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## COMMENT

### REGIONAL RECIPROCAL BANKING LAWS: CONSTITUTIONAL, BUT WHAT NEXT?

C. TIMOTHY GRAY

ON JUNE 10, 1985, the United States Supreme Court upheld as constitutional the ever-increasing number of state laws that establish regional reciprocal banking arrangements. In *Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System*,<sup>1</sup> the Court unanimously validated the Massachusetts and Connecticut statutes that permit those states' bank holding companies (BHC's) to be acquired by bank companies with their principal places of business in reciprocating New England states. The Court grounded its decision on a finding that regional reciprocal banking arrangements are authorized by section 3(d) of the Bank Holding Company Act of 1956.<sup>2</sup> In an opinion written by Justice Rehnquist, the Court further concluded that state-imposed geographic restrictions on interstate bank company mergers do not violate the commerce, compact, or equal protection clauses of the United States Constitution.<sup>3</sup>

The effects of the *Northeast Bancorp* decision will reach far beyond New England; it gives the states virtual carte blanche to authorize interstate bank mergers that will significantly restructure the nation's financial services industry. The purpose of this Comment is to review the Supreme Court's analysis and decision in *Northeast Bancorp* as well as the decision's impact on the movement toward true nationwide interstate banking. The Comment will conclude with a survey of potential federal and state legislative actions to address the discriminatory and anticompetitive effects of regional reciprocal banking.

#### I. THE EVOLUTION OF REGIONAL RECIPROCAL BANKING LAWS

In recent years, many states have adopted statutes that permit interstate bank company acquisitions by BHC's from states that

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1. 105 S. Ct. 2545 (1985).

2. Bank Holding Company Act of 1956, ch. 240, § 3, 70 Stat. 133, 134 (codified as amended at 12 U.S.C. § 1842(d) (1982)).

3. *Northeast Bancorp*, 105 S. Ct. at 2556.

grant comparable privileges.<sup>4</sup> These laws are designed to allow BHC's from outside the authorizing state, but within a defined geographic region, to purchase banks or bank holding companies within the authorizing state. Typically, the reciprocity feature is based on a requirement that the state in which the acquiring BHC conducts the bulk of its business allow its bank companies and banks to be purchased by BHC's from the authorizing state.<sup>5</sup> Usually supplementing this requirement is a proviso that when the bulk of a BHC's deposits no longer are located in the region defined by the authorizing state's law, the out-of-state bank company ceases to qualify as a regionally held BHC and must divest itself of its banking operations in the state granting the reciprocal entry privilege.<sup>6</sup> This provision is designed to prevent "leapfrogging," a practice that would arise if the state in which the acquiring BHC conducts its operations were to drop its regional restriction and allow in bank companies from outside the region.<sup>7</sup>

Scholars have traced the policy basis for regional reciprocal interstate banking to three reports that are not yet a decade old. In 1979 the Association of Bank Holding Companies, a trade group, recommended allowing bank company mergers between contiguous states.<sup>8</sup> Two years later, the Treasury Department recommended a period of regional bank consolidation as a transitional step to full nationwide interstate banking.<sup>9</sup> Finally, in 1982, the Southern

4. See *infra* note 144.

5. See, e.g., **Florida:** FLA. STAT. § 658.295(3)(a) (1985); **Massachusetts:** MASS. GEN. LAWS ANN. ch. 167A, § 2 (West 1984).

6. See, e.g., **Connecticut:** CONN. GEN. STAT. ANN. § 36-553 (West Supp. 1985); **Florida:** FLA. STAT. § 658.295(4)(b) (1985).

7. See Staff of Fla. H.R. Comm. on Com., CS for HB 795 (1984) Staff Analysis 1 (final May 22, 1984) (on file with the committee) [hereinafter cited as Commerce Comm. Staff Analysis]. For example, Maine does not restrict acquisition of its BHC's to New England region banks. See ME. REV. STAT. ANN. tit. 9-B, § 1013 (Supp. 1985). If a Maine BHC were to acquire a Connecticut BHC, and the Maine BHC were then acquired by a New York bank, the resulting entity would be required to divest itself of its Connecticut banking operations under that state's anti-leapfrogging provision. See CONN. GEN. STAT. ANN. § 36-553 (West Supp. 1985).

8. Simonson, Pringle & Cardwell, *Regional Interstate Banking Developments*, 10 OKLA. CITY U.L. REV. 69, 76 (1985) (quoting GOLEMBE ASSOC., INC., A STUDY OF INTERSTATE BANKING BY BANK HOLDING COMPANIES (May 26, 1979) (prepared for the Association of Bank Holding Companies)).

9. Wilmarth, *The Case for the Validity of State Regional Banking Laws*, 18 LOY. L.A.L. REV. 1017, 1033 (1985) (quoting REPORT OF THE PRESIDENT, DEP'T OF THE TREAS., GEOGRAPHIC RESTRICTIONS ON COMMERCIAL BANKING IN THE UNITED STATES 17-18 (Jan. 1981)). The concept of regional reciprocal banking had its genesis in Florida during the 1970's, when there was legislative consideration of an "Intersouth" banking arrangement. See Frieder, *Legislating for Interstate Bank Expansion: Financial Deregulation and Public Policy*, 9 J. CORP. L.

Growth Policies Board, a planning group for twelve southern states, urged its twelve member states to adopt regional reciprocal legislation.<sup>10</sup> Underlying these reports was a sense of the inevitability of full nationwide banking.

As the perception grew in the financial services industry that the historic geographic restrictions on commercial banks would fall in the near future, local bankers seized on the idea of regional reciprocal interstate banking.<sup>11</sup> To the directors and officers of the nation's more than ten thousand banks, the advent of nationwide interstate banking would mean that large bank companies based in the "money centers" of New York, Chicago, and California could enter geographic markets that local bankers had long regarded as geographically protected. Local bankers feared the money-center banks would drain them of deposits, or growth in deposits, and compete with them in the business of making commercial loans. In many states, the defensive strategy chosen by local bankers was to allow BHC's within their respective geographic regions to merge assets and combine operations prior to the onset of full nationwide interstate banking, allowing the resulting regional BHC's to become large enough to compete with the money-center institutions.<sup>12</sup> State policy-makers contended that regional banking com-

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673, 676 (1984) [hereinafter cited as *Florida Banking Study*]. Professor Frieder's article is an adaptation of a report entitled *Interstate Bank Expansion: Market Forces and Competitive Realities*, which was prepared by the Florida Interstate Banking Study Group for the Florida House of Representatives Committee on Commerce. It was the primary research used in the legislative consideration of regional reciprocal banking in Florida. *Id.* at 673 n.\*.

10. *Florida Banking Study*, *supra* note 9, at 696 n.123 (quoting SOUTHERN GROWTH POLICIES BOARD, REPORT OF THE REGIONAL BANKING COMMITTEE TO THE EXECUTIVE COMMITTEE OF THE SOUTHERN GROWTH POLICIES BOARD 9 (Nov. 1982)).

Significantly, the Southern Growth Policies Board report recommended that "reciprocal banking agreements should be limited to the states of the Southern Growth Policies Board region for a specified period of time with provisions for nationwide agreements beyond the limiting period." *Id.* Florida and the other southeastern states ignored the latter part of this recommendation—a "trigger" allowing all United States BHC's to enter the Southeast after a transitional period. *See infra* text accompanying note 151.

11. *See, e.g.*, REPORT OF THE COMMITTEE APPOINTED BY THE GOVERNOR OF FLORIDA TO EXAMINE THE IMPLICATIONS FOR FLORIDA OF REGIONAL INTERSTATE BANKING 2 (Feb. 10, 1984) [hereinafter cited as GOVERNOR'S BANKING REPORT].

12. An alternative rationale might be that the economic value of a resulting regional BHC could be greater than the value of the BHC's as separate entities—that is, the whole would be greater than the sum of the parts. If this theory were to hold, then the economic benefit to shareholders of a regional BHC might be greater when full nationwide interstate banking is established and money-center banks seek to acquire established networks of banks. *Cf.* Commerce Comm. Staff Analysis, *supra* note 7, at 4 (regional reciprocal banking would increase the value of shares of in-state BHC's, but they might be further increased by nationwide interstate banking).

panies would be more responsive to state economies than would giant financial institutions headquartered on Wall Street.<sup>13</sup>

## II. THE *Northeast Bancorp* CASE

In 1982, Massachusetts became the first state to enact legislation authorizing regional bank acquisitions with a reciprocity requirement.<sup>14</sup> In 1983, Connecticut<sup>15</sup> and Rhode Island<sup>16</sup> passed similar legislation.<sup>17</sup> The first regional reciprocal mergers in New England were arranged soon after, presenting the test cases for regulatory and judicial review of regional banking laws.

### A. *The Federal Reserve Board and the Second Circuit*

After the passage of the regional reciprocal banking acts in Massachusetts and Connecticut, BHC's in those states began consolidating. Three acquisitions initiated the consolidation of New England BHC's.<sup>18</sup> The surviving bank companies sought approval for

In any event, regional banking laws are having a profound effect. Prior to the *Northeast Bancorp* decision, the largest BHC in the Southeast had 15 billion dollars in assets. One year later, after a frenzy of mergers, the region's largest BHC has 24 billion dollars in assets. Moreover, the largest BHC's in the Southeast are relatively stronger than many money-center banks. NCNB Corp. and First Union Corp., both of Charlotte, N.C., have market capitalization levels of 2.3 and 2.4 billion dollars respectively. BankAmerica Corp. of San Francisco, Cal., and Chemical New York Corp. each have about 2.6 billion dollars in market capitalization. One authority said, "What we have in a nutshell is that the biggest, strongest banks no longer exist in New York." *The transformation of banking*, St. Petersburg Times, July 14, 1986, at 10E, col. 1.

13. *Florida Banking Study*, *supra* note 9, at 696. "[R]egional banking organizations might tend to be more locally oriented with regard[] to their accommodation of middle market firms and municipalities. There is no empirical evidence to support such a contention, however." *Id.*

14. Ch. 626, § 4, 1982 Mass. Acts 1366, 1372 (codified at MASS. GEN. LAWS ANN. ch. 167A, § 2 (West 1984)).

15. P.A. 83-411, §§ 2, 3, 1983 Conn. Acts 450, 451 (codified at CONN. GEN. STAT. ANN. §§ 36-552 to -554 (West Supp. 1985)).

16. Ch. 201, § 1, 1983 R.I. Pub. Laws 363 (codified at R.I. GEN. LAWS §§ 19-30-1, -2 (Supp. 1985)).

17. In 1975, Maine became the first New England state to authorize out-of-state BHC's to enter its banking market, effective in 1978. Ch. 500, § 1013, 1975 Me. Laws 1370, 1538 (codified as amended at ME. REV. STAT. ANN. tit. 9-B, § 1013 (1980)). Later, Maine eliminated its reciprocity requirement. Ch. 597, § 2, 1983 Me. Laws 24, 24 (codified at ME. REV. STAT. ANN. tit. 9-B, § 1013 (Supp. 1985)).

