justice Department they certainly can accept banking evidence about banking from the banking agencies. Courts have the responsibility for reviewing all facets of our laws, not just the antitrust components . . . . 112 Cong. Rec. 2336 (daily ed. Feb. 8, 1966).
560 See text accompanying notes 570-71 infra."
proposed merger the right to intervene and appear as a party before the court when suit is brought by the Attorney General. Proponents of this provision argued that agency interest in a merger does not end with approval, but includes a public duty to insure that the merger is effected.\textsuperscript{561} They also felt that the Attorney General has neither the knowledge nor the experience to speak on the "convenience and needs of the community to be served."\textsuperscript{562} Those arguing against the inclusion of paragraph 7(D) stated that the provision "derogates the Attorney General's authority and responsibility to control Government litigation" on behalf of the United States, and presents the anomalous situation of the Government opposing itself in court.\textsuperscript{563}

(4) \textit{Operational Effectiveness}

Under the Bank Merger Act of 1960, as interpreted in \textit{Philadelphia}, two major problems prevented uniform control of bank mergers. The Department of Justice and the banking agencies viewed mergers from mutually-exclusive vantage points—the former under the Clayton Act, which requires a consideration of only the competitive factor; the latter under the Bank Merger Act, which required a consideration not only of the competitive factor, but of the banking factors as well. A dispute also existed between the two groups as to the manner of evaluating a merger's competitive effects.\textsuperscript{564} The 1966 amendment seeks to solve these problems by unifying the ultimate statutory authority under which mergers are viewed into one legislative act. This act, while still allowing the Attorney General to assess and challenge a proposed bank merger \textit{solely} on the basis of traditional antitrust laws as in \textit{Philadelphia}, goes beyond the \textit{Philadelphia} decision by permitting the merger to be consummated, even though it violates the Sherman or Clayton Acts, if its anticompetitive effects are "clearly outweighed in the public interest . . . in meeting the convenience and needs of the community to be served."

Unfortunately, one year of regulation under the 1966 amendment shows that some problems still exist. Due to the less than clear standards in paragraph 5(B), the doctrinal conflict in evaluating the competitive effects of a merger remains. The Comptroller has continued to emphasize the financial benefits of proposed mergers, while the Department of Justice has stressed their effects on competition.\textsuperscript{565} Rather than establishing the promised uniformity, the 1966 amendment has resulted in the banking agencies and the Department of Justice continuing their "clawing at each other's throats."

Though judicial interpretation of the Bank Merger Act of 1966 has been limited, the cases that have been decided show, for the most part, a conscientious effort to end the present conflict and to implement congressional intent. In

\textsuperscript{561} Bratter, \textit{Should the Justice Department Represent the Comptroller?}, Banking, Sept. 1965, p. 47.
\textsuperscript{564} Waxberg & Robinson, \textit{Chaos in Federal Regulation of Bank Mergers: A Need for Legislative Revision}, 82 \textit{Banking L.J.} 377, 381-84 (1965).
United States v. Crocker-Angelo Nat'l Bank, the United States District Court for the Northern District of California rejected the contention of the Justice Department that the Bank Merger Act of 1966 made no substantial change in banking antitrust law or in the standards that courts must use in assessing the legality of bank mergers. The Justice Department argued that the clause "convenience and needs of the community to be served" in paragraph 5(B) was only a rephrasing of the "failing company" doctrine. This doctrine makes section 7 of the Clayton Act inapplicable to an otherwise illegal acquisition of a competitor "which is in such straits that the termination of the enterprise and the dispersal of its assets seem inevitable unless a rival proprietor shall acquire and continue the business." The court believed this interpretation "absurd" and ruled that even if the bank to be merged was not a "failing company" the transaction could still be upheld under the standard of paragraph 5(B). The court also faced a jurisdictional problem. Paragraph 7(A) requires de novo judicial review of all the issues presented. The court found no problem in hearing evidence on the antitrust question—the legal issue—but it balked when faced with evidence to determine the convenience and needs of the community.

