Bargaining for Justice: An Examination of the Use and Limits of Conditions by the Federal Reserve Board

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Bargaining for Justice: An Examination of the Use and Limits of Conditions by the Federal Reserve Board

Alfred C. Aman Jr.*

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*Professor of Law, Cornell Law School; A.B. 1967, University of Rochester; J.D. 1970, University of Chicago. This Article is based upon a report submitted to the Administrative Conference of the United States. Recommendations based on this report were accepted by the Conference at its June 1988 plenary session. All views in this Article, however, are those of the author and do not necessarily represent those of the Conference. I wish to thank Eugene Fidell, Professors Jonathon Macey and Ed Rubin, and the members of the Finance Services Committee of the United States Administrative Conference for their valuable comments and assistance. I also wish to thank my research assistants, James Applebaum, Paul Tyler, and Katherine West for all of their help.
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INTRODUCTION

Congress's use of conditions in the context of spending legislation has produced an extensive legal literature analyzing the constitutional ramifications of exercising power in this manner.¹ Conditioning the grant of federal funds on activities arguably outside of Congress's direct regulatory authority raises a number of issues and, in certain kinds of cases, can risk undermining the civil liberties of the recipients or other basic constitutional principles such as federalism.² Courts usually have interpreted Congress's conditioning power expansively.³ Only recently have some commentators become more interested in the appropriate limits of those powers.⁴

Although there is clearly an administrative law analogue to Congress's use of conditions, there has been little analysis of the use and outer limits of conditions that administrative agencies impose when granting regulatory benefits to applicants or issuing administrative orders for litigants. Conditions are an important regulatory tool that many agencies regularly use, particularly those, like the Federal Reserve Board, that are engaged in the administration of essentially one-on-one regulatory programs that put a premium on an agency's ability to tailor informally its regulatory demands to the facts particular to the party before it.⁵

This Article explores the use of conditions at the agency level. Its primary purpose is to provide an appropriate administrative law framework for analyzing the use and limits of an agency's conditioning power. There are three additional purposes or by-products of this analysis. First, this Article focuses on the use of conditions and voluntary commitments⁶ by the Federal Reserve Board (Fed). The Fed is one of the most powerful and

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². See Rosenthal, supra note 1, at 1120.
³. See infra text and accompanying notes 214-25 (discussing South Dakota v. Dole, 483 U.S. 203 (1987)).
⁴. See Rosenthal, supra note 1, at 1131-61.
⁵. For a detailed examination of the application process under the Bank Holding Company Act, see infra text and accompanying notes 149-88.
⁶. As used by the Federal Reserve Board, a condition is a specific requirement in an agency order that, presumably, is supported by the record and is subject to judicial review. See infra p. 881. A voluntary commitment is a condition that a party presumably agrees to honor voluntarily. It may or may not be supported by the record or appear on the face of the agency's order (it often is in a letter of transmittal), and it usually is not subject to judicial review. See infra pp. 881-82.
independent federal agencies engaged in economic regulation. The Fed derives much of its power from its ability to set the monetary policy of the United States; however, it has extensive regulatory authority as well. It is one of the primary regulators of banks and banking policy in the United States. Although the Fed has long been analyzed, criticized, and praised for its substantive monetary or regulatory policies, few studies have focused on the Fed as an administrative agency. An important by-product of this discussion of administrative conditions and voluntary commitments is, thus, the application of administrative law principles to the exercise of some of the Fed’s regulatory powers.

Second, an analysis of the Fed’s use of conditions leads to a more general exploration of a significant informal agency decisionmaking process, one more akin to regulatory negotiation and settlement than to the commonly studied agency processes of adjudication or rulemaking. Conditions and commitments are the currency of the informal bargaining process by which the Fed reviews applications for expansion and acquisitions under the Bank Holding Company Act. Thus, the Fed’s use of conditions and commitments presents an important opportunity to study an aspect of the administrative process heretofore relatively unexplored in legal literature.

Finally, this Article comments on the relationship between the Fed’s use of its conditioning powers and change, particularly the technological changes and the increasing globalization of financial markets that have dramatically affected banking and the banking industry. Conditions can provide an agency an opportunity to extend its regulatory powers either in a manner that seeks to accommodate new market and technological forces, or in a manner that seeks to resist these changes. The overall regulatory framework sets the formal limits on how far an agency can go in either direction, but the struggle between market and political forces occurs most dramatically in a time of rapid change. Controversies surrounding some of the informal uses of the Fed’s regulatory powers highlight both this struggle and the limits of the regulatory and statutory frameworks within which it occurs.

To set the stage for analysis of the Fed’s use of conditions, this Article takes a contextual approach. Part I begins with a brief description of the Federal Reserve Board, its history, and its structure. Part II then examines the Bank Holding Company Act of 1956, the Act on which our analysis of the Federal Reserve Board’s use of conditions focuses. In so

9. Agencies exercise most of their power informally. This ad hoc, flexible manner seems to defy analysis, and one must be careful not to impose an artificial structure on these processes. The malleability of informal decisionmaking makes it difficult to study, but extremely important to the everyday functioning of an agency. This Article’s study of conditions contributes to the growing and important literature dealing with informal agency processes.
11. See infra text accompanying notes 15-59.
doing this Article demonstrates how changes in technology, the globalization of financial markets, and the emergence of a new financial services industry have created a variety of regulatory pressures on the Fed. These pressures can encourage the Fed to authorize certain kinds of banking activities with the hope of enabling a bank holding company to compete effectively when the bank is subject to more intense and different forms of competition. Many of these pressures are apparent in the Fed's imposition of conditions and raise some perennial administrative law issues: How should agencies resolve important policy questions, and what role should an administrative staff play in their resolution?

Part II sets forth the substantive and procedural background necessary to the detailed exploration of these questions in Part III. Part II first studies the evolution of the Bank Holding Company Act and then examines the procedures by which the Fed entertains applications under sections 3 and 4 of that Act. Part II specifically analyzes the formal and informal adjudicatory procedures used to resolve some of the disputes that arise under the Act. Although these procedures are not used often, they nevertheless provide the adversarial framework within which disputes under this Act theoretically may be resolved.

With the structural, substantive, and procedural background set forth in Parts I and II, Part III analyzes the Fed's conditioning powers. It begins by differentiating among three interrelated but analytically distinct phases of the administrative process: the informational phase, the bargaining or negotiation phase, and the more commonly studied adversarial phase. Part III then focuses on the bargaining phase of the process and sets out five types of regulatory conditions. In so doing, this Article examines more fully the concept of "voluntariness" in the context of bargaining with the Federal Reserve Board. It concludes that there are certain contexts in which agency conditions should be used sparingly, if at all.

More importantly, this Article suggests that there are limits to an agency's ability to foster or inhibit change without direct congressional involvement. The global era in which we live requires comprehensive regulatory changes that, at some point, only Congress can institute.

I. THE REGULATORY CONTEXT OF THE FEDERAL RESERVE BOARD

Part I sets forth the structure and powers of the Federal Reserve Board. This part of the Article sketches the basic regulatory context in which the Fed exercises its powers over bank holding companies. This contextual approach not only enables us to track the evolution of the Fed into a powerful administrative agency, but it also highlights the new, global realities the Fed now faces. These include an essentially new financial services industry that seems increasingly at odds with a regulatory structure created at a different time to meet similar, but also very different, problems.

14. Part III divides conditions into five general types: the perfect condition, the policy condition, the legal authority condition, the prospective condition, and the null condition. See infra text accompanying notes 287-48.
A. The Federal Reserve System—Substantive Powers

Congress established the Federal Reserve System with the Federal Reserve Act on December 23, 1913. This Act created a central banking structure consisting of three components: a Board of Governors, twelve regional Federal Reserve Banks, and various member banks. This federal reserve system initially was designed to remedy perceived defects in United States monetary policy and banking organization. Before its passage, there had been recurrent money panics and bank failures. Particularly notable was the panic of 1907 that, in many ways, was perhaps most responsible for the creation of the Federal Reserve System.

From the outset, the drafters of the Act viewed the new reserve system as a means to promote economic stability through regulation of credit conditions. As expressed in the Act's preamble, the original purposes of

16. On October 22, 1907, the country's third-largest bank, Knickerbocker Trust Company, failed because of a run by its depositors. A run on most New York City banks followed, and within a few days the Trust Company of America, the country's second-largest bank, was forced to close temporarily. At that point, J.P. Morgan organized a group of Wall Street bankers to guarantee enough cash to all New York banks to prevent additional bank failures. The panic made it obvious that the banking system provided inadequate protection for depositors. With no central organization, banks acted independently to protect their own reserves. Thus, a run on one bank resulted in every bank rushing to protect its own position. In addition, many smaller banks had deposited their reserve requirements in the large New York banks. The New York banks, in turn, used the money to purchase stocks. When the panic began, these large banks were not able to return the deposits to the smaller banks because the money was tied up in stock market investments that could not be liquidated. This had a pyramid effect, drastically reducing the liquidity of all banks at a time when depositors were demanding their money. The banking community concluded that a central bank, acting as lender of last resort (the role played by Morgan in the autumn of 1907), was needed. Congress, spurred on by these New York bankers, responded by enacting the Federal Reserve Act of 1913. See M. Friedman & A. Schwartz, A Monetary History of the United States, 1867-1960, at 156-68 (1963).
17. Henry Parker Willis, one of the chief draftsmen of the Federal Reserve Act and the first secretary of the Federal Reserve Board, stated the goals of the Federal Reserve Act in a memorandum to the Senate subcommittee responsible for the bill:

The object of the . . . proposed measures is that of arranging a cooperative organization of the banks of the United States which should serve to afford these banks the means of rediscounting their paper at times when they require assistance or accommodation in order to continue extending loans to their customers, and in order to avoid the curtailment of credit which in the past has frequently resulted in precipitating commercial panics and stringency. The fundamental idea running through these proposals is that of centralizing the control of discounts and reserves as well as that of applying a more rigorous method of oversight to the operations of the several banks which are expected to participate in the new scheme. It is supposed by the authors of these plans that the institution which they aim to create would accomplish at least the following financial results:

(1) Establishment of a uniform rate of discount throughout the United States, and thereby the furnishing of a certain kind of control over bank operations which should be similar in all parts of the country.

(2) General economy and centralization of reserves in order that such reserves might be held ready for use in protecting the banks of any section of the country and
the Federal Reserve System were to give the country an elastic currency, to provide facilities for discounting commercial paper, and to improve the supervision of banking. The Act outlined the framework for achieving these objectives. To provide a sound and elastic currency supply, the reserves of member commercial banks in the twelve newly created Federal Reserve Bank Districts were centralized. Member banks had access to reserves through discount and borrowing facilities. Additionally, if a bank held sufficient assets to be eligible for discount with a Reserve Bank, it was able to convert such deposits into Federal Reserve currency under section 16 of the Act. Facilities for discounting commercial paper were created by empowering the Reserve Banks to discount standardized commercial paper and to deal in certain securities.

Finally, the twelve Federal Reserve Banks and the Federal Reserve Board, composed of seven members, including the Secretary of the Treasury and the Comptroller of the Currency, comprised a supervisory body with the authority to oversee the volume, availability, and cost of credit. Congress also delegated to the Federal Reserve Board the power to issue currency without limit. It is important to note that the Fed’s responsibility for establishing monetary policy was not the primary purpose envisioned by the drafters. The Act created the Fed “as a collection of super correspondent banks organized chiefly to improve the country’s payments mechanism and to provide for seasonal currency needs, while supporting the soundness of banking through its role as lender of last resort.”

The two principal functions of the Federal Reserve today, if not examined closely, seem remarkably similar to those undertaken by the original Federal Reserve. Today, the Board of Governors of the Federal Reserve System, in conjunction with several other agencies, regulates the for enabling them to go on meeting their obligations instead of suspending payments, as has so often been necessary in the past.

(3) Furnishing of an elastic currency by the abolition of the existing bond secured note issue in whole or in part, and the substitution of a freely issued and adequately protected system of bank notes which should be available to all institutions which had the proper class of paper for presentation.

(4) Management and commercial use of the funds of the government which are now isolated in the treasury and subtreasuries in large amounts.

(5) General supervision of the banking business and furnishing of stringent and careful oversight.


20. _Id._ § 14, 38 Stat. at 264.

21. _Id._ § 16, 38 Stat. at 265.


23. _Id._ § 11, 38 Stat. at 261.

24. _Id._ § 11, 38 Stat. at 262.


26. The most notable of these agencies are the Comptroller of the Currency, under 12 U.S.C § 1 (1982), which creates the bureau known as Office of the Comptroller, and the Federal Home Loan Bank Board (FHLBB), under the Federal Home Loan Bank Act of 1932, ch. 522, 47 Stat. 725 (codified at 12 U.S.C. § 422 (1982)), which supervises thrifts; and the
commercial banking system of the United States. Under section 16 of the Federal Reserve Act, the Fed also determines the United States money supply and functions essentially as an independent central bank for the United States Government. Despite the apparent coherence between the original directives of the preamble to the 1913 Act and today's perception of the Federal Reserve's duties, the modern Federal Reserve has assumed a more extensive role in economic regulation.

The commercial banking system the Fed now regulates differs radically from the pay-on-demand account system that was familiar to the Reserve Act's creators and that was based on the gold standard. Little is mentioned in the original Act about the establishment of a national monetary and credit policy conducive to maintaining economic stability. Rather, the Act focused on establishing service functions for member banks. In today's economy, however, the introduction of wide-scale credit-based networks, NOW accounts, and other transactional forms of credit present the Federal Reserve Board with a very different and


28. The preamble to the 1913 Act states: "To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." Federal Reserve Act of 1913, ch. 6, 38 Stat. 251, 251.

29. The Act did provide for such powers as discounting, changing the discount rates, open market operations, and examinations of member banks. See Federal Reserve Act, ch. 6, §§ 11-21, 38 Stat. 251, 261-73 (1913). These were, however, secondary considerations designed to promote sound credit conditions. See T. de SAINT PHALLE, supra note 7, at 55-56.

30. See T. de SAINT PHALLE, supra note 7, at 55. The drafters' plan to infuse banking with stability included giving the Federal Reserve the ability to provide services such as the Federal Reserve note and a mechanism to discount it. As Professors Friedman and Schwartz note:

The Federal Reserve System was created by men whose outlook on the goals of central banking was shaped by their experience of money panics during the national banking era. The basic monetary problem seemed to them to be banking crises produced by or resulting in an attempted shift by the public from deposits to currency. In order to prevent such shifts from producing either widespread bank failures or the restriction of cash payments by banks, some means were required for converting deposits into currency without a reduction in the total of the two. This in turn required the existence of some form of currency that could be rapidly expanded—to be provided by the Federal Reserve note—and some means of enabling banks to convert their assets readily into such currency—to be the role of discounting. Since commercial banks then held a large fraction of their assets in the form of "notes, drafts, and bills of exchange arising out of actual commercial transactions," limiting the "lender of last resort" to the rediscounting of only such paper was not a serious limitation, though it is hard to see any advantage in it. Its imposition doubtless reflected, on the one hand, a disapproval of "speculative" as opposed to "commercial" activities, on the other, confusion between "elasticity" of one component of the money stock relative to others and "elasticity" of the total—a disapproval and a confusion that have plagued the Reserve System throughout its history and are still with us in nearly undiminished strength.

The role of the Federal Reserve as the central bank for the United States is more significant than ever. Control of the money supply has made the Fed the monetary policy planner for the United States. The fact that the entire global economy has been operating on a paper dollar monetary system since 1971 means that the Federal Reserve Board has enormous influence over the economic growth and functioning not only of the United States, but of the world as well. One commentator observes that actions of the Board may determine whether the global economy functions in an inflationary or deflationary cycle; whether economic growth is encouraged or constrained; and whether, and to what extent, spending or saving is stimulated or discouraged through greater or lesser growth of the United States money supply.

33. See T. de SAINT PHALLE, supra note 7, at 10. Of course, Japan, West Germany, and other developed countries now have a great effect on global economic events. Nevertheless, the Fed has long recognized its significant role in influencing the global economy. In its handbook of operations, the Board of Governors wrote:

In forming the judgments about prospective economic developments that underlie monetary policy decisions, Federal Reserve policy makers regularly take into account the relationships that link the domestic economy to the rest of the world—for example, the forces that affect foreign demand for U.S. goods and services, the determinants of supply and demand in this country for U.S. products that compete with imports, the factors influencing international flows of funds, and the effects of international flows of funds on domestic financial markets. These relationships are viewed from two related perspectives. First, developments in the rest of the world may have significant implications for the domestic economic objectives of the United States and for the use of monetary policy in attaining these objectives. Second, economic developments in this country have important influences on the net balance of goods and services transactions and the net flow of long-term and liquid capital between the United States and foreign countries, which in turn affect the international value of the dollar and the international reserve position of the United States.

K. COOPER & D. FRASER, BANKING DEREGULATION AND THE NEW COMPETITION IN THE FINANCIAL SERVICES INDUSTRY 71 (1984). Cooper and Fraser also concluded that while the path of deregulation may vary among nations because of differing economic and political circumstances (as well as differences in the present structure of their financial systems), it is equally apparent that there is now a world financial system and that national financial systems can exercise total independence from it only by imposing upon the larger economy a highly significant cost.
Another important aspect of the Federal Reserve's enormous power is the relationship between its control of United States monetary policy and financing of government spending. For example, the Fed could tighten the money supply through open market transactions or increased reserve requirements. Either action independently could increase interest rates and affect the financing of the public debt. In addition, the size of the federal budget deficit affects interest rates and public debt financing.34 When the Federal Reserve Act was passed in 1913, the public debt was very small. No one could have predicted either its monumental increase in size or the use of the Fed's resources to finance this deficit.35

In short, there can be little dispute that the Fed's power and influence is now enormous. Characterizing the changes that have occurred since the Federal Reserve System was established in 1913, Thibaut de Saint Phalle concludes, "It is no longer a mechanism mandated to make the banking system function better through new tools but rather a most powerful quasi-independent agency of government subject to no control or even audit."36

B. The Structure of the Federal Reserve System

The Federal Reserve Board of Governors37 sits at the apex of the


35. See id. at 141-42 (borrowing by Department of Treasury to finance public debt affects Fed's credit policies).

36. T. de Saint Phalle, supra note 7, at 56. Of course, given the powerful role the Fed now plays in monetary policy, it does not necessarily follow that the Fed may be or should be less independent. Perhaps administration of monetary policy needs to be above the political fray. Nevertheless, the question arises as to what extent the independence exercised by the Fed in carrying out its monetary responsibilities does or should carry over to the Fed's more regulatory and, thus, more administrative-agency-like duties under acts such as the Bank Holding Company Act. As we shall see, the Fed also exercises much of its regulatory power with remarkable independence, thereby highlighting some of the procedural issues that arise in the context of the Fed's imposition of certain kinds of conditions. See infra text accompanying notes 229-49.