18. Hartford National Corp., a Connecticut BHC, agreed to acquire Arltru Bancorporation, a Massachusetts BHC. Hartford Nat'l Corp., 70 Fed. Res. Bull. 353 (1984). Bank of New England Corp., a Massachusetts BHC, agreed to merge with CBT Corp., a Connecticut BHC. Bank of New England Corp., 70 Fed. Res. Bull. 374 (1984). Bank of Boston Corp., a Massachusetts BHC, agreed to acquire Colonial Bancorp, Inc., a Connecticut BHC. Bank of Boston Corp., 70 Fed. Res. Bull. 524 (1984).

the acquisitions from the Board of Governors of the Federal Reserve System under the Bank Holding Company Act (the Act).<sup>19</sup> Upon receipt of the applications, the Board invited comment. Citicorp<sup>20</sup> and Northeast Bancorp, Inc.<sup>21</sup> filed comments opposing the acquisitions.<sup>22</sup>

Citicorp and Northeast Bancorp challenged the Connecticut and Massachusetts statutes as "unconstitutional under the provisions of the Compact Clause, the Equal Protection Clause, and the Commerce Clause of the United States Constitution."<sup>23</sup> The Board was compelled by judicial decisions to decide the constitutional issues,<sup>24</sup> and it did so under a standard that it not hold a state statute to be unconstitutional unless there is "clear and unequivocal evidence of the inconsistency of the state law with the federal Con-

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19. 12 U.S.C. § 1842 (1982). In addition, Bank of Boston and Bank of New England sought approval under § 1843(c)(8) because they also had agreed to acquire nonbanking subsidiaries of the Connecticut bank companies. *Bank of New England*, 70 Fed. Res. Bull. at 374; *Bank of Boston*, 70 Fed. Res. Bull. at 524.

20. Citicorp, a New York BHC, has been one of the most aggressive money-center banks in seeking entry into states outside its principal place of business. See Wilmarth, *supra* note 9, at 1046 n.149.

21. Northeast Bancorp's subsidiary bank, Union Trust Co., joined its parent in protesting the acquisitions. *Northeast Bancorp, Inc. v. Board of Governors*, 740 F.2d 203, 204 (2d Cir. 1984), *aff'd*, 105 S. Ct. 2545 (1985).

A Connecticut BHC, Northeast Bancorp agreed on Aug. 3, 1983, to merge with the Bank of New York Co., a New York BHC. The merger was contingent upon the Connecticut statute being amended to allow full interstate banking or being found constitutionally defective so that only the geographic restrictions on interstate mergers were excised. *Northeast Bancorp, Inc. v. Woolf*, 576 F. Supp. 1225 (D. Conn. 1983), *aff'd*, 742 F.2d 1439 (2d Cir. 1984). Northeast sought a declaratory judgment on the constitutionality of the Connecticut law, based on many of the same grounds subsequently raised before the Federal Reserve Board and in the federal courts. The case was dismissed because, among other things, the district court determined that the only remedy would be to invalidate the entire statute, which would not grant relief to Northeast. Therefore, Northeast did not have standing. *Id.* at 1230. The Board subsequently denied Bank of New York's application to acquire Northeast because the combination was not permitted by Connecticut law. *Bank of New York Co.*, 70 Fed. Res. Bull. 527 (1984).

22. *Hartford Nat'l*, 70 Fed. Res. Bull. at 354 (Citicorp protesting Hartford National-Arltru merger); *Bank of New England*, 70 Fed. Res. Bull. at 375 (Citicorp and Northeast protesting Bank of New England-CBT merger); *Bank of Boston*, 70 Fed. Res. Bull. at 524 (Citicorp protesting Bank of Boston-Colonial merger).

23. *Bank of New England*, 70 Fed. Res. Bull. at 376 (footnotes omitted). The constitutional and statutory issues in all three cases were identical; the Board most thoroughly discussed the issues in the Bank of New England order. Therefore, it will be the order principally cited in reviewing the Board's analysis.

24. *Id.* (citing *Jefferson Parish v. Bank of New Orleans & Trust Co.*, 379 U.S. 411 (1965); *First State Bank v. Board of Governors*, 553 F.2d 950 (5th Cir. 1977); *Gravois Bank v. Board of Governors*, 478 F.2d 546 (8th Cir. 1973)).

stitution.'"<sup>25</sup> Under this standard, and relying upon a detailed staff analysis,<sup>26</sup> the Board concluded, "[W]hile the issue is not free from doubt, there is no clear and unequivocal basis for a determination that [the Connecticut and Massachusetts statutes are] inconsistent with the Commerce Clause, Compact Clause or Equal Protection Clause of the United States Constitution."<sup>27</sup> It found the state statutes authorized under the Douglas Amendment<sup>28</sup> and approved the acquisitions.<sup>29</sup>

As provided by the Act,<sup>30</sup> Citicorp and Northeast Bancorp sought judicial review of the Board's orders in the United States Court of Appeals for the Second Circuit. They raised the same constitutional objections, but the Second Circuit ruled against them.<sup>31</sup> They also argued "that the Massachusetts and Connecticut statutes, to avoid conflicting with federal law, must either permit all bank holding companies throughout the United States to acquire their banks or permit none."<sup>32</sup> This argument was analyzed and rejected in only two sentences. Having lost again, Citicorp and Northeast Bancorp were granted review by the United States Supreme Court.<sup>33</sup>

25. *Bank of New England*, 70 Fed. Res. Bull. at 376 (quoting NCNB Corp., 68 Fed. Res. Bull. 54, 56 (1982)).

26. *Id.* at 377 n.15. The staff analysis was published as an appendix to the order. *Id.* at 379-86 app. The Board cited to this analysis in both the Hartford National order, 70 Fed. Res. Bull. at 354 & n.6, and the Bank of Boston order, 70 Fed. Res. Bull. at 524 & n.7.

27. *Bank of New England*, 70 Fed. Res. Bull. at 376-77 (footnote omitted).

28. *Id.* at 375. For an explication of the Board's legal analysis of the Douglas Amendment issue, see *id.* at 383-86 app.

29. *Hartford Nat'l*, 70 Fed. Res. Bull. at 355; *Bank of New England*, 70 Fed. Res. Bull. at 379; *Bank of Boston*, 70 Fed. Res. Bull. at 526.

Nevertheless, the Board expressed misgivings about the evolving policy toward interstate banking limited to regions defined by the states, not the federal government.

[I]f the New England regional approach to interstate banking is emulated in other parts of the country, there is a potential danger that the result could be to divide the country into a number of banking regions. The Board believes that the public policy issues that are raised by the regional approach are inherently national and would be best resolved by Congressional action.

*Bank of New England*, 70 Fed. Res. Bull. at 379.

30. Under 12 U.S.C. § 1848, "any party aggrieved by an order of the Board . . . [may] obtain review of such order in the United States Court of Appeals within any circuit wherein such party has its principal place of business or in the Court of Appeals in the District of Columbia." *Id.*

31. *Northeast Bancorp*, 740 F.2d at 208-10. All appeals of the Board's orders were consolidated in this case. *Id.* at 206.

32. *Id.* at 208.

33. *Northeast Bancorp*, 105 S. Ct. 776 (1985) (mem.).

### B. *The Supreme Court's Analysis*

Before analyzing the constitutional issues raised by the three New England regional bank company acquisitions, the Supreme Court examined the federal statute that specifies the procedure to be used by the Board for the review of proposed bank company mergers and acquisitions.<sup>34</sup>

#### 1. *The Douglas Amendment*

The challenge to the regional reciprocal banking laws turned on subsection (d) of 12 U.S.C section 1842, which is commonly referred to as the Douglas Amendment<sup>35</sup> because it was offered on the Senate floor by Senator Paul Douglas.<sup>36</sup> The Douglas Amendment prohibits "any bank holding company or any subsidiary thereof [from acquiring], directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located outside the State in which operations of such bank holding company's banking subsidiaries [are] principally conducted."<sup>37</sup> An exception to this prohibition is made for cases in which "the acquisition of such shares or assets of a State bank by an out-of-State bank holding company is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication."<sup>38</sup>

The Court first asked whether the New England acquisitions were consistent with the Douglas Amendment.<sup>39</sup> Indeed, the Amendment presented a dilemma that Justice Rehnquist framed succinctly:

It does not specifically indicate that a State may partially lift the ban, for example in limited circumstances, for special types of acquisitions, or for purchasers from a certain geographic region. On the other hand, it also does not specifically indicate that a State

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34. 12 U.S.C. § 1842 (1982).

35. *Bank of New England*, 70 Fed. Res. Bull. at 385 app. (staff analysis discussing legislative history of Douglas Amendment).

36. Dem., Ill., 1949-67.

37. 12 U.S.C. § 1842(d) (1982).

38. *Id.*

39. *Northeast Bancorp*, 105 S. Ct. at 2550. By framing the issue in this manner, the Court sought to separate it from the argument that, under the commerce clause, the Douglas Amendment was insufficient authorization by the Congress for the states to enact territorially discriminatory economic legislation. *Id.*; see *infra* notes 84-98 and accompanying text.



is allowed only two alternatives: leave the federal ban in place or lift it completely.<sup>40</sup>

To discern the effect of the Douglas Amendment, the court turned to the legislative history of the Act.

The principal purpose of the Act, the Court concluded, was to restrict BHC's from "purchas[ing] banks in different localities both within and without a State, and thereby provide the equivalent of branch banking"<sup>41</sup> without violating the restrictions of the McFadden Act.<sup>42</sup> The separate bills to regulate BHC's passed by each house of the Congress contained divergent provisions on BHC's acquiring banks or bank companies outside their home states. The House proposed a total ban while the Senate Banking Committee would have permitted interstate acquisitions subject only to approval by the Federal Reserve Board.<sup>43</sup> The Douglas Amendment was "a compromise between the two extremes" that also protected each state's right to allow interstate acquisitions.<sup>44</sup>

Because the Douglas Amendment was born in the heat of Senate debate, there were no committee reports or other materials to show Congress' intent. Consequently, the Senate floor debate was the only legislative history available to the Court to assist it in construing the Douglas Amendment.<sup>45</sup> The crux of the debate was Senator Douglas' comparison of the restrictions on BHC acquisitions that would be imposed by his Amendment with those that the McFadden Act imposed on branching by national banks.<sup>46</sup> In a passage that later drew the Court's attention, Senator Douglas explained that "our amendment will permit out-of-State holding

40. *Northeast Bancorp*, 105 S. Ct. at 2551.

41. *Id.*

42. 12 U.S.C. § 36 (1982). The McFadden Act was enacted by Congress in 1927 in part to prohibit national banks from branching nationwide. Act of Feb. 25, 1927, ch. 191, § 7, 44 Stat. 1224, 1228 (codified as amended at 12 U.S.C. § 36 (1982)). It was amended in 1933 to allow national banks to branch within a state to the same extent as state-chartered banks. Act of June 16, 1933, ch. 89, § 23, 48 Stat. 162, 189 (codified as amended at 12 U.S.C. § 36 (1982)).

43. *Northeast Bancorp*, 105 S. Ct. at 2551.

44. *Id.* at 2552.

45. *Id.* at 2551. The Court accorded the statements of Senator Douglas "substantial weight" regarding the meaning of the legislation because no other "authoritative indicators of legislative intent" existed regarding the Douglas Amendment. *Id.* However, the Federal Reserve Board's staff analysis suggested that, at least for some issues, the Senate debate excerpts might be "too fragmentary and unspecific to show congressional intent." *Bank of New England*, 70 Fed. Res. Bull. at 385 app.

