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The Antitrust Aspects of Bank Mergers - Panel Discussion I: Development of Bank Merger Law

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SYMPOSIUM

THE ANTITRUST ASPECTS OF BANK MERGERS†

PANEL DISCUSSION I: DEVELOPMENT OF BANK MERGER LAW

WELCOME

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1. Carl Felsenfeld is a Professor of Law and Director of the Financial Services Institute at Fordham University School of Law.
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3. Albert A. Foer is the President of the American Antitrust Institute.
4. Dr. Anne Gron is a Senior Consultant in the Securities and Finance Practice of NERA Economic Consulting.

PROF. FELSENFELD: I would like to welcome you here this morning to Fordham Law School.[5] My name is Carl Felsenfeld. I am the Director of the Financial Services Institute, which is one of the sponsors of today's program, along with K&L Gates[6] and the American Antitrust Institute[7] in Washington.

I would like to mention two major events. One is the United States Supreme Court case *United States v. Philadelphia National Bank* in 1963,[8] that held, among other things, that banks are subject to the antitrust laws in their merger activities and that banking is essentially a local business.[9] The *Philadelphia National Bank* case was strict in their antitrust considerations.

We jump ahead thirty-one years, when the Riegle-Neal Banking and Branching Efficiency Act of 1994 was enacted.[10] That, for the first time, enabled banks in the United States generally to go interstate.[11] That led, of course, to the mammoth mergers that we have seen, which brings antitrust laws to mind.

What I have seen since 1994 is that the number one bank in the country will merge with the number five bank in the country and create a multi-state institution, with billions of dollars in assets, and if it is found to violate the antitrust laws, the solution is to knock off half a dozen branches in the Peoria area or something like that, which makes me wonder: Do we really have an effective law of antitrust for banks? I hope the discussion today will consider that.

With that, I just want to thank the *Fordham Journal of Corporate & Financial Law*[12] for all their help. Doug, why don't I turn it over to you. It's your program.

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5. For more information, please visit the Fordham University School of Law website, http://law.fordham.edu (last visited Mar. 23, 2008).

6. For more information, please visit the K&L Gates website, http://www.klgates.com (last visited Mar. 1, 2008).

7. For more information, please visit the American Antitrust Institute website, http://www.antitrustinstitute.org (last visited Mar. 1, 2008).

8. 374 U.S. 321 (1963).

9. *Id.* at 325.

10. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 2338 (codified in scattered sections of 12 U.S.C.).

11. *See* 12 U.S.C. § 1831u (1999) (codification of § 102(a) of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994).

12. For more information, please visit the Fordham Journal of Corporate & Financial Law website, http://law.fordham.edu/jcfl.htm (last visited Mar. 10, 2008).

MR. BRODER: Thank you, Carl.

Good morning. My name is Doug Broder. I'm the co-head of the Antitrust Group at K&L Gates, resident here in New York. Our panel this morning is going to discuss the substantive competitive analysis of bank mergers. We have two very distinguished and knowledgeable panelists who are going to talk to us about this subject.

Bert Foer is the President of the American Antitrust Institute in Washington, a nonprofit think tank focused on antitrust issues.[13] Bert's career has included both private law practice, at Hogan & Hartson and Jackson & Campbell, and government service, as the Assistant Director and the Acting Deputy Director of the FTC's Bureau of Competition.[14] While at the FTC, Bert was a commissioner on the National Commission on Electronic Fund Transfers.[15] Bert also served in the private sector as the CEO of a chain of jewelry stores for twelve years.[16] Bert is a graduate of the University of Chicago Law School, has an A.B. from Brandeis and an M.A. in political science from Washington University.[17] Bert is going to focus on the legal analysis of mergers.

Anne Gron is a senior consultant in the Securities and Finance Practice of NERA Economic Consulting.[18] Anne has conducted research on, among other things, the effect of regulation in banking and insurance, and the effect of bank portfolio composition on lending.[19] Before joining NERA, Anne was an assistant professor at the Kellogg School of Management, after beginning her career as an assistant professor at the University of Chicago's Graduate School of Business.[20] Anne received her Ph.D. in economics from MIT, after graduating from Williams College with a degree in economics and computer science.[21] Anne, logically enough, will focus on the economic side of bank merger analysis.

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13. American Antitrust Institute, Our People: Officers, Directors, Fellows, and the Advisory Board, http://www.antitrustinstitute.org/About_Us/People/index.ashx (last visited Mar. 1, 2008).
14. *See id.*
15. *See id.*
16. *See id.*
17. *See id.*
18. NERA Economic Consulting, Experts, http://www.nera.com/Expert.asp?e_ID=1482 (last visited Mar. 1, 2008).
19. *See id.*
20. *See id.*
21. *See id.*

Before I turn things over to Bert and Anne, I would like to briefly outline the statutory and regulatory context within which bank mergers are analyzed. Generally, the basic law that governs merger analysis in the antitrust laws is the Clayton Act, section 7, which outlaws mergers and acquisitions "the effect of which may be to substantially lessen competition or create a monopoly."[22] Enforcement of section 7 is invested primarily in the Department of Justice ("DOJ"), and specifically in the Antitrust Division of the Department of Justice, and in the Federal Trade Commission ("FTC") and its Competition Bureau.[23]

The way mergers get analyzed now, since 1976, under the Hart-Scott-Rodino Act, is under a regime of pre-merger notification.[24] Anytime two or more parties are planning an acquisition or a transaction of a certain size—the current threshold is about $60 million—they are required to notify the DOJ and the FTC of their planned transaction, and then wait thirty days while the agencies take a preliminary look at the proposed transaction to see whether there may be a competitive antitrust problem under section 7.[25] If the agencies decide there is not, the parties can go ahead and close at the end of that thirty-day waiting period.[26] Otherwise, the agencies may seek additional information and extend the waiting period until thirty days after obtaining that information from the parties.[27]

The agencies do not have self-executing power to block a proposed transaction.[28] They have to convince a federal court that the proposed transaction would violate section 7.[29] If they can do that, they can get a preliminary, and ultimately a permanent, injunction against the transaction.[30] More often than not, when there is an investigation and the agencies have a problem with a proposed transaction, they can come up with a settlement with the parties that allows the transaction to go

22. 15 U.S.C. § 18 (1996).

23. *Id.*

24. *Id.* § 18a(a).

25. *See id.* § 18a(a)-(b). On February 28, 2008, the thresholds for all Hart-Scott-Rodino transactions increased, the threshold referenced in the text increased to $63.1 million. *See* FEDERAL TRADE COMMISSION, REVISED JURISDICTIONAL THRESHOLDS FOR SECTION 7A OF THE CLAYTON ACT 1 (2008).

26. 15 U.S.C. § 18a(b).

27. *Id.*

28. *Id.* § 18f.

29. *Id.*

30. *Id.*

forward, subject to some kind of remedy in the form of divestiture or, perhaps, a conduct remedy.[31]

Bank mergers are subject to similar, but not identical, procedures. Bank mergers are analyzed under section 7, but with a difference. The relevant statutes are the Bank Merger Acts of 1960 and 1966 and the Bank Holding Company Act.[32] For the most part, bank mergers do not require notification under the Hart-Scott-Rodino Act, but that's because they require approval from one of several regulatory agencies—the Comptroller of the Currency, the Board of Governors of the Federal Reserve, the FDIC, or the Office of Thrift Supervision—depending on what category the merging banks fall into.[33] The banks file notice for approval with those agencies.[34] The agencies notify the DOJ, which weighs in with its thoughts on the competitive analysis of the proposed merger.[35]

On the substantive side, though, there is a key distinction applied to the analysis of bank mergers under the Bank Merger Act. The Act requires the regulator who is making the decision to take into account the Clayton section 7 standard that says the transaction should be disapproved if it would violate section 7, unless—and here is the important caveat—"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."[36]

With that, I will turn it over to Bert.

MR. FOER: Thank you, Doug. Thank you all for coming out today.

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31. *See* Paul J. Stancil, *Atomism and the Private Merger Challenge*, 78 TEMP. L. REV. 949, 969 (2005).

32. Bank Merger Act of 1960, Pub. L. No. 86-463, 74 Stat. 129; Bank Merger Act of 1966, Pub. L. No. 89-356, 80 Stat. 7; Bank Holding Company Act of 1956, Pub. L. No. 110-131, 70 Stat. 133 (codified in scattered sections of 12 U.S.C.); Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, 84 Stat. 1760 (codified in scattered sections of 12 U.S.C.).

33. *See* Jonathan R. Macey, *Bank Failures, Risk Monitoring, and the Market for Bank Control*, 88 COLUM. L. REV. 1153, 1215-23 (1988) (discussing the regulatory scheme of banks under the various acts).

34. *See id.*

35. *See id.*

36. 12 U.S.C. § 1828(c)(5)(B) (2007).

How many know what the Herfindahl[37] is? I will be focusing primarily on the market definition and concentration issues that are before us.

It was about thirty years ago, in October of 1977, that the National Commission on Electronic Fund Transfers issued its report.[38] I was the FTC's representation, one of twenty-six commissioners. We were dealing then with the emerging technology of automated teller machines and debit cards.[39] It was a very forward-looking report. It set forth a program intended to maximize both consumer protection and competition for this unfolding industry.[40]

Congress quickly, and maybe surprisingly, enacted most of what we had proposed.[41] In retrospect, the EFT Commission served the country unusually well for a statutory study commission. We saw then that there were thousands of banks in the country, mostly small, but that local banking tended to be rather concentrated. We believed, as a commission, that consumers would benefit from fewer and larger banks more directly in competition with one another.[42]

How do banks compete? Let's start there.