37. Although the Board supervises and regulates commercial banks and the Federal Reserve Banks, its primary function is to formulate monetary policy. Board members make up a majority of the Federal Open Market Committee. 12 U.S.C. § 263 (1982 & Supp. 1987). The Board sets the reserve requirements of member banks, reviews the discount rate actions, governs the discount windows of the Federal Reserve Banks, sets ceiling rates on interest that member banks may pay on time-and-demand deposits, and sets the margin requirements on stock market credit purchases. Id. § 248. The seven members of the Board are appointed by the President of the United States, with the advice and consent of the Senate. Members are appointed for fourteen-year terms, with one term to expire every two years. Members may serve for only one full term. The chairman and vice chairman, selected by the President from among the Board members, serve for four-year terms, and can be reappointed. See id. § 241; see also Board of Governors, supra note 33, at 13-14 (discussing the appointment provisions of the The Federal Reserve Act).
Federal Reserve System. Beneath it are twelve regional Federal Reserve Banks and a number of member banks. Member banks are the financial institutions that become members of the Federal Reserve System by purchasing stock in their local Federal Reserve Banks. National Banks, banks chartered by the federal government, must become members of the Federal Reserve System; state-chartered commercial banks or trust companies, however, are not required to join.

38. The administration of the regional banks is summarized as follows:
Each of the twelve Federal Reserve banks has nine directors, divided into three classes: A, B, and C. The directors serve for three-year terms, with one-third of each class retiring each year; but those retiring are eligible for reelection or reappointment. Class A and B directors are elected by the member banks which for the purpose of election are divided by size of capital funds into three groups. Each group of banks elects one class A and one class B director. Class A directors are representatives of stock-holding banks, i.e., bankers; class B directors are actively engaged in commerce, agriculture, or industry, but they may not be officers, directors, or employees of any bank. Class A directors are expected to be familiar with the problems of lenders and class B directors with those of borrowers.

Class C directors are appointed by the Board of Governors and represent the public; none may be an officer, director, employee, or stockholder of any bank. Most are public-spirited individuals, serving by reason of a sense of community responsibility. Often a class C director is actively engaged in academic work. The Board of Governors designates one class C director as chairman of the local board and another as deputy chairman. The chairman serves also as Federal Reserve agent, exercising certain administrative duties connected with the issue of Federal Reserve notes.

39. The requirements for member banks are summarized as follows:
National banks, which are chartered by the Comptroller of the Currency, an official of the Department of the Treasury, are required by law to be members of the System. Banks chartered by any of the 50 States may elect to become members if they meet the requirements laid down by the Board of Governors. The member banks own all of the stock of the Reserve Banks. However, ownership of that stock, which is a legal requirement of membership, does not carry with it the usual attributes of control and financial interest.

B. Beckhart, supra note 33, at 45.

40. The stock requirements of member banks are summarized as follows:
Each member bank subscribes to an amount of stock in its own Federal Reserve bank equal to 6 percent of its capital and surplus, actually paying in an amount equal to 3 percent. The balance is subject to call by the Board of Governors, but the prospect that it will ever be demanded is very remote because the Reserve banks have little need of the money. Stock ownership by a member bank is increased or decreased from time to time as the bank augments or reduces its own capital and surplus. This stock may not be transferred or used as collateral for loans.

B. Beckhart, supra note 33, at 44.

41. Since passage of the Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified in scattered sections of 12 U.S.C.), nonmember banks have access to some of the same services as member banks, including borrowing privileges, and also are subject to the same reserve requirements. See § 103(b), 94 Stat. 132, 133-35.
Congress established the Federal Reserve Banks to carry out the day-to-day operations of the Federal Reserve System. Subject to control by the Board of Governors, the Federal Reserve Banks operate the discount window through which member banks can borrow from their district Federal Reserve Bank. The Federal Reserve Banks carry out other open-market operations, such as the purchase and sale of government securities, that increase or decrease the funds available for banks to lend. These banks also issue Federal Reserve notes, collect, clear, and transfer funds, handle government debt and cash balances, and, in effect, serve as principal fiscal agents for the United States Government.

Congress divided the country into twelve Federal Reserve Districts, each with one principal bank. These banks were privately owned with special charters. Each of the twelve district banks was to have twenty-five branches to serve particular areas within its district. Congress's purposes in establishing a system of regional branches were threefold: to ensure that all parts of the United States would have access to the Federal Reserve; to offer representation of regional needs in monetary policy and economic develop-

42. The Board of Governors describes the purpose of the discount window as:

The provision of Federal Reserve credit to member banks—at the initiative of the borrowing bank but subject to administrative constraints—serves essentially as (1) a source of temporary funds to help with large, unexpected deposit or portfolio adjustments that individual banks sometimes encounter and (2) a safety valve for member banks as a group during periods of monetary restraint. In addition, through lending operations the Federal Reserve provides somewhat longer-term credit to member banks that lack ready access to national money markets when these banks need help in covering recurring seasonal needs for funds. On rare occasions of emergency, when members confront urgent needs for liquefying their assets (such as needs arising from, say, unexpected developments in the local, regional, or national economy), they may obtain credit on a longer than temporary basis. Finally, nonmembers may borrow from the Federal Reserve under unusual and exigent circumstances in the financial markets, but at an interest rate that is above the discount rate available to member banks.

Board of Governors, supra note 33, at 70; see also id. at 70-78 (describing operation of discount window process); B. Beckhart, supra note 33, at 82 (same).

43. One analyst describing open-market operations writes:

[The most important instruments of credit policy in the United States, are conventionally defined as those credit activities initiated by a central bank. They include the purchase and sale of government obligations and other securities, bankers' acceptances, and commercial paper. They may also include purchases and sales of foreign exchange and gold, although such purchases do not usually result from the initiative of the central bank itself.

Central banks' open-market operations are often distinguished from lending operations, which allegedly result from the initiative of borrowers, including commercial banks, other financial institutions, and the government. It is not easy to determine initiative in all instances. Financial institutions may be forced to borrow from a central bank because it has engaged in open-market operations—has sold securities—or because it has increased reserve requirements. The initiative of the borrower then results from the initiating action of the central bank.

B. Beckhart, supra note 33, at 490-91; see also id. at 490-94 (discussing open-market operations in other countries); Board of Governors, supra note 33, at 49-67 (discussing open-market operations).

development; and to allow private individuals to participate in the banking system. This plan also represented a compromise between members of Congress who favored complete control by the Board of Governors and members who favored the existing arrangement of private dominance.

With the onset of the Depression, it was clear that greater centralization of monetary policy was necessary. The 1935 Banking Act vested centralized authority over monetary policy in the Federal Open Market Committee (FOMC). Today the FOMC is composed of all seven members of the Board of Governors as well as five of the twelve regional bank presidents. The president of the New York Fed holds a permanent position on the FOMC, and the other eleven bank presidents fill the remaining four places on a rotating basis.

The establishment of the FOMC supplanted the authority of the regional banks to determine the availability of reserves to the banking system. The FOMC deprived the regional banks of virtually all independent power to make policy and left their boards of directors with only symbolic authority. The 1935 Banking Act did not, however, change the legal structure of the regional banks. They remained privately owned, had boards of directors, and continued to pay dividends to their shareholding member banks.

Today the responsibility of the Federal Reserve Board is, simply put, twofold: it guides the nation's monetary policy, and it regulates banks.

45. See W. Melton, supra note 25, at 8 (citing H. Willis, The Federal Reserve: A Study of Banking Systems in the United States 68 (1915)).
49. The constitutionality of the Federal Open Market Committee was recently challenged in Melcher v. Federal Open Mkt. Comm., 644 F. Supp. 510 (D.D.C. 1986), aff’d on other grounds, 836 F.2d 561 (D.C. Cir. 1987), cert. denied, 108 S. Ct. 2034 (1988). Senator John Melcher challenged the process by which the five “Reserve Bank Members” of the FOMC are selected. Melcher, 644 F. Supp. at 512. The boards of directors of the several Federal Reserve Banks elect their presidents who are then eligible for a position on the FOMC. Id. (citing 12 U.S.C. § 263(a) (1982)). The D.C. District Court held that the Reserve Bank members were neither officers of the United States that required appointment by the President and confirmation by the Senate, nor “inferior officers” that were appointed by the Board of Governors of the Federal Reserve System. Id. at 518-20. The court further held that Congress could delegate to private individuals some of its article I, § 8 powers, i.e., coinage of money and regulation of its value, specifically including the purchase and sale of obligations. Id. at 522-23. Because the President appoints seven of the thirteen members of the FOMC with the advice and consent of the Senate, the court reasoned, Congress did not give the decisive vote in monetary policy to private persons. Id. at 523 & n.26. The D.C. Circuit affirmed but, relying on a previous decision involving the FOMC, found that the District Court should have dismissed the suit on grounds of equitable discretion. Melcher v. Federal Open Mkt. Comm., 836 F.2d 561, 565 (D.C. Cir. 1987) (citing Riegle v. Federal Open Mkt. Comm., 656 F.2d 873, 882 (D.C. Cir. 1981) (holding similar challenge to voting powers of FOMC “improperly interfered with legislative processes”)).
Although the Fed exercises exclusive jurisdiction over monetary policy, it shares regulatory authority over 15,000 United States banks with various agencies, particularly the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and state bank superintendents. Although various agencies possess regulatory responsibilities, the Fed maintains extensive authority over banks in the United States:

In its regulatory role, the Board exercises functions related to both the Federal Reserve banks and the member banks. With respect to the Federal Reserve banks, the Board can examine these institutions, require reports from them, set the discount rates they allow their borrowing members, and regulate their check clearing operations. It also has complete supervision over relations between a Federal Reserve bank and any foreign bank. In regard to member banks the Board examines them and receives periodic reports (although the Comptroller of the Currency has the prime responsibility for the examination of national banks, as opposed to state member banks where the prime responsibility for examinations rests with the Federal Reserve Board). Under the Depository Institutions Deregulation and

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50. As one commentator has noted, the structure of the Federal Reserve System is "bizarre" and without "parallel among central banks abroad or among other domestic agencies." W. Melton, supra note 25, at 4, 7. To complicate matters even further, the jurisdictional overlap among the various federal governmental agencies that regulate banks and banking policy also may be described as "bizarre." Regulatory agencies that have some control over depository institutions include: (1) the Federal Reserve Board; (2) the Comptroller of the Currency; (5) the Federal Deposit Insurance Corporation (FDIC); (4) the National Credit Union Administration (NCUA); and (5) the National Credit Union Share Insurance Fund (NCUSIF).


This regulatory hodgepodge is rendered even more complicated by the fact that almost all banks in the United States are regulated by some state or federal governmental authority. Which authority prevails is determined by little other than historic justification as to which authorities these shall be. As Melton notes:

State-chartered banks that are not members of the Federal Reserve System are regulated by their states' banking commissions. The Fed itself, however, supervises state-chartered banks that are members of the Fed. (In addition, the Fed regulates bank holding companies.) Nationally chartered banks are regulated by the Comptroller of the Currency. Similarly, thrift institutions with state charters are supervised on the state level, while those with national charters are subject to the Federal Home Loan Bank Board. Money market mutual funds, which provide services similar to bank deposits, are regulated by the Securities and Exchange Commission. U.S. branches of foreign banks fit into this scheme depending on whether they are state chartered (and supervised by state banking commissions) or nationally chartered (and supervised by the Comptroller of the Currency). In addition, to ensure uniformity of regulation, the Federal Reserve has residual supervisory authority over all U.S. operations of foreign banks. As a regulatory hodgepodge, this stands comparison to any.

W. Melton, supra note 25, at 6. It is not the purpose of this Article to reform or untangle the multiple political compromises that have, over time, contributed to the crazy-quilt structure and regulatory landscape within which the Fed operates.
Monetary Control Act of 1980, the Federal Reserve Board is authorized to require nonmember depository institutions, including savings and loan associations, savings banks, and credit unions, to supply reports to the Board on their assets and liabilities. The Board also has considerable regulatory powers through its administration of the Bank Holding Company Act.\footnote{51}

The Board of Governors exercises its extensive regulatory authority relatively free from executive and congressional controls. The President, with the advice and consent of the Senate, appoints the seven members of the Board for fourteen-year terms.\footnote{55} These terms are staggered so that one member's term expires every two years, thus limiting the number of appointments a President can make in a single term. Members are removable by the President only for cause.\footnote{55}

More significantly, the Board does not depend on congressional appropriations for its operating funds. The Board has the power to levy an assessment against Federal Reserve Banks to supply funds for its operating expenses, and the Board has complete discretion to determine how these funds will be spent.\footnote{54} Since the Federal Reserve Act excludes these assessments from "appropriated funds,"\footnote{55} they are not part of the federal budget and, thus, not subject to congressional review. The Board monitors its own finances through audits by respected private firms and in-house procedures. The Board's exception from the requirement to obtain advance approval from the Office of Management and Budget or any other federal agency prior to testifying before or submitting legislative proposals to Congress further attests to the Fed's extensive independence.\footnote{56} Compared to most regulatory agencies, even independent commissions, the Fed is remarkably free from direct political control.\footnote{57}

Courts, of course, can review some of the Fed's regulatory actions, but play no role in reviewing monetary policy; the Board's decisions in this area are essentially unreviewable. In addition, many of the Fed's regulatory

\footnote{52. 12 U.S.C. § 241 (1982).}
\footnote{53. Id. § 242. The President, with the advice and consent of the Senate, appoints the chairman of the board to a four-year term. Id. Therefore, the Chairman is likely to be more vulnerable to presidential pressure. Since the chairman exercises power on a daily basis, he or she is much more responsible for Board policy than the individual members.}
\footnote{54. Id. § 243.}
\footnote{55. Id. § 244.}
\footnote{56. Id. § 250.}
\footnote{57. The Fed, however, is subject to the checks in the Federal Administrative Procedure Act, 5 U.S.C. §§ 551-59, 701-06 (1982), and the Government in the Sunshine Act, 5 U.S.C. § 552b (1982). Also, many of the Fed's regulatory decisions are subject to congressional oversight and judicial review. It must submit to Congress twice-annual reports that review developments in the national economy, state objectives in monetary policy, and discuss the relationship between the Fed's objectives and the objectives of Congress and the President. The Fed also must submit to Congress an annual report on the Board's operations. 12 U.S.C. § 225a (1982). Similarly, the chairman and governors frequently speak before congressional committees about the condition of the banking system, pending banking legislation, the federal budget, economic legislation, and general economic matters. Information presented at these hearings, including statistical reports, is usually summarized in the monthly Federal Reserve Bulletin.}
activities are far too discretionary for courts to review in any significant way. As we shall see, a great deal of informality surrounds the Fed’s administration of the Bank Holding Company Act and the applications and negotiation process that this Act necessitates. The informality, coupled with most applicants’ need for prompt decisions, often undercuts any significant oversight role that a court might play by reviewing the substance of the Board’s regulatory decisions. The relative degree of independence with which the Board exercises many of its regulatory responsibilities often exacerbates the conflicts that can arise in particular regulatory contexts when the Fed imposes conditions or informally extracts so-called “voluntary commitments.” To appreciate fully the Fed’s use of conditions and commitments and the conflict that certain kinds of conditions can generate, it is necessary to examine both the evolution and application of the Bank Holding Company Act.

II. THE BANK HOLDING COMPANY ACT

Perhaps the Fed’s most important regulatory role is its implementation of the Bank Holding Company Act (BHCA). This Act has two fundamental purposes. First, it is intended to preserve competition within the banking industry. It, therefore, attempts to prevent bank holding companies from overly rapid expansion that can undermine effective competition among banks in local and regional markets. Second, the Act is based on the premise that there should be a separation between “the business of banking” and commerce. Thus, the Board has exclusive jurisdiction to determine the extent to which bank holding companies (BHCs) can engage in “nonbank” activities. To ensure the stability of the banking industry, the Act assumes that some risks are inappropriate for banks to take. The Act also assumes that easy access to bank funds by companies engaged in pursuits unrelated to banking should be prohibited because, in addition to the risks involved, such access may provide these companies with an inappropriate competitive edge.


59. See Part III infra.


Controversy over what is or should be the business of banking challenges the rationales for banking regulations. Changes in data processing and communications technology have created a new financial services industry. "These new methods have revolutionized the business, and created new businesses and new products. Money market funds, central asset accounts, and universal life policies would have been impossible before modern data processing and communication technologies." These new services raise questions about just what "the business of banking" in fact is. Is a line of credit provided by one's local supermarket a form of "banking?" Is a supermarket a bank? New products and new services have created what can be called financial services holding companies. These new institutions elude the Fed's jurisdiction, but nonetheless are very competitive with the commercial banks and BHCs under the Fed's control. Because BHCs need to compete effectively with the new financial service holding companies, the Fed faces enormous pressure to enlarge—through the bank holding company concept—the scope of activities in which BHCs can engage.

As we shall see, in examining the evolution and regulation of BHCs, a modern version of the perennial struggle between market and political forces appears. Market pressures have always pushed BHCs in new directions and the flexibility provided by the bank holding company concept often has allowed the kind of organizational innovation necessary

64. See Macey & Miller, Bank Failures, Risk Monitoring, and the Market for Bank Control, 88 Colum. L. Rev. 1153, 1159-60 (1988). In addition to advocating that banks should be allowed to diversify, the authors suggest eliminating deposit insurance because "[i]n a world without deposit insurance, depositors would demand that banks refrain from engaging in risky investment strategies or else demand that they be compensated in the form of a higher interest rate for the extra risk." Id. at 1165; see also Butler & Macey, The Myth of Competition in the Dual Banking System, 73 Cornell L. Rev. 677, 688 (1988) (arguing regulatory protection of some well-organized economic interest group from potential competition provides the only basis for some current restrictions on bank activity); Fischel, Rosenfield & Stillman, The Regulation of Banks and Bank Holding Companies, 73 Va. L. Rev. 301, 305 (1987) (private sector monitoring activity as a supplement to federal monitoring would produce more efficient oversight of banking activities); Garten, Banking On the Market: Relying on Depositors to Control Bank Risks, 4 Yale J. on Reg. 129, 140 (1986) (depositors able to make informed decisions because information about the operation and financial condition of banks is available and trustworthy). Macey & Garrett, Market Discipline By Depositors: A Summary of the Theoretical and Empirical Arguments, 5 Yale J. on Reg. 215, 217 (1988) (failure of one bank no longer causes a general run because FDIC and FSLIC provide overall public confidence in the banking system); Macey & Miller, supra, at 1169-70 ("expanding the scope of permissible bank activities may reduce bank risk by enabling banks to diversify into investments with a low covariance to traditional bank activities"); Miller, The Future of the Dual Banking System, 53 Brooklyn L. Rev. 1, 12 (1987) (when federal deposit insurance is available, the large increase in bank failures in recent years has not resulted in any significant loss of confidence in the banking system); Smith & Warner, On Financial Contracting: An Analysis of Bond Covenants, 7 J. of Fin. Econ. 117, 118-19 (1979) (market-driven mechanisms can work for depositors' control over excessive risk-taking by bank managers).