No difficulty would be presented here so far as reviewing de novo the first of these determinations for this court has traditionally adjudged whether mergers have anti-competitive effects. But the problem of reviewing the second determination by the Comptroller, namely, whether the proposed transaction is outweighed in the public interest, and whether it meets the convenience and needs of the community, is plainly and unquestionably a legislative or administrative determination of a type which this court, as a constitutional court, is prohibited from deciding.

Rather than hold this provision of the act unconstitutional, the court interpreted de novo review to mean not an independent judicial decision based upon facts presented, but a review of the banking agency's decision to determine if it is supported by the evidence. Finally, the court outlined what specific facts are required from the Comptroller or other banking agency in order to make judicial review effective: (1) "what he finds to be the convenience and needs of the community"; (2) "what he considers will be the effect of the merger thereon"; (3) "how and by what means he weighs these effects as against the anticompetitive effects of the transaction"; (4) "assuming that the merger has the effect upon potential competition which the Government claims, . . . whether . . . that effect would be outweighed in the public interest by the probable effect of the transaction in meeting the interest and convenience of the community to be served."

In United States v. Provident Nat'l Bank, the Department of Justice attempted to attack a bank merger solely under section 7 of the Clayton Act—the successful technique of the Philadelphia case. The United States District
Court for the Eastern District of Pennsylvania, however, stating that the purpose of the 1966 amendment was to overrule Philadelphia, ruled that "the only suit open to Justice to enjoin a bank merger lies solely within the ambit of . . . [the Bank Merger Act of 1966]."

United States v. Third Nat'l Bank, the Nashville case, substantiated the holding in Crocker-Angelo by stating that paragraph 5(B) of the 1966 amendment was not a mere rewording of the "failing company" doctrine, but established new standards to be used in assessing the legality of bank mergers. The court also ruled that the banking agency's findings regarding the convenience and needs of the community "should not be disturbed unless they are unsupported by substantial evidence."

The decision in United States v. First City Nat'l Bank, the Houston case, shows an obvious disregard for congressional intent. The United States District Court for the Southern District of Texas held not only that the Attorney General must prove the anticompetitive effects of the merger, but also that he must prove that these effects are not outweighed by the convenience and needs of the community to be served.

The culmination of these lower court opinions is the decision in United States v. First City Nat'l Bank, in which the Supreme Court answered the

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574 Id. at 377.
576 Id. at 875.
577 Id. at 874.
579 Id. at 83434.
580 35 U.S.L. WEEK 4303 (U.S. Mar. 28, 1967). This case was a consolidated appeal of United States v. First City Nat'l Bank, 5 TRADE REG. REP. ¶ 71970 (S.D. Tex. Dec. 2, 1966) and United States v. Provident Nat'l Bank, 259 F. Supp. 373 (E.D. Pa. 1966). During argument before the Court two main questions emerged: what is the meaning of the phrase "review de novo" in paragraph 7(A) of the 1966 amendment, and who must assume the burden of proof when a bank merger is challenged for its alleged anticompetitive effects.

"Familiar with the phrase 'trial de novo,' the Justices could not grasp the significance of the Act's use of 'review de novo.'" 35 U.S.L. WEEK 3297 (U.S. Feb. 28, 1967). Counsel for the parties to the litigation suggested three conflicting interpretations. The Department of Justice interpreted the phrase to mean "that there is to be a complete new trial of all the issues in the court action." Ibid. When Mr. Justice Brennan asked how much weight was to be given, under the Department's interpretation, to the determinations of the banking agencies, the assistant Attorney-General stated:

To the administrative determination as such, none. To expertise as to particular issues, I don't think there is a single answer. . . . We are not urging that the expertise of the agencies . . . is to be disregarded. They have an opportunity by statute to appear as parties in the court proceeding. They can appear as witnesses and give testimony treated as expert testimony. Id. at 3298.

Counsel for the banks involved interpreted "review de novo" to mean a relitigation of all issues of fact de novo and an acceptance "in the absence of clear abuse of discretion, [of] the judgment of the Comptroller of the Currency as to whether the proven anticompetitive effects are in fact clearly outweighed by other public-interest factors." Id. at 3297.

