Section 7 of the Clayton Act Applies to Banks and Bank Holding Company Mergers.

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CASENOTE

ANTITRUST—BANK MERGERS—Section 7 of the Clayton Act Applies to Banks and Bank Holding Company Mergers.

Mercantile Texas Corporation v. Board of Governors
638 F.2d 1255 (5th Cir. 1981)

Mercantile Texas Corporation, the fifth largest bank holding company in Texas,1 instituted suit seeking review of a Federal Reserve Board order denying approval of a merger between Mercantile and Pan National Group, Inc.,2 another Texas bank holding company. The Board disallowed the proposed merger stating that potential competition between the two companies would be eliminated, thereby unduly concentrating the Waco and El Paso markets.3 In response to Mercantile’s appeal, the Board contended that section 1842(c) of the Bank Holding Company Act4 bestows upon the Board broad discretion to reject mergers, regardless of whether the Board finds the merger would violate anticompetitive standards of Section 7 of the Clayton Act incorporated in 12 U.S.C. §18.5

Held—Vacated and remanded. Section 7 of the Clayton Act applies to banks and bank holding company mergers.6

Antitrust theory is based on the premise that competition is necessary and desirable to promote the development of a free-market economy.7

1. Mercantile Tex. Corp. v. Board of Governors, 638 F.2d 1255, 1259 (5th Cir. 1981). Mercantile owns nine banks having total deposits of $2.8 billion comprising 4.2% of Texas bank deposits. Id. at 1259.
6. Id. at 1263.
7. See United States v. South-Eastern Underwriters Ass’n, 322 U.S. 533, 559 (1944)
Therefore, abuses of competition must be controlled to prevent destruction of our free economy. Finding that federal intervention was necessary to thwart abuses caused by trusts and cartels, Congress enacted the Sherman Act in 1890. The Clayton Act, passed in 1914, was designed to prohibit abuses outside the scope of the Sherman Act by preventing conspiracies and monopolies before they exist, thus averting their harmful effect on competition. Section 7 of the Clayton Act gives the government the power to attack the three basic types of anticompetitive mergers: horizontal mergers, vertical mergers and conglomerate

(general objective is to insure a free economy); United States v. American Linseed Oil Co., 262 U.S. 371, 388 (1923) (competition necessary to U.S. economy). Antitrust theory dates back centuries as the ancient Sumerians, Babylonians, Athenians, and Puritans all found it necessary to control competition to prevent destruction of their free economies. See J. Van Cise & W. Lifland, Understanding The Antitrust Laws 4-17 (8th ed. 1980).

8. See Charles A. Ramsey Co. v. Associated Bill Posters, 260 U.S. 501, 512 (1923). The preservation of competition has been said to be as fundamental to our economy as the Bill of Rights is to our personal freedoms. See United States v. Topco Assoc., 405 U.S. 596, 610 (1972).


mergers.18 While horizontal and vertical mergers involve corporations having some economic relationship with each other,19 a conglomerate merger involves two corporations that do not compete in the same product or geographic market nor have a buyer-seller relationship in the same chain of production.17 In analyzing these mergers, section 7 does not require a certainty that anticompetitiveness will result;18 it prohibits a merger only when there is proof of a "probability" that the merger will lessen competition.19 The Supreme Court originally stressed a qualitative analysis in proving probable anticompetitiveness of a merger.20 Recently,
however, the Court has emphasized the importance of concentration ratios derived from the leading firms in specific industries to indicate anticompetitive behavior. Originally, section 7 of the Clayton Act was used to prevent anticompetitive mergers when there was a decrease in actual competition within the relevant market. Section 7 was later applied to the regulation of conglomerate mergers by proscribing mergers which tended to lessen potential competition between the acquiring and acquired firms. Proscribing


mergers by an analysis of the effects on potential competition has been applied under three distinct legal theories: the dominant entrant theory, the perceived potential entrant theory and the actual potential entrant theory. Although the Supreme Court has utilized the first two theories as a basis for prohibiting mergers which may lessen competition, the Court has reserved ruling on the validity of the actual potential entrant theory. The actual potential entrant theory assumes that the acquiring firm exercises no present competitive influence on the market.


