ORIGINAL

In the

Supreme Court of the United States

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, Petitioner,	)	
v.	)	No. 77-832
FIRST LINCOLNWOOD CORPORATION, Respondent.	)	

Washington, D. C.
October 11, 1978

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Petitioner :

v. : No. 77-832

FIRST LINCOLNWOOD CORPORATION :

Respondent

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Washington, D. C.

Wednesday, October 11, 1978

The above-entitled matter came on for argument at 1:44 o'clock p.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the Supreme Court
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice
JOHN PAUL STEVENS, Associate Justice

APPEARANCES:

STEPHEN M. SHAPIRO, ESQ., Office of the Solicitor General, Department of Justice, Washington, D. C. 20530; on behalf of the Petitioner

GEORGE B. COLLINS, ESQ., One N. LaSalle Street, Chicago, Illinois 60602; on behalf of the Respondent

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C O N T E N T S

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P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments next in 77-832, Board of Governors of the Federal Reserve System versus First Lincolnwood Corporation.

Mr. Shapiro, you may proceed whenever you are ready.

ORAL ARGUMENT OF STEPHEN M. SHAPIRO, ESQ.

ON BEHALF OF THE PETITIONER

MR. SHAPIRO: Mr. Chief Justice and may it please the court:

This case is here on the Federal Reserve Board's petition for certiorari to the United States Court of Appeals for the Seventh Circuit. The Seventh Circuit set aside an order of the Board which it denied respondent permission to become a bank holding company under the Bank Holding Company Act of 1956.

This case presents the question whether the Board may deny a bank holding company application where the proposed bank's subsidiary is undercapitalized and where the proposed holding company would be so encumbered by debt that the bank would remain undercapitalized for a period of at least twelve years.

QUESTION: Do you mean by that -- the question is whether they have the authority to do it or whether they have the discretion to do it?

MR. SHAPIRO: Whether they have the statutory

authority to deny the application. And we are here today to contend that the Board may indeed deny such an application unless and until the capital deficiency is remedied.

Respondent is an Illinois corporation.

QUESTION: Do I correctly understand that the under-capitalization is conceded here?

MR. SHAPIRO: That is correct. In Respondent's brief the point is made that the capital ratios were low. That is recognized in the Seventh Circuit opinion and indeed it is recognized in all of the other submissions from the Comptroller and from the Federal Reserve Bank and from the Board's staff.

Respondent is an Illinois corporation which planned to acquire 80 percent of the voting stock of the First National Bank of Lincolnwood. It stated in its application that it would assume not only the stock but also a debt in the sum of $3,700,000. Respondent also planned to cause the bank to issue an additional $1 million in debt securities after formation o the holding company and an additional $1 million in equity after the holding company was formed.

The application was initially reviewed by the Chicago Federal Reserve Bank. The Reserve Bank recommended approval of the application despite its recognition that the capital level in the bank was below the Board's current guidelines and would remain below the guidelines during the 12-year period needed to retire the debt.

The Reserve Bank believed, however, that the competence of management and possible improved earnings were positive factors which outweighed the low capitalization factor. And in a brief letter the Comptroller of the Currency joined in that affirmative recommendation.

When the application was received by the Board in Washington, it was reviewed initially by the Board's Division of Research and Statistics and then again by its Division of Banking Regulation and Supervision, both of which recommended denial. They pointed out again that the Bank was seriously undercapitalized at present. The ratio of capital to assets was five percent, when it should have been at least eight percent.

That meant that the bank needed an additional $2-1/2 million in equity capital to meet the Board's minimum standards.

QUESTION: Well denying the application was not going to give it that additional capital though, was it?

MR. SHAPIRO: That is quite correct, but the insistence in this category of cases that capital be replenished as a prerequisite to getting the desired change in status is the motivation that makes applicants come up with the additional equity capital.

QUESTION: In other words, the Board kind of has a red light and says unless the Bank meets particular qualifications which we would not independently enforce of your holding

company application, we will deny leave for formation of the holding company?

MR. SHAPIRO: The light is red until the Board examines the financial resources of the parent and the subsidiary and it has to find that each is adequate under the Board's current standards. And in this case it found a serious deficiency in the bank and it found that the holding company by extracting dividends from the bank would keep the bank in that under-capitalized state for a period of at least 12 years.

QUESTION: Well, would not dividends be extracted by the present owners if there is no holding company?

MR. SHAPIRO: That is correct. That is quite true.

QUESTION: So what good does it do to deny the application?

MR. SHAPIRO: By insisting on replenishing capital in this kind of case where there is a serious deficiency, the Board has obtained an injection of badly needed capital in some 400 separate cases and an injection of some $2 billion in badly needed equity in the banking system. That is the good that is done and that is what is at stake with this application approval power.

The power has been used effectively and successfully to augment the capital base in the nation's banks.

QUESTION: The Board just charges a price, in other words, for somebody who wants to form a simple bank holding

company and get the tax advantages of that. He has to pay the price by improving the capitalization of the bank.

MR. SHAPIRO: That is correct.

QUESTION: Is that correct?

MR. SHAPIRO: There is a test that has to be passed --

QUESTION: Even though the capitalization of the bank would be unchanged absent Board action, whether or not it was owned as before by individual owners or owned thereafter by a holding company?

MR. SHAPIRO: That is precisely the point. And this procedure is identical to the procedure under the Federal Reserve Act which Congress stated was the model to be applied here.

When an applicant seeks membership in the Federal Reserve System, it does not matter whether the change in status would cause a worsening of its condition. It hardly ever will. It is inconceivable that it would.