[Counsel for the Comptroller found both these interpretations, while compatible with the words "de novo," to conflict with the concept of a "review." The Comptroller would have the court accept all agency findings supported by substantial evidence and would give effect to the words "de novo" by letting both parties introduce new facts in the district court. Ibid.]

Regarding the question of burden of proof, the Department of Justice believed that Congress intended the Bank Merger Act's "convenience and needs" standard as an affirmative defense to be proven by the banks once the government had shown
vexing procedural questions raised by the Bank Merger Act of 1966: the problems of pleading and burden of proof, and the meaning of "review de novo." In the Provident case the district court ruled that the Government's complaint, alleging solely a violation of section 7 of the Clayton Act, was defective because it failed to state that the action was brought under the Bank Merger Act. In overruling the district court's opinion in Provident, the Supreme Court held that the Bank Merger Act of 1966 did not affect the applicability of the Sherman or Clayton Acts to bank mergers.

There is no indication that an action challenging a merger on the ground of its anticompetitive effects is bottomed on the Bank Merger Act rather than on the antitrust laws. . . . [T]he Government's failure to base the actions on the Bank Merger Act of 1966 does not constitute a defect in its pleadings. Nor is the Government's failure to mention the Bank Merger Act fatal . . . . [A]n action challenging a bank merger . . . is [to be] brought under the antitrust laws. Once an action is brought under the antitrust laws, the Bank Merger Act provides a new defense or justification to the merger's proponents — "that the anticompetitive effects of the proposed merger are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served."860A

The Court went on to overrule the district court decision in the Houston case by holding that the burden of proving this new "defense or justification" rested with the banks seeking to merge. Mr. Justice Douglas, speaking for the Court, observed that this "is the general rule where one claims the benefits of an exception to the prohibition of a statute."860B

In deciding the jurisdictional problem — the meaning of "review de novo" as it applies to the "convenience and needs" standard in paragraph 5(B) of the 1966 amendment — the Court disagreed with the holding in Crocker-Angelo that "review de novo" means a review of the banking agency's decision to determine if it is supported by the evidence. The Court stated:

This language does not express the conventional standard, e.g., [sic] whether the agency's action is supported by substantial evidence. . . . Traditionally in antitrust actions involving regulated industries, the courts have never given presumptive weight to a prior agency decision . . . . ["Review de novo"] means[s] to us that the court should make an independent determination of the issues . . . .

The courts may find the Comptroller's reasons persuasive or well nigh conclusive. But it is the court's judgment, not the Comptroller's, that finally determines whether the merger is legal. That was the practice prior to the 1966 Act; and we cannot find a purpose on the part of Congress to change

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a violation of the Section 7 Clayton Act standards incorporated into the Bank Merger Act. Ibid.

Counsel for the banks, however, under the questioning of the Chief Justice and Mr. Justice Black, expressed the opinion that the entire burden of proof — the anticompetitive effect of the merger as well as the fact that this effect is not outweighed by the convenience and needs of the community to be served — must be borne by the Department of Justice. 35 U.S.L. WEEK 3297-302 (U.S. Feb. 28, 1967).


580B Id. at 4305.
the rule. This conclusion does not raise serious constitutional questions by making the courts perform nonjudicial tasks. The "rule of reason," long prevalent in the antitrust field . . . has been administered by the courts . . . We see no problems in bringing . . . [the "convenience and needs" standard] into the area of judicial competence. There are no constitutional problems here not present in the "rule of reason" cases.580D

In deciding these procedural questions the Court made clear that it was reserving its opinion on any substantive questions raised by the 1966 amendment.580D In doing so, it left undetermined the important question of whether the omission of the Clayton Act phrase "in any line of commerce" from paragraph 5(B) of the 1966 amendment in any way liberalizes the Philadelphia approach for determining the relevant geographic or product markets in assessing the anticompetitive effect of a proposed bank merger.

c. The Future of the Bank Merger Act of 1966

Over 175 years ago, Alexander Hamilton made the following observation:

[W]here there are a number of actors who may have . . . different degrees and kinds of agency, though we may clearly see upon the whole that there has been mismanagement, yet it may be impracticable to pronounce to whose account the evil which may have been incurred is truly chargeable.581