46. 102 CONG. REC. 6858 (1956).

companies to acquire banks in other States *only to the degree* that State laws expressly permit them to."<sup>47</sup> He described his proposal as being consistent with the McFadden Act's purpose of preventing the expansion of national banks within a state or across state lines "in a way contrary to State policy."<sup>48</sup>

The Court closely examined the McFadden Act analogy. It reviewed an earlier decision that had weighed the McFadden Act's restrictions on branch banking<sup>49</sup> and concluded that "[t]he McFadden Act did not offer the States an all-or-nothing choice."<sup>50</sup> The Court then noted that, at the time the Bank Holding Company Act was passed, some states limited branching to specific locales instead of allowing it statewide.<sup>51</sup> Reasoning by analogy, the Court then decided "there can be *no other conclusion* but that Congress *contemplated* that some States might partially lift the ban on interstate banking without opening themselves up to interstate banking from everywhere in the Nation."<sup>52</sup> Thus, the Court rejected Citicorp and Northeast Bancorp's argument that Senator Douglas' phrase "only to the degree that State laws expressly permit them" was intended "merely as a quantitative reference to the number of States which might lift the ban, and did not mean that a State could partially lift the ban."<sup>53</sup>

The Court not only found the Massachusetts and Connecticut statutes "consistent with the Douglas Amendment's *anticipation* of differing approaches to interstate banking,"<sup>54</sup> it also found that the two states' regional reciprocal banking statutes were consistent with the more general congressional goal of maintaining local control over banking.<sup>55</sup> The Court suggested that these states were concerned with the competition that local banks and geographically restricted BHC's were receiving from nonbank financial insti-

47. *Id.* (statement of Sen. Douglas), *quoted in Northeast Bancorp*, 105 S. Ct. at 2552 (emphasis added).

48. 102 CONG. REC. 6860 (1956), *quoted in Bank of New England*, 70 Fed. Res. Bull. at 385 & n.32 app.

49. *Northeast Bancorp*, 105 S. Ct. at 2552 (quoting *First Nat'l Bank v. Walker Bank & Trust Co.*, 385 U.S. 252, 258 (1966)).

50. *Id.*

51. *Id.* The Court quoted Senator Douglas regarding geographic restrictions on intrastate branching in 1956: "In New York the State is divided into 10 zones. Branch banking is permitted within each of the zones, but a bank cannot have branches in another zone." *Id.* at 2552-53 (quoting 102 CONG. REC. 6858 (1956)).

52. *Id.* at 2553 (emphasis added).

53. *Id.* at 2552.

54. *Id.* at 2553 (emphasis added).

55. *Id.*

tutions not limited by state lines.<sup>56</sup> If that was the motivation for the Connecticut and Massachusetts laws, then unlimited entry by out-of-state BHC's would only have exacerbated the problem. Therefore, the states adopted an approach that was intended to allow the development of regional BHC's, which are perceived as more locally oriented, before they must compete against large money-center banking organizations.<sup>57</sup> An additional justification was that the regional approach would allow a local assessment "of the benefits and detriments that might result from a broader program of interstate banking."<sup>58</sup> Taking these factors into account, the Court concluded that "Connecticut's approach is *precisely* what was *contemplated* by Congress when it adopted the Douglas Amendment."<sup>59</sup>

The Court's analysis and conclusion on this issue—that there could be "no other conclusion" but that Congress "precisely contemplated" discriminatory interstate banking laws<sup>60</sup>—is curious and troubling. Except for Senator Douglas' account of how one state structured its intrastate branching practices,<sup>61</sup> the Amendment's meager legislative history contains no express reference to the concept of regional interstate banking.<sup>62</sup> Indeed, the Amendment's purpose easily could have been otherwise; it may have been offered primarily to appease those who felt a total ban on interstate BHC acquisitions would be offensive to states' rights.<sup>63</sup> Alternatively, given that no state at that time allowed interstate acquisitions,<sup>64</sup> a more plausible objective would have been to reinforce the interstate merger prohibition that was the principal goal of the legislation.<sup>65</sup> Although most commentators agree that the Douglas Amendment gives states the authority to admit out-of-state BHC's, "[n]owhere did the discussion touch upon the specific issue of regionalism, or even upon the broader issue of the fashion in

56. *Id.*; see *infra* notes 154-78 and accompanying text.

57. *Northeast Bancorp*, 105 S. Ct. at 2553 (quoting REPORT TO GEN. ASSEMBLY OF THE STATE OF CONNECTICUT (Jan. 5, 1983)).

58. *Id.*

59. *Id.* (emphasis added).

60. "Contemplate" means "[t]o view or consider with continued attention; to regard thoughtfully; to have in view as contingent or probable as an end or intention." BLACK'S LAW DICTIONARY 288 (5th ed. 1979).

61. 102 CONG. REC. 6858 (1956) (statement of Sen. Douglas).

62. *Id.* at 6050-63.

63. *Northeast Bancorp*, 105 S. Ct. at 2552; *Florida Banking Study*, *supra* note 9, at 742.

64. 102 CONG. REC. 6060 (1956) (statements of Sens. Douglas and Bennett).

65. See Note, *Regional Banking Laws: An Analysis of Constitutionality Under the Commerce Clause*, 60 NOTRE DAME L. REV. 548, 559 (1985).

which states might choose to exercise their power under the Amendment.”<sup>66</sup>

This lack of certainty about the intent and scope of the Douglas Amendment, at least in the context of regional interstate banking, has been authoritatively acknowledged. When considering the same issue, the Federal Reserve Board was anything but certain. Two views were expressed. The Amendment could have been written to give the states plenary power to admit out-of-state BHC's on an individual, deal-by-deal basis.<sup>67</sup> On the other hand, an argument can be made that the Amendment's legislative history is too sketchy to support a conclusion that Congress intended to authorize a discriminatory practice otherwise contrary to the commerce clause.<sup>68</sup> This latter argument is highly significant because the Court requires “explicit and clear authorization of discrimination [in interstate commerce] by the Congress because of the fundamental implications of such discrimination for the federal union.”<sup>69</sup>

Instead of relying exclusively on a brief legislative history, the Court could have buttressed its conclusion by relying on other authority. While the issues of the Douglas Amendment presented in *Northeast Bancorp* were ones of first impression for the Supreme Court, a similar question had been decided earlier in the United States Court of Appeals for the District of Columbia Circuit.

In *Iowa Independent Bankers v. Board of Governors of the Federal Reserve System*,<sup>70</sup> an association of more than four hundred Iowa banks challenged two bank purchases by a Minnesota BHC and the 1972 Iowa statute that authorized the acquisitions.<sup>71</sup> The Iowa bankers argued, as Citicorp and Northeast Bancorp did in challenging the New England laws, that the Douglas Amendment limited states to deciding only “whether to extend the right to acquire in-state banks to all out-of-state bank holding companies or

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66. Golembe & Kumin, *Regional Interstate Banking Compacts: Ill-Conceived and Unconstitutional Anomalies*, 18 *LOYOLA L.A.L. REV.* 993, 998 (1985); see also *Florida Banking Study*, *supra* note 9, at 742 (“The specific question of whether the states might permissibly discriminate on the basis of bank holding company location, however, appears not to have been considered.”); Note, *supra* note 65, at 558-59.

67. *Bank of New England Corp.*, 70 Fed. Res. Bull. 374, 385 app. (1984) (staff analysis of Douglas Amendment).

68. *Id.*; see also *Iowa Indep. Bankers v. Board of Governors*, 511 F.2d 1288, 1296 (D.C. Cir.) (“Not once in the entire debate [over the Douglas Amendment] is the discrimination question raised.”), *cert. denied mem.*, 423 U.S. 875 (1975).

69. *Bank of New England Corp.*, 70 Fed. Res. Bull. at 385 app.

70. 511 F.2d 1288 (D.C. Cir.), *cert. denied mem.*, 423 U.S. 875 (1975).

71. *Id.* at 1292 (citing IOWA CODE ANN. § 524.1805 (West Supp. 1974-75)).

to prohibit such acquisitions."<sup>72</sup> Reviewing the Amendment's legislative history, the court noted that "Senator Douglas seem[ed] to anticipate that states might be selective in allowing bank holding companies to cross state lines."<sup>73</sup> The court concluded that the Douglas Amendment was structured to allow states to condition entry by out-of-state BHC's in a way that would not contravene state policy.<sup>74</sup> Moreover, the court found that the narrow all-or-nothing interpretation urged by the Iowa bankers was at odds with another provision of the Act, which provision specifically preserved to the states all regulatory rights they had before the enactment.<sup>75</sup>

In reviewing the New England statutes, the Federal Reserve Board employed *Iowa Independent Bankers* as support for a general argument that states, under the Douglas Amendment, may selectively admit out-of-state BHC's to achieve specific state policies.<sup>76</sup> Indeed, as the Board noted, several states have permitted out-of-state BHC's to enter their markets under narrowly drawn conditions. These conditions have included "limitations on activities, number of offices and home office location,"<sup>77</sup> which do not apply to in-state BHC's. These conditions have restricted the general operations of out-of-state BHC's, but permitted specific operations such as credit card services. States have employed this strategy in attempting to entice out-of-state BHC's to relocate specific services in order to avoid more stringent home-state restrictions on interest rates and insurance powers, to allow acquisitions of financially troubled banks,<sup>78</sup> and to "grandfather" BHC's already in the state when preventing further entry.<sup>79</sup> These limited-entry statutes

72. *Id.* at 1296.

73. *Id.* Eight years later, the District of Columbia Circuit revisited the Douglas Amendment and reaffirmed the conclusions reached in *Iowa Independent Bankers*. *Conference of State Bank Examiners v. Conover*, 715 F.2d 604, 612, 615 (D.C. Cir. 1983), *cert. denied mem.*, 466 U.S. 927 (1984).

74. *Iowa Independent Bankers*, 511 F.2d at 1297.

75. *Id.* at 1296 (citing 12 U.S.C. § 1846 (1982)). However, the Supreme Court said in *Northeast Bancorp* that, without the specific authorization it found in the Douglas Amendment, the dormant commerce clause would preclude regional banking laws that discriminated among the states. *Northeast Bancorp*, 105 S. Ct. at 2553-54. Therefore, this leg of the court's analysis in *Iowa Independent Bankers*—which is missing from the Supreme Court's discussion—is suspect.

76. *Bank of New England*, 70 Fed. Res. Bull. at 385-86 app.

77. *Id.* at 386 app.

78. *See id.*; *see also Florida Banking Study*, *supra* note 4, at 688-89; Wilmarth, *supra* note 9, at 1038-39.

79. *Bank of New England*, 70 Fed. Res. Bull. at 385 app. Florida law prohibits out-of-state BHC's from acquiring Florida banks, but it "grandfathered" foreign BHC's owning banks or trust companies in the state as of 1972. FLA. STAT. § 658.29(3) (1985). Prior to the

reflect that “[b]etween the extremes of authorizing only specific acquisitions and erecting no barriers to acquisition at all lies a wide range of intermediate legislative approaches.”<sup>80</sup> Significantly, however, these statutes are not—at least facially—geographically discriminatory and “might be viewed as imposing substantially less of a burden on commerce”<sup>81</sup> than regional reciprocal banking laws. If the Supreme Court had concluded that the Douglas Amendment permitted the states only an “on and off switch”<sup>82</sup> for interstate acquisitions, the validity of these limited-purpose statutes would have been brought into question.<sup>83</sup>

While the Supreme Court chose not even to mention what limited secondary authority existed supporting restrictive approaches to out-of-state BHC acquisitions, its holding plainly validates regional reciprocal banking laws under any likely scheme that might be presented. This conclusion follows logically from the Court’s divining what no one else had discerned—that regional reciprocal banking laws were “precisely contemplated” by Congress when it passed the Act in 1956.

