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Antitrust Law: Mergers-Preliminary Injunctions-District Court May Consider Company's Imminent Departure from Market as Evidence Rebutting FTC's Prima Facie Case

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RECENT DEVELOPMENTS

Antitrust Law: Mergers—Preliminary Injunctions—DISTRICT COURT MAY CONSIDER COMPANY'S IMMINENT DEPARTURE FROM MARKET AS EVIDENCE REBUTTING FTC'S PRIMA FACIE CASE

FTC v. National Tea Co.,
603 F.2d 694 (8th Cir. 1979)

Companies seeking to protect their share of the market through a merger frequently run afoul of the Clayton Act.[1] The acquisition of a weak company may occasionally be defended by employing the failing company defense if, without the merger, the weak company will face business failure and leave the market. Recently the Supreme Court, in *United States v. General Dynamics Corp.*,[2] added to the arsenal of defendant corporations by permitting them to argue that the acquired company, despite a statistically significant share of the relevant market, added no competitive strength to the acquiring company.[3] In *FTC v. National Tea Co.*,[4] the Eighth Circuit Court of Appeals read *General Dynamics* expansively to permit the introduction of evidence showing that the "weak" company, absent the proposed merger, would leave the market. In affirming a district court's refusal to order a preliminary injunction, the court blurred the requisites of both the failing company and *General Dynamics* defenses. The *National Tea* decision overstepped the clear limits of *General Dynamics* and in doing so permits defendants to evade the strictures of the failing company defense.

I

TRADITIONAL DEFENSES OF "WEAK COMPANIES"

The Clayton Act proscribes any acquisition by one corporation of the stock or assets of another if "the effect of such acquisition may be substantially to lessen competition."[5] Enforcement of

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[1] 15 U.S.C. § 18 (1976).
[2] 415 U.S. 486 (1974).
[3] *Id.* at 503-06.
[4] 603 F.2d 694 (8th Cir. 1979).
[5] 15 U.S.C. § 18 (1976).

the act is vested in the Federal Trade Commission and the Justice Department.[6] Only rarely have corporations repelled government enforcement efforts.[7] Courts have, however, established two defenses for companies with weak competitive positions—the failing company defense and the *General Dynamics* defense—to help alleviate the harshest applications of the Clayton Act standard.

A. *The Failing Company Defense*

The Supreme Court, in *International Shoe Co. v. FTC*,[8] laid the foundation for the failing company defense. The Court held that even if the FTC establishes that a merger will substantially lessen competition, a court may allow the merger if the acquired company has "resources so depleted and the prospect of rehabilitation so remote that it face[s] the grave probability of business failure,"[9] and the acquiring company is the only prospective purchaser.[10] The Court subsequently hinted at an even more stringent "prospect of rehabilitation" standard[11] but later cases have not followed this interpretation.[12]

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[6] 15 U.S.C. §§ 21(a), 25 (1976). The FTC may seek preliminary injunctions to prevent violations of § 7 of the Clayton Act (15 U.S.C. § 18 (1976)), prior to an administrative determination on the merits. 15 U.S.C. § 53(b) (1976). The Justice Department may obtain a temporary restraining order pending disposition of a case arising under § 7. 15 U.S.C. § 25 (1976).

[7] *See* United States v. Von's Grocery Co., 384 U.S. 270, 301 (1966) (dissenting opinion, Stewart, J.); Robinson, *Recent Antitrust Developments: 1974*, 75 COLUM. L. REV. 243, 243 (1975).

[8] 280 U.S. 291 (1930).

[9] *Id.* at 302. *See* United States v. Greater Buffalo Press, Inc., 402 U.S. 549, 555 (1971); Citizen Publishing Co. v. United States, 394 U.S. 131, 137 (1969).

[10] 280 U.S. at 302. *See* Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1969).

Congress approved the defense after its judicial introduction in *International Shoe*. *See* H.R. REP. No. 1191, 81st Cong., 2d Sess. 6 (1949); S. REP. No. 1775, 81st Cong., 2d Sess. 7 (1950), *reprinted in* [1950] U.S. CODE CONG. & AD. NEWS 4293, 4299.

[11] *See* Citizen Publishing Co. v. United States, 394 U.S. 131, 137 (1968). By its language, *Citizen Publishing* appeared to tighten the requirements set down in *International Shoe*. *See* Note, *The Failing Company Doctrine Since* General Dynamics: *More Than Excess Baggage*, 47 FORDHAM L. REV. 872, 878 (1979). The Court in *Citizen Publishing* noted that, since *International Shoe*, more and more companies have been able to reorganize through receivership or the Bankruptcy Act. The Court went on to say: "The prospects of reorganization ... would have ... to be dim or nonexistent to make the failing company doctrine applicable ...." 394 U.S. at 138. This language may tighten the requirements of *International Shoe* by upgrading "grave" to "dim or nonexistent," and by adding a third test—no chance of reorganization.

[12] *See* United States v. M.P.M., Inc., 397 F. Supp. 78, 96 (D. Colo. 1975). *But see* United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1259-60 (C.D. Cal. 1973), *aff'd*, 418

The defense has been subject to varying justifications. Some courts reason that since, absent the merger, the failing firm will leave the market, there is no anticompetitive effect if another corporation absorbs the failing firm.[13] The general trend, however, is toward the "lesser of two evils" approach recently described by the Court in *General Dynamics*:[14] possible anticompetitive effects are outweighed by the potential harm to the employees, stockholders, and creditors of the failing firm.[15]

U.S. 906 (1974). The Supreme Court, in United States v. Greater Buffalo Press, Inc., 402 U.S. 549 (1971), merely repeated the *International Shoe* language. *Id.* at 555.

The "only prospective purchaser" requirement has also been subject to varying interpretations. The Court in *Citizen Publishing*, after using the word "prospective" (394 U.S. at 137), switched to "available" (*id.* at 138). The latter may be a stricter standard. *See* Note, *supra* note 11, at 878. "Prospective" may connote a purchaser who is already interested, while "available" may mean *any* purchaser who could become interested. Some courts, including the Supreme Court, bave ignored *Citizen Publishing*. *See* United States v. Greater Buffalo Press, Inc., 402 U.S. 549, 555 (1971); United States v. M.P.M., Inc., 397 F. Supp. 78, 101-03 (D. Colo. 1975). *But see* United States v. Black & Decker Mfg. Co., 430 F. Supp. 729, 781-82 (D. Md. 1976) (defendant failed to establish failing company defense because it made no attempt to secure alternative purchaser). If there really is a difference, "available" seems to be followed: courts tend to look at the defendants' efforts to procure another buyer. *See Greater Buffalo*, 402 U.S. at 556 ("the numerous other [prospective purchasers] were never even approached"); *Black & Decker*, 430 F. Supp. at 781-82; *M.P.M., Inc.*, 397 F. Supp. at 101-03. Both words, however, are misleading. The best approach is to require the buyer to be the least anticompetitive purchaser. *See* United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1259 (D.C. Cal. 1973), *aff'd*, 418 U.S. 906 (1974). If the only other "available" or "prospective" buyers are *more* anticompetitive than the proposed buyer, the weak company should not be denied the defense.

[13] *See* United States v. M.P.M., Inc., 397 F. Supp. 78, 95 (D. Colo. 1975) (apparent rationale of defense: if one of the merging companies is bound to fail, competition cannot be harmed by acquisition of that firm); United States v. Maryland & Va. Milk Producers Ass'n, Inc., 167 F. Supp. 799, 808 (D.D.C. 1958) ("the acquisition of a failing corporation . . . cannot result in lessening competition . . . .") (citing *International Shoe), modified and aff'd*, 362 U.S. 458 (1960).

[14] *See* 415 U.S. at 507.

[15] *See* United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 372 n.46 (1963) (suggesting that the failing company defense "might have somewhat larger contours as applied to bank mergers *because of the greater public impact* of a bank failure compared with ordinary business failures.") (emphasis added); International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930) ("with resulting loss to . . . stockholders and injury to the communities where . . . plants were operated"); United States v. M.P.M., Inc., 397 F. Supp. 78, 95 (D. Colo. 1975); Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 340 (1960).

Citizen Publishing suggested a reason for a shift in the rationale:

> [A]t the time the *International Shoe Co.* case was decided § 7 of the Clayton Act provided: "[N]o corporation . . . shall acquire . . . stock or other share capital of another corporation . . . where the effect of such acquisition may be to substantially lessen competition *between the corporation whose stock is so acquired and the corporation making the acquisition.* . . ." Consequently, where the acquired company was "such as to necessitate liquidation," and where "the prospect for future competition . . . was entirely eliminated," it may have been reasonable to conclude that there was no more existing competition between the companies to

B. *The General Dynamics Defense*

In 1974, a second defense became available to weak companies attempting to merge. The Supreme Court in *General Dynamics* held that a defendant in an FTC action to block a merger can rebut the FTC's prima facie case by demonstrating that the acquired company was not an effective competitor at the industry's focus of competition.[16] The case involved the acquisition of a coal company by General Dynamics, a large, diversified company attempting to expand its operations. The Supreme Court found that competitive ability in the coal industry hinged on the availability of coal reserves.[17] The acquired company had committed nearly all of its reserves and had little chance of expanding its supply.[18] General Dynamics successfully rebutted the government's statistical showing of undue concentration[19] by showing that the acquired company had little potential to compete in the future, and "was a far less significant factor in the coal market than ... the production statistics seemed to indicate."[20]

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be lessened by acquisition. In 1950, bowever, § 7 was amended to make the measure of anticompetitive acquisitions the extent to which they lessened competition "in any line of commerce," rather than the extent to which they lessened competition "between" the two companies.

394 U.S. at 136-37 n.3 (citation omitted) (emphasis in original).

The current rationale, however, may also be derived from the original sources on the failing company defense. *See International Shoe*, 280 U.S. at 302-03; S. REP. No. 1775, 81st Cong., 2d Sess. 7 (1950) ("any firm in [a failing] condition should be free to dispose of its stock or assets"), *reprinted in* [1950] U.S. CODE CONG. & AD. NEWS 4293, 4299.

The "lesser of two evils" approach is preferable because the "no competition to lessen" approach disregards the possibility that the failing company will become revitalized. *See* Note, *supra* note 11, at 886-87. Furthermore, if the acquisition of a failing company does not lessen competition, an affirmative defense is unnecessary—the companies will have rebutted the FTC's case. *See* United States v. Black & Decker Mfg. Co., 430 F. Supp. 729, 776 (D. Md. 1976) ("the court's finding that the ... merger does not violate section 7 precludes defendants' need to rely on the failing company defense ...."). Finally, the "only available purchaser" requirement is irrelevant unless imposed to minimize the merger's anticompetitive effects; it is not needed where there are presumed to be no such effects. *See* note 12 *supra*.

[16] 415 U.S. at 503-04.

[17] *Id.* at 499-502.

[18] *Id.* at 502-03.

[19] *Id.* at 493. By a showing of concentration "in terms of market share statistics," the government may "[make] out a prima facie case of a violation of § 7." United States v. Citizens & Southern Nat'l Bank, 422 U.S. 86, 120 (1974). The defendant must then show "tbat the market-share statistics [give] an inaccurate account of the acquisitions' probable effects on competition." *Id. See* United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 365-67 (1963). In *General Dynamics*, the number of competitors in the relevant market had decreased by 73% in a ten-year span, and the merger substantially increased the concentration of market shares among the top firms. 415 U.S. at 494-95.

[20] 415 U.S. at 503.