The question though in this context is whether minimal standards are met, and if they are not met, the applicant is told to go back and improve the situation and come back at a later date for Board approval. And that is the approach that has been applied consistently under the Holding Company Act.

QUESTION: Mr. Shapiro, having interrupted you, may I ask you this which does not seem to be very clear from my

reading of the briefs at least.

Do the individual owners -- if this should become a holding company, do the individual owners remain guarantors of the debt?

MR. SHAPIRO: Yes, they are. They are indeed guarantors, secondarily liable.

QUESTION: So if that is true, the situation remains as before from the point of view of the stability of that indebtedness and any advantage of the holding company, however slight, is a net advantage, is it not?

MR. SHAPIRO: That is correct. The situation remains in the state of serious undercapitalization. There is no improvement over a 12-year period and that is the crux of our --

QUESTION: No improvement in the capitalization of the bank and there would not have been had there been no holding company?

MR. SHAPIRO: Well, that is correct. And that is why at this juncture the Board insists that there now be an improvement to --

QUESTION: As a price for these people getting the tax advantage of forming a bank holding company.

MR. SHAPIRO: It is not a price; it is the statutory criteria. Our financial resources --

QUESTION: Well, it is a condition.

MR. SHAPIRO: Correct; correct.

QUESTION: Mr. Shapiro, if I understand you correctly, if the holding company were a multi-million dollar concern, just all cash and no risk business in it and no multiple bank situation, you would nevertheless -- and if the results of the formation of the holding company would be totally to the benefit of the bank because they would get the tax deduction they do not now get, you would nevertheless disapprove the application unless they poured additional capital into the bank?

MR. SHAPIRO: That is correct. Until the 8 percent standard has been satisfied, the subsidiary's condition is seriously deficient and that has to be remedied as a prerequisite to approval. That is quite correct.

QUESTION: Is there not some value to the guarantees resulting from a Holding Company Act -- from the holding company status?

MR. SHAPIRO: There certainly is very significant advantage in having the holding company status. The holding company for one thing is in a position to issue --

QUESTION: Advantage to whom?

MR. SHAPIRO: -- debt securities without restrictions under Regulation Q that apply to individual banks. With the holding company base additional business activities can be entered into. There are numerous benefits in addition to the tax advantage.

QUESTION: A branch bank or almost.

MR. SHAPIRO: Not in Illinois. Illinois has limits on branch banking, one facility within 1,500 yards, a second facility within two miles and that is it, but in many states, of course, where there are limits on branching, you can get around those limits by setting up a holding company with multi-bank subsidiaries.

Now Oklahoma and Texas are clear examples of that situation.

QUESTION: But if your answer is accurate that the original owners here remain as guarantors of indebtedness, then there is the advantage of now there being two sets of debtors instead of just one.

MR. SHAPIRO: Well, the holding company --

QUESTION: The holding company is now added as an additional debtor and the original debtors remain debtors, correct?

MR. SHAPIRO: The holding company under this application would remain simply a shell. It would have no additional working --

QUESTION: It assumes the indebtedness though, does it not?

MR. SHAPIRO: That is correct. It assumes the indebtedness.

QUESTION: So it is an additional debtor?

MR. SHAPIRO: And it would have no income other than

the dividends paid from the bank which would otherwise be paid to these guarantors which you referred to.

QUESTION: It would otherwise be paid to Uncle Sam? The dividends for the most part you are talking about are the product of the tax saving?

MR. SHAPIRO: That is correct. In the first year the saving would be roughly $130,000 diminishing every year down to --

QUESTION: The government's position is it is better to have that money go to the government really?

MR. SHAPIRO: The government's position is that if this new valuable status is sought, it is incumbent upon the party seeking this new advantage to shoulder the responsibility of maintaining adequate capital in the bank. That is the government's position in a nutshell.

QUESTION: And your position is based entirely on the statutory language that the Board shall take into consideration the financial and managerial resources in future prospects of the company or companies in the bank's concern?

MR. SHAPIRO: And it is based on the long history that we cite in the brief. One pertinent portion of that is the analysis -- or the analogy to the practice under the Federal Reserve Act where an applicant cannot obtain membership in the system unless its capital is adequate relative to assets and relative to liabilities --

QUESTION: Well there, of course, you are talking about membership in a system of banks, all of which affect one another in their operation. You do not have any consideration like that here, do you?

MR. SHAPIRO: There are certainly economic differences, but Congress said that they are inconsequential and that the same pattern is applicable under the Holding Company Act.

QUESTION: Does the government still concede as it did -- at least Judge Fairchild quoted you in the Court of Appeals as saying that in any economic analysis of this, the formation of a new company can only be beneficial to the bank, cannot cause any harm.

MR. SHAPIRO: I think that concession has been strained a bit but we do agree that a $130,000 benefit is better than no $130,000 benefit and that is a positive factor.

QUESTION: And you cannot point to any harm other than the failure to do something you want them to do?

MR. SHAPIRO: We can point to possible harm and the Board did that in its opinion. It pointed out that there could be a weakening of the bank's financial condition. And what it meant by that was what the staff had indicated in its projections of the condition of the bank for a 12-year period.

Capital ratios could decline slightly to 4.8 percent, starting at 5.2 percent, but that was based on a number of assumptions and it was caused by a number of factors.

QUESTION: All of which would have applied if there had been no bank holding company involved?

MR. SHAPIRO: Well, some of which would not have applied. The issuance of $1 million in debt securities was a new step and that gives rise to new debt service requirements of $100,000 every year. That was a new element.

