

October 1974

## Federal Savings & Loan Law

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### Recommended Citation

Shelley B. Gardner, *Federal Savings & Loan Law*, 51 Chi.-Kent L. Rev. 656 (1974).

Available at: <https://scholarship.kentlaw.iit.edu/cklawreview/vol51/iss2/18>

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## FEDERAL SAVINGS & LOAN LAW

*Lyons Savings and Loan Association v. Federal Home Loan Bank Board*,  
377 F.Supp. 11 (N.D. Ill. 1974).

From their nineteenth century "thrift club" origins, savings and loan associations have grown to become the nation's second largest financial intermediary. Within the past three decades, de-urbanization, the emergence of suburbs as the primary home financing areas, and the corresponding exodus of savings funds have caused the ability to open branch facilities to become a primary growth, if not survival, goal for savings and loan associations. In order to compete for savings funds and new markets, savings and loan associations have sought to expand their operations through branch offices. Industry growth through branching has become a significant factor, with the number of savings and loan branch offices now exceeding the number of main operating sites.<sup>1</sup>

While the Federal Home Loan Bank Board may authorize branch operations for federally-chartered associations, a number of states historically have prohibited or restricted branching for state-chartered associations.<sup>2</sup> Litigation has focused on the Federal Home Loan Bank Board's authorization of branching for federal associations in states where local law prohibits or restricts state association branching. Although Illinois prohibits branching for its state associations,<sup>3</sup> since 1973 the Federal Home Loan Bank Board has granted its approval for branch offices to Illinois-based federal associations.<sup>4</sup> This note will analyze *Lyons Savings and Loan Association v. Federal Home Loan Bank Board*,<sup>5</sup> a case challenging the permissibility of federal association branching in Illinois. In this context, federal policy and regulations, state law and

1. At year-end 1973 there were 12,344 savings and loan associations in the United States. Of the total number of associations, 57.5%, or 7,100, were branch offices, and 42.5% were main operating sites. In 1973, savings and loan associations became the nation's second largest financial intermediary, with assets in excess of 272.4 billion dollars and over-the-counter assets of 227.3 billion dollars. U.S. LEAGUE OF SAVINGS ASSOCIATIONS, SAVINGS AND LOAN FACT BOOK 62, 53 (1974 ed.) [hereinafter cited as FACT BOOK.]

2. Federal Home Loan Bank Board branching regulations are found at 12 C.F.R. 556.5. For a survey of state savings and loan branching laws, see Harth, *Additional Offices and Facilities of Savings Associations*, XL LEGAL BULL. 95, 107, 115-23 (1974) [hereinafter cited as Harth].

3. ILL. REV. STAT. ch. 32, § 709(b) (1973).

4. Letter of January 12, 1973, to U.S. Representative Edward R. Madigan from Carl O. Kamp, Jr., Acting Chairman of the Federal Home Loan Bank Board, found as Exhibit 1 to Defendant's Supplemental Memorandum in *Lyons Savings & Loan Ass'n v. Federal Home Loan Bank Board*, 377 F. Supp. 11 (N.D. Ill. 1974).

5. 377 F. Supp. 11 (N.D. Ill. 1974).

practice, case precedent, and the impact of branching on industry competition will be assessed.

### FEDERAL HOME LOAN BANK BOARD AND ILLINOIS POLICY

Branching has long been the subject of controversy. Its proponents argue that branching may provide greater convenience and more accessible services to the public at lower cost to associations, and that through branching associations may compete more effectively for their share of the savings market.<sup>6</sup> Branching's opponents, on the other hand, maintain that savings and loan associations are, historically and functionally, neighborhood "grass roots" organizations peculiarly responsive to unsophisticated savers and community needs for savings and home-financing services, whose unique character is lost in expansion and decentralization.<sup>7</sup>

The laws of the various states have historically differed rather markedly as to the permissibility of branching for financial institutions.<sup>8</sup> As to federally-chartered associations, the Federal Home Loan Bank Board (FHLBB) has traditionally pursued a policy of "competitive equality," gearing its approval for federal association branching to local statutes governing state association branching.<sup>9</sup> FHLBB regulations are, however, directive rather than mandatory, and the FHLBB may authorize practices inconsistent with local statutes when it determines that the "best practices" of state associations condone practices such as branching.<sup>10</sup>

In 1973, only one of the fifty states prohibited savings and loan branching. Illinois, with the second greatest volume of savings and loan assets in the nation,<sup>11</sup> forbade branching operations for its state-chartered associations, and federal savings and loan associations, in conformity with FHLBB regulation, were likewise prohibited from branching.<sup>12</sup>

The FHLBB aggressively supports savings and loan branching. Its current stance was summarized by the director of its Office of Industry Development: "Over the past couple of years, the Board has attempted to clear the

6. G. Gilbert and W. Longbrake, *The Effects of Branching by Financial Institutions on Competition, Productive Efficiency and Stability*, 1973 J. BANK RES. 154-56, 298-300 (two-part article published in Autumn and Winter issues) [hereinafter cited as Gilbert and Longbrake].

7. *Id.*

8. Harth, *supra* note 2, at 107, 115-123.

9. 12 C.F.R. 556.5(b)(1).

10. 12 U.S.C. § 1464(a) (1970); 12 C.F.R. 556.5(b)(1).

11. Assets of Illinois savings and loan associations in 1973 were 20.97 billion dollars, or 7.7% of the national total. FACT BOOK, *supra* note 1, at 56.

