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Savings and Loan Insolvency in the 80's

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1980 was a particular gloomy year for the savings and loan industry. The combination of high interest rates paid on deposits and low interest rates from outstanding mortgages has lead to predictions of widespread financial ruin in the industry. As the economy continues to falter, many institutions are faced with the possibility of becoming insolvent, likely resulting in merger or the appointment of receiver. The latter event is the focus of this project.

All the states and the federal government have established procedures under which a receiver may be appointed to take over the assets of an insolvent savings and loan association. Usually, the appointment of a receiver results from a summary adjudication by a government agency that the association's assets are in jeopardy. This project will focus on the legal ramifications of the appointment of a receiver. Several important questions are addressed: What are the procedures for the appointment of a receiver? What factors are considered in making this decision? What rights does the association have during the administration process? What is the scope of judicial review of the decision? What other remedies do the officers, shareholders and depositors have?

Lack of pertinent authority makes many of these questions difficult to answer. Nevertheless, some preliminary conclusions can be drawn. A savings and loan association has little or no chance of overturning an administrative decision to appoint a receiver, provided that there is some rational basis for the decision. Courts generally allow the supervisory agency a great deal of latitude in taking such steps as the agency deems necessary to protect the assets of the association. Constitutional objections to the summary nature of such proceedings are not likely to succeed. In fact, the only remedy may be for the failure to protect adequately the assets of an insolvent savings and loan association. Some courts have held a state liable for the negligent supervision of an insolvent savings and loan association.

This project is divided into five parts. Part I examines the federal statutory scheme for the supervision of federally-chartered savings and loans. The provisions of 12 U.S.C. § 1464 are examined closely to determine the extent of the power of the Federal Home Loan Bank Board to appoint a receiver. The due process implications of this process are examined in light of the United States Supreme Court's opinion in *Fahey v. Mallonee*. Finally, the question of the scope of judicial review of the Board's decision is examined. Whether the association is entitled to a review de novo is a question which could play a significant role in litigation in this area in the future.
Part II compliments the discussion of Part I with an examination of the recent decision of *Washington Federal Savings and Loan Association v. Federal Home Loan Bank Board*. In this case, the officers of the association challenged the Board’s decision to appoint a receiver and merge the association. The Federal District Court in Cleveland, Ohio, upheld the appointment. This case represents the first challenge to a receivership proceeding in many years.

Part III examines the issues in terms of the states’ supervision of savings and loan associations. The same questions that arise in the federal area are addressed here. The statutory scheme in Ohio is used as a starting point for the analysis. As is the case in the federal area, the small amount of precedent indicates that associations have little or no recourse from the appointment of a receiver.

Part IV represents an exploration of a different area of the supervision of the savings and loan industry. Six states, including Ohio, have organized deposit guarantee funds to protect the depositors of savings and loan associations. These funds represent important alternatives to the Federal Savings and Loan Insurance Corporation. This part examines the statutory framework of these funds (in conjunction with Professor Ronald Alexander’s article on the Ohio Deposit Guarantee Fund, found elsewhere in this issue) and discusses the question of whether such funds are agencies of the respective states for purpose of compliance the states’ Administrative Procedure Act.

Part V concludes the project by analyzing whether a state might be liable to the shareholders or depositors for the negligent supervision of an insolvent savings and loan association. Two cases which have found such liability are examined in depth. Finally, the Ohio Court of Claims Act is analyzed to determine whether such action is possible in Ohio.

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I. FEDERAL SUPERVISION OF SAVINGS AND LOAN ASSOCIATIONS

The Federal Home Loan Bank System is a three-tiered network composed of the Federal Home Loan Bank Board,1 the twelve regional Federal Home Loan Banks,2 and their member institutions which include federally chartered savings and loan associations.3 This article will focus on the member savings and loan associations4 and more particularly on the procedures by which such an association can be placed into conservatorship or receivership.

After a review of the relevant statutory material, this article will explore the due process aspects of such procedures and the judicial review available. Obviously, an action to place a given savings and loan institution into receivership will give rise to many other complex and perplexing issues, depending on the particular facts of the case.6 This article will not attempt to deal with issues of that sort, but will provide an overview of the due process considerations any such action will give rise to.

A. The Statutory Framework

The relevant federal law in this area is found in the Home Owners' Loan Act of 19338 and the National Housing Act7 both set forth in title 12 of the United States Code. Of primary importance is section 1464 (d)(6)(A) which reads in part as follows:

The grounds for the appointment of a conservator or receiver for an association shall be one or more of the following: (i) insolvency in that the assets of the association are less than its obligations to its creditors and others, including its members; (ii) substantial dissipation of assets or earnings due to any violation or violations of law, rules, or regulations, or to any unsafe or unsound practice or practices; (iii) an unsafe or unsound condition to transact business; (iv) willful violation of a cease-and-desist order which has become final;8 (v) concealment of books, papers, records, or assets of the association or refusal to submit books, papers, records, or affairs of the association for inspection to any examiner or to any lawful agent of the Board.9

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4 For a discussion of the similar issues faced by a district bank in this position, see, Fahey v. O'Melveny & Myers, 200 F.2d 420 (9th Cir. 1952).
5 The recent case of Washington Fed. Sav. & Loan Ass'n v. FHLLB, 526 F. Supp. 343 (N.D. Ohio 1981) illustrates this point. The activity of the Board was challenged upon ten counts, ranging from "estoppel" to improper rule-making.
9 12 U.S.C. § 1464(d)(6)(B) also authorizes the appointment of a conservator or receiver when the association consents to it, when an association is removed from membership in a federal home loan bank, or when the association loses its insured status under the Federal Savings and Loan Insurance Corporation.
In implementing these provisions the Board is given “exclusive power and jurisdiction” to decide whether to appoint a conservator or receiver, and may act when in its “opinion” one or more of the above stated grounds exist. The statute expressly permits the Board to make such an appointment “ex parte and without notice” to the association. When appointed, a conservator receives all the powers possessed by the members, directors, and officers of the association. In addition, it is granted the authority to operate the association in its own name or to conserve the association’s assets, provided such authority is exercised within the standards established by the Board. These standards are found in the regulations promulgated by the Board pursuant to section 1464(d)(11).

Regulations concerning conservators are found in parts 547 and 548 of title 12 of the Code of Federal Regulations. They provide that upon taking possession, a conservator “shall immediately take possession of the association’s books, records, and assets.” The conservator is further required to collect immediately all obligations and money due the association and, subject to the supervision of the Director, must take any action necessary to conserve the association’s assets. Its only other affirmative duty is to inventory the association’s assets as of the date possession was taken.

Sections 548.2 through 548.4 list the discretionary powers granted to the conservator, most of which involve the payments of debts and the sale of assets. Although a detailed discussion of all these powers is beyond the scope of this article, one important element should be noted. Virtually all of the conservator’s discretionary authority can be exercised only with the approval of the Board or Director.

In the event that the Board considers it more advisable to appoint a receiver than a conservator, it is required by statute to appoint the Federal Savings and Loan Insurance Corporation (Corporation). To ascertain the full extent of the Corporation’s powers as receivers, reference need be made to sections 1464, 1729, and 1730, and the regulations promulgated by the Board under their authority. The regulations provide that upon taking possession, the “receiver shall, without further action, succeed to the rights, titles, powers, and privileges of the association, and to the rights, powers,
The specific powers and duties of the receiver are found in part 549 of title 12 of the Code of Federal Regulations. As with a conservator, the receiver is under a duty to collect all obligations and money due the association and to take an inventory. In most respects its discretionary authority is the same as that of a conservator. However, its actions pursuant to this power generally do not require Board or Director approval.

Among the receiver's most important duties is its obligation to handle claims against the association in relation to its liquidation. In this area the Board maintains significant control over the receiver, supervising when and how such claims should be processed. Methods required for handling the claims depend on whether a particular association is a deposit association or not. In any event, however, the main concern is providing notice and opportunity to creditors, shareholders, and account holders so that they may timely present their claims and participate in any liquidation of assets.

The Corporation as receiver is further empowered upon appointment:

(1) to take over the assets of and operate such association, (2) to take such action as may be necessary to put in a sound and solvent condition, (3) to merge it with another insured institution, (4) to organize a new Federal savings and loan association to take over its assets, or (5) to proceed to liquidate its assets in an orderly manner, whichever shall appear to be to the best interests of the insured members of the association in default; and in any event the Corporation shall pay the insurance as provided in section 1728 of this title and all valid credit obligations of such association.

Whether or not the Corporation has been appointed receiver, it has additional authority to deal with associations in default. It can make loans to or purchase the assets of a troubled association. Or, in order to facilitate a merger or consolidation with another association, it may authorize a "purchase and assumption" agreement as opposed to merely paying claims under its obligation as insurer. Subject to the approval of the Board, the

21 12 C.F.R. § 549.6(a) (1981).
24 Section 1728(b) gives the FSLIC the option of paying the insurance claims either in cash, or by making available a transferred account in another insured institution.
25 12 U.S.C. § 1799(b) (1976). The section further states that upon payment, the FSLIC is subrogated to the rights of the insured.
27 12 U.S.C. § 1729(f)(2) (1976). The power of the FSLIC to enter into purchase and assumption agreements was challenged recently in Washington Fed. Sav. & Loan v. FHLBB, 526 F. Supp. at 393-96, and upheld. For the preferability of purchase and assumption agreements over the cash payment of claims, see Bransilver, Falling Banks: FDIC's Options and Constraints, 27 Ad. L. Rev. 327 (1975); see also Burgee, Purchase

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Corporation may also provide for the organization of a new federal savings and loan association to facilitate the liquidation of one of its insured members. 28

B. The Decision to Appoint a Conservator or Receiver: Due Process Implications

The statutory scheme for the appointment of a conservator or a receiver over a federally chartered savings and loan association permits action by the Board without notice and hearing, commonly referred to as "summary action." 29 The first response to such summary action is instinctively that it is a denial of due process. Generally notice and a hearing are necessary before governmental action may interfere with a life, liberty, or property interest. 30 In 1947, the United States Supreme Court decided Fahey v. Mallonee. 31 Fahey is now frequently cited for the proposition that a financially troubled savings and loan institution has no due process rights to notice and a hearing before being placed into conservatorship or receivership. 32 Had such bank failures been common at the time of this decision it is quite possible that this reading of the case would have been questioned long ago. Instead, the heretofore financial soundness of our nation's savings and loan institutions has offered no incentive for a reexamination of the precise significance of the case. 33 The inquiry therefore becomes, what was actually decided in Fahey?