But we do not say if there is any assurance that this bank subsidiary would be worse off 12 years hence. It is a possibility. And there are other possible dangers that result from the affiliation of a bank and a leverage holding company. The Beverly Hills National Bank case is a good example. In that case the holding company issued commercial paper, short-term debt securities and it was unable to meet its obligations on that commercial paper, only $2 million in debt and that caused a run on the bank even though the bank was sold.

QUESTION: Yes, but that was a situation in which they did not maintain the 80 percent necessary to take advantage of the tax advantage which is the whole purpose of this transaction.

MR. SHAPIRO: Well, I have never seen that fact referred, Your Honor, that there was less than 80 percent control in the Beverly Hills National Bank case. I believe that there was 80 percent control.

The difficulty was that the holding company could not meet a relatively small obligation on its debt securities.

And even though the bank was sound, this caused a panic among depositors; $30 million in deposits were withdrawn in three days. This is a possible difficulty that results from the combination of a highly leverage holding company with large amounts of debt outstanding and the possibility of not being able to meet its obligations.

This is a danger imposed on the bank that would not otherwise exist. We are not saying that that will happen. The Board made no finding that it necessarily would result, but that is the sort of danger that the Board takes into account when it talks about possible weakening which it referred to in its opinion.

QUESTION: What criteria do you suggest were taken into account by the Federal Reserve Bank of Chicago in recommending approval of this computation?

MR. SHAPIRO: The Reserve Bank in Chicago recognized the low capitalization problem and recognized its persistence, but it felt that there was a strong management in this bank and that the management had done a lot good for the bank which we do not dispute. And that this management should not be faulted for taking over the bank in a time of difficulty and a sop, if you will, should be thrown to them and that possible improved earnings could reduce the strain on the capital.

But the Board simply disagreed, concluding that the low capitalization factor was such a serious problem that steps

had to be taken now, that persuasion and suggestion and urging of improvement was not enough, and that the Board had to insist upon application of its 8 percent rule.

QUESTION: And what about the Comptroller's view of this?

MR. SHAPIRO: The Comptroller originally recommended against the transaction on the ground that the bank's capital was too low. Later he changed his mind on the theory that the injection of $1 million in debt and $1 million in equity would be some improvement in the situation. And indeed it would.

Initially, capital in the bank would be raised somewhat, but it would still be $1-1/2 million short and that is the objection of the Board. And even with this injection of capital, it is not close to the standard that it should be.

QUESTION: What sanctions are available on the part of any federal agency for the bank's failure to meet the standards you are referring to, apart from the application for a holding company?

MR. SHAPIRO: Apart from denial of the holding company, it is in theory possible that the Comptroller could commence a cease and desist proceeding involving a trial.

QUESTION: Which he did not do here?

MR. SHAPIRO: He did not do here. He has relied extensively on moral persuasion and urging for improvement. And the reason for that is obvious. This trial procedure is a

highly cumbersome, time-consuming proceeding that may end up nowhere. By that I mean that if there is an order to cease and desist from being undercapitalized and market conditions are such that stock cannot be sold, there may be no way to comply with the order.

QUESTION: So the holding company regard it because it is kind of a goody that is held out in exchange for giving up this rather extended proceeding that would be necessary if the bank did not want --

MR. SHAPIRO: Well, if the Board or the Comptroller had to conduct a trial and an appeal and a judicial enforcement proceeding every time that they needed to correct a capital deficiency in some 400 cases at the Board alone, they would be doing nothing else but conducting these kinds of trials.

QUESTION: In the criminal law area this has been outlawed for years. I suppose you realize that making someone give up a right to jury trial and that sort of a thing -- in fact, the case right behind you is not too different.

Granted, this is the area of civil rather than criminal, but do you not have any hesitation about advancing that argument?

MR. SHAPIRO: I do not because no right here is being given up. There is no right to holding company status unless and until it is determined that the resources of the bank and the holding company are adequate in the judgment of the Board.

And what that means is that this 8 percent test has to be met. And it is perfectly common in this industry for a bank that seeks a change in status to have to pass a test of financial soundness. And until it does that, the application's approval is withheld.

That is a common procedure under the Federal Reserve Act, under the Federal Deposit Insurance Company Act.

QUESTION: But those Acts specifically authorize that sort of test, do they not?

MR. SHAPIRO: In this Act the legislative history makes very clear -- incorporates these same standards. Congress said that the very same considerations that are used under the Federal Reserve Act and under the FDIC Act should be applied under the bank holding company --

QUESTION: They did not say it in this Act.

MR. SHAPIRO: They said it in the House Report to the company, and they used the term "financial resource". And what, after all, is a resource? The literal definition of that term means something set aside and extra, additional support. That is the dictionary definition of the word "resource", and that is just what capital is in the banking system. It is a cushion, something extra, something set aside as insurance against poor earnings, against bad loans, against unexpected demands from depositors or other creditors.

So resource adequacy is what we are talking about when

we are talking about capital adequacy. I think the statute literally read supports us directly this history that I referred keying this statute to the Federal Reserve Act supports us directly and the whole history before that under the 1933 Act supports us directly where Congress expressly said that the holding company should be a source of strength to an undercapitalized subsidiary and that if capital was inadequate at the application stage, that is a ground for denial. That has been the pattern since 1933.

And for that reason we think that not only the history but the literal text is four square behind us. We would expect respondent to point to something in the history that suggests that the Board's inference is incorrect about its own statutory authority, but respondent has not done that. And I think that that is testimony to the support of the nature of this history.

QUESTION: Mr. Shapiro, I just want to clear one thing up in my mind. You mentioned that if you had to get a cease and desist order in undercapitalization situations that you would be engaged in almost constant litigation.