12. See Office of Industry Development, Federal Home Loan Bank Board: *Branch Banking in Illinois: Fact or Fiction?*, prepared August, 1972, and contained in Exhibits to Defendant's Consolidated Memorandum of Points and Authorities in *Lyons Savings & Loan Ass'n v. Federal Home Loan Bank Board*, 377 F. Supp. 11 (N.D. Ill. 1974) [hereinafter cited as OID study].

path . . . for associations to branch. The new Board has indicated its desire to continue in the same direction."<sup>13</sup> The FHLBB urges associations to compete aggressively for a share of the savings market and to accelerate their movement into new market areas. It warns that savings and loan associations are in competition for savings accounts with other types of financial institutions, and that savings associations can effectively compete only if they pursue a more customer-oriented branching policy. In summary, "[i]f associations do not have branch offices, or only one or a few branch offices, they will be at a competitive disadvantage in the growing struggle for the savings dollar."<sup>14</sup>

In contrast, Illinois-chartered savings and loan associations are specifically denied branching privileges "unless and to the . . . extent branch powers and offices are granted to state banks", nor are Illinois banks permitted to operate branch offices.<sup>15</sup> Until 1973, the FHLBB similarly prohibited Illinois-based federal association branching, in line with its regulations and the Home Owners Loan Act.<sup>16</sup> The Home Owners Loan Act (HOLA) provides, however, that the Board shall give "*primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.*"<sup>17</sup> The Act is directive rather than mandatory in nature, in contrast with the National Banking Act, which specifically requires that national bank branching be tied to state law.<sup>18</sup> The FHLBB is vested with broad discre-

13. Carrington, *Not Planning to Branch?*, FHLBB JOURNAL, September, 1973, at 15.

14. *Id.* at 19.

15. ILL. REV. STAT. ch. 32, § 709 (1973); ILL. REV. STAT. ch. 16-1/2, § 106 (1968).

16. The Home Owners Loan Act of 1933, § 5a, 12 U.S.C. § 1464(a) (1970) provides:

In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation of . . . Federal Savings and Loan Associations . . . and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.

12 C.F.R. 556.5(b)(1) (1974) sets out the Board's general branching policy:

(1) As a general policy, the Board permits branches and mobile facilities by Federal savings and loan associations in a particular State if the State law, or State practice in the absence of statutory prohibition, permits savings and loan associations, savings banks, or commercial banks of the State to establish branches in such State or to conduct chain, group or affiliate operations.

17. 12 U.S.C. § 1464(a) (1970).

18. The branching provisions of the National Banking Act, 12 U.S.C. § 36(c) (1970), are as follows:

(c) A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches: (1) Within the limits of the city, town or village in which said association is situated, if such establishment and operation are at the time expressly authorized to State banks by the law of the State in question; and (2) at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely

tionary powers to determine what it deems to constitute "best practices" within a particular state. Thus, when the Board, pursuant to its plenary authority under the HOLA, determines that conditions within a particular state justify branching (even when as in Illinois, branching is specifically prohibited) or broader branching powers (in states with restrictive branching laws) it may authorize *full* branching for federally-chartered associations. Such a "best practices" determination in Illinois recently brought about FHLBB authorization of full-scale federal branching in the face of the Illinois Savings and Loan Act's specific prohibition of branching.<sup>19</sup> The Board's action is being contested in a case pending in the district court for the Northern District of Illinois.<sup>20</sup>

#### "DE FACTO BRANCHING" IN ILLINOIS

In August, 1972 the Office of Industry Development (OID) of the Federal Home Loan Bank Board prepared a position paper, "Branch Banking in Illinois: Fact or Fiction."<sup>21</sup> The study first noted that the Board had approved federal association branching in three states where group, chain or affiliate banking was conducted in the face of state statutory prohibitions (Florida, 1949; Wisconsin, 1965; and West Virginia, 1972). Illinois, it was noted, was the last state in which federal associations were denied branching privileges.<sup>22</sup> The study identified twenty-nine separate groups of banks which, through chain operations, controlled one hundred thirty-nine Illinois banks.<sup>23</sup> The largest combine, the Heritage Bank group, at the time of the study controlled one national and ten state banks, and had been granted permission to organize three new banks. Interlocking directorates among the primary banking groups, documented in the study, were seen to

by implication or recognition, and subject to the restrictions as to location imposed by the law of the State on State banks.

The Illinois Banking Act, ILL. REV. STAT. ch. 16-1/2, § 106 (1968), provides:

No bank shall establish or maintain more than one banking house, or receive deposits or pay checks at any other place than such banking house, and no bank shall establish or maintain in this or any other state of the United States any branch bank, nor shall it establish or maintain in this State any branch office or additional office or agency for the purpose of conducting any of its business.

The Illinois Savings and Loan Act, ILL. REV. STAT. ch. 32, § 709 (1973), ties savings and loan branching policy to the Illinois Banking Act:

No association shall establish branches or offices at which savings or investments are regularly received or loans approved unless and to the geographical extent branch powers and offices are granted to state banks under the 'Illinois Banking Act', as amended, or as it may be amended or supplemented, except the Commissioner may adopt regulations which provide for the establishment of a facility as defined by the Commissioner, in the case of a supervisory merger, or a single facility in the case of a relocation.

19. ILL. REV. STAT. ch. 32, § 709 (1973).

20. 377 F. Supp. 11 (N.D. Ill. 1974).