This statement clearly applies to the present unsettled state of federal bank merger regulation, which has culminated in two departments within the Executive branch of the Government battling each other in court. The federal banking agencies and the Department of Justice, however, are not solely to blame for this conflict. Its roots extend to the vague standards embodied in the Bank Merger Act of 1960, the infamous decision of the Supreme Court in Philadelphia, and the standards and procedures of questionable utility in the Bank Merger Act of 1966. Even after passage of the 1966 amendment, the bank merger conflict seems to be far from resolved. Experience has shown that, due to the equally strong political influence of the banking industry and the Department of Justice, the enactment of legislation establishing definite standards in this area is doubtful. The burden, therefore, lies with the judiciary. The Supreme Court's decision in United States v. First City Nat'l Bank582 has answered some important questions, but others—particularly the interpretation of the 1966 amendment's substantive standards—remain unsettled. The fact remains, however, that the ultimate effectiveness of the act, notwithstanding the establishment of clear judicially defined standards and procedures, depends upon a conscientious effort by both the banking agencies and the Department of Justice to achieve uniformity of opinion in assessing the competitive effects of bank mergers. If this is not accomplished, the Bank Merger Act of 1966, like its predecessor, is doomed to failure.

580C Id. at 4305-06.
580D Id. at 4306 n.1.
581 THE FEDERALIST No. 70, at 460 (Modern Library ed. 1941).
C. Bank Holding Companies

In addition to the bank merger device, unified control of banking interests may also be achieved by bringing banks under the control of a holding company. The major difference between the two methods lies in the fact that mergers are accomplished by asset acquisition, whereas holding companies gain control over banks by acquiring their stock. For this reason it has been argued that anticompetitive bank acquisitions by holding companies have always been subject to section 7 of the Clayton Act. The Clayton Act, however, was not successfully used in this regard until 1953 and aside from its recent limited use, the history of federal regulation of bank holding companies parallels the ineffectiveness of attempts to regulate bank mergers.

1. The Bank Holding Company Act of 1956

In an attempt to end ineffective control over bank holding companies, Congress enacted the Bank Holding Company Act in 1956. This legislation was directed against two major problems: the "unrestricted ability" of bank holding companies to concentrate commercial banking facilities in a specific area under unified control and management; and the combination of both banking and nonbanking interests within the control of a single enterprise, which violated the principle that banking institutions should not engage in unrelated businesses, lest the funds of depositors of the banking affiliate be used to assist affiliated nonbanking interests that are financially unsound. The act defined a "bank holding company" as any "company" that owns at least twenty-five percent of the voting shares of two or more banks. Included within the definition of "company" were corporations, business trusts, and similar organizations. The act

584 Transamerica Corp. v. Board of Governors, 206 F.2d 163 (3d Cir. 1953).
585 Limited control over bank holding companies was achieved under the Banking Act of 1933. 48 Stat. 162, as amended, 12 U.S.C. §§ 221-522 (1964), as amended, 12 U.S.C.A. §§ 221-503 (Supp. 1966). This act gave the Federal Reserve Board authority to regulate bank holding companies only if one of the banking affiliates of the holding company was a member of the Federal Reserve System and if the holding company voted the stock which it owned in such a bank. In the limited situations where the Board did have authority, the act was of little help in controlling banking concentration:

[T]he regulation to which a holding company . . . [was] subject under the 1933 legislation . . . [was] aimed primarily at protecting the soundness of affiliated banks rather than controlling the holding companies with respect to either expansion or their ability to engage in nonbanking business. LAMB, GROUP BANKING 176 (1961).

In 1954 only 18 bank holding companies were subject to the act's provisions. This situation led Federal Reserve Board Chairman William McChesney Martin, Jr. to state:

Existing provisions of law, originally enacted in the Banking Act of 1933, have proved entirely inadequate to deal with the special problems presented by bank holding companies. It has been, and still is, the Board's view that additional legislation is essential to deal effectively with these problems.

required that all bank holding companies register with the Federal Reserve Board and prohibited formation of a bank holding company without the Board’s approval. Board approval was also required when a bank holding company sought to acquire a bank’s voting shares in an amount that would result in the holding company controlling more than five percent of the bank’s total voting stock, when a bank holding company sought to acquire substantially all the assets of a bank, or when two or more bank holding companies sought to merge or consolidate. Bank holding companies were prohibited from engaging in any business other than banking and were required to divest themselves of all nonbanking interests, except for holdings of five percent or less of the stock of nonbanking corporations.