Bank pricing includes a combination of interest rates and fees. There is non-price competition also, and that focuses on location, customer service, alternative delivery channels, the set of products being offered, brand recognition, and relationship competition.[43] To make a couple of quick generalizations: (1) Large banks often face each other in multiple markets,[44] which might temper their aggressiveness; (2) The

37. Herfindahl refers to the Herfindahl-Hirschman Index (HHI), a commonly accepted measure of market concentration. *See* David J. Saylor, *Cable Television Law 2008: Competition in Video, Internet & Telephony*, 925 PLI/PAT. 423, 444 (2008).

38. NAT'L COMM'N ON ELEC. FUND TRANSFERS, EFT IN THE UNITED STATES: POLICY RECOMMENDATIONS AND THE PUBLIC INTEREST: THE FINAL REPORT OF THE NAT'L COMM'N ON ELEC. FUND TRANSFERS 1 (1977) [hereinafter FINAL REPORT].

39. *Id.*

40. *See generally id.*

41. Electronic Funds Transfer Act, 15 U.S.C. §§ 1693-1693r (1978).

42. *See* FINAL REPORT, *supra* note 38, at 12-13.

43. *See* John T. Scott, *Nonprice Competition in Banking Markets*, 44 S. ECON. J. 594 (1978).

44. *Compare* Bank of America, Global Reach, http://corp.bankofamerica.com/public/public.portal?_pd_page_label=products/regions/emea (last visited Mar. 1, 2008), *with* Citigroup, Global Locations, http://www.citigroup.com/citigroup/global/index.htm (last visited Mar. 1, 2008) (Note that both banks have branches in the same locations, indicating competition with each other in multiple markets.).

presence or threat of a large bank may inhibit the pricing of a local dominant bank;[45] (3) Small banks are less profitable than large ones, but beyond something like $50 billion in assets, profitability declines, suggesting that the largest mergers may not gain much in the way of economies of scale.[46]

Because of the risks to individuals and to the economy, banking has been among the most regulated of American industries.[47] However, the amount of regulation has decreased since the 1970s. After the EFT report—but surely not because of it—many restrictions on banking, such as branching and interstate banking, were lifted.[48] By 1995, all states allowed interstate banking, and by 1994, only two states prohibited statewide branching.[49]

Extensive consolidation was occurring in the 1980s and 1990s. There were some very large deals, like NationsBank joining with Bank of America.[50] These were common. Today it is estimated that 630 financial holding companies control over 970 banks and 84% of all banking assets in the U.S.[51] Most of the rest operate as members of one of almost 5000 bank holding companies that account for 13% of the assets.[52]

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45. *See* ALLEN N. BERGER ET AL., DIV. OF RESEARCH & STATISTICS AND MONETARY AFFAIRS, FED. RESERVE BD., THE EFFECTS OF COMPETITION FROM LARGE, MULTIMARKET FIRMS ON THE PERFORMANCE OF SMALL, SINGLE-MARKET FIRMS: EVIDENCE FROM THE BANKING INDUSTRY 8-9 (2005), *available at* http://www.federalreserve.gov/PUBS/FEDS/2005/200515/200515pap.pdf.

46. *See* Statement of Janet L. Yellen, 81 Fed. Res. Bull. 1093, 1100-02 (1995).

47. *See* Duncan E. Alford, *Core Principles for Effective Banking Supervision: An Enforceable International Financial Standard?*, 28 B.C. INT'L & COMP. L. REV. 237, 237 (2005).

48. *See generally* Patrick Mulloy & Cynthia Lasker, *The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994: Responding to Global Competition*, 21 J. LEGIS. 255 (1995) (providing a summary of the history of banking law).

49. *See* Thomas A. Garrett et al., *A Spatial Analysis of State Banking Regulation* 1 (Fed. Reserve Bank of St. Louis, Working Paper 2003-44C, 2003), *available at* http://research.stlouisfed.org/wp/2003/2003-044.pdf ("By 1994, all states except Iowa permitted statewide branching through the acquisition of existing bank offices . . . [and] all states except Hawaii permitted some entry by out-of-state holding companies.").

50. Michael J. de la Merced and Peter Edmonston, *Builder of Sallie Mae Deal Has a Daring History*, N.Y. TIMES, Apr. 18, 2007, at C5.

51. OECD, *Roundtable on Competition and Regulation in Retail Banking*, at 4, DAF/COMP/WP2/WD(2006)60, http://www.ftc.gov/bc/international/docs/Banking_US.pdf.

52. *See id.*

The large increase in concentration at the national level—aggregate concentration—has not been matched by increased concentration at the local level. In fact, it appears that at the local level concentration, on average, has not changed very much. This is both because the newer, larger banks were able to enter local markets through market-extension mergers and because entry conditions are such that many new banks were able to get started, even as old banks were failing or merging out of existence. In other words, neither exit nor entry barriers seemed to be particularly high. It has generally been the case that retail customers and small businesses utilize local commercial banks.[53] Corporate banking is regional, national, and sometimes international.

What are the effects of concentration in banking?

Empirical analysis tends to indicate that bank efficiency is negatively correlated to concentration.[54] Banks operating in more concentrated markets earn higher profits than banks operating in less concentrated markets.[55] One can speculate that consolidation, in combination with technological advancement, has resulted in major efficiencies. We can compare the automated teller machine with live tellers. This combination of technology and consolidation has probably provided consumers with more choices than they had thirty years ago.

Nonetheless, concentration in specific markets seems to have negative consequences. This implies, first, that bank mergers will continue to be a concern for those who weigh the effects on competition. A second implication is that the starting point in any given competition analysis has to be finding what the relevant market is, since one cannot be concerned with concentration until there is a market in which participants can be counted and their shares can be evaluated. Aggregate concentration is interesting politically, but in specific markets that is where the effects of competition have to be analyzed.

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53. Arthur E. Wilmarth, Jr., *Too Big to Fail, Two Few to Serve? The Potential Risks of Nationwide Banks*, 77 IOWA L. REV. 957, 1038-39 (1992) ("More than ninety percent of smaller firms rely on local commercial banks as their primary source of financial services . . . .").

54. *See* Ash Demirgüç-Kunt et al., *The Impact of Bank Regulations, Concentration, and Institutions on Bank Margins* 27 (World Bank, Policy Research Working Paper 3030, 2003), http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2003/05/30/000094946_03052004111117/Rendered/PDF/multi0page.pdf.

55. *Id.*

Bank regulating agencies have the jurisdiction to approve or deny a bank merger.[56] By statute, probable competitive effects must be taken into account.[57] If the merger is approved, the DOJ has thirty days to block it on antitrust grounds.[58] Generally, there is staff cooperation between the DOJ and the regulatory agency during a simultaneous review.[59] The DOJ applies the basic antitrust law and analysis used in other contexts, other industries, although there are a few banking wrinkles.[60]

The key statute is the Clayton Act, specifically section 7, which makes illegal those mergers whose effect may be substantially to lessen competition, in any line of commerce, in any section of the country.[61] The key Supreme Court case is *United States v. Philadelphia National Bank*.[62] This 1963 landmark case involved a merger between the second- and third-largest of forty-two commercial banks in the Philadelphia metropolitan area.[63] The lower court had held that section 7 was not applicable to banks and that, in any event, the merger would not lessen competition.[64] In its decision reversing this, the Supreme Court emphasized that there was a trend toward concentration in banking in Philadelphia.[65] The Court held—and the author was Justice

56. *See* Gina M. Killian, *Bank Mergers and the Department of Justice's Horizontal Merger Guidelines: A Critique and Proposal*, 69 NOTRE DAME L. REV. 857, 857 (1994) (stating that "[t]he Federal Reserve Board ("Fed") and the Department of Justice ("DOJ") are two agencies with regulatory jurisdiction over bank mergers.").

57. United States v. Phila. Nat'l Bank, 374 U.S. 321, 334 (1963) (stating that in "the case of a merger, consolidation, acquisition of assets, or assumption of liabilities, the appropriate agency shall also take into consideration the effect of the transaction on competition . . . .").

58. *See* Killian, *supra* note 56, at 865.

59. *See* J. Robert Kramer II, *Antitrust Review In Banking and Defense*, 11 GEO. MASON L. REV. 111, 117 (2002) (stating that cooperation between the DOJ and Federal Reserve Board has grown, and that they "routinely hold joint meetings with the parties and collectively give parties feedback on competitive concerns").

60. *See* Catherine M. Bejerana, *Capitalist Manifesto: The Inadequacy of Antitrust Laws In Preventing the Cannibalism of Competition*, 2 ASIAN-PAC. L. & POL'Y J. 144, 160-63 (2001) (stating that "[t]he Department of Justice's analysis for bank mergers is essentially similar to that of other industries" and providing the other laws and rules applicable to bank mergers).

61. 15 U.S.C. § 18 (1996).

62. *Phila. Nat'l Bank*, 374 U.S. at 321.

63. *Id.* at 330.