The Court rejected the FTC's argument that the result allowed General Dynamics to defend on the ground of the acquired company's weakness without having to meet the stringent failing company standards.[21] It found that General Dynamics' defense, unlike the failing company defense, was not an affirmative defense—General Dynamics' evidence "went to the heart of the Government's . . . prima facie case"[22] by showing that the merger would not have significant anticompetitive effects.[23]

Unless carefully limited, *General Dynamics* is vulnerable to abuse. The defense requires more than a mere showing that one of the companies is a weak competitor: the weakness must occur at the focus of competition.[24]

United States v. International Harvester Co.[25] demonstrates the problems that occur when a court does not adhere to this limitation.[26] In *International Harvester*, the defendant acquired another

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[21] *Id.* at 506-08.

For the argument that under *General Dynamics* "the failing company defense might well become a piece of excess baggage," see Robinson, *supra* note 7, at 251-52. *But see* Note, *supra* note 11. The problem may have been anticipated in Bok, *supra* note 15, at 341:

> [E]ven if business failure seems remote, evidence of financial weakness may tend somewhat to reduce the apparent significance of the disappearance of the acquired firm from the market. As a result, there will be an inevitable temptation to introduce evidence of financial instability in an attempt to have the ambiguities of the case resolved in favor of the merger.

[22] 415 U.S. at 508.

[23] *Id.* at 498, 510-11.

[24] *Id.* at 501. *See* United States v. Amax, Inc., 402 F. Supp. 956, 970 (D. Conn. 1975) ("[u]nder . . . *General Dynamics* this court must analyze the present and future competitive strength at the 'focus of competition.'" (citation omitted). This is consistent with the Supreme Court's requirement of clear evidence rebutting the government's prima facie case. *See* United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 363 (1963) ("a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence *clearly showing* that the merger is not likely to have such anticompetitive effects.") (emphasis added). Precise limitations on the *General Dynamics* defense may be necessary because "Congress used the words '*may* be substantially to lessen competition,' to indicate that its concern was with probabilities, not certainties." Brown Shoe Co. v. United States, 370 U.S. 294, 323 (1962) (emphasis in original) (citations omitted). With regard to the words "may be," the final Senate Report on the 1950 amendments to the Clayton Act (*see* note 15 *supra*) stated that "[a] requirement of certainty and actuality of injury to competition is incompatible with any effort to supplement the Sherman Act by reaching incipient restraints." S. REP. No. 1775, 81st Cong., 2d Sess. 6 (1950), *reprinted in* [1950] U.S. CODE CONG. & AD. NEWS 4293, 4298. Easing the government's burden of proof without placing corresponding limits upon rebuttal evidence might introduce "the danger of subverting congressional intent by permitting a too-broad economic investigation." *Philadelphia Nat'l Bank*, 374 U.S. at 362 (citing Standard Oil Co. of Cal. v. United States, 337 U.S. 293, 313 (1949)).

[25] 564 F.2d 769 (7th Cir. 1977).

[26] For criticisms of the *International Harvester* decision, see Note, *Horizontal Mergers after*

heavy equipment manufacturer that was very weak financially and could not obtain credit to solve its problems.[27] The Seventh Circuit assumed that because the acquired company was weak, its acquisition by defendant would not damage competition.[28] The court failed to relate the acquired company's weakness to competition in the industry.[29] International Harvester provided the acquired company with the necessary funding to become a thriving competitor.[30]

II

FTC v. National Tea Co.

In *FTC v. National Tea Co.*,[31] the Eighth Circuit read *General Dynamics* broadly and, in doing so, added a new dimension to the weak company defenses. National Tea, a national chain of supermarkets operating stores in the Minneapolis area, attempted to acquire Applebaums' Food Markets, Inc., a local chain of supermarkets.[32] The FTC brought an action for a preliminary injunction to restrain the merger on the ground that the merger would

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United States v. General Dynamics Corp., 92 HARV. L. REV. 491, 510-11 (1978); Note, *supra* note 11, at 878.

[27] 564 F.2d at 774-75.

[28] *Id.* at 774.

[29] The court seems to have based its decision partially upon the *General Dynamics* defense and partially upon the finding that due to "a 'clear understanding . . . [the acquiring company] had no intent nor was it to seek control of [the acquired company] through the stock acquisition.' . . . [T]he Stock Purchase Agreement expressly stated this intent." United States v. International Harvester Co., 564 F.2d 769, 777 (7th Cir. 1977).

[30] *Id.* at 777. Because the court was aware of the merger's consequences, the decision may well have been based on the acquiring company's failure to exercise control. *See* note 29 *supra*. But in that case, the discussion of the acquired company's weak financial status was unnecessary.

An even broader reading of *General Dynamics* was assayed in United States v. Consolidated Foods Corp., [1978-1] TRADE CAS. (CCH) ¶ 62,063 (E.D Pa. 1978). The Department of Justice brought suit to enjoin the merger of Consolidated Foods, then 78th on Fortune's 1977 Directory of the Five Hundred Largest U.S. Industrial Corporations, and Chef Pierre, Inc., a producer of frozen dessert pies. The court, citing *International Harvester* approvingly, found that Consolidated's pie division, Sara Lee, was such a "weakened firm"—particularly in the market for frozen pumpkin pies—that *General Dynamics* mandated that the court look beyond the post-merger market shares. The court noted that Chef Pierre's technological expertise would enable Sara Lee "to market a truly competitive pie for the first time" (*id.* at 74,614), choosing to ignore the fact that the pie would be produced in a market where the merged companies, and two others, would control 62% of the market (*id.* at 74,613).

[31] 603 F.2d 694 (8th Cir. 1979).

[32] *Id.* at 695.

create undue concentration among the major grocery retailing firms in the relevant market.[33] The district court denied the motion for a preliminary injunction, basing its decision primarily on the finding that National Tea would probably leave the market if the merger were enjoined.[34] The Eighth Circuit affirmed, ruling that the district court had neither used an incorrect standard[35] nor abused its discretion.

After considering the facts of the case in light of *General Dynamics*, the appellate court held that the lower court had properly considered National Tea's probable exit if the merger was blocked.[36] National Tea's inability to compete resulted from its

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[33] *Id.* at 695-96. *See* note 6 *supra*. For the FTC's complaint, see National Tea Co., 3 TRADE REG. REP. (CCH) ¶ 21,556 (Apr. 17, 1979).

[34] 603 F.2d at 699, 701.

[35] 15 U.S.C. § 53(b) provides:

> Upon a proper showing that, weighing the equities and considering the [FTC's] likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted . . . .

The Eighth Circuit approved of the district court's decision to consider both public and private equities. The magistrate to whom the matter was first referred had found that the public equities (primarily the difficulty of effective divestiture) prevailed over the private equities (Applebaum's management problems) and recommended that the motion for the preliminary injunction should be granted. The district court, however, found the equities to be "close": divestiture would not be a severe problem because National Tea had committed itself to full divestiture within six months after a final judgment against it. 603 F.2d at 697 & n.3. The Eighth Circuit suggested that public equities should generally be given the greater weight but found that the district court had not abused its discretion. *Id. But cf.* FTC v. Food Town Stores, Inc., 539 F.2d 1339, 1346 (4th Cir. 1976) (consideration of private equities improper; hardship will always result if merger is enjoined yet Congress gave it little weight); Bok, *supra* note 15, at 340-41.

The court then examined the FTC's likelihood of success. The court approved a standard that required the FTC to raise "questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." 603 F.2d at 698. The court rejected an even more stringent standard concluding that it would frustrate the Clayton Act's "intended protection of the public interest." *Id.*

The court's acceptance of a rather tentative finding of National Tea's probable departure from the market (*see* note 49 *infra*) may be, in part, a corollary to its selection of the standard for "likelihood of success." The FTC may meet this burden simply by showing that the issues and evidence to be presented are so complex as to be inappropriate for a ruling at a preliminary hearing. Given judicial time constraints and the broad range of economic inquiry permitted by *General Dynamics*, tentative findings may be the only available defensive technique. A more thorough exposition of the defendant's position merely plays into the FTC's hands.

[36] 603 F.2d at 699. Although the precedential effect of the court's acceptance of a tentative finding of National Tea's departure from the market (*see* note 35 *supra*) may be confined to FTC preliminary injunction actions, its finding only goes to the weight to be given that evidence. The court's ruling on admissibility, however, should apply both in preliminary injunction hearings and hearings on the merits: the defendant used its probable departure as part of its rebuttal of the FTC's prima facie case.

small, poorly located stores. With its outdated buildings, National Tea could not stock as many items as its competitors.[37] Despite its employment of a real estate department, it failed to obtain new sites. Indeed, real estate developers viewed National Tea as a "nonissue."[38] Thus National Tea, like the acquired company in *General Dynamics*, had exhausted its ability to obtain a vital, limited resource.[39] Similarly, the disability caused significant weakness at the industry's focus of competition—sales.[40]

The merger's probability of improving National Tea's competitive strength, however, raises a significant difference between *General Dynamics* and *National Tea*. In *General Dynamics*, the acquired company added little competitive strength to the acquiring company.[41] In *National Tea*, the acquiring company had little future competitive strength *in its present state*. But the merger would almost certainly increase National Tea's competitive strength because Applebaum's would provide National Tea with store sites, managerial expertise, and a more favorable image.[42] National Tea could capitalize on these gains from its post-merger position as the market's leading firm.[43]

The *National Tea* court looked beyond the immediate effects of the merger and compared the market's future if the merger occurred with the market's future if it did not.[44] The court de-

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[37] National Tea's stores averaged 13,751 square feet in selling area, while those of its largest competitors ranged in size from 20,000 to 92,000 square feet. Most of National Tea's stores were built in the late 1950's and early 1960's. Since then the necessary number of stock items has risen from 6,000 to over 12,000. 603 F.2d at 699.

[38] *Id.*

[39] *See* text accompanying notes 17-20 *supra*.

[40] The *National Tea* court did not explicitly find sales to be the industry's focus of competition (*see* 603 F.2d at 699-700), but it left no other logical choice. While deciding that sales were not the focus of competition in the coal industry, the Court in *General Dynamics* stated:

> In markets involving groceries or beer, . . . statistics involving annual sales naturally indicate the power of each company to compete in the future. Evidence of the amount of annual sales is relevant as a prediction of future competitive strength, since in most markets distribution systems and brand recognition are such significant factors that one may reasonably suppose that a company which has attracted a given number of sales will retain that competitive strength.

415 U.S. at 501.

[41] 415 U.S. at 493-94.

[42] *See* Petitioner's Memorandum of Points and Authorities in Support of Injunction Pending Appeal at 9 & n.5, FTC v. National Tea Co., 603 F.2d 694 (8th Cir. 1979).

[43] 603 F.2d at 701. The market share of the top four firms, with the merger, would increase from 44.5% to 49%. *Id.* This, essentially, was the FTC's prima facie case.

[44] *Id.* at 700.

termined that National Tea would probably leave the market if the merger failed, and that increased concentration would result:[45] "Obviously, if National had experienced such serious marketing problems in the Minneapolis-St. Paul area that it was leaving the area, its present market share was an inaccurate reflection of its future competitive strength."[46] This was not the case in *General Dynamics*, where the present status of the market accurately reflected its future—the acquired company did not have coal reserves and was not going to get any. In *General Dynamics* the government's market share statistics were shown to be irrelevant because they did not reflect the company's weakness at the focus of competition. The *National Tea* court found the FTC's statistics relevant, but concluded that they did not fully reflect the market's future because of National Tea's imminent departure from the market.