65. See G. Fischer, The Modern Bank Holding Company: Development, Regulation and Performance 97-98 (1986) (Board recommends allowing BHCs to engage in broader range of activities); id. at 157-62 (pressure to allow insurance activities); id. (entry of unregulated institutions into the financial service industry); id. at 287 ("a whole new group of 'non-BHC' BHCs are moving into what many thought was commercial banking territory").
to meet new market demands. Overlap, if not total congruence, between the demands of the market, as perceived by the regulated, and the political goals of the regulators often provided enough flexibility to accommodate both market and regulatory perspectives. Thus, the bank holding company device was able to achieve substantial product and geographic diversification; for this ability the government exacted a regulatory price. To wit, product and geographic expansion could not undermine competition, nor jeopardize the safety of the depositor by allowing banks or BHCs to go too far afield when it came to “the business of banking.” Given the structure of the post-New Deal banking industry, this regulatory price was not perceived as particularly high.

These “regulatory goals”—or, depending on one’s perspective, these “regulatory barriers” to competition—are now subject to intense scrutiny. One line of argument is that new data processing and communications technologies have created such a new and different financial services industry that the statutory goals expressed in the Bank Holding Company Act and its amendments are undercut substantially in at least two interrelated ways. First, changes in technologies allow new activities that the old acts simply do not cover. Thus, even if one agrees with the BHCA’s basic goals—protection of competition and the need to ensure bank safety—these goals cannot be realized in the new industry and the new entities that now exist. Second, these regulatory rationales are steeped in New Deal conceptions and fears, as well as a conception of an industry that no longer exists.

For example, the technological advances that have allowed growth in the use of credit cards have made the provisions of the McFadden Act functionally irrelevant. The McFadden Act was designed to prohibit interstate branch banking by preventing national banks from establishing branches across state lines. Yet Wallace Sellers has aptly noted:

[M]ajor money center banks have offices in nearly every state. These take the form of loan production offices, mortgage processing and service centers, and related activities. Although they may not take deposits, they perform a variety of other banking functions. In addition, every major bank is a sponsor of one or more credit cards. Since credit cards are not limited by state boundaries, the McFadden Act restrictions become more irrelevant with every passing day. We may not have interstate branching, but we certainly have interstate banking.

Similarly, financial institutions as well as financial subsidiaries of nonfinancial firms can compete with BHCs without Board restrictions. These so-called “non-BHC BHCs” have sidestepped the BHCA’s requirement that nonbank activities of BHCs be closely related to the business of banking. This loophole was available to domestic financial institutions before passage of the Competitive Equality Banking Act of 1987, but the

68. See id. § 36(c).
69. Sellers, supra note 65, at 4.
globalization of financial markets has created new entities that continue to circumvent the requirements of the BHCA.71 Closing loopholes by extending regulation within the United States does not and cannot prevent competition from abroad.

The limitations that a global market poses on domestic banking legislation, and the ability of market forces and new technology to render statutes increasingly irrelevant or obsolete, are at the heart of many issues presented to the Board. These issues also are at the heart of many of the

Congress time to consider new legislation for the financial services industry and encouraging the financial services industry to participate in the drafting of laws that affect federally insured depository institutions. S. REP. No. 19, 100th Cong., 1st Sess. 2, reprinted in 1987 U.S. CODE CONG. & ADMIN. NEWS 492. The loopholes frustrated the policy of separating banking from commerce, a policy that ensures equal availability of credit and minimizes the concentration of financial power. Id.

71. In their criticism of the Competitive Equality Banking Act, some Senators found that the Act's provisions were "inconsistent with the need to modernize our system and stay competitive in the face of the increasing internationalization of capital markets." S. REP. No. 19, 100th Cong., 1st Sess. 79 (dissenting views of Senators Garn, Hecht, Gramm, Bond, and Chafee), reprinted in 1987 U.S. CODE CONG. & ADMIN. NEWS 568. The Senators believed that if a "'protectionistic' model" is applied to domestic financial institutions, "the marketplace, technology, and consumer tastes will move beyond. The victim would be one more U.S. industry that would not—or in this case could not—evolve to meet the competition." Id. at 95, 1987 U.S. CODE CONG. & ADMIN. NEWS at 584 (quoting James Baker, Secretary of the Treasury Department).

The popular press also noticed this situation. One analyst has called for global regulation of securities markets because, first, "as much money moves around the globe through stocks and bonds these days as through the commercial banking system..." Second, in the United States we cannot adequately police foreign issuers in our own markets without agreements with overseas authorities on procedures for investigation and enforcement." Garten, We Need Global Regulations for Stocks, N.Y. Times, June 12, 1988, § 3, at F3, col. 1. This analyst also warns that the global equity business eventually could be dominated by 15 to 20 international firms. Trading as we now know it could be replaced by deals conducted "within and between these giants, computer to computer." Id. § 3, at F3, col. 4. He suggests that

regulation of the markets might start with tighter supervision of these global firms. In fact, a regulatory focus on intermediaries could be more important than the traditional emphasis on markets. The standard priority of securities regulation—protection for "the little guy"—might also have to be rethought in light of the increasing dominance, on an international scale at least, of the larger institutional investors.

Id. According to another commentator,

[deregulation of banking and the entry into different parts of the banking business of less-regulated American financial institutions such as brokerage firms and insurance companies have placed what was once a highly protected industry under intense competitive pressure. Adding to the pressure is the rising competition from less regulated Japanese and European banks and financial concerns, which are often several times the size of those in the United States... While 30 years ago seven of the world's largest banks were American, today only one—Citicorp—ranks in the top 25. Of the top 10 banks in the world, seven are Japanese... As Congress considers the regulatory and antitrust problems that will inevitably arise, the issue will not necessarily be whether Chase Manhattan can compete with Bankers Trust, but whether the American financial system is competitive with the Japanese or the West German giants.

Nash, In the Darwinian Age of Global Finance Only Megabanks May Survive, N.Y. Times, June 26, 1988, § 4, at E6, col. 2. This same analyst suggests that too much deregulation is responsible for the current thrifts crisis, and that when an industry is deregulated the government must increase its policing mechanism. See Nash, Who to Thank for the Crisis in the Thrift Industry, N.Y. Times, June 12, 1988, § 3, at F14, col. 3.
calls for comprehensive congressional reform in this area.\textsuperscript{72} As one commentator notes:

[T]he BHC as we have known it for more than a half century is in its twilight years. The era of the financial holding company (FHC) is now upon us. The BHC should quite naturally evolve into the FHC of the future. But what should and will occur may be two different things. Unless it is recognized that banks are in the financing business, and they are given the authority to meet their competitors over the broad range of financing activity on an equal basis, a list of leading FHC's of the 1990's will carry few familiar names from the domestic BHC's of the 1980's.\textsuperscript{73}

As this quotation suggests, the BHC acts are undercut in a second related sense. In addition to easily sidestepped regulatory purposes, the BHCA addresses concerns, such as providing special protection for depositors,\textsuperscript{74} that are no longer at the center of the newly evolved industry.

The following sections provide some sense of the evolution of bank holding company regulation and an explanation of why, in a global and highly competitive context, the evolutionary limits of that Act may have been reached. Moreover, this brief history highlights a long standing battle—the battle between regulatory political forces and market forces.

Agencies attempt to use their regulatory authority to carry out their statutorily mandated political goals. The regulated read the same statutes, but usually in a way that enables them to react legally to market forces to which they must be responsive. When there is substantial congruence between the market goals of the regulated and the political goals of the regulators, or at least when all of the industry is subject to the same rules, the regulatory regime is able to function smoothly. Problems begin to emerge when market forces push in a significantly different direction than the political goals of the governing statute. This tension between the demands of the market and the goals of the regulators is exacerbated when those who are regulated must compete with those who are not. This kind of mismatch is especially acute when there is global competition from entities that are theoretically impossible to control by domestic regulation, no matter how cleverly an agency is able to extend its jurisdictional reach. Thus, the perennial battle between market and political forces is most intense when regulatory conditions change and the regulated find themselves in competition with new unregulated entities that play by a very different set of rules.

It is within this context of change that the issues of administrative discretion examined in Part III take on particular significance. To understand fully both the use and limits of an agency's conditioning powers, it is important to develop the changing context in which administrative agen-

\textsuperscript{72} See supra note 71.
\textsuperscript{73} G. Fischer, supra note 66, at 288.
\textsuperscript{74} T. de Saint Phalle, supra note 7, at 9 (arguing historical justifications for special protections of depositors need re-examination); see also Macey & Miller, supra note 64, at 1195 (arguing uninsured depositors should "provide healthy, not a destructive, monitoring function on banks").
cies function. The next three sections shall examine the evolution of the Bank Holding Company Act and then look at its application to the new financial services industry.

A. The Years Prior to Federal Bank Holding Company Regulation

Bank holding companies have “surprisingly little in common with each other apart from their Bank Holding Company (BHC) designation.” Before exploring the intricacies of the legal form of BHCs, it is useful to note a number of related organizational forms that preceded the bank holding company approach and to set forth the basic regulatory policy that underlies earlier state and federal attempts to regulate these diverse legal entities.

Banking is subject to entry restrictions. Express authority is required from either a state or the federal government before any entity can enter into the business of banking. National banks obtain the approval of the federal government through the Comptroller of the Currency. State banks obtain the approval of the state. The resulting state or national bank will be supervised by the chartering authority—its primary regulator. A bank can, however, convert from one type of charter to the other if it obtains permission from the new regulator. The regulated entities can always try to find a regulator more accommodating to their needs. Thus, the dual system of state and federal regulation checks any excess regulation that may develop.

Banking entry restrictions of various forms were developed for two fundamental reasons: (1) to protect depositors, because banks are, above all, the custodians of “other people's money,” and (2) to limit competition. Highly competitive industries are characterized by unacceptable rates of withdrawals and failures for the kind of safety and stability necessary for consumer confidence in the banking system. Concern about consumer confidence has resulted in various attempts to control banks' competitive urges to set up branch banks or to engage in what was called chain or group banking.

Branch banking involves only one bank, but more than one banking office. In contrast to branching, chains or groups of banks include at least two affiliated but separately chartered banks. Thus, in states that allow branching, members of chains or group systems could be either single- or multiple-office institutions. Branch banking flourished in the United States during the first third of the nineteenth century. At the same time, the concept of the bank holding company began to emerge. As Professor Fischer observes, “the common-law right of a bank to establish branches was rarely questioned,” and branching was “considered the natural means

75. G. FISCHER, supra note 66, at 4.
77. Id. at 1141.
78. See generally L. BRANDIES, OTHER PEOPLE'S MONEY AND HOW BANKERS USE IT (1914).
79. See Ginsburg, supra note 76, at 1142. But see Macey & Miller, supra note 64, at 1155, 1162 (allowing bank failures increases “society's stock of wealth” by ensuring money lent to the best user and by driving “obsolete firms out of the industry”).
of providing banking facilities to smaller communities."80 Indeed, branch
banks themselves closely resembled bank holding companies because of the
autonomy exercised by branch offices.81

Branching, however, was prohibited for national banks and restricted
in many states for state banks. Because it was difficult for banks to serve
rural areas, pressures gradually mounted to invent new ways to serve these
markets. Some states began to ease their branching restrictions, and the
Federal Government soon followed. Congress passed the McFadden Act in
1927, authorizing national banks to open a limited number of branches in
their home communities.82

An earlier response to branching limitations was multi-unit banking.
Multi-unit banking usually took the form of chain banking; that is, *one
individual* had common ownership in two or more separate banks. Thus, the
entities were neither branches, nor completely unrelated unit banks. Before
1900 these chains were limited to a few banks. At the turn of the century,
however, multi-unit chain banking began to flourish. The kinds of forces
that encouraged widespread multi-unit banking remain relevant today.83
Quoting from an issue of the *Journal of Business*, published around the turn
of the century, Professor Fischer noted:

> The growth of population and increasing congestion of traffic
> made for rapid development of banking in the outlying districts.
> The downtown banks could hardly but look with envy at the
> lucrative savings bank business that thus developed. With branch
> banking prohibited, the only solution was to buy into established
> banks in the new territory or establish new ones.84

Many doubted the wisdom of this approach. Relying on the traditional
reasons for imposing entry restrictions on banks, opponents of chain
banking stressed the sanctity of the unit bank concept. They were not
unsuccessful. While federal law remained silent on this issue, some states
passed laws disallowing ownership of bank stock by corporations, but most
states simply prohibited the purchase of shares of a state bank's stock by
another state-chartered bank. BHCs fell outside most existing regulatory
schemes because a holding company was not considered a bank *per se.*85

Beginning around 1920, holding companies became the primary vehicle by

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81. *Id.* As Professors Jessee and Seelig note:
[B]ranches of the First Bank of the United States not only had their own directors and
presidents but also functioned autonomously. Several large state banks also had many
of the characteristics of holding companies. However, as a result of the Civil War and
the National Bank Act . . ., few branch banks remained in operation after the 1860s.
Unit banks almost completely dominated the American banking structure as the
twentieth century began.

(1982)).
83. G. Fischer, *supra* note 66, at 7 ("Although over 70 years have passed since these systems
were organized, the reasons for their formation are not without parallels in the 1980s.").
84. *Id.* at 8 (quoting Thomas, *Concentration in Banking Controls through Interlocking
Directorates as Typified by Chicago Banks*, 6 J. of Bus. 9 (1933)).
which state branch banking restrictions were circumvented; a single BHC with ten unit banks could easily substitute for a single bank with nine branches.\textsuperscript{86}

BHCs were similar to chain banks in concept, but different in crucial ways. Corporate giants holding great financial power tended to control BHCs, rather than individuals or small groups of investors. In such corporations, stockholders were widely dispersed, professional management made decisions, and the entity typically included at least one metropolitan bank. Two characteristics thus set BHCs apart from chain groups: a metropolitan lead bank and a form of centralized management.\textsuperscript{87}

In the 1920s a variety of reasons contributed to the growing popularity of this organizational form.\textsuperscript{88} Fischer notes four in particular: (1) the need for rural bank expansion and reform; (2) the general merger movement of the 1920s; (3) bankers' fear that their correspondent business would be lost to expanding holding companies if their own bank holding companies were not formed; and (4) the bull market of the 1920s.\textsuperscript{89} One can add a fifth reason as well: bankers used the BHC to avoid branching restrictions, but since they anticipated more liberal branching laws, they also wanted to be well-positioned for the new market they envisioned. They thus sought to acquire the banks that they believed would ultimately become branches.

These factors led to the essentially uncontrolled growth of bank holding companies during the 1920s. This growth did not go unnoticed, or fail to concern some observers.\textsuperscript{90} The stock market crash of 1929, however, quickly dwarfed these concerns. As the Depression spread, public attention focused less on the expansion of bank holding companies and more on the nonbanking acquisitions of those companies. Congressional investigators who examined loans that various types of banks made prior to the 1929 collapse concluded that the factors that caused BHCs to expand also played a significant part in the kinds of speculation that led to the 1929 crash.\textsuperscript{91} Four bills designed to limit holding company actions were introduced in

\textsuperscript{86} Ginsburg, supra note 76, at 1156.

\textsuperscript{87} Id.

\textsuperscript{88} Holding companies "controlled 2,103 banks at year-end 1929. These banks constituted 8 percent of the nation's total number of banks and operated more than 12 percent of all banking offices." M. Jesse & S. Seelig, supra note 81, at 6.

\textsuperscript{89} G. Fischer, supra note 66, at 157-52.

\textsuperscript{90} Federal Reserve Board System Board of Governors, Annual Report for the Year 1927, at 31, quoted in M. Jesse & S. Seelig, supra note 81, at 7. The report stated:

Bank holding companies have been organized in increasing numbers to operate extensively in the field of banking, not simply as investment agencies, but specifically in individual instances to acquire control of corporately independent banking institutions through stock ownership and to exercise this centralized control in effecting bank mergers; in extending identical or virtually single corporate control over companies operating as subsidiaries in special fields of banking; and in building up chain systems embracing in individual instances banking institutions operating under national and state charters in several states.

\textsuperscript{91} Id.

1930, but none was passed.\textsuperscript{92} Not until 1956 did a federal legislative coalition pass the Bank Holding Company Act.

An important precursor of this Act, however, was the Banking Act of 1933—the Glass-Steagall Act.\textsuperscript{93} Although the few sections the Act contained pertaining to group banking had little impact, the Act nevertheless represented the first federal attempt to regulate bank holding companies. These provisions were, in large part, a partial response to the fundamental concerns that had always formed the regulatory justification for entry restrictions. At the hearings that preceded the Glass-Steagall Act, many participants believed the Act would threaten the existence of small banks.\textsuperscript{94} Similarly, participants noted the substantial potential for conflicts of interest that might arise when a bank holding company controls nonbanking interests.\textsuperscript{95} Indeed, Congressman Letts asked Federal Reserve Board Chairman Roy A. Young of the Federal Reserve Board the following probing questions:

\begin{quote}
I have noticed a tendency on the part of banking institutions to go into many lines of business—the handling of securities; the handling of mortgage business; agencies for the sale of real estate—to the point that I understand the Transamerica Corporation has announced that it has the necessary funds to put over any enterprise that they wish . . . .

\ldots . . . Is there danger that a policy of this kind will lead to the point where financial institutions will serve themselves and their affiliates and not the public?

\ldots . . . In other words, will they compel men in business as individuals or in a corporate capacity, to play hand in hand with the financial groups, in order to get necessary accommodations?

\ldots . . . My concern is in regard to the powers that may be acquired through the policies of holding companies that sit in back of the screen and control the activities of the banking institutions in a community and many other lines of industry. It is conceivable it may even go to the point of involving the control of companies that are engaged in the distribution of our foods and other necessities of life.\textsuperscript{96}
\end{quote}

The Act did not deal very effectively with these concerns. It did, however, require holding companies to meet certain conditions before they could obtain a permit to vote in the selection of directors of affiliated banks.


\textsuperscript{94} \textit{Branch, Chain, and Group Banking: Hearings on H.R. 141 Before the House Comm. on Banking and Currency}, 71st Cong., 2d Sess. 17 (1930) (statement of John W. Pole, Comptroller of the Currency).