64. United States v. Phila. Nat'l Bank, 201 F. Supp. 348, 372 (E.D. Pa. 1962).

65. *Phila. Nat'l Bank*, 374 U.S. at 331 (stating that "the trend toward concentration

Brennan[66]—that bank mergers are covered by section 7 of the Clayton Act.[67] Second, it held that the Bank Merger Act of 1960, which directed the banking agencies to consider competitive factors before approving mergers, did not immunize approved mergers from challenge under the federal antitrust laws.[68] In other words, the DOJ could block a merger, even though the Comptroller approved it.

Next, the Court turned to the lawfulness of the proposed merger under section 7.[69] The first issue was to determine the line of commerce.[70] That is a statutory line; we call it the relevant market, relevant product, or relevant geographic market.[71] The section of the country is the relevant geographic market.[72] These two aspects of a market definition interact.

The Court agreed with the lower court's finding that a cluster of products and services denoted by the term "commercial banking" constituted a distinct line of commerce.[73] It disagreed, however, on the appropriate section of the country.[74] In banking, the Court said, individuals and corporations typically confer the bulk of their patronage on banks in their local community.[75] The four-county area in which the banks' offices are located would seem to be the relevant geographic

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is noticeable in the Philadelphia area generally, in which the number of commercial banks has declined from 108 in 1947 to the present 42").

66. *Id.* at 323.

67. *See id.* at 346.

The stock-acquisition provision of Section 7, though reenacted *in haec verba* by the 1950 amendment, must be deemed expanded in its new context to include, at the very least, acquisitions by merger or consolidation, transactions which entail a transfer of stock of the parties, while the assets-acquisition provision clearly reaches corporate acquisitions involving no such transfer.

Id.

68. *Id.* at 350 (holding that the district court below was correct in rejecting the contention that the "[b]ank Merger Act, by directing the banking agencies to consider competitive factors before approving mergers immunizes approved mergers from challenge under the federal antitrust laws") (citation omitted).

69. *See id.* at 355.

70. *Id.* at 356.

71. *See id.*

72. *Id.*

73. *Id.*

74. *Id.* at 357.

75. *Id.* at 358.

market in which the companies operate and the customers can practically turn for service.[76]

Finally, the Court turned to the prediction of a merger's effect on competitive conditions.[77] This is a prediction about the future; it has to be. The purpose of section 7 is to arrest anticompetitive tendencies in their incipiency.[78] In a key interpretation, Justice Brennan stated,

> Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined, in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[79]

This structure-based test, the Court said, "is fully consonant with economic theory"; namely, that competition is more likely "to be greatest when there are many sellers, none of which has any significant market share."[80] The Court went on to convert these observations into some presumptions and presented a burden-shifting approach, a model, for how merger analysis should proceed.[81]

First, if the merger results in a bank controlling at least 30% of the market, there is a presumption of danger.[82] Further, if there is an increase of more than 33% in concentration, this is significant.[83] These structural indicia raise an inference of illegality, which can then be rebutted by the merging parties.[84]

In the case at hand, the Court dismissed the various rebuttal arguments that were put forward by the banks.[85] *Philadelphia National Bank*'s emphasis on incipiency meant that merger analysis would focus on predicted future effects.[86] Its emphasis on market structure meant

76. *Id.* at 359.
77. *See id.* at 362.
78. *See id.*
79. *Id.* at 363.
80. *Id.*
81. *See id.* at 363-64.
82. *See id.* at 364.
83. *Id.* at 365.
84. *See id.* at 363.
85. *See id.* at 370-73.
86. *See id.* at 362.

that measurements of concentration, which are highly dependent on market definition, would play the essential role.[87]

The focus on future effects was heightened by passage of the Hart-Scott-Rodino Act in 1976.[88] The Hart-Scott-Rodino Act has had a largely unanticipated effect of moving the merger law development and enforcement policy process from a regime of *post hoc* adjudication to *pre hoc* administration/negotiation.[89] Today, relatively few mergers are actually litigated in court.[90] A new body of administrative law has consequently evolved outside of the judiciary's sight. To a large extent, the antitrust treatment of mergers is driven by a step-by-step application of the principles in the horizontal merger guidelines.[91]

Philadelphia National Bank recognized that merging parties could, in theory, rebut the presumptions created by concentration, but it did not provide much hope that rebuttals would be found persuasive.[92] This is what has changed since *Philadelphia National Bank*. In one Supreme Court and several appellate cases, ease of entry and efficiencies have been allowed to rebut the structural presumption of harm.[93] To an extent

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87. *See id.*

88. *See* Susan Harriman, Note, *Parens Patriae Actions on Behalf of Indirect Purchasers: Do They Survive* Illinois Brick*?*, 34 HASTINGS L.J. 179, 184 (1982) (stating that one purpose of the Hart-Scott-Rodino Act was "to deter future antitrust violations" (quoting H.R. REP. NO. 94-499, at 3 (1975))).

89. Albert A. Foer, *Toward Guidelines for Merger Remedies*, 52 CASE W. RES. L. REV. 211, 212 (2001) (stating that the "Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR") has had the largely unanticipated effect of moving the merger law development and enforcement policy process from a regime of post hoc adjudication to ad hoc regulation and pre hoc administrative negotiation") (footnote omitted).

90. Robert Pitofsky, Chairman, Fed. Trade Comm'n, Remarks at the Cutting Edge Antitrust Conference Law Seminars International (Feb. 17, 2000), *available at* http://www.ftc.gov/speeches/pitofsky/restruct.shtm (stating that "few merger cases are fully litigated in the United States courts or the FTC's administrative process").

91. *See* WILLIAM C. HOLMES, ANTITRUST LAW HANDBOOK § 6:6 (West 2007) (defining the Guidelines as guidelines jointly issued by the Justice Department and the Federal Trade Commission which set forth case selection criteria that both agencies use when screening mergers for potential challenge under section 7 of the Clayton Act, and stating that the "[g]uidelines employ a basic five-part analysis to determine whether a particular merger threatens to create or further entrench market power").

92. *See Phila. Nat'l Bank*, 374 U.S. at 363-64 (holding that "the concentration of firms . . . is so *inherently* likely to lessen competition substantially that it must be enjoined in the absence of evidence *clearly* showing that the merger is not likely to have such anticompetitive effects") (emphases added).

93. *See* United States v. Phillipsburg Nat'l Bank & Trust Co., 399 U.S. 350, 377 (recognizing two aspects of market structure that the court thought might well rebut the

that probably will not be clear until the next Supreme Court rendezvous with a merger, it appears that the structural presumption has definitely been weakened, but nevertheless stands as controlling doctrine.

It has been said that the modern era of merger policy began with the 1982 Merger Guidelines.[94] The current guidelines were issued jointly by the DOJ and the FTC in 1992 and revised a little bit in 1997.[95] They are limited to horizontal mergers—not vertical mergers, not conglomerate mergers.[96] Reflecting the influence of the Chicago School,[97] they focus on market power as the source of concern, and they don't talk about trends of concentration, as Justice Brennan did, or protection of small business, which was one of the objectives of some of the earlier merger decisions.[98]

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presumption raised by concentration, one of which included new entry).

94. *See* Jonathan B. Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*, 77 N.Y.U. L. REV. 135, 148 (2002) (stating that the same problem that William Baxter confronted in drafting the 1982 Merger Guidelines—"harmonizing the older structural-era decisions with contemporary economic thinking—remains central to horizontal merger analysis today").

95. *See* Robert M. Vernail, *One Step Forward, One Step Back: How the Pass-on Requirement for Efficiencies Benefits in* FTC v. Staples *Undermines the Revisions to the Horizontal Merger Guidelines Efficiencies Section*, 7 GEO. MASON L. REV. 133, 134 (1998) (stating that "[i]n April 1997, the FTC and DOJ issued revisions to the Horizontal Merger Guidelines' Efficiencies Section").

96. *See* Joseph P. Bauer, Symposium, *The 1982 Merger Guidelines: Government Enforcement Policy of Section 7 of the Clayton Act: Carte Blanche for Conglomerate Mergers?*, 71 CAL. L. REV. 348, 350 (1983) (stating that in 1982 the "Department of Justice promulgated new Merger Guidelines, indicating that it will not challenge non-horizontal mergers, unless the transactions are likely to have an adverse impact on actual or potential competition").

97. The "Chicago School" refers to "the approach of the members of the Department of Economics at the University of Chicago over the past century . . . associated with a particular brand of economics which adheres strictly to Neoclassical price theory in its economic analysis, "free market" libertarianism in much of its policy work and a methodology which is relatively averse to too much mathematical formalism and willing to forego careful general equilibrium reasoning in favor of more results-oriented partial equilibrium analysis." History of Economic Thought, The Chicago School, http://cepa.newschool.edu/het/schools/chicago.htm (last visited May 1, 2008).