Speaking for many members of Congress, Representative Patman stated that although the Bank Holding Company Act was “an excellent piece of ground-breaking legislation. . . . [it] was not designed to stand the test of time.” He based his views on the fact that in order to assure passage of the act, provisions had been included that exempted particular groups or organizations from the act’s coverage, even though they were de facto bank holding companies. The act exempted certain companies, and their affiliates, that were registered under the Investment Company Act of 1940, long-term nonbusiness trusts, and charitable, religious, and educational organizations; and companies that controlled only one bank.

The act’s antitrust provision differed significantly from the vague antitrust provisions in the Bank Merger Act of 1960. A savings clause was included that made it clear that any anticompetitive conduct of a bank holding company, although approved by the Federal Reserve Board and performed pursuant to the act’s provisions, could nonetheless be attacked under the Sherman or Clayton Acts.

2. The Bank Holding Company Act of 1966

Disapproval of the 1956 act’s exemptions was repeatedly voiced by the Federal Reserve Board and echoed by the Department of Justice. Congress agreed with them that it was time, in the interest of “justice and fairness,” to remove the exemptions, which should never have been included. The existence of exempt de facto bank holding companies violated the basic principle that “banking and nonbanking activities should be kept apart.” Consequently,

588 Id. at 24022-23. In signing the Bank Holding Company Act into law, President Eisenhower remarked, “[T]he exemptions and other special provisions will require the further attention of Congress.” Hearings on S. 2253, S. 2418, and H.R. 7371 Before a Subcommittee of the Senate Committee on Banking and Currency, 89th Cong., 2d Sess. 29 (1966) [hereinafter cited as Senate Hearings on H.R. 7371].
589 Senate Hearings on H.R. 7371, at 29.
591 111 Cong. Rec. 24024 (daily ed. Sept. 23, 1965); Senate Hearings on H.R. 7371, at 43.
593 Senate Hearings on H.R. 7371, at 28.
595 Id. at 24036.
in 1966 Congress enacted an amendment\textsuperscript{596} to "improve and perfect"\textsuperscript{597} the original act by broadening its coverage.\textsuperscript{598}

a. The Registered Investment Company Exemption

The 1956 act excluded from its coverage any company, including all its affiliates, that prior to May 15, 1955, had registered under the Investment Company Act of 1940. This exemption applied as long as these companies or affiliates did not directly own twenty-five percent or more of the stock of two or more banks. Congress believed that the Investment Company Act, as administered by the Securities and Exchange Commission, provided adequate regulation of such companies, so that the additional regulatory authority of the Federal Reserve Board under the Bank Holding Company Act would be unnecessary.\textsuperscript{599} Congress also believed it would be impossible for any bank holding company to utilize this provision as a means of escaping regulation under the Bank Holding Company Act, since the act applied only to companies that had registered prior to its passage.\textsuperscript{600} Both assumptions of Congress proved to be incorrect. The purpose of the Bank Holding Company Act differed from that of the Investment Company Act. The former sought "to control the expansion and operation of bank holding companies in furtherance of Federal bank regulatory policy,"\textsuperscript{601} whereas the latter was primarily concerned with the protection of investors in securities of investment companies.\textsuperscript{602} Chairman Cohen of the Securities and Exchange Commission admitted that the Commission had no "special expertise or particular experience"\textsuperscript{603} in effectively carrying out the purposes of the Bank Holding Company Act. Besides these administrative difficulties, the exemption contained a major loophole. Although prior to May 15, 1955, only 275 companies were registered under the Investment Company Act,\textsuperscript{604} other companies could . . . take advantage of this exemption to evade regulation under the act, simply by acquiring 5 percent of the stock of any one of . . . [the] investment companies registered before May 15, 1955 . . . . As an "affiliate" of a registered investment company, they would be exempt as long as they avoided "direct" ownership of 25 percent or more of the stock of two or more banks.\textsuperscript{605}