The case arose when a conservator was appointed by the Board to take over the operations of the Long Beach Federal Savings and Loan Association. The appointment was made without prior notice or hearing. The conservator then began to take steps necessary to merge Long Beach Federal with other similar institutions. The plaintiff shareholders of Long Beach Federal sought to prevent the merger. 34 As the lower court 35 noted, the plaintiffs focused their attack on section 1464(d). 36 They argued that, in authorizing the Board to promulgate rules and regulations thereunder, Congress was guilty of an impermissible delegation of the powers granted


30 See text accompanying notes 55-56 infra.
31 332 U.S. 245 (1947).
32 See text accompanying notes 48 and 62-63 infra.
33 The court in Washington Fed. Sav. & Loan v. FHLBB, 526 F. Supp. at 343, makes the point that the issue has not arisen since 12 U.S.C. 1464 was amended in 1966. See footnote 1 of the court's memorandum and order dated July 17, 1981.
35 The case was heard before a three-judge district court and was then directly appealed to the United States Supreme Court.
36 This section of the code has since undergone several amendments which have substantially altered the provisions of § 1464(d).
it under Article I of the United States Constitution. Their argument was that subsection (d) of the statute granted to the Board essentially legislative authority "without prescribing either adequate, or any statement of policy, standards, limitations, or criteria to guide the board in exercising its functions."37

The lower court looked to *Panama Refining Co. v. Ryan*38 and *Schechter Poultry Corp. v. United States,*39 the two most important "impermissible delegation"40 cases of their time. *Panama Refining* had held that there were limits to the congressional power to delegate authority to other organs of government, limits which could not constitutionally be transcended. The hallmark of an unconstitutional delegation is a lack of standards or policy limits which circumscribe the authority delegated. Where such standards are lacking, it is the legislative prerogative itself which has been conferred. This analysis was later approved and expanded in *Schechter Poultry.* Applying these principles, the lower court in *Fahey* concluded that the statutory section at issue gave the Board unlimited authority and discretion to conduct conservatorships and receiverships: "We hold Sec. 5(d) of Home Owner's Loan Act of 1933, as amended, unconstitutional and void as attempting to delegate legislative power to the Federal Home Loan Bank Board."41

That was the posture of the case when it came before the Supreme Court. In its opening remarks, the Court noted in passing that the case might present a due process claim.42 That, however, was the only time the issue was raised. The Court then reviewed the lower court's holding that the statute in issue was an "unconstitutional delegation of the congressional function."43 It characterized the *Panama Refining and Schechter Poultry* cases relied upon below as follows: "Both cited cases dealt with delegation of a power to make federal crimes of acts that never had been such before and to devise novel rules of law in a field in which there had been no settled law or custom."44

Since the two cases had addressed matters criminal in nature, the Court declined to apply them to the issue of purely regulatory authority before it in *Fahey.*45 An additional factor was that the various problems and

38 293 U.S. 388 (1935).
40 This principle is found nowhere in the body of the Constitution, but its source is probably Chief Justice Marshall's opinion in *Wayman v. Southard,* 23 U.S. (10 Wheat.) 1 (1825).
41 Mallonee v. Fahey, 68 F. Supp. at 421. The court also noted at page 420, in a statement which was clearly dictum: "We think due process requires a hearing on notice and this should be provided within the Act itself."
42 *Id.* at 247.
43 *Id.* at 249.
44 *Id.* at 250.
remedies dealt with in the Board’s regulations were “as old as banking enterprise” itself, and had traditionally been the subject of expert supervision and regulation. These considerations led the Court to pronounce a different standard for deciding delegation cases involving supervisory administrative actions. When regulations promulgated under statutory authority are “sufficiently explicit, against the background of custom, to be adequate for proper administration,” the delegation is not unconstitutional. At this point in the opinion the Court’s language is somewhat ambiguous, and uncritical readers have assumed that the due process issue was addressed. In fact, the Court held merely that summary action concerning the appointment of conservators and receivers is so well engrained in the custom and history of the banking industry that it falls within the ambit of the established tests for constitutionality. It found that there was no impermissible delegation. By deciding the case on these grounds, it left the due process issues raised by summary action for another day. It is unfortunate that subsequent authorities have interpreted the Court’s holding on the constitutionality of the delegation as settling all of the due process issues as well. 

The second basis for the holding was also far removed from contemporary due process analysis. The Court stated that even if the statute in question were defective in a constitutional sense, the decision of the lower court would have had to be reversed. Long Beach Federal had been granted its charter as a federal savings and loan association under the same statute that it then sought to have declared unconstitutional. In the Court’s view, the chartering and dissolution provisions of the statute were “hardly severable” from one another, and the association could not take advantage of the privilege and then attack the validity of the statute. “We hold that plaintiffs are estopped, as the Association would be, from challenging the provisions of the Act [at issue].” This ground for the holding could be read as relegating to dictum all aspects of the opinion dealing with the delegation doctrine and the Court’s passing reference to due process. Although this estoppel analysis is of dubious constitutional validity today, it is on occasion resurrected to support a result-oriented decision. In any event, the

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46 Id.
47 Id. at 253.
48 See, e.g., Greater Del. Valley Fed. Sav. & Loan Ass’n v. FHLBB, 262 F.2d 371, 373 (1958), where the court stated: “It is now settled that such an administrative taking over of a savings and loan association by the parent Board without provision or opportunity for advance litigation of the propriety of the seizure is constitutionally unobjectionable,” citing Fahey v. Mallonee.
49 Fahey v. Mallonee, 332 U.S. at 255.
50 Id.
51 Id. at 256.
52 See text accompanying notes 66-71 infra.
53 Id.
Court's treatment of the delegation issue illustrates the principle that such attacks are generally unsuccessful. ⁶⁴

If we assume that Fahey did not decide whether summary action in this area is constitutionally permissible under a due process analysis, the issue becomes, what would the Court do if it were confronted with this question today? The inquiry begins with the basic proposition that, "The fundamental requisite of due process of law is the opportunity to be heard." ⁵⁵

A further requirement is the opportunity be granted "at a meaningful time and in a meaningful manner." ⁵⁶ These considerations might lead one to question the rationale for permitting a hearing after the governmental intrusion.

It has been said that, "The justification for summary action lies in the necessity for the government to act immediately."⁵⁷ Although recent cases have indicated that this statement is not completely accurate, it provides a good starting point for analysis because it is based on the assumption that under certain conditions the public interest can be served only by expedited procedures. The summary action cases which have reached the Supreme Court to date appear to fall into three main categories: those involving emergency situations; those concerning statutory entitlements; and those in the area of replevin-type statutes (including wage garnishment).⁵⁸

If the Court categorizes a case before it as involving an emergency situation, summary action is likely to be upheld. Classic examples are North American Cold Storage Co. v. City of Chicago⁵⁹ and Ewing v. Myttinger & Casselberry, Inc.⁶⁰ In North American, the Court was confronted with an Illinois statute which permitted summary seizure and destruction of unwholesome food. Finding that the storage of contaminated food presented a serious threat to public health, the Court had little difficulty upholding this governmental activity on the ground that the property interest of its owner was vastly outweighed by public concerns. Ewing involved mislabelled vitamins, and the Court upheld a summary seizure on grounds similar to those in North American. Although in Ewing the impact on public health was less clearly established, the Court deferred to the congressional finding that mislabelled products constituted a matter of serious public con-

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⁶⁴ But see Industrial Union Dep't, AFL-CIO v. American Petroleum Inst., 448 U.S. 607, 664, n.1 (1980), in which Justice Burger, in a concurring opinion joined by Justice Rehnquist, appears to assume the continuing vitality of this doctrine.
⁶⁷ Freedman, supra note 29, at 1.
⁶⁸ Freedman, supra note 29, at 9-14 gives further examples of the use of summary action in the areas of national security and tax assessments.
⁶⁹ 211 U.S. 306 (1908).
cern, and on that basis upheld the federal statute permitting their summary seizure.61

Fahey is usually grouped with these two prior cases. The three are viewed as having created a constitutional jurisprudence of "emergency." This characterization has been reiterated by the Court in a number of decisions, including some very recent ones,62 and has been adopted by some very reputable authors.63 Thus, convincing the Court to undertake a reevaluation of Fahey in light of modern developments in the due process arena would be a formidable task. The greatest preliminary hurdle would be to persuade the Court that the appointment of a conservator or receiver for a savings and loan association does not constitute an emergency.64 The Court would otherwise summarily uphold the statutory procedures on the basis of the emergency doctrine.65

Furthermore, a favorable determination on the emergency issue would be unlikely to settle the matter. In many ways this kind of case is similar to the line of "statutory entitlement" cases the Court has decided over the last decade. A given savings and loan association is granted a charter to become a member of the local district bank. Under the same statutory scheme its membership can be taken away, particularly when a receiver is appointed and the association is dissolved or merged with another. In reevaluating the statutory procedures, therefore, the Court might look to Goldberg v. Kelly66 and its progeny. Goldberg involved a New York statute which granted federally assisted welfare benefits to those who qualified, and provided for summary termination of benefits upon disqualification. The case is noted not only for recognizing that statutory entitlements such as welfare benefits are protected property rights for due process purposes, but also for its discussion of the "hearing" requirements of due process. In determining whether summary action was permissible in this situation, or whether a pre-termination hearing was necessary, the Court endeavored