98. *See* Baker, *supra* note 94, at 147 (stating that a Chicago-oriented legal scholar, William Baxter, appointed by President Reagan to head the Antitrust Division of the Department of Justice, issued the 1982 Merger Guidelines where "he confronted the problem of harmonizing the existing horizontal merger precedent with the economic

The guidelines proceed in five steps to summarize its defining markets and examine market competition: adverse competitive effects, entry, efficiencies, and the possibility that one of the firms is failing.[99] Merger law is concerned with predicting the competitive effects of a merger. It is presumed that when there is market power, there will be negative competitive effects.[100] Going back one step further, it is presumed that when there is a high market share, there will be market power.[101] A crucial link in the inquiry is whether the merging parties will have a high market share.[102]

This is not always an easy question to answer. In fact, it's usually the nub of a merger antitrust analysis. For instance, there is a pending merger between XM and Sirius.[103] It will go from a duopoly to a monopoly if the market is defined as satellite radio. The parties argue that is not the relevant market, because there is also AM and FM, and there are other types of communications with which they say they compete. That is going to be the issue that the Justice Department has to determine: What is the relevant market?

Whole Foods wants to acquire Wild Oats.[104] These are the two primary competitors in the organic/natural foods market. The merger would create a near-monopoly in that market. But is that the relevant market? They were able to convince a district court that the market is actually much broader. It includes Safeway and Kroger's and all the

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approach of the Chicago School").

99. Mr. Foer failed to name the fifth step, which is "significantly increase concentration and result in a concentrated market." *See* 1992 Horizontal Merger Guidelines Notice, 57 Fed. Reg. 41552-01 (Apr. 2, 1992) [hereinafter Notice], *available at* http://www.ftc.gov/bc/docs/horizmer.htm (last visited Feb. 15, 2008).

100. *See* FTC v. Procter & Gamble Co., 386 U.S. 568, 577 (1967) (holding that "[s]ection 7 of the Clayton Act was intended to arrest the anticompetitive effects of market power in their incipiency").

101. *See* Notice, *supra* note 99 (stating that when the post-merger Herfindahl-Hirschman Index exceeds 1800 points, "it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power . . . .").

102. *See id.* (stating that a federal agency will first assess "whether the merger would significantly increase concentration and result in a concentrated market").

103. *See* Frank McGuire, *Year-End Review of Markets & Finance 2007*, WALL ST. J., Jan. 2, 2008, at R12. The DOJ approved the merger on March 24, 2008, leaving only one more regulatory hurdle—approval from the FCC. Sarah McBride & Amy Schatz , *XM, Sirius Move Closer To Improbable Merger*, WALL ST. J., Mar. 25, 2008 at B1.

104. David Kesmodel, *Whole Foods Sets Probe As CEO Apologizes*, WALL ST. J., July 18, 2007, at A3.

other places where you can buy organic foods, even though they don't specialize in them.

We'll see. That's on appeal by the FTC.

The question is which close substitutes are close enough so that they should be considered to be in the same market? Under the guidelines, we begin the market-definition process by accounting for the possibility that buyers would defeat an attempt by sellers to profitably exercise market power because they will purchase close substitutes from alternative sellers.

The technique used for this is kind of hypothetical. It is the process of the hypothetical monopolist. You are trying to define a market as a collection of products or services that would form a valuable monopoly within a defined geographic region. Were the hypothetical monopolist in this market to raise the price by a small but significant and non-transitory amount, which is usually considered to be 5% for the foreseeable future[105]—would enough potential substitutes flow into the market so that the price would come back down to where it was before the monopolist raised the price? If the answer is yes, enough would flow in, then you have defined the market too narrowly. We have to go back and try a broader definition and do the same test, until we come to a market that is defined in such a way that a monopolist in that market could maintain its price increase. Then we have the right definition. That's the way this process works.

In *Philadelphia National Bank*, the market was a cluster of services, such as loans and other types of credit, deposit accounts, checking services, trust administration.[106] The Court said, "Yes, that cluster is distinct, and it represents cost advantages and consumer preference. We think that that is a viable definition of a market."[107] They were not going through the guidelines test at that time, because it didn't exist.[108]

Once you have the market defined satisfactorily, the next step is to figure out who the participants are in the market. The guidelines count as firms participating in the market all firms that currently produce or sell in the market.[109] This is not always obvious. For example, in a

105. *See* Notice, *supra* note 99, § 1.11.

106. *See* United States v. Phila. Nat'l Bank, 374 U.S. 321, 356 (1963).

107. *See id.* at 356-57.

108. *Compare id.* at 321 (stating that *Phila. Nat'l Bank* was decided on June 17, 1963), *with* Baker, *supra* note 94, at 148 (stating that the modern era of merger regulation began with the creation of the 1982 Merger Guidelines).

109. *See* Notice, *supra* note 99, § 1.2.

commercial bank merger, what do you do about thrifts? Are they in the market, not in the market, or partially in the market? It depends. In a retail product market, the thrift and the credit union deposits are given full weight, because they are alternatives for the customer. But in the small business lending market, less credit, or maybe no credit, would be given to thrifts and credit unions.

For the most part, DOJ investigation of a commercial bank merger is generally similar to its other merger investigations.[110] One difference is that they have an unusually large amount of information because of regulatory oversight of banks.[111] The DOJ staff usually requests information that it needs through a simple request for information, rather than a civil investigative demand.[112]

Unlike other mergers, a bank merger receives antitrust immunity after the post-approval waiting period expires.[113] In other words, if the DOJ and the regulatory agency both approve it, nobody else can go after it.[114] If the DOJ does file suit, there is an automatic stay, and a federal district court will conduct a *de novo* review of the transaction.[115]

The geographic market determination[116] in this area tends to be more of an issue than the product market determination.[117] The starting point for the DOJ is the Federal Reserve Board-defined banking market.[118] The geographic market definition will probably depend on the product market at issue. In retail banking, it is generally going to be defined by the customers—where they live, where they work. For small businesses, customers generally choose a bank that is within a few miles of their business location. The geographic market for middle-market

110. *See* Bejerana, *supra* note 60, at 160.

111. *See* Jonathan R. Macey, *Commercial Banking and Democracy: The Illusive Quest for Deregulation*, 23 YALE J. ON REG. 1, 1 (2006).

112. *See* Yvonne S. Quinn, *Practical Aspects of Defending Bank Mergers Before The Federal Reserve Board and the Department of Justice*, 62 ANTITRUST L.J. 91, 94 (1993).

113. *See* Kramer, *supra* note 59, at 116.

114. *See* Killian, *supra* note 56, at 857.

115. *See* Kramer, *supra* note 59, at 116.

116. *See* United States v. Phila. Nat'l Bank, 374 U.S. 321, 356 (1963) (defining the relevant geographic market as the section of the country "in which to appraise the probable competitive effects" of a proposed merger).

117. *See id.* (defining the relevant product market as the line of commerce "in which to appraise the probable competitive effects" of a proposed merger).

118. *See generally* Killian, *supra* note 56 (explaining the process that the Fed and the DOJ use to analyze a bank merger).

customers is going to be larger than for small businesses; for very large banks, it could be international. Critically, though, the market definition is not set in concrete. A new method of doing business might trigger a change in market definition.

Let's take Wal-Mart, for instance. Traditionally, Wal-Mart was not considered to be a supermarket, or in the same market with supermarkets. So when two supermarkets wanted to merge, Wal-Mart, operating through a different channel of distribution and with a whole different style, was excluded. That made it somewhat difficult for large supermarkets to merge, because, at least in some geographic areas, they would have a high share of the market. If you include Wal-Mart as a supermarket, or within that food retailing market, and you say *that* is the relevant market and Wal-Mart is bigger than any of the others, you have a whole different picture.

There is some indication that this is going to happen. It did happen in a settlement the FTC reached in Puerto Rico when Wal-Mart entered the market.[119] If you shift your paradigm of market definition and you include Wal-Mart in the market, then the ability of large supermarkets to merge becomes much greater. The point is that we can have all kinds of changes that might lead to a different definition of a market. The changes could involve transportation costs, consumer buying habits, technological advancements, governmentally-established barriers to entry, and patterns of trade. All of these are possibilities. There is a major monopolization case going on right now in which AMD is suing Intel.[120] The complaint describes the relevant geographic market as nothing less than global.[121] As the world changes, market definitions can expand or, in some cases, shrink.

If the accepted geographic market for commercial banks were to be enlarged by merger analysis from local to regional, national, or global, the levels of concentration would in many situations fall below the thresholds that give today's antitrust enforcers concern. Similarly, if the

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119. *See* Orson Swindle, Comm'r, Fed. Trade Comm'n, Remarks Before the 126th Annual Meeting of the New York State Bar Association (Jan. 23, 2003), *available at* http://www.ftc.gov/speeches/swindle/030123osremarks.shtm (stating that "the Commission announced its acceptance of a consent agreement in settlement of its challenge to Wal-Mart's acquisition of Supermercados Amigo, the largest supermarket chain in Puerto Rico").

120. *See* Complaint at 1, Advanced Micro Devices, Inc. v. Intel Corp., Civ. Action No. 05-441-JJF (D. Del. June 27, 2005).

121. *See id.*

line between commercial banks and non-banking financial institutions is weakened, the product market definition could change. Banks that are very large ducks in today's banking pond could appear much smaller to the expanded financial lake. In either case, the adoption of a new and enlarged market definition would open the way to new and potentially much larger institutions. Needless to say, the implications would be both enormous and enormously controversial.

There is ample justification for careful and ongoing empirical research to test the accuracy of both prevalent and alternative assumptions. Consolidation that has created national banking and ongoing changes in banking services do assure us that antitrust analysts will have to continue to visit and revisit the assumptions relating to market definition, to participants in the market, and to the role of concentration in commercial markets.