## 2. *The Commerce Clause*

The Court’s conclusion about the clarity of the congressional intent behind the Douglas Amendment may have been fashioned partly to ease the Court’s analysis of the claim based on the commerce clause.<sup>84</sup> Citicorp and Northeast Bancorp argued that the Massachusetts and Connecticut statutes erected barriers that were contrary to the commerce clause’s primary goal—to eliminate trade barriers between the states and prevent “precisely this type

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advent of regional reciprocal banking, NCNB Corp., a North Carolina BHC, exploited this provision to become one of the largest bank companies in Florida, giving it a three-year head start over its regional competitors. Taylor, *After the Takeovers, Bank Colonizing Begins in Earnest*, FLA. TREND, Feb. 1986, at 57-59. For a thorough review of this provision and how a few out-of-state bank companies used it for early entry to the lucrative Florida market, see Dunlap, *Interstate Banking Developments in Florida: Pushing Through Legal Barriers and Toward a Level Playing Field*, 9 NOVA L.J. 1, 2-11 (1984).

80. *Florida Banking Study*, *supra* note 9, at 742.

81. *Bank of New England*, 70 Fed. Res. Bull. at 386 app.

82. *Id.*

83. Ironically, Citicorp has been a major beneficiary of these limited-purpose bank statutes. See Wilmarth, *supra* note 9, at 1046 n.149.

84. U.S. CONST. art. I, § 8, cl. 3 (“Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several states, and with the Indian Tribes.”). The Court deliberately segregated its analysis of the Douglas Amendment from the commerce clause even though the two issues were inextricably related. See *supra* note 39.

of economic 'Balkanization' [of the nation] into a confederation of States to the detriment of the welfare of the Union as a whole."<sup>85</sup>

The Court said that, without the Douglas Amendment granting to the states the power to specify the conditions for entry by out-of-state BHC's into their banking markets, the "dormant Commerce Clause would prohibit a group of states from establishing" regional reciprocal banking schemes,<sup>86</sup> and that individual states lacked independent power to regulate out-of-state BHC acquisitions.<sup>87</sup> However, the Court concluded that the commerce clause was not dormant, but had been affirmatively employed in the Douglas Amendment, granting to Massachusetts and Connecticut the authority to enact regulatory legislation discriminating on a geographic basis.<sup>88</sup> The Court determined that Congress had "plainly authorize[d]" these state laws, making them "invulnerable to constitutional attack under the Commerce Clause."<sup>89</sup> Although the Court sought to segregate the commerce clause arguments from the Douglas Amendment issue, its brusque dismissal of the commerce clause issue can only be based on its view of the Douglas Amendment's legislative history as showing "plain authorization" for regional reciprocal banking laws.

Surprisingly, the Court's summary analysis and treatment of the commerce clause arguments lacks the exacting scrutiny it has employed when dealing with other economic legislation that discriminated on the basis of geographic location. The Court has required that the congressional authorization for protectionist legislation "be 'expressly' or 'explicitly' or 'specifically' stated in federal law."<sup>90</sup> In *New England Power Co. v. New Hampshire*,<sup>91</sup> the Court

85. *Northeast Bancorp*, 105 S. Ct. at 2553 (citations omitted); cf. P. Volcker, Statement by Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System, before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives (Apr. 24, 1985), reprinted in *Statements to Congress*, 71 Fed. Res. Bull. 430, 434 (1985) [hereinafter cited as *Interstate Banking Testimony*].

86. *Northeast Bancorp*, 105 S. Ct. at 2553-54.

87. *Id.* at 2554.

88. *Id.*

89. *Id.*

90. *Bank of New England*, 70 Fed. Res. Bull. at 384 app. (citing *White v. Massachusetts Council of Constr. Employers*, 460 U.S. 204, 213 (1983) (state regulation "specifically authorized by Congress . . . not subject to the Commerce Clause even if it interferes with interstate commerce"); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 340-41 (1982) (Federal Power Act did not expressly state congressional intent to sustain state laws contravening commerce clause); *Western and Southern Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 653-54 (1981) ("Congress explicitly intended" McCarran-Ferguson Act to restore states' plenary authority over insurance industry).

91. 455 U.S. 331 (1982).

adopted an analysis that stands in vivid contrast to its handling of the Douglas Amendment in *Northeast Bancorp*. At issue in *New England Power Co.* was a federal statute that reserved to the states the "authority now exercised over exportation of hydroelectric energy which is transmitted across a State line."<sup>92</sup> At the time Congress enacted the provision, New Hampshire required state approval for the exportation of hydroelectric energy.<sup>93</sup> The Court held that the federal statute did not sufficiently "evinced a Congressional intent 'to alter the limits of state power otherwise imposed by the Commerce Clause.'"<sup>94</sup> If a similarly rigorous analysis had been applied to the Douglas Amendment, it would have been difficult to find sufficient congressional authorization to overcome the burdens that the regional reciprocal banking statutes place on interstate commerce.

Under the "stringent test of explicitness laid down by the Supreme Court," there is nothing in the text of the Douglas Amendment to authorize the economic Balkanization created by regional reciprocal banking laws.<sup>95</sup> Any authorization must be found through the use of extrinsic aids.<sup>96</sup> To find in the Douglas Amendment's "sparse legislative history"<sup>97</sup> that the regional reciprocal banking laws are clearly authorized stretches the meaning of express authorization. Considering that favoritism of one region over another has never been judicially evaluated within the context of the commerce clause,<sup>98</sup> a more thorough analysis by the Court of the effect that regional banking arrangements have on interstate commerce would have been welcome. Unfortunately, such an analysis was not forthcoming, and *Northeast Bancorp* settles the constitutional discussion under the commerce clause of regional reciprocal banking statutes.

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92. Federal Power Act of 1935, ch. 687, § 201(b), 49 Stat. 803, 847 (codified as amended at 16 U.S.C. § 824(b)(1) (1982)).

93. *New England Power Corp.*, 455 U.S. at 335.

94. *Id.* at 341.

95. *Bank of New England*, 70 Fed. Res. Bull. at 384 app. Indeed, the analysis for the Federal Reserve Board concluded that "the Douglas Amendment does not appear on its face to authorize discrimination" by New England states against BHC's from outside the region. *Id.* (emphasis in original). See also Golembe & Kumin, *supra* note 66, at 997.

96. *Bank of New England*, 70 Fed. Res. Bull. at 384 app.

97. Golembe & Kumin, *supra* note 66, at 998.

98. *Bank of New England*, 70 Fed. Res. Bull. at 384 app.



### 3. *The Compact Clause*

Citicorp and Northeast Bancorp also attacked the Connecticut and Massachusetts statutes as violative of the compact clause, which provides: "No state shall, without the Consent of the Congress . . . enter into any Agreement or Compact with another State . . . ."99 A determination of whether an agreement among states is within the scope of the compact clause, and thus requires congressional approval, encompasses a dual analysis. First, the existence of a compact or an agreement amounting to a compact must be found. Second, the agreement or compact must tend to increase the political power of the compacting states in a manner that diminishes federal supremacy.<sup>100</sup>

The Court began the first step of its compact clause analysis by noting the similarity of the four New England statutes, and that the passage of the four New England statutes resulted from a cooperative effort.<sup>101</sup> However, the Court attached more importance to the absence of "several of the classic indicia of a compact."<sup>102</sup> The Court observed that there was no requirement for a state to pass the legislation in any particular form, and the statutes did not mandate that the reciprocal legislation in the state of the acquiring BHC contain the same regional restriction. After pointing out that Maine's legislation did not include a regional restriction and that Rhode Island's regional restriction would terminate soon,<sup>103</sup> the Court decided that a true compact did not exist. It based this conclusion on the fact that not all states participating in the asserted compact limited entry rights for out-of-state bank companies to BHC's based in the New England region.<sup>104</sup> While probably not crucial to the compact clause inquiry in light of the second part of

99. U.S. CONST. art. I, § 10, cl. 3.

100. *Bank of New England*, 70 Fed. Res. Bull. at 380 app.; see also *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452 (1978); *New Hampshire v. Maine*, 426 U.S. 363 (1976).

101. *Northeast Bancorp*, 105 S. Ct. at 2554.

102. *Id.*

103. *Id.*; see **Maine**: ME. REV. STAT. ANN. tit. 9-B, § 1013 (Supp. 1985); **Rhode Island**: R.I. GEN. LAWS § 19-30-1(c) (Supp. 1985). The Court said Rhode Island would drop its regional restriction in 1986, *Northeast Bancorp*, 105 S. Ct. at 2554, however, the current Rhode Island statute mandates that the regional restriction not be dropped until July 1, 1987. R.I. GEN. LAWS § 19-30-1(c) (Supp. 1985).

104. *Northeast Bancorp*, 105 S. Ct. at 2554. The Court's analysis was flawed by considering Rhode Island and Maine statutes in determining whether there was a compact. These states' statutes were not before the Court. Simply because BHC's from Massachusetts and Connecticut could acquire bank companies from Rhode Island and Maine does not mean those states sought to become part of a New England bank zone of indefinite duration. In

the Court's analysis, this finding was at odds with the conclusion of the Federal Reserve Board and the Second Circuit. Both concluded that the New England regional reciprocal banking statutes were most likely, in the Board's words, an "implicit compact or agreement that has never been approved or authorized by Congress."<sup>105</sup>

The Court then conducted what it has deemed to be the more important aspect of the compact clause analysis—an inquiry into the impact of an agreement on federal supremacy.<sup>106</sup> It reaffirmed the doctrine that only those agreements designed to increase the political power of the states, and which might encumber federal supremacy, would fail under the compact clause.<sup>107</sup> In determining the impact of the regional reciprocal banking statutes on federal supremacy, the Court found that the Douglas Amendment was an abrogation of federal supremacy in this area and immunized the regional banking statutes from attack as unconstitutional compacts.<sup>108</sup> The Court concluded that aspects of the statutes that might conflict with other federal statutes, such as the provision that allows out-of-state BHC's to rescue financially troubled banks, would be preempted and render a compact clause argument "academic."<sup>109</sup> The Court also summarily rejected the contention that the regional reciprocal banking laws would interfere with the sovereignty of states outside New England.<sup>110</sup> It concluded that the statutes would in no way enhance the political power of the participating states or adversely affect the federal structure.<sup>111</sup>

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fact, their renunciation of continuing regional restrictions exemplifies policies greatly different from those of Massachusetts and Connecticut.

105. *Northeast Bancorp*, 70 Fed. Res. Bull. at 380 app.; see also *Northeast Bancorp, Inc. v. Board of Governors*, 740 F.2d 203, 209 (2d Cir. 1984), *aff'd*, 105 S. Ct. 2545 (1985); Golembe & Kumin, *supra* note 66, at 999.

