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FINANCIAL INSTITUTION INTERLOCKS AFTER THE BANKAMERICA CASE

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It appears that we have entered a chaotic time in the area of interlocks among financial institutions. Not only are traditional financial institutions expanding the range of their services, but new entrants—even new types of entrants—have begun competing with old line institutions. As regulatory barriers continue to fall, the line between a financial institution and other types of businesses will become increasingly difficult to discern.

Among others whose lives have been complicated by these developments is the antitrust lawyer who is asked to comment on an interlock between (or among) two or more firms, at least one of which is a financial institution. He or she needs some familiarity with the traditional antitrust prohibitions, the Depository Institution Management Interlocks Act,¹ and with any specialized statutes dealing with interlocks that may have a bearing on the situation. The recent decision of the Supreme Court in *BankAmerica Corp. v. United States*² should provide some guidance. The purpose of this paper is to provide an introduction to the law governing financial institution interlocks with particular emphasis on the impact of the *BankAmerica* case.

It should be noted at the outset that the broad category of “financial institutions” includes banks, thrift institutions that compete with banks in seeking deposit accounts and in other ways, and other types of firms that also may compete with banks and thrift institutions, such as brokerage houses or insurance companies. Whether a particular distinction, e.g., between a savings and loan association and a bank, should be made will depend upon the specific question being addressed.

I. SECTION 8 OF THE CLAYTON ACT

Although a number of provisions of the traditional antitrust statutes may apply to interlocks among financial institutions, the most important

¹ 12 U.S.C. §§ 3201 *et seq.* (Supp. IV 1980).

² 103 S. Ct. 2266 (1983).

provisions are to be found in Section 8 of the Clayton Act.³ The first three paragraphs of that section have for 70 years prohibited some, but not all, interlocks among banks. At present,⁴ these paragraphs prohibit (subject to seven enumerated exceptions) a director, officer or employee from serving simultaneously any member bank of the Federal Reserve System and any other national or state bank, banking association, savings bank or trust company.

Since approximately 60 percent of all banks are not members of the Federal Reserve System, a considerable number of potential interlocks among banks would not be affected by these provisions and, obviously, interlocks among financial institutions that are not banks are outside of these provisions. However, the fourth paragraph of Section 8 provides:

No person at the same time shall be a director in *any two or more corporations*, any one of which has capital, surplus and undivided profits aggregating more than \$1,000,000, engaged in whole or in part in commerce, *other than banks, banking associations, trust companies and common carriers* subject to the [Interstate Commerce Act] . . . if such corporations are or shall have been theretofore, by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the provisions of any of the antitrust laws.⁵

This provision would apply to any interlocks among competing financial institutions of the requisite size, provided none of the linked firms was a bank. It was also generally agreed that it would not apply to an interlock among competing banks that escaped the ban of the first three paragraphs.⁶ It was an open question, however, whether the paragraph applied to an interlock between two competing financial institutions, one of which was a bank and the other of which was not.

To get that question answered, the government brought several test cases in 1975 against ten corporations and five individuals. Each of the individuals served as a director of an insurance company and as a director of a bank and/or a bank holding company. Both sides moved for summary judgment in the district court, having first stipulated to the existence of all the facts otherwise necessary to make Section 8 applicable if bank/nonbank interlocks were not exempted from it. The district court ruled

³ 15 U.S.C. § 19 (1976).

⁴ As enacted, the first three paragraphs forbade interlocks among banks "organized under the laws of the United States" and other such banks or banks organized under state law. See 2 LEGISLATIVE HISTORY OF THE FEDERAL ANTITRUST LAWS AND RELATED STATUTES 1063-64 (Kintner ed. 1978).

⁵ The emphasis is that supplied by Chief Justice Burger in his opinion in *BankAmerica Corp v. United States*, 103 S. Ct. at 2266, 2268 (1983).

⁶ It appears that the government did argue that the "other than banks" language should be read as exempting only those interlocks covered by the first three paragraphs, however.

that the fourth paragraph of Section 8 applied only if none of the interlocked corporations was a bank and dismissed the suit.⁷ The Ninth Circuit, in a two-to-one decision, reversed. The majority held that interlocks were exempted from this provision only if both (or all) of the interlocked companies were banks.⁸

The district court regarded the language as clear and unambiguous: the paragraph required that each of the interlocked corporations be "other than a bank." The district court did, however, support its view with pre- and post-enactment aids, like legislative history. The Ninth Circuit found all of this data sufficiently ambiguous to permit it to rely upon some general canons of antitrust constructions: it found a strong policy against horizontal interlocks and relied as well upon the strong presumption against implied exemptions from the antitrust laws.