Given the importance of empirical research and what economics has to tell us about these matters, it's appropriate to turn the table over to Anne now.

DR. GRON: Thank you. I am going to be speaking more about the economic side of the market. This discussion is really going to focus on retail banking. In the current implementation of the 1963 Supreme Court ruling, and subsequent judgments upon the matter, bank mergers at the retail banking services level are primarily analyzed in terms of their geography and product line.[122] The initial analysis is typically that the geographic market is, in fact, local and that the product line is this cluster of retail branch banking services that include demand deposits and lending.

Implementation, as a first pass, is a pretty standardized process for bank mergers. However, there are slight variations in implementation at a screening level—when they initially propose a merger and how regulators may look at them and evaluate them.

What we know from economic research, in terms of what we can discern about the size of relevant markets, depends, in some ways, on the product. The particular product may suggest a narrower or broader market. The nice thing about the research is that it's not just an "it

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122. *See* United States v. Phila. Nat'l Bank, 374 U.S. 321 (1963) (defining the geographic markets where the effect of the merger on competition will be direct and immediate); *see also* United States v. Conn. Nat'l Bank, 418 U.S. 656, 666 (1974) (stating that geographic markets are described as the area in which the acquired bank was in direct competition with other banks).

depends" answer; it's actually an answer that provides some insight into the types of products and the size of the markets.

What is a typical bank merger process? In the beginning of the process the geographic market, if urban, is typically going to be defined as the metropolitan area. For rural areas, it's typically going to be one county, maybe two, depending on where the population and the bank branches in those counties tend to be. Initially, the product lines probably receive the most focus are deposits or loans.[123]

Merger analysis is typically based on the Department of Justice Merger Guidelines[124] and by the Hirschman-Herfindahl Index,[125] which is really just a measure of market concentration. The typical way to measure concentration in a market is a concentration ratio.[126] For example, a concentration ratio for the top four banks would tell you what percent of market share the top four banks have. But if you have a concentration ratio of 40, you don't know, for the top four banks, whether each one has 10% or whether one bank has 35% and the next three have the remaining 5%.

As an economist judging the performance of this market, you care about the difference. The Herfindahl Index provides a better index in those terms, because it is the square of the market shares. As such, a larger market share, when it gets squared, gets proportionately larger. That is why we use a Herfindahl Index.

A 200-point increase in the Herfindahl caused by the merger and a post-merger Herfindahl of 1800 or more is often seen as reason to look further.[127] You look at whether the ease of entry and exit is going to

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123. FDIC, FDIC STATEMENT OF POLICY ON BANK MERGER TRANSACTIONS 5145 (2003), *available at* http://www.fdic.gov/regulations/laws/rules/5000-1200.html (stating that "[t]he relevant geographic market(s) includes the areas in which the offices to be acquired are located and the areas from which those offices derive the predominant portion of their loans, deposits, or other business").

124. *See* U.S. DEP'T OF JUSTICE, BANK MERGER COMPETITIVE REVIEW—INTRODUCTION AND OVERVIEW (2000), http://www.usdoj.gov/atr/public/guidelines/6472.pdf.

125. *See* Saylor, *supra* note 37.

126. Concentration ratio is a percentage figure representing the aggregate market share of a given number of leading firms in an industry. *See* Michael O. Finkelstein & Richard M. Friedberg, *The Application of an Entropy Theory of Concentration to the Clayton Act*, 76 YALE L.J. 677 (1967) (stating that the measure of economic concentration most frequently used by lawyers and economists in the horizontal merger cases is the concentration ratio).

127. *See* U.S. Dep't of Justice, The Herfindahl-Hirschman Index (HHI),

have an impact on the competition among the banks that result from the merger. You also look at the types of business in which those particular banks are engaged. A separate issue is whether the concentration of deposits that results from this merger gives the merging entity over 35% of the deposits in the market, which would also result in further scrutiny. It doesn't mean that is the end of the process; it just means that there will be more of the process.

One difference between the different regulatory bodies, to some extent, is the initial firms that each might include in the market. The Office of the Comptroller of the Currency and the FDIC typically include thrifts at full measure.[128] If they have \$100 in assets, the \$100 is included in the market and included in their shares. The Federal Reserve Board, in contrast, often includes a thrift deposit at 50% weight.[129] If they have \$100, it's going to be in at \$50. The Department of Justice might include the thrifts in the deposit.[130] It depends on the basic size of the thrift competition in that market.

The research is best grouped into three areas. The first type of research basically looks at markets defined by "use." It looks at surveys of households and small businesses, and asks, "Where do you get your financial transactions?" If you get your financial transactions from the set of banks within the local geographic area, as just defined—based on either a metropolitan area or a county—then the local measure is a pretty good measure of the market structure. If, however, you are getting a fair amount of your financial services from outside that market, then clearly you don't have all the firms within the market. The size of the market is correctly defined when you have a market such that a monopolist operating in the market could raise and hold prices higher by 5%, because if you have a lot of customers doing business with firms outside

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http://www.usdoj.gov/atr/public/testimony/hhi.htm (last visited Feb. 4, 2008) (stating that "[t]ransactions that increase the HHI by more than 100 points in concentrated markets presumptively raise antitrust concerns . . . .").

128. *See* KEITH R. FISHER, MERGERS AND ACQUISITIONS OF BANKS AND SAVINGS INSTITUTIONS § 3.12, at 3:91-92 (1993).

129. Robert B. Avery and Katherine A. Samolyk, *Bank Consolidation and Small Business Lending: The Role of Community Banks* 19 n.16 (FDIC Working Paper No. 2003-05, 2003), *available at* http://www.fdic.gov/bank/analytical/working/wp2003_05/wp2003_05.pdf.

130. *See generally* Robert E. Litan, Deputy Assistant Attorney Gen., Dep't of Justice, Address before Antitrust Section of ABA on the Antitrust Assessment of Bank Mergers (Apr. 6, 1994), *available at* http://www.usdoj.gov/atr/public/speeches/litan.txt.

of your local market structure, you clearly don't have all the competitive effects.

The second set of research looks at the determinants of prices—that is, interest rates, not the fees *per se*. It looks at price variation over a larger geographic area, and asks, "Are prices seemingly most influenced by local market conditions—the structure, the profitability of businesses, and so forth—or are they also influenced by larger economic conditions over a larger geographic area, like statewide or, in some cases, national?"

There are a couple of studies that are closely related to this question. The market structure analysis really asks how well different types of financial institutions compete with each other or, more importantly from an antitrust standpoint, how important is the competitive effect of one type of financial institution on another. A Herfindahl Index or a concentration ratio weighs all firms similarly. If you decided to weigh the thrifts at 50%, everybody is either full-weight or 50%. In reality, firms are differentiated. This market structure analysis tries to look at in what way financial institutions are differentiated and learn something about their competitive influences on each other.

Finally, some relatively new research looks at the prices of bank branch sales and asks whether these are influenced by local market conditions or whether they are influenced more by state market conditions. The survey data addresses whether households or small businesses do most of their financial transactions with geographically local banks. The answer has been that it depends on the type of product. For consumers, checking and NOW accounts[131] remain primarily local. Most consumers and households get their transaction accounts at banks within a small local geographic market. That said, the percentage of households getting all their financial services from banks has fallen significantly over time.[132] The research I saw tended to stop as of the late 1990s, but I think we can strongly expect the trends to continue. For

131. NOW stands for Negotiable Order of Withdrawal. *See* James D. Lawlor, *Power of Savings Bank or Similar Institution to Provide Checking Facilities or Negotiable Orders of Withdrawal (NOW) to Customers*, 64 A.L.R.3d 1314 (1975).

132. Dr. Anne Gron, Bank Merger Analysis: Defining the Relevant Market (Nov. 13, 2007) (unpublished PowerPoint slides, on file with the Fordham Journal of Corporate and Financial Law).

example, by 1998, less than 45% of the households in the surveys borrowed locally.[133] That is likely to continue.

This isn't that surprising. Borrowing is something that, because of the significant cost to consumers, they are going to search for pretty far. Meanwhile, transaction accounts are something that you might want locally, because you are coming in and out of the bank and have a lot of interactions with them.

For small businesses, the research gives a little more of a mixed message. Research from the mid-1990s suggested that distances between borrowers and lenders may have increased and, in fact, are currently likely to be larger than a local geographic market.[134] Specifically, the study looked at a survey of small business lending, and it found that distances between borrowers and their lenders in the 1970s were relatively close to a local market.[135] They were about seventy miles apart, on average, whereas by the early 1990s, research indicated that they were closer to 160 miles away, which is larger than most geographically local markets.[136] The challenge, however, is that we don't have a lot of data from the 1970s. We only observed agreements made in the 1970s in the 1990s, so you have some bias.

Like good academics, people ran off and asked the question again. The next study basically came out somewhat contradictory. While the distance between small business borrowers and their lenders varied according to the type of product, small business borrowers much like households get their transaction accounts locally, too. Regarding lines of credit, another measure of lending investigated, small businesses typically transact with financial institutions within about thirty miles or so, and have not increased in distance throughout the 1990s.[137] This study concluded that, on average, small businesses get a lot of their

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133. *See id.*

134. *See* FED. RESERVE BD., 1993 NATIONAL SURVEY OF SMALL BUSINESS FINANCES (1993), *available at* http://www.federalreserve.gov/Pubs/Oss/oss3/bibliography/index.html (providing various reports and memoranda summarizing the 1993 survey results and their impact).