21. OID study, *supra* note 12.

22. *Id.* at 3.

23. *Id.* at 4-5.

be extensive.<sup>24</sup> Further, it was noted that as of June, 1972 one hundred twenty-eight bank holding companies were registered in Illinois, two of which maintained at least operational control of seven banks. The operation of drive-in and pedestrian walk-up facilities allowed by the Illinois Banking Act was noted as another instance of "de facto" branch banking in the Board study.<sup>25</sup>

As to savings and loan associations, the Board study noted that fifteen savings and loan associations in Illinois were controlled by holding companies. Although only one such holding company controlled more than one association,<sup>26</sup> the study predicted an increase in such operations.<sup>27</sup> Of greater concern to the OID were the provisions of the Illinois Savings and Loan Act authorizing the Commissioner of Savings and Loan Associations to adopt regulations for the maintenance of facilities upon the relocation or merger of associations. While federal associations may also be granted approval for relocation and/or merger, the authors of the study noted that conditions for approval of such actions were more stringently construed by the FHLBB than corresponding conditions imposed by the Illinois Commissioner.<sup>28</sup>

The Illinois Commissioner is empowered to approve relocation for state associations when it is established that:

- (1) need exists for savings and loan association services in the community or area of operation of the proposed facility and the proposed facility will satisfy said need; or that it is in the best interest of the association that the proposed facility be maintained, and
- (2) that the proposed facility can be maintained without undue injury to properly conducted existing associations.<sup>29</sup>

Thus, under the Illinois Act, state associations may retain their former office as a facility when relocating their main office, or retain one office as a facility in the case of merger.<sup>30</sup> Remarks of the then Commissioner, nominally addressed to the problem of red-lining in metropolitan areas, were interpreted as favoring "de facto" branching through liberal application of facility regulations.<sup>31</sup> State laws and regulations, as construed and imple-

24. *Id.* at 7-8.

25. *Id.* at 6.

26. *Id.* at 7.

27. *Id.* at 9.

28. Article X, Rules and Regulations of the Illinois Savings and Loan Commissioner.

29. ILL. REV. STAT. ch. 32, § 709 (1973).

30. *Id.*

31. In a speech before the Cook County Council Spring Conference, June 6, 1972, quoted in the OID study, *supra* note 12, at 9, Commissioner Lanigan, referring to the effects of regulations allowing state associations to relocate and maintain the former office as a facility, stated:

They [savings and loan associations] can now satisfy their obligation to the

mented, were deemed to effectuate the de facto equivalent of branching for Illinois banks and savings and loan associations. Federal associations were judged to be at a competitive disadvantage in light of local associations' ability to move their main offices to new markets or to increase their operations by merger. The OID study concluded that branching was an accomplished fact in Illinois, stating:

There is a national policy to permit branching of FS&LA's, even in states where banks are limited in branching powers. This situation places FS&LA's in Illinois in a position where they are not able to compete and serve customers as well as FS&LA's do in other states. As the Board is required to give primary consideration to 'best practices', and not state law under Home Owner's Loan Act, the presence of branching by FS&LA's in all but one state, and the healthy growth of associations in such states, indicates that branching, controlled by the criteria of the regulations, is a 'best practice' for mutual thrift and home-financing institutions.<sup>32</sup>

If Illinois-chartered savings and loan associations engage in "de facto branching", they do so in a highly restrictive fashion. More than one office may be maintained only in the case of supervisory merger or relocation.<sup>33</sup> Before such actions are approved, an association must establish a need for savings and loan operations in the community in which it proposes to establish a facility or relocate; further, it must be shown that such operations may be maintained without undue injury to existing associations.<sup>34</sup> These provisions are nearly identical to federal branching regulatory criteria. Moreover, the FHLBB may approve relocation and merger for federal associations, although its regulations are by comparison more stringently applied.

Federal associations may apply to open one branch office in 1974 in Illinois; there is no apparent limit to the number of branches that may be opened after 1974.<sup>35</sup> State associations, on the other hand, have the option of merger or relocation with the maintenance of a facility. As a practical matter, either option is a major business upheaval, and probably a sin-

communities of their birth and make a significant social contribution by providing a meaningful remedy to use against the cancer of urban blight.

At the same time, they can participate in the dynamic growth of the 70's by bringing their resources and experience to the expanding suburban communities.

The problem of red-lining, or the discrimination against the making of mortgage loans in depressed, inner-city areas, has been investigated by the Illinois Legislative Investigating Commission. The Commission's report, tentatively titled *Red-Lining: Discrimination in Mortgage Loans*, is scheduled for publication in early 1975.

32. OID study, *supra* note 12, at 14.

33. ILL. REV. STAT. ch. 32, § 709 (1973).

34. *Id.*

35. Letter of January 12, 1973 to U.S. Representative Edward R. Madigan from Carl O. Kamp, Jr., Acting Chairman of the FHLBB, found as Exhibit 1 to Defendant's Supplemental Memorandum in 377 F. Supp. 11 (N.D. Ill. 1974).

gular occurrence. It is difficult to envision a situation in which an association might be allowed to relocate its main office or to merge with another association whenever it seeks to increase its share of the market.

It should be noted that the OID study laid primary emphasis on the proliferation of group, affiliate and chain *banking* and the activities of bank holding companies. No comparable activities on the part of savings and loans were cited; and only one instance of holding company operations was noted. The vast majority of Illinois associations are of the mutual-association type and are denied the option of proliferation through holding company acquisitions, which is permitted only to capital stock associations.<sup>36</sup> In short, the cited instances of "de facto branching" which effected the change in FHLBB policy related far more directly to Illinois bank activities than to Illinois savings and loan activities.