61 Id. at 600-602.
64 It appears that the violation of a cease and desist order, one ground for the appointment of a conservator or receiver under § 1464(d)(6)(A) arguably does not constitute an emergency situation.
65 It is curious that the Court in Fahey did not cite North American Cold Storage v. Chicago, 211 U.S. at 306, a case which presumably would have supported the Court's position, had it actually been deciding the due process issue.
66 397 U.S. 254 (1970). Reference might also be made to the line of "license" cases decided by the Supreme Court under modern due process analysis. If a court adopted a "license" analysis, as opposed to a "statutory entitlement" analysis, in the federal savings and loan area, a constitutionally protected property right would still be implicated. See, e.g., Mackey v. Montrym, 443 U.S. 1 (1979); Dixon v. Love, 431 U.S. 105 (1977); Bell v. Burson, 402 U.S. 535 (1971).
to balance the public interest involved against the private interests at stake. In this setting the Court found that the continuation of welfare benefits, often an individual's only means of support, outweighed the governmental interests of administrative convenience and avoiding additional expense.67

The case is notable in a further respect relevant to procedures involving savings and loan associations. In resorting to a balancing test, the Court seemed to recognize that in some situations the public and private interests involved may actually be less divergent than they might appear. For example, although an individual has a substantial interest in the continued receipt of welfare benefits, the government's interest in social welfare programs, i.e., in maintaining a minimal standard of living for its citizens, is equally important.68 The Court therefore, in applying the balancing test, found governmental interests on both sides of the scale. This suggests that in certain settings the individual interests involved may be supported by various governmental interests thereby weighing against the permissability of summary action.

Much the same analysis could be applied to a savings and loan institution. On the one side, the government has an interest in protecting investors from the unsound practices of a given association.69 But, on the other side, these associations exist primarily to help people finance the purchase of homes, notwithstanding the fact that they are in the business of making money. The dissolution of such an institution might have the effect not only of reducing available home purchasing funds but also of creating a cloud on neighboring banks and banking in general.70 So, as in Goldberg, the situation may be one in which the private and public interests are pursuing complimentary goals.

The inquiry does not stop with Goldberg. Some time later in Matthews v. Eldridge,71 the Court developed a three part test to evaluate summary terminations of a statutory entitlement: 1) the private interests at stake; 2) the risk of an erroneous termination which the summary procedure may entail, and the probable value of additional procedural safeguards; and 3) the governmental interests involved.72 The first and third of these factors have already been discussed, leaving for consideration the risk of error involved in any given instance. It could be argued that the very fact that a summary procedure is being used implies a substantial risk of error.73 The Court in Ewing, intimated as much.74 It is especially true

67 Id. at 266.
68 Id. at 264-265.
69 See Freedman, supra note 29, at 14-16.
70 See Bransilver, supra note 27, at 329, 334, 336.
72 Id. at 335.
73 Freedman, supra note 29, at 27-29.
74 211 U.S. at 316-17.
in determining the financial status of a bank where the factors are plentiful and the record is voluminous. An attempt could be made to convince the Court that the appointment of a conservator or receiver for a savings and loan association is a situation in which summary action creates a high risk of error.

For present purposes, a discussion of the statutory entitlement cases would be incomplete without making reference to *Arnett v. Kennedy.* The plurality opinion by Justice Rehnquist is interesting in two respects: first, because it is barely reconcilable with other statutory entitlement cases, and secondly, because it cites *Fahey v. Mallonee* as authority. Again, the question before the Court was whether a statutory property right could be terminated without a prior hearing. The opinion concluded that, “where the grant of a substantive right is inextricably intertwined with the limitations on the procedures which are to be employed in determining that right, a litigant in the position of appellee must take the bitter with the sweet.” If this principle were uniformly applied, cases such as *Goldberg* would never reach the Supreme Court and much of the law of due process relevant to statutory entitlements would be in serious jeopardy. The impression that this position is very similar to the “estoppel” approach taken by the Court in *Fahey* is unmistakable. Indeed, Justice Rehnquist cites *Fahey* at length for the proposition that one who derives benefit from a statutory provision is estopped from questioning its constitutionality in other regards. Does this opinion indicate that the justices who concurred in it believe that the *Fahey* situation should today be analyzed under a statutory entitlement rationale? Or does it confirm this article’s suggestion that *Fahey* was decided on an estoppel theory and not on due process grounds? These questions appear ripe for consideration.

Finally, any exploration of the procedural due process aspects of summary action must make mention of *Sniadach v. Family Finance Corp.* and *Fuentes v. Shevin.* These cases demonstrate that the Court is willing to require a pre-termination hearing even when the interest deprived does not involve vital necessities. *Sniadach,* of course, involved the summary garnishment of a debtor’s wages; *Fuentes* dealt with the summary seizure of a debtor’s property pursuant to a state replevin statute. In both cases the Court noted that the property seizures were initiated not by the government but by individual creditors. Therefore, the governmental interests implicated were not so compelling as in other areas where summary action had been

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*416 U.S. 134 (1974).*
*Id. at 153-54.*
*Id. at 153.*
*395 U.S. 337 (1969).*
*407 U.S. 67 (1972).*
*Matthew v. Eldridge, 424 U.S. at 326.*
permitted. In balancing the interests, the Court found that the debtor's private interest in retaining his property outweighed the other interests involved.

Some doubt was cast on Fuentes by Mitchell v. W. T. Grant Co., in which the Court found sufficient procedural substitutes for prior hearings so as to permit the summary seizure. North Georgia Finishing, Inc. v. Di-Chem, Inc. appears to have revived Fuentes, and has left the field somewhat muddled. Nonetheless, the cases in this area demonstrate that the Court will utilize its balancing test in determining the constitutionality of a particular replevin-type statute. In these cases the interests to be balanced are mostly private, and the government's interests are subordinated. Thus it is not altogether certain that the Court would apply the learning of this line of cases if it were to face the due process issue presented by the ex parte appointment of a conservator or receiver for a savings and loan association. However, these cases are often critical in the due process area and are worth consulting.

C. Judicial Review

One aggrieved by agency action often has resort to judicial relief. This situation might easily arise when a savings and loan association believes that the Board has acted improperly in appointing a conservator or receiver. In this respect, section 1464(d)(6)(A) appears to provide some opportunity for judicial intervention by stating in part:

In the event of such appointment, the association may, within thirty days thereafter, bring an action in the United States district court for the judicial district in which the home office of such association is located, or in the United States District Court for the District of Columbia, for an order requiring the Board to remove such conservator or receiver, and the court shall upon the merits dismiss such action or direct the Board to remove such conservator or receiver.

Unfortunately, this vague description of the judicial role in this context raises many questions which are not easily answered.

It is likely that a court would view the standard to be applied as that of "judicial review," invoking the various principles long established as proper for this judicial function. In so doing, it would necessarily be guided by the relevant provisions of the Administrative Procedure Act. Although this appears to be a safe approach to the question, it may not be

85 This was the approach taken in Washington Fed. Sav. & Loan v. FHLBB, 526 F. Supp. at 343.
the correct one. More is involved here than merely the review of agency action.

As previously indicated, governmental deprivation of a protected property interest is permissible only where there has been compliance with the principles of due process. At the very least, notice and an opportunity to be heard are required. Congress has quite clearly authorized the Board to act summarily in appointing a conservator or receiver, i.e. without the opportunity of a prior hearing. Equally clear is the absence of a post-appointment hearing requirement before the Board. Thus an association's right to bring suit in federal court for the removal of the conservator or receiver is its only opportunity for a hearing. If the right to bring suit were not so construed, the statute would be constitutionally defective as violative of due process. The only possible construction of this statute which is consistent with constitutional requirements is that the ability to bring suit provides the association with an opportunity to be heard. The question then becomes whether the various standards of judicial review are consistent with due process hearing requirements. If not, they cannot be applied, because the present statute creates a singular situation in which the constitutionally required hearing and the opportunity for judicial review occur at the same time.

The various standards for judicial review of agency action are found in section 706 of the Administrative Procedure Act. Generally, agency action may be set aside if found to be arbitrary and capricious, unsupported by substantial evidence, or unwarranted by the facts where factual findings are subject to a trial de novo. To date, the most significant Supreme Court decision interpreting this section is *Citizens to Preserve Overton Park v. Volpe.* Overton Park would indicate that review pursuant to the "substantial evidence" test is not available to an affected savings and loan association, because that standard applies only to formal agency action. As the Court indicated, the basic requirement for obtaining this standard of review is that agency decision drawn into question be one made on the record. Since there is no requirement in section 1464(d)(6)(A) that the Board's action be conducted formally on the record, a different standard of review must be applied.

Review under the arbitrary and capricious standard is "a narrow one." To make such a finding, a court must consider whether a given agency decision was based on a consideration of relevant factors and whether a

87 See text accompanying notes 55-56 infra.
90 Id. at 415.
91 Id. at 416.
clear error of judgment has been made.\textsuperscript{92} Of the three possible standards of review, this is the most restrictive and provides the aggrieved party with little chance of changing the outcome. On the other hand, de novo review provides the most searching, thorough analysis of agency action available. The Court in \textit{Overton Park} stated that this level of review is authorized in two circumstances: 1) where the agency action is adjudicatory in nature and the agency fact finding procedures are inadequate; or, 2) when issues that were not before the agency are raised in a proceeding to enforce non-adjudicatory agency action.\textsuperscript{93}

Since the intermediate standard of review, the “substantial evidence” standard, will not be available to an association seeking review, a court will have to choose between “arbitrary and capricious” or “de novo” review. A court will more than likely be inclined to defer to agency expertise and limit its review to the arbitrary and capricious standard, especially since the requirements for de novo review are hard to meet. Nonetheless, \textit{Overton Park} decidedly does not preclude or limit de novo review where the statutory provisions concerning the availability of review expressly permit it. This fact becomes significant in the present context because the statutory language of section 1464(d)(6)(A) states that the Court shall review “upon the merits.” It is unfortunate that the phrase “upon the merits” does not appear in any analogous statute in the United States Code so as to provide some insight as to the scope of review available. However, an inference can be drawn that the broadest possible review is required under this statute.