I gather from that -- and is this a correct inference -- that the problem of banks not complying with your 8 percent rule is a very common problem. A lot of banks do not comply with it, is that right?

MR. SHAPIRO: Since 1970 400 applications have been

held to be deficient under this standard under the Holding Company Act alone. And that is just one agency scrutinizing capital in banks. And in each of these cases the Board has insisted on --

QUESTION: You mean there are 400 applications in which the acquired banks' capitalization did not meet the 8 percent test and that was the reason for denial?

MR. SHAPIRO: That is correct. And the denial was combined with an improvement at a later stage resulting in a replenishing of the needed capital.

And the Board's testimony before the Senate in 1976 was that this has resulted in the injection of some $2 billion in additional capital. And so we are talking about a recurrent problem that is dealt with, we think, economically under --

QUESTION: Well if there are 400 banks that this was a problem in that were subject to application, I presume there must have been a lot of other banks that were not involved in proposal to transaction that also were deficient in capital, is that right?

MR. SHAPIRO: That is correct.

QUESTION: So that maybe it is almost a characteristic of the banking industry that they do not satisfy this particular criterion.

MR. SHAPIRO: Well, we know that that is not true because the Board has made a statistical analysis of banks

within different peer groups. And within this peer group which is a size criterion the average nationally is 9 percent, and so the Board's 8 percent standard is somewhat lower than the national average. It is a problem in many cases, but on the average the banks do better than the Board's standards.

But that is not to say that it is not a recurrent problem that has to be dealt with in an economical way under the Board's supervisory powers.

QUESTION: And is a flat rule of the Board that no one bank holding company will be permitted to be organized if the bank to be acquired has a capital ratio of less than 8 percent?

MR. SHAPIRO: I am informed that it is as close to a flat rule as it could possibly be. I believe that it is.

QUESTION: Is the rule contained in a written regulation anywhere?

MR. SHAPIRO: It is contained in the uniform system of bank classification which is in the bank examiner's manuals which has been in existence since 1969. It is referred to from time to time in Board opinions. It is contained in the banking treatises that bankers rely on and it is constantly the subject of discussion between bankers and bank examiners when there is a case of undercapitalization.

QUESTION: And then basically what they do, they never allow any change of status or anything to the bank unless it will

make the change to comply with this standard?

MR. SHAPIRO: Well, a bank that was below the 8 percent standard would not get into the Federal Reserve System until it improved. The holding company that sought to acquire it would get holding company status until it was improved and FDIC insurance would not be had until the capital deficiency was improved. It is a very serious matter.

QUESTION: Well, do banks lose their FDIC insurance when they get below this amount?

MR. SHAPIRO: Pardon me?

QUESTION: Will the bank lose its FDIC insurance coverage if its capital ratio falls below this percentage?

MR. SHAPIRO: That is such a draconian sanction that it has never been done.

QUESTION: It just will not grant new insurance to a bank that does not comply?

MR. SHAPIRO: Well, if this bank were denied its FDIC insurance, it would mean that it would go into receivership. It is a national bank and it has to have it. And so methods other than the ultimate weapon are used. And one weapon, of course, is just urging from the regulatory authorities to improve, but that has proven to be inadequate. In this case it has proven to be inadequate.

The Comptroller urged this bank repeatedly that its capital funds picture should be replenished and restructured to

a fully acceptable level and that the Board of Directors should take immediate steps to achieve that end. The Comptroller --

QUESTION: The denial of the application has not achieved the end, I gather?

MR. SHAPIRO: Not to this date because it is still in litigation and, of course, they hope for success which --

QUESTION: And if the FDIC wins the litigation, then its objective will not be achieved?

MR. SHAPIRO: Well, we hope that it will be achieved through the offer of new equity securities by the bank, by finding new venturers at the holding company level, or by retaining earnings for a period of time in the bank. Any of these steps could be employed to replenish the capital base. And if that occurs -- and it should occur within a reasonable period of time -- then this respondent is free to return to the Board to get a fresh appraisal of its application.

We are not being obstructive; we are not standing in the way. When this improvement takes place, we will give the application a fresh consideration and we welcome that return from respondent. This is not the death knell to the formation of the holding company I would stress.

I would also stress that the Board's interpretation of this law which has been in existence since the early '60s and has been applied again and again in denials of holding company applications which have been published, this

interpretation has been in existence during the period of time when Congress amended the law. It amended it in 1966; it amended it again in 1970 and it did not express even the slightest disagreement with the Board's policies.

And under this Board's decision -- this Court's decisions when Congress amends a law without disagreeing with a visible and obvious policy of this sort, that amounts to a ratification by Congress of the agency's interpretation.

And this Court has said repeatedly that the greatest discretion is owing to an administrative agency's interpretation of its own enabling statute. And that argument applies a fortiori we say when there have been two amendments of the law without any hint of disagreement. And, of course, this policy of strong capitalization has been at the base of the Congressional concern in this area since 1913.

QUESTION: Mr. Shapiro, has any other court considered this question -- any court other than the Court of Appeals for the Seventh Circuit?

MR. SHAPIRO: No, Your Honor, no other court has and you will notice that the Seventh Circuit relies upon general reasoning rather than the citation of any precedent. And that is because there is no case law in this area. We have to turn to the statute, its literal text and its history and --

QUESTION: One other question: Who wrote the opinion for the panel December 7, 1976?

MR. SHAPIRO: Senior Judge Hastings wrote the panel decision and Judge Fairchild who had dissented in the original case wrote the decision for en banc court.