According to Board policy and case law,<sup>37</sup> once the determination has been made that federal savings and loan associations will be permitted to branch in a particular locus, *full* branching is allowed (provided the usual requirements of need and lack of undue injury are met), even though state association branching may be statutorily prohibited, or restricted by geographical limitations, number of branches, and so forth. Thus, a federal association, once branching is authorized, may expand and reach markets prohibited to state associations which are prohibited or restricted as to branching activities. In certain situations, therefore, federal associations might be able to wield virtually monopolistic power over new markets.

It is not herein suggested that federal associations should be denied the opportunity to expand their operations in the face of "de facto branching operations by state savings associations. It is submitted, however, that to liberalize the local interpretation of federal regulations pertaining to relocation and merger to more nearly conform with prevalent local practices and regulations, rather than authorizing unrestricted branching, would have achieved an equitable result more closely approximating competitive equilibrium. If, as the OID study concludes, federal associations suffered a competitive disadvantage, under the full branching provisions they may potentially enjoy competitive superiority.

*Lyons Savings and Loan Association  
v. Federal Home Loan Bank Board*

As a result of the OID study, the FHLBB in January, 1973 reversed its prior "no branching" policy and began approving branch applications from federal savings and loan associations located in Illinois. This action has

36. ILL. REV. STAT. ch. 32, § 792.1 (1973).

37. E.g., *Springfield Institution for Savings v. Worcester Fed. Savings & Loan Ass'n*, 329 Mass. 184, 107 N.E.2d 315 (1952), *cert. denied*, 344 U.S. 884 (1952).



prompted litigation now pending in the district court for the Northern District of Illinois. *Lyons Savings and Loan Association v. Federal Home Loan Bank Board*<sup>38</sup> and seven consolidated cases were brought to challenge the Board's action. Eight state-chartered savings and loan associations sought declaratory and injunctive relief against the FHLBB authorization of de novo branching by federally chartered Illinois associations. The FHLBB, its individual directors, and federal associations whose branch applications had been approved by the FHLBB were named parties defendant.

The issues in *Lyons*, rarely litigated in the Seventh Circuit, were as follows: the authority of the FHLBB to approve branch applications in any case, and specifically where state law prohibits branching; the constitutionality of permitting federal associations a wider latitude than that available to state associations and banks; noncompliance by the Board with its own branching regulations; the Board's procedure in processing branch applications; and whether the Board's approval of individual branch applications was arbitrary and capricious.

In one of the first cases arising under the Home Owners Loan Act, *First Federal Savings and Loan Association of Wisconsin v. Loomis*,<sup>39</sup> the Seventh Circuit held that the HOLA was constitutional, supported by both the fiscal powers and general welfare clauses of the Constitution. Viewing the preservation of home ownership and the promotion of a sound system of home mortgage<sup>40</sup> a matter of national importance, the court affirmed the constitutionality of the HOLA and the validity of the transaction of business by the federally-chartered association independent of the authority of the state of Wisconsin. In *Fahey v. Mallonee*<sup>41</sup> the Supreme Court held that the HOLA did not violate articles 1 and 8 of the Constitution, finding that delegation of legislative authority in one of the longest-regulated and most closely supervised of public callings might be more readily permitted than in the area of "new crimes in uncharted fields."<sup>42</sup>

The HOLA is silent as to branching, merely directing the FHLBB to give "primary consideration to [local] best practices".<sup>43</sup> Several cases have challenged the Board's authority to approve branching applications. The courts have unanimously characterized the powers granted by the HOLA as plenary, evidencing a "clear intent" by Congress that the Board have the

38. 377 F. Supp. 11 (N.D. Ill. 1974).

39. 97 F.2d 831 (7th Cir. 1938). The case contains extensive constitutional interpretation.

40. 97 F.2d at 840 (7th Cir. 1938).

41. 332 U.S. 245 (1947). The Court particularly rejected appellee's arguments of invalid legislative delegation, based on the rationale of *Panama Ref. Co. v. Ryan*, 293 U.S. 388 (1935), *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935). See generally cases cited at 91 L. Ed. 203.

42. 332 U.S. at 250 (1947).

43. 12 U.S.C. § 1464(a) (1933).

power to develop rules and regulations governing the conduct of thrift institutions.<sup>44</sup>

*North Arlington National Bank v. Kearny Federal Savings and Loan Association*<sup>45</sup> is the case most frequently cited as sustaining FHLBB authority to establish branch associations. There the court, after considering the pertinent statutes, administrative regulations and congressional action, found ample support for the authority of the Board to approve federal association branch offices. Further, the court justified the disparities of federal banking and federal savings and loan laws regarding branching on policy grounds. It noted that savings and loan associations, although pursuing some banking functions, do not do a general banking business.<sup>46</sup> Their primary purpose is to encourage thrift and provide home financing. Further, the court deemed the possibility of unfair competition or monopolization by any single organization unlikely in view of the requisite statutory showing of community need for an association and absence of undue injury to existing associations. The exercise of such business judgment by the FHLBB in passing on charter and branch applications, the court held, is wholly consonant with the legislative policy declared in the HOLA.