Section 1464 was amended in 1966. Before that, section 1464(d)(2) had provided that upon certain findings the Board could appoint a temporary Supervisory Representative in Charge to supervise a troubled association. After such an appointment and before a conservator or receiver could be appointed, the Board was required to afford the association an opportunity for an administrative hearing on the matter. Once the Board then decided to appoint a conservator or receiver, the association still could seek judicial review of the Board’s decision. The review was conducted “upon the weight of the evidence,” which was interpreted to mean a preponderance of the evidence.\textsuperscript{94} Under the previous statute, therefore, an association was entitled to an administrative hearing before the Board appointed a conservator or receiver plus subsequent judicial review upon the weight of the evidence. Although legislative history concerning the 1966 amendment is sparse, one thing is clear: Congress’ purpose in enacting the amendment was to facilitate quick, responsive action by the Board in case of a financial emergency.\textsuperscript{95} The procedures under the prior statute were viewed as cumbersome and

\textsuperscript{92} \textit{id.}
\textsuperscript{93} \textit{id.} at 415.
\textsuperscript{94} \textit{Beacon Fed. Sav. & Loan Ass’n. v. FHLBB}, 162 F. Supp. 350 (E.D. Wis. 1958).
slow. Congress meant to remedy that situation, not to limit the judicial review available to the association. Before the amendment the association was entitled to two hearings upon the weight of the evidence - one before final agency action and the other at the point of judicial review. If the amendment is interpreted to permit only the “arbitrary and capricious” standard of review, not only is the association limited to one “after the fact” hearing, but at that hearing there is a presumption in favor of the propriety of the Board’s action. Such an interpretation would represent not only a drastic change in prior law, but also one wholly outside of the congressional purpose in enacting the amendment. It is more logical to infer that while Congress desired to expedite the procedures for appointing a conservator or receiver, it also intended to preserve an association’s full panoply of rights for the post-appointment suit authorized by the statutes. It is reasonable to conclude that “upon the merits” as found within section 1464(d)(6)(A) provides for something other than the “arbitrary and capricious” scope of review, namely a trial de novo.

This result is suggested not merely by the statutory language and purpose but by constitutional requirements as well. As previously indicated, the hearing provided for here is the only opportunity for the due process hearing that the association is entitled to. It is difficult to believe that a statute which provides only for a post-seizure hearing can also provide only for a very limited standard of judicial intervention and not be constitutionally objectionable, especially since the language of section 1464(d)(6)(A) can be read to allocate to the association the burden of proof in its suit to be relieved from conservatorship or receivership.

The 1966 amendment made yet another significant change. Prior to the amendment, Board action concerning the appointment of a conservator or receiver required formal action upon the record. The amendment eliminated this requirement. Review without a record is speculative enough to begin with. When taken into consideration along with the other changes made by the amendment, it is difficult to avoid the conclusion that a court should engage in its own fact finding and hear the cause de novo. Due process should permit no less. Since an association placed into conservatorship or receivership has the right under the present statute only to a post-seizure hearing, that hearing should be conducted so as to maximize judicial review. Anything less makes it difficult to correct agency error, provides an association with extremely minimal hearing and review standards, and raises serious questions with regard to procedural due process requirements.

96 See Citizens to Preserve Overton Park v. Volpe, 401 U.S. at 403.
97 This was again the approach taken in Washington Fed. Sav. & Loan v. FHLBB, 526 F. Supp. at 343.
II. WASHINGTON FEDERAL SAVINGS AND LOAN ASSOCIATION V. FEDERAL HOME LOAN BANK BOARD


On the same day the Board, by resolution 80-182, authorized the sale and transfer by the FSLIC as receiver of certain assets and liabilities of Washington Federal to Broadview Savings and Loan Company (hereinafter Broadview) pursuant to a purchase and assumption agreement. Resolution 80-182 also authorized an agreement of sale between the FSLIC as receiver and the FSLIC in its corporate capacity for certain assets and the assumption of certain liabilities of Washington Federal not purchased or assumed by Broadview. Additionally, the Board adopted resolution 80-183 authorizing the FSLIC in its corporate capacity to enter into an indemnity agreement with Broadview and the agreement of sale with the FSLIC as receiver. Broadview employees took over Washington Federal main offices and branches on March 18th, the same day these resolutions passed.

Washington Federal filed a complaint in federal district court against the Board and the FSLIC, basing jurisdiction in part on 12 U.S.C. § 1464(d)(6)(A). The complaint alleged that the Board's findings on which it based the appointment of the FSLIC as receiver "were clearly erroneous and unsupportable and there were no other facts on March 18, 1980 justifying the FHLBB's actions." Washington Federal prayed for a mandatory injunction ordering the Board to remove the FSLIC as receiver and dissolve the receivership and directing the Board, FSLIC, and Broadview to rescind all actions taken pursuant to the receivership and to reestablish Washington Federal's business and restore its assets.

3 Broadview was the successful bidder among those savings and loan associations who submitted bids to enter the purchase and assumption agreement with the FSLIC. 526 F. Supp. at 394.
4 Id. at 349.
5 Id.
6 Id.
7 Id.
8 Id.
9 Id.
10 Id.
Prior to trial the court entered a memorandum and order establishing that the ultimate issue at trial was to be "whether Washington Federal has sustained the burden of proving that the Board abused its discretion in reaching its 'opinion' that a receiver should be appointed.” The court placed the burden of proof on Washington Federal to show by a preponderance of the evidence that the Board acted arbitrarily and capriciously in order to establish that the Board abused its discretion.

On July 17, 1981, the court issued its lengthy decision and concluded that plaintiff failed to sustain its assigned burden of proof. Accordingly, judgment was entered against Washington Federal and for the Board on this count.

The court considered numerous facts and issues en route to its decision. This segment will explore the major issues and facts considered, the court's interpretation and application of the pertinent case law and statutes, its reasoning and holdings on the major issues and the ultimate issue, and the impact of the decision on the practicing attorney. The discussion will be divided into three major sections: (1) exploration of the court's consideration of the ultimate issue of the appointment of the receiver; (2) exploration of the court's consideration of the related issue concerning the legality of the purchase and assumption transaction entered into by the FSLIC after its appointment; and (3) an analysis of specific issues from the point of view of counsel for a savings and loan which has been forced into receivership.

A. The Appointment of a Receiver

1. Scope of Judicial Review and Content of the Administrative Record

At the outset, the court determined that the scope of judicial review applicable to the case was defined by the language of section 706(2)(A) of the Administrative Procedure Act as follows: "The reviewing court shall . . . (2) hold unlawful and set aside any agency action, findings and conclusions found to be (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; . . ." As to the record to be reviewed, the court pointed out that section 706 directs that a court reviewing an agency action must "review the whole record or those parts of it cited by a party." The court determined, however, that section 706's requirement that the administrative agency compile the administrative rec-

11 Id.
12 Id. at 349-50.
13 Id. at 402.
14 Id.
16 Id. (quoted by the court, 526 F. Supp. at 350).
17 526 F. Supp. at 350.
ord\textsuperscript{18} was inapplicable to this case; it was found instead that section 1464 (d)(6)(A), under which Washington Federal brought its action, controls.\textsuperscript{19} Under section 1464(d)(6)(A) the association may seek an order requiring the Board to remove the receiver in the United States district court. The statute states that the court will decide whether to dismiss the action or to direct the receiver be removed “on the merits.”\textsuperscript{20} In order to decide “on the merits,” however, the court noted that the statute provides no guidance as to the nature of the administrative record to be reviewed under this provision.\textsuperscript{21} Because no prior judicial interpretation of this language existed,\textsuperscript{22} the court began its own determination of the permissible content of an administrative record underlying the Board’s appointment of a receiver.

In order to reconstruct the record, the court required the Board to bring forward any facts, analysis or findings upon which it based its opinion to appoint a receiver. Without dispute from either party, the court accepted transcripts of tapes of the actual conduct of several Board meetings for the administrative record. More problematical was the oral testimony regarding meetings or briefing sessions between staff members, Board members and their assistants held prior to formal Board meetings. Washington Federal argued that this testimony should not be included in the administrative record which should be limited to documents and records declaring policy of the agency on which its judgment was based.\textsuperscript{23} The court found, however, that comments by staff members to Board members at briefing sessions were a valid inclusion in the administrative record.\textsuperscript{24} The court seemed to agree with the logic of the Board’s argument that an agency rightfully relies on its staff for information compilation and that discussions and recommendations made by the staff relative to this information should be part of the administrative record.\textsuperscript{25}

\begin{itemize}
  \item\textsuperscript{18} \textit{Id.} The court made use of the interpretation of Overton Park v. Volpe, 401 U.S. 402 (1971).
  \item\textsuperscript{19} 526 F. Supp. at 350.
  \item\textsuperscript{21} \textit{Id.}
  \item\textsuperscript{22} \textit{Id.} The court said at n.1 that this was the first receivership initiated by the Board since the Financial Institution’s Supervisory Act of 1966 (FISA) rewrote 12 U.S.C. § 1464(d)(6)(A). The procedure under former § 1464(d) provided for an administrative hearing and, therefore, an administrative record based on the Board’s application for appointment of a receiver. This procedure was abolished by FISA.
  \item\textsuperscript{23} \textit{Id.} at 351. Washington Federal based its argument on language from Home Box Office, Inc. v. FCC, 567 F.2d 9, 54 (D.C. Cir. 1977). The Home Box Office court did not allow \textit{ex parte} comments made to commissioners to be included in the administrative record, however, finding that it would be impossible to remove \textit{ex parte} comments from the commissioner’s memory.
  \item\textsuperscript{24} 526 F. Supp. at 351. The court noted that in this case only the comments of agency personnel were at issue where in \textit{Home Box Office} even comments of non-agency persons were allowed as part of the record if they were disclosed and identified.
\end{itemize}
2. The Statutory Scheme and the Relevant Factors