In sum, unlike *General Dynamics*, the *National Tea* court sanctioned a merger that would remedy the weak company's weakness at the focus of competition. More important, the court allowed the acquiring company's alleged departure from the market to be weighed, not as a failing company affirmative defense, but in rebuttal to the government's prima facie statistical case.

III

The Future of the Failing Company Defense

Because *National Tea* hinged on a finding that without the merger, National Tea would probably leave the market, the decision may seriously impair the viability of the failing company defense.[47] Admission of that evidence was arguably within the ambit of *General Dynamics*: the government's market share statistics should be ignored if they do not reflect the market's future. The court's opinion, however, evidences a resurgence of the discarded rationale for the failing company defense: if the weak firm will leave the market absent a merger, the merger will have no anticompetitive effects.[48] Traditionally, a small failing firm must meet the stringent failing company standards in order to dispose of its stock. *National Tea* permitted a large national firm to expand

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[45] *Id.* at 701.

[46] *Id.* at 700.

[47] The Eighth Circuit rejected this objection without discussion. *Id.* at 700 n.8.

[48] *See* notes 13-15 and accompanying text *supra*.

by showing that it would leave one market. The latter merger is less desirable, yet the requisite showing under *National Tea* is easier.[49]

To ensure that every "weak company" cannot successfully avoid Clayton Act enforcement actions solely on the basis of weakness, courts should require that the weakness occur at the focus of competition[50] and that the weakness be caused by an irremediable lack of a physical resource vital to the particular industry. In *General Dynamics* the acquired company's weakness was due to a limited physical resource—coal reserves—not a limited fungible commodity—finances—as in *International Harvester* or resources that could be supplied by the other party to the merger—store sites, expertise and a positive consumer image—as in *National Tea*.[51] The availability of the natural resource on which the industry thrives better indicates the competitive effects of the merger; a company's weak financial status may reflect no more than fluctuating conditions in the industry, low prices,[52] or past business judgments.[53] If courts allow mergers to remedy such temporary phenomena, strong companies could merge with "weak" ones and create an anticompetitive market merely by providing financing.

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[49] Besides the absence of the "only prospective purchaser" requirement, *National Tea* may permit a lower evidentiary standard for a showing of incipient failure than the failing company defense. *See* notes 9-12 and accompanying text *supra*. The Eighth Circuit found only that *National Tea* would "probably" fail. 603 F.2d at 709. This evidentiary standard, however, may be linked to the court's selection of a "likelihood of success" standard (*see* note 35 *supra*) and confined to preliminary injunction actions (*see* note 36 *supra*).

[50] It is important to note the evidentiary purpose the "focus of competition" requirement serves. In *International Harvester* the Seventh Circuit found that, due to the required company's weakness, sales figures did not accurately reflect the firm's competitive ability. But the court found no other measure of competitive ability. The Supreme Court tried to avoid such loose analysis when it directed courts "to simplify the test of illegality . . . in the interest of sound and practical judicial administration." United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 362 (1963).

[51] *See* The Pillsbury Co., [1976-79 Transfer Binder] TRADE REG. REP. (CCH) ¶ 21,586, 21,709 (June 15, 1979) (suggesting limitation of *General Dynamics* "to situations involving a depletable natural resource.)"

Finding a limited physical resource is not the same as finding the focus of competition. The limited resource must *cause* the company's weakness at the focus of competition. Thus, in *General Dynamics,* long-term contracts were the focus of competition; the acquired company could not compete because of its lack of coal reserves. *See* text accompanying notes 17-20 *supra*.

[52] *See* United States v. Amax, Inc., 402 F. Supp. 956, 971 (D. Conn. 1975) (court refused to credit evidence of defendant's weak financial condition because of "the current lull in [the industry's] prices").

[53] The FTC, reacting in part to the decisions in *International Harvester* and United States v. Consolidated Foods Corp., [1978-1] TRADE CAS. (CCH) ¶ 62,063 (E.D. Pa. 1978)

Further, courts should not admit evidence of a company's departure from the market outside the context of the failing company defense. The defendant in *National Tea* could not have qualified as a failing company. First, it was not "failing." At worst National Tea would choose to leave the Minneapolis area while continuing in business on a national scale—the merger was not compelled by irreversible business failure.[54] Second, National Tea would have to meet the "only prospective purchaser" requirement.[55] Despite the reversal of roles—the weak company was the acquiring company—National Tea would have had to show that there was no other entity with which it could combine to avoid "failure."[56]

Under the heady influence of *General Dynamics*, the *National Tea* court permitted an inadequately supported weak company response to obtain a result unjustified under either the failing company or *General Dynamics* defense. Perhaps the court was swayed by the equities—in a time of economic distress, the loss of 850 jobs would be a heavy blow to a community whether National Tea's departure was caused by abject failure or an exercise of business judgment. But Congress and the Supreme Court balanced these equities in creating the Clayton Act defenses. Outside this narrow list of exceptions, the protection of the public-at-large should not admit of any variance.

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(*See* note 30 *supra*), has drawn a hard line on the admissibility of "financial weakness":

> [I]nclusion of financial weakness as a separate ... defense ... raises serious antitrust policy problems. First, there may be a sort of double counting in that financial weakness may already be reflected in a market share of the troubled company that is lower than it would have been .... Second, the issue of financial weakness is extremely difficult to handle in court, and susceptible to invented claims and vague expert testimony generating factual issues that the courts are not well equipped to measure. Third, if all sorts of company "weaknesses" or structural market changes operating to the disadvantage of particular companies, can overcome a *prima facie* case of illegality, then the whole valuable trend in merger enforcement toward streamlining cases by concentrating on properly measured market shares and concentration ratios will be undermined.

The Pillsbury Co. [1976-79 Transfer Binder] TRADE REG. REP. (CCH) ¶ 21,586, 21,709 (June 15, 1979). *See* Kaiser Aluminum & Chemical Corp., [1976-79 Transfer Binder] TRADE REG. REP. (CCH) ¶ 21,578 (May 17, 1979).

[54] *See* notes 9, 11-12 and accompanying text *supra*.

[55] *See* note 10 *supra*.

[56] *See* United States v. M.P.M., Inc., 397 F. Supp. 78, 101-02 (D. Colo. 1975).

Banks and Banking—Administrative Law—FEDERAL HOME LOAN BANK BOARD DECISION ON BRANCHING APPLICATION RIGOROUSLY REVIEWED UNDER ARBITRARY AND CAPRICIOUS STANDARD

City Federal Savings & Loan Association v. FHLBB, 600 F.2d 681 (7th Cir. 1979)

Branching is currently the most common means of expansion in the savings and loan industry.[1] Although the total assets held by savings and loan associations have increased relative to other financial intermediaries in recent years,[2] the absolute number of associations has declined.[3] Expansion in the number of branch

[1] In 1955, there were only 601 branch offices in existence. By 1970, this figure had increased to 4,318. At the end of 1978, there were 14,162 branch offices and 4,723 main or unit offices for a total of 18,885 savings and loan offices. UNITED STATES LEAGUE OF SAVINGS ASSOCIATION, 1979 SAVINGS AND LOAN FACT BOOK 54 [hereinafter cited as 1979 FACT BOOK].

Savings and loan associations also expand through merger. Merger activity peaked in 1971, when 132 mergers occurred, but has since declined; only 44 mergers took place in 1978. *Id.* at 52-54, table 45. Congress recently took steps to curtail expansion of savings and loan associations by limiting company consolidations and interlocking directorships. Title II of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 prohibits new interlocking directorships within the same city or metropolitan area and outlaws expansion of a savings and loan holding company beyond $1 billion in assets. Depository Institution Management Interlocks, 12 U.S.C.A. § 8201 (1978). *See generally* 44 Fed. Reg. 42,161 (1979) (FHLBB's regulations implementing the Act).

An association may wish to establish branch offices for various reasons. Branching allows an association to expand its serviceable market area, which is likely to increase its asset portfolio. Branching also offers the advantages of economies of scale. *See* Benston, *Cost of Operations and Economies of Scale in Savings and Loan Associations,* in 2 STUDY OF THE SAVINGS AND LOAN INDUSTRY 676, 712 (I. Friend ed. 1969) (economies realized by branching in areas that attract customers through branch offices); Brigham & Pettit, *Effects of Structure on Performance in the Savings and Loan Industry,* in 3 STUDY OF THE SAVINGS AND LOAN INDUSTRY 971, 1027 (I. Friend ed. 1969) ("A new facility, regardless of its size, will always have lower operating costs if it is part of a branch system that is large enough to be operating efficiently . . . ."). *Cf.* Gilbert & Longbrake, *The Effects of Branching by Financial Institutions on Competition, Productive Efficiency, and Stability: An Examination of the Evidence,* 4 J. BANK RESEARCH 209, 306 (1974) (branching increases efficiency and competition without harming smaller institutions); Mullineaux, *Economies of Scale and Organizational Efficiency in Banking: A Profit-Function Approach,* 33 J. FINANCE 259, 278 (1978) (legal restrictions in unit banking states prohibit achievement of scale economies).

[2] In 1950, savings and loan associations ranked behind commercial banks, life insurance companies, and mutual savings banks in total assets behind commercial banks. At the end of 1978, savings and loans ranked second with $523.6 billion in assets, behind commercial banks, which controlled $1,284.0 billion in assets. 1979 FACT BOOK, *supra* note 1, at 46, table 37. During 1978, total assets of savings and loans grew by 14% as compared to 10.1% for commercial banks, 7.4% for mutual savings banks and 10.6% for life insurance companies. *Id.* at 47.

[3] The total number of savings and loan associations (both state and federally chartered) peaked at 6,112 in 1966. *Id.* at 54, table 46. There were only 4,723 chartered associations at the end of 1978. *Id.*

offices for each chartered association[4] has matched growth in total assets.

A trend toward modernized banking regulations[5] has fostered the proliferation of branching. The Federal Home Loan Bank Board (FHLBB), an independent federal agency charged with regulating all federally chartered savings and loan associations,[6] championed the liberalization of federal branching policy.[7] The results of this crusade have not been uniformly beneficial. Relaxed branching regulations have impeded the ability of competing savings and loans to challenge Board approval of branching applications. Such challenges are especially difficult under FHLBB procedures for processing applications and under the arbitrary and capricious standard for judicial review of the Board's decision. Courts have incorrectly applied this standard to FHLBB branching decisions, compounding the problems gener-

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[4] *See* note 1 *supra*.

[5] On the regulation of savings and loan associations, and of branching in particular, see Bartell, *Examination and Supervision*, in 4 STUDY OF THE SAVINGS AND LOAN INDUSTRY 1689, 1749-50 (I. Friend ed. 1969) (recommending changes in supervision to prevent savings and loan failures); COMMISSION ON MONEY AND CREDIT, MONEY AND CREDIT, THEIR INFLUENCE ON JOBS, PRICES AND GROWTH 166-67 (1961) (recommending that federal savings and loans branch into any trading area); Friend, *Summary and Recommendations*, in 1 STUDY OF THE SAVINGS AND LOAN INDUSTRY 1, 12 (I. Friend ed. 1969) (widen scope of branching to achieve economies of scale); PRESIDENT'S COMMISSION ON FINANCIAL STRUCTURE AND REGULATION, REPORT 59 (R. Hunt chrm. 1972) (states should remove branching restrictions).

Numerous other commentators have criticized the current regulation of banks and other financial intermediaries. *See, e.g.*, Clark, *The Soundness of Financial Intermediaries*, 85 YALE L.J. 1, 44 (1976); Davis, *Banking Regulation Today: A Banker's View*, 31 L. & CONTEMP. PROB. 639 (1966); Kreps, *Modernizing Banking Regulation*, *id.* at 648.