Courts have uniformly noted congressional intent that the HOLA and its attendant regulations pre-empt the field of savings and loan law, both as to state branching prohibition<sup>47</sup> and state branching restrictions.<sup>48</sup> Thus, in *Springfield Institution for Savings v. Worcester Federal Savings and Loan Association*,<sup>49</sup> it was held that the FHLBB is "clothed with congressional sanction" to establish regulations.<sup>50</sup> State law restricting branching operations to an area within fifteen miles of the home office was found to be in direct conflict with federal regulations, which permitted branching within one hundred miles of the main office situs.<sup>51</sup> Where state and federal provi-

44. *Lyons Savings & Loan Ass'n v. FHLBB*, 377 F. Supp. 11, 17 (N.D. Ill. 1974); *Bridgeport Fed. Savings & Loan Ass'n v. FHLBB*, 307 F.2d 580 (3rd Cir. 1962), cert. denied, 371 U.S. 950 (1963); *Springfield Institution for Savings v. Worcester Fed. Savings & Loan Ass'n*, 329 Mass. 184, 107 N.E.2d 184 (1952), cert. denied, 344 U.S. 884 (1952); *North Arlington Nat'l Bank v. Kearny Fed. Savings & Loan Ass'n*, 187 F.2d 564 (3rd Cir. 1951), cert. denied, 342 U.S. 816 (1951); *United States v. First Fed. Savings & Loan Ass'n*, 151 F. Supp. 690 (E.D. Wisc. 1957), modified on other grounds, 248 F.2d 804 (7th Cir. 1957); *Central Savings & Loan Ass'n v. Chariton, Iowa v. FHLBB*, 293 F. Supp. 617 (S.D. Iowa 1968), aff'd, 422 F.2d 504 (8th Cir. 1970); *First Nat'l Bank of McKeesport v. First Fed. Savings & Loan Ass'n of Homestead*, 225 F.2d 33 (D.C. Cir. 1955).

45. 187 F.2d 563 (3rd Cir. 1951), cert. denied, 342 U.S. 816 (1951).

46. 187 F.2d at 567.

47. *United States v. First Fed. Savings & Loan Ass'n*, 151 F. Supp. 690 (E.D. Wis. 1957), modified on other grounds, 248 F.2d 804 (7th Cir. 1957).

48. *Springfield Institution for Savings v. Worcester Fed. Savings & Loan Ass'n*, 329 Mass. 184, 107 N.E.2d 315 (1952), cert. denied, 344 U.S. 884 (1952).

49. *Id.*

50. *Id.* at 187.

51. 12 U.S.C. § 1464(a, c, i) (1970).

sions were in direct conflict, the *Springfield* court held, federal regulations must prevail; federal associations were allowed the geographical latitude in branching denied to local associations. The court cryptically stated: "If it be thought that the result reached is not in accord with the most approved principles of economics, the remedy must lie with Congress."<sup>52</sup>

Arguments have been similarly propounded where state laws specifically prohibit branching. Analogies to the National Banking Act, which specifically ties national bank branching powers to state law, as opposed to the HOLA's "best practices" directive,<sup>53</sup> have been repeatedly drawn. The courts have consistently referred to the continual failure of legislative attempts to conform the HOLA to the National Banking Act provisions,<sup>54</sup> and have distinguished the functional differences between commercial banks and thrift institutions.<sup>55</sup> As the *Lyons* court said, "[t]he fact that any particular state has not adopted for its own institutions what the Board deems to be a 'best practice' cannot limit the Board's authority without undermining the fundamental purpose of the statute."<sup>56</sup>

Allegations of deprivation of property without due process of law and violation of the equal protection clause, grounded on the premise that state associations would not possess branching rights identical to those of federal associations, have been consistently rejected in light of the overriding "national" concern for the promotion of thrift and home-financing institutions. Allegations of tenth amendment violations have been rejected on the same grounds.<sup>57</sup>

Courts considering questions of administrative law and the propriety of Board hearing procedures have typically upheld its practices. Thus, it has been held that the FHLBB is not required to conduct hearings in connection with its consideration of branch applications. Both Board procedures and determinations are committed to agency discretion, subject to judicial review only when arbitrary or capricious.<sup>58</sup> Nor is the Board required to issue findings of fact or law; a "curt explanation" will suffice.<sup>59</sup> Relying on the plenary powers granted by the HOLA, courts have viewed FHLBB application

52. 329 Mass. at 187; 107 N.E.2d at 318.

53. Compare 12 U.S.C. § 36(c) with 12 U.S.C. § 1464(a).

54. E.g., Sen. Rep. No. 1118, 81st Cong., 1st Sess. (1949); Rep. of Comm. on Banking and Currency, Sen. Rep. No. 1186, 83rd Cong., 2d Sess. 1 (1954); 100 Cong. Rec. 6895-6911; Sen. Rep. No. 518, 84th Cong., 1st Sess. 1 (1955).

55. 377 F. Supp. at 18.

56. *Id.*

57. 377 F. Supp. at 18-20 and cases cited therein; *North Arlington Nat'l Bank v. Kearny Fed. Savings & Loan Ass'n*, 187 F.2d 564 (3rd Cir., 1951); *Central Savings & Loan Ass'n of Chariton, Iowa v. FHLBB*, 293 F. Supp. 617 (S. D. Iowa, 1968).