\textsuperscript{597} Senate Hearings on H.R. 7371, at 28.
\textsuperscript{598} H.R. REP. No. 534, 89th Cong., 1st Sess. 1 (1965).
\textsuperscript{600} Ibid.
\textsuperscript{601} Senate Hearings on H.R. 7371, at 39.
\textsuperscript{602} Ibid.
\textsuperscript{603} Ibid. In reporting H.R. 7371, which after amendment became the Bank Holding Company Act of 1966, the Senate Committee on Banking and Currency stated:

This exemption was granted because it was felt that regulation under the Investment Company Act of 1940 would provide adequate protection. However, experience has demonstrated that the SEC's authority under the Investment Company Act does not in any way substitute for the type of control provided under the Bank Holding Company Act from the point of view of banking policies. S. REP. No. 1179, 89th Cong., 2d Sess. 5 (1966).
\textsuperscript{604} Senate Hearings on H.R. 7371, at 38.
\textsuperscript{605} Ibid.
The restriction on the percentage of "direct" ownership could easily be avoided if the holding company formed a subsidiary corporation to control the banks acquired. If this manner the affiliate of a registered investment company could gain control over every bank in the United States without being subject to any type of federal regulation. This was possible since the regulations of the Investment Company Act applied only to dealings between the registered investment company and its affiliates, and not to dealings between affiliates and their subsidiaries. Although at the time the 1966 amendment was enacted, only one company had taken advantage of this loophole, Congress repealed the exemption for registered investment companies and their affiliates because of a fear that more companies might take advantage of it in the future.

b. One-Bank Holding Companies

In determining whether to remove the exemption contained in the 1956 act for holding companies that controlled only one bank, Congress heard cogent arguments from two factions. Chairman Martin of the Federal Reserve Board was in favor of removing the exemption in order to avoid possible abuses. He believed abuses could occur where a bank’s customer would be required to do business with the holding company’s nonbanking interests as a condition to receiving banking services, or where profitable extensions of credit would be denied by a bank to competitors of the bank’s nonbanking fellow subsidiaries. Other proponents of removing this exemption stated that it presently left unregulated 341 bank holding companies in 44 states with deposits of approximately 14 billion dollars. Those in favor of retaining the exemption argued that its repeal would be unjustified since no showing of actual abuse had been made. Rather, they believed the exemption was “consistent with the primary purpose of the Bank Holding Company Act” of maintaining “independent competitive banking.” Senator Robertson stated that

repeal of the exemption would make it more difficult for individuals to continue to hold or to form small independent banks. The repeal of the exemption would, therefore, be likely to cause the forced sale of large

606 Id. at 40.
607 Id. at 39.
608 Id. at 38.
609 112 Cong. Rec. 11792 (daily ed. June 6, 1966). This company was Financial General Corporation, which, through subsidiary corporations, owned from 14% to majority interests in 26 banks located in 6 different states and the District of Columbia. Seventeen of these banks were acquired subsequent to passage of the Bank Holding Company Act of 1956. In addition, Financial General also owned controlling interests in several nonbanking businesses. Senate Hearings on H.R. 7371, at 38; S. Rep. No. 1179, 89th Cong., 2nd Sess. 5 (1966).
613 Id. at 24043; Senate Hearings on H.R. 7371, at 59.
614 Senate Hearings on H.R. 7371, at 194.
615 Id. at 142.
numbers of banks and . . . a diminution of competition rather than an increase of competition.\textsuperscript{616}

The basis for the difficulty mentioned by the Senator lies in the management structure of small country banks, many of which are owned and controlled by a single person or family.\textsuperscript{617} Many of these people own the bank by means of a holding company in order to take advantage of an eighty-five percent dividend-received tax credit on dividends received by the holding company.\textsuperscript{618} However, if this holding company is owned by five persons or less, it must engage in some nonbanking business in order to avoid tax penalties that are imposed upon “personal holding companies.”\textsuperscript{619} Since removal of the exemption would force divestiture of the nonbanking interests, the “personal holding company” tax penalties would immediately be imposed. The result would be that the small independent bankers could no longer carry on a profitable banking business, and most of their banks would be absorbed by larger financial institutions.\textsuperscript{620}