[6] In 1932, Congress passed the Federal Home Loan Bank Act, establishing a system of 12 federal banks analogous to the Federal Reserve Bank system, and the Federal Home Loan Bank Board, designed to service the savings and loan industry. Pub. L. No. 72-304, 47 Stat. 725 (codified at 12 U.S.C. §§ 1421-1449 (1976)). In 1933, it enacted the Home Owners' Loan Act, which authorized the FHLBB to charter savings and loan associations. Pub. L. No. 73-43, 48 Stat. 128 (codified at 12 U.S.C. §§ 1461-1468 (1976)). The FHLBB was originally an independent federal agency, but during the 1940's and early 1950's it was subordinate to several federal housing agencies. In 1955, the FHLBB resumed its status as an independent regulatory agency. *See* 12 U.S.C. § 1437(b) (1976); T. MARVELL, THE FEDERAL HOME LOAN BANK BOARD 38-39 (1969).

[7] "As a general policy, the Board encourages the establishment of branch offices and other office facilities by Federal associations in communities and market areas which either are not serviced or are underserviced by existing savings and loan facilities." 12 C.F.R. § 556.5(b)(5) (1979). The Board also favors increasing competition by "permitting more than one savings and loan facility in a market area." *Id. See generally* Carrington, *Not Planning to Branch?*, FED. HOME LOAN BANK BOARD J. 15 (Sept. 1973); 44 Fed. Reg. 36,057, 36,059 (1979) (comments by FHLBB supporting proposed rule to expand branching).

ated by the Board's failure to provide an adequate forum for challenging its decisions and to explain those decisions.

The Seventh Circuit confronted these difficulties in *City Federal Savings & Loan Association v. FHLBB*.[8] It correctly repudiated settled practice concerning judicial review of FHLBB decisions and undermined the Board's long-standing privilege of operating in obscurity.

I

THE LEGAL CONTEXT OF CITY FEDERAL

A. *FHLBB Procedures*

Acting on applications for branch offices has become one of the FHLBB's important regulatory functions. The Home Owner's Loan Act of 1933[9] (HOLA) did not explicitly grant the FHLBB power to authorize federal associations to establish branches. Nonetheless, many courts have held that the Act confers this authority by implication,[10] and the FHLBB has issued extensive regulations to govern branch applications. An applicant association must show:

(1) the necessity for the branch in the community it will serve;
(2) the reasonable probability of success for the branch;
(3) that there will be no undue injury to existing thrift institutions; and
(4) that the applicant has met the credit requirements of communities it currently serves.[11]

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[8] 600 F.2d 681 (7th Cir. 1979).

[9] Act of June 13, 1933, Pub. L. No. 73-43, 48 Stat. 128 (codified at 12 U.S.C. § 1464 (1976)). For a general history of the Home Owners' Loan Act and federal law creating savings and loans, see Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 908-10 (C.D. Cal. 1978).

[10] Section 5(a) of the Home Owners' Loan Act, 12 U.S.C. § 1464(a) (1976), gave the FHLBB authority to charter savings and loan associations "giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States." Several federal courts have relied on the broad grant of discretion in § 5(a) of the Act as authority for the FHLBB's power to allow federal associations to branch. *See, e.g.*, City Fed. Sav. & Loan Ass'n v. FHLBB, 600 F.2d 681, 685-86 (7th Cir. 1979). Other federal courts have implied this authority from § 5(c) of the Act, 12 U.S.C. § 1464(c) (1976), which allows federally chartered associations to invest in mortgages on residential property located within 100 miles of the home office. *See, e.g.*, North Arlington Nat'l Bank v. Kearny Fed. Sav. & Loan Ass'n, 187 F.2d 564, 565 (3d Cir. 1951). *See generally* Fayetteville Sav. & Loan Ass'n v. FHLBB, 570 F.2d 693, 697 (8th Cir. 1978).

[11] 12 C.F.R. § 545.14(c) (1979). These criteria are the same as those the Board uses in its chartering decisions, except that branch applicants must show that they have met the

Federally chartered savings and loan associations, and, in some cases, state chartered associations and state and federally chartered banks,[12] may challenge a branch proposal. If the Board

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credit needs of their communities rather than that persons of "good character and responsibility" run the association. *Compare* 12 U.S.C. § 1464(e) (1976) *with* 12 C.F.R. § 545.14(c) (1979).

The Board recently proposed a regulation which, if adopted, would modify these branching criteria. The proposed rule would "revise criteria to include only the 'undue injury' test and applicant's performance under the Community Reinvestment Act." 44 Fed. Reg. 36,060 (1979). Performance under the Community Reinvestment Act (CRA) shows the extent to which an applicant has made loans in its local community. The Board also proposes to apply these same criteria to all other facilities requiring Board approval (*i.e.*, satellite, limited facility, and mobile offices). The reason for the change is that the Board "believes that branching should be a business decision of the management of an association and that it should generally defer to that decision unless supervisory, 'undue injury', or CRA problems exist." 44 Fed. Reg. 36,061 (1979). Although elimination of the "necessity" test is questionable, it is possible to rephrase challenges based on lack of necessity in terms of undue injury. Elimination of this criterion will not likely reduce the number of challenges to the Board's branching decisions.

Under current law, a branch applicant also must be eligible under 12 C.F.R. § 545.14(b) (1979) and its proposed operations must not "afford a basis for supervisory objection." 12 C.F.R. § 545.14(d)(2) (1979). The FHLBB's regulations empower the Director of the Office of Examinations and Supervision to determine whether the applicant's net worth, management, lending practices, assets, and current operations are satisfactory before the Board will consider the branch application. 12 C.F.R. § 556.5(a)(7) (1979). No reported cases challenging the Board's discretion concerning this factor have been discovered.

There are several other, more objective criteria which may affect a branching decision. Although the Board now allows statewide branching (*see* 44 Fed. Reg. 4899, 36,012-13 (1979)), it generally does not allow interstate branching. *See* 12 C.F.R. § 556.5(b)(2) (1979). There are, however, exceptions to this rule, and the Board recently proposed a new regulation which would allow interstate branching within the Washington, D.C.-Maryland-Virginia area. 44 Fed. Reg. 36,057 (1979). The Board also generally prohibits a federal association from branching in a state which does not allow its own state chartered associations to establish branches. 12 C.F.R. § 556.5(b)(1) (1979). *See* Bloomfield Fed. Sav. & Loan Ass'n v. American Community Stores, Inc., 396 F. Supp. 384, 388-89 (D. Neb. 1975). The Board nevertheless makes exceptions to this rule, and a recent case upheld the Board's discretion to allow branching in such a state. Lyons Sav. & Loan Ass'n v. FHLBB, 377 F. Supp. 11 (N.D. Ill. 1974). *See* 51 CHI.-KENT L. REV. 656 (1975). The Board will also give special treatment to an application for a branch office that will serve "low-income, inner-city areas which are inadequately served by existing savings and loan facilities." 12 C.F.R. § 556.5(b)(4)(ii) (1979).

[12] In theory the FHLBB may be sued only by a federally chartered savings and loan association, its officers, and its directors. Central Sav. & Loan Ass'n v. FHLBB, 422 F.2d 504, 505 (8th Cir. 1970); 12 U.S.C. § 1464(d) (1976). But a state chartered bank or savings and loan may sue the Board if it names the individual members of the Board as party defendants. Courts have held, without explanation, that this triggers federal question jurisdiction under 28 U.S.C. § 1331(a) (1976). Bank of Ozark v. FHLBB, 402 F. Supp. 162, 165 (E.D. Ark. 1975). *See also* Community Sav. & Loan Ass'n v. FHLBB, 443 F. Supp. 927 (E.D. Wis. 1978), *vacated sub nom.* City Fed Sav. & Loan Ass'n v. FHLBB, 600 F.2d 681 (7th Cir. 1979) (state chartered associations named Board members as defendants).

receives a "substantial protest," a hearing officer appointed by the Board hears oral argument on the application at the request of the protesting party.[13] The Board itself, after reviewing the evidence and the recommendations of its staff and the hearing officer, either grants or denies the application.[14]

No statute or regulation requires the Board to announce reasons for the decisions it makes on branching applications and subsequent protests.[15] Although Congress amended the HOLA

State chartered associations are not free from federal regulation, however; many are subject to both state and federal control. Deposit insurance through the Federal Savings and Loan Insurance Corporation (FSLIC), mandatory for federally chartered institutions, is also available to state chartered associations, provided they meet the requirements of 12 U.S.C. § 1726 (1976). The FSLIC insured 2,053 of the 2,723 state associations existing in 1978. FEDERAL HOME LOAN BANK BOARD, 1978 COMBINED FINANCIAL STATEMENTS 4 (1979). Thus, dual regulation of state chartered associations is quite common. *See* Wille, *State Banking: A Study In Dual Regulation*, 31 L. & CONTEMP. PROB. 733, 735 (1966).

[13] The FHLBB uses essentially the same procedures in processing charter applications and branch applications. *See* 12 C.F.R. § 545.14(e) (1979) (referring to 12 C.F.R. § 543.2(c)-(f) (1979)). Recent FHLBB regulations explicitly set out the criteria and procedures to be used in branching cases instead of relying on this cross-reference to chartering regulations. 44 Fed. Reg. 36,061 (1979).

The Board's primary actors in this process are the Principal Supervisory Agent of the Board (who may be either the President of the Federal Home Loan Bank of the district in which the applicant's home office is located or someone designated by the Board) and the Supervisory Agent (who may be a staff officer or employee of the Board or the Principal Supervisory Agent). 12 C.F.R. § 545.14(a)(3) (1979). The Supervisory Agent oversees most of the application process. He is responsible for determining whether a protest to a proposed branch application is "substantial." *See* 12 C.F.R. §§ 543.2(3), 545.14(e) (1979). These regulations do not define "substantial"; it is apparently left to the discretion of the Supervisory Agent. If a protest is certified as substantial, the protesting party may then request that oral argument be heard on the application. The regulations provide no procedures for oral argument, nor do they incorporate any provisions of the Administrative Procedure Act, 5 U.S.C. §§ 500-706 (1976). The regulations only mention that exhibits may be received and that a transcript will be kept.

[14] 12 C.F.R. § 545.14(K) (1979).