58. E.g., *Bridgeport Fed. Savings & Loan Ass'n v. FHLBB*, 307 F.2d 580 (3rd Cir. 1962); *First Nat'l Bank of McKeesport v. First Fed. Savings & Loan Ass'n of Homestead*, 225 F.2d 33 (D.C. Cir. 1955).

59. E.g., *Camp v. Pitts*, 411 U.S. 138 (1973).

and hearing procedures properly the subject of exclusive FHLBB discretion.<sup>60</sup>

The *Lyons* court declined to depart from prior decisions upholding FHLBB branching practices. In its memorandum opinion of March 27, 1974,<sup>61</sup> it granted defendants' motions for summary judgment as to all issues save the factual determination of the reasonableness of the Board's internal processing of each subject branch application.

In reaching its decision, the *Lyons* court found full judicial support for its position. The court upheld the constitutionality of the Home Owners Loan Act, emphasizing the plenary, discretionary powers granted the FHLBB as necessarily including the authority to approve branch applications.<sup>62</sup> Further, the court reasoned, the plenary nature of these powers shows a clear congressional intent that federal regulations pre-empt the field.<sup>63</sup> Countering the argument that savings and loan branching should be tied to state law as is bank branching, the court noted the failure of legislative attempts to add such restrictions to the HOLA.<sup>64</sup> The court, in short, found that "no exact parity between state and federal savings and loan associations is either required or necessarily intended."<sup>65</sup>

#### THE ANTI-COMPETITIVE ASPECTS OF *Lyons*

Several cases have involved unsuccessful allegations of unfair competition or violation of the antitrust laws.<sup>66</sup> Courts presented with this issue have to date held that Board regulations requiring a showing of community need for a new association and lack of undue injury to existing associations adequately safeguard against anticompetitive abuses.<sup>67</sup> Similarly, the *Lyons* court reasoned that since branch associations may be established only in areas served inadequately or not at all, no undue competitive advantage would arise from condoning fuller branching capacity to federal savings and loan associations.<sup>68</sup>

The issue of competition among savings and loan associations with unequal branching capabilities has been argued unsuccessfully before several

60. See, e.g., cases cited *supra* note 58.

61. 377 F. Supp. 11.

62. *Id.* at 16.

63. 377 F. Supp. at 17, citing *Washington Fed. Savings & Loan Ass'n v. Balaban*, 281 So. 2d 15, 17 (Fla. 1973), and *People v. Coast Fed. Savings & Loan Ass'n*, 98 F. Supp. 311, 316 (S.D. Cal. 1951).

64. *Supra* note 54.

65. 377 F. Supp. at 18.

66. *North Arlington Nat'l Bank v. Kearny Fed. Savings & Loan Ass'n*, 187 F.2d 564 (3rd Cir. 1951); *Central Savings & Loan Ass'n of Chariton, Iowa v. FHLBB*, 293 F. Supp. 617 (S.D. Iowa, 1968); *United States v. First Fed. Savings & Loan Ass'n*, 151 F. Supp. 690, 701 (E.D. Wis. 1957).

67. 377 F. Supp. at 17.

68. *Id.*

courts.<sup>69</sup> The alleged competitive disadvantage of Illinois-based federal savings and loan associations was, in fact, the impetus for the actions taken by the Board. To date, the courts have rejected state associations' allegations that full-branching federal associations may enjoy a competitive superiority over state associations where branching is restricted or prohibited, finding that FHLBB regulations provide adequate protection against undue competition.<sup>70</sup> Viewing the development of antitrust litigation in the related commercial banking industry in connection with growth and concentration indicia for the savings and loan industry, however, it is arguable that colorable claims of undue competition or antitrust violation may arise in the savings and loan industry.

Historically, savings and loan associations have developed from local, neighborhood foundations. Unlike commercial banks, associations have offered only two services, savings deposits and home mortgage financing, and these functions have been performed on a highly localized basis. The goal of the savings and loan industry has been said to be "to intermeditate between savers and borrowers, with an emphasis on individual (as opposed to corporate) savers and residential mortgage borrowers (as opposed to other types of credit).<sup>71</sup> The prevailing rationale has been that the relatively small neighborhood association is uniquely able to respond to local savings and mortgage financing needs. Public convenience and policy would thus appear to dictate a large number of unit associations to fully serve a community. Further, a large number of unit associations would arguably stimulate competition.

It has been generally feared that if concentration of financial facilities is permitted to develop, monopoly practices and an insufficient number of facilities might ultimately result.<sup>72</sup> Further, institutions which are able to concentrate resources, especially in a locale where entry of associations is restricted or prohibited, might diminish the effects of competition and exert market power. Public policy has traditionally militated against such wield-

69. 377 F. Supp. at 17. *E.g.*, *Central Savings & Loan Ass'n of Chariton, Iowa v. FHLBB*, 293 F. Supp. 617 (S.D. Iowa 1968), involved an appeal of FHLBB approval of mobile facilities to be operated in three areas by a federal association. The court upheld the authority of the Board to approve such operations. Notably, plaintiffs argued that defendant's operation of mobile facilities would tend to monopolize competition in violation of the Clayton Act, 15 U.S.C. § 5 *et seq.* (1970), and the Sherman Act, 15 U.S.C. §§ 1-3 (1970). The court dismissed this contention in noting that the need for such facilities had been established (in the Board's sole determination), stating "[i]mplicit in the determination of need for the facility is a determination that there is no unlawful monopoly." *Id.* at 624.

70. 12 C.F.R. 545.14 requires a finding of community need for the proposed facility and lack of undue injury to existing associations.