135. *See id.*

136. *See id.*

137. *See* FED. RESERVE BD., 1998 NATIONAL SURVEY OF SMALL BUSINESS FINANCES (1998), *available at* http://www.federalreserve.gov/Pubs/Oss/Oss3/ssbf98/ssbf98home.html (providing various reports and memoranda summarizing the 1998 survey results and their impact).

financial services from local markets, and that this has not changed over time.[138]

A second set of research asked, "Do we have all the banks in the market?" Using some information from the Community Reinvestment Act,[139] researchers looked at how many banks were providing credit for small businesses within a local geographic area. They found that, while a lot of the relationships were with local banks, a number of banks were excluded. In particular, they tended to be large, multimarket bank types. The excluded lending was also typically credit card-related.

If you include these banks, the measure of concentration falls significantly in the market area. It tends to be that the share of outside banks in this sort of measure is greater in more concentrated markets. If you are looking in a market where you might be particularly concerned that concentration would affect pricing and profitability within the market, interestingly enough, those are the markets which seem to have more use of outside credit by small businesses.

There is also a branch of literature that looks at price determination within a market. This question basically asks, "Are interest rates reflective of concentration?" The structure-performance paradigm[140] really underlies much of the antitrust analysis. If you are looking at an industry that is very concentrated, the likelihood that competition is very intense is less than when you have lots of small firms all acting atomistically in the sort of standard, perfectly competitive world. Under that scenario, a competitive market would likely have low prices and low profitability and be very efficient. A very concentrated market is likely to lead to conduct that is less competitive among firms and likely to lead to higher profitability. This research looked for both the connection between prices and profitability, and also the difference between prices and concentration.

Early research found a very a surprising result. Deposit interest rates—remember, the higher the deposit interest rate, the better it is for the consumer—were positively related to concentration measures, which would suggest that maybe concentrated markets are better, from a consumer standpoint.[141] This turns out to be an artifact of that particular

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138. *See id.*

139. Community Reinvestment Act of 1977, 12 U.S.C. §§ 2901-2908 (1997).

140. The structure-conduct-performance approach to antitrust analysis sets elements of performance as the main goals. *See* Leonard W. Weiss, *The Structure-Conduct-Performance Paradigm and Antitrust*, 127 U. PA. L. REV. 1104 (1979).

141. *See* Thomas W. Hazlett, Symposium, *Is Antitrust Anticompetitive?*, 9 HARV.

study, and later researchers have been unable to replicate it. In fact, they have overturned the results.[142]

Typically, you look at interest rates on local and state or national measures and ask, "Is a variation in prices most related to local concentration and local structure, or is it also influenced, or more influenced, by state level?" Again, you get some variation on the local. State measures actually explain a fair amount of the variation. Similar to the survey data, prices and interest rates on local transaction accounts appear to be heavily locally determined. However, if you look at something like six-month certificates of deposit that are pretty liquid and fairly easy to price, their rates seem much more nationally determined.

The evidence suggests that most deposit rates are, not positively, but negatively, correlated with concentration, meaning you get lower interest rates on your deposits if you are in a more concentrated market.[143] But prices are going to be influenced by state and super-regional effects, not just by the local market.

This research went further and actually looked at different types of banks. This is particularly important when you think about concentration measures as treating all banks and all products within them uniformly. This research has separated two kinds of commercial banks—banks that participate across multiple markets, which we generally call multimarket banks, and single-market banks. The bulk of the assets in the U.S. banking system are in multimarket banks. When you separate them and look at them individually, it turns out that multimarket banks don't set prices at individual market levels.[144] They set policies for interest rates and so forth that go across local markets. They do not vary that much with local market conditions.

Do the multimarket bank interest rates charged or given on different kinds of financial instruments just represent a weighted average of the places these banks are in? The answer is actually no. They more closely represent the statewide conditions than simply the weighted average of the local conditions these banks are in. In contrast, single-market banks actually do seem to price to the locality.[145] They reflect

J.L. & PUB. POL'Y 277, 286-87 (1986).

142. *See id.* at 287.

143. *See id.* at 286-87.

144. *See* Andrew M. Cohen & Michael J. Mazzeo, *Market Structure and Competition Among Retail Depository Institutions*, REV. OF ECON. AND STATISTICS, Feb. 2007, at 60, 61 n.3.

145. *See id.*

the local market conditions, not as much the state conditions. In fact, deposit rates are lower when market concentration is higher.

Interestingly enough, the two types of banks do compete against each other and have an effect on each other. The relationship between the deposit rates and local market concentration is weaker when multimarket banks are very strong in the market, suggesting that they are going to have a significant disciplinary effect on each other.

One important caveat: this structure-performance paradigm is really about concentration leading to, eventually, higher profits because of less intense competition. It is difficult to fully know whether the differences in prices reflect differences in quality or whether they reflect differences in both quality and costs that are systematically different among the different types of banks.

That's where these other studies are attractive. These other studies try to work in an environment where they don't look at prices *per se*. They have underlying a model of profitability and they then observe something else in the world. Based on their underlying model of profitability, they infer something either about competition or about the value of a certain thing.

The first type of study I call market-structure studies.[146] These studies use the composition of a market to analyze the competition within and across financial institutions.[147] This is supposed to answer, "How competitive is the market?," beyond just, "What's the concentration ratio? What's the Herfindahl Index?" They want to look at the players, look at how they interact. How important is it that you have one thrift, two single-market banks, one multimarket bank, versus two multimarkets and two single-markets? What kind of a difference might it make?

To do this, you basically need geographically isolated markets. They have typically been done in rural markets, which is a sacrifice, because you are not going to be able to transfer these results as naturally to an urban market. But with that sacrifice comes a benefit, in that you can then look at the number of firms in the market and the types of firms in the market. You look at the variation across the markets and the market size, and if these firms are in the market and no more, then we

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146. For an explanation of market-structure studies, see Almarin Phillips, *Market Concentration and Performance: A Survey of the Evidence*, 61 NOTRE DAME L. REV. 1099, 1105 (1986).

147. *See id.*

know that these guys are profitable. Putting in one more of any of those types, the marginal guy is going to be unprofitable. What can we infer about the effect of competition of one type versus another?

This research has identified multimarket banks, single-market banks, and thrifts. Thrifts are probably the most differentiated—not a surprise, given that the history of thrifts has been somewhat different than the history of commercial banks, in terms of the product markets and the things in which they were involved. They have less of a competitive effect on single- and multimarket banks, except in the rural markets that are closer to urban markets. The study defined less rural and more rural markets, depending on whether you were closer to a larger city than not.

Multimarket and single-market banks are closer substitutes in the more rural markets. They definitely have competitive effects on each other. An additional single-market bank, however, does not have as big an effect on an existing multimarket bank as an additional multimarket bank. They are not perfect substitutes in terms of the profitability of these kinds of institutions.

What does it say about merger analysis? It says that you have to think about the composition of the market, not just the number of players in the market. Again, it depends on the product lines.

The last type of study I want to mention looks at branch sales,[148] instead of prices, which could be influenced by quality or cost differences across firms. If somebody is going to buy this branch, they are going to be willing to pay an amount that should reflect the profitability that this asset should generate. The question is, "Does that profitability depend on local market conditions—how concentrated that local market is—or does that price reflect state or super-regional market structure or market conditions?"

Any price is the outcome of a bargaining situation. Prices are going to be higher if the seller has more bargaining power, if the potential synergies are very large, and if the buyer is more interested in the product and there are multiple bidders. When you have competition for an asset, price goes up. When you have less competition bidding, price goes down. With that in mind, however, the research suggests that branch prices are correlated with state, not local, factors.[149] The

148. *See* Martin R. Garay, III, *New Developments in Savings and Loan Law*, 39 BUS. LAW. 781, 791-91 (1984).

149. *See* TIMOTHY H. HANNAN & ROBIN A. PRAGER, FED. RESERVE BD.,

inference is that profitability is not a locally based event. It's actually something that depends on the market conditions at the state level.

Remember, when you are looking at a branch, you are looking at a cluster of products, some of which may be more local, some of which may be serving a broader market. You again come back to this issue that when you are looking at a specific merger, you want to consider the products that are most effective at that time.

So what do we learn? First, many markets for banks appear to be broader than a narrow local geography—although NOW and checking accounts are not—and they appear to be getting broader. Second, there are significant variations in competitors and competition, both within and across markets. There is room for people to discuss—jobs for lawyers, jobs for economists. Third, the relevant market is likely to shift as the composition of competitors within markets shifts. That is particularly important because there has been a lot of consolidation in the U.S. banking industry, and to the extent multimarket banks are going to continue to increase their market presence, you are going to get a change in how pricing occurs. To the extent multimarket banks price over a larger area than single-market banks, there will continue to be changes in the breadth of markets considered for competition.

Some trends exist in the marketplace that are likely to influence the nature of the relevant market as we continue forward. Financial services are no longer one-stop shops. They are no longer all together. With securitization,[150] you can see how many parts of the mortgage process have been unbundled.