[15] The APA seems like a promising place to look for such a provision. Courts, however, complemented their early hesitancy to apply the APA's judicial review standards to the FHLBB (*see* notes 45-49 and accompanying text *infra*) by refusing to bind the Board to any of the APA's procedural safeguards. These procedures are set out in 5 U.S.C. §§ 551-559 (1976) and include detailed requirements for certain types of administrative decisionmaking processes. The Home Owners' Loan Act failed to mention the APA or to include any other procedural requirements, and courts interpreted this omission to mean that the Board did not have to hold a hearing on a branching decision or to issue findings and conclusions. *See* Reich v. Webb, 336 F.2d 153, 159 (9th Cir. 1964) (challenge to transfer of controlling interest in savings and loan); Bridgeport Fed. Sav. & Loan Ass'n v. FHLBB, 307 F.2d 580, 581 (3d Cir. 1962), *cert. denied*, 371 U.S. 950 (1963); FHLBB v. Rowe, 284 F.2d 274, 275 (D.C. Cir. 1960) (cbarter application); First Nat'l Bank v. First Fed. Sav. & Loan Ass'n, 225 F.2d 33, 36 (D.C. Cir. 1955); *cf.* Home Loan Bank Bd. v. Mallonee, 196 F.2d 336, 379-81 (9th Cir. 1952) (hearing required in some cases involving appointment of conservator), *cert. denied*, 345 U.S. 952 (1953).

in 1966 to provide that the Administrative Procedure Act's (APA) procedural requirements would apply to certain administrative actions of the Board,[16] these amendments did not apply to that section of the HOLA which courts have held to be the source of the FHLBB's branching authority.[17] Thus, courts have consistently concluded that the APA neither requires the Board to hold any kind of a hearing when it acts on a branching application nor to state reasons for its conclusions.[18]

These decisions are correct; the APA requirement for a hearing in adjudicatory decisions applies only to those agency decisions "required by *statute* to be determined on the record after opportunity for an agency." 5 U.S.C. § 554(a) (1976) (emphasis added). The Home Owners' Loan Act has no such statutory requirement. The inapplicability of the APA hearing procedures to the FHLBB also draws indirect support from the legislative history of the APA; Congress apparently intended to exclude "banking agencies" from the various hearing requirements. *See* COMMITTEE ON ADMINISTRATIVE PROCEDURE, ADMINISTRATIVE PROCEDURE IN GOVERNMENT AGENCIES, S. DOC. No. 8, 77th Cong., 1st Sess. 142-43 (1943); *Administrative Procedure, Part 4: Hearings on S. 674, S. 675, and S. 918 Before a Subcomm. of the Sen. Comm. on the Judiciary*, 77th Cong., 1st Sess. 1525, 1546 (1941) (statement by Treasury Dept. that administrative procedure bills should not apply to banking agencies). *See generally* 1 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 4.04 (1958).

[16] Pub. L. No. 89-695, tit. I, § 101(a), 80 Stat. 1028, 1033 (1966).

[17] The amendments affected 12 U.S.C. § 1464(d)(7)(A) (1976), which grants to the Board wide discretion in regulating "unsafe and unsound" practices of savings and loans and provides the Board with authority to issue cease and desist orders, remove officers and directors, and appoint conservators. This language brings any hearings by the Board and judicial review of Board decisions exclusively under this subsection within the explicit scope of the APA. But courts have held that the Board's authority to allow branching arises under either 12 U.S.C. § 1464(a) (1976) or 12 U.S.C. § 1464(c) (1976). *See* note 10 *supra*.

[18] *See* note 15 *supra*. Courts have also reached this result by analogizing to Camp v. Pitts, 411 U.S. 138 (1973). *See* First Fed. Sav. & Loan Ass'n v. FHLBB, 426 F. Supp. 454, 457 (W.D. Ark. 1977), *aff'd sub nom.* Fayetteville Sav. & Loan Ass'n v. FHLBB, 570 F.2d 693 (8th Cir. 1978); Reliance Fed. Sav. & Loan Ass'n v. FHLBB, 407 F. Supp. 950, 954 n.1 (N.D. Ill. 1976); Bank of Ozark v. FHLBB, 402 F. Supp. 162, 166 (E.D. Ark. 1975); Elm Grove Sav. & Loan Ass'n v. FHLBB, 391 F. Supp. 1041, 1043 (E.D. Wis. 1975); Lyons Sav. & Loan Ass'n v. FHLBB, 377 F. Supp. 11, 24-25 (N.D. Ill. 1974); Benton Sav. & Loan Ass'n v. FHLBB, 365 F. Supp. 1103, 1104 (E.D. Ark. 1973). In *Pitts*, the Supreme Court held that the APA did not compel the Comptroller of the Currency, when chartering national banks, to hold hearings or to make formal findings of fact and law based on a hearing record. 411 U.S. at 140-41. But the *Pitts* Court did order the lower court to remand the case for further explanation by the Comptroller. It cited no statutory authority for this disposition, arguing instead that judicial review was impossible on the existing record. *See id.* at 143. For a discussion of the similar roles of the Comptroller and the FHLBB, see notes 27-29 and accompanying text *infra*.

Interestingly, FHLBB regulations prior to 1970 did provide for quasi-trial procedures even though the courts did not require any hearing. *See* 12 C.F.R. § 545.14(h)(2) (1970). *See also id.* § 545.14(h)(1). In 1970, amendments to these regulations eliminated all references to a hearing requirement. *See* 35 Fed. Reg. 2509, 2511-12 (1970). Since 1970, the Board has further amended these regulations to require a hearing only in the event of a "substantial protest." *See* 12 C.F.R. §§ 543.2(f), 545.14(e) (1979). Thus, the Board has eliminated the procedural limitations it once imposed upon itself. *See generally* Scott, *In Quest of Reason: The Licensing Decisions of the Federal Banking Agencies*, 42 U. CHI. L. REV. 235, 268-69 (1974).

B. *Judicial Review of Branching Decisions*

1. *The Applicability of the Administrative Procedure Act*

During the 1950's and 1960's, some courts questioned whether the APA and its standards of judicial review[19] applied to branching decisions of the FHLBB.[20] Some courts even found that FHLBB decisions were not susceptible to judicial review of any kind.[21] This uncertainty had several sources. First, the APA classifies agency proceedings as either rulemaking or adjudicatory.[22] Branching decisions do not fit neatly within either cate-

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[19] The APA sets out six standards for judicial review of administrative decisions:

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;
(B) contrary to constitutional right, power, privilege or immunity;
(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;
(D) without observance of procedure required by law;
(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or
(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

5 U.S.C. § 706(2) (1976). Since a court may always review administrative action under (B), (C), and (D), the question arising in litigation is which, if any, of the other three standards—arbitrary and capricious, substantial evidence, or trial de novo—is appropriate.

[20] *See* Bridgeport Fed. Sav. & Loan Ass'n v. FHLBB, 307 F.2d 580, 581-82 (3d Cir. 1962), *cert. denied*, 371 U.S. 950 (1963); First Nat'l Bank v. First Fed. Sav. & Loan Ass'n, 225 F.2d 33, 35-36 (D.C. Cir. 1955).

[21] *See* FHLBB v. Rowe, 284 F.2d 274, 277-79 (D.C. Cir. 1960) (chartering decision); First Nat'l Bank v. First Fed. Sav. & Loan Ass'n, 225 F.2d 33, 36 (D.C. Cir. 1955) (branching decision).

[22] Rulemaking involves prospective agency policy decisions which apply to a group of people or entities and is governed by 5 U.S.C. § 553 (1976). Adjudication is analogous to a trial where a decision is rendered based on a record after an agency hearing under 5 U.S.C. § 554 (1976). *See* Independent Bankers Ass'n of Georgia v. Board of Governors of Fed. Reserve System, 516 F.2d 1206, 1215 (D.C. Cir. 1975); 2 K. DAVIS, ADMINISTRATIVE LAW TREATISE §§ 7:2-:3 (2d ed. 1979). The substantial evidence standard of review applies only to those rulemaking and adjudicatory proceedings which require a hearing under 5 U.S.C. §§ 556-557 (1976). *See* Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 414 (1970); 5 U.S.C. § 706(2)(E) (1976). Essentially, courts have applied the substantial evidence test to review formal rulemaking and adjudicatory decisions made on a record required by statute. Courts have employed the arbitrary and capricious standard to review agency decisions involving more informal procedures. *See* K. DAVIS, ADMINISTRATIVE LAW OF THE SEVENTIES § 29.01-3 (1976). 5 U.S.C. § 706(2)(F) (1976) limits the application of the trial de novo standard to instances where there is inadequate factfinding in an adjudicatory action, or new issues are raised in a proceeding to enforce nonadjudicatory agency action. *See Overton Park*, 401 U.S. at 415.

gory because they have features of both.[23] Second, many courts interpreted Congress' broad grant of discretionary authority to the Board as precluding judicial review.[24] Third, branching decisions often involve complex policy choices and produce voluminous records of economic evidence. Many courts were content to leave such decisions to the Board.[25] As a result of this confusion, courts applied a variety of reviewing standards.[26]

Camp v. Pitts,[27] a 1973 Supreme Court decision, was the watershed case concerning the standard for judicial review. In *Pitts,* plaintiff challenged a decision of the Comptroller of the Currency denying its application for a national bank charter. The Court held that the APA applied and that the proper standard of review was whether the decision was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[28]

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[23] *See* Community Sav. & Loan Ass'n v. FHLBB, 443 F. Supp. 927, 932 (E.D. Wis. 1978), *vacated on other grounds sub nom.* City Fed. Sav. & Loan Ass'n v. FHLBB, 600 F.2d 681 (7th Cir. 1979).

[24] Under 5 U.S.C. § 701(a)(2) (1976), review of agency action under the APA is precluded if the "agency action is committed to agency discretion by law." Several courts interpreted the Home Owners' Loan Act of 1933 as granting broad discretion to the FHLBB and, thus, precluded judicial review. *See* FHLBB v. Rowe, 284 F.2d 274, 277-79 (D.C. Cir. 1960) (chartering decision); First Nat'l Bank v. First Fed. Sav. & Loan Ass'n, 225 F.2d 33, 36 (D.C. Cir. 1955) (branching decision).

[25] The Federal Home Loan Bank Board is an agency which has been granted a broad discretion by the Congress in its disposition of applications of the type involved. The rulings of the Board are the result of its expert judgment, its policy, the reports, recommendations and analyses of its staff, plus any special evidence it might conclude necessary to obtain by way of hearing.

Bridgeport Fed. Sav. & Loan Ass'n v. FHLBB, 307 F.2d 580, 584 (3d Cir. 1962), *cert. denied,* 371 U.S. 950 (1963).

[26] The first reported decision applying the arbitrary and capricious standard to a branching decision was Central Sav. & Loan Ass'n v. FHLBB, 293 F. Supp. 617, 623 (S.D. Iowa 1968), *aff'd,* 422 F.2d 504 (8th Cir. 1970).

[27] 411 U.S. 138 (1973). *Pitts* resolved the judicial review issue raised in numerous cases during the 1960's and early 1970's involving the Comptroller of the Currency, who is responsible for chartering and regulating national banks. *See, e.g.,* Peoples Bank v. Saxon, 373 F.2d 185 (6th Cir. 1967); Webster Groves Trust Co. v. Saxon, 370 F.2d 381 (8th Cir. 1966); First Nat'l Bank v. Saxon, 352 F.2d 267 (4th Cir. 1965), *aff'd sub nom.* First Nat'l Bank v. Walker Bank, 385 U.S. 252 (1966); Farmers Nat'l Bank v. Camp, 345 F. Supp. 622 (D. Md. 1971).

[28] 411 U.S. at 142 (quoting 5 U.S.C. § 706 (1976)). *See* note 19 and accompanying text *supra.*

The first holding of *Camp v. Pitts* was that Comptroller decisions were reviewable. 411 U.S. at 140 (citing Association of Data Processing Serv. Orgs. v. Camp, 397 U.S. 150, 156-58 (1970)). This holding contrasts strikingly with the view that prevailed in some federal courts during the 1950's and 1960's that the Comptroller's decisions were unreviewable. *See, e.g.,* Michigan Nat'l Bank v. Gidney, 237 F.2d 762 (D.C. Cir.), *cert. denied,* 352 U.S. 847 (1956); Stokes, *Public Convenience and Advantage in Applications for New Banks*

Because the Comptroller's charter decisions are very similar to FHLBB branching decisions,[29] courts reviewing FHLBB cases have subsequently followed *Pitts* and applied the arbitrary and capricious standard.[30]

Several considerations support the extension of *Pitts* to FHLBB branching decisions. Courts have held that the Board's decisions are sufficiently discretionary to insulate them from judicial review.[31] This view, however, is unpersuasive. A statutory grant of broad discretionary power to an agency does not, without more, preclude judicial review of agency decisions.[32] Federal courts have found agency action committed by law to agency discretion only where: (1) Congress intended to foreclose judicial review; (2) the issue is inappropriate for judicial determination; or (3) other policy reasons justify denial of review.[33] These factors suggest that the HOLA should not preclude judicial review of FHLBB branching decisions.[34] Moreover, absent a clear legisla-

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and Branches, 74 BANK L.J. 921, 930 (1957) (no right to appeal from Comptroller's decision). *Cf.* FHLBB v. Rowe, 284 F.2d 274 (D.C. Cir. 1960) (similar attitude for review of FHLBB decisions); note 21 and accompanying text *supra*.