By a five-to-three vote, the Supreme Court reversed.⁹ Justice Burger's opinion adopted much of the reasoning of the district court. He found the district court's reading to be the most "natural." He found this reading reinforced by the structure of the section (and the paragraph), by 60 years of popular and administrative construction, and by the internal legislative history. In dissent, Justice White found the statutory language far from clear; he thought the legislative history conclusive for the government's view.

The immediate effect of the decision is to enlarge the no-man's land in Section 8, to expand the class of interlocks not covered by the section. Beyond this, I am doubtful that the case will have much impact on general antitrust doctrine. Both opinions are likely to be of more interest to the student of statutory interpretation than to the antitrust lawyer. Having said that, I would like to mention a couple of features of the Chief Justice's opinion. As was noted, the Ninth Circuit saw a strong policy against horizontal interlocks. The Chief Justice discerned no such policy; he saw instead a "pattern of specific and limited regulation." He contrasted the section as enacted with the prohibitions that had been proposed and concluded that "rather than enacting a broad scheme to ban all interlocks between potential competitors, Congress approached the problem of interlocks selectively, limiting both the classes of corporations and the kinds of interlocks subject to regulation."¹⁰

⁷ *United States v. Crocker National Corp.*, 422 F. Supp. 686 (N.D. Cal. 1976).

⁸ *United States v. Crocker National Corp.*, 656 F.2d 428 (9th Cir. 1981).

⁹ *BankAmerica Corp. v. United States*, 103 S. Ct. 2266 (1983). Justices Blackmun, O'Connor, Rehnquist and Stevens joined Justice White in dissent. Justice Powell took no part.

¹⁰ *Id.* at 2270.

Furthermore, Chief Justice Burger showed a good deal of solicitude about those persons who had served on boards of banks and insurance companies in reliance upon "what was universally perceived as plain statutory language." One may infer that the Chief Justice does not think these persons would be warned by any "inherent wrongness" of the interlock. Finally, I think the dissent has the better of the argument regarding the clarity of the statutory language. I would guess that the majority regards its reading as the most natural because at some level it sees little value in a sweeping prohibition of interlocks.

II. THE SHERMAN ACT AND SECTION 5 OF THE FEDERAL TRADE COMMISSION ACT

Justice White's dissenting opinion argues that the majority's holding exempts "this entire species from any regulation whatsoever, even though such interlocks undisputably may have serious anticompetitive consequences directly contrary to the policies of our antitrust laws."¹¹ I think this is a misconception although Chief Justice Burger does not call Justice White on it. Interlocks not within Section 8 are not immune from attack under the Sherman Act or the Federal Trade Commission Act.¹² At a minimum there must be involved some agreement between the director and each corporation. Often there would be an underlying agreement among the interlocked corporations to share a director. One might argue (1) that either of these overt agreements constitutes a restraint of trade, or (2) that either of these overt agreements is conclusive evidence of some covert agreement to restrain trade. For example, the sharing of a director by competing corporations might make sense only as a device for policing a hidden price-fixing agreement.¹³

In practice, however, Section 1 is rarely invoked against interlocking directorates.¹⁴ The reason is not hard to discover. Unless an interlock among competing corporations could be characterized as per se unlawful, an attacker would have to establish that the particular arrangement had, in fact, restrained trade. If, for example, the interlock had been an

¹¹ *Id.* at p. 2276.

¹² See generally Travers, *Interlocks in Corporate Management and the Antitrust Laws*, 46 TEX. L. REV. 819 (1968); ABA ANTITRUST SECTION, MONOGRAPH NO. 10, INTERLOCKING DIRECTORATES UNDER SECTION 8 OF THE CLAYTON ACT (1984) [hereinafter cited as ABA INTERLOCK MONOGRAPH].

¹³ The temptation of each cartel member to "chisel" on his co-conspirators often requires some such policing device. Many of the information exchange cases have been thought to involve devices to protect the cartel against destruction by centrifugal forces. See L. SULLIVAN, ANTITRUST 265-68 (1977).

¹⁴ A rare and unsuccessful effort is *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953).

effective device for policing an agreement to fix prices or restrict output, it is likely that an econometric study could reveal what had happened. But in such a case the interlock would be a secondary consideration. Although dissolving the interlock would be an important part of the relief should the covert agreement be proved, the agreement, and not the interlock, would be the focus of the litigation. The case would not differ much from most other cases in which it is sought to establish the existence of a price-fixing agreement by circumstantial evidence.

This would change, of course, were the Supreme Court to espouse a *per se* rule for interlocks among competitors. This seems a remote possibility. In the first place, the attitude of the majority in *BankAmerica* (if I have read it right) would not be hospitable to this step. More generally, the Court has not been entirely consistent recently in charting the boundary between the domain of the rule of reason and that of the *per se* rule. In *GTE Sylvania*,¹⁵ Justice Powell suggested that an economic test would be used: if it were possible to say about a class of arrangements that they were anticompetitive (output restricting) and not procompetitive (output enlarging), then any arrangement that was a member of that class would be illegal *per se*. Conversely, if it were necessary to evaluate the arrangement in question to determine whether it was anti- or procompetitive, then the rule of reason would be employed.¹⁶ In cases like *BMI*¹⁷ and *Maricopa County*,¹⁸ the Court has been more inclined to regard the *per se* rule as something that has evolved historically from the Court's decisions—as simply another name for *stare decisis*.