Banks, up to this point, have not been able to identify the potential switchers from locked-in consumers. Locked-in consumers are, of course, the ones for which you can potentially raise price and create a niche market, where you will price-discriminate and charge them more than the potential switchers. To the extent that banks or other financial institutions will be able to identify the switchers from the locked-in consumers in the future, you will get this kind of differentiation in your

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MULTIMARKET BANK PRICING: AN EMPIRICAL INVESTIGATION OF DEPOSIT INTEREST RATES 1 (2004), *available at* http://www.federalreserve.gov/pubs/feds/2004/200438/200438pap.pdf (stating that a study found that for multimarket banks, state level concentration is more strongly and consistently related to deposit interest rates than local market concentration).

150. For a definition and discussion of securitization, see Claire A. Hill, *Securitization: A Low-Cost Sweetener for Lemons*, 74 WASH. U. L.Q. 1061 (1996).

products—one aimed at the group that is locked in and one aimed at the group that is more likely to switch.

There have also been huge changes in information availability, which is particularly pertinent for financial institutions. Obviously, the information provided by the Internet is going to tend to increase the market size and to have a significant price effect. The six-month CD is a great example. To the extent that it's easy to get the information about what interest rate is being offered in what location, you are going to put your money where the highest interest can be earned rather than a local market. Having that information at low cost is going to just increase the extent to which that's true. Internet access to banking came along a little slower than some people might have thought, but it is still growing. It is definitely going to have an effect on how you would define a local market and the competition among players.

Almost all households with a bank account have at least one electronic fund feature. Many are not things that we would worry about as having significant effects on the market structure—like direct deposit. However, in 2003, 32% of households reported using computer banking,[151] up from 4% in 1995.[152] The early adopters were characterized by higher incomes, more financial assets, younger heads of household.[153] They were less than fifty-five years old.[154] They had more formal education, on average.[155]

Now that we have expanded to about 32%, the surveys suggest that the users of computer banking are actually much more diverse than one might have predicted. A typical prediction would be that the people using computer banking would stay younger and stay within the higher-income group, because they would have easier access to computers. Interestingly enough, it's much more diverse in terms of age.[156] Researchers commented that they were older than they thought they would be. Education of household head has changed a lot, too.[157] As

151. *See* Christoslav E. Anguelov et al., *U.S. Consumers and Electronic Banking, 1995-2003*, Fed. Res. Bull. (Winter 2004), *available at* http://www.federalreserve.gov/pubs/bulletin/2004/winter04_ca.pdf.

152. *See id.*

153. *See id.*

154. *See id.*

155. *See id.*

156. *See id.*

157. *See id.*

we move forward, that is going to have an impact on how you want to think about the relevant market.

Securitization is what I consider predominantly an effect. Securitization reduces the cost of rapidly expanding loans and changes the dynamics of the competition. It is also important in terms of the market structure. Securitization has been around for a long time. There has been tons of experience with government-sponsored entities like Freddie Mac[158] and Ginnie Mae[159] and Fannie Mae[160] for the conforming mortgages. But that is for your typical mortgage. Of interest is that there has really been an expansion of the use of securitization into other forms of credit lending—for example, subprime[161] and jumbos.[162] Auto loans are in there; student loans are in there; credit card securitization is in there. All kinds of lending has been subject to securitization.

What does that do to the local market structure? First of all, it has contributed to an unbundling of the lending process. Brokers specialize in originating loans. Lenders are no longer just banks; they include non-bank firms, firms organized as REITs,[163] firms organized as specialty financial organizations. Specialized firms service the loans, and so on and so forth. By having outside investors provide the liquidity, you are no longer tied to the deposits in your marketplace in the same way—hence, breaking that link between your concentration of deposits and what you might be doing in terms of the lending side of the market.

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158. For more information, please visit the Freddie Mac website, http://www.freddiemac.com (last visited Mar. 22, 2008).

159. For more information, please visit the Ginnie Mae website, http://www.ginniemae.gov (last visited Mar. 22, 2008).

160. For more information, please visit the Fannie Mae website, http://www.fanniemae.com (last visited Mar. 22, 2008).

161. *See* R. Stephen Painter, Jr., *Subprime Lending, Suboptimal Bankruptcy: A Proposal to Amend §§ 522(F)(1)(B) and 548(A)(1)(B) of the Bankruptcy Code to Protect Subprime Mortgage Borrowers and Their Unsecured Creditors*, 38 LOY. U. CHI. L.J. 81 (2006) (defining a subprime mortgage as a loan catered to higher risk borrowers).

162. *See* Wayne Passmore et al., *GSEs, Mortgage Rates, and the Long-Run Effects of Mortgage Securitization* 1 n.2 (Fed. Reserve Bd., Working Paper No. 2001-26, 2001), *available at* http://ssrn.com/abstract=275008.

163. REIT is short for real estate investment trust, which is a "financial vehicle that allows investors to pool their capital for participation in real estate ownership or mortgage financing." Jack H. McCall, *A Primer on Real Estate Trusts: The Legal Basics of REITs*, 2 TRANSACTIONS: TENN. J. BUS. L. 1, 2 (2001).

What does that do for your market analysis? The presence of the secondary loan markets and other developments in structured finance means a lower cost of entry. Not only are entry and exit already pretty easy in the banking industry, this makes it potentially much easier to enter at a much larger scale, quickly. When there is an attractive profit opportunity—which might come about if a merger has reduced competition and prices have been raised and profitability is higher—it should be easier for a bank or another financial institution to expand its presence in a local market, in a lending market, if they have access to securitization. Securitization is a force that is likely to reduce the cost of entry, providing the liquidity for lending and affecting loan rates, bringing prices back down, to the extent that concentration might have increased them.

From a consumer perspective, securitization helps broaden the market. It helps bring other competitors into the market. It is particularly relevant for antitrust analysis when a merger may reduce the number of firms in particular markets. For example, a recent merger was proposed between two of the largest student lenders in the business.[164] The government is also a big contributor of student lending.[165] There are many ways in which you might want to analyze this. The fact that securitization is out there—it's a profitable business—means that even though they are likely to increase concentration in the industry, there is going to be a significant offsetting effect of likely entry.

Thank you.

MR. BRODER: Thank you, Anne. I think we have a few minutes, if there are any questions for Anne or Bert.

QUESTION: Anne, as I understand it, deposits are really down in banks. A deposit is really the other side of a loan. How does it go into your analysis, that true deposits are way down from where they were years ago?

DR. GRON: That's a very good point. When you talk about local banking, NOW accounts and checking accounts are still being held largely locally. Casual empiricism says people you know have a local

164. *See* Press Release, JPMorgan Chase & Co., Chase Student Loans to Purchase Collegiate Funding Services, Creating a Comprehensive Education Finance (Student Lending) Business (Dec. 15, 2005), *available at* http://www.cfsloans.com/student-loan/chase-student-loans-merger.html.

165. For more information, please visit the Federal Student Aid website, http://studentaid.ed.gov (last visited Mar. 1, 2008).

bank account, but the money gets parked there for a little bit and then it goes into a money market account somewhere or other places.

That's going to feed into the analysis, to the extent that other financial instruments are important for the local market—line of business again. The local bank, by having transaction accounts available for you, is allowing you that ready access. The fact that deposits are down just means that overall market size has declined over time. Profitability might be expected to decline. You have to ask where are banks getting their other profits from? How is the business model changing?

I don't think you can ask the question in isolation. You have to look at the banking model as a whole. To the extent that deposits alone were a big source of profits for banks and now they have declined in magnitude, clearly banks will be less profitable. Some of the mergers might be caused by banks that are not doing as well as they used to. That is, again, part of the whole merger analysis that you can easily incorporate.

QUESTION: When looking at the projected interest rates that will be paid on savings as a result of a merger, is there any weight to the argument that it's better for a bigger bank, which is usually more highly concentrated, to pay higher interest rates than smaller banks that are probably adversely affected by the merger? Larger banks are better regulated, and there is more competition for deposits that causes smaller banks to up the price on their deposits.

MR. FOER: I think there is a false assumption in this conversation. The price that a bank offers for a service is some combination of interest and a variety of fees that hit from all different directions, making it very difficult to compare sometimes, but also making it somewhat of a false reference, if we are going to make judgments just on interest.

It might be that large banks offer higher interest, but lower fees. I don't know. I don't know how to answer the question, but I am worried about the way we measure this. We may not have any choice, because it gets too complicated.

DR. GRON: Some of the research looks at a combination of average fees and interest rates. You can't measure exactly what you would like in all of these things. You have to take it with a grain of salt. But your question is whether it's better to have a large bank competing for consumers' deposits because they can better manage the risk?

QUESTIONER: Yes.

DR. GRON: There is the question of efficiency, whether a larger bank has lower costs, and whether that is offset in the consumers' interest. If they are that much more efficient, they may be able to offer consumers a better deal at the same time, by passing some of that on. But it's not going to be the only reason. You need a pretty strong efficiency argument to say that you are going to do better than some of the smaller banks.

QUESTION: One thing shown in the credit crunch that we are facing today is that the bigger banks are not better "managers" in terms of the interest rates they charge. In fact, some may have to be given back if there is a bailout of the type that took place in the S&L crisis.[166] You get 5% today, but if your taxes go up later on because they have to pay $250 billion or $1 trillion, then that is a phony interest rate. We have had lots of mergers, and now enormously powerful banking institutions straddle the planet.[167] When we talk about market power, we talk about a conscious act by a company that may be a monopoly or that can elbow people away. *The New York Times*, on Sunday, had an article that if they are too big to fail, they are too big to manage.[168] Citicorp is $2.5 trillion.[169]

I don't know whether this is a question or a comment.