\textsuperscript{95} Id. at 67 (statement of John W. Pole, Comptroller of the Currency) (comments of Congressman Letts).

\textsuperscript{96} Id. at 479-80.
These conditions required the holding company to agree to: (1) allow federal officials to examine the holding company's subsidiary banks; (2) completely cease from the investment business within five years from the date of the Act's application; (3) hold a certain percentage of marketable assets other than bank stock; and (4) submit financial reports and declare dividends only out of actual net earnings.97

The Glass-Steagall Act proved inadequate when it came to bank holding companies. BHCs were covered only if they controlled at least one Federal Reserve member bank.98 Thus, BHCs could avoid the Act if all of their bank subsidiaries were nonmember institutions. Moreover, the Act did not affect the ability of BHCs to expand or acquire additional nonbanking interests. Thus, the Act required no consideration of the effect on competition that bank holding company expansion might have.

The Act's limited reach did not seem to matter much during the 1930s. This was a period of retrenchment for BHCs. Bank failures reduced the number of BHCs and there was little economic incentive to form new ones. Moreover, the federal government was increasingly hostile to these organizational forms and the future of multi-unit banking was in serious doubt. At one point, President Roosevelt essentially sought to eliminate all holding companies; bills to that effect were introduced.99 Even the Federal Reserve Board of Governors began to play a much more active regulatory role vis-à-vis existing holding companies. In 1948 the Board initiated antitrust proceedings against Transamerica Corporation,100 the largest BHC then in existence. Although the Board ultimately lost, the case focused attention on the economic power concentrated in the Transamerica Corporation and the difficulty under existing law to control companies like it.101

The threat of federal legislation arose for many reasons. Concerns were expressed over the soundness and safety of group banking as a whole and the problems of regulatory coordination. As early as 1929, Comptroller John Pole noted before the House Banking and Currency Committee:

99. See infra text accompanying note 104.
101. G. FISCHER, supra note 66, at 138. In 1949 economic incentives also had sparked new interest in BHCs.

Although there was negligible expansion in group banking from 1933 to 1948, considerable growth of these systems occurred from 1948 through 1956 . . . . Just as in the 1920s, there was an increasing amount of merger activity in other fields and a very good market for the shares of leading financial institutions. The movement of population and industry again raised problems for banks. This time, however, it had been mainly the city bank which found that it was losing its customers to the suburban institution. While the primary causes of the earlier expansion of group banking were the speculative mood of the 1920s and the extremely poor condition of many rural banks, the fundamental element in the growth of group banking in the early 1950s was the threat of federal legislation. It was feared that regulations would severely affect the merger activity of bank holding companies.

Id. at 22.
Where a group is composed of both state and national banks, as well as of other types of financial institutions, it becomes practically impossible for any supervising governmental official to ascertain authoritatively and accurately the financial condition of the group as a whole. Each corporation in the group is an independent legal entity, some responsible to both state and national governments, and this creates a situation in which the public is not sufficiently protected, insofar as it can be protected by governmental authority.\textsuperscript{102}

He went on to suggest that control should be consolidated in one regulatory body.\textsuperscript{103}

In addition to lack of effective control, legislation proposed by the Roosevelt Administration focused on the "great economic power" wielded by holding companies. In a special message to Congress in 1938, President Roosevelt stated:

> It is hardly necessary to point out the great economic power that might be wielded by a group which may succeed in acquiring domination over banking resources in any considerable area of the country. That power becomes particularly dangerous when it is exercised from a distance and notably so when effective control is maintained without the responsibilities of complete ownership.

> We have seen the multiplied evils which have arisen from the holding company system in the case of public utilities, where a small minority ownership has been able to dominate a far-flung system.

> We do not want those evils repeated in the banking field, and we should take steps now to see that they are not.

> I recommend that the Congress enact... legislation that will effectively control the operation of bank holding companies; prevent holding companies from acquiring control of any more banks, directly or indirectly; prevent banks controlled by holding companies from establishing any more branches; and make it illegal for a holding company, or any corporation or enterprise in which it is financially interested, to borrow from or sell securities to a bank in which it holds stock.

> I recommend that this bank legislation make provision for the gradual separation of banks from holding company control or ownership...\textsuperscript{104}

The Federal Reserve Board itself echoed this theme. In hearings before the Senate Banking Committee, Marriner Eccles, then Chairman of the Federal Reserve, explained the need for legislation:

> Accepted rules of law confine the business of banks to banking and prohibit them from engaging in extraneous businesses such

\textsuperscript{102} Id. at 139.
\textsuperscript{103} Id.
\textsuperscript{104} S. Doc. No. 173, 75th Cong., 3d Sess. 8-9 (1938).
as owning and operating industrial and manufacturing concerns. It is axiomatic that the lender and the borrower or potential borrower should not be dominated or controlled by the same management. In one exceptional situation, however, the corporate device has been used to gather under one management many different and varied enterprises wholly unrelated to the conduct of a banking business.

... The problem of how far bank holding company systems should be permitted to expand has long been of serious concern. There is perhaps a greater need for a positive declaration of congressional policy on this question than on any other phase of the holding company problems. It is in this area that one of the greatest potential evils of bank holding company operations exists. That evil, which permits a holding company... to dominate major portions of the banking facilities of particular sections, is one which strikes at the heart of our traditional system of competitive banking.\footnote{105}

He went on to note the size and power of the Transamerica Corporation—41 banks, 619 banking offices in California, Nevada, Arizona, Oregon, and Washington.\footnote{106} In addition, Transamerica Corporation controlled various nonbanking companies.\footnote{107}

When Congress failed to act, the Board brought its own action against Transamerica Corporation under section 7 of the Clayton Act.\footnote{108} The failure of this suit also helped stir the legislative fires.\footnote{109} In 1956 these various legislative threats and the political coalitions that were forming finally came to fruition. The legislative result was the Bank Holding Company Act of 1956.\footnote{110}

\footnote{105. Providing for Control and Regulation of Bank Holding Companies: Hearings on S. 829 Before the Senate Comm. on Banking and Currency, 80th Cong., 1st Sess. 15-17 (1947) (statement of Marriner Eccles, Chairman of the Federal Reserve Board).}

\footnote{106. Id. at 22.}

\footnote{107. Id. at 24-32 (noting control of companies engaged in life, fire, automobile, and marine insurance; fish canning and processing; frozen foods; castings; forging; diesel engines; food processing machinery; power control equipment; kitchen tools; color cameras; and agricultural equipment); see Natter, Legal Antecedents To The Bank Holding Company Act, Congressional Research Service Paper, at 9 (June 4, 1986) (setting forth background in detail).}

\footnote{108. Transamerica Corp. v. Board of Governors, 206 F.2d 163 (3d Cir.), cert. denied, 346 U.S. 901 (1953).}


\footnote{110. Bank Holding Company Act of 1956, ch. 240, §§ 1-12, 70 Stat. 133 (codified as amended at 12 U.S.C. §§ 1841-50 (1982)). This Act was amended in 1966, Pub. L. No. 89-485, §§ 1-14, 80 Stat. 236 (1966), and, most significantly, in 1970. Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, tit. I, §§ 101-05, 84 Stat. 1760-68. See Chase, supra note 109, at 1288-36 (discussing historical background to 1970 amendments). It should be noted that section 3(d) of the 1956 Act is often called the Douglas Amendment. That provision was incorporated into the original Act during the Senate debate, see 102 Cong. Rec. 5902, 6856 (1956), and it prohibited interstate acquisitions of banks by BHCS unless these acquisitions were specifically authorized by the statutes of the state in which the bank is located.}
USE AND LIMITS OF CONDITIONS

B. The Bank Holding Company Act of 1956

Participants in the hearings held on the bills that became the Bank Holding Company Act of 1956 reiterated concerns over the adverse effects of BHCs.111 The House report issued with the Bank Holding Company Act noted that the holding company movement threatened the existence of independent community banks, could result in monopolistic control of credit, and enabled banks to sidestep branching restrictions on both state and federal levels. Moreover, the holding company's nonbanking businesses could occupy a preferred position in obtaining credit that might not be appropriate under traditional banking standards.112

Despite these concerns, the bill that passed was by no means a radical one. Congress did not view holding companies as "evil" or try to abolish them. The BHCA of 1956 sought to control them. The purposes of the Act were:

1) the maintenance of separate banking and commerce institutions; 2) the preservation of a competitive atmosphere in banking markets; 3) the prevention of concentration of economic power; and 4) the protection of the states' right to select the way in which banks were structured within their borders.113

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111. For example, in hearings before the Senate Committee on Banking and Currency, William McChesney Martin, then Chairman of the Fed, stated "[e]xisting provisions of law originally enacted in the Banking Act of 1933 have proved entirely inadequate to deal with the special problems presented by bank holding companies." S. Rep. No. 1095, 84th Cong., 2d Sess. 2 (1955), reprinted in 1956 U.S. CODE CONG. & ADMIN. NEWS 2483. Chairman Martin noted two particular problems with bank holding companies. First, the unrestricted ability of BHCs to acquire new banking units allows a single group of managers to control the banking facilities in a particular area. Second, combinations of banking and nonbanking interests permit depositors' money to be lent to nonbanking interests. Id.

112. H.R. Rep. No. 609, 84th Cong., 1st Sess. 6-7, 16-17 (1955) (extending credit to affiliated companies "is to the detriment of other competitive businesses in the community"). Similar concerns were expressed on the Senate side.

Mr. Martin. . . . I believe the potential abuse in this field is the combination of banking and nonbanking interests. You could not prove the extent to which there will be a danger. I am not trying to take the holding company device and say it is no good, but I can see quite a good deal of use for a bank holding company as to banks, but when you start mixing it and putting it into the area of possibly empire building, then I think you mix two functions that can lead to a great deal of trouble.

Senator Douglas. The possibility of abuse depends almost in a direct ratio to the degree of control the holding company has over bank facilities. If there are adequate alternative sources of credit you cannot coerce people into using it, but if there are not alternative sources of credit then you can use your control of credit to get control over manufacturing, too.

Mr. Martin. That is right.

Senator Douglas. So that you do go back to the other field of the bank holding companies, namely, that they may get too large a share of control of credit within many localities.

Mr. Robertson. That is true.


113. M. Jesse & S. Seelig, supra note 81, at 11.
Section 2(a) of the Act defined a bank holding company as:

any company (1) which directly or indirectly owns, controls, or holds with power to vote, 25 per centum or more of the voting shares of each of two or more banks or of a company which is or becomes a bank holding company . . . or (2) which controls in any manner the election of a majority of the directors of each of two or more banks . . . .114

By limiting application of the Act to companies controlling two or more banks, the Act continued to exempt one-bank holding companies from federal regulation. At the time the Act was passed, one-bank holding companies were primarily small, closely held, family corporations or small banks held by nonbanking corporations.115 Specific exemptions from coverage were also given for religious, charitable, and educational organizations as well as certain investment companies.116

The Act required all BHCs, as defined by the Act, to register with the Board of Governors. Section 3(a) required Board approval of BHC acquisition of more than five percent of any bank's voting shares. The Act also required Board permission for the formation of a new holding company, for nonbank company's acquisition of all or substantially all of the assets of a bank, and for the merger of any two bank holding companies.117

Section 4 of the Act called for BHCs to divest themselves of nonbanking affiliates within two years and to refrain from any future acquisition of such enterprises.118 The Act exempted from divestiture companies whose activities were all in the financial, fiduciary, or insurance areas and which the Board determined to be "so closely related to the business of banking or of managing or of controlling banks as to be a proper incident thereto."119

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117. Id. § 3(a)(1)-(4), 70 Stat. at 134 (codified as amended at 12 U.S.C. § 1842(a) (1982)).
118. Id. at § 4(a)-(b), 70 Stat. at 135-36 (codified as amended at 12 U.S.C. § 1843(a) (Supp. V 1987)).
As Professors Jessee and Seelig have noted, this Act was, like most pieces of legislation, a compromise. It satisfied neither those who feared the power of bank holding companies nor those who opposed all types of regulation. In the Federal Reserve Board's first report to Congress two years after passage of the Act, and in each of its Annual Reports thereafter, the Board urged Congress "to subject a holding company to the provisions of the 1956 act if it owned 25 percent or more of the stock of a single bank; and to include not only corporations, business trusts, and the like, but also long-term trusts" as well as firms previously exempted and operated for religious, educational, or charitable purposes. Except for the expansion of the definition of a BHC to include the ownership of a single bank, Congress adopted these changes in 1966. In addition, Congress made section 3(c) more specific concerning competitive effects, and repealed section 6.

The Board continued to urge Congress to extend coverage of the Act to one-bank companies. The one-bank exemption caused a significant increase both in the number of one-bank holding companies and the diversity of the activities that they pursued. One-bank holding companies grew for the same reasons BHCs first developed. They allowed market forces to sidestep regulatory forces. Indeed, changes in technology and market dynamics greatly encouraged the growth of one-bank holding companies. Competition for savings from other types of financial institutions and customer demands for services such as credit cards, record keeping, and computer services all combined to provide strong incentives for expansion. Throughout the 1960s, competition for savings from other types of financial institutions had grown so intense, and technological development had so changed the nature of banking, that the generic holding company was a logical outgrowth of failure to include the one-bank holding company under the 1956 Act." Pressure, however, continued to build to include one-bank holding companies within the purview of the Act.

The position taken by opponents of the 1970 amendments to the 1956 Act reflected the significance of the above-mentioned market forces.

120. M. JESSEE & S. SEELIG, supra note 81, at 11. Some felt the legislation was a victory for group banks. But most bankers were not so optimistic. Some provisions, such as the prohibition of interstate banking, were clearly punitive. Others hindered normal credit and investment operations. Compliance would entail much . . . expense. And the wide discretionary power vested in the Federal Reserve Board would raise a great deal of dispute and many problems for all parties involved.

Id.
121. Id. at 12.
123. Id. §§ 7, 9, 80 Stat. at 237, 240.
125. HOUSE COMM. ON BANKING, FIN., AND URBAN AFFAIRS, 98TH CONG., 1ST SES., FORMATION AND POWERS OF NATIONAL BANKING ASSOCIATIONS—A LEGAL PRIMER 5-17 (Comm. Print 1983) (prepared by R. Natter of the American Law Division).
126. Note, supra note 124, at 1209.
127. Id.
Opponents of the amendments contended that the responsive and procompetitive nature of the one-bank BHC had enabled the banking industry to survive the challenges of the 1960s. Proponents, however, had argued that unregulated one-bank BHCs threatened to destroy the wall traditionally perceived as separating commerce and banking.\(^{128}\)

Congress passed the 1970 amendments primarily to bring one-bank holding companies under the Board's control.\(^{129}\) In addition, the 1970 amendments made several other important changes including (1) the expansion of the definition of "control" of a company to include more indirect forms of control; (2) the modification of the definition of "bank" to include any institution that is organized under the laws of the United States or any state, that accepts deposits that the depositor has a legal right to withdraw on demand, and that engages in the business of making commercial loans;\(^{130}\) (3) the change in wording of the directives pertaining to permissible nonbanking activities; and (4) the introduction of a public welfare balancing standard for assessing the value of the related nonbanking activities.

The amendments' expanded test for control gave the Federal Reserve Board authority to determine that a company was a bank holding company even when the applicant had control of less than twenty-five percent of an affiliate's stock.\(^{131}\) The impetus for this change stemmed from Congress's recognition that the complexities inherent in contemporary business practices allowed a company with widely diffused stock ownership to be controlled by an individual possessing only a minority percentage of shares.\(^{132}\) Under the 1970 standard, an applicant is considered to be a bank holding company if it directly or indirectly exercises a controlling influence over the management or policies of the affiliate.\(^{133}\) This change gave the Board the flexibility to prevent potential abuse of the bank holding company device.

\(^{128}\) Edwards, *The One Bank Holding Company Conglomerate: An Analysis and Evaluation*, 22 VAND. L. REV. 1275, 1292 (1969) ("[T]he likelihood of achieving economies is much greater when banks are joined with other financial institutions, since the economic interrelationships among the products of banks and financial institutions are much greater.").

\(^{129}\) Because "company" remained the operating word in the statute, not all loopholes were closed. Although the 1956 provision exempting partnerships from the definition of "company" was eliminated, Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, § 101 (b)(3), 84 Stat. 1762 (codified at 12 U.S.C. §§ 1841-50 (1982)), individual ownership was not addressed. This proved to be particularly significant in chain-banking situations when one person controls a string of banks. The need to close this loophole was a principal motivator for Congress to pass the Change in Bank Control Act of 1978, Pub. L. No. 95-630, § 602, 29 Stat. 3683 (codified at 12 U.S.C. § 1841 (1982)).

\(^{130}\) This definition effectively exempts foreign banks that do business with the United States only as an incident to their foreign activities. More importantly, under the Garn-St. Germain Depository Institutions Act of 1982, institutions chartered by the Federal Home Loan Bank Board or insured by the Federal Savings and Loan Insurance Corporation are also explicitly excluded. Pub. L. No. 97-320, §§ 333, 404(a)(1), 96 Stat. 1504, 1511 (codified at 12 U.S.C. §§ 24, 1841(c), (1982)).


\(^{132}\) See id.

\(^{133}\) Id. The Act provides that companies controlling five percent or less of the stock of an affiliate be considered outside this test. Id.
Congress made several important alterations affecting the scope of permissible nonbanking activities in section 4. This section expanded the Federal Reserve Board's authority to make decisions concerning the appropriateness of nonbank acquisitions by BHCs. It deleted the 1956 exemption for companies of a “financial, fiduciary or insurance nature.” The 1970 amendments directed the Board to authorize activities that are "so closely related to banking or managing or controlling banks as to be a proper incident thereto." The amendments also deleted from the original clause the words "business of banking" in favor of simply "banking."

The House and Senate disputed the expansion of the BHCA's applicability and the indirect expansion of the Board's powers. The dispute was apparent from their inability to agree upon original versions of the bill. The final language of section 4(c)(8) was the product of the conference committee's consideration of two drafts: the first was that of the House Conferees, the second was that of Chairman Burns. House members were concerned with the inclusion of "a negative laundry list" that enumerated specific activities in which one-bank holding companies and their subsidiaries were not to engage. This reflected the general sentiment in the House that BHCs should be restricted to the more narrow standards of the 1956 Act. In conference, a majority of House members finally abandoned the "laundry list" in exchange for an agreement from the Senate to include the "closely related standard."