QUESTION: It does not appear who the author was of the panel.

MR. SHAPIRO: I noticed that myself, Your Honor, with some embarrassment, but those are the authors of the opinions.

QUESTION: Thank you.

MR. SHAPIRO: Respondent asserts that because a capital deficiency already exists here but there is no rational ground for us to stand in the way, that we are being arbitrary and capricious because the milk has already been spilled. The damage is done, they say, and there is no reason to make a fuss.

But we say that the situation should be improved and that new powers and new status should not be conferred until that improvement takes place. And I do not think there is anything arbitrary or capricious about that.

The old maxim about greater rights, presupposing greater responsibility, we think applies fully in this case.

QUESTION: How do you relate that specifically to this statute, that doctrine?

MR. SHAPIRO: Under the statute the Board is directed to consider in every case financial resources and the legislative history says that these considerations of financial

soundness and managerial soundness, the so-called banking factors, are the basis for granting or denying and if the applicant has not shown sufficient responsibility to raise capital to minimally adequate levels, then the statute we say authorizes a flat denial until the applicant approves the condition of the bank and meets minimum Board standards.

Mr. Chief Justice, I see that the white light is on and I request your leave to reserve the remainder of my time to reply.

MR. CHIEF JUSTICE BURGER: Very well. Mr. Collins.

ORAL ARGUMENT OF GEORGE B. COLLINS, ESQ.

ON BEHALF OF THE RESPONDENT

MR. COLLINS: May it please the Chief Judge and this honorable court:

The transaction here involved does not change anything except for the better. The Federal Reserve Bank of Chicago wrote an analysis of this transaction which was quite full and which pointed out that the -- I think their exact language was that the bank would be severely prejudiced or severely hindered if the transaction were not allowed.

The reason for that is that by this transaction -- by the formation of this holding company the bank will -- or the entity consisting of the bank and its owners will benefit by $130,000 per year. Right now the amount would be $160,000 a year because it is based upon the current average interest

rate.

Now if the court please that is a large benefit and that is why the bank sought holding company status. In Illinois having a bank holding company a one bank holding company is of no particular great benefit from a business point of view. You cannot open branch banks with it; you cannot have multiple holding company banks; you cannot do anything with it except really do what the voting trust does now.

Now the bank has a voting trust right now where the four men who are involved belong to this voting trust and that voting trust does exactly what the holding company will do which is sit there and vote every year at the time of election of directors and receive a dividend and use the dividend to pay interest on the loan which exists.

Now in this transaction there is absolutely nothing new created by the transaction. There is only a reshaping in form from a voting trust to a holding company which will perform precisely the same function as the voting trust.

QUESTION: Mr. Collins, I take it you are not defending the judgment below on the theory espoused by the Seventh Circuit, however?

MR. COLLINS: I am, Your Honor.

QUESTION: You are not?

MR. COLLINS: I am. I do contend that Judge Fairchild wrote correctly. I contend that Judge Fairchild wrote correctly

when he said that "in order to strike down a transaction or to deny a transaction, there must be something about that transaction which in some manner causes some detriment to some banking factor." The Board denies this, Your Honor, on the basis of a policy decision, a basic economic policy decision. And I think in that respect I differ very much with counsel. Counsel puts that to Your Honor here today that the Board has the right under their reading of the statute to decide basic economic policy to fix an 8 percent rate which they affixed no place in any written regulation. They have not one piece of paper, not one thing that is published as a regulation that I know of that says 8 percent.

They have the right to say that and then to deny on the --

QUESTION: They have the power to say that?

MR. COLLINS: Well, they might have the power to make such a regulation.

QUESTION: You mean that is the argument?

MR. COLLINS: That they surely have not made such a regulation.

QUESTION: Right.

MR. COLLINS: I do not know that they have that power.

QUESTION: Well, you say they do not.

MR. COLLINS: Well, it would seem to me to be this,

that they have the power only to relate to the specific transaction. Is this transaction a good one or a bad one?

Now if Your Honor please, the Board has many powers, the power over money policy in the United States which does not involve hearings; it does not involve a record. They meet once a week and decide if we are going to be richer or poorer or whatever they decide.

But that is not what this is. This is supposed to be a judicial type decision, where you take a record in a case and decide yes or no.

QUESTION: Certainly, the Board could have a general rule though by which it treats a number of applications.

MR. COLLINS: If they do, it does not appear from their opinions. They simply say in this instance we think there would be a strain on the bank's capital or, in this instance, there would be no strain.

You cannot read their opinions and come away with any understanding of any policy other than that sometimes they say it will cause a strain and sometimes they say it will not. They are not written like judicial opinions. One of them is here and many are cited in the briefs. They are not judicial opinions. They do not appear to be -- they do not really go with precedent. They simply say that this is a strain and that is not.

In this instance, I would suggest that the primary

regulation of a bank is through the Comptroller of Currency. And I think it important that the Court understand that banks are heavily regulated by a most responsible and competent regulatory authority. There are basically three: the FDIC, the Comptroller of Currency, and the State Banking Authorities. In this instance, it is the Comptroller because it is a national bank and a member of the Federal Reserve System, I would add.

QUESTION: Well, you take the position that the Board had no authority to make this decision at all?

MR. COLLINS: No, sir. Please do not put me on that. No, sir. They had authority to decide the case.

QUESTION: Well, you said the Comptroller of Currency had that authority.

MR. COLLINS: No, they had the authority to decide the case, but this is how it is supposed to work according to the statute. The Bank applies or the holding company applies; the Comptroller is then asked to pass judgment upon it before the FRB does. The Comptroller -- if the Comptroller says no because the banking factors are adverse, then you get an evidentiary hearing before the Federal Reserve Board or some delegate thereof.