[29] *See* Scott, *supra* note 18, at 243-68 (tracing parallel development of branching authority of Comptroller and FHLBB). This similarity is sufficiently strong that FHLBB cases often cite and apply the holdings from Comptroller cases without discussion of their applicability. *See, e.g.*, Community Sav. & Loan Ass'n v. FHLBB, 443 F. Supp. 927, 933 (E.D. Wis. 1978), *vacated and remanded sub nom,* City Fed. Sav. & Loan Ass'n v. FHLBB, 600 F.2d 681 (7th Cir. 1979); Bank of Ozark v. FHLBB, 402 F. Supp. 162, 166 (E.D. Ark. 1975); Lyons Sav. & Loan Ass'n v. FHLBB, 377 F. Supp. 11, 25 (N.D. Ill. 1974).

[30] *See* Community Sav. & Loan Ass'n v. FHLBB, 443 F. Supp. 927, 932-33 (E.D. Wis. 1978), *vacated and remanded sub nom,* City Fed. Sav. & Loan Ass'n v. FHLBB, 600 F.2d 681 (7th Cir. 1979); First Fed. Sav. & Loan Ass'n v. FHLBB, 426 F. Supp. 454, 458 (W.D. Ark. 1977), *aff'd sub nom,* Fayetteville Sav. & Loan Ass'n v. FHLBB, 570 F.2d 693 (8th Cir. 1978); Bank of Ozark v. FHLBB, 402 F. Supp. 162, 166 (E.D. Ark. 1975); Elm Grove Sav. & Loan Ass'n v. FHLBB, 391 F. Supp. 1041, 1042 (E.D. Wis. 1975); Lyons Sav. & Loan Ass'n v. FHLBB, 377 F. Supp. 11, 25 (N.D. Ill. 1974); Benton Sav. & Loan Ass'n v. FHLBB, 365 F. Supp. 1103, 1104 (E.D. Ark. 1973).

[31] *See* note 24 *supra*.

[32] K. DAVIS, ADMINISTRATIVE LAW OF THE SEVENTIES § 28.16-1 (1976).

[33] *Id.* at 641. Professor Davis rejects the Supreme Court's formulation, enunciated in Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402 (1971), that a decision is committed to agency discretion whenever there is no "law to apply" as being unreliable and contrary to previous holdings on this issue. *Id.*

[34] *Compare* Bridgeport Fed. Sav. & Loan Ass'n v. FHLBB, 307 F.2d 580 (3d Cir. 1962), *cert. denied*, 371 U.S. 950 (1963) *and* FHLBB v. Rowe, 284 F.2d 274 (D.C. Cir. 1960) *and* First Nat'l Bank v. First Fed. Sav. & Loan Ass'n, 225 F.2d 33 (D.C. Cir. 1955) *with* K. DAVIS, *supra* note 32 (discussing case law on decisions committed to agency discretion). Although many "standards" have been used to determine what subjects are appropriate for judicial review, the narrow inquiry is whether the court is *"qualified* to resolve" the issue. First Nat'l Bank v. Smith, 445 F. Supp. 1117, 1120 (D. Minn. 1977) (citing K. DAVIS, ADMINISTRATIVE LAW TEXT 515 (3d ed. 1972) (emphasis added)). Branching cases may involve complex economic data, but courts frequently confront such evidence.

tive command, courts should be reluctant to refrain from reviewing administrative action that broadly regulates primary conduct.[35] Finally, the due process clause of the fifth amendment may require judicial review of all agency action for arbitrariness and capriciousness, regardless of the APA.[36]

2. *The Arbitrary and Capricious Standard*

During the past decade, courts have significantly modified the arbitrary and capricious standard of review. Courts once viewed this standard as a general test of rationality,[37] but recently the Supreme Court has expanded the scope of review available under the arbitrary and capricious standard.[38] The Court's 1971 decision in *Citizens to Preserve Overton Park v. Volpe*[39] reflects this trend. The Court remanded this case, challenging a decision of the Secretary of Transportation, to the lower court. It instructed the district court to apply the arbitrary and capricious standard by "consider[ing] whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment."[40]

This formulation of the arbitrary and capricious test does not permit lower federal courts to rubber-stamp administrative decisions; they must subject agency action to searching and substantial inquiry.[41] The Court promoted active judicial review even

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[35] FHLBB regulation of the savings and loan industry clearly affects primary conduct in the business community. *See* notes 1-3 and accompanying text *supra*; notes 79-80 and accompanying text *infra*.

[36] *See* Berger, *Administrative Arbitrariness and Judicial Review*, 65 COLUM. L. REV. 55 (1965). In Yick Wo v. Hopkins, 118 U.S. 356, 373-74 (1886), the Supreme Court held that a valid law may not be enforced in an unconstitutional manner. Professor Berger argued that since an arbitrary and capricious law violates due process, an arbitrary application of that law, as occurred in *Yick Wo*, also violates due process. Berger, *supra*, at 71-74. After analyzing the legislative history of the APA in light of these constitutional principles, Professor Berger concluded that Congress could not have intended to preclude judicial review of any agency's actions for arbitrariness. *Id.* at 58-74.

[37] *See, e.g.*, Carlisle Paper Box Co. v. NLRB, 398 F.2d 1, 5-6 (3d Cir. 1968); Security Bank v. Saxon, 298 F. Supp. 991, 992 (E.D. Mich. 1968); East Cent. Motor Carriers Ass'n v. United States, 239 F. Supp. 591, 594-95 (D.D.C. 1965); Arrowhead Freight Lines v. United States, 114 F. Supp. 804, 812 (S.D. Cal. 1953).

[38] The best indicia of this expansion is the blurring of the distinctions between the arbitrary and capricious test and the substantial evidence standard. *See* K. DAVIS, *supra* note 32 at § 29.00. *See generally* note 19 *supra*. Courts once allowed "considerably more generous judicial review" under the latter. Abbott Laboratories v. Garner, 387 U.S. 136, 143 (1967).

[39] 401 U.S. 402 (1971).

[40] *Id.* at 416.

[41] [T]he arbitrary and capricious standard of review . . . is not a ritualistic procedure by which courts summarily endorse agency decisions as correct. To the

further in *Camp v. Pitts* by ordering the district court to remand to the Comptroller a case contesting his denial of a bank charter application. The record failed to reveal the grounds for the administrative decision and thus did not afford an adequate basis for judicial review.[42] Both the Supreme Court[43] and lower federal

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> contrary, a reviewing court must engage in a "substantial inquiry" into the facts, an inquiry that is "searching and careful," in order to determine whether the agency decision was based on a consideration of relevant factors . . . [citing *Overton Park inter alia*]. In complicated cases such as this one, moreover, the court must undertake an intensive review of the evidence relied upon by the agency in reaching its decision.

NAACP v. Wilmington Medical Center, Inc., 453 F. Supp. 280, 304-05 (D. Del. 1978). *Accord*, National Citizens Comm. for Broadcasting v. FCC, 555 F.2d 938, 956-62 (D.C. Cir. 1977), *aff'd in part, rev'd in part on other grounds*, 436 U.S. 775 (1978); Ethyl Corp. v. EPA, 541 F.2d 1, 34-35 (D.C. Cir.), *cert. denied*, 426 U.S. 941 (1976); Chrysler Corp. v. DOT, 472 F.2d 659, 664-71 (6th Cir. 1972).

The need for this substantial inquiry intensifies when evidence before the court suggests an agency has made inconsistent decisions: "While the courts cannot be concerned with the consistency or inconsistency of the conclusions and findings of the Commission, consistency of administrative *rulings* is essential, for to adopt different standards for similar situations is to act arbitrarily." HC&D Moving & Storage Co. v. United States, 298 F. Supp. 746, 751 (D.C. Hawaii 1969) (quoting Dixie Highway Express, Inc. v. United States, 268 F. Supp. 239, 241 (S.D. Miss. 1967) (emphasis in original) (footnotes omitted). *Accord*, Marco Sales Co. v. FTC, 453 F.2d 1, 7 (2d Cir. 1971); National Alliance of Postal & Fed. Employees v. Nickerson, 424 F. Supp. 323, 327 (D.D.C. 1976). *See generally* 2 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 8:9, at 196-200 (2d ed. 1979).

[42] 411 U.S. at 142-43.

[43] *See, e.g.*, Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, 435 U.S. 519, 542-50 (1978); FPC v. Transcontinental Gas Pipe Line Corp., 423 U.S. 326, 331 (1976); Dunlop v. Bachowski, 421 U.S. 560, 571 (1975); Bowman Transp., Inc. v. Arkansas-Best Freight Sys., Inc., 419 U.S. 281, 285 (1974); Gulf States Utils. Co. v. FPC, 411 U.S. 747, 763-64 (1973); *cf.* SEC v. Chenery Corp., 318 U.S. 80 (1943) (holding that court should remand decision to agency for better explanation).

In *Bachowski*, the Court held that, under the arbitrary and capricious standard of review, the Secretary of Labor had to give a statement of reasons for his decision for the lower court to intelligently review the case because the decision involved the Secretary's expertise and policy. 421 U.S. at 571. *See generally* K. DAVIS, *supra* note 32, § 29.01-6, at 271-72 (Supp. 1978). The *Vermont Yankee* decision reaffirmed the holding and disposition of *Camp v. Pitts* in a case reviewing informal administrative rulemaking. 435 U.S. at 548-49. The Court harsbly criticized the D.C. Circuit for imposing its own idea of rulemaking procedures on the agency when it had no authority to do so. The Court, however, still remanded the decision for the D.C. Circuit to consider whether the agency's rule was sustainable on the administrative record. *Id.* at 549.

These cases may even have reversed the relative strictness of the two standards of review. In *Bowman*, Justice Douglas implied that review under the arbitrary and capricious standard may be broader than under the substantial evidence test in some cases because a decision supported by substantial evidence "may nonetheless reflect arbitrary and capricious action." 419 U.S. at 284.

Professor Davis has argued that the use of the phrase "clear error of judgment" in *Overton Park* tended to equate the arbitrary and capricious standard with the "clearly er-

courts[44] have subsequently relied on this rationale.