I have a hard time seeing a *per se* rule for horizontal interlocks under either approach. Clearly there is no solid precedent with respect to interlocks. I could imagine a determination, under the economic approach, that some horizontal interlocks are inherently anticompetitive. The trick would be in specifying the conditions that must be present for this conclusion to be drawn. The sharing of a director by two highly diversified firms, both of which are minor factors in the single market in which they compete, might well be procompetitive. But the logic of a *per se* analysis requires that the class to which it applies be clearly defined. All horizontal interlocks would be too large a class, but I find it difficult to define a subclass *a priori*.

The lesson seems to be that a director and his interlocked corporations have little to fear from the Sherman Act, unless they have otherwise

¹⁵ *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

¹⁶ See *National Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679 (1978).

¹⁷ *Broadcast Music, Inc. v. CBS*, 441 U.S. 1 (1979).

¹⁸ *Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332 (1982).

agreed to restrain trade. In that case, they have more than the interlock to worry about.

A complete treatment of Section 5 of the Federal Trade Commission Act would take us too far afield, but a few observations may be of use. There are entangled here both substantive and jurisdictional issues. Banks not being subject to the FTC's jurisdiction, we may set aside bank/bank interlocks. In the *Perpetual Savings and Loan*¹⁹ case, the Commission faced an interlock between a bank and a savings and loan association. It decided that, although banks were not subject to its jurisdiction, thrift institutions were. Of course, it needs jurisdiction over but one of the interlocked corporations in order to achieve the dissolution of the interlock. The FTC also ruled that the interlock violated Section 8 of the Clayton Act. By adopting this approach, it avoided the necessity of deciding whether interlocks not prohibited by either Section 8 or by the Sherman Act might nevertheless violate Section 5.

The FTC's ruling on the jurisdictional question was overturned when Congress amended Section 5 to exempt savings and loan associations from the jurisdiction of the Commission.²⁰ The Commission then vacated its order.²¹ The Commission's construction of Section 8 was rejected in the *BankAmerica* case. The Commission may still employ the *Perpetual* case's approach to its jurisdiction to attack any interlock involving one corporation subject to Section 5, but now it must do so by either employing the Sherman Act or expanding the reach of Section 5 beyond the other Acts.

III. THE DEPOSITORY INSTITUTIONS MANAGEMENT INTERLOCKS ACT

The passage of the Depository Institutions Management Interlocks Act in 1978²² has reduced the importance of the traditional antitrust laws, but it has not rendered the old learning entirely obsolete. There are three reasons for this.

First, although repeal of Section 8 as it applied to depository institutions was initially proposed, the Act did not repeal Section 8 or any other antitrust law. It is conceivable that, for example, a bank/bank interlock would run afoul of both the Act and the first three paragraphs of Section

¹⁹ *Perpetual Savings & Loan Ass'n*, 90 F.T.C. 608 (1977), *vacated*, 94 F.T.C. 401 (1979).

²⁰ Act of July 23, 1979, Pub. L. No. 96-37, 93 Stat. 95 (1979), codified in 15 U.S.C. § 45(a)(2) (Supp. IV 1980).

²¹ 94 F.T.C. 401 (1979).

²² 12 U.S.C. §§ 3201 *et seq.* (Supp. IV 1980).

8. In such a case, one might think that the new Act should suffice. But the new Act is to be enforced primarily by the appropriate federal regulatory agency. Judicial action to enforce the Act by the Attorney General must be preceded by a referral by the appropriate agency.²³ This requirement of a referral was added to the bill during the legislative process; as introduced, the Act allowed the Justice Department to proceed on its own initiative.²⁴

If, however, an interlock also violates the antitrust laws, there is no explicit requirement of a referral though an argument for reading in such a requirement as a way of preventing an inconsistency between the statutes is certainly possible. Private actions against interlocks that also violate the antitrust laws remain a theoretical possibility although the requirement that such a private plaintiff demonstrate that he has been injured by the anticompetitive activity complained of diminishes the practical importance of this threat.

Second, the Act "grandfathers" existing interlocks until 1988, but only if they are not in violation of Section 8 of the Clayton Act. The decision in *BankAmerica* thus expands considerably the class of interlocks protected by this grandfather clause. If an interlock were to be found to violate the Sherman Act, on the other hand, the protection of the grandfather clause would still be available.