Strangely, the Court did not even acknowledge its previous conclusion that "[a]greements effected through reciprocal legislation may present opportunities for enhancement of state power at the expense of the federal supremacy similar to the threats inherent in a more formalized 'compact.'" *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 470 (1978) (footnote omitted).

106. *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 471 (1978).

107. *Northeast Bancorp*, 105 S. Ct. at 2554 (citing *New Hampshire v. Maine*, 426 U.S. 363, 369 (1976)).

108. See *id.*

109. *Id.* at 2554-55. Federal law allows BHC's to acquire banks outside their home states when the target banks are in financial distress under Federal Deposit Insurance Corp. supervision. 12 U.S.C. § 1823(f) (1982).

110. *Northeast Bancorp*, 105 S. Ct. at 2555.

111. *Id.* (quoting *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 471 (1978)).

The Court may well be correct in its conclusions, however, its cursory analysis fails to recognize the reason that major political battles have been fought over the control of the nation's banking structure throughout American history.<sup>112</sup> Many of these battles were initiated by those wanting to wrest power from national banks and place it in local state-regulated banks—and, by doing so, assert the rights of the states as against those of the central government.<sup>113</sup> The Supreme Court has acted as the final arbiter in these disputes since *McCulloch v. Maryland*.<sup>114</sup> For the Court to overlook the role that banking plays in the economy—and the attendant political power that accrues to the states by virtue of the economic influence they gain from control over financial institutions—ignores the very purpose of the regional banking acts. Among other things, these statutes are intended to foster the growth of regional bank companies that will be more entrenched as competitors of the national banking companies, and more responsive to local political and economic forces. As regional bank companies are constructed, the increased financial power they will create should redound to the benefit of the participating states, or at least the states where the regional bank companies will be based. The enhanced economic power of those states in turn may be translated into increased political power within the federal system. This prospect escaped the Court's attention.

#### 4. *Equal Protection*

The last line of constitutional attack on the regional reciprocal banking laws was founded on the equal protection clause.<sup>115</sup> The argument focused on the facial discrimination in the statutes, which limited potential acquiring BHC's to those whose principal place of business was located in New England.<sup>116</sup> Citicorp and Northeast Bancorp had abandoned this argument in their original briefs filed with the Court,<sup>117</sup> apparently conceding the deference the Court grants state legislatures when economic regulations are

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112. For a concise overview of the historic role of banking issues in federal-state relations, see Golembe & Kumin, *supra* note 66, at 999-1005.

113. *Id.*

114. 17 U.S. (4 Wheat.) 316 (1819).

115. U.S. CONST. amend. XIV, § 2.

116. *Northeast Bancorp*, 105 S. Ct. at 2555.

117. *Id.*

challenged on equal protection grounds.<sup>118</sup> However, they revived this argument after the Court's decision, earlier in the 1985 Term, in *Metropolitan Life Insurance Co. v. Ward*.<sup>119</sup>

In *Metropolitan Life*, the Court held unconstitutional an Alabama statute that levied a gross premiums tax on foreign insurance companies at a rate higher than that imposed on domestic insurance companies.<sup>120</sup> The Court reaffirmed the rule that "the Equal Protection Clause imposes limits upon a State's power to condition the right of a foreign corporation to do business within its borders."<sup>121</sup> The standard by which the Court judged Alabama's authority to impose discriminatory taxes was that

whatever the extent of a State's authority to exclude foreign corporations from doing business within its boundaries, that authority does not justify imposition of more onerous taxes or other burdens on foreign corporations than those imposed on domestic corporations, unless the discrimination between foreign and domestic corporations bears a rational relation to a legitimate state purpose.<sup>122</sup>

Applying this lenient rational relationship test, the Court rejected Alabama's differential gross premiums tax because it was based on illegitimate state purposes—encouraging the formation of new domestic insurers and the investment in Alabama assets and state government securities.<sup>123</sup> The Court considered the discriminatory burdens on nonresident insurers to be "the very sort of parochial discrimination that the Equal Protection Clause was intended to prevent."<sup>124</sup> Indeed, it concluded that accepting Alabama's contention, that promoting local industry is a legitimate purpose under the equal protection clause, would emasculate that provision.<sup>125</sup> Plainly, the discriminatory Massachusetts and Connecticut bank-

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118. See, e.g., *Metropolitan Life Ins. Co. v. Ward*, 105 S. Ct. 1676, 1683 (1985) (rational relationship necessary to sustain discriminatory economic legislation "not difficult to establish").

119. 105 S. Ct. 1676 (1985) (5-4 decision).

120. *Metropolitan Life*, 105 S. Ct. at 1684.

121. *Id.* at 1680.

122. *Id.* (quoting *Western & Southern Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 667-68 (1981) (emphasis added)).

123. *Id.* at 1683-84. The foreign companies received a credit for investments in Alabama but could never receive treatment equal to domestic insurance companies, which paid taxes at a preferred rate regardless of their investments in the state. *Id.* at 1684.

124. *Metropolitan Life*, 105 S. Ct. at 1681-82.

125. *Id.* at 1683.

ing statutes were more onerous than the Alabama tax law at issue in *Metropolitan Life*; they did not simply impose more rigorous standards for entry into the Massachusetts and Connecticut markets by nonresident corporations, they completely excluded many bank companies altogether. Nevertheless, the Court distinguished away the case,<sup>126</sup> although not persuasively.

The first difference the Court articulated was that the regional banking statutes did not favor domestic BHC's over out-of-state BHC's.<sup>127</sup> Rather, the statutes discriminated against BHC's from outside the designated region. This reasoning was based on a "distinction without a difference."<sup>128</sup> The discrimination against out-of-state corporations was of the same kind as in *Metropolitan Life*, if not of the same degree. In both cases, the discriminatory treatment of the out-of-state concerns was based exclusively on their place of domicile.

The second difference the Court perceived was the legitimacy of the purposes behind the statutes. A "legitimate state purpose" is the initial step in determining the constitutionality of a statute under the equal protection clause.<sup>129</sup> The purposes the Court saw behind the Connecticut and Massachusetts statutes were "to preserve a close relationship between those in the community who need credit and those who provide credit," and to protect the "independence of local banking institutions."<sup>130</sup> After a brief discussion, the Court concluded that these motivations were different from those in *Metropolitan Life*.<sup>131</sup>

The Court concluded these purposes were legitimate by implying that the states have a greater interest in local control of banking than they do with respect to insurance companies.<sup>132</sup> The Court found support for this proposition in an observation it had made in an earlier case, *Lewis v. B.T. Investment Managers, Inc.*,<sup>133</sup> that "both as a matter of history and as a matter of present commercial reality, banking and related financial activities are of profound lo-

126. *Northeast Bancorp*, 105 S. Ct. at 2555 (citing *Metropolitan Life*, 105 S. Ct. at 1684 n.10).

127. *Id.*

128. *Metropolitan Life*, 105 S. Ct. at 1684.

129. *E.g.*, *City of New Orleans v. Dukes*, 427 U.S. 297, 303 (1976); see also Note, *Regional Banking Statutes and the Equal Protection Clause*, 84 COLUM. L. REV. 2025, 2032 (1984).

130. *Northeast Bancorp*, 105 S. Ct. at 2555.

131. *Id.* at 2556.

132. See *id.* at 2555-56.

133. 447 U.S. 27 (1980).

cal concern."<sup>134</sup> That case focused on a Florida statute that prohibited out-of-state BHC's from conducting investment advisory services in Florida.<sup>135</sup> The Court held that the statute was unconstitutional because, despite the historic local concern with banking, it impermissibly burdened interstate commerce in a discriminatory fashion.<sup>136</sup> Thus, no matter how venerated this policy, constitutional principles were held to limit the states in seeking to achieve it.

The Court's unquestioning acceptance of local control of banking as a legitimate state purpose is perplexing in light of its rejection of a similar argument in *B.T. Investment Managers*.<sup>137</sup> There, the Court suggested that this asserted justification for a discriminatory policy could easily mask an improper motive. As a skeptical but diplomatic Court put it: "[W]e doubt that the interest itself is entirely clear of *any tinge* of local parochialism."<sup>138</sup> Moreover, the Court found the Florida statute did not even serve its purported purpose because out-of-state ownership of Florida BHC's was not prohibited. Thus, the Court concluded that "the State's interest in local control, to the extent it legitimately exists, has [not] been significantly or *evenhandedly* advanced" by the Florida statute.<sup>139</sup>

Admittedly, the Court's determination in *B.T. Investment Managers* that this purpose was illegitimate took place within the context of a commerce clause analysis.<sup>140</sup> However, as the Court demonstrated in *Metropolitan Life*, the legitimacy of a state purpose under the equal protection clause may be determined by analogy to commerce clause analysis.<sup>141</sup> In any event, the Court offered no explanation of how the New England states' interests would be realized evenhandedly in *Northeast Bancorp* when Florida's interests were not advanced evenhandedly in *B.T. Investment Managers*.<sup>142</sup> The Court simply concluded that the motivations for the

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134. *B.T. Inv. Managers*, 447 U.S. at 38, quoted in part in *Northeast Bancorp*, 105 S. Ct. at 2555.

135. FLA. STAT. § 659.141(1) (1973).

136. *B.T. Inv. Managers*, 447 U.S. at 43-44.

137. *Id.*

138. *Id.* at 43 (emphasis added).

139. *Id.* at 44 (emphasis added).

140. *Id.* at 35.

141. See, e.g., *Metropolitan Life*, 105 S. Ct. at 1684. For a comparison of these two modes of analysis, see *id.* at 1681 n.6.

142. Plainly, they were not. Local control of a state's banks logically could not be advanced in any significant way by letting its BHC's buy bank companies in other states, and it certainly could not be advanced by letting out-of-state banks buy local BHC's. Even if this interest were advanced, it was hardly done so in an evenhanded manner; the statutes

Massachusetts and Connecticut regional reciprocal banking statutes were different and nobler than those for the Alabama statute in *Metropolitan Life*. Had the Court looked behind the asserted purpose of local control in *Northeast Bancorp*, it might well have concluded that "local control" really meant keeping big New York banks out of New England states while creating expansion opportunities for their own BHC's.<sup>143</sup> Characterized in this manner, the Massachusetts and Connecticut statutes should have been invalidated on equal protection grounds.

### III. THE IMPLICATIONS OF *Northeast Bancorp* FOR THE STATES

At least one-third of the states have enacted regional banking statutes that do not provide for entry from states outside their regions at any time.<sup>144</sup> Virtually all of them require reciprocity. In addition, at least six other states have passed regional reciprocal banking acts with a "trigger" that opens those states to nationwide

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facially discriminated in favor of New England banks whose states had reciprocal laws and against those from all other states.

143. Note, *supra* note 129, at 2035. One commentator suggests that the success or failure of an equal protection challenge to a statute can hinge on whether the Court characterizes the statute as being discriminatory in purpose or in means. *Id.* at 2032. This commentator analogizes the local control purpose supporting regional reciprocal banking statutes to the past contributions rationale asserted in *Zobel v. Williams*, 457 U.S. 55 (1982). In *Zobel*, Alaska sought to distribute surplus state funds derived from oil revenues to residents based on the duration of their residency. The state argued that long-time residents deserved rewards for their past contributions to Alaska. Four Justices concluded that the past contributions rationale was really unfounded favoritism for long-time residents, and thus an illegitimate state purpose, unsupportable on an equal protection challenge. Note, *supra* note 129, at 2035 (citing *Zobel*, 457 U.S. at 70-71 (Brennan, J., concurring)). The commentator further suggests that the equal protection clause contains a federalism component which prevents a state from discriminating against other states in the federation. *Id.* at 2036 (citing *Allied Stores v. Bowers*, 358 U.S. 522, 530 (1959) (Brennan, J., concurring)). This commentator concludes that because regional reciprocal banking statutes patently discriminate against nonresidents, i.e., BHC's from outside the region, they violate the equal protection clause. *Id.* at 2043.