3. *Application of the Arbitrary and Capricious Standard to FHLBB Branching Decisions*

The modern interpretation of the arbitrary and capricious standard has not exerted a discernible effect on judicial review of FHLBB branching decisions. Although courts have purported to follow *Pitts*,[45] they have done so in form rather than substance. Instead of engaging in a searching review of the record and remanding cases which lack adequate explanations, several courts have upheld Board decisions supported only by a cursory statement by the Board that the applicant has or has not satisfied the branching criteria.[46] *Elm Grove Savings & Loan Association v.*

roneous" standard, which is the narrowest form of judicial scrutiny of facts. K. DAVIS, *supra* note 32, § 29.00, at 648. He reasoned that the Court clearly committed an inadvertent error, and as a result lower courts might interpret *Overton Park* as mandating much narrower review under the arbitrary and capricious standard. *Id.* He criticized the *Camp v. Pitts* decision for failing to clarify *Overton Park's* language, although he conceded that *Pitts* clearly distinguished the substantial evidence standard from the arbitrary and capricious standard. *Id.* at 651. Davis's criticism of *Overton Park* and *Camp v. Pitts* is diluted by his own conclusion that the label courts give a reviewing standard is trivial compared to what they actually do:

> [w]hat matters is that federal judges generally understand that they may not properly substitute their judgment for administrative judgment except on questions of law ... and that in most cases other factors have a much stronger influence than the words of the formula that is supposed to apply. Whatever the formulas, good judges customarily tread lightly when they are impressed with the care, conscientiousness, and balance of the administrators ....

Id. at 653.

[44] *See, e.g.*, American Meat Inst. v. EPA, 526 F.2d 442, 447 (7th Cir. 1975); National Nutritional Foods Ass'n v. Weinberger, 512 F.2d 688, 701-04 (2d Cir.), *cert. denied*, 423 U.S. 827 (1975); Coates v. Laird, 494 F.2d 709, 711 (4th Cir. 1974); Calcutta E. Coast of India & E. Pakistan/U.S.A. Conf. v. FMC, 399 F.2d 994, 997 (D.C. Cir. 1968); McNutt v. Hills, 426 F. Supp. 990, 1004 (D.D.C. 1977). *Cf.* Hill v. Morton, 525 F.2d 327, 328 (10th Cir. 1975) (district court opinion which failed to explain why agency decision was arbitrary and capricious did not provide basis for judicial review); First Nat'l Bank v. Smith, 508 F.2d 1371, 1374 (8th Cir. 1974) (appellate court reviews evidence anew under arbitrary and capricious standard), *cert. denied*, 421 U.S. 930 (1975).

[45] *See* cases cited in note 30 *supra*.

[46] For example, in Reliance Fed. Sav. & Loan Ass'n v. FHLBB, 407 F. Supp. 950 (N.D. Ill. 1976), the court cited the following conclusory statement by the Board as satisfying the requirements of the branching regulations under the arbitrary and capricious standard: "[A] necessity exists for such a branch office, ... there is a reasonable probability of its usefulness and success, and ... it can be established without undue injury to properly conducted existing local thrift and home-financing institutions." *Id.* at 954.

These decisions rely on a statement by the Court in *Pitts* that although "[t]he explanation may have been curt ... it surely indicated the determinative reason for the final action taken." 411 U.S. at 143. This reliance is misplaced, for the Court did not intend to sanction "curt" explanations for any administrative decision; the Court was merely distinguishing *Overton Park* from the instant case. Unfortunately, several courts have seized upon this statement to uphold cursory administrative statements of reasons and conclusions.

FHLBB [47] typifies this approach:

> [T]he question on review is whether there is at least *some evidence in the record* to support the agency's decision. So long as there exists *some rational basis* for the agency's action, it may not be upset on review.[48]

This application of the standard neutralizes the impact of *Camp v. Pitts* on judicial review in FHLBB cases.[49]

II

CITY FEDERAL SAVINGS & LOAN ASSOCIATION v. FHLBB

In *City Federal Savings & Loan Association v. FHLBB* [50] the Seventh Circuit vacated two district court decisions upholding the FHLBB's approval of branch applications for a Milwaukee savings and loan association. In the first case,[51] the lower court upheld

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Other courts, however, have closely reviewed the facts underlying Board decisions. *See* Benton County Sav. & Loan Ass'n v. FHLBB, 450 F. Supp. 884, 887-88 (W.D. Ark. 1978); First Fed. Sav. & Loan Ass'n v. FHLBB, 426 F. Supp. 454, 458-61 (W.D. Ark. 1977), *aff'd sub nom,* Fayetteville Sav. & Loan Ass'n v. FHLBB, 570 F.2d 693 (8th Cir. 1978); Bank of Ozark v. FHLBB, 402 F. Supp. 162, 168-70 (E.D. Ark. 1975). This approach is more consistent with the general interpretation of the arbitrary and capricious standard.

[47] 391 F. Supp. 1041 (E.D. Wis. 1975).

[48] *Id.* at 1042 (quoting Winnetka Sav. & Loan Ass'n v. FHLBB, No. 73-C-2820, slip op. at 6 (N.D. Ill. Jan. 20, 1975)). The court went on to uphold the Board's decision. *Id.* at 1043-44.

[49] Courts have also found that brief, conclusory statements can satisfy the arbitrary and capricious text in Comptroller cases, which eviscerates *Camp v. Pitts. See* Scott, *supra* note 18, at 264-68. First Nat'l Bank v. Smith, 508 F.2d 1371 (8th Cir. 1974), *cert. denied,* 421 U.S. 930 (1975), exemplifies these cases. After citing *Pitts* for the appropriate reviewing standard, the court interpreted this test as requiring the decision only to have a rational basis and that "the party challenging the action must prove that it was 'willful and unreasoning action, without consideration and in disregard of the facts or circumstances of the case.' " 508 F.2d at 1376 (quoting 73 C.J.S. *Public Administrative Bodies and Procedure* § 209, at 569 (1951)). One court held that state banking law, not *Camp v. Pitts,* determined the appropriate standard of review for the Comptroller's chartering decisions. Grenada Bank v. Watson, 361 F. Supp. 728, 732 (N.D. Miss. 1973). Several Comptroller cases, mistakenly relying on language in *Camp v. Pitts* (*see* note 48 *supra*), have also upheld "curt" explanations by the Comptroller. *See* Central Bank v. Smith, 532 F.2d 37, 39-40 (7th Cir.), *cert. denied,* 429 U.S. 895 (1976); City Nat'l Bank v. Smith, 513 F.2d 479, 484-85 (D.C. Cir. 1975); Bank of Commerce v. City Nat'l Bank, 484 F.2d 284, 288-89 (5th Cir. 1973), *cert. denied,* 416 U.S. 905 (1974).

[50] 600 F.2d 681 (7th Cir. 1979).

[51] Community Sav. & Loan Ass'n v. FHLBB, 443 F. Supp. 927 (E.D. Wis. 1978), *vacated and remanded sub nom,* City Fed. Sav. & Loan Ass'n v. FHLBB, 600 F.2d 681 (7th Cir. 1979).

the Board's decision granting an application which the Board had denied to the same association under similar circumstances four years earlier.[52] In the second case,[53] the district court affirmed the Board's approval of a limited facility branch application for the same association involved in the first case.[54]

The Seventh Circuit remanded both cases to the FHLBB, holding that "the reasons for the Board['s] decisions [were] not explained adequately to permit judicial review at this time in either case."[55] The court did not want to make judicial review a "token matter."[56] On the other hand, it had to avoid substituting its judgment for that of the Board. It justified its holding by asserting that a court "cannot properly restrain its review unless the agency gives an adequate explanation of the connection between the record before it and the choice it makes."[57]

This ruling harmonizes the Seventh Circuit's treatment of FHLBB decisions with judicial review of other administrative decisions under the arbitrary and capricious standard.[58] Review is limited only by the admonition that a court may not merely substitute its own judgment for that of the Board. A court should hesitate to overturn a FHLBB decision if it determines, after scrutiny of the record, that the Board carefully considered the facts, but if the record does not reflect reasoned consideration, or if the Board failed to explain its decision adequately in the face of both favorable and unfavorable evidence, the court should reverse or remand the FHLBB's decision.[59]

Although the court framed *City Federal* in terms of the general application of the arbitrary and capricious standard, the decision is likely to have a unique impact on the FHLBB. The Seventh Circuit's holding requires the Board to make findings

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[52] *Id.* at 929-31.

[53] City Fed. Sav. & Loan Ass'n v. FHLBB, 441 F. Supp. 89 (E.D. Wis. 1977), *vacated and remanded*, 600 F.2d 681 (7th Cir. 1979).

[54] *Id.* at 98. A limited branch facility is defined in 12 C.F.R. § 545.14(j) (1979). The Board may approve the establishment of such a facility if it finds that the "necessity and reasonable probability of usefulness and success" of the branch does note satisfy the criteria for a regular branch office but "are met to a degree which would support a limited operation of a branch office." *Id.* The district court in *City Federal* held that judicial review of a limited facility branch "is even more circumscribed than review of [a] decision on a branch application." 441 F. Supp. at 97.

[55] 600 F.2d at 688.

[56] *Id.* at 692.

[57] *Id.* at 688.

[58] *See* notes 45-49 and accompanying text *supra*.

[59] 600 F.2d at 688-89.

and conclusions of some kind when evaluating branch applications. The court stressed that unless the Board indicates at least the "grounds and essential facts" supporting its decisions,[60] judicial review under the arbitrary and capricious standard is impossible. Unfortunately, neither the HOLA nor the APA require the Board to conduct hearings, make formal findings and conclusions, or state the reasons for its decisions.[61] Under what authority, then, may a court remand a branching decision to the FHLBB to state reasons and conclusions that it never had an obligation to reveal?

Arguably, section 706 of the APA[62] supports the *City Federal* decision by implication. Section 706 requires judicial review based on the "whole record" as developed by the agency.[63] There can be no review when there is no record before the court, as the Supreme Court reasoned in *Overton Park*.[64] No court, however, has adequately explored this statutory basis for the "remand if lacking explanation" disposition of a case.[65]

Policy considerations shore up this statutory analysis, however.[66] Without an explanation of an agency's action, the review-

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[60] *Id.* at 689 (quoting Dunlop v. Bachowski, 421 U.S. 560 573-74 (1975)). The court indicated that review should be possible if the Board states its "grounds and essential facts." *Id.*

[61] *Id.* at 689. *Accord*, Bank of Ozark v. FHLBB, 402 F. Supp. 162, 166 (E.D. Ark. 1975); Elm Grove Sav. & Loan Ass'n v. FHLBB, 391 F. Supp. 1041, 1043 (E.D. Wis. 1975); Lyons Sav. & Loan Ass'n v. FHLBB, 377 F. Supp. 11, 25 (N.D. Ill. 1974); Guaranty Sav. & Loan Ass'n v. FHLBB, 330 F. Supp. 470, 473 (D.D.C. 1971).

[62] 5 U.S.C. § 706 (1976).

[63] In *Overton Park*, the Court remanded because the lower court did not review the decision based on the whole record, as required under § 706, and not because of a lack of a formal statement of reasons. 401 U.S. at 417-20. The *Camp v. Pitts* opinion extended this interpretation by holding that the administrative decision must be "sustainable on the administrative record made." 411 U.S. at 143. The logical conclusion, then, is that a record which lacks an explanation is not sufficient to constitute the "whole record" required for judicial review under § 706.

[64] 401 U.S. at 419.

[65] The *City Federal* court noted in a footnote that the APA did not provide the basis for its decision to remand for a statement of reasons; it implied that the HOLA required the Board to state reasons. 600 F.2d at 689 n.11. No other court has cited the HOLA for this proposition.

It is arguable that § 706 and its "whole record" requirement is only a directive to reviewing courts, and not a command to administrative agencies to develop hearing records. Nevertheless, there is a right to judicial review in these cases (*see* notes 31-36 and accompanying text *supra*), and an agency should not be able to cripple this review by refusing to make an administrative record.