After determining the scope of judicial review and the content of the administrative record, the court turned to an examination of the relevant factors under the statutory scheme and whether those relevant factors were considered.26

Before appointing a receiver one or more of the grounds set out in section 1464(d)(6)(A) must exist. The five possible grounds are:

(i) insolvency in that the assets of the association are less than its obligations to its creditors and others including its members; (ii) substantial dissipation of assets or earnings due to any violation or violations of law, rules, or regulations, or to any unsafe or unsound practice or practices; (iii) an unsafe or unsound condition to transact business; (iv) willful violation of a cease-and-desist order which has become final; (v) concealment of books, papers, records, or assets of the association or refusal to submit books, papers, records, or affairs of the association for inspection to any examiner or to any lawful agent of the Board.27

Although section 1464(d)(6)(A) gives the Board the exclusive power to appoint a receiver, this power is capable of abuse. The Board's power, therefore, is subject to review by the court to determine "whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment."28

In order to blend the exclusive grant of power in the Board to appoint a receiver upon the existence of one or more specified grounds with the requirement of consideration of the relevant factors, the court formulated two "welding" rules. "Factors are only relevant if they may be subsumed under 'one or more' grounds that form the basis of the Bank Board's 'opinion' to order a receivership. A relevant factor may be considered only in connection with the ground or grounds under which it is subsumed."29

The Board appointed a receiver for Washington Federal after finding two of the statutory grounds existed: "(1) Washington Federal [was] in an unsafe and unsound condition to transact business in that it [was] unable to meet its liabilities or obligations; and (2) the assets of Washington Federal [had] been substantially dissipated due to violations of law.

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26 The court noted that the parties agreed it was for the court to determine the relevant factors. 526 F. Supp. at 354 n.4. PPG Industries v. Costle, 630 F.2d 462, 466 (6th Cir. 1980), endorsing Asarco, Inc. v. EPA, 616 F.2d 1153, 1160 (9th Cir. 1980), was cited for the proposition that a reviewing court need not accept the agency's word that it considered all relevant factors.
29 526 F. Supp. at 354.
or regulations and to unsafe or unsound practices.”30 Using its welding rules, the court concluded that the “true condition” of Washington Federal was a relevant factor subsumed under ground one.31 However, the court limited this factor to a consideration of the true financial condition of Washington Federal for the month of March, 1980, the month the Board authorized appointment of the receiver.32

3. Scrutiny of the Facts

The court examined financial reports, reports of periodic Board examinations of Washington Federal, accounting information, supervisory history, market operations and philosophy, and other information about the association from periods prior to March, 1980, considering it pertinent background. Also considered were numerous reports, memoranda, letters, proposals, recommendations, statements made at meetings, and other information produced by both sides, which either formed or may have formed part of the basis of the Board’s decision to appoint a receiver. In each case, the standards applied to each piece of information were whether the statements it contained were rationally based in fact found in the judicial record,33 were material to a determination of the true financial condition of the association in March, 1980,34 or reasonable.35

A general concern raised by Washington Federal was whether there were any relevant factors which were not considered by the Board but which should have been. Ultimately, the court found that the Board did consider all relevant factors. Though there were several instances where the court felt that the Board should have had certain specific information before it, in each case the court found that the Board either had the substantial equivalent,36 had access to the more specific information,37 or based on the information the Board did have, it was reasonable to conclude that the Board would have made the same decision had it had the missing information before it.38 These alternatives were found to be sufficient in determining that the Board did consider all relevant factors.

Washington Federal also claimed that its financial condition was affected by 12 C.F.R. § 563.17-3, a regulation dealing with forward commitments.39 That the Board can regulate forward commitment of savings

30 Id.
31 Id.
32 The court did receive into the record evidence from earlier months to provide background for the appraisal of Washington Federal’s condition in March, 1980.
33 Id. at 363, 374.
34 Id. at 371.
35 Id. at 362.
36 Id. at 388, 389.
37 Id. at 367.
38 Id. at 389.
39 Id. at 390.
and loans under this regulation was not challenged. However, the plaintiff claimed that the Board was itself responsible for Washington Federal's financial condition due to the impact of this regulation and the Board's failure to explain how Washington Federal should proceed in light of it. This fact, it was contended, was a relevant factor not considered by the Board. The court viewed this challenge as essentially an attack on the regulation and as such, of no merit. The purpose of the regulation was to limit the activities of an association but it sought to minimize the impact on associations conducting forward commitment activities by grandfathering in those commitments in excess of the regulation. Knowledge of the fact that this regulation would have varying effects on associations was imputed to the Board. The Board's failure to specifically state those effects was found by the court not to be arbitrary or capricious behavior.

A more critical flaw in this argument was said by the court to be Washington Federal's failure to show that the Board was required to consider a causal relationship between the regulation and its financial condition as a relevant factor even if it was found to exist. The Board's regulations are premised on the protection of the public health, safety and welfare. Private rights may be adjusted on this policy basis. To consider the casual relationship Washington Federal claimed, the Board would effectively be subordinating its concern for public good to its concern for an entity it regulates.

Washington Federal also claimed that the Board based its decision to place it in receivership on the application of accounting rule R-48 to the association, which thereby rendered it insolvent. Contending that R-48 had no legal binding effect on it, Washington Federal was successful in its claim that the receivership decision was therefore arbitrary and capricious. However, the court concluded that this did not void the receivership order because the Board's decision that the association was insolvent or retroactively insolvent was based on other valid reasons.

The court closely examined the actions of the Board during the last days before appointment of the receiver and on the day of the appointment and determined that there were no defects, procedural or otherwise, that would void the receivership order. Of particular concern was the timing of the order by the FSLIC to Broadview that it could take over Washington Federal's office. Though Broadview's authority to enter was pursuant to the purchase and assumption agreement executed by the receiver, FSLIC, the evidence indicated that the takeover of Washington Fed-

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40 Id.
41 Id.
42 Id. at 382.
43 Id. at 383-84.
44 Id. at 384-87.
eral's offices actually occurred prior to the formal execution of this document. The court found, however, that "the adoption of the receivership resolution, 80-181, and the execution of the purchase and assumption agreement ratified the entry." Because Washington Federal did not allege that Broadview committed wrongful acts during the premature entry, no actionable injury was found on the record.

4. Existence of Ground for Appointment of a Receiver

The court examined separately each of the two grounds upon which the Board rested its decision to appoint a receiver pursuant to section 1464 (d)(6)(A) in determining whether the Board abused its discretion.

The first ground found to exist by the Board was that "Washington Federal [was] in an unsafe and unsound condition in that it [was] unable to meet its liabilities or obligations." Based on the administrative record corroborated by undisputed facts in the judicial record, the court made seven factual findings which showed the true condition of Washington Federal on March 18, 1980, and which supported the first ground for receivership. Additionally, the court found that the Board considered all the relevant factors in finding that this ground existed and, therefore, did not abuse its discretion.

The second ground found by the Board to justify the appointment of a receivership was that "[t]he assets of Washington Federal [had] been substantially dissipated due to violations of law or regulations and to unsafe or unsound practices." The court noted that the Board did not specify what law or regulation had been violated to cause the dissipation of Washington Federal's assets. By an examination of the Board's proposed findings and other arguments the court surmised that 12 C.F.R. § 563.8, a regulation which provides a limitation on outside borrowing, and 12 C.F.R. § 563.17, a regulation dealing with management and financial policies including regulation of forward commitments, were the provisions allegedly violated. The Board argued that its staff could reasonably have concluded that certain association practices were in violation of these two regulations. However, the court noted that even if these conclusions were reasonable, there was no evidence on the record that the Board was either told or had any knowledge of them.

In regard to the forward commitment regulation, the Board also failed to show how the alleged violation of this regulation caused any dissipation

45 Id. at 387.
46 Id.
47 Id. at 387-88.
48 Id. at 388-90. See supra, text accompanying notes 26-41.
49 Id. at 391.
50 Id.
in assets as required by the second ground for appointment. The only way this dissipation could have been shown would have been by construing the accounting rules, R-48, in conjunction with 12 C.F.R. § 563.17 which was not possible given the court's ruling that Washington Federal was not bound by R-48.\(^5\) The court found that there was no showing that facts existed which would allow the Board to rationally conclude that a "substantial dissipation of assets" was occurring under the outside borrowing regulation (section 562.8), or that such dissipation if it did exist was caused by continuing violation of that regulation.\(^5\) The court therefore concluded that the Board's determination that the association had sustained substantial dissipation of assets due to violation of either regulation was arbitrary, capricious and in violation of law.\(^5\)

The court found the only facts offered by the Board to show dissipation of Washington Federal's assets due to unsafe or unsound practices were also used to support the first ground for appointment of a receiver.\(^6\) More significantly, none of these facts showed a dissipation and the Board was found never to have been aware of any facts that constituted a dissipation.\(^5\) Though the facts offered by the Board were sufficient to justify appointment of a receiver under the first ground, the court held that its use of the second ground was arbitrary, capricious and in violation of law.\(^6\)

B. Purchase and Assumption Transaction

By resolution 80-182, the Board authorized the FSLIC as receiver for Washington Federal to sell and transfer certain assets and liabilities to Broadview through a purchase and assumption agreement. The FSLIC was further authorized to enter into an agreement of sale of certain assets of Washington Federal with the FSLIC in its corporate capacity.