25. The dominant entrant theory arises in the context of a very powerful firm outside the market acquiring a firm within the market and, due to the acquiring firm’s substantial resources, the resulting merger presents the likelihood of a severe anticompetitive result. See United States v. Falstaff Brewing Corp., 410 U.S. 526, 558-59 (1973) (Marshall, J., concurring); FTC v. Proctor & Gamble Co., 386 U.S. 568, 575 (1967).

26. The perceived potential entrant theory arises when there is a potential competitor which appears to the existing firms to be a very likely entrant into their market. See United States v. Falstaff Brewing Corp., 410 U.S. 526, 559 (1973) (Marshall, J., concurring). The existing firms’ perception of this potential entrant causes them to act competitively. Consequently, the removal of the potential competition from the edge of the market (through the contested merger) releases this competitive pressure, resulting in a decrease in competition. Id. at 559; see also United States v. Marine Bancorporation, Inc., 418 U.S. 602, 624-25 (1974); United States v. Penn-Olin Chem. Co., 378 U.S. 158, 173-74 (1964).

27. See United States v. Siemens Corp., 621 F.2d 499, 504 (2d Cir. 1980). The theory would proscribe a merger with a large firm already in the market if the acquiring firm would have independently entered the market and increased competition. Id. at 504.

28. See United States v. Falstaff Brewing Corp., 410 U.S. 526, 531-37 (1973) (adopting perceived potential entrant theory); FTC v. Proctor & Gamble Co., 396 U.S. 568, 575-78 (1967) (relying on dominant entrant theory). Although each of these three theories are forms of potential competition analysis, they are not interchangeable; each theory applies to a particular market structure. See United States v. Falstaff Brewing Corp., 410 U.S. 526, 558-62 (1973) (Marshall, J., concurring). There is some overlap in the applicability of the three theories in attacking a contested merger, as a particular market structure may fit the requirements of more than one theory. Id. at 558.


glomerate merger, therefore, has no immediate anticompetitive effect. If
the acquired firm holds a significant market share, however, the acquisi-
tion may prevent future competition that would have arisen had the ac-
quiring firm entered the market independently.

The Supreme Court has stated that to reach the question of the valid-
ity and applicability of the actual potential entrant theory the govern-
ment must prove the existence of three preconditions before the theory
can be applied. First, the target market must consist of several domi-
nant participants engaging in parallel behavior with power to control the
market. Second, independent entry by the acquiring firm must be feasi-
ble. Finally, the government must show a likelihood that independent
entry will produce deconcentration in the market. Past attempts by the
government to apply this theory have failed, however, due to the inability
to prove these three preconditions exist.

The Bank Holding Company Act of 1956 was designed to give the
Board discretion in approving or preventing mergers and acquisitions in-