136. This change was requested by then-Chairman of the Board Arthur Burns, who wrote: "We have in mind indicating that a non-bank subsidiary's activities should be related to banking (or managing or controlling banks) generally, rather than to the specific business carried on by the subsidiary banks of the particular holding company involved." Letter from Arthur Burns to Rep. Wright Patman (Nov. 25, 1970), reprinted in 116 CONG. REc. 41,959 (1970).
137. For an in-depth discussion, see Note, supra note 124, at 1209, 1220.
138. 115 CONG. REc. 33,133-34 (1969). The "laundry list" prohibited one-bank BHCs from maintaining travel agencies, providing data processing, providing auditing or other professional accounting services, selling mutual funds, and operating insurance agencies.
139. The Senate, along with the Federal Reserve Board, had sought to adopt a standard that called for an activity to be "functionally related" as a means of creating maximum flexibility. The Senate bill originally included this language. S. REP. No. 1084, 91st Cong., 2d Sess. 12 (1970).

One commentator reviewing the proceedings concluded that in the overall context of the situation "the decision to retain the 'closely related' language of the 1956 Act marks a compromise between the stringent bill passed by the House and the Senate's more liberal counterpart, and would seem to require the same interpretation recorded in the 1956 Act." M. JESSEE & S. SEELIG, supra note 81, at 30; see also G. FISCHER, supra note 66, at 151.

The Federal Reserve Board, however, has indicated that it intends to give this section a broader interpretation, one that would in essence construe the provision as though the "functionally related" language had been adopted. M. JESSEE & S. SEELIG, supra note 81, at 30. Shortly after the new legislation was signed into law, the Board proposed to amend Regulation Y. See 21 Fed. Reg. 10,473 (1956) (proposed Dec. 29, 1956). The amendment contained the Board's interpretation and policies toward holding companies, setting forth the nonbanking activities that it regarded as falling within the scope of the new section 4(c)(8). Id.
Congress delegated additional regulatory duties to the Federal Reserve Board by modifying certain procedural requirements. Section 4 includes the language “by order or regulation.” Thus, the Board can determine which activities are closely related to banking by either rule or order. The new language also provides for due notice and opportunity for hearings. The oral hearings are not, however, required on all applications. Precisely when the Board may dispense with oral hearings and when it must grant them has proven to be ambiguous and has generated litigation and controversy.

The other major change in the 1956 Act was the introduction of a public benefits test. In deciding whether a nonbanking activity is closely related to banking, the Board is required to consider whether the activity's performance by a nonbank subsidiary of a bank holding company:

- can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.

The Act did not include more concrete guidelines as to how the Board should apply this standard. At the time of enactment, members of Congress disputed how this new test would affect the resolution of applications by the Reserve Board. A minority believed that the imposition of this test made the standard more difficult than the 1956 law because it provided a second obstacle to approval. The majority, however, believed that the public benefits test would free the Board of the restrictive precedents established under the present Act. From a procedural point of view, the addition of this test ensured at least the possibility of a hearing. The Board could by rule or order determine what activities were closely related to banking. But each individual applicant nonetheless had to be prepared to show that engaging in an approved activity would also meet the public benefits test on a case-by-case basis.

The Fed's restrictions on acquiring nonbank interests were, for a time, circumvented by the so-called nonbank bank loophole. Many BHCs sought to acquire thrift institutions and other banking entities that fell outside the language of the statute. The Board reacted aggressively and interpreted the BHCA in a manner that extended its regulatory authority to cover such entities. In a unanimous decision, the United States Supreme Court struck down the Fed's interpretation, appropriately leaving it to Congress, rather

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141. This provision is the basis for the Board's issuance of Regulation Y.
142. "[S]hares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking..." 12 U.S.C. § 1843(c)(5) (1982).
143. These procedural issues are dealt with in detail in Part III, infra.
145. 116 Cong. Rec. 41,950 (1970). See Note, supra note 124, at 1222 (adding “public benefits” test that requires Federal Reserve Board use two separate tests in deciding cases under section 4(c)(8)).
than the Fed, to close this loophole.\textsuperscript{147} In 1987 Congress responded by passing the Competitive Equality Banking Act of 1987 that, among other things, closed the nonbank bank loophole.\textsuperscript{148}

\begin{center}
\textbf{C. The Fed and Adjudication}
\end{center}

Under sections 3 or 4 of the BHCA, bank holding companies may request permission to expand their banking interests or to acquire nonbanking interests through applications to the Fed. These applications can have a variety of substantive effects. From the point of view of the agency, they may raise new issues that have important policy implications. The Fed must consider whether its decision to grant or deny these applications advances the primary purposes of the BHCA—preventing the anticompetitive effects of BHCs and limiting the concentration of power that BHCs represent. From the point of view of the regulated, expansion or acquisition often can make a significant difference between levels of financial success or between success and failure. As a legal organizational form, the BHC has long provided an opportunity for institutions to avoid various state and federal restrictions on geographic diversification and can also serve as a vehicle for product expansion.\textsuperscript{149} Indeed the flexibility of the BHC concept has done much to change both the structure and regulation of banking.\textsuperscript{150}

The granting or denying of these applications can have important and often adverse effects on third parties as well, particularly the competitors of applicants. There is often a strong incentive for competitors to be sure that the Board's decision is correct. They often can shed light on the merits of a pending application by participating in the proceeding, but they also may have a significant interest in delaying the decision, especially if it is likely to be adverse to their interests.

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\textsuperscript{148} This Act closed the "nonbank bank" loophole by redefining the term "bank" in the Bank Holding Company Act as an institution that either is insured by the Federal Deposit Insurance Corporation (FDIC) or both "(i) accepts demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others; and (ii) is engaged in the business of making commercial loans." Pub. L. No. 100-86, § 101, 101 Stat. 522, 554 (codified at 12 U.S.C. § 1813 (Supp. V 1987)). The Conference Report states that a demand deposit includes any deposit account from which funds are transferred automatically and deposits withdrawable by check or similar means for payment to third parties including NOW accounts as well as accounts providing for electronic transfers to third parties. Commercial loans include broker call loans, the purchase of retail installment paper, loans to securities dealers, and overdrafts in the account of a business customer. The Act required immediate divestiture for companies that become bank holding companies as a result of the Act and that acquired, between March 5, 1987, and the enactment of the Act, a nonbank bank that is defined under the Act as a "bank." See H.R. CONF. REP. No. 261, 100th Cong., 1st Sess. 122-26, \textit{reprinted in} 1987 U.S. CODE CONG. & ADMIN. NEWS 588, 591-94.
\textsuperscript{149} The United States Supreme Court has interpreted the McFadden Act in such a way as to encourage geographic expansion on the part of national banks and to increase competition in the securities industry. See Clarke v. Securities Indus. Assoc., 479 U.S. 388, 407-08 (1987).
\textsuperscript{150} See G. Fisch, \textit{supra} note 66, at 165.
\end{flushright}
The competitive forces that encourage BHCs to submit applications, the agency's regulatory goals, and the interests of competitors all shape the Fed's procedural and substantive responses. These regulatory responses, in turn, affect and are affected by the time and resources it takes to process applications. BHC applications have continued to flow to the Fed in record numbers in the 1980s. Their numbers suggest both the importance and extent of the changes occurring in the banking industry. They also indicate why it is important that the Fed rule on these applications in an expeditious manner.

Section 3 of the Act was passed to deal with BHC expansion. Section 3 requires prior approval from the Board before BHCs may be formed or additional banks acquired. No application can be approved if it violates the antitrust standards of either the Sherman Act or the Clayton Act. In addition, the Board must consider the safety and soundness of these transactions. In the nonbanking area, holding company expansion is subject to even more strict requirements and, as we shall see, more specific, statutorily mandated procedures as well.

The following Part deals first with the procedural hearing requirements of section 3, namely those that are necessary before the Board can grant or deny applications for the formation of new BHCs or applications for the acquisition of a bank by a BHC. It then examines the hearing

151. Professor Fischer recently wrote:
   In just six years, the number of BHCs had very nearly tripled, but this was merely one element of a vast change in the American banking structure begun in the early 1980s. Broader branch banking, nonbank banks, and interstate banking were to change the BHCs movement's thrust from intrastate to interstate and ultimately to nationwide banking. This was to be one of the most challenging periods faced by the Federal Reserve Board in administering the BHCA, and, as this is written in 1986, it is far from over.

G. Fischer, supra note 66, at 238-39. Similarly, a report prepared by the Federal Reserve Board's own staff notes:

The Federal Reserve's domestic supervisory and regulatory activities should be considered in the context of two significant trends within the holding company movement. First, the number of bank holding companies and the percentage of commercial bank assets controlled by such companies have increased significantly since the passage of the 1970 Amendments. By bringing companies that owned just one bank under the statutory definition of bank holding companies, these Amendments increased the number of such companies supervised by the Federal Reserve from 121 in 1970 to 1,567 in 1971. In 1975, there were 1,821 bank holding companies controlling 68 percent of all commercial bank assets. By 1985, the number of companies had increased to 6,458 and such companies controlled over 90 percent of all commercial bank assets. While the overwhelming majority of bank holding companies have consolidated assets of less than $150 million, over 80 percent of aggregate holding company assets are held by large regional and multinational companies with consolidated assets in excess of $1 billion.


153. Id.
procedures for section 4 applications that involve the control or the acquisition of ownership interest in nonbanks by BHCs.

1. Section 3 Procedures—The Expansion of Banking Interests

Prior approval by the Board is required before: (1) any company becomes a BHC; (2) any bank becomes the subsidiary of a BHC; (3) any BHC acquires ownership or control of more than five percent of any class of voting shares of any bank holding company; (4) any BHC or subsidiary (except a bank) acquires the assets of a bank; or (5) any BHC merges or consolidates with any other bank holding company. In acting on section 3 applications, the Board must apply statutory factors which include an evaluation of the competitive impact of the transaction, the convenience and needs of the community to be served, and the financial and managerial resources and future prospects of the BHC and the banks concerned. Section 3 of the BHCA sets forth the procedures governing these applications. The Board's own regulations are set forth in Regulation Y.

Pursuant to the Board's regulations, applications for BHC formation or expansion are filed initially with the Federal Reserve Bank of the district in which the head office of the bank holding company is located, rather than directly with the Board. Prior to this filing, notice must be published in a general circulation newspaper. The Reserve Bank then investigates and prepares a report on the relevant facts; the report is submitted to the Board along with the Reserve Bank's recommendations on the application. Reserve Banks usually cooperate with applicants in an informal way and help to "clean up" applications before they are sent on to the Board with their recommendation. After the Board receives the Reserve Bank's report and recommendations, the Board's staff prepares comments for the Board. The Board may then take "such action as it deems appropriate in the public interest." As a recent Board report makes clear, there is a good deal of give and take in this process:

The scrutiny involved in the applications process provides an important discipline on the behavior of banking organizations. Thus, applicants are often responsive to suggestions from the Federal Reserve for improvements in their condition or for changes to their proposals in order to limit adverse effects and thereby increase the chances for approval. Applicants often take action to improve their condition even before filing proposals.

While only a relatively small percentage of proposals is denied, a significant number are modified after filing. Others are

154. Id. § 1842(c).
155. Id. § 1842(a).
156. Id. § 1842(b).
158. Id. § 262.3(c).
159. Id. § 262.3(b)(vi).
160. Id. § 262.3(d).
161. Id.
162. Id. § 262.3(f).
withdrawn, at least until remedial changes can be effected. Through this process, banking organizations are encouraged to constrain their expansion to appropriate levels, to avoid excessive risk-taking and, if necessary, to improve their condition. 163

This kind of negotiated regulation usually is not susceptible to formal or even informal adversarial hearings. Negotiated regulation increases efficiency and provides the agency with an opportunity to tailor its decisions to the individual applicant. As discussed in Part III, however, problems may arise, particularly if the agency imposes conditions or makes informal suggestions that arguably go beyond its authority or represent a policy that has not been officially established or published. A party eager to close a deal may not feel it has much negotiating room. In such cases, the Board has superior, indeed coercive, bargaining power.

The regulations also provide for comments and timely written requests for a hearing. Such requests must include a statement explaining why a written presentation would not suffice, identifying specifically any disputed questions of fact, and summarizing the evidence that would be presented at a hearing. 164 If adverse comments are received from any interested party, the applicant receives a copy of the comments and an opportunity to respond in writing. 165 If there are no adverse comments, the matter is ready for Board action. 166

In addition to the Board's regulations, section 3 of the Act requires the Board to give notice to the Comptroller of the Currency if a national bank is involved or to the relevant state supervisory authority if a state bank is involved. 167 Their "views and recommendations shall be submitted within thirty calendar days of the date on which notice is given or within ten calendar days of such date if... an emergency exists requiring expeditious action." 168

If a section 3 hearing is statutorily required, that is, if the Board issues a denial within thirty days, the Federal Administrative Procedure Act 169 requires a full-blown, trial-type adjudicative hearing pursuant to the

163. BHC Hearings, supra note 151, at 151 (Board Report, at B-6) (emphasis added).
164. 12 C.F.R. § 262.3(e) (1988).
165. Id.
166. Id.
168. Id. The statute then goes on to state:
If the thirty-day notice period applies and if the Comptroller of the Currency or the State supervisory authority so notified by the Board disapproves the application in writing within this period, the Board shall forthwith give written notice of that fact to the applicant. Within three days after giving such notice to the applicant, the Board shall notify in writing the applicant and the disapproving authority of the date for commencement of a hearing... Any such hearing shall be commenced not less than ten nor more than thirty days after the Board has given written notice to the applicant of the action of the disapproving authority. The length of any such hearing shall be determined by the Board, but it shall afford all interested parties a reasonable opportunity to testify at such hearing. At the conclusion thereof, the Board shall, by order, grant or deny the application on the basis of that record made at such hearing.

Id.
Board's own rules of practice for hearings. These hearings require a hearing examiner, the admission of parties, testimony under oath, cross-examination, rules of evidence, and ultimately, a decision on the record. The Board has the right to waive this hearing for emergencies, such as the need for immediate action to prevent a bank failure. When no section 3 statutory hearing is required, the Board can, at its discretion, grant requests for a formal hearing submitted by interested parties even if the Comptroller or a state regulatory authority does not object to the application.

As a practical matter, the Board seldom grants such hearings. It may be that once an applicant believes its application will be denied, it withdraws the application to make whatever changes are necessary. The lack of hearings also may be due to the fact that if the Comptroller or state authority involved wishes to deny the application, she simply may wait for the thirty-day period to run and then express her disapproval. This does not mean that there will be no hearing, but that the Board will grant a hearing at its discretion.

Section 3 requires the Board to act on applications for approval within ninety-one days of the submission of the application. Although the Board's regulations trigger the rule at specific times, there has been considerable dispute as to when the ninety-one-day period begins to run.  

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170. See 12 C.F.R. § 263 (1988); see also id. at §§ 261.3(a), 263.4 (requiring notice of formal hearings to be published in the Federal Register).
174. See 12 U.S.C. § 1842(b) (1982) (disapproval of application by Comptroller of the Currency or state authority within 30-day notice period triggers hearing); see also 12 C.F.R. § 262.3(e) (1988) (requests for hearings must be "before the 30th day after the date notice is first published").
175. Section 3 states:

In the event of the failure of the Board to act on any application for approval under this section within the ninety-one-day period which begins on the date of submission to the Board of the complete record on the application, the application shall be deemed to have been granted.

12 U.S.C. § 1842(b) (1982). Section 4 of the BHCA contains a similar provision that applies to applications submitted by bank holding companies under section 4(c)(8). See id. § 1843(c).
176. For the purpose of computing the ninety-one-day period, the records shall be regarded as complete on the latest of:

(i) the date of receipt by the Board of an application that has been accepted for processing by the Reserve Bank;

(ii) the last day provided in any notice for receipt of comments and hearing requests on the application;

(iii) the date of receipt by the Board of the last relevant material regarding the application that is needed for the Board's decision, if the material is received from a source outside of the Federal Reserve System; or

(iv) the date of completion of any hearing or other proceeding [ordered by the Board].

12 C.F.R. § 225.14(g)(2) (1988). These regulations apply to both section 3 and section 4 applications. See id. § 225.29(b).
177. See Republic of Texas Corp. v. Board of Governors of Fed. Reserve Sys., 649 F.2d 1026, 1034-43 (5th Cir. 1981) (discussing "proper operation of 91-day rule").
Dates for commencement of the ninety-one-day period have emerged from court decisions interpreting the rule.\textsuperscript{178} Because the ninety-one-day period may be affected by processing events, including the publication of notice that the application has been submitted, or the Reserve Bank's acceptance of the application for forwarding to the Board, the Board's regulations also provide detailed rules regarding each step of the application process.\textsuperscript{179} Despite these rules and clarifications, a number of questions arise. When circumstances and economic conditions change, new information is often required. Can the Board begin the ninety-one-day period anew by requesting new information?\textsuperscript{180} If so, how significant must this request for information be? Even with these ambiguities, applications that are not withdrawn are processed relatively efficiently.\textsuperscript{181} In part this is because of the strong

\textsuperscript{178} See Republic of Texas Corp., 649 F.2d at 1037 (noting courts differ in determining what material is relevant and necessary to begin the ninety-one-day period).

\textsuperscript{179} For example, the Board's regulations regarding processing of applications received under section 3 of the BHCA provide that, upon receipt of an application, "the Reserve Bank shall promptly furnish notice" of the application to the appropriate banking supervisor, and "notice of the application shall be promptly sent to the Federal Register for publication." 12 C.F.R. § 225.14(b) (1988). The regulation also provides that the Federal Register notice shall invite public comment for a period of no longer than 30 days. Id.

The regulations also provide that within ten business days of an application's receipt by the Reserve Bank, the Reserve Bank shall accept the application for processing or notify the applicant that additional information is necessary to complete the application. Id. § 225.14(c). If the application is resubmitted with the requested additional information, the Reserve Bank, under the Board's regulations, must either accept the application for processing or return it within five business days, if the application continues to be incomplete. Id. Finally, the Board's regulations provide that upon acceptance of the application, the Reserve Bank immediately must forward the application to the Board. Id.

\textsuperscript{180} There are other ambiguities as well. For example, "[t]he effect of the lapse of the ninety-one day period on the rights of protestants to an application is unclear." P. Heller, \textit{Federal Bank Holding Company Law} § 7.04, at 7-25 (1986). The Act seems to place the burden on these protestants to show that statutory criteria have not been met. See id; see also BankAmerica v. Board of Governors of Fed. Reserve Sys., 596 F.2d 1368, 1377-79 (9th Cir. 1979) (finding a third party's protest was relevant because the protest "contain[ed] information relevant to public benefit criteria the Board must apply"). It also is unclear whether an acquired company is entitled to the requirements of the rule or whether those rights could be waived by the applicant.