The court first addressed the issue of whether the question of the legality of the purchase and assumption transaction was within the court's power of review. The Board argued that the court's power of review under section 1464(d)(6)(A) extended only to the appointment of the receiver pursuant to resolution 80-181 and not to actions entered pursuant to resolutions 80-182 and 80-183, adopted after 80-181. The court rejected this argument, however, reasoning "that what is joined together in fact cannot be separated by abstract logic."\(^5\) Concluding that the receivership action and the purchase and assumption transaction were "indismissibly" interwoven

\(^{51}\) Id.
\(^{52}\) Id. at 392.
\(^{53}\) Id.
\(^{54}\) Id. at 393.
\(^{55}\) Id.
\(^{56}\) Id.
\(^{57}\) Id.
in fact, the court found that review of the latter was properly before the court.58

Resolution 80-182 authorized the FSLIC as receiver to execute the purchase and assumption agreement with Broadview and the sales agreement with the FSLIC in its corporate capacity. The Board premised its enactment of resolution 80-182 on section 406 of the National Housing Act,69 section 5(d) of the Home Owners Loan Act of 1933,60 and regulations issued pursuant to these statutes.61 The court considered these statutes and noted that under section 1464(d)(6)(A) the Board is required to appoint only the FSLIC as receiver for an association. Further, section 1729(b) requires the corporation (FSLIC) to be appointed as receiver when a federal savings and loan association is in default. Default is defined in section 1724(d) as "as adjudication or other official determination of a court of competent jurisdiction or other public authority pursuant to which a conservator, receiver, or other legal custodian is appointed for an insured institution for the purpose of liquidation."62 On this basis the court concluded that a receiver could only be appointed for "the purpose of liquidation."63 While under the definition of default the appointment of a receiver is only for the purpose of liquidation, the court pointed out that the FSLIC as receiver may take five actions under section 1729(b), four of which do not require irreversible liquidation.64 The fifth alternative allows the receiver to liquidate the associations assets in an orderly manner.

The Board argued that Congress intended the term liquidation to be given an expansive and flexible meaning in order to cover all the alternatives specified in section 1729(b). Washington Federal urged that liquidation should not be read so broadly. The court agreed with Washington Federal.

Resolution 80-182 stated that the receiver of Washington Federal was authorized to liquidate or sell its assets and property. The court reasoned that section 1729(b)(5) implicitly gives the receiver the power to sell the assets through the explicit grant of authority to liquidate the assets of an association in default.65 In support of its finding the court discussed analog-

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58 Id.
61 526 F. Supp. at 394.
62 Id. at 395 (quoting 12 U.S.C. § 1724(d) (1976)).
63 Id. The court also noted that regulation 547.6 combined § 1729(b) and 1724(d), providing: "The Board shall appoint only the [FSLIC] as receiver for a Federal association and only for the purpose of liquidation." Id. at 395 n.45.
64 Id. The court set out the four actions listed in 12 U.S.C. § 1729(b): "(1) to take over the assets of and operate such association, (2) to take such action as may be necessary to put in sound and solvent condition, (3) to merge it with another insured institution, (4) to organize a new Federal savings and loan association to take over its assets." Id. at n.46.
65 Id. at 396.
ous law regarding national bank receiverships. It has been recognized that a receiver of a national bank has the power to sell assets and engage in a purchase and assumption transaction as a form of liquidation. In reaching its conclusion, the court relied on the opinion of the 9th Circuit in Gockstetter v. Williams and Hancock Financial Corp. v. FSLIC, which both concerned the sale of assets of an association in default to another association. The court found that it was “evident that the authority of a receiver to liquidate includes its power to sell any or all of its assets and property.”

The court further noted that while “[i]n the case of national banks, as Gockstetter points out, ‘Congress has . . . made provision for bringing the liquidation of the assets of national banks to an end by providing for the sale of . . . assets,’” a savings and loan association has authority to sell assets and property under several regulations adopted by the Board pursuant to its power to make rules and regulations under section 1464 (d)(11). The court examined several regulations which clearly give the receiver of a savings and loan association in default the power to enter sales agreements and sell the assets and property of an association. Based on these findings, the court concluded that the FSLIC as receiver had the power to liquidate and sell the assets and property of Washington Federal.

Board resolution 80-183 authorized the FSLIC as corporation to enter into an indemnity agreement with Broadview as part of the purchase and assumption transaction and also to enter an agreement of sale with the FSLIC as receiver. Washington Federal accepted the authority of the FSLIC to act as it did pursuant to section 1729(f), noting the simil-

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68 Id.
69 9 F.2d 354 (9th Cir. 1925). In Gockstetter v. Williams, the court upheld the sale of assets to a newly formed bank that had entered into what amounted to a purchase and assumption agreement with the receiver of a national bank.
68 492 F.2d 1325 (9th Cir. 1974). The court in Hancock Financial Corp. v. FSLIC upheld the receiver's sale of assets of an association in default to another savings and loan association.
69 526 F. Supp. at 396 n.47.
70 Id. at 396 (quoting 9 F.2d at 356). The provision referred to is codified at 12 U.S.C. § 192 (1976).
71 526 F. Supp. at 396-97. The regulations construed by the court as conferring this power are 12 C.F.R. § 547.7, § 548.2, § 549.3(a), § 549.3(b)(2) and (4).
72 Id. at 397. The court noted that prior to the 1978 addition of 12 U.S.C. § 1729(f)(2) to the National Housing Act (the Financial Institutions Regulatory Interest Rate Control Act of 1978, Pub. L. No. 95-620, 92 Stat. 3641), the FSLIC as corporation had no authority to enter into an indemnity agreement as part of a purchase and assumption agreement. Without the 1978 amendment to the act, the FSLIC had no authority to pay for the purchase of assets of a refaulted association whose liabilities were being assumed by another insured institution.
73 12 U.S.C. § 1729(f) states in relevant part:
Whenever an insured institution is in default or, in the judgment of the Corporation is in danger of default, the Corporation may, in order to facilitate the sale of assets of such insured institution and upon such terms and conditions as the Corporation may determine, purchase any such assets or assume any such liabilities or guarantee such other insured institution against loss by reason of its assuming the liabilities and purchasing the assets of such insured institution in or in danger of default.
arity in language between this statute and section 1823(e) which empowers the Federal Deposit Insurance Corporation to avoid loss by sale of assets and assumption of liabilities by another insured bank.\textsuperscript{14} Washington Federal pointed out, however, that section 1823(e) concludes with the following sentence not found in section 1729(f)(2): “Any insured national bank or District bank, or the Corporation and receiver thereof, is authorized to contract for such sales or loans and to pledge any assets of the bank to secure such loans. . . .”\textsuperscript{15} It was argued that since this sentence specifically grants the FDIC as receiver the power to enter a purchase and assumption transaction, Congress’ failure to include similar language in section 1729(f)(2) evinces Congressional intent that the FSLIC as receiver not have the powers now claimed by the Board to conduct a purchase and assumption transaction.\textsuperscript{16} Noting lack of Congressional comment on the 1978 amendment to section 1729(f), the court determined that plaintiff’s argument was thereby undermined.\textsuperscript{17} The only information available in the Senate’s history of the 1978 amendment was a statement by the Board’s associate general counsel, Goldberg, which made clear that the FSLIC as receiver had the power to engage in a purchase and assumption transaction, including the power to guarantee or indemnify. This statement gave no reason for Congress to find any significance in the absence of the last sentence of section 1823(e) from the proposed amendment to section 1729(f).\textsuperscript{18}

The court rejected Washington Federal’s argument based on First Empire Bank v. Federal Deposit Insurance Corp.\textsuperscript{19} where the last sentence of section 1823(e) was found not to authorize the FDIC as receiver to enter into a purchase and assumption agreement but merely to acknowledge the fact that the receiver may enter a contract with the corporation.\textsuperscript{20} The First Empire court discussed the history of purchase and assumption agreements in support of its conclusion. Washington Federal’s argument that under section 1729(f)(2) the FSLIC had authority to purchase Washington Federal’s assets from the receiver but that the receiver did not have the authority to sell those assets to the FSLIC as corporation was found to be groundless. The court concluded that the statute “reflects no such congressional intent to authorize only one-half of a transaction.”\textsuperscript{21}

\textsuperscript{14} 526 F. Supp. at 397 (citing 12 U.S.C. § 1823(e) (1976)).
\textsuperscript{15} Id. at 398.
\textsuperscript{16} Id.
\textsuperscript{17} Id.
\textsuperscript{18} Id. at 399.
\textsuperscript{19} 572 F.2d 1361 (9th Cir. 1978). In First Empire holders of standby letters of credit issued by a national bank that was insolvent and in receivership sued the FDIC, arguing that the purchase and assumption transaction which the FDIC entered with another national bank amounted to a preference of creditors whose obligations were assumed and such assumed obligations did not include plaintiff’s letters of credit.
\textsuperscript{20} 526 F. Supp. at 399 (quoting 572 F.2d at 1370-71).
\textsuperscript{21} Id. at 400.
As final support for its view that the FSLIC in its corporate capacity is empowered to purchase at its own receiver sale, the court read section 1729(f)(2) in conjunction with section 1464(d)(6)(D). Section 1464(d)(6)(D) enables the receiver to enter into such a sale with the corporation and was found by the court to supply the same authority as the First Empire court construed the last sentence of section 1823(e) to extend—that the receiver “can contract with the corporation.”

Based on its statutory analysis the court concluded that the FSLIC’s actions in entering the purchase and assumption agreement and entering the sales agreement and indemnity agreements was in accordance with the law. In authorizing these agreements it was held that the Board did not act arbitrarily or capriciously.