Persuaded by these arguments, the Senate Committee on Banking and Currency reported adversely on the proposal to remove the one-bank holding company exemption,\textsuperscript{621} and it was retained in the present law. However, in order to minimize the possibility that the banking affiliate of a bank holding company would make imprudent loans to, or investments in, the holding company’s nonbanking affiliates, Congress broadened the coverage of section 23A of the Federal Reserve Act\textsuperscript{622} to prohibit any insured bank from extending credit by means of loans or investments totaling more than ten percent of its capital and surplus to any one affiliate, or more than twenty percent to all affiliates. Prior to this amendment, section 23A had applied only to banks that were members of the Federal Reserve System.

c. Long Term Trusts and Charitable Institutions

In deciding to exclude charitable, religious, and educational organizations from the provisions of the Bank Holding Company Act of 1956, the Senate Committee on Banking and Currency stated:

The exclusion of religious and other charitable organizations is similar to that granted to such organizations under the Internal Revenue Code. The committee’s attention was invited to at least one case where a bona fide religious organization controls two or more banks as well as nonbanking interests as an incident to its main purpose. In the opinion of the committee, even though these incidental business activities are organized for the primary purpose of profit, the very nature of the religious organization itself precludes the possibility of violating the spirit of this bill.\textsuperscript{623}

\begin{footnotesize}
\begin{enumerate}
\item 112 Cong. Rec. 11792 (daily ed. June 6, 1966). For additional arguments on this point, see Senate Hearings on H.R. 7371, at 277-82.
\item Id. at 140-41.
\item Id. at 140.
\item Id. at 141.
\end{enumerate}
\end{footnotesize}
Ten years later, however, the feelings of the Committee members had changed radically:

The committee reached the conclusion that it was not consistent with the basic policy of the Bank Holding Company Act to permit an exemption from the broad public purposes of that act for long-term trusts and religious, charitable and educational institutions. This conclusion does not, of course, indicate any reflection whatever on the desirability or value of such institutions or of their purposes and objectives. It simply means that the basis for special treatment of such institutions, for example in the field of tax exemption, does not warrant exemption from statutes carrying out broad public policy purposes, such as the Bank Holding Company Act, any more than it would support an exemption from the antitrust laws or the Interstate Commerce Act.624

The congressional hearings and debates on the value of retaining this exemption centered around one organization. This was the perpetual testamentary trust created under the will of the late Alfred I. duPont.625 The duPont trust controlled over thirty banks within the State of Florida as well as various industries, railroads, land, and stockholdings, with an aggregate value of over one billion dollars.626 The will provided that substantially all the trust income be distributed to Mr. duPont's widow for her life and then to the duPont Foundation, a charitable organization, in perpetuity.627 Although the principal beneficiary had irrevocably assigned twelve percent of her income from the trust to the Foundation,628 and although after her death the entire income would be used strictly for charitable purposes, Congress believed it best to eliminate the exemption that allowed this de facto bank holding company and other similar organizations to control both banking and nonbanking interests. According to Senator Morse, "the point of the Bank Holding Company Act is not who gets the money but who holds the power — and how that power should be wielded."629 Speaking for repeal of the exemption, Vice-Chairman Balderson of the Federal Reserve Board stated:

[T]he trust device can be used to achieve control for an indefinite period, and the potentiality for abuse through long-term trusts is just as great as in the case of the more normal forms of business organizations now covered by the act's definition of "company."630