In addition, if the ninety-one-day period expires and approval is thus assumed, how can the applicant proceed to complete the transaction? This question is particularly relevant if the Board does not believe the ninety-one-period period has expired. If an applicant asks the Board for a ruling and the Board finds the ninety-one-day period has not elapsed, is the Board's order appealable or must the applicant await the Board's final order? Given that acquisition or merger deals are fluid and often require very prompt action, the expiration of the ninety-one-day period could have a significant impact. See generally BankAmerica, 596 F.2d at 1374-75.

The applicability of the ninety-one-day rule to acquisitions that Congress prohibits also poses problems. See, e.g., North Lawndale Economic Dev. Corp. v. Board of Governors of Fed. Reserve Sys., 553 F.2d 23, 26-27 (7th Cir. 1977) (deem application for engaging in nonbanking interests granted for Board's failure to act within the ninety-one-day period).

\textsuperscript{181} The staff of the Federal Reserve reports:

The Board's Regulation Y and internal operating procedures make timeliness a principal objective in the applications process. Although the Act provides that the Board may take up to 91 days after the submission of the complete record, procedures were voluntarily developed in 1971 that established internal processing periods substantially shorter than those required by statute. Since that time, the internal goal of 90 calendar days has been reduced to 60 days and processing
incentives that exist to negotiate rather than to litigate over these applications. As we shall see in Part III, the ability to start and stop the running of the ninety-one-day rule is significant in the bargaining relationship that develops between the staff and the applicant.

2. **Section 4(c)(8) Procedures**

In contrast to section 3 cases, section 4(c)(8) cases involve nonbanking interests. Section 4(c)(8) authorizes Board approval only of BHC acquisitions of nonbanking entities whose activities are "closely related" to and a "proper incident" of banking. The acquiring holding company must apply to the Board for approval under this nonbank provision of the Act.

The BHCA permits bank holding companies to acquire shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto . . . . In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as efficiencies have continued. In addition, the Board has developed a "notification" process for certain bank holding company proposals that normally do not present any issues. Thus, a bank holding company need only notify the Reserve Bank—rather than receive prior approval—for the acquisition of a de novo permissible nonbanking firm, the acquisition of a "small" nonbanking going concern, or the redemption of the bank holding company's shares. After a waiting period of 15-30 days from acceptance, the proposal may be consummated unless objected to by the Reserve Bank. Several hundred such proposals are processed by the System each year.

As indicated above, the Board has, over time, been concerned that applications be processed in as timely a manner as possible, and in the early 1970s established an objective of processing 90 percent of all applications within 90 days. The Board modified this goal in 1983 to process 90 percent of all applications within 60 days. These processing objectives have been met every year since 1977. In 1985, the Federal Reserve processed 96 percent of all applications within the 60 day period. During 1986, the Board processed a total of 1,681 applications under the BHCA. The Board processed over 95% of those applications within the 60-day period provided in the Board's regulations. The remainder of the cases were considered by the Board within the ninety-one-day rule. See **Annual Report of the Board of Governors of the Federal Reserve System** 196, 198 (1986).


183. Recently, one court noted that the Federal Reserve System was subjected to "an avalanche of applications by bank holding companies seeking to establish hundreds of deposit taking institutions across state lines. . . . " Florida Dept. of Banking v. Board of Governors of the Fed. Reserve Sys., 760 F.2d 1135, 1138 (11th Cir. 1985). To some extent, this activity was due to the so-called nonbank bank loophole, a loophole that has now been closed by the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 101, 101 Stat. 522, 554 (codified at 12 U.S.C. § 1813 (Supp. V 1987)). Nevertheless, section 4(c)(8) of the BHCA continues to be an important vehicle for nonbank acquisitions, particularly those involving insurance, real estate and securities activities.
undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices . . .\textsuperscript{184}

In practice, the Board’s “so closely related to banking . . . as to be a proper incident thereto” determination is based upon other provisions of the BHCA,\textsuperscript{185} as well as regulations that the Board formulated and adopted in its Regulation Y.\textsuperscript{186} Consequently, the Board typically evaluates applications by pre-existing and generalized standards.

The second determination—whether the benefits to the public can reasonably be expected to outweigh the possible adverse effects—must be made on an application-by-application basis “after due notice and opportunity for hearing.” Not surprisingly, existing competitors and trade associations often oppose a holding company’s proposed entry into “their” market on public benefit grounds. Although the issues inherent in the public benefit determination often may be adequately aired in written submissions to the Board, opponents of a holding company’s application may allege “adverse effects” and demand that the Board permit discovery and conduct a full evidentiary hearing on the matter. Whatever the merits of these requests, providing trial-type hearing procedures virtually guarantees a protracted and more expensive application process; conversely, by denying a protestant’s request for a hearing, the Board runs the risk of providing the protestant with a viable issue for judicial review. The question of when to grant a protestant’s request for a hearing looms as a procedural obstacle for both the Board and expanding holding companies.\textsuperscript{187}

This problem created a split among the federal circuits reviewing the Board’s section 4(c)(8) determinations. All courts recognize that an agency need not order a hearing unless it determines that there are disputed issues of material fact whose resolution will bear on the matter at hand.\textsuperscript{188} Put another way, courts agree that the Board is not obligated to order a hearing on an application if a hearing would serve no purpose.\textsuperscript{189} The circuit courts


\textsuperscript{185} See P. Heller, \textit{supra} note 181, § 5.01(1)-(22), at 7-24.


\textsuperscript{187} Professors Helfer and Morse contend that because of the confusion over when a hearing is necessary, opponents of holding company acquisitions can challenge applications and delay resolution for months or even years with expensive and time-consuming administrative proceedings of questionable value. See Helfer & Morse, \textit{Hearings Under Section 4(c)(8) of the Bank Holding Company Act}, 101 BANKING L.J. 50, 64 (1984). Helfer and Morse advocate streamlining the application process by creating stages of review in which the members determine if there is a legitimate factual dispute that has bearing on the Board’s decision before resorting to an expensive evidentiary hearing. The Board appears to have informally adopted this procedure. See \textit{generally} Independent Ins. Agents of Am., Inc. v. Board of Governors of the Fed. Reserve Sys., 658 F.2d 571 (8th Cir. 1981) (remanding for evidentiary hearing); Connecticut Bankers Ass’n v. Board of Governors of the Fed. Reserve Sys., 627 F.2d 245 (D.C. Cir. 1980) (upholding of denial of request for hearing on grounds that no material issue of fact existed).

\textsuperscript{188} See, e.g., Ohio Power Co. v. Federal Energy Regulatory Comm’n, 744 F.2d 162, 170 (D.C. Cir. 1984).

have disagreed, however, as to the type of information that a protestant must initially proffer to establish a disputed issue of fact.

In Independent Insurance Agents of America, Inc. v. Board of Governors of the Federal Reserve System,190 the Independent Insurance Agents of America (IIAA) opposed Mercantile Bancorporation's application to sell credit-related property and casualty insurance through a nonbank subsidiary.191 Although these activities were among those approved by the Board and listed in Regulation Y as being "closely related" to banking, the IIAA nevertheless challenged the acquisition on public benefit grounds, contending that in this case the possible adverse effects outweighed the public benefits.192 Specifically, the IIAA contended that customers would purchase insurance from the subsidiary to improve their chances of getting a loan from the bank, that the insurance would be priced above competitive levels, and that consumers would be deprived of the services of an agent.193 The Board requested the protestants (IIAA) file detailed descriptions of their objections and the issues they wished to explore in a hearing.194 After requiring Mercantile to submit additional information in response to the protestant's charges, and after allowing the protestants to respond to Mercantile's additional submissions, the Board denied the request for a hearing and approved the application.195

The Eighth Circuit vacated the approval, reasoning that "the Board's refusal to hold an evidentiary hearing . . . prevented the IIAA from substantiating its claim that [Mercantile's] activities would not result in overall net benefits to the public."196 Despite the Board's seemingly careful review of written submissions and resubmissions, the court rejected the argument that the IIAA's objections were mere speculation. The court stated that "[t]he Board cannot deny a request for an evidentiary hearing when, as here, it is presented with legitimate contentions which place material facts in dispute."197 Upon remand, the Board conducted a full evidentiary hearing before again approving Mercantile's application—over two and one-half years after the Board had initially approved the proposal.198

In contrast to the Eighth Circuit, the District of Columbia Court of Appeals has adopted a more restrictive view of a protestant's right to an evidentiary hearing. In Connecticut Bankers Association v. Board of Governors of the Federal Reserve System,199 the District of Columbia Circuit upheld the Board's decision to deny Connecticut Bankers Association's request for a hearing, stating that "a protestant does not become entitled to an evidentiary hearing merely on request, or on a bald or conclusory allegation that such a dispute exists. The protestant must make a minimal showing that

190. 658 F.2d 571 (8th Cir. 1981).
191. Id. at 573.
192. Id. at 575.
193. Id.
194. Id.
195. Id. at 573.
196. Id. at 576.
197. Id.
198. Id.
199. 627 F.2d 245 (D.C. Cir. 1980).
material facts are in dispute, thereby demonstrating that an ‘inquiry in depth’ is appropriate.” The protestors had opposed Citicorp’s application to establish a nonbank subsidiary through which it planned to sell credit-related insurance and second-mortgage loans. Although these activities were approved by the Board’s Regulation Y, the Association alleged that the adverse effects of the operation—undue concentration of economic resources, diminution of competition, and unfair competition against Connecticut banks—would outweigh the public benefits.

In Connecticut Bankers, the Board had required the applicant, Citicorp, to provide specific and detailed answers to the protestant’s questions, allowed the protestant to make an informal oral presentation to the Board’s staff to develop and clarify issues of fact, and reviewed written arguments in support of the hearing request before denying the request “because there [were] no facts in dispute that bear upon the determination the Board must make.” Although the District of Columbia Circuit remanded the case to the Board for further reconsideration of certain issues, it did not order the Board to conduct a hearing. The court observed that the protestant’s evidence of Citicorp’s great size and proliferation of lending subsidiaries alone did not raise issues of material fact, nor had the protestant offered any reason why the Board could not rely on Citicorp’s representation that it would not operate the subsidiary as a branch.

Unlike the Eighth Circuit, the District of Columbia Circuit was not of the view that “legitimate contentions . . . place material facts in dispute.” Instead, it required evidence—“as contrasted with mere possibility or speculation”—to dispute a fact the applicant asserted or denied. The District of Columbia Circuit also indicated that even when a protestant has raised an issue of fact, the Board need not grant a hearing if the issue is not material to the Board’s determination. Moreover, the Board’s conditioning its approval on the applicant’s acceptance of Board-imposed operating restrictions may also preclude the necessity of a hearing. Upon remand, the Board required Citicorp to file a written submission on how it planned to minimize the danger of unfair competition. Again concluding that there was no issue of material fact in dispute, the Board approved Citicorp’s application without a hearing.

200. Id. at 251.
201. Id. at 247.
202. Id.
203. Id. at 248.
204. Id. at 253.
207. Id. at 248.
209. Id. at 446. Both the Tenth and the Fourth Circuits appear to subscribe to the District of Columbia Circuit’s more restrictive view of a protestant’s right to a hearing under the nonbank exception to the BHCA. See Oklahoma Bankers Ass’n v. Federal Reserve Bd., 766 F.2d 140 (10th Cir. 1985); Independent Ins. Agents of Am., Inc. v. Board of Governors of the Fed. Reserve Sys., 646 F.2d 868 (4th Cir. 1981). Although considering a different portion of the BHCA, the Eighth Circuit recently relied heavily on the District of Columbia Circuit’s...
The way in which the court and the Board handled the hearing requirement clearly affected the pace of holding companies' nonbank expansion.\textsuperscript{210} The Board allows hearings only if a material issue of fact is in dispute and an evidentiary hearing is necessary to resolve it. This has resulted in infrequent adjudicatory hearings. We now turn to the informal bargaining phase.

III. Bargaining for Justice—Regulatory Conditions and Voluntary Commitments

Part III examines the Fed's informal decisionmaking, particularly its use of conditions and voluntary commitments. It first presents the three distinct regulatory phases Congress established in the BHCA's applications process. These phases are (1) the informational phase; (2) the bargaining phase; and (3) the adjudicatory or adversarial phase. Each phase is subject to its own model of dispute resolution. Part III then examines in detail the bargaining phase of the process, particularly the Fed's use of conditions and voluntary commitments. It also examines the assumptions that underlie this bargaining model, points out why that model is not fully applicable in an agency setting such as this, and makes recommendations to help ensure additional fairness without undercutting agency flexibility.

A. Three Models—An Overview

The Board's action at the preliminary stage of an application usually prevents the need for a formal or informal hearing. The Board routinely may approve an uncontroversial application. If an application is controversial, however, the Board may indicate to the applicant that problems exist with the initial submission. An applicant may withdraw the application at this preliminary stage, particularly if it appears that it is going to be denied. An applicant may revise and amend the application to respond to the staff's concerns. This phase of the administrative process is based less on a judgmental model and more on an informational model and, ultimately, on a bargaining or negotiation model of the administrative process.

An applicant may not have supplied the data and information necessary for the Board to act. The application is thus deniable because it is incomplete. At this preliminary stage of the proceeding, the agency staff simply is requesting information that the Board needs to consider the...
merits of the applicant's proposal and to reach the next, more judgmental part of the process. In its purest form, this phase of the process involves no disputes over facts or law. Of course, conflicts can arise during the informational phase. Disputes over the relevancy of the information sought and provided can reflect the applicant's and staff's differing theories of the case. At this point, the ninety-one-day rule comes into play. New requests for information toll the ninety-one-day period and thus extend the time period in which the agency must make its decision. Controversial cases—cases in which the theory of the case held by staff differs significantly from that of the applicant—can take more than ninety-one days to be resolved. Theoretically, the informational phase of the process should be distinct from the judgmental phases. In most instances, this is the case. It is possible, however, for an application to founder at this stage because of a disagreement over the relevancy or availability of requested information.

Once an application is informationally complete, the agency begins to consider its merits. The merits include not only what the applicant seeks to accomplish, but who the applicant is. The staff must consider not only the competitive effects of a proposed acquisition and the degree to which the nonbank that the applicant wishes to acquire is related to banking, but also the financial status of the applicant: can it successfully do what it seeks permission to accomplish? In addition, the Board must consider the longterm policy implications of granting or denying the application. At least three decisionmaking factors interact when the Board reaches the merits of an application: (1) the legal requirements of the Act; (2) the factual context of a particular application; and (3) the policy implications of allowing the applicant to pursue the course of action it proposes.

Once it reacts to the merits of the case, the Board adheres to a bargaining or negotiation model of agency decisionmaking. From a purely theoretical viewpoint, this model of dispute settlement differs from the adversarial model inherent in the adjudicatory hearings examined in Part II. Though perhaps oversimplified, especially as applied to the administrative process, Professor Gulliver's description helpfully captures some of the key differences between these two, pure models:

[t]he picture of negotiation is one of two sets of people, the disputing parties or their representatives, facing each other across a table or from opposite sides of an open space. They exchange information and opinion, engage in argument and discussion, and sooner or later propose offers and counter offers relating to the issues in dispute between them, seeking an outcome acceptable to both sides. The comparable picture of adjudication is that of two [or more] parties . . . who, separated from one another, face an adjudicator who sits in front of, apart from, and often raised above them. They address him, offering information, opinion, and arguments. Each seeks to refute the other's presentation and to persuade the adjudicator to favor his own case. Eventually the adjudicator pronounces his decision on the issues, often sorting out and summing up the information given to him and explaining
his judgment. Clearly, the crucial difference between the two models is the absence of the third-party decision maker who is present not only at the formal adjudications carried on at the Fed on rare occasions, but also at the more informal Board hearings. Given that final Board orders are subject to judicial review, that neutral third party theoretically may enter the process at a later point in the proceedings.

In reality, however, most Board proceedings, particularly at the early stages of the application process, more accurately fit within the negotiation or bargaining model. A decision made during the early stages of the process appears to be, and often is, a joint decision. The applicant, of course, wishes to have its application granted. The staff may wish to do so, but may be troubled by certain aspects of the proposal. They may suggest changes or condition approval upon commitments the applicant is willing to make. Each party can obtain only what in the end the other is prepared to allow. If staff and petitioner have a different view of the legal significance of the facts presented in a particular application, informal discussions and bargaining may enable one side to move closer to the other's point of view. Regulatory conditions and voluntary commitments often play a significant role in this phase of the process. Particularly from the applicants' point of view, conditions and voluntary commitments are the very currency of the negotiating process.

From the agency's viewpoint, a condition is a well-established regulatory device that enables it to tailor its decision to the peculiarities of the applicant, further a policy goal it wishes to achieve, or both. It allows the agency to grant the benefit that the applicant seeks, and to obtain some assurances in exchange. Conditions can be fact specific and peculiar to the individual applicant or represent a general policy that may or may not be implicated by the facts of the case. Because conditions usually appear in final agency orders, they are presumably supported by the administrative record, and their legality can be tested at the adversarial stage of the agency's proceedings and through judicial review.

Not all conditions necessarily require support by the record, nor are they always susceptible to judicial review. This is particularly true when conditions take the form of voluntary commitments. Such commitments often are not a part of the Fed's final order, nor are they eligible for judicial review. Voluntary commitments usually are found in letters of transmittal between the Fed and the applicant, and confidentiality may require that they not be included in the final order. If they are truly voluntary, they also may represent so fact-specific an agreement between the Board and the applicant that they have little general relevance and no real precedential effect. Such commitments often are the result of the bargaining phase of the regulatory process and represent requirements that were voluntarily accepted by the applicant to meet the Fed's applicant-specific regulatory concerns. In some cases, The Fed does not seek the commitments that are volunteered by applicants who hope to expedite the decisionmaking process and eliminate doubt concerning the appropriateness of their

proposal. As we shall see below, however, "voluntariness" is a complicated concept. In some contexts, a commitment may result from an applicant's sense that its application would be denied unless it "voluntarily" agreed to a condition that it thought was unwise, unnecessary, or even ultra vires.

Not all issues arising under sections 3 and 4 are resolved informally. The Fed occasionally uses full-blown formal hearings, as well as more informal adjudicatory hearings before the Board. These formal or informal hearings are based on an adversarial model of administrative law. They assume that there are disputes over facts, law, or policy, and that there is a need for a neutral third party to resolve them. Such decisions are subject to judicial review.