31. Id. at 560.
32. Id. at 560. Independent entry may be accomplished by a de novo entry or a toe- hold
acquisition. See United States v. Marine Bancorporation, Inc. 418 U.S. 602, 625 (1974) (toe-
hold acquisition is acquisition of small, existing firm already in market); United States v.
plished by internal expansion of the acquiring company). See generally Carter, Actual Po-
tential Entry Under Section 7 of the Clayton Act, 66 Va. L. Rev. 1485, 1485-89 (1980);
Kaplan, Potential Competition and Section 7 of the Clayton Act, 25 Antitrust Bull. 297,
298-99 (1980).
34. Id. at 630 (market must be concentrated).
35. Id. at 632. This independent entry may be made by de novo entry by the acquiring
company or by a toe- hold acquisition. See id. at 625 (toe- hold acquisition is acquisition of
small, existing firm already in the market); United States v. Black & Decker Mfg. Co., 430
F. Supp. 729, 742 (D. Md. 1976) (de novo entry refers to acquiring company entering market
through internal expansion).
centration refers to a lowering of the concentration ratios of the dominant firms in the mar-
ket. See id. at 633-39 (large new banks added to market would result in deconcentration).
37. See, e.g., BOC Int'l, Ltd. v. FTC, 557 F.2d 24, 30-31 (2d Cir. 1977); FTC v. Atlantic
Richfield Co., 549 F.2d 289, 296-98 (4th Cir. 1977); United States v. First Nat'l State Ban-
Bancorporation and not a pure actual potential entrant case), aff'd mem., 418 U.S. 906
(1974). Courts have established both a "reasonable probability" standard and a "certainty"
standard to define the level of proof required to establish that the preconditions exist for
application of the actual potential entrant theory to a proposed merger. See BOC Int'l, Ltd.
v. FTC, 557 F.2d 24, 28-29 (2d Cir. 1977) (reasonable probability); FTC v. Atlantic Richfield
Co., 549 F.2d 289, 294-95 (4th Cir. 1977) (certainty).
volving bank holding companies,88 based on the merger's effect on competition.49 Applying antitrust laws to banks, courts have historically held the relevant product market40 is commercial banking.49 Recently, however, some controversy has arisen as to whether the relevant product market should be enlarged to include thrift institutions8 and their competitive influence on the banking industry.44 The result of the application of

39. Id. § 1841(a)(1)(2). A bank holding company means any company which “ . . . has control over a bank . . . .” Id. § 1841(a)(1)(2).

40. Id. § 1842(c). This restriction on acquisitions caused the banking industry to respond with the Bank Merger Act of 1960 in an attempt to insulate the banking industry from antitrust prohibitions. See id. 12 U.S.C. § 1828 (c)(5)(a)(b) (1976) (balance anticompetitiveness with needs of the community). The Act, however, never accomplished this purpose. See United States v. First Nat'l Bank & Trust Co. of Lexington, 376 U.S. 665, 669-70 (1964) (merger prohibited); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 342 (1963) (merger proscribed). This setback led to another special interest bill, the Bank Merger Act of 1966, which was a compromise between lawmakers who felt the banking community should be insulated completely from antitrust scrutiny and others who believed antitrust laws should be applied with full force to the banking industry. See Austin, The Evolution of Commercial Bank Merger Antitrust Law, 36 BUS. LAW. 297, 310-12 (1981); see also 12 U.S.C. § 1828(c)(5) (1976). See generally Hale, Comment on Dr. Austin's Article, "The Evolution of Commercial Bank Merger Antitrust Law", 36 BUS. LAW. 1557, 1560-61 (1981).


antitrust law to the banking industry displays a clear division of success: the government has never lost an actual competition case and has never won a potential competition case. The government’s lack of success in potential competition cases has been attributed to the fact that banking is a highly regulated industry. This has placed an almost impossible burden on the government to prove that the acquiring firm would increase competition through merger or independent entry.

In Mercantile Texas Corp. v. Board of Governors, the United States Court of Appeals for the Fifth Circuit held that in analyzing a proposed merger involving bank holding companies, the Federal Reserve Board is to apply the antitrust standards which have evolved under section 7 of the Clayton Act. The Mercantile court reasoned that section 7 standards may borrow and discount funds with the Federal Reserve. See 12 U.S.C. § 461(a), (b)(7) (Supp. IV 1980). In addition, all depository institutions may offer interest bearing-checking accounts in the form of negotiable orders of withdrawal. See id. § 1832. Certain thrift institutions can offer credit cards and exercise trust and fiduciary powers. See id. § 1964 (b)(4), (n). As one court notes, thrift institutions and banks offer the same services to the household customer. See United States v. First Nat’l State Bancorporation, 499 F. Supp. 793, 900 (D.N.J. 1980). Commercial banks do, however, offer a distinct line of services to the business customer that thrift institutions do not. See generally at 800-801 (business loans, letters of credit, bankers’ acceptances, buying and selling foreign exchanges).