71. *See generally* Brigham and Pettit, *Effects of Structure on Performance in the Savings and Loan Industry*, 3 A STUDY OF THE SAVINGS AND LOAN INDUSTRY 971, 996 (I. Friend ed. 1969) [hereinafter cited as Brigham and Pettit].

72. Gilbert and Longbrake, *supra* note 6, at 155.

ing of market power, since institutions possessing such power may drive prices (e.g., the cost of getting a loan) upward disproportionate to cost, and discriminate in pricing and allocation of resources to the public detriment.<sup>78</sup>

Yet if firms may realize cost savings from increased size, internal specialization and centralization, that is, if economies of scale exist in the industry,<sup>74</sup> a multi-unit system could be more expensive to operate than a system comprised of a smaller number of larger firms. An institution which can utilize economies of scale may lower its operating costs and increase its output of financial services.<sup>75</sup> Such a process, however, may produce a system comprised of fewer, large institutions, or concentration; the objectives of market competition and a large number of localized unit associations would be ultimately frustrated. Further, if an association may recognize significant economies of scale by opening branch offices, smaller local institutions might be economically precluded from reaching new markets.<sup>76</sup>

Several studies have shown that economies of scale exist in the savings and loan industry.<sup>77</sup> In addition to the profit impetus of entry into new markets, these studies conclude, savings and loan associations may realize cost-saving economies in proportion to increasing size.<sup>78</sup> There is also evidence that at least as to some functions, branch offices may be less costly to operate than unit institutions, although the economies are not significant and some functions may be performed more cheaply by unit than branch offices.<sup>79</sup> These studies have generally concluded that the optimum competitive atmosphere is one in which both unit and branch offices operate.<sup>80</sup> When, however, branching is prohibited or restricted, too few institutions may be represented in a local market to insure effective price and service

73. *Id.*

74. Brigham and Pettit, *supra* note 71, at 1003, summarize the reasons for the existence of economies of scale as follows: indivisible factors of production (i.e., the cost per unit of output of expensive equipment, staffing and the like is lowered as output increases); purchasing economies (i.e., quantity discounts); specialization of labor; and the law of large numbers (i.e., large assets tend to stabilize deposit flow and reduce risk, and to facilitate lower liquidity reserves). For a general discussion of the concept of economies of scale, see SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE*, ch. 4 *passim* (1970).

75. Gilbert and Longbrake, *supra* note 6, *passim*; Brigham and Pettit, *supra* note 71, *passim*.

76. Gilbert and Longbrake, *supra* note 6, at 156.

77. Gilbert and Longbrake, *supra* note 6; Brigham and Pettit, *supra* note 71; Dhrymes and Taubman, *An Empirical Analysis of the Savings and Loan Industry*, 1 *A STUDY OF THE SAVINGS AND LOAN INDUSTRY* 67 (I. Friend ed. 1969); Benston, *Cost of Operations and Economies of Scale in Savings and Loan Associations*, 2 *A STUDY OF THE SAVINGS AND LOAN INDUSTRY* 677 (I. Friend ed. 1969) [hereinafter cited as Benston].

78. Benston, *supra* note 77, at 711-12, 721-61 (tables, appendix, statistical data).

79. Gilbert and Longbrake, *supra* note 6, at 165-66.

80. *Id.*

competition, and offices of large branch organizations may be able to out-price smaller, single-office firms.<sup>81</sup>

The evidence would appear to indicate that concentration is occurring in the savings and loan industry, and that branching is increasing rapidly. For example, the nation-wide total of savings and loan associations has declined from 6,320 in 1960 to 5,244 in 1973 — an attrition rate of 17 per cent.<sup>82</sup> Notably, this attrition occurred mainly among state-chartered associations;<sup>83</sup> the number of federally-chartered associations increased by 72 during this period, while the number of state associations declined by 1,076.<sup>84</sup> Average assets per association and per office increased significantly during the period, as did the corresponding office/association populations.<sup>85</sup> Further, the number of association mergers increased during the period 1960-1973, from 23 in 1960 to 124 in 1973, a 43.9 per cent increase.<sup>86</sup> Federal association mergers increased by 60 per cent; state mergers increased correspondingly by 26.9 per cent.<sup>87</sup> Moreover, the number of savings and loan branch offices surpassed the number of main offices in 1973.<sup>88</sup> Thus, it appears that concentration in the savings and loan industry is occurring at appreciable rates.

It has been posited that in a situation similar to that giving rise to *Lyons*, Illinois "de facto" branching is a far less effective means of market entry than the full branching permitted to Illinois-based federal associations and that state associations may consequently be unable to compete *pari passu* with federal savings and loan associations. While it is not intimated that colorable anti-competitive practices exist or will necessarily develop, it is possible that a pattern of incipient over-concentration could emerge from the Illinois situation, both as to branching and merger practices.<sup>89</sup> It is suggested

81. For example, Gilbert and Longbrake, *supra* note 6, at 164, commented as follows:

Regulations prohibiting or restricting entry of de novo institutions or de novo branches of existing institutions may result in too few institutions being represented in a local market to assure effective price competition. Moreover, lenient merger policies which lead to concentration of financial resources in a few firms may also result in noncompetitive pricing in a local market. If economies of scale exist, larger firms may be able to charge lower prices for services and offer higher rates on deposits. Accordingly, offices of large branch organizations may be able to charge lower prices than single office firms.