It is impossible to segregate the three phases of the administrative process. The informational, bargaining, and adjudicatory phases of dispute settlement, particularly as applied to the application process, overlap and intersect in many ways. We have already discussed how the informational needs of the agency can implicate the judgmental aspects of the bargaining process.\footnote{212. See supra text accompanying notes 176-82.} Similarly, the Fed's bargaining stage has adjudicatory overtones, particularly when what is in contention is not the significance of the facts, but the significance of broad questions of law and policy. Because the administrative staff inherently has greater bargaining power than the applicant, the staff takes on the qualities of an adjudicator as well as a negotiator. By resolving the legal questions themselves, the staff effectively can decide the case, particularly if time and circumstances preclude resort to the more adversarial phase of the process.

This is often the case. Most merger or acquisition opportunities require very prompt action, putting pressure on both the Board and the applicants to settle contentious matters quickly. Conditions and commitments expedite agreement, making appeals to the Board to resolve issues of fact, law, or policy unlikely. Applicants rarely resort to the courts or to the formal adjudicatory hearings provided under sections 3 and 4 because the deal struck in the negotiation will seldom survive litigation.

Board members tend to treat voluntary commitments as waivers of an applicant's arguments on the legal and policy issues inherent in their applications. Thus, they have a way of becoming a \textit{fait accompli}, making Board involvement in the policy implications of voluntary commitments unlikely and judicial review impossible. There is no need to build a record for purposes of judicial review if the commitment is a voluntary one; the applicant cannot agree to a commitment and then renege on the deal by going to court. Negotiated commitments, therefore, in effect often are as final as formally adjudicated orders.

Theoretically, the bargaining stage of the process should be different than the adjudicatory or adversarial phase. No third party determines the outcome of the bargaining phase. The only outcome is the one to which both disputants agree, even though their reasons for acceptance are likely to be very different. The Fed's legal monopoly on the regulatory benefits that applicants seek in section 3 and section 4 cases, however, can significantly diminish the relative bargaining strength of the applicant and,
in certain regulatory contexts, improperly convert the bargaining phase of the regulatory process into an adjudicatory one.

Of course, the nature of regulation properly militates against equality of bargaining positions between the regulated and the regulator. No one expects them to be equal. For example, Congress gave the Fed power to coerce the kind of behavior that the law requires from banks and bank holding companies. Nevertheless, our focus is on the bargaining process and the use of this process as a regulatory tool. It is important to understand both the advantages and the limitations of the informal bargaining process if the regulation is to occur within that context. An applicant's ability and opportunity to bargain are extremely important to the success of the application processes Congress established in the BHCA. Of vital importance is the decisionmaking flexibility that this process provides. In most cases, flexibility is preferable to the all-or-nothing consequences of either granting the application as requested, or denying it outright. The nature of an individually oriented application process allows an agency to tailor its regulatory powers to the case at hand.

Definite risks, however, attach to this kind of negotiated regulation. Not all negotiated outcomes are proper, particularly when the bargaining involves disputed issues of law and unarticulated or unclear Board policies. While most cases may be handled in a routine fashion, and are susceptible to negotiated decisions, difficult cases can raise serious questions concerning the substance of commitments and the extent to which they are voluntarily accepted. The process by which these commitments are made arguably should be more, rather than less formal. Certain kinds of regulatory outcomes are best achieved through the use of adjudicatory and rulemaking proceedings, rather than informal bargaining processes.

The remainder of this Article examines the contexts in which bargaining occurs and the kinds of conditions that can result. To provide a broad legal framework for our analysis of the appropriate limits of an agency's conditioning power, the next section sets forth the United States Supreme Court's recent approach to reviewing conditions imposed by Congress when exercising its spending power. With this as background, we then examine the use of conditions and commitments at the agency level in general, and at the Fed in particular.

B. Unconstitutional Conditions and the Spending Power

Conditions have always been an important Congressional regulatory tool and a source of considerable governmental power. This form of regulatory power has grown as the power of the government has grown. The more benefits or largess government provides, the more opportunities there are for the government to condition the grant of these benefits on the extension of various policies and goals. A large legal literature has developed dealing with the constitutional limits on Congress in its use of conditions. A full review of these cases and literature is outside the scope

213. For a thorough rendition of this literature and the key cases that have arisen, see generally Kreimer, supra note 1, at 1293.
of this Article, but it is a useful starting point to examine the constitutional limits on the use of conditions the United States Supreme Court set forth in a recent case dealing with the congressional spending power.

In *South Dakota v. Dole*, South Dakota challenged the constitutionality of a federal statute that conditioned the states' receipt of five percent of federal highway funds on the adoption of a minimum drinking age of twenty-one. South Dakota, which permitted nineteen year-olds to purchase beer containing 3.2 percent alcohol, contended that Congress's decision to condition highway funds in this way violated Congress's spending power and the twenty-first amendment. The twenty-first amendment gives the states virtually complete control over whether to permit the importation or sale of liquor and how to structure liquor distribution systems. South Dakota argued that conditioning federal highway funds on action that clearly is reserved to the discretion of the states is unconstitutional.

Chief Justice Rehnquist disagreed. Writing for the majority, he held that Congress had acted constitutionally by indirectly encouraging uniformity in the states' drinking ages. This was so even if one were to assume that Congress could not, under the twenty-first amendment, directly regulate drinking ages. This opinion provided Congress with very broad, but not unlimited, conditioning powers. Justice O'Connor, in dissent, succinctly set forth those limits: 

- The expenditures must be for the general welfare.
- The conditions imposed must be for the general welfare.
- The conditions imposed must be unambiguous.
- They must be reasonably related to the purpose of the expenditure.

In Justice O'Connor's view, the fourth condition was not satisfied in this case: "establishment of a minimum drinking age of 21 is not sufficiently related to interstate highway construction to justify so conditioning funds appropriated for that purpose."

The majority applied these factors more expansively. In evaluating the relationship between the condition and the general welfare, the Court concluded that "the condition imposed by Congress is directly related to one of the main purposes for which highway funds are expended—safe interstate travel." The Court also took an expansive view of the voluntariness of the program. The Chief Justice emphasized that South Dakota was under no compulsion to change its drinking law; it simply could refuse the federal funds and retain a minimum drinking age of nineteen.

The majority quoted *Steward Machine Co. v. Davis* to distin-
USE AND LIMITS OF CONDITIONS

guish coercion from temptation:

“[E]very rebate from a tax when conditioned upon conduct is in some measure a temptation. But to hold that motive or temptation is equivalent to coercion is to involve the law in endless difficulties. The outcome of such a doctrine is the acceptance of a philosophical determination by which choice becomes impossible. Till now the law has been guided by robust common sense which assumes the freedom of the will as a working hypothesis in the solution of its problems.”

As we shall see below, the use of conditions at the agency level raises a number of issues and problems. Nevertheless, some general agency guidelines can be extracted from this constitutional approach. First, an agency extends conditions and agrees to commitments in accordance with its enabling act. Just as congressional conditions are judged first in relation to the Constitutional power that authorized them, regulatory conditions and commitments are judged in terms of the agency's statutory (or "regulatory constitutional") power. An ultra vires condition imposed by an agency is the regulatory counterpart to an unconstitutional condition imposed by Congress.

Second, the requirement that conditions be unambiguous and easily followed fully applies at the agency level where conditions are more easily administrated and enforced. Perhaps less obvious in the requirement of clarity at the congressional level is the implicit requirement that agency conditions be public. They should be accessible, and thus, a known and knowable source of law. This, however, is not always the case. Many voluntary commitments at the Fed, for example, are not found in the published orders of the Board. Moreover, the Fed's conditions create a body of law that may be so fact-specific that the underlying policy is unclear. While the statute at issue in South Dakota v. Dole clearly indicates that Congress's policy was to raise the drinking age and reduce alcohol-related traffic accidents, clear policy indications often are lost in the high-volume and fact-specific nature of agency conditions. It is advisable for the Fed to examine periodically the conditions in its orders, summarize their policy, and then make this summary available to the public. If a new policy has emerged, an agency rulemaking proceeding might be in order.

Third, the Court's analysis in South Dakota v. Dole suggests that agency conditions should be within the agency's statutory power, and reasonably related to the agency's regulatory goals. Requirements for agency conditions, however, can be even more specific. Because an agency considers individual applications, its conditioning power should be limited to the issues raised in the application or petition before it. In other words, the conditions and commitments should be in response to needs arising from the facts of the case before the Board. What is, and what is not a relevant condition should be construed more narrowly at the agency level than at the congressional level. This is because agencies have other processes available to resolve legal and policy issues that go beyond the individual

applicant. Conditions that seek to further a controversial interpretation of a question of law or policy are best resolved at a more adversarial stage of the administrative process.

Finally, it is appropriate to take a less expansive view of what is and what is not voluntary when dealing with agency commitments. This is because, unlike the State of South Dakota in the Dole case, individual applicants dealing with a federal agency have even less bargaining power than a state's representatives in Congress. The Fed's monopoly on the regulatory benefits that it can provide pursuant to the BHCA seriously undermines the use of bargaining to resolve legal or policy regulatory issues.

C. Conditions and Commitments at the Agency

Level—The Federal Reserve Board

Before examining the use of conditions and commitments at the Fed, it is important to review the conditioning power of the Fed and the kinds of cases in which conditions are important. This section then examines five specific kinds of conditions or commitments that can be used at the Fed or at any administrative agency.

1. Conditions—General Fed Powers

The Bank Holding Company Act clearly authorizes the use of conditions. As Pauline Heller has noted in her treatise: "Authority to approve or to deny reasonably implies authority to impose conditions." Specific and implied statutory authority for the Board's use of conditions is found throughout the Act. Pursuant to this authority, the Fed has long used conditional orders to accomplish a variety of tasks in a variety of ways. Conditions may result from the application of general regulations, the provisions of an individual order, or the extraction of a "voluntary" commitment from an applicant.

The Board may impose conditions on application approvals in a variety of contexts. Such conditions include: shortening the life of a grandfather exemption; limiting activities in which BHCs may engage; requiring compliance with the Community Reinvestment Act; and prohibiting various activities.

228. P. Heller, supra note 181, § 7.08, at 59 & n.10.
229. See id.; see also 12 U.S.C. §§ 1843(a)(2), 1843(c)(8), 1843(c)(9), 1843(c)(12), 1843(c)(13), and 1843(d) (1982) (Congress delegating authority to Board in recognition of its expertise); 12 U.S.C § 1844 (1982) (to carry out the provisions of, and prevent evasion of, the Bank Holding Company Act); 12 U.S.C. § 1818(b) (1982) (to protect the safety and soundness of banking).
230. Various regulatory provisions impose conditions on the approved activity. See, e.g., 12 C.F.R. § 225.25(b)(95) (1988) (leasing); id. § 225.25(b)(8) (assurance); id. § 225.25(b)(10) (courier); id. § 225.25(b)(17) (foreign exchange); id. § 225.25(b)(18) (futures commission merchant); id. § 225.25(b)(19) (futures and options on futures); id. § 225.25(b)(20) (tax planning and preparation); id. § 225.25(b)(22) (check guaranty); id. § 225.25(b)(23) (collection agency); id. § 225.25(b)(24) (credit bureau).
Act; requiring divestiture of interests that pose anticompetitive problems; requiring divestiture of impermissible activities. The Fed also extracts more controversial “voluntary commitments.”

2. Five Conditional Contexts

The various substantive contexts in which the Board imposes conditions and extracts commitments involve a number of variables. On a general level, these variables involve questions of law, policy, and fact. Working with these variations, the Article constructs five ideal types of conditions or commitments. Innumerable variations on these five themes...
may emerge, but these five categories capture a good deal of the richness and complexity involved. The five types are set forth in order ranging from the least controversial use of any agency's conditioning or commitment power to the most controversial.

a. The Perfect Condition

The least controversial type of condition or voluntary commitment is one that is fact-specific, clearly within the legal power of the Board to impose, and furthers a previously articulated Board policy. The most common condition of this type requires an agency to consider the safety and soundness of a proposed activity. The Board must consider these factors under both section 3 and section 4 of the Act. In so doing, the staff is often confronted with applicants whose capital adequacy or debt-to-equity ratio appears to be borderline. As a condition of approval, the staff may request that the applicant agree to increase capital or reduce debt. This kind of condition is fully grounded in law, policy, and fact. It also permits the Board to carry out its regulatory duties without denying an otherwise grantable application and enables the applicant to achieve its business goals in a safe manner. This kind of condition provides regulatory flexibility and allows the staff to treat each applicant's situation on an individual basis.

b. The Policy Condition

A second type of condition is one that is usually fact-specific and arguably within the agency's legal authority, but illustrative of a policy that is not formally articulated or widely known. This context raises issues akin to those present in SEC v. Chenery. In that case, the United States Supreme Court, inter alia, dealt with the question of whether the agency had to make policy through use of a rulemaking proceeding or whether it could formulate new policy in the context of an adjudication and, in effect, apply that new policy retroactively. The Board may have the power to apply a condition that represents a new policy or a policy that it has not formally articulated, but should the Board proceed in this manner?

The answer may turn on how likely the issue is to arise in other cases, or whether its imposition in this particular case is fact-specific. If the condition represents a policy that the Board consistently pursues in cases of this type, but nevertheless has failed to adopt in the context of a rulemaking, the policy may not have been as fully developed or as carefully thought.

237. See Texas Commerce Bancshares, Inc., 58 Fed. Res. Bull. 838, 841 (1979). In Texas Commerce Bancshares, Inc., the Board approved acquisition of shares of one bank subject to the condition that shares of a second bank acquired incident to the transaction be divested within a specified period of time. This condition was based on the Board's finding that acquisition of shares of both banks would have an anticompetitive effect on the banking market. Id. In Security Pac. Corp., 73 Fed. Res. Bull. 381 (1987), as with any action implicating the Douglas Amendment, the Board ultimately conditioned its approval upon the approval of the state banking supervisor of the state in which the bank sought to be acquired is located. Id. at 841. In this case, approval from the Oregon Banking Supervisor was required. Id.

238. 332 U.S. 194 (1947).
out as it should have been. Thus, even if the policy is widely known, but not formally articulated, the use of conditions to implement the policy may deprive applicants and the Board of an opportunity to consider the ramifications of the policy beyond the narrow context of the specific case. 239 If the policy is not only unarticulated, but unknown as well, it is subject to the retroactivity problems that arose in *Chenery*. Moreover, if this policy is furthered by voluntary commitments and, thus, never appears in the Board's published orders, it can be a source of "secret law."

c. Legal Authority Conditions

Legal authority conditions involve issues in which the Board's regulatory authority is at best unclear and, at worst, nonexistent. It often will embody a known Board policy, but one that has not been formally articulated and it may or may not be fact-specific. For example, the Board has been troubled by the financial risks to a bank holding company system when one of its subsidiary banks conducts real estate investment and development activities. To deal with this problem, the Board will condition its approval of BHC applications to acquire state-chartered banks on the assurance that the newly acquired state bank will not engage in real estate development activities.

The problem with such conditions is twofold: (1) some states—for example, Washington and California—authorize real estate development, as well as other activities the Board might frown upon; 240 and (2) the Board has agreed that it lacks legal authority to regulate activities of state-chartered banks. 241 Arguably, conditions of this type inappropriately extend federal jurisdiction into the state's domain.

These conditions, nevertheless, have been particularly common in the real estate development and insurance areas. The Board often insists on these voluntary commitments on behalf of both state-chartered bank subsidiaries of bank holding companies and their subsidiaries. In *Equimark*

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239. See, e.g., *First Bancorporation v. Board of Governors of the Fed. Reserve Sys.*, 728 F.2d 434 (10th Cir. 1984). In *First Bancorporation*, the court overturned a Board order conditioning approval of a section 4 acquisition of an industrial loan company on the applicant's agreement not to engage in NOW activity through this company, even though it was permissible under state law. Id. at 456-37. The Board additionally subjected such activity already engaged in by the applicant's subsidiaries to banking regulations. Id. The court characterized the Board's action as an impermissible attempt to create legislative policy by adjudicative order. Id. at 438.

According to the court, NOW activity cannot be considered "banking" as a matter of law, and thus, cannot be subject to banking regulations. Id. at 437. The court also found the Board's attempt to apply these conditions to the applicant's previously acquired loan company particularly egregious because the Board made absolutely no conclusions, and its order contained no adjudicative facts, relevant to that company. Id. at 438. Finally, the court recognized the impropriety of the Board's subsequent use of the order as precedent to impose similar conditions on other applicants engaged in NOW activity, characterizing the Board's original order as "merely a vehicle by which a general policy would be changed." Id. at 437.

240. For specific authorization of banks to invest and develop real estate, see *Cal. Fin. Code* § 751.3 (West 1989); *Wash. Rev. Code Ann.* § 30.04.2121(a)-(b) (West 1986). For specific authorization of banks to act as insurance agents, see *Cal. Fin. Code* § 1208 (West 1989) (in towns of less than 5000 persons).

Corporation," for example, Equimark sought to acquire a nonbanking subsidiary of a state-chartered bank authorized to engage in real estate investment and development activities. Another subsidiary of the same bank was authorized to engage in general insurance activities. The Board obtained assurances from Equimark that in both cases the activities would be discontinued and either divested or dissolved within a predetermined time period.

In this and other cases like it, the Board argued that such activities are impermissible because the Board "has not determined that real estate investment and development activity is closely related to banking under section 4(c)(8) of the Act, and thus this activity is not permissible for bank holding companies under section 4 of the Act." Recently, the Board took a different approach in section 3 cases. The Board proposed that real estate development activities conducted directly or indirectly by a state bank subsidiary of a bank holding company would constitute per se unsafe and unsound banking practice warranting the Board's denial of any such application under section 3 of the BHCA.

This resort to rulemaking makes good sense, particularly when the Board's legal authority to implement such a policy is unclear. It is also a sound approach to take when the Board thinks its authority is clear, but its policy is not. Yet, rulemaking is not a cure-all for the kinds of commitment problems raised by the Equimark example. Even if we assume that such a policy is within the Board's statutory power to implement, opponents argue that a per se rule runs counter to the statute's requirement that section 3 criteria be considered "in every case." The Act seems to mandate an individual determination of the financial and managerial factors of each applicant and its proposed subsidiary bank.

In short, resort to the Board's rulemaking power may be inappropriate to resolve a controversial policy question proposed as a per se rule. When formulation of a per se rule is not possible, the Board may be able to impose a condition that relates only to the financial condition of the individual applicant. This individualized process, as mandated by the statute, may require that any imposition of conditions or extraction of commitments be fact-specific and related to the financial soundness of the applicant. The Board's use of applicants as vehicles for policy implementation arguably

stretches its powers too far. To sidestep this problem with a per se rule deprives the applicant of a statutorily mandated, fact-specific determination.