49. 638 F.2d 1255 (5th Cir. 1981).

50. Id. at 1261; see 15 U.S.C. § 18 (1976). The government argued that the Bank Holding Company Act’s language directing the Board to consider the “convenience and needs” of the community in analyzing a proposed merger gave the Board power to approve or disapprove a merger, even if it did not violate section 7 standards. See Mercantile Tex. Corp. v. Board of Governors, 638 F.2d 1255, 1259-61 (5th Cir. 1981).
dards were intended to be incorporated into the Bank Holding Company Act. The Bank Holding Company Act specifically incorporates the exact language of section 7.

Further, the legislative history of the Act evi-
denced a congressional intent to establish "uniform standards" applicable to both bank mergers and bank holding company mergers. Moreover, the "convenience and needs" language relied on by the Federal Reserve Board was designed to balance against a Clayton Act violation to determine whether any public benefit from the proposed merger outweighed the anticompetitiveness. Additionally, the Bank Merger Act, which uses the identical language of the Bank Holding Company Act, has been held by the Supreme Court to incorporate the standards set forth under section 7 of the Clayton Act.

Finally, two circuits have adopted the Clayton Act standard as being applicable to the Bank Holding Company Act. Although the Mercantile court found no violation of the actual potential entrant theory, it noted the theory was logical and consonant with section 7.

The court in Mercantile Texas Corp. analyzed and set forth guidelines for application of the controversial, and as yet unproven, actual poten-

52. See Mercantile Tex. Corp. v. Board of Governors, 638 F.2d 1255, 1261 (5th Cir. 1981).
53. Id. at 1261; see S. REP. No. 1179, 89th Cong., 1st Sess. 10, reprinted in 1966 U.S. CODE CONG. & AD. NEWS 2385, 2394.
55. See Mercantile Tex. Corp. v. Board of Governors, 638 F.2d 1255, 1261-63 (5th Cir. 1981).
58. See Mercantile Tex. Corp. v. Board of Governors, 638 F.2d 1255, 1261 (5th Cir. 1981); see also County Nat'l Bancorporation v. Board of Governors, 444 F.2d 1253, 1260 (8th Cir. 1971); Washington Mut. Sav. Bank v. FDIC, 482 F.2d 459, 464 (9th Cir. 1973).
59. See Mercantile Texas Corp. v. Board of Governors, 638 F.2d 1255, 1259 (5th Cir. 1981). The Mercantile court referred to the actual potential entrant theory as the "actual potential competition doctrine". Id. at 1264.
60. Id. at 1255. The Mercantile Court set out four factors to be found by the Board to establish a violation of the actual potential entrant theory. First, the market in which the merger is to occur must be concentrated. Id. at 1266-67. Second, a determination of the number of other potential competitors should be made to see if the elimination of the acquir ing firm as a potential competitor will have a significant effect on competition within the market. Id. at 1267-68. Third, the Board must show a "reasonable probability" that the acquiring firm would independently enter the market if the contested merger was proscribed. Id. at 1268-70. Finally, independent entry must be likely to cause a significant increase in competition. Id. at 1270-72.
61. See FTC v. Atlantic Richfield Co., 549 F.2d 289, 293 (4th Cir. 1977) (doctrine evolv-
tial entrant theory. The theory is not consistent with the purposes of the Clayton Act, since the contested merger may have no real effect on competition. The theory states that a merger of a firm outside the market with a leading firm in the market may violate the Clayton Act because the acquiring firm might have otherwise entered the market de novo or through a “toe-hold” acquisition, thereby theoretically increasing competition. Even in the event of such a merger, there would be no increase or decrease in competition because the acquiring firm merely assumes the position of the acquired firm in the market. The Clayton Act, on the other hand, proscribes only those mergers which tend to decrease competition. Furthermore, although the Supreme Court has, on two occasions, taken notice of the theory, it has refused to apply or endorse the doctrine. Moreover, the Second Circuit has noted the theory


63. See United States v. Siemens Corp., 621 F.2d 499, 504 (2d Cir. 1980) (doctrine would proscribe merger if acquirer is expected to enter market independently causing increase in competition).