144. **Connecticut:** CONN. GEN. STAT. ANN. §§ 36-552 to -554 (West Supp. 1985); **District of Columbia:** D.C. CODE ANN. §§ 26-801 to -809 (Supp. 1986); **Florida:** FLA. STAT. § 658.295 (1985); **Georgia:** GA. CODE ANN. §§ 7-1-620 to -625 (Supp. 1985); **Idaho:** IDAHO CODE §§ 26-2601 to -2612 (Supp. 1985); **Illinois:** ILL. ANN. STAT. ch. 17, § 2510 (Smith-Hurd Supp. 1986); **Indiana:** IND. CODE ANN. §§ 28-2-15-1 to -28 (Burns 1986 Repl.); **Maryland:** MD. FIN. INST. CODE ANN. §§ 5-1001 to -1007 (Supp. 1985); **Massachusetts:** MASS. GEN. LAWS ANN. ch. 167A, §§ 1-3 (West 1984); **Minnesota:** Ch. 339, 1986 Minn. Sess. Law Serv. 66 (West) (to be codified at MINN. STAT. § 48); **Missouri:** Act of Apr. 30, 1986, 1986 Mo. Legis. Serv. 122 (Vernon) (to be codified at Mo. REV. STAT. §§ 362.910, .925); **North Carolina:** N.C. GEN. STAT. §§ 53-209 to -218 (Supp. 1984); **Oregon:** OR. REV. STAT. § 715.065 (1985); **South Carolina:** S.C. CODE ANN. §§ 34-24-10 to -100 (Law. Co-op. Supp. 1985); **Tennessee:** TENN. CODE ANN. §§ 45-12-101 to -108 (Supp. 1985); **Utah:** UTAH CODE ANN. § 7-1-702 (Supp. 1985); **Virginia:** VA. CODE § 6.1-398 to -407 (Supp. 1985).

reciprocal banking at some future date.<sup>145</sup> For states that have adopted these regional banking laws, the implication of *Northeast Bancorp* is that their statutes are constitutional.

The Florida law is typical of these statutes. In 1984, Florida joined the first wave of southeastern states to authorize regional reciprocal bank mergers.<sup>146</sup> In its most important respects, the Florida statute is best seen as a refinement of the Connecticut and Massachusetts statutes upheld in *Northeast Bancorp*.<sup>147</sup> It requires that regional BHC's owning Florida banks have at least eighty percent of their deposits in the region,<sup>148</sup> where the Massachusetts and Connecticut laws only require that the BHC's have their principal places of business in New England, or not be owned by an out-of-region BHC, either directly or indirectly.<sup>149</sup> Moreover, the Florida statute follows the Connecticut law in requiring that an out-of-state BHC which acquires a domestic institution divest itself of in-state bank operations once it fails to qualify as a regional BHC.<sup>150</sup> The differences between the Florida and the Connecticut and Massachusetts statutes are merely in form, not substance. The

145. **Kentucky:** KY. REV. STAT. § 287.900 (Supp. 1984) (contiguous states until July 13, 1986); **Michigan:** MICH. COMP. LAWS ANN. § 487.430b (West Supp. 1986) (regional until Oct. 10, 1988); **Nevada:** NEV. REV. STAT. § 666.225-.385 (1985) (regional except California until Dec. 31, 1988); **New Jersey:** Ch. 5, 1986 N.J. Sess. Law Serv. 19 (West) (to be codified at N.J. REV. STAT. §§ 17:9A-370 to -372) (regional and national triggers based upon reciprocity in other states); **Ohio:** OHIO REV. CODE ANN. § 1101.5 (Page Supp. 1985) (regional until Oct. 17, 1988); **Rhode Island:** R.I. GEN. LAWS §§ 19-30-1 to -13 (Supp. 1985) (regional until July 1, 1987).

New Jersey has the most cumbersome trigger. Under that state's interstate banking law—which was made contingent upon passage of separate legislation—New Jersey BHC's could be acquired by bank companies from a 15-state Central Atlantic region when any three states in the region, each of which has twenty billion dollars in commercial bank deposits, offer reciprocity to New Jersey BHC's. In addition, New Jersey would offer nationwide reciprocity when any 13 states, including four of the 10 largest by total commercial bank deposits, allow in New Jersey BHC's. Ch. 5, 1986 N.J. Sess. Law Serv. 19 (West).

146. Regional Reciprocal Banking Act of 1984, ch. 84-42, 1984 Fla. Laws 96 (principal provisions codified at FLA. STAT. § 658.295 (1985)). For a detailed analysis of the Florida regional reciprocal banking law, see Loumiet & Crim, *Florida's Regional Reciprocal Banking Act of 1984*, 14 STETSON L. REV. 1 (1984).

147. Compare **Florida:** FLA. STAT. § 658.295 (1985) with **Connecticut:** CONN. GEN. STAT. ANN. §§ 36-552 to -554 (West Supp. 1985) and **Massachusetts:** MASS. GEN. LAWS ANN. ch. 167A, §§ 1-3 (West 1984).

148. FLA. STAT. § 658.295(2)(h),(l) (1985).

149. See **Massachusetts:** MASS. GEN. LAWS ANN. ch. 167A, § 2 (West 1984); **Connecticut:** CONN. GEN. STAT. ANN. § 36-552(j) (West Supp. 1985).

150. **Florida:** FLA. STAT. § 658.295(4)(b) (1985); **Connecticut:** CONN. GEN. STAT. ANN. §§ 36-553, -554 (West Supp. 1985); cf. **Massachusetts:** MASS. GEN. LAWS ANN. 167A, § 1(f) (West 1984) (banking commissioner may further define "successor" bank to prevent evasion of statute's purpose).



purpose of the statutes is to allow the regional consolidation of BHC's, and to continue to exclude money-center banks from the states' growing commercial markets.

This comparison is significant because the Florida statute is the one after which other states in the Southeast have patterned their regional reciprocal banking laws.<sup>151</sup> In style and form, they are from the same mold. Substantively, the statutes are pure regional reciprocal banking laws, generally requiring that eighty percent of each regional BHC's deposits be located in the region, and mandating divestment if the out-of-state acquiring BHC no longer qualifies as a regional BHC. Still, there are differences. For one thing, the states do not agree on which of their sister states are located in the region.<sup>152</sup> For another, they do not agree on how long a domestic bank should be in business before it is eligible for takeover by a regional BHC.<sup>153</sup> These differences, however, belie the remarkable uniformity of purpose and design. The decision in *Northeast Bancorp* means all are constitutional.

#### IV. THE MOVEMENT TOWARD NATIONAL INTERSTATE BANKING

Although regional reciprocal banking laws now have been validated by the Supreme Court, the debate over them will not end. In fact, it may just be beginning. These laws, varying as they do from state to state, will soon be the principal barrier to nationwide financial services as the nation continues to drift toward true interstate banking.

151. Compare **Florida**: FLA. STAT. § 658.295 (1985) with **Georgia**: GA. CODE ANN. §§ 7-1-620 to -625 (Supp. 1985); **Maryland**: MD. FIN. INST. CODE ANN. §§ 5-1001 to -1007 (Supp. 1985) (limited to contiguous states until 1987, then to 14 states and the District of Columbia); **North Carolina**: N.C. GEN. STAT. §§ 53-209 to -218 (Supp. 1984); **South Carolina**: S.C. CODE ANN. §§ 34-24-10 to -100 (Law. Co-op. Supp. 1984); **Tennessee**: TENN. CODE ANN. §§ 45-12-101 to -108 (1985); and **Virginia**: VA. CODE §§ 6.1-398 to -407 (Supp. 1985).

152. Florida excludes Kentucky. FLA. STAT. § 658.295(2)(j) (1985). Georgia excludes Maryland, GA. CODE ANN. § 7-1-620(10) (Supp. 1985), but Maryland includes Georgia after July 1, 1987. MD. FIN. INST. CODE ANN. § 5-1001(o) (Supp. 1985).

153. **Florida**: FLA. STAT. § 658.295(3)(a)(3) (1985) (two years); **Georgia**: GA. CODE ANN. § 7-1-621(d)(2) (Supp. 1985) (five years); **Maryland**: MD. FIN. INST. CODE ANN. § 5-1003(a) (Supp. 1985) (de novo entry or bank in existence for four years); **North Carolina**: N.C. GEN. STAT. § 53-211(a) (Supp. 1985) (five years); **South Carolina**: S.C. CODE ANN. § 34-24-50(b) (Supp. 1984) (five years); **Tennessee**: TENN. CODE ANN. § 45-12-103(4) (Supp. 1985) (five years); **Virginia**: VA. CODE § 6.1-399(3) (Supp. 1985) (two years).

### A. *The Reality of Nonbank Banks*

The expressed purpose behind the regional reciprocal banking concept is to allow smaller bank holding companies the opportunity to consolidate prior to the advent of national interstate banking.<sup>154</sup> However, most of the states that have enacted regional reciprocal banking legislation have not defined this interim period by adopting a trigger that would authorize nationwide reciprocity in the future.<sup>155</sup> Only six states have enacted regional reciprocal banking laws with a trigger for nationwide reciprocity.<sup>156</sup> If the regional reciprocal banking statutes were designed as a transitional step between a state-limited banking structure and nationwide interstate banking, then they have not been cast to attain that goal because they do not specify when the transition will end. Certainly, the time has come to determine the duration of this interim period.

The reality of the marketplace may be that interstate banking already has come about in everything but name, without regard to—or possibly in spite of—regional reciprocal banking laws. A scholarly study undertaken for the Florida House of Representatives in 1984 noted that if banking is defined as the provision of financial services, then interstate banking has already arrived.<sup>157</sup> One of the principal ways that BHC's have avoided the Douglas

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154. *Florida Banking Study*, *supra* note 9, at 696 n.123 (citing SOUTHERN GROWTH POLICIES BOARD, REPORT OF THE SOUTHERN REGIONAL BANKING COMMITTEE TO THE EXECUTIVE COMMITTEE OF THE SOUTHERN GROWTH POLICIES BOARD 9 (Nov. 14, 1982)); Dunlap, *supra* note 79, at 12-13; *Interstate Bill Becomes Law in Florida*, *American Banker*, May 24, 1984, at 1, col. 4; *Regional Interstate Banking Bill Nears Approval in Florida*, *American Banker*, May 16, 1984, at 23, col 3.

155. For example, Florida rejected a trigger when considering regional reciprocal banking legislation in 1984. FLA. H.R. JOUR. 214 (Reg. Sess. 1984) (Amendment 1 to Fla. CS for HB 795 (1984)) (laying on the table proposed Dec. 31, 1986, trigger); FLA. S. JOUR. 215, 250 (Reg. Sess. 1984) (Amendment 3 to Fla. CS for HB 795 (1984)) (defeating proposed phase-in of nationwide reciprocity over three years). Another trigger proposal was rejected in 1985. FLA. S. JOUR. 406 (Reg. Sess. 1985) (Amendment 3 to Fla. HB 1321 (1985)) (defeating proposed July 1, 1989, trigger).