It seems that when you talk about market power and about mergers that lead to gargantuan institutions, the antitrust laws ought to have some room for the concept of dysfunctional power. The same effect can take place. It's not that they are consciously elbowing people away, but they affect competition because of the damage they cause, for example, in the subprime.

MR. FOER: There is a lot of stuff there, and you are hitting some very basic points about the way we deal with mergers and about the course of antitrust in the last thirty years. The course of antitrust has

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166. *See* Fred Galves, *Might Does Not Make Right: The Call for Reform of the Federal Governments D'Oench, Duhme and 12 U.S.C. § 1823(E) Superpowers in Failed Bank Litigation*, 80 MINN. L. REV. 1323, 1333-39 (1996) (stating that the U.S. government bailed out multiple failing savings and loan associations in the 1980s and 1990s).

167. *See generally* Tim McCarthy, *Refining Product Market Definition in the Antitrust Analysis of Bank Mergers*, 46 DUKE L.J. 865 (1997).

168. Nelson D. Schwartz, *Perhaps Too Many Acts in the Corporate Tent*, N.Y. TIMES, Nov. 11, 2007, § 4, at 5.

169. *See* Press Release, Citigroup Inc., Citibank Agency and Trust Announces Opening of a New Office in Orange County, California (Oct. 12, 2004), *available at* http://www.citibank.com/citigroup/press/2004/data/041012a.htm.

been determined by the Chicago School, where we focus on microeconomics, and in particular on short-term price effects—not completely, but largely, to the exclusion of other issues—which means aggregate concentration, the total amount of wealth in a small number of banks, is irrelevant. That's a political issue.

This is the argument: If we wanted to deal with that, we would have to deal with it politically, through regulation. But the predominant philosophy, at least for thirty years, has been that we don't want to go that route. We want the markets to prevail, for a variety of reasons. *Laissez-faire* is triumphant right now.

That leads to this concentration movement that we are seeing in every industry. New industries are invented and they bring new kinds of competition. The Internet is going to have, and has already had, an impact on financial institutions and the way we borrow money. Things are constantly changing. The one consistency is the increase in concentration. Where we used to worry about industries with six or ten major competitors, now we only worry about industries with three or four. Two or one is a problem still. The threshold of concern in antitrust enforcement today is more like a merger from four to three than from eight to seven, or even six to five.

Ask the question, as a general matter: "Would you rather have industries, including banking, where there are eight or ten major players, as opposed to three?" It's not such an easy question, actually. First of all, every industry is different. Second, you may be giving up some important efficiencies if you opt for the eight to ten. But there may be some benefits of the type to which you were alluding, perhaps, that are less quantifiable.

It has to do with power, political power. That's one reason why commercial banking was separated from investment banking, why we had branching limitations and unit banking rules and so forth. These were political decisions that were based not on how you achieve efficiency, but how you keep the economic power from getting too concentrated.

We moved away from that, for a variety of reasons. Maybe it's time to move back in that direction a little bit. I do think we are paying a price for having institutions that are too large—unnecessarily large. As I pointed out, above $50 billion, it does not appear that there are efficiency gains.

DR. GRON: I would hesitate to want the government to be the decider of whether a company can manage itself well or not. I think our ability to assess that is imperfect at best. As a management challenge, yes, big institutions are a challenge. But I don't think that the government or a set of standards is a better way to analyze that than the market. Failures of organizations are perhaps the best discipline in telling people not to undertake certain types of endeavors. Unless their money is on the line, they are not going to make the same kind of decision. I don't see why the government would make a better decision to start off with.

I also observe that booms and busts have existed before concentration was high and they will exist whether concentration is high or not. That is actually an aspect of the marketplace. I definitely agree that the subprime mortgage situation[170] is a mess. I think that is an uncontroversial statement. I don't know if government intervention would help it particularly. It's going to be very costly to get out of. I don't think that concentration alone is going to prove to be the cause of the effect. There are multiple things happening at the same time. I think you can point to things that government did that may have contributed to it, not that the government is solely at fault.

There are many things that happened that have led to that. There has been an overall expansion of the use of credit. There is something much larger than just a concentration in a couple of investment banks which, I agree, is high. But it's beyond something that we have discussed here. To the extent that investment banks are very dominant in certain types of product lines, it's really a different question when you look at their types of mergers as well.

QUESTION: In retail banking, when you do your economic analysis, how much are you looking at the possibility that these structures which are based on market power and price might be undermined by a situation in which the user cannot figure out what the price is? As an example, Chase Manhattan Bank, which has branches now every two blocks on the Upper West Side, put out a fifty-page bulletin about their fee structure, with twenty different kinds of banking retail packages, which was totally incomprehensible in terms of how much we would actually be paying.[171]

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170. *See* Painter, *supra* note 161.

171. For more information on the products, services and other information that would have been contained in the bulletin referenced by the speaker, please visit the Chase Online Banking website, http://www.chase.com (last visited Mar. 22, 2008).

DR. GRON: That's a fantastic comment. You are absolutely right. Economic models and economic analyses assume that consumers actually understand what they are charged. What is also true is, whether people read that material or not, they don't always seem to understand it.

One would hope that over the course of actually engaging in those transactions, you would see whether you are spending more or less. When you get a fifty-page document—if you get a two-page document, with the size of type I get, there are about fifty pages in there—you can't tell what it's going to mean for you. You start actually consuming the product, and then you find out whether things are more or less costly, just like whether you go to one grocery store or another. They may be advertising a gallon of milk for a certain price, but it doesn't tell you how much your particular basket of goods is going to come out costing.

So banking is an experience good in that sense. To the extent that they are charging you an interest rate and a set of fees, it's the responsibility of the consumer to understand, at some point, what it's costing them. To the extent, over time, you don't analyze that, that's really something that the economic models would fail at. We actually assume that either a consumer over time would understand that they are spending a lot or a competitor will come in and say, "Hey, guys, you're spending, on average, this amount on your checking account." Then you get the simplified checking account solution guys coming in and telling you, "No. Come to us."

Your cell phone also has that attribute, to some extent—maybe not yours; mine might. Your car—you buy an inexpensive car. It costs a fortune to fix it. There are all those goods in life that have a certain experience to them. What you are saying is that banking is no longer something that you can look at from the outside, understand the price it's going to be, and just settle. It's something that, while you consume it, you are going to understand what it costs you and what the benefits are. You are going to make your decision that way.

MR. FOER: I would say that obfuscation is a strategy of differentiation. If all you looked at were interest rates, what kind of competition would there be? Everybody would have the same interest rate. So you have to differentiate it, and one of the ways is through all these different fees and complications. What it says to me is that consumer protection and antitrust have to go hand in hand. Unless you have consumers who understand what they are buying, competition is affected.

I just went through an experience with securitized loans. It was a commercial loan, where I was the borrower. I started hearing things that I had never known anything about—conduit loans. Those are loans created in such a way that they can be sent off in securitized packages and serviced by third parties out somewhere in the world. I was told that there are certain risks to that. If you get into a little bit of trouble and somebody is holding one of those loans, they don't care anything about you; they are going to foreclose very quickly. My benefit was that I went with somebody that didn't do that, and I paid a little bit more. This happened a couple of days before the bubble burst on the subprimes.[172] Instead of pulling the loan like they did with everybody else, I got the loan.

Here's the point. This was an incredibly complicated transaction compared to the last time I did a refinancing of this sort, several years back. Because of securitization, the loan documents are suddenly this thick. They want all kinds of information, and there are all kinds of third-party charges. The transaction costs of a loan—this was not a huge loan—were the same as if it was a $1 billion loan. We are going to start seeing some kind of reaction to these increased transaction costs, as this whole process has gotten more and more complicated.

On the other side, as we see more and more transactions on the Internet—when you borrow on the Internet or you buy something on the Internet—you are going to be confronted with these lengthy disclosure statements that you are not going to read.[173] You can't make the deal until you have checked that you have read it, and you will check. That brings us into a whole new area, because you will be giving away rights left and right. You will be required to arbitrate. You might be required not to participate in class actions.

We are going to have to resolve a lot of these questions that used to come under the rubric of a contract of adhesion, because these are all contracts of adhesion. How we are going to make them, in some way, fair, or avoid the worst abuses that are likely? This is a challenge that is going to affect banking and all other transactions.

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172. *See* David Anderson, *Year in Review 2007: The Subprime Lending Crisis*, 71 TEX. B.J. 20 (2008) (stating that the subprime bubble burst in 2007 when "housing prices fell in many parts of the country at the same time rates on many subprime loans adjusted upward and borrowers were required to start repaying principal").

173. *See generally* Jeffrey P. Taft, *Internet-Based Payment Systems: An Overview of the Regulatory and Compliance Issues*, 56 CONSUMER FIN. L.Q. REP. 42 (2002).

MR. BRODER: That's the end of our time. Bert, thank you, and Anne. I also want to thank Carl Felsenfeld, the Fordham Law School, and the *Fordham Journal of Corporate & Financial Law* for sponsoring this.