In repealing this exemption, however, it was made clear that long term trusts

625 The bill which ultimately became the Bank Holding Company Act of 1966, H.R. 7371, before substantial amendment by the Senate, appears to have been introduced primarily, if not solely, as a direct attack upon the holding company activities of the duPont trust. See H.R. Rep. No. 534, 89th Cong., 1st Sess. 4 (1965). During debate in the House the bill was criticized as special punitive legislation, 111 Cong. Rec. 22753-55 (daily ed. Sept. 15, 1965), and recommendations were made that it be expanded to cover all the then exempt de facto bank holding companies. Id. at 22753.
626 Senate Hearings on H.R. 7371, at 30.
627 Id. at 446.
628 Ibid.
629 Id. at 31.
630 Hearings on H.R. 7371 Before the House Committee on Banking and Currency, 89th Cong., 1st Sess. 9 (1965).
or charitable, religious or educational organizations would not be required to
divest themselves of charitable hospitals or tax-exempt educational institutions,
because these publicly beneficial activities would not constitute "nonbanking in-
terests" as defined by the 1966 amendment.\textsuperscript{631}

d. The Antitrust Provision

Although the Bank Holding Company Act of 1966 has broadened the 1956
act's coverage to include previously exempt \textit{de facto} bank holding companies,
it emasculated the 1956 act's savings clause, which made anticompetitive conduct
of a bank holding company subject the Sherman and Clayton Acts. In its
stead, the Bank Holding Company Act of 1966 adopted the liberal antitrust
standards and procedures of the Bank Merger Act of 1966.\textsuperscript{632} This significant
change was neither contemplated by any of the original bills introduced to amend
the Bank Holding Company Act,\textsuperscript{633} nor was it discussed during the committee
hearings.\textsuperscript{634} Rather, it was added to the bill by the Senate Banking and Curre-
cy Committee after hearings had been concluded.\textsuperscript{635} Senator Bennett, sponsor
of the provision, speciously argued that it was necessary "in the interest of uni-
formity and equity," since a similar provision had been included in the Bank
Merger Act of 1966.\textsuperscript{636} Vigorous arguments were advanced against his position.
The Department of Justice believed that the presence of such a provision in the
recently amended Bank Merger Act was no reason for its inclusion in the Bank
Holding Company Act.

The position of bank holding companies that have made acquisitions is not
at all similar to the position of banks that have merged, for prior to 1963
merging banks may reasonably have believed that bank mergers were not
subject to the Clayton Act, but bank holding companies could not have
believed that they were free from antitrust scrutiny. Moreover, since stock
acquisitions are involved, an antitrust suit cannot produce difficult "un-
scrambling of assets" problems, as allegedly occurred when bank mergers
were attacked.\textsuperscript{637}

Senator Hart, also opposing inclusion of this provision, noted that while many
members of Congress believed that bank mergers should be assessed by a more
liberal antitrust standard than is applied to other types of industrial mergers,
there always has been a clear congressional understanding that "all bank holding
company acquisitions are governed by the antitrust laws."\textsuperscript{638} Senator Hart rightly
believed that the historic congressional intent of "unqualified application of the
antitrust laws" to bank holding companies should not be changed without a
showing of substantial desirability.\textsuperscript{639}

\textsuperscript{631} 112 CONG. REC. 11791 (daily ed. June 6, 1966).
\textsuperscript{632} Compare §§ 4-8 of the Bank Merger Act of 1966, 80 Stat. 8, 12 U.S.C.A. § 1828c
(Supp. 1966), \textit{with} §§ 7(c), 11 of the Bank Holding Company Act of 1966, 80 Stat. 237,
\textsuperscript{633} 112 CONG. REC. 11841 (daily ed. June 6, 1966).
\textsuperscript{634} Id. at 11841-42.
\textsuperscript{635} Id. at 11842.
\textsuperscript{636} Id. at 11804.
\textsuperscript{637} Id. at 11794.
\textsuperscript{638} Id. at 11842.
\textsuperscript{639} Ibid.
The arguments presented by the opponents of this provision are persuasive. Since, unlike the chaos in the bank merger field, no serious dispute has ever arisen concerning the applicability or wisdom of strict antitrust regulation of bank holding companies, the change promulgated by the 1966 amendment can only extend the bank merger conflict into another area of our economy.

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640 Text accompanying notes 224-355 supra.
641 Text accompanying notes 1-191 supra.
642 Text accompanying notes 192-223, 356-421 supra.
643 Text accompanying notes 422-639 supra.