C. Impact of the Opinion

Washington Federal contains several issues which might be of interest to attorney practicing in the savings and loan industry. Given the present economic condition of many associations across the nation, counsel might very well find himself in a position similar to those of Washington Federal. Three points emerge as crucial: 1) the court’s holding on to what constitutes the contents of the administrative record; 2) the failure of Washington Federal to show that the Board’s actions caused its financial condition; and 3) the findings necessary to support the appointment of a receiver.

1. The Contents of the Administrative Record

In determining the contents of the record from which it was to review the Board’s decision, the court found inapplicable the requirement in section 706 of the Administrative Procedure Act that the agency compile the record. The court ruled that section 1464(d)(3)(A) controlled instead. Washington Federal was the first receivership initiated by the Board since the Financial Institution’s Supervisory Act of 1966 rewrote section 1464(d)(6)(A), eliminating its requirement for an administrative record. The court found the statute gave them no guidance concerning the nature or composition of a judicial record in an action brought under section 1464(d)(6)(A). The only language in the statute which indicates the possible content of the record is the phrase: “the court shall upon the merits dismiss such action or direct the Board to remove such conservator or receiver.” In interpreting the scope of “upon the merits” the court determined

82 Id. (quoting First Empire Bank v. FDIC, 572 F.2d at 1371).
83 526 F. Supp. at 400.
87 526 F. Supp. at 350.
that the association could develop all of the facts that bear upon the merits of the issues to be decided. The association could develop all of the facts that bear upon the merits of the issues to be decided. This allows the development of a broad judicial record since the only limitation is that "upon the merits is not subject to the construction that it grants a trial de novo with the 'opinion' of the Board wiped clean." In a memorandum issued by the court, the Board was required to "assume the initial burden of placing on the record the factual results of any investigation or analysis of the financial condition and business practices of Washington Federal and any other findings upon which the Board based its opinion." Thus, the court elected to have the record of the Board's decision reconstructed at trial. The court held that the administrative record should include transcripts of verbatim tapes of participants' oral statements and proceedings of the various Board meetings. The court also included the testimony of staff members recounting any briefing sessions held preceding a Board meeting and attended by Board members, their assistants, and staff members. The testimony of staff members was limited to their own statements at briefing sessions and staff members were not permitted to testify as to what others said at the briefing sessions.

Washington Federal argued that oral recollections of Bank Board witnesses as to what they said at briefing sessions should not be part of the administrative record since they were not part of the basis upon which the Bank Board acted. The district court held otherwise, relying on Home Box Office, Inc. v. F.C.C. In Home Box Office, the court remanded the administrative record to the commission to hold an evidentiary hearing "to determine the nature and source of all ex parte pleas and other approaches that were made to the commission or its employees." The Washington Federal court stated

An evidentiary hearing "to determine the nature and source of all ex parte pleas and other approaches that were made to the commission or its employees" conveys a pertinent message. Provided the ex parte comments of non-agency persons to members or employees of an agency are disclosed and identified, they may become a part of an administrative record in an informal agency action. Broader that this court's ruling, Home Box Office supports this court's ruling. Here, only comments by staff members (no outsiders) to agency Board members are held to be a part of the administrative record.

98 526 F. Supp. at 350.
99 Id. at n. 2.
100 Id. at 350.
101 Id. at 351-52.
102 Id. at 352.
103 567 F.2d 9 (D.C. Cir. 1977).
104 Id. at 58.
105 526 F. Supp. at 352.
Since section 1464(d)(6)(A) no longer requires the procedure of developing an administrative record, a reviewing court must reconstruct an administrative record at the trial in order to determine the basis for the Board’s action. This presents a difficult situation for any association attacking the appointment of a receiver because an after-the-fact reconstruction of an administrative record, which includes oral recollections by witnesses as to what they said at briefing sessions, can not assure the accuracy of the record as well as the creation of the administrative record at the time the statements were actually made.

One possible alternative approach to such reconstruction might have been to remand the case to the Board for a detailed explanation and clarification of its decision, as was done in City Federal Savings and Loan Association v. Federal Home Loan Bank Board, a case reviewing the Board’s denial of a branching application. At least one commentator has suggested a statutory and a policy argument for such remand:

[S]ection 706 [of the Administrative Procedure Act] requires judicial review based on the “whole record” as developed by the agency. There can be no review when there is no record before the court, as the Supreme court observed in Overton Park . . . .

Policy considerations shore up this statutory analysis, however. Without an explanation of an agency’s action, the reviewing court must either replace the agency’s judgment with its own or abdicate the reviewing function by accepting the agency’s judgment without inquiry . . . . The result [of remand] preserves the court’s role without extending it beyond natural boundaries.

Application of this rationale to cases such as Washington Federal will require overcoming the court’s specific finding that section 706’s requirements of an administrative record are inapplicable to a receivership action. Given section 706’s specific language and section 1464(d)(6)(A)’s lack thereof, the two could arguably be welded in later cases, at least to some extent.

2. The Failure to Show Causal Relationship Between the Board’s Action and Washington Federal’s Financial Condition

One of Washington Federal’s prime contentions was that the actions of the FHLBB in the months preceding the appointment of the receiver actually caused the financial condition in March, 1980. Specifically, plaintiff argued that the Board’s regulation of the participation in the forward commitment market, together with the Board’s silence as to how Washington Federal was to comply with the regulation, led to its precarious
position. The complicated nature of the Board's activity requires an in-depth analysis of the events leading up to the appointment of a receiver.

In 1977 Washington Federal ranked first among the 1,000 largest associations nationally in terms of return on average assets; in 1978 it ranked third and in 1979 it was approximately 160th. Much of this success was attributable to its participation in the Government National Mortgage Association (hereinafter GNMA) standby or forward commitment market. In this market Washington Federal could, for a fee, "sell" a standby contract to another party, under which Washington Federal was committed to standby to purchase a GNMA security of a particular coupon at the agreed upon price. On the agreed upon date the other party could exercise its option to deliver the GNMA or it could choose to let the delivery option pass. This type of contract is referred to as a "buy" or a "long," since under the contract Washington Federal is obligated to buy the GNMA if the delivery option is exercised. Washington Federal could also obtain a standby commitment from another party for a fee paid by Washington Federal, which under the terms of the contract, Washington Federal could deliver to the other party a GNMA security of a particular coupon at the agreed upon price. Then Washington Federal could exercise its option to deliver on the agreed upon date or it could choose to let the delivery option pass. This type of contract is referred to as a "sell" or a "short," since under the contract Washington Federal may choose to sell the GNMA.

On June 1, 1979, a regulation went into effect which placed limitations on the amount of outstanding forward commitments to purchase securities (buys) that an association could be involved in. Under this regulation Washington Federal was limited to $29.9 million in outstanding forward commitments. At this time, however, Washington Federal's forward commitments totaled $727 million which exceeded the limitation by $697 million. Washington Federal was “grandfathered” as to the excess and the regulation in no way limited the buying of forward commitments from others (sells).

In July of 1979, Washington Federal met with a Board supervisory agent and presented a plan which projected compliance with the forward commitment regulation within five years and made a request for a waiver from the regulation during that five year period. At the meeting's end, the Regional Director stated his opposition to the waiver request but promised to take it up with his superiors in Washington.

100 Id. at 355 n. 7.
101 Id. at 355.
102 Id. at 355 n. 8.
104 526 F. Supp. at 357.
105 Id.
106 Id. at 358.
Soon after the meeting, Washington Federal received a call from the supervisory agent who asked that a written waiver request be submitted by Washington Federal. The waiver request was submitted in writing by Washington Federal on September 7, 1979.\textsuperscript{107} The request contained projections and six sets of pro-forma financial statements each based on different economic assumptions. On September 25, the supervisory agent of the Board sent a memorandum to the Regional Director of O.E.S. recommending that the Association’s request be approved subject to certain listed limitations and/or conditions.\textsuperscript{108}

Ten days after the July 6 meeting, the Regional Director of the O.E.S. requested the assignment of a different examiner to perform the next supervisory examination scheduled for late July of 1979. He stated that the Association had requested a waiver from the new regulations on forward commitments and that he wanted the new examiner to “rigorously analyze [enclosed] projections and the assumptions upon which they are based and advise us whether they are reasonable.”\textsuperscript{109} The new examiner filed an interim report and on October 29, 1979, his full report was filed with the Supervisory Agent. The interim report found that “the projections were deemed reasonable,”\textsuperscript{110} but the final report merely stated: “[t]he basic assumptions were reviewed for reasonableness.”\textsuperscript{111} The Supervisory Agent received the reports and continued his recommendation, in the final report, that the request should be granted subject to certain limitations.\textsuperscript{112}

By October 1979, the Regional Director of O.E.S. had the supervisory agent’s recommendation for approval and the examiner’s report which found the Association’s projections reasonable. The Regional Director, however, took no further action on the Association’s request for waiver until January of 1980. On January 9, 1980, he submitted a request to the Director of the Office of Finance, for “comments . . . on the merits of the Association’s request.”\textsuperscript{113} On February 8, 1980, the Regional Director received back a two page memorandum which stated the Association’s request had no merit for several reasons. The Regional Director finally submitted a memorandum concerning the request to the Deputy Director of O.E.S.

The Regional Director listed various reasons why he did not process the Association’s request to the Bank Board immediately. He claimed that “there was insufficient information for his personal evaluation of the As-

\textsuperscript{107} Id.
\textsuperscript{108} Id.
\textsuperscript{109} Id.
\textsuperscript{110} Id. at 359.
\textsuperscript{111} Id.
\textsuperscript{112} Id. at 368.
society's projections." He also said that he "did not find the examiners conclusion to be too reassuring in light of their consistent disregard of the seriousness of the Association's situation." His second reason was that "the Association's projections became quickly obsolete." Finally, he stated,

I did not believe that there was any great urgency in submitting the Association's request to the Bank Board. I believed that the requests were without merit. It was inconceivable to me that the bank board would permit the Association to violate its recently adopted Regulations.