If the Comptroller says yes on banking factors, then you still have the competitive factors, the antitrust factors, that must then be decided and the Board can then decide the

case on the antitrust and competitive factors and review the Comptroller on the so-called banking factors.

Now as Congress wrote it and as it would appear to me to have been intended to be written, and as Chairman Burns said when the 1971 Bank Holding Company Act was passed, the Federal Reserve Board does not pretend to want to regulate what goes on inside a bank. And Mr. Burns said; Governor Burns said that. He said, "We do not want to regulate banks. That is up to the Comptroller."

Now the Comptroller has plenary powers over banks. They have vast and enormous powers. It is not some involved court thing. One of the cases cited in the government's reply brief here, the Maloney case, I believe, gives an example of the breadth of that power. They can go in a bank and say you are closed. And you are. There is really very little you can do about it. You go to a hearing later.

So the Comptroller has very full powers to do as he wishes with the bank and he has the primary responsibility. And in this instance the Comptroller exercised a very basic primary responsibility and said after there was a change, go ahead.

The ironic thing is that the change the Comptroller proposed the Federal Reserve Board did not like. They said -- one of the items in the record here says that the Federal Reserve Board regards it as less favorable -- that the changes that the

Comptroller required is making the proposition less favorable. So you have the situation where you have essentially two regulatory bodies having input into one decision. But it is supposed to be a judicial --

QUESTION: May I interrupt you just a minute? The difficulty with the argument you are now making as I perceive is that the Comptroller has authority only to make a recommendation to the Federal Reserve Board with respect to the formation of a holding company. The Congress made the choice of putting the decision-making authority in the Federal Reserve Board with respect to a holding company.

MR. COLLINS: Very much so.

QUESTION: The Comptroller can only make a recommendation.

MR. COLLINS: May I respond on that point, Your Honor?

QUESTION: Please do.

MR. COLLINS: The Comptroller has the duty to respond to the application. He may respond yes or no. If he responds yes, then it is decided by the Federal Reserve Board without any hearing. They simply take the papers, the documents that are presented.

If the Comptroller says no, then the Federal Reserve Board is obliged to grant a hearing. My point is that some status is given by that statutory scheme to the Comptroller's acquiescence or non-acquiescence. And the Comptroller remains

in all events the primary regulatory authority over the bank and the Federal Reserve Board does not pretend, according to its Chairman, to govern what goes on inside a bank or to concern itself with the day-to-day capitalization of the bank.

QUESTION: Now all of that is true, but Section 3 imposes the obligation on the Board to consider the financial conditions not only of the bank but of the holding company --

MR. COLLINS: Correct.

QUESTION: -- and the future prospects of both so that your reliance on the Comptroller seems to me to be perhaps misplaced to some extent.

MR. COLLINS: Well, if Your Honor thinks so, then --

QUESTION: Well, it is relevant, but I am talking about the ultimate responsibility.

MR. COLLINS: But the point that I would make is that the decision that they are to make is supposed to be a judicial decision and not an economic decision. The Federal Reserve Board --

QUESTION: Well, what authority do you have for that?

MR. COLLINS: That is a statute that it impose an obligation to decide the competitive factors, that it comes out of the Bank Merger Act. It is taken whole right out of the Bank Merger Act. The legislative history to which counsel adverts just does not exist for this statute except for the Bank Merger Act.

QUESTION: Are you arguing that the financial condition of a bank is a judicial decision rather than an economic banking decision?

MR. COLLINS: Well, no. I think it is up to the Comptroller whether or not a bank should open tomorrow morning. And he makes that decision everyday as to every bank in America.

And I do not know that that is a judicial decision unless it was a case of gross abuse. And I do not know that there has ever been such a case. But my point to Your Honor is that the decision of whether to allow or to withhold the privilege of a bank holding company is one which is accorded or not accorded in accordance with judicial principles and not as part of the money policy of the Federal Reserve Board.

QUESTION: Well, except, Mr. Collins -- maybe I am simply repeating the concern expressed by my brother Powell, but the statute enacted by Congress clearly provides that in every case -- that is in every application to become a bank holding company -- the Board shall take into consideration the financial and managerial resources of the bank's concern.

MR. COLLINS: Correct.

QUESTION: It imposes a statutory duty upon the Board in every case to take those concerns into consideration.

MR. COLLINS: I have no quarrel with that because to me what that means is that you view this case and this

record and if there is anything about this transaction which harms any one of those considerations or does not even -- you could even say does not benefit the situation upon these considerations that it is entirely proper for the Board to take that into consideration --

QUESTION: Well, it has to in every case. That is the will of Congress.

MR. COLLINS: Certainly. But the point is that in this case they are denying this status, I suggest, as part of their basic monetary policy of the United States and not because of anything good, bad or indifferent about this case. And I think that is the difference between the open market committee or the money type actions of the Board and this particular item.

QUESTION: Well, the Board simply says we took into consideration the financial resources of the bank concerned.

MR. COLLINS: In their opinion.

QUESTION: And which Congress directed us to do in every case.

MR. COLLINS: The most that can be said is that they claim in their opinion which is in the petition -- they take the position that because the owner of this bank, the holding company will owe money which is already owed and has been owed for three, four years now -- because they owe money that the holding company could -- that this debt could prevent

the holding company from resolving any unforeseen problems that may arise at the bank. That is language right out of their opinion at 26a of the Petition for Certiorari.