82. FACT BOOK, *supra* note 1, at 57.

83. *Id.*

84. *Id.*

85. *Id.* at 59.

86. *Id.* at 61.

87. *Id.*

88. *Id.* at 62.

89. There is a relative lack of savings and loan antitrust litigation, although several commentators have considered the potential for such litigation. See, e.g., *The New and the Old in Bank Merger Antitrust Principles*, XL LEGAL BULL. 288 (1974); Manning, *Savings and Loan Operations under Antitrust*, 1965 LEGAL BULL. 187; Groebe, *Savings Associations and the Antitrust Laws*, 1963 LEGAL BULL. 1. The commercial bank-

that the branching capabilities of federal associations vis-a-vis the limited "de facto" branching practiced by state-chartered associations may facilitate nearly exclusive entry into and pre-emption of new market areas by federal associations while state associations are limited to singular relocation or merger. Aggressively branching federal associations might thus acquire the potential to gain market power over state associations. Moreover, state associations, in order to combat such an effect, might correspondingly seek their own market shares by greater merger, acquisition and holding company activities to the further detriment of multiple-association policy and competitive parity. In this light, the words of Chief Justice Warren in *Brown Shoe Co v. United States*<sup>90</sup> seem particularly apt:

Some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered unlawful by the mere fact that small independent stores may be adversely affected. It is competition, not competitors which the [Clayton] Act protects. We cannot fail to recognize Congress' desire to promote competition through the protection of small locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. If resolved these competing considerations in favor of decentralization. We must give effect to that decision.

ing industry, for example, is a line of commerce closely similar to the savings and loan industry. It has been held that the banking industry, although regulated by the Bank Holding Company Act, 12 U.S.C. § 1842 (1970), and the Bank Merger Act, 12 U.S.C. § 1828 (1970), is subject to § 7 Clayton Act sanctions. The Clayton Act, 15 U.S.C. § 18 (1970), applies to such a federally regulated industry to the extent that that industry's regulations fall short of Clayton Act strictures. *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963); *United States v. Third Nat'l Bank*, 390 U.S. 171 (1968); *United States v. Phillipsburg Nat'l Bank*, 399 U.S. 350 (1970). For a concise survey of the development of antitrust law, see NEALE, *THE ANTITRUST LAWS OF THE U.S.A.* (2d ed. 1970). See also Shull and Horvitz, *Branch Banking and the Structure of Competition; The Impact of Branch Banking on Bank Performance*, NAT'L BANKING REV., March, December, 1964 at 117.

Recent banking antitrust litigation has focused on the potential competition doctrine as defined in *United States v. Falstaff Brewing Co.*, 410 U.S. 526 (1973). The potential competition doctrine contemplates that a firm perceived as a potential entrant into a concentrated market ("waiting in the wings") exerts a pro-competitive effect on that market. When such a firm enters a market by merger or foothold acquisition rather than de novo, such entry has been found to "substantially lessen competition" under section 7 of the Clayton Act. The Supreme Court has indicated that the potential competition doctrine is applicable to the banking industry when potential entrants are able to enter de novo. *United States v. Marine Bancorporation, Inc.*, 94 S. Ct. 2856 (1974). A recent comment on the banking antitrust cases states that the "changing competitive picture and vigorous growth and expansion" in the savings and loan industry "increases the likelihood that [savings and loan] mergers may draw increased attention of the Justice Department." XL LEGAL BULL. 288, 292 (1974). Cf. FDIC Release PR 54-70, Board Report 35 (Oct. 5, 1970) which prohibited a proposed merger between two large Washington savings banks as violative of § 7 of the Clayton Act. Although savings and loan antitrust litigation is minimal to date, the growth and concentration trends of the industry, considered by analogy to banking antitrust cases, point the way to future litigation in the area.

90. 370 U.S. 294, 324 (1962).



## CONCLUSION

*Lyons* indicates that the Illinois district court will remain consistent with case law supporting the plenary and discretionary power of the Federal Home Loan Bank Board to determine federal branching policy apart from the strictures of state law. While the continuation of such a policy may encourage industry growth through branching, it neglects the potential for competitive disparity between state and federal associations and may foster concentration in the savings and loan industry. Whether such concentration is pro- or anti-competitive is an open question of public policy interpretation. If, as has been traditionally suggested, the neighborhood unit association is most responsive to, and best equipped to deal with, the idiosyncrasies of savings and home financing for relatively small savings and mortgage accounts, then market concentration may indicate a diminution of financial services to consumers. If, however, the public need is well served by fewer and larger associations, and if such a system is operationally more economical, concentration within the savings and loan industry need not be per se invidious. Regulation of savings and loan growth, and maintenance of competitive parity, especially as to branching and merger policies, is essential to prevent potential over-concentration to the detriment of small, neighborhood associations.

Branching may undoubtedly promote growth and stimulate competition within the savings and loan industry. Unequal branching opportunities as between state and federal associations, however, may prove ruinous to smaller state savings associations. FHLBB "best practices" determinations similar to the action taken in Illinois have helped to effect liberalization of other states' restrictive or prohibitive branching laws.<sup>91</sup> *Lyons* and the body of savings and loan case law indicate that the courts will not, at the present state of industry development, promote competitive equilibrium through judicial measures. The remedy for state-chartered associations rests with the Illinois legislature.

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91. The OID study, *supra* note 12, notes legislative reform in West Virginia, Florida and Wisconsin after FHLBB authorization of full branching for federal associations.