64. See, e.g., Carter, Actual Potential Entry Under Section 7 of the Clayton Act, 66 Va. L. Rev. 1485, 1507 (1980) (courts will abandon the doctrine); Kaplan, Potential Competition and Section 7 of the Clayton Act, 25 Antitrust Bull. 297, 317 (1980) (doctrine not consonant with § 7); Rahl, Applicability of the Clayton Act to Potential Competition, 12 A.B.A. Antitrust Section 128, 143 (1958) (§ 7 should not apply to potential competition).

65. See United States v. Falstaff Brewing Corp., 410 U.S. 526, 537 (1973) (actual potential entrant theory proscribes mergers that have no present effect on competition).


68. Id. at 625 (independent entry would increase competition). The prevention of this projected increase in competition produces the violation; see United States v. Falstaff Brewing Corp., 410 U.S. 526, 560 (1973) (Marshall, J., concurring).

69. See United States v. Falstaff Brewing Corp., 410 U.S. 526, 537 (1973) (theory proscribes mergers that have no present effect on competition). Justice Marshall also noted that there is no present effect on competition. Id. at 560 (Marshall, J., concurring).


is based on mere speculation. While the Clayton Act does prohibit mergers which involve a decrease in future competition, violations under the Act always involve a decrease in future, as compared to existing, competition in the market. Alternatively, the actual potential entrant theory compares one level of future competition (if the merger were to take place) with another level of future competition (if the acquiring firm were to enter independently). To compare one projected level of competition with another projected level of competition borders on predicting an "ephemeral possibility" which section 7 will not proscribe. Moreover, courts which have applied the theory have been uniformly unable to find a section 7 violation because of the inability to prove independent entry would occur and would cause an increase in competition within the market.

Even assuming the actual potential entrant theory can be applied to proposed mergers under the Clayton Act, the Mercantile court's required findings to prevent a merger are unworkable and will not adequately es-

72. See United States v. Siemens Corp., 621 F.2d 499, 504 (2d Cir. 1980).
tablish anticompetitiveness. A finding that the market must be concentrated ignores the additional requirement that the concentrated market's participants must be acting collusively. If the target market is competitive, there is no need to deconcentrate the market. Factors such as competition from thrift institutions, bank market concentration due to government policy, the market's loan activity, the differences in fees and services, any efficiency economies, and similar criteria should have been noted by the Fifth Circuit as possible evidence to rebut the anticompetitiveness presumption created by the market's concentration ratios.

The Mercantile court's requirement that the number of potential competitors "waiting in the wings" be considered when evaluating a merger under the actual potential entrant theory is, in effect, a hollow requirement. The past and current growth trends of banks and bank holding


82. Id. at 631. The Supreme Court did note that high concentration ratios establish a prima facie case for the application of potential competition doctrines. Id. at 631.


85. See United States v. First Nat'l State Bancorporation, 499 F. Supp. 793, 805-06 (D.N.J. 1980) (higher the loan activity, the more competitive the market).


87. See FTC v. Proctor & Gamble Co., 386 U.S. 568, 597-98 (1967) (Harlan, J., concurring) (economies achieved by one firm may stimulate other firms, creating competition).


89. See Mercantile Tex. Corp. v. Board of Governors, 638 F.2d 1255, 1267-68 (5th Cir. 1981).

companies ensure there will always be, as the Fifth Circuit noted, "[a] significant number of large Texas bank holding companies [that] remain as possible entrants." Furthermore, proving a "reasonable probability" exists that an acquiring firm, if prevented from merging, would enter the market independent lends itself to mere speculation. Instead, "clear proof" of probable entry should be required. This "clear proof" of probability of entry measure recognizes the inherent lack of accuracy of future projections. By adopting such a standard, the courts will avoid consideration of mere ephemeral possibilities as opposed to realistic probabilities of anticompetitiveness.