156. See *supra* note 145. In addition, two states have provided for nationwide reciprocity. **New York**: N.Y. BANKING LAW § 142-b (Consol. Supp. 1984); **Washington**: WASH. REV. CODE ANN. § 30.04.230 (1986). Four states have open-entry banking laws with no reciprocity required by an acquiring BHC's home state. **Alaska**: ALASKA STAT. § 06.05.235 (Supp. 1985); **Arizona**: ARIZ. REV. STAT. ANN. §§ 6-321 to -327 (Supp. 1985) (open entry effective Oct. 1, 1986, with de novo charters available in 1992); **Maine**: ME. REV. STAT. ANN. tit. 9-B, § 1013 (Supp. 1985); **Oklahoma**: Ch. 155, § 4, 1986 Okla. Sess. Law Serv. 439, 448 (West) (to be codified at OKLA. STAT. tit. 6, § 506) (effective July 1, 1987).

157. *Florida Banking Study*, *supra* note 9, at 697-706; see also Cohen, *Interstate Banking: Myth and Reality*, 18 LOY. L.A.L. REV. 965 (1985).

Amendment's geographic restrictions on expansion of commercial banking has been through the use of so-called "nonbank banks." Section 4(c)(8) of the Act<sup>158</sup> was drawn so that BHC's may provide financial services in another state as long as a subsidiary does not *both* offer commercial loans and accept demand deposits, that is, checking accounts.<sup>159</sup> By separating the taking of demand deposits and the making of commercial loans between different subsidiaries, BHC's have been able to circumvent the federal and state barriers to interstate expansion. Out-of-state BHC's have been aggressive in exploiting this legal quirk, and nowhere has the result been more apparent than in Florida. Florida has the second-largest number of nonbank subsidiary offices in the country,<sup>160</sup> and the greatest proportion—eighty-five percent—operated by out-of-state BHC's.<sup>161</sup>

Out-of-state BHC's are establishing their presence in Florida almost to the point of conducting full-scale banking operations. The Federal Reserve Board has allowed out-of-state BHC's to establish Florida subsidiaries that take demand deposits and make consumer, but not commercial, loans.<sup>162</sup> In some instances, these companies had previously established a commercial lending presence in

158. Bank Holding Company Act of 1956, ch. 240, § 4(c)(8), 70 Stat. 133, 135 (codified as amended at 12 U.S.C. § 1843(c)(8) (1982)).

159. *Florida Banking Study*, *supra* note 9, at 699. This loophole arises because of the definition of bank in the Act. "'Bank' means any institution . . . which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." 12 U.S.C. § 1841(c) (1982) (emphasis added).

160. *Florida Banking Study*, *supra* note 9, at 702. See also *Interstate Banking Testimony*, *supra* note 85, at 431 (Chairman Volcker noting Florida was the target of approximately 20% of the nonbank bank applications by BHC's).

161. This figure is derived by comparing the number of nonbank subsidiary offices operated by local BHC's and the total number of interstate nonbank subsidiary offices in the state. See Whitehead, *Interstate Banking: Probability or Reality?*, *ECON. REV.* Mar. 1985, at 6, 11 (Federal Reserve Bank of Atlanta) (comparing maps 3 and 4). As of January 1985, more applications were pending for the establishment of nonbank banks in Florida than in any other state. *Id.* at 16.

162. See, e.g., *Bankers Trust New York Corp.*, 71 Fed. Res. Bull. 51 (1985) (approving application for New York BHC subsidiary in Palm Beach, Fla., to offer time and demand deposits and make consumer loans); *Bank of Boston Corp.*, 71 Fed. Res. Bull. 55 (1985) (approving application for Massachusetts BHC subsidiaries in Sarasota and Deerfield Beach, Fla., to offer time and demand deposits and make consumer loans).

The critical decision in this wave of nonbank bank applications came in *U.S. Trust Corp.*, 70 Fed. Res. Bull. 371 (1984). After that decision, "virtually all of the nation's largest bank holding companies . . . filed applications for hundreds of nonbank banks to be located nationwide." This development "effect[ed] fundamental changes in the structure of banking in this country by weakening if not altogether eliminating . . . the restrictions on interstate banking." *Bankers Trust New York Corp.*, 71 Fed. Res. Bull. at 54 (dissenting statement of Gov. Wallich).

the state<sup>163</sup> in addition to trust and investment advisory services.<sup>164</sup> To abide by at least the letter of the law, the Federal Reserve Board has required the out-of-state BHC's to refrain from the integration of checking account and consumer lending with their commercial lending.<sup>165</sup> The Florida Comptroller and the Florida Bankers Association have opposed these applications, contending that the out-of-state BHC's commercial lending activities would be conducted in an integrated fashion with the consumer banking services.<sup>166</sup> The Board has accepted the out-of-state BHC's assurances that they will not integrate their services.<sup>167</sup>

The Board's approval of these interstate banking services—the offering of demand deposits, consumer lending, and commercial loans in the same state, albeit through different subsidiaries—illustrates just how far down the road to interstate banking the nation has traveled.

### B. *The Catalyst: The Dimension Financial Decision*

The financial services industry has undertaken this journey despite the misgivings of the Federal Reserve Board.<sup>168</sup> The Board has tried but failed to halt this process. For purposes of determining which institutions would be banks regulated by the Board under the Bank Holding Company Act, the Board attempted to amend Regulation Y to provide for a broader definition of banks. Under that proposal, "banks" would be those institutions which accepted deposits that were "as a matter of practice" payable on demand,<sup>169</sup> and made what the Board considered "commercial loans" by means of conventional or alternative instruments.<sup>170</sup> The

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163. *E.g., Bankers Trust New York Corp.*, 71 Fed. Res. Bull. at 52. Significantly, U.S. Trust Corp. did not engage in commercial lending in Florida prior to approval of its 1984 nonbank bank application. *Id.*

164. *E.g., id.* at 51.

165. *E.g., id.*

166. *E.g., id.* at 52. For a detailed account of the U.S. Trust Corp. case and its aftermath, see Taylor, *Why Nonbanks Strike Fear In The Hearts of Florida Bankers*, FLA. TREND, Dec. 1984, at 74. Despite their proliferation, nonbank banks are considered a poor substitute for conventional banking operations. *Id.* at 76 (expert explaining nonbank banks are "longest, most tedious and expensive way to get into banking" and are not popular with consumers).

167. *E.g., Bankers Trust New York Corp.*, 71 Fed. Res. Bull. at 53.

168. *U.S. Trust Corp.*, 70 Fed. Res. Bull. at 373 (trend toward nonbank banks threatens "possibly dangerous alteration of the banking structure without Congressional action on the underlying policy issues").

169. Regulation Y, 12 C.F.R. § 225.2(a)(1)(A) (1985).

170. *Id.* at § 225.2(a)(1)(B).

purpose of this measure was to regulate as banks those financial entities "offering the functional equivalent of traditional banking services."<sup>171</sup> Such an expansive definition of "bank" would have restricted commercial enterprises not engaged in banking from offering these financial services across state lines. Furthermore, it would have effectively blocked interstate banking by BHC's which have exploited the nonbank bank loophole.<sup>172</sup>

The United States Court of Appeals for the Tenth Circuit invalidated the rule change shortly after it was adopted in 1984.<sup>173</sup> Recently, the Supreme Court affirmed that decision in *Board of Governors of the Federal Reserve System v. Dimension Financial Corp.*<sup>174</sup> The Court concluded that Congress intended the term "commercial loans" to embrace only direct loans, not "commercial loan substitutes."<sup>175</sup> Further, it struck down the Board's broadened definition of "demand deposits," which was crafted to include Negotiable Order of Withdrawal (NOW) accounts.<sup>176</sup> The Court said the duty to change the definition of a bank for purposes of regulation under the Bank Holding Company Act rests with Congress, and that the Board could not "correct flaws that it perceives in the statute it is empowered to administer."<sup>177</sup> One effect of *Dimension Financial* will be to allow BHC's to conduct virtually all traditional banking services by offering NOW accounts<sup>178</sup> and commercial loans, or by offering traditional demand deposits along with commercial loan substitutes. Unless Congress acts, the expansion of interstate banking services through the proliferation of nonbank banks seems certain to continue.

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171. *Board of Governors v. Dimension Fin. Corp.*, 106 S. Ct. 681, 683 (1986), *aff'g* 744 F.2d 1402 (10th Cir. 1984).

172. For an extended discussion of the Board's concerns over the proliferation of nonbank banks, see P. Volcker, Statement by Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System, before Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives (Apr. 17, 1985), *reprinted in Statements to Congress*, 71 Fed. Res. Bull. 424, 425 (1985) [hereinafter cited as *Nonbank Bank Testimony*].

173. 744 F.2d 1402 (10th Cir. 1984), *aff'd*, 106 S. Ct. 681 (1986).

174. 106 S. Ct. 681 (1986).

175. *Dimension Financial*, 106 S. Ct. at 686-87.

176. *Id.* at 686.

177. *Id.* at 689.

178. *Id.* at 685 ("A NOW account functions like a traditional checking account . . .").

C. *The Board's Solution: Regional Banking With a Trigger*

In dealing with the nonbank bank issue Congress will also be forced to deal with the interstate banking issue because the two are "inextricably related."<sup>179</sup> The link between the nonbank bank issue and interstate banking stems from the fact that BHC's are forced to compete with nondepository businesses—retail chains like Sears, Roebuck & Co., for example—that offer bank-like services, and thrift institutions which are not prohibited from interstate branching.<sup>180</sup> Additionally, BHC's want to expand into regions with rapidly growing economies.<sup>181</sup> These market forces have prompted the BHC's to undertake interstate expansion by what Chairman Volcker has described as the "unnatural" channel" of nonbank banks.<sup>182</sup> Because "the status quo is hardly satisfactory,"<sup>183</sup> the Board has suggested congressional action to deal with the interstate banking issue. The approach suggested by the Board is to allow states to construct regional reciprocal banking arrangements and then be required after a few years to permit entry by BHC's from any state that offers reciprocal rights.

The Board's proposal to allow limited regional reciprocity with a federally mandated national trigger would ameliorate the weaknesses and unfairness of the regional arrangements. Principal among these shortcomings is what Chairman Volcker has described as the alignment of regions "without clear and objective rationale" other than to exclude money-center banks.<sup>184</sup> Such arrangements might result in combinations of banks long distances and many states apart without allowing banking between contiguous states or in metropolitan areas divided by state lines. "Viewed as a permanent arrangement, regional compacts would tend to balkanize banking, with a tendency toward regional concentrations."<sup>185</sup> A

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179. Interstate Banking Testimony, *supra* note 85, *reprinted in* 71 Fed. Res. Bull. at 430.

180. *Id.*, *reprinted in* 71 Fed. Res. Bull. at 431.