[66] As far back as 1943, the Supreme Court stated:

> If the action rests upon an administrative determination—an exercise of judgment in an area which Congress has entrusted to the agency—of course it must

ing court must either replace the agency's judgment with its own or abdicate the reviewing function by accepting the agency's judgment without inquiry.[67] The *City Federal* court avoided this choice by remanding for clarification:

> In some circumstances, however, the record before an agency shows that significant questions were seriously contested. If the agency decision does not address these issues, even a restrained exercise of judicial review is impossible, and a remand for clarification is necessary.[68]

This result preserves the courts' role without extending it beyond its rational boundaries.

In addition, *City Federal* fosters the integrity of the administrative process. In the absence of a statute that directly requires the FHLBB to hold a hearing on branch applications,[69] the court's demand for a statement of reasons is the only safeguard against arbitrary administrative action.[70] "[A]s a fundamental require-

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> not be set aside because the reviewing court might have made a different determination were it empowered to do so. But if the action is based upon a determination of law as to which the reviewing authority of the courts does come into play, an order may not stand if the agency has misconceived the law. In either event the orderly functioning of the process of review requires that the grounds upon which the administrative agency acted be clearly disclosed and adequately sustained.

SEC v. Chenery Corp., 318 U.S. 80, 94 (1943).

[67] City Fed. Sav. & Loan Ass'n v. FHLBB, 600 F.2d 681, 688 (7th Cir. 1979). It is important to distinguish judicial review of administrative action from other forms of review, including constitutional review under the rational basis test. Although arbitrary and capricious agency action may also be unconstitutional, these two standards serve different functions. Rational basis review is designed to determine whether there is a legitimate, rational connection between a problem and its legislative solution. Arbitrary action may result from improper motivation, impermissible legal grounds, unsupported evidence, or other improprieties that a rationale basis test would not necessarily reveal. *See* Berger, *supra* note 36 at 82-83. The arbitrary and capricious test is designed to discover and overturn such decisions.

[68] *Id.* at 689. *See* note 41 *supra*.

[69] *See* note 13 and accompanying text *supra*.

[70] Judge Stephens expressed this point well in 1938: "The requirement of findings is thus far from a technicality. On the contrary, it is to insure against Star Chamber methods, to make certain that justice shall be administered according to facts and law." Saginaw Broadcasting Co. v. FCC, 96 F.2d 554, 559 (D.C. Cir.), *cert. denied sub nom*, Gross v. Saginaw Broadcasting Co., 305 U.S. 613 (1938). *See* Dunlop v. Bachowski, 421 U.S. 550, 572 (1975) (" 'reasons' requirement promotes thought by the Secretary and compels him to cover the relevant points and eschew irrelevancies"); Verkuil, *The Emerging Concept of Administrative Procedure*, 78 COLUM. L. REV. 258, 302-03 (1978) ("The language [quoted above from *Bachowski*] is broad enough to reflect a new approach to policymaking and some have so viewed it." (footnote omitted)). Although this may not be a panacea, such a judicial reviewing policy, if nothing more, announces to administrators that the court will no longer defer blindly to their discretion.

ment of fair play, parties should know why a particular decision was [made]."[71] Awareness of the grounds for agency decisions will also enhance faith in the administrative process—a process responsible for a steadily increasing proportion of lawmaking today.[72] Stating the reasons for its decisions should not burden the Board unduly.[73] The *City Federal* court recognized that a statement of reasons need not be written with artistic refinement and that a separate statement may not be essential in every case.[74]

Judicial legislation of this sort arguably violates separation of powers. The courts, however, have a primary duty here: guarding against arbitrary administrative action. For courts to carry out their duty, they may need to adopt rules and procedures which indirectly affect matters of legislative policy.

[71] Flick, *Administrative Adjudications and the Duty to Give Reasons—A Search for Criteria*, 1978 PUBLIC L. 18, 19. Preservation of fundamental values of fair play in administrative procedure is a problem that both courts and commentators have wrestled with since Roscoe Pound's controversial speech to the ABA in 1906 when he questioned the wisdom of imposing adversarial concepts on administrative procedure. *See* Pound, *The Causes of Popular Dissatisfaction with the Administration of Justice*, 29 A.B.A. REP. 395, 397 (1906), *reprinted in* 57 A.B.A.J. 348, 349 (1971). Although most judges, lawyers, and legislatures believed the adversarial approach was best for administrative procedure, Congress in the APA adopted a different approach, recognizing that general procedural guidelines would be sufficient to assure administrative fairness. Verkuil, *supra* note 70, at 276-79. Justice Frankfurter was one of the first to recognize that the adversarial model was not appropriate for administrative procedure: "These differences in origin and function [between the courts and administrative agencies] preclude wholesale transplantation of the rules of procedure, trial, and review which have evolved from the history and experience of courts." FCC v. Pottsville Broadcasting Co., 309 U.S. 134, 143 (1940). The problem now is to determine what procedures are necessary to maintain democratic ideals of fair play while permitting implementations of administrative goals. Verkuil, *supra* note 70, at 282. Justice Frankfurter also answered this question: "To be sure, the laws under which these agencies operate prescribe the fundamentals of fair play. They require that interested parties be afforded an opportunity for hearing and that judgment must express a reasoned conclusion." *Pottsville Broadcasting*, 309 U.S. at 143-44.

[72] Professor Davis notes that there is a tendency for administrative agencies in the 1970's to rely on informal rulemaking procedures which, unlike their formal counterparts, do not require an agency to provide a hearing. Moreover, informal rulemaking is generally reviewed under the arbitrary and capricious standard, whereas formal rulemaking is subject to the substantial evidence test. *See* K. DAVIS, *supra* note 32, §§ 29.01, 29.01-2 (Supp. 1978).

[73] The Administrative Conference of the United States has recommended that if the FHLBB's decision is contested, if an invested person makes a request for a statement of reasons, or if the case presents issues of general importance, the Broad should furnish a written opinion. ADMINISTRATIVE CONFERENCE OF THE UNITED STATES, 1974-75 REPORT 38-40 (1976) (Recommendation 75-1). The Conference also recommended that a written opinion be furnished as a matter of course in all chartering decisions by the FHLBB. *Id.* The Conference reasoned that this scheme was an adequate compromise between eliminating review and requiring a written statement in each case. *Id.*

[74] 600 F.2d at 693 (citing SEC v. Chenery, 318 U.S. 80, 95 (1943)). Critics might cite the Supreme Court's recent decision in Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, 435 U.S. 519 (1978), to cast doubt on the thesis of this Note.

Finally, requiring the Board to explain its decisions in branching cases will force the FHLBB to articulate its branching policy clearly. An intelligible policy will better guide the primary conduct of those affected by these decisions—savings and loan associations planning to file or challenge a branching application. A clearly stated FHLBB policy also would be susceptible to congressional evaluation and modification. Congress has allowed the Board to develop its policies freely, presumably "giving primary consideration to the best practices" for savings and loans.[75] But this quiescence may be inappropriate; savings and loan branching policy exerts a significant impact on the public interest which the Board may overlook. The Board has concluded that "increased opportunity for branching will improve competition and enhance consumer services without harming small competitive institutions."[76] But branching affects location, hours of operation, and other factors that determine competition for savings and loan services.[77] Although large single-unit savings and loans may compete effectively against associations with branches, unrestricted branching throughout the industry may result in concentration and the elimination of smaller, marginal associations.[78] Several commentators believe that the gains in efficiency achieved through concentration outweigh the costs of concentration,[79] but none can

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There, the Court soundly reprimanded the D.C. Circuit Court for "unwarranted judicial examination of perceived procedural shortcomings of a rulemaking proceeding [which would] seriously interfere with that process prescribed by Congress." *Id.* at 548. *Vermont Yankee* is distinguishable, however, from cases such as *City Federal* and *Camp v. Pitts* which remanded administrative decisions for failure to state reasons. In *Vermont Yankee*, the D.C. Circuit held that a rule promulgated by the Atomic Energy Commission was invalid because of perceived inadequacies in the rulemaking proceedings. *Id.* at 541. Although the lower court had not specifically set out procedures for the Commission to use, the Supreme Court criticized the lower court's interference with the agency's authority to fashion its own rules. *Id.* at 542-45. The *City Federal* decision does not attempt to invalidate any valid FHLBB rule or to invalidate the procedures the Board follows. Instead, it only requires that the Board state reasons for its decisions as a prequisite to the court's effective exercise of the judicial reviewing function.

[75] 12 U.S.C. § 1464(a) (1976).

[76] 44 Fed. Reg. 36,059 (1979).

[77] *See* Note, *Branch Banking in Utah: Legal and Economic Analysis*, 9 UTAH L. REV. 372, 374-76, 391-92 (1964).

[78] *See* Gilbert & Longbrake, *The Effects of Branching by Financial Institutions on Competition, Productive Efficiency and Stability: An Examination of the Evidence*, 4 J. BANK RESEARCH 154, 298-304 (1974) (same conclusion applied to commercial banks); Verkuil, *Perspectives on Reform of Financial Institutions*, 83 YALE L.J. 1349, 1361-66 (1974).

[79] *See, e.g.*, Brigham & Pettit, *supra* note 1, at 1025-28; Clark, *supra* note 5, at 39-40 & n.116.

strike the balance precisely.[80] Congressional intent on this issue is unclear; the original rationale underlying Congress' creation of federally chartered savings and loans and the FHLBB has limited relevance today.[81] The Board may also be incapable of developing a reasoned, unbiased branching policy without congressional guidance.[82]

CONCLUSION

In the past, courts have failed to review FHLBB decisions meaningfully. *City Federal Savings & Loan Association v. FHLBB* subjected an FHLBB decision to a rigorous inquiry by adopting a modern interpretation of the arbitrary and capricious standard of judicial review. The Board has generally failed to issue explanations adequate to support judicial review under the arbitrary and capricious standard, and to guide the primary conduct of savings and loans. *City Federal* may curtail this ill-advised practice, at least where it seriously hinders judicial review of administrative action.

Jeffrey Heller

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[80] No one can determine whether the danger of oligopolistic behavior which accompanies increasing concentration outweighs the benefits of efficiency due to economies of scale. The structure of the savings and loan industry hampers any inquiry into the field. Studies of the effects of concentration in the banking industry tend to focus on quantifiable factors such as interest rates, cost of checking account services, and the price of other banking services. *See* Clark, *supra* note 5, at 39-40 & n.116. But the government limits competition involving many of these price related factors. *See, e.g.*, Regulation Q, 12 C.F.R. pt. 217 (1979) (limiting rate of return on accounts in national banks); 12 C.F.R. pt. 526 (1979) (limiting rate of return on accounts in savings and loans). These regulations limit the dangers flowing from concentration to the extent that they hold the cost of savings and loan services close to a competitive level. On the other hand, such non-price factors as hours of operation, branches, and customer service are a significant source of competition. *See generally* Note, *supra* note 77, at 375. Thus, even though price competition is limited in the savings and loan industry, avoiding concentration is important to consumer interests. Branching policy should be geared toward maintaining the level of competition among associations.

[81] Congress passed this legislation during the Depression to prevent the failure of the savings and loan industry. *See* Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 908-10 (C.D. Cal. 1978).

[82] Congress has delegated to the Board a wide range of powers. Since the Board is an independent agency, there is little legislative or executive control over its functions. Like most administrative agencies, the Board is highly susceptible to pressures of the industry it regulates. T. MARVELL, THE FEDERAL HOME LOAN BANK BOARD 217-18 (1969). As a result, "the FHLBB is subject to lopsided pressures—a great deal from the industry and none from the account holders and borrowers. In similar situations, some federal agencies have employees whose function is to air peoples' interests that would not otherwise come to light. The FHLBB could do the same." *Id.* at 231.