Now if it is the point of the Seventh Circuit opinion -- and I believe it to be correct; I hope it is -- that they have to see something wrong with this transaction, with this particular transaction, some way in which this transaction is harmed by a holding company status before they can deny the benefit of $160,000 a year tax saving to this ownership entity. Now the ownership entity exists right now and right now it owes $3,700,000. If there is a holding company, they will still owe it; they will still owe it personally because they have to guarantee the note as the lender would require and does require.

So nothing changes except there is $160,000 benefit per year that goes towards reducing that debt. That is $160,000 that is not created now. So essentially, what is done here by the Federal Reserve Board is they are saying that the tax laws of the United States -- you may not have the benefit of this tax law because you did not do something else that we want you to do, which in our monetary policy we believe you should do.

Now their monetary policy is not really written because it changes so much. There is evidence in the book that the government cites --

QUESTION: Do you think they should ignore "monetary policy"?

MR. COLLINS: Well, I would hope --

QUESTION: How could they? In one breath you say that that is their job and then in your next breath you say that they should not do it when it comes up against my bank.

MR. COLLINS: I think that is the difference between this Court and any judicial body and an administrative body, and I will agree with Your Honor that they will have a hard time doing that.

But I think they have the obligation when they have the judicial decision to make --

QUESTION: Where is the legislative history that you get any of this?

MR. COLLINS: The legislative history -- if I may, the legislative history is that this is a judicial type decision and a judicial type decision means you have got to be fair to both sides and act equally among all parties, and that is what a judicial decision should --

QUESTION: Well, I should assume that any administrative body is obliged to do that whether judiciary or anything else.

MR. COLLINS: But in an open market money committee meeting at the Federal Reserve Board there is no plaintiff and no defendant, and they simply decide on the basis of some

administrator to what they are doing.

QUESTION: Well, what is wrong with what we have done here?

MR. COLLINS: What was done here -- what is wrong is --

QUESTION: What you wanted -- you think the rule says that once the Comptroller meets and decides in favor of the bank that all the Federal Reserve Board does is rubber stamp?

MR. COLLINS: Not at all.

QUESTION: Well, what is different from that?

MR. COLLINS: The obligation of the Federal Reserve Board is they could definitely, I think, overrule the -- suppose the Comptroller had a bank that was in a failing condition and he said we will start a holding company and that will put it out. I think they definitely have a function here but they have to exercise it in a judicial and not economic manner.

It has been documented that the Federal Reserve's --

QUESTION: It is a Federal Reserve Board; it is not the Federal Reserve court.

MR. COLLINS: When they are supposed to make a judicial decision and decide between parties on the basis of a record, they are supposed to do so fairly. And I think that that is different from their general administrative

responsibility over the money system.

QUESTION: When you say between parties, who are the parties?

MR. COLLINS: The parties would be the applicant and the respondent, which would be the staff of the Federal Reserve Board which chose to go against this. They made a submission against it.

QUESTION: That is not a party situation in the normal context of --

MR. COLLINS: In the administrative law context, I think it might be considered that. The Federal Reserve Board in Chicago strongly recommended this in the strongest of terms. They said the bank would suffer severe detriment if it were not granted.

The people at staff here -- of course, we do not know that as it goes through. You only learn that when you get the record, but the staff here said, no, they did not like it because it was in conflict with the current posture was their words -- the current posture of the Board, the current policy of the Board. And so they said this does not comply with our current policy.

All right. Then the Board has to decide what is right and what is wrong. And I think when they decide that, they are deciding between two contentions.

QUESTION: Mr. Collins, I am having a little difficulty

following you when you talk about the Board decision in this case being based on the Federal Reserve Board's monetary policy. Is that referred to by the Board in this decision?

MR. COLLINS: No, it is not. I base that upon an analysis in a book that the government cites called "Heller, Guidebook to Holding Company Law". I believe it is page 128 to 130 of that book which I just read yesterday and which says plainly that up until 1974 they were very liberal with the formation of these holding companies and they tended to approve them.

Then in 1974 when there was economic difficulty in the country, they decided that they would change their policy and attempt to get more money into the banking system by refusing the holding companies and by making the banks come up with more money in order to start them.

Now Mr. Shapiro this morning -- my good friend here, argues that they are right because they have the right to require more money simply as part of their general governance of the American economic system.

QUESTION: That is not really what the Board said in this case.

MR. COLLINS: No, it is not. It was the observation of the author of that book that whatever they say in their opinions -- what they do is they decide things on the basis of policy.

Now the internal Board report which -- or the staff report to the Board which is in the Appendix uses the words "current posture". Counsel argues here today forcedly that it is policy that causes them to do this and that they have the right to deny this tax advantage because of policy that banks should have more capital.

QUESTION: Well, any time you are adjudicating a case involving a particular applicant like your client here, you make the adjudication on individual factual determinations, but then you apply policy to them, do you not, whether it is legislation or rule-making or what?

MR. COLLINS: My point is that it should be at least some kind of written policy that someone can know. And for them simply to deny it on the basis of a record when in fact on the facts of the particular case nothing but benefit flows from it, I think that is just plain arbitrary, wrong and capricious because when the problem will be on its way to being solved if they will grant the holding company status, which in Illinois means nothing as far as other businesses are concerned -- if they will but grant it, then we are $160,000 a year towards solving every problem that there is. If they deny it, we are not.

QUESTION: But suppose the Federal Reserve Board, looking down the road as their business, includes that anything that will encourage speculation in bank stocks at a particular

time is bad for the whole monetary system. Then do you say they cannot take that policy into account?