Because banking regulations controlling entry and branch operations make it highly improbable that independent entry will substantially increase competition, requiring that the government prove that indepen-

mers from 1960 to 1979).


93. See Mercantile Tex. Corp. v. Board of Governors, 638 F.2d 1255, 1268 (5th Cir. 1981). The Mercantile court purported to adopt the "reasonable probability" standard from the Second Circuit. Id. at 268. The Second Circuit, however, adopted a "clear proof of a reasonable probability" standard. See United States v. Siemens Corp., 621 F.2d 499, 506-07 (2d Cir. 1980). This standard is similar, if not the same as the Fourth Circuit's "certainty" or "clear proof" requirement. Compare United States v. Siemens Corp., 621 F.2d 499, 506-07 (1980) (clear proof of reasonable probability) with FTC v. Atlantic Richfield Co., 549 F.2d 289, 294-95 (4th Cir. 1977) (entry must appear certain or be shown by clear proof).

94. See Mercantile Tex. Corp. v. Board of Governors, 638 F.2d 1255, 1268 (5th Cir. 1981).


96. See FTC v. Atlantic Richfield Co., 549 F.2d 289, 294-95 (4th Cir. 1977).

97. Id. at 294-95; see also Kaplan, Potential Competition and Section 7 of the Clayton Act, 25 Antitrust Bull. 297, 320-22 (1980); Turner, Conglomerate Mergers and Section 7 of the Clayton Act, 78 Harv. L. Rev. 1313, 1384, 1386 (1965).

98. See FTC v. Atlantic Richfield Co., 549 F.2d 289, 294-95 (4th Cir. 1977).

dent entry will result in a "substantial likelihood of ultimately producing deconcentration or other procompetitive effects" is a burden the government cannot meet. A projection that a small de novo entry or toe-hold acquisition under branch banking prohibitions will have a future procompetitive impact is conjecture. Conversely, a more reliable projection of future procompetitive impact is that an acquiring firm's introduction into the market by way of the litigated merger may add an aggressive competitor to the market thereby increasing competition and outweighing any remote results of independent entry.

Finally, the Mercantile court made no findings as to the relevant product market applicable to banks. Following long established precedent, the court simply assumed the relevant product was commercial banking. This assumption ignores the competitive impact caused by thrift institutions in the particular geographic market, distorting the analysis of competition within the market. For example, all depository

LAW. 1537, 1549 n.57 (1981) (government has never won a bank potential competition case).
108. See Mercantile Tex. Corp. v. Board of Governors, 638 F.2d 1255, 1266-67 (5th Cir. 1981) (concentration ratios included only banks).
institutions can offer interest-bearing checking accounts to the public. 110 Certain thrift institutions can exercise trust and fiduciary powers and offer credit card services. 111 Thrift institutions can also offer the same services as to the household customer banks. 112 In Texas, there may be an even greater competitive impact since thrift institutions can establish branch offices while banks are prohibited from doing so. 113 In view of this likelihood of competitive influence, the Mercantile court should have addressed the issues and instructed the parties to investigate the particular markets. 114

The court in Mercantile Texas Corp. furthered the confusion surrounding the theoretically unsound actual potential entrant theory. The inability of this doctrine to proscribe mergers should be evidence to the court that the theory should be rejected as an inoperable tool in the government's arsenal of antitrust prohibitions. Furthermore, the Mercantile court's failure to adopt a realistic view of the banking relevant product market impedes the factfinder from accurately assessing the competitiveness of the market. The result of the court's decision is confusion and inaccuracy in the application of antitrust laws to proposed bank mergers.

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111. See id. § 1464 (b)(4),(n) (Board may allow associations to offer credit cards and trust services).