181. *Id.* Some money-center banks are entering new territories by buying failing banks and thrifts. Chase Manhattan Corp., a New York BHC, recently acquired Park Bank of St. Petersburg, Fla., in an auction by the Federal Deposit Insurance Corp. State law imposed an 18-month moratorium on expansion beyond the bank's home county. *Chase Plots Its Florida Strategy*, FLA. TREND, Apr. 1986, at 79. Citicorp took over Biscayne Federal Savings and Loan of Miami, Fla., in a similar deal in 1983. *Id.*

182. Interstate Banking Testimony, *supra* note 85, *reprinted in* 71 Fed. Res. Bull. at 434.

183. *Id.*

184. *Id.*

185. *Id.*

time limitation on the regional arrangements would allow the express purpose of regional reciprocal banking statutes to be fulfilled—that is, it would allow smaller BHC's to consolidate to compete with money-center banks—and yet ensure the eventual benefits of national interstate banking. Furthermore, it would reserve to each state the decision whether to allow outside BHC's to enter its market; however, once a state chose to allow entry, it could not limit entry based on geographic discrimination beyond the trigger date.<sup>186</sup>

#### D. *The Congressional Response: Cautious Steps*

National legislation would most effectively create uniform conditions throughout the American economy, but so far Congress has not acted definitively. Representative St. Germain, Chairman of the House Banking Committee, has proposed legislation to sanction regional interstate banking arrangements for a limited period.<sup>187</sup> The bill provides that each state could enact reciprocal interstate banking laws, either nationwide or regional, but by 1990 or two years after a state enacted an authorizing statute, whichever was later, that state's geographic restrictions on entry would end.<sup>188</sup>

The bill also contains several provisions suggested by the Federal Reserve Board as part of a transition to full interstate banking. In order to maintain the nation's dual banking system,<sup>189</sup> Chairman Volcker has suggested that interstate expansion be "confined to separately incorporated and chartered components of a holding company."<sup>190</sup> This procedure would allow each state to maintain its authority over a BHC operating within its borders. The House proposal would prohibit interstate branching of banks unless the branches were already in place.<sup>191</sup> Thus, if a BHC wished to expand nationwide, it would be forced to do so through the acquisition of existing banks or by chartering de novo banks.

186. *Id.*

187. H.R. 2707, 99th Cong., 1st Sess. § 2 (1985).

188. *Id.* The proposal excluded several kinds of special purpose banks, insolvent banks, and "grandfathered" banks. *Id.*

189. This term means that the banking industry is regulated by both national and state regulatory agencies. See *Interstate Banking Testimony*, *supra* note 85, reprinted in 71 Fed. Res. Bull. at 433.

190. *Id.*

191. H.R. 2707, 99th Cong., 1st Sess. § 3 (1985).

Another concern addressed in the House bill is the prevention of excessive concentration of financial resources in BHC's as they expand nationwide. The concentration of bank deposits and assets in a few large, money-center banks has been raised frequently as an argument against nationwide interstate banking.<sup>192</sup> Although the evidence of the extent of concentration likely to occur is not conclusive,<sup>193</sup> "it is quite likely that interstate banking will significantly increase the concentration of banking resources at the national level."<sup>194</sup> However, there is little evidence to support the assertion that nationwide interstate banking would result in concentration of banking resources at the local level.<sup>195</sup>

The House bill includes several measures to prevent excessive concentration through interstate bank mergers. On the national level, the measure would: (1) grant the Federal Reserve Board authority to reject any merger that would result in an "undue concentration" of banking resources within the nation, a region, or a state; (2) prevent any of the nation's twenty-five largest BHC's from merging with one another; and (3) prohibit any merger in which the resulting BHC would control more than one percent of the nation's banking deposits.<sup>196</sup> Further, each state would be entitled to limit the percentage of deposits or assets that any BHC could hold so long as any such restriction applied equally to all banking organizations, whether domestic or foreign.<sup>197</sup>

### *E. State Responses: Pulling the Trigger*

The House Banking Committee has favorably reported the St. Germain proposal, but the prospects for congressional approval any time soon are bleak. Thus, while congressional action may be the only way uniformly to address interstate banking—because the combined pressures of that issue and the nonbank bank issue focus

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192. *E.g.*, Interstate Banking Testimony, *supra* note 85, reprinted in 70 Fed. Res. Bull. at 432; see also Rhoades, *Concentration in Local and National Markets*, ECON. REV., Mar. 1985, at 28 (Federal Reserve Bank of Atlanta); *Florida Banking Study*, *supra* note 9, at 693.

193. Interstate Banking Testimony, *supra* note 85, reprinted in 71 Fed. Res. Bull. at 432; Rhoades, *supra* note 192, at 28-29.

194. Rhoades, *supra* note 192, at 29. While the fear of banking concentration at the national level is raised as an argument against nationwide interstate banking, little has been said about concentration of regional banking resources. *But see Florida Banking Study*, *supra* note 9, at 693 (regional banking may lead to "increased concentration of resources and economic power in these regions").

195. Rhoades, *supra* note 192, at 29-30.

196. H.R. 2707, 99th Cong., 1st Sess. § 4 (1985).

197. *Id.*



there—the possibility of action by the states should not be dismissed.

The central issue in each state will be the same as in Congress: De facto interstate banking already exists,<sup>198</sup> so how can its full benefits be brought to the public? Many scholars agree the status quo in most interstate banking jurisdictions—indefinite regional reciprocal banking—is not in the public interest.<sup>199</sup> In fact, the literature suggests that, over the long term, national interstate banking would offer the most benefits to consumers through more competitive interest rates for borrowers and savers, more product lines, and greater access to capital for burgeoning businesses.<sup>200</sup> The only reasonable rationale advanced for regional reciprocal banking was to give state-limited banks a transition period in which to grow large enough to compete with money-center banks.<sup>201</sup> Now that regional reciprocal banking laws are in place in most parts of the country—and with any questions about the constitutionality of these transitional arrangements having been resolved by the *Northeast Bancorp* decision—the regional mergers are taking place rapidly.<sup>202</sup> State policy-makers should now take the next step and set dates to end all geographic restrictions on entry.

Reaching a resolution of this contentious issue will not be easy. Florida's experience illustrates the policy impasse that can develop from the conflict between the views of self-interested money-center banks on the one hand and self-interested local bankers on the other. Since regional reciprocal banking was first contemplated in Florida, the adoption of a trigger for nationwide reciprocity has

198. See *supra* notes 154-67 and accompanying text.

199. See *Florida Banking Study*, *supra* note 9, at 757-58; Golembe & Kumin, *supra* note 66, at 1008-15; D. Savage, *Regional Interstate Banking—Better Than the Alternatives?* 1 (undated) (unpublished report) (prepared by Senior Economist, Financial Structure Section, Board of Governors of the Federal Reserve System) (on file, *Florida State University Law Review*).

200. Dunlap, *supra* note 79, at 21; L. Frieder, *Interstate Banking; A Public Policy Perspective* 2 (undated) (unpublished monograph) (on file, *Florida State University Law Review*).

201. GOVERNOR'S BANKING REPORT, *supra* note 11, at 4-5; *Florida Banking Study*, *supra* note 9, at 696.

202. Craddock, *The Field Is Narrowing In the Banking Merger Game*, FLA. TREND, Spr. 1985 (1985 Economic Yearbook), at 153 (only five Florida BHC's left in prime takeover target category of one to three billion dollars in assets); *Regional Interstate: The New Merger Game*, FLA. TREND, Oct. 1984, at 71 (banker predicting Southeast's 15 to 20 largest statewide BHC's will combine into as few as five by 1989).

been a policy option.<sup>203</sup> A study committee dominated by executives from large Florida BHC's in 1984 recommended against including a trigger until there was time to "assay the results from any period of regional reciprocal interstate banking."<sup>204</sup> However, the scholarly study undertaken for the Florida House of Representatives that same year strongly suggested adoption of a trigger. That study concluded that regional reciprocity with a national trigger would deliver most of the potential benefits of each policy option. The report was unequivocal in its ultimate conclusion:

The "trigger" to nationwide reciprocity assures that some of the remaining geographical restrictions and any potential anticompetitive effects of the eventual consolidation and concentration of state and regional markets would be addressed. The public interest is best served when the state can achieve a more geographically diverse representation (a national presence) in the various local Florida markets. Only nationwide interstate banking can provide this end result.<sup>205</sup>

A law designed to bring to Florida businesses and consumers the full benefits of nationwide interstate banking could easily be patterned after the St. Germain proposal. While "[t]he optimum 'trigger' time is conjectural,"<sup>206</sup> many of the reasons for having an extended phase-in period have been removed. In the Southeast, the states that want to participate in the regional arrangement have had time to grant reciprocity. At least since the Supreme Court decision in June 1985, the regional BHC's have been able to plan their expansions with certainty.<sup>207</sup> A 1990 trigger date seems like a more-than-reasonable transition period for establishment of regional banks. Indeed, the regional BHC's could well become entrenched by then. A 1990 date would, however, conform to the St. Germain proposal.<sup>208</sup>

More significantly, the public policy concerns underlying much of the opposition to nationwide reciprocity—as opposed to the purely protectionist impulses of local bankers—also could be addressed by state law. The issue of economic concentration is a good

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203. GOVERNOR'S BANKING REPORT, *supra* note 11, at 6; *Florida Banking Study*, *supra* note 9, at 760.

204. GOVERNOR'S BANKING REPORT, *supra* note 11, at 6.

205. *Florida Banking Study*, *supra* note 9, at 760.

206. *Id.*

207. *Cf. id.*

208. *See supra* text accompanying note 188.

example. A legislature could impose a limitation on the size of any BHC in that state, whether measured by assets or deposits, as is contemplated in the St. Germain proposal. Chairman Volcker has suggested fifteen percent to twenty percent as a reasonable limitation for states to impose.<sup>209</sup> Of course, any limitation should be nondiscriminatory between in-state and out-of-state banking organizations.<sup>210</sup> By easing entry with these safeguards, the public could be served by an expansion in the availability of credit while minimizing the dangers inherent in concentration.

## V. CONCLUSION

About two-thirds of the states have adopted some form of interstate banking legislation, abrogating to some degree the geographic limitations authorized by the Douglas Amendment. The most common form of interstate banking law is the regional reciprocal banking statute which discriminates geographically against some BHC's. In *Northeast Bancorp*, the Supreme Court upheld these laws against challenges based on the commerce, compact, and equal protection clauses. More states may now enact regional reciprocal banking laws, and BHC's where these laws are operative may now consolidate without any legal uncertainties.

The states' efforts to restrict interstate banking ignore the realities of the marketplace, however. Bank companies and others are establishing federally approved nonbank banks that circumvent the restrictions on interstate banking; by doing so, these companies have entered some of the nation's most appealing markets—like Florida—and, by doing so, have frustrated the purpose of regional reciprocal banking laws. With Congress unable to bring order to the structure of the nation's financial services industry, the states can ensure that their borrowers and savers receive the full benefits of interstate banking by adopting trigger dates granting nationwide reciprocal entry rights. And they can do so while offering protection against excessive concentration of resources by state, regional, or money-center BHC's. States like Florida—populated by burgeoning enterprises with an insatiable appetite for capital—should provide a time certain when full, nationwide interstate banking will be allowed.

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209. Interstate Banking Testimony, *supra* note 85, reprinted in 71 Fed. Res. Bull. at 433.

210. *Id.*; cf. *Lewis v. B.T. Inv. Managers*, 447 U.S. 27 (1980).