Third, there are interlocks that are not prohibited even by the expanded provisions of the new Act that might nevertheless be attacked under the traditional statutes. The new Act prohibits "management of-ficial" interlocks between unaffiliated "depository institutions" or "depository holding companies" that meet the size and location requirements of the Act.²⁵ As defined, a "depository institution" would be virtually any type of bank or thrift institution. The Federal Reserve Board staff has already rendered an opinion that an industrial loan company, although technically not one of the types listed in the definition of "depository institution," should be so considered since it offered investment certificates analogous to savings deposits, made various types of loans, and was examined annually for soundness. It is too early to know whether this commodious approach will be followed, but it would appear that interlocks may develop among depository institutions and firms that simply cannot be so classified, even if a very expansive view of the Act

²³ 12 U.S.C. § 3206 (Supp. IV 1980).

²⁴ See Yoerg, Report to the Section 7 (Clayton Act) Committee of the Antitrust Section of the American Bar Association on the Present Status of Financial Institution Interlocks, n. 40 and accompanying text (March, 1984).

²⁵ 12 U.S.C. §§ 3202, 3203.

is taken. These escape the prohibitions of the Act, but the traditional antitrust laws may still be applicable.

Turning now to the Act itself, the term "management official" is defined to mean "an employee or officer with management functions, a director (including an advisory or honorary director), a trustee of a business organization under the control of trustees, or any person who has a representative or nominee serving in any such capacity. . . ." ²⁶ "Person" evidently includes a corporation or other business organization; ²⁷ hence, the statute purports to answer one question—the nominee question—that had been vexing under Section 8.

This broad definition goes considerably beyond the fourth paragraph of Section 8 but not the first three paragraphs which apply to interlocks effected through a "director, officer, or employee." While it may be said in favor of a broad definition that the sharing of high ranking management personnel by competitors poses the same threat to competition as the sharing of directors, the Act does restrict the pool of available outside directors. Moreover, the question of whether a given employee has "management functions" is not easily answered in an age in which every sales manager with two subordinates is styled a "marketing executive." There has been some activity by the regulatory agencies in this area, but not much.

Had the Act prohibited interlocks among "competing" depository institutions, it would have been incumbent on lawyers and judges to determine the relevant product and geographic markets to ascertain whether certain interlocked firms were, in fact, competitors. The drafters did not adopt this approach. As remarked above, it attempted to resolve the question of the relevant product market by its definitions of "depository institutions" and "depository holding companies" although basic analysis is still useful on the edges. It also attempted to provide at least a partial solution of the geographic market question. A depository institution or depository holding company having total assets exceeding one billion dollars may not share a management official with any institution or holding company having total assets in excess of five hundred million dollars. ²⁸ Presumably, geographic location is an incidental detail in the case of institutions of such magnitude.

So far as smaller institutions are concerned, the interlock is forbidden only if they have offices in the same "primary metropolitan statistical

²⁶ 12 U.S.C. § 3201(4).

²⁷ No such definition appears in the Act, but the phrase "natural person" is used when the evident interest is to confine the scope of the term. *See* 12 U.S.C. § 3201(4).

²⁸ 12 U.S.C. § 3203.

area, the same metropolitan statistical area, or the same consolidated metropolitan statistical area that is not comprised of designated primary metropolitan areas as defined by the Office of Management and Budget," or, "in the case of depository institutions with less than \$20,000,000 in assets," the same "city, town, or village."²⁹

The Act defines an "office" as "either a principal office or a branch." This elaboration, however, applies only with reference to a depository institution and not to a depository holding company. Exactly what will qualify as a branch remains to be seen. Presumably it would not include a robot teller machine, although these have been held to be branches in some states for some purposes.³⁰

IV. CONCLUSION

We have not even discussed some of the specialized statutory bans on interlocks. Even without these it should be apparent that the law respecting financial institution interlocks has become moderately complex. In part, this seems to be due to our inability to decide exactly how we feel about interlocks in general and interlocks among financial institutions in particular. One hopes that the subcommittee's monograph on interlocks,³¹ produced under Norman Yoerg's leadership, will be the impetus for a discussion of the entire area.

MR. YOERG: Our next speaker will be Bill McLeod, who presently is the Director of the Chicago Regional Office of the FTC. He was the attorney advisor to Chairman Miller of the FTC at the time of the *Borg-Warner* case. His topic today is "Interlocks at the Federal Trade Commission: Room for Reason in a 'Per Se' Statute?"

²⁹ 12 U.S.C. § 3202.

³⁰ See 12 U.S.C. § 3201(5). With respect to a holding company, the notion of a branch office loses its meaning. It should be noted that the robot teller cases have been decided under state branch banking laws that are anticompetitive. The effect of such a ruling under the Act would also be anticompetitive.

³¹ ABA INTERLOCK MONOGRAPH, *supra* note 12.