Nevertheless, it should be emphasized that rulemaking by the Board is preferable to a policy condition that is based on an unknown or unarticulated, controversial Board policy. Rulemaking provides all applicants and potentially affected parties with an opportunity to participate. More importantly, it enables the Board to think through the long-term policy implications of its positions. This suggests a fourth kind of condition.

d. Prospective Conditions

Prospective conditions are closely related to policy and legal authority conditions. A prospective condition embodies a policy that is arguably enacted within the Board’s legal authority. It may or may not be formally articulated, but does not necessarily arise from the facts of the specific application. The applicant is purely a policy vehicle because it must agree to conditions regarding future activities in which it presently has no intention of engaging.

Commitments to refrain from real estate development as well as insurance activities are sometimes extracted even though the applicant has no present intention to engage in these activities.\(^\text{247}\) Although this may circumvent the argument that the statute bans per se rules, such commitments are, in their own way, another form of per se rule. The agency makes an activity impossible in the future even though the activity is not a part of the present case. The strength of the Board’s bargaining position is particularly strong because the applicant is usually not willing to fight for something it does not presently plan to do.

e. Null Conditions

Finally, the most controversial conditions would be those that are not grounded in law, not based on articulated Board policy, or not closely related to the facts of the particular applicant’s case. These may be called null conditions and clearly would be ultra vires conditions.\(^\text{248}\)

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\(^\text{247}\) See, e.g., Yellowstone Holding Co., 66 Fed. Res. Bull. 250, 251 (1980). The Board issued an order approving the formation of a bank holding company under section 3 of the Act. Approval was conditioned on the applicant’s “commitment to comply promptly with any new policy adopted by the Board concerning the disposition of income from the sale of credit life, health or accident insurance in connection with loans made by Banks.” Id. at 251. Although the applicant was not presently engaging in such activity, and did not appear to have any interest in doing so, the Board effectively foreclosed any possibility of such engagement other than by ways prescribed by the Board according to general policy. The Board’s action was not necessarily related to the applicant’s specific characteristics.

\(^\text{248}\) See, e.g., Securities Indus. Ass’n v. Board of Governors of the Fed. Reserve Sys., 839 F.2d 47, 67-68 (2d Cir. 1988) (striking down Board’s interpretation of market share limitations); First Bancorporation v. Board of Governors of the Fed. Reserve Sys., 728 F.2d 434, 437-38 (10th Cir. 1984) (striking down condition imposed by the Board, finding condition was ultra vires and based on an incorrect interpretation of the law). In Securities Industry the court reviewed a condition imposed by the Board in an order approving applications to engage in certain limited securities activities under the Glass-Steagall Act. See Securities Industry, 839
These conditions may be summarized as follows:

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<th>Condition Type</th>
<th>Law</th>
<th>Policy</th>
<th>Fact-Specific</th>
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<td>Perfect</td>
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<tr>
<td>Policy</td>
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<td>Prospective</td>
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D. Regulatory Conditions, Voluntary Commitments, and the Limits of the Bargaining Model as Applied to the Administrative Process

A recent Board report noted that bank holding companies "are often responsive to suggestions from the Federal Reserve for improvements in their . . . [applications] or for changes to their proposals in order to limit adverse effects and thereby increase the chances for approval." The negotiations between applicants and Federal Reserve Board staff are best described by the bargaining model of the administrative process. There is no neutral third party adjudicator to resolve disputes at this stage of the process. The issues that arise and the resolution that is reached is between the applicant and the staff. As we have seen, an integral part of this bargaining process is the Fed's use of conditions and the extraction of voluntary commitments. It is not the purpose of this Article to second guess the substantive wisdom of the results that these processes reach. This Article is not concerned with the consequences of the Board's decisions, but rather the processes by which decisions are made. It is for this reason that it is important to examine the limits of the bargaining model as applied to this kind of administrative process as well as the procedural consequences of accepting or extracting voluntary commitments.

1. The Limits of the Bargaining Model

The bargaining model assumes that the decision reached between two parties is a joint decision. This, in turn, assumes that each party has something to gain and something to give in the process of making compromises. For this process to work, neither party can have overwhelming bargaining superiority. In the regulatory process, however, the Fed has a legal monopoly on the benefits that the applicants seek. Though a

F.2d at 68 (citing 12 U.S.C. § 20 (1982)). The condition limited underwriting activities of applicants based on a percentage "market share" analysis. The court, finding this quantitative limitation to be unreasonable and unsupported by the law as evidenced by past interpretations of the Glass-Steagall Act and legislative history, struck down the condition. Id. For the original order, see Citicorp, 73 Fed. Res. Bull. 473, 502 (1987).

249. See BHC Hearings, supra note 151, at 410 (Board Report at B-6).

250. See supra p. 881.

251. See supra pp. 882-83. This is not to argue that the Fed's power should be equal to those whom it regulates. Rather, it is to emphasize that when one uses the bargaining process as a means of regulating, one must be aware of the limits of that process. Adversarial procedures are more appropriate to resolve disagreements over significant issues of law or policy. In other
USE AND LIMITS OF CONDITIONS

Denial of an application cannot be arbitrary; judicial review generally operates as a check only in the most extreme cases. The agency's discretion is not easily constrained. As a result, the bargaining process takes on great importance. Because applicants do not want their requests to be denied, they are susceptible to the Board's suggestions that they make certain commitments or accept various conditions. Even if they disagree with the legality or need for these conditions and commitments, they usually prefer to accept them rather than to have their application denied. Something is better than nothing.

This is not to argue that the Board misuses its power or improperly manipulates applicants. Regulatory negotiations and the unequal bargaining power that results are a natural by-product of the regulatory framework that Congress established in the Bank Holding Company Act. The use of conditions and commitments does not indicate a power grab by the Board. The use of these regulatory tools is inherent in an applications process that, by definition, requires a one-on-one decisionmaking process.

Moreover, this kind of regulatory process has many advantages. The Board can pinpoint its concerns and, through conditions or commitments, precisely tailor its regulation to meet those concerns. This bargaining or negotiation approach also has advantages for the applicant. Rather than risk outright denial of its application, bargaining allows the individual applicant to achieve some, if not most, of its business goals. In addition, the nature of the applicant's business transactions often necessitates prompt Board action. It is in an applicant's interest simultaneously to negotiate an acceptable regulatory result and take advantage of business opportunities. In short, the nature of the regulatory system established by the BHCA, the regulatory goals of the Board, the applicant's business needs, and the Board's demand for prompt, focused action on the part of applicants make a bargaining approach to the application process virtually inevitable.

The limits of this approach, however, are apparent in the context of "voluntary commitments." In such contexts, the unequal bargaining strength of the parties may result in involuntary agreements. The applicant is advantaged, however, by the opportunity to accept a commitment that is fact-specific, fully within the Board's power to impose, and directly related to an articulated policy. Such acceptance can expedite the application process, mitigate the Board's regulatory concerns, and allow the success of the proposed transaction. But as we move away from the "perfect" condition or commitment, the probability that the commitment is "voluntary" becomes less likely. This can have a number of unfortunate regulatory consequences.

In other words, some kinds of issues are not appropriate for bargaining processes, though they may very well involve regulatory demands that are ultimately justifiable.
2. The Regulatory Consequences of Accepting or Extracting Voluntary Commitments

Applicants may agree to the Board's requests even when faced with a commitment not to engage in activities they believe are fully allowed under the law, or when asked to forego action that represents an unarticulated or new policy. That agreement, however, is likely to be based on a "lesser of two evils" kind of reasoning. Rather than entirely forego a proposed acquisition, the applicant is often willing to choose a modified form of approval.

One might argue, not unlike Chief Justice Rehnquist in South Dakota v. Dole,\(^2\) that this choice nevertheless is made "voluntarily." In reality, however, the applicant has no alternative; there is no regulatory substitute for the authorization that the applicant seeks. Though we may assume that the Board is carrying out its regulatory duties in a conscientious and effective manner, an applicant's voluntary acceptance of a commitment prevents the conversion of the bargaining model into an adjudicatory model. In fact, the agency may be encouraged to bargain because voluntary agreements will not be challenged by the applicant. Because applicants have, in effect, waived their legal rights by voluntarily agreeing to conditions, the agreement is impossible to challenge in court. There is no record upon which findings of fact or conclusions of law are based, and upon which courts could review the agency's determinations. Meaningful judicial review under these circumstances would be impossible. A court could not take the agreement between the parties at face value. To allow applicants to undermine their agreements in court would allow them to whipsaw the agency.

A commitment in the form of a condition stated in the Board's order, however, is presumably supported by the record and subject to judicial review. The possibility of judicial review equalizes the bargaining strength of the applicant and the agency, and gives the applicant the opportunity to transform the bargaining phase of the process into an adversarial phase. The possibility of third-party adjudication also constrains the bargaining process. Agency fears of what a third party might do if it imposes a condition gives the applicant added bargaining power and helps keep the bargaining phase of the process within legal guidelines.

But even if we assume that an applicant's decision to make a commitment truly is voluntary, several regulatory consequences follow, particularly when issues of law and policy are involved. The bargaining process may give an inordinate amount of policymaking power to the staff involved. Policymaking through the imposition of individual voluntary commitments may remove long-term policy considerations from the Board's planning processes and effectively exclude Board members from the decisionmaking process. The following problem is illustrative.

On February 3, 1987, the Board of Governors of the Fed heard an appeal involving section 20 of the BHCA. This hearing considered applications of Citicorp, J.P. Morgan and Co., Inc., and Bankers Trust New York

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Corporation to underwrite and deal in municipal revenue bonds, mortgage related securities, consumer-receivable-related securities, and commercial paper. The Board considered, among other things, whether a bank affiliate was "engaged principally" in bank-ineligible underwriting activities. During the negotiation phase of these proceedings, each bank holding company had consented "voluntarily" to market share limitations while protesting that commitments were not legally required or economically constructive. The "voluntary" nature of the agreements made the policy decisions inherent in the commitments appear as a fait accompli when they ultimately were presented to the Board. The following excerpt highlights how a voluntary commitment can deprive the Board of an opportunity to examine fully the legal and policy implications of the staff positions embodied in them.

VICE CHAIRMAN JOHNSON: You've also proposed market share tests on your activities as well, and I take it that you did that to make it clear that even if you used some volume requirement, volume measure of activity in the affiliate, you would not violate some sort of market share test. I think you've all proposed about three percent.

MR. WEATHERSTONE: Governor Johnson, I think we did that reluctantly because we think the market share test has very little to do with "principally engaged."

VICE CHAIRMAN JOHNSON: I agree with that, but you proposed it. I'm just asking.

MR. WEATHERSTONE: We proposed it, yes, but with some reluctance. We think it serves very little purpose, but we did propose it. We think it's anti-competitive, and I think the Justice Department has a view about that as well.

VICE CHAIRMAN JOHNSON: Why did you propose it?

MR. WEATHERSTONE: To expedite the applications.

GOVERNOR ANGELL: So, in other words, you thought we might be more apt to approve it if that was in, but you see no justification in terms of economic or legal reasons for having it in?

MR. WEATHERSTONE: We would rather not have it.

GOVERNOR ANGELL: You see no legal or economic justification for it.

MR. THEOBALD: We take exception.

CHAIRMAN VOLCKER: The relevant question may not be whether it's economic, but whether it's legal.253

The Board ultimately accepted these market share limitations. The Court of Appeals, however, overturned the Board's decision in Securities Industry Association v. Board of Governors of the Federal Reserve System.254

Apart from shifting the policymaking role to the staff, voluntary commitments also can become a source of "secret law." Unlike the Securities Industry case above, many voluntary commitments do not appear in the Board's final order, are not likely to be challenged in court, and are not likely to be widely known to the public. Many times the fact-specific, confidential nature of these commitments requires that they be "privatized." But fact-specific commitments made in a number of cases are likely, over time, to add up to particular policies that may or may not have been articulated by the Board. When the unarticulated policy is controversial, the aggregation of fact-specific commitments poses a significant problem.

In short, commitments play a valuable fine-tuning, regulatory role. But the further the commitment strays from the facts of a particular request, or the more controversial the policy and legal positions of the staff, the less voluntary these commitments are likely to be. In such situations, it is more likely that the Board's power will remain relatively unchecked and run the risk of being overextended. To retain the positive and useful features of the bargaining approach to the BHCA's applications process, and to limit the potential for abuse that may exist, it is necessary to consider ways to equalize the bargaining power between applicants and the Board, as well as to discern just when the bargaining model is appropriate and when it is not.

3. Rationalizing Bargaining Positions

The Board's power in these cases is, as we have noted, a by-product of the regulatory scheme set forth by Congress. That scheme is, by and large, a good way to proceed in the routine case. When the agency, however, extracts commitments in cases in which law and policy are unclear and the issues controversial, the commitments are unlikely to be voluntary. Conditions that emerge from an expansive interpretation of the Board's legal authority, or that represent controversial policy positions are somewhat less of a problem because they are more easily challenged in court. This possibility of appeal to a third-party decisionmaker strengthens the applicant's bargaining power. Applicants can invoke what they believe to be the likely perspective of decisionmakers beyond the staff. If the applicant's characterization of the views of these third parties is persuasive, the staff may modify the commitments or conditions as requested. If the staff does not modify the commitments, a court or the Board itself may act, presumably in the way that the applicant had predicted. One way to equalize bargaining power between staff and applicant is to encourage judicial review of "voluntary commitments." This would at least provide some protection against the use of arguably ultra vires commitments.

Creating greater opportunities for judicial review can be accomplished in two ways. First, when legal issues are in contention, the Board should refrain from extracting or accepting voluntary commitments. Second, if a voluntary commitment is accepted, it should be part of the Board's order and, to the extent possible, converted into a condition which is part of the administrative record and appealable to a court. There should be a presumption that commitments involving serious questions of law or policy are made to facilitate the processing of an initial application. Applicants do
not concede that these commitments are either permitted or required under the Bank Holding Company Act, and therefore, applicants reserve the right to seek modification or termination of these commitments in court or in another application proceeding. This process can be facilitated by converting these commitments into conditions when the record allows. Another way to equalize the bargaining relationships between staff and applicants is to encourage the Board of Governors to look closely at “voluntary commitments.” The Board should be encouraged to view commitments not as waivers, but as issues worthy of their careful consideration.

In addition to the involvement of such third parties as courts or the Board of Governors, it is important to recognize that certain issues are more appropriate for adversarial dispute resolution models and less appropriate for bargaining models. This is particularly the case when important legal issues involving, for example, the jurisdictional reach of the agency are in contention. Such questions should be decided in court and should not be part of the bargaining process. When issues of policy are in contention, adjudication, and especially rulemaking, are the appropriate procedural responses. When law and policy are reasonably clear, however, and only the financial strength of the applicant is at issue, a bargaining model is more appropriate. The bargaining strength of the applicant is enhanced if the applicant is financially strong and weakened if financially unsound. Given the safety and soundness considerations of the Act, this is as it should be.

Finally, another way to equalize bargaining power is to further clarify the ninety-one-day rule. During the informational phase, perceptions concerning such variables as economic conditions vary. A Board request for additional information tolls the ninety-one-day period. Although requests for new information are often necessary, there is often confusion concerning when a file is informationally complete. To ensure that the informational and bargaining phases of the process are distinct, as well as to avoid confusion concerning the running of the ninety-one-day period, the Board’s regulations should require an explicit Board finding that a file is complete and ready for consideration. This is particularly needed in the small minority of cases in which varying perceptions concerning the merits of an application and a rapidly changing economic setting create confusion about the running of the ninety-one-day rule.

In short, problems emerge when the bargaining approach to regulation is applied to issues more appropriate for adjudication or rulemaking. Some are the inevitable result of the BHCA’s regulatory processes. Some result from good faith legal and policy differences between applicants, staff, and, in some cases, the Board of Governors. Much, however, is due to both the perception and the reality of unequal bargaining power.

It would be an overreaction to these problems to discourage the flexibility and fine-tuning capabilities that conditions and commitments make possible. It would be equally wrong, however, to assume that a true bargaining model can apply in all regulatory contexts or that all commitments are truly “voluntary.” An appropriate balance between the flexibility of a bargaining process and the potential abuse of a legal monopoly may
best be achieved by equalizing the bargaining power between staff and applicants and by counseling regulatory restraint on the part of the Board when issues of law and policy are in serious contention.

**Conclusion**

The regulatory use of conditions and commitments can significantly expand an agency's power and jurisdictional reach. In certain contexts, the applicant's strong incentives to avoid litigation and to avoid the denial of its requested regulatory benefits give the agency substantial, informal, and largely unreviewable discretionary powers. This Article does not suggest that these powers should be unnecessarily judicialized. Rather, it has argued that in certain contexts these powers should be exercised with restraint. Some conditions and commitments are not appropriate for the bargaining context in which they arise. They involve issues that are best resolved in more detailed rulemaking or adjudicatory procedures.

More importantly, this Article has looked at administrative conditions and commitments in a contextual way. This approach highlights that what appears to be voluntary, may in fact be involuntary, and what appears to be a legal use of agency power is, in some circumstances, an extension into new and often uncharted areas. Legal issues, or important principles of federalism may be at stake. On a more subtle level, there are complex relationships between change and the legal processes by which it is accommodated or frustrated that deserve further study.

Technological change has transformed banking and has altered our conception of what a bank is or can be. Technological change also has facilitated the globalization of financial markets. These changes have created a changing banking industry whose structure is in flux. Competition from abroad, coupled with competition from new entities engaged in what banks and traditional bank holding companies used to do almost exclusively has created new tensions between market and political regulatory forces. Increasingly, the forces are pulling in opposite directions, particularly for larger bank holding companies that seek to compete nationally and globally. In this context of global, technological, and market change, how should the legal system respond? How should the new regulatory issues that these changes have spawned be decided, and who should make the decisions?

The Board sometimes has used conditions in controversial cases to deal with these changes, extending regulation into areas where it was arguably not intended. The Board has been true to the conception of banking that underlies statutes passed during a very different time to solve some similar, but also some very different societal problems. There are limits to the extent an agency can either retard change in an industry that now faces new global and domestic competition or restructure and regulate it in new and more meaningful ways.

New Deal agencies gradually extended their regulatory powers to conform to changing conditions, but they did so with certain assumptions in place: regulators were dealing with domestic regulation, not interna-
tional competition, and to a large extent they were not dealing with the technological change that is transforming the marketplace. Today, the related factors of globalization and technology typify the financial services industry. These factors and the rapid change that they encourage undercut more common-law-like regulatory approaches that depend on incremental change. Without comprehensive Congressional reform, the incremental regulation accomplished by regulatory conditions is doomed to failure. It ultimately will be seen not as a form of agency fine-tuning, but as agency obstruction to market innovation. For the regulatory system to mediate between market and political forces, there must be some congruence between the goals pursued by these two fundamental sources of change. This requires new global statutes for a new global age.