MR. COLLINS: If that policy were applied to this case, they would grant the holding company because when four people own stock that is tied up for many years that is not readily salable because it is closely held, and where they have to keep the 80 percent block together to qualify for the tax consideration, then in this case it would not -- the application of such a policy would leave them in an arbitrary and capricious position.

I do not know what the deciders of great questions consider. I have never decided anything. But to me if they have a record before them, they should decide their case on the basis of the record before them and upon the harm or good to be done out of that transaction.

QUESTION: Just for this one transaction --

MR. COLLINS: I would think so. You so judge -- if a man does an armed robbery, you judge the one transaction.You do not convict him because of the general policy on that.

QUESTION: Well, but the Federal Reserve Board has got somewhat different function, has it not?

MR. COLLINS: Well, I think in this instance the way the statute and the procedure is written, I think they have the duty of deciding two antitrust questions, and I think you could consider this part as part of the antitrust

consideration or you can consider separately.

Now in the Third National Bank case, which was written and decided in this court eleven years ago, the same language out of the Bank Merger Act was held to apply to the specific transaction as viewed through an antitrust -- in an antitrust perspective. So this language has been precisely interpreted in that statute as having to do only with the antitrust considerations of the case, and having to do only with that specific circumstances and not otherwise.

QUESTION: Mr. Collins, I have read a few of these opinions over the years and uniformly the Federal Reserve Board and also the courts treat about three basic elements in analyzing these requests. The competitive factors are one; the Antitrust Division second guesses the Board on those. Then the banking factors are the second package of things that the Board and courts look at. And finally, the Board looks at the convenience of the community, whether or not the community will be better served, the convenience and needs of the community.

So I do not quite understand how you can say that all the Board is concerned with is the competitive factor.

MR. COLLINS: I was pointing out, if Your Honor please, that the same language in the Bank Merger Act -- it has exactly the same language --

QUESTION: Yes, that is right.

MR. COLLINS: -- has so been interpreted by this Court. I agree that the Federal Reserve Board certainly looks at it as Your Honor describes, but the Bank Merger Act was not so construed in the Third National Bank case which involved banks at Nashville, Tennessee. It just was done differently.

And I wanted to bring up one other point. In the legislative history argument they go back to a statute passed in 1933 which would appear to require the holder of bank stock, if a corporation, to have certain financial standing. Well if Your Honors please, that was because in the '30s there was a law that said bank stock holders were personally liable on their bank stock to the extent of the par value of that stock in case the bank failed. Now there was such a law once upon a time. It is Section 64 of the National Banking Act and then 64-A repeals that as to bank stock acquired after some date back in the '30s. And it is no longer the law.

Now there was once a very real and precise reasoning -- reason for requiring the owner of bank stock to have a certain financial status. Now the Board here tries to make that old law back into the law by saying that the owner of bank stock, if it is a corporation, should have a lot of money so that if there is trouble at the bank, they can come up with the money.

And that is what they say in the opinion in this case, that they want the applicant -- the holding company to have

money to come up with. Now if that -- that is not the law anymore. The owner of bank stock can own nothing except that bank stock if he is an individual. He can be as poor as can be and it is not against the law to own bank stock, no matter how poor you are in other matters. You can only own that stock and you can owe on it to 100 percent of its worth and you can still lawfully own it.

I think that the legislative history that counsel cites is undercut by the fact that in the initial writing of the laws on this subject, there was then existent this law requiring that you make up any loss in a bank if you are a stockholder to the extent of the par value of that.

If the Court please, we contend that the Seventh Circuit was right, that if it does not make any difference, it should not make any difference; that this transaction does not harm anyone and that it is a correct transaction. And I thank you all.

MR. CHIEF JUSTICE BURGER: Very well, Mr. Collins. Mr. Shapiro, you have three minutes. Do you have anything further?

REBUTTAL OF STEPHEN M. SHAPIRO, ESQ.

ON BEHALF OF THE PETITIONER

MR. SHAPIRO: Mr. Chief Justice and may it please the court:

I would differ with Mr. Collins with great deference

on the question of monetary policy. This case has nothing to do with monetary policy in simple terms.

Monetary policy is concerned with the level of money in the general economy and it is regulated through open market transactions, Reserve requirements and through the interest rate at the discount window at the --

QUESTION: How would you say that relates, if at all, to the desirability or undesirability of speculation in bank stocks at any particular period? Is there some nexus there?

MR. SHAPIRO: I believe that that is a separate question, Your Honor. The point I would like to may, if I may, is that this case is dealing not with money supply but with the safety of banks. It is not concerned with aggregate demand of the economy but with the cushion of equity in the banking system.

And Mr. Collins referred to Mrs. Heller's treatise. I think that if the court reviews that, it will make very clear that the policy that we are talking about here is the capital cushion for bank safety. In 1974 that became an issue because banks were failing. There were several large failures, including the Franklin National Bank, and the Board decided that at this point in time that these strict capital standards were essential to the safety of the banking system.

The argument was made that the Board's opinion was too cursory. I refer the court briefly to Camp versus Pitts, 411 U. S. 138. This is a case we have not cited, but it deals

with the adequacy of banking agency's opinion in denying an application. The opinion is about three years old of this Court, 411 U. S. 138.

And I would say in closing that the Comptroller does not have the final word here. As this Court said in the Whitney National Bank case "Congress had no intention to give the Comptroller a veto over the Federal Reserve Board under the Federal Bank Holding Company Act." And we think that this case should be viewed from that perspective because the statute is explicit that the Board makes this decision and the Comptroller merely advises.

Thank you very much.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

(Whereupon, at 2:38 p.m., the above-entitled case was submitted.)