The court found none of these excuses persuasive and stated: "In effect, he arrogated to himself the right to decide how the Board would rule on the Association's waiver request. This was arbitrary." The court, however, ruled this arbitrary action was immaterial, stating:

Plaintiff submits no evidence that expressly shows, or from which it may be inferred, that the absence of Board action on the request for waiver until the meeting of March 14, 1980 contributed to the true financial condition which Washington Federal faced in March. In the absence of such evidence, Mr. Arnall's arbitrariness becomes an immaterial factor in terms of the final result.

In Washington Federal, the evidence indicates that the Board's failure to rule on the Association's waiver request, if anything, helped prevent further losses by the Association, since, during the time of the Board's inaction, GNMA prices continued to decline. This decline probably would have caused additional purchase commitments by the Association, resulting in additional losses.

We must look beyond the particular fact in Washington Federal, however, since the reasoning of the court regarding the Board's delay may prove pivotal in future cases of this nature. By finding the arbitrary action of the Board immaterial because the Association did not offer evidence to show, or infer, that the delay contributed to the true financial condition of the Association in March, the court implies that if such evidence had been shown, the opposite results would have been reached.

It is therefore essential that an association compile evidence to show that arbitrary actions, or inaction, by the Board contributed to the financial position they were in at the time a receiver was appointed. This will require an association to be farsighted in their dealings with the Board. If an as-
sociation waits until they are placed in receivership before they think about how to overturn such an action, it may be too late.

Even though an association does not know in advance that the Board is going to appoint a receiver, they certainly should forsee when there is a possibility they may encounter serious financial difficulty. It is at this time that they should make contingent plans on how to get a receivership action overturned. An association should go further than merely compiling enough documentation to support their proposal to the Board. After they have presented their proposal to the Board, the association must keep track of how their financial condition would have changed had the proposal been granted on a timely basis. In this manner, if, at a later date, the Board is found to have taken arbitrary action, the association can show exactly what their financial position would have been had the Board granted the proposal. This figure can then be used to get an approximation of damages incurred by the association due to the Board's arbitrary action or inaction. For this approach to be successful, it must be shown that the arbitrary action of the Board contributed to the true financial condition which led to the appointment of a receiver. Therefore, if (as in Washington Federal) it is shown that the approval of the proposal would only have led to additional losses, the Board's actions will be immaterial.

3. Substitution of Court's Judgment for that of the Board

On March 13, Washington Federal officials met with Bank Board staff. At this meeting Washington Federal distributed documents showing their commitment position, cash/collateral needs, and their March cash requirements. The document, entitled "Pro Forma Analysis of Cash/Collateral Needs," contained three alternative plans; each of the plans required differing amounts of cash advances and guarantees by the Board. The Association members explained each of the plans at the meeting so that the Board could choose any one of the alternatives. The highest dollar amount of guarantees required under any of the plans was shown as $84,526,524.

The following day a Board meeting was held during which the Board voted on Washington Federal's proposal. The Board was told by its staff that Washington Federal's proposal required a guarantee of $510,000,000. The Board was not shown or informed of the three proposed plans of Washington Federal. The Board after being shown only one plan and after being told it required a $510 million guarantee and forbearance of accounting techniques on reverse repos, voted against the proposal made by Washington Federal.

120 Id. at 372.
121 Id. at 374.
122 Id. at 375.
In resolving the controversy concerning the amount of guarantee requested by the Association the court stated:

Yet the need continued to assure the dealers on the street that the outstanding dollar reverse repos and the outstanding standby commitments held by them (purchase price of $588,000,000 as of February 29, 1980) would be funded when any of the commitments came due. Because of this continuing reality, despite the maximum guarantee figure in the plans, an association request for a commitment guarantee of $510,000,000 (gross $588,000,000 as testified to by Messrs. Timmins and Hall) is determined to be rationally based in fact.\textsuperscript{123}

After finding a rational basis to the Board's use of $510,000,000 as the amount of guarantee required, the court said, "[w]hether the Board would have approved any one of the three plans (Assumptions A, B, and C), assuming they had had the physical plans before them, probably would have depended upon the willingness of the Board to accept and approve the plans' express assumptions."\textsuperscript{124} The court then went on to list reasons why it felt the Board would not have approved any of the alternative plans if they had been aware of them.\textsuperscript{125} The court implies that even though the Board should have been given all three proposals to vote on, it was immaterial that they were only aware of one since, in the court's judgment, the Board would have denied all three proposals if they had been aware of them.

The Supreme Court in \textit{Citizens to Preserve Overton Park v. Volpe}\textsuperscript{26} stated, "[a]lthough this inquiry into the facts is to be searching and careful, the ultimate standard of review is a narrow one. The court is not empowered to substitute its judgment for that of the agency."\textsuperscript{127}

In \textit{Asarco, Inc. v. United States Environmental Protection Agency},\textsuperscript{28} the court said, "If the court determines that the agency's course of inquiry was insufficient or inadequate, it should remand the matter to the agency for further consideration and not compensate for the agency's dereliction by undertaking its own inquiry into the merits."\textsuperscript{129}

The courts reasoning in \textit{Washington Federal} of why the Board would have rejected the two plans which it was unaware of appears to be a substitution of its judgment for that of the Board which is prohibited by \textit{Overton Park} and \textit{Asarco}.  

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\textsuperscript{123} \textit{Id.} at 374. \\
\textsuperscript{124} \textit{Id.} at 376. \\
\textsuperscript{125} \textit{Id.} at 376-77. \\
\textsuperscript{126} 401 U.S. 402 (1971). \\
\textsuperscript{127} \textit{Id.} at 416. \\
\textsuperscript{128} 616 F.2d 1153 (9th Cir. 1980). \\
\textsuperscript{129} \textit{Id.} at 1160.
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The court reviewed various background material on Washington Federal which would have made the Board better informed if they would have had it at the March 14 meeting. The court, while finding such background material would have been helpful, did not find its use mandatory. The court reasoned that,

[S]ince the true condition of the association in March 1980 is the relevent factor to be considered under the first ground upon which the Board based the receivership, the question is whether the Board was sufficiently informed as to its true condition in the meetings of March 14 and March 18, 1980.130

III. STATE SUPERVISION OF SAVINGS AND LOAN ASSOCIATIONS

A. Statutory Scheme in Ohio

The Ohio superintendent of building and loan associations may take possession and control of the assets of an insolvent building and loan association upon finding:

that [its] affairs . . . are in an unsound or unsafe condition, that it is conducting its business in whole or in substantial part contrary to law, that it is failing to comply with the law, or that its affairs are not being conducted for the best interests of its depositors, shareholders, or creditors.1

Prior to 1975, the superintendent's authority to take possession of a building and loan association was subject to the prior written approval of the Director of the Division of Commerce,2 who appointed the superintendent.3 Legislation passed in 1975 however, authorized the Governor to appoint a superintendent to a four-year term.4 Today, superintendent's authority is concurrent with that of the Director of the Division of Commerce.5 Thus, it appears that the superintendent now has the authority to take possession of a building and loan association "forthwith," without prior approval from the Director.

Section 1157.03 of the Ohio Revised Code6 specifies the action a

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130 526 F. Supp. at 378.


2 Id. (amended 1975).

3 Id. § 121.08 (amended 1975).

4 Id. § 121.08 (Page Supp. 1981).

5 Id.

6 Id. § 1157.03 (Page 1968) provides:

The building and loan association named in the title of the proceedings provided for in section 1157.02 of the Revised Code may, within seven days after filing of the notice provided for in division (C) of such section, make application to the court with which such notice was filed for an order requiring the superintendent of building and loan associations, within such time, not exceeding fifteen days, as is fixed by such court, to file in such court a bill of particulars specifying the grounds named in section 1157.01 of the Revised Code on which he has taken possession of its business and
building and loan association can take when it believes the superintendent has taken possession without proper grounds or authority. This section indicates the type of pleadings which must be filed, specifies a determination of the issues by the court, and allows for an appeal.

Within seven days of the superintendent's filing of the notice of takeover, a building and loan association may apply to the court in which the notice was filed for an order requiring the superintendent to file a bill of particulars. The bill must specify the grounds enumerated in section 1157.01 of the Ohio Revised Code upon which he based his decision to take possession of the business and property. It must also indicate the operative facts regarding the taking of possession. The superintendent must reply to this request within the time fixed by the common pleas court. The time period must not exceed fifteen days. If the superintendent fails to comply with the order within the designated time period, the liquidation proceedings against the building and loan association will be dismissed.

If, after examining the issues, the court finds the bill of particulars insufficient, the liquidation proceedings will be dismissed. The proceedings will also be dismissed if the court finds that the superintendent exceeded or abused his power or discretion. In such a situation, the superintendent will be ordered to surrender the assets back to the control of the association. The association, however, bears the burden of proving that the superintendent abused his discretion. Such proof may be difficult to establish conclusively.

property and the operative facts found by him with respect to such taking of possession. If the superintendent does not comply with such order within the time so fixed, the liquidation proceedings shall be dismissed. Within fifteen days after the filing of such bills of particulars, the association may file an answer and cross-petition in such proceedings, joining issue on the allegations set forth in the bill of particulars. If issue is so joined, such court, or a judge thereof in vacation, shall set the proceedings down for immediate hearing upon such issue. If the court finds that the bill of particulars is insufficient in law or that the superintendent has exceeded or abused his power and discretion, it shall dismiss the liquidation proceedings and direct the superintendent to surrender such business and property to the association and the decree and order of the court shall operate to revest the title of all such property in the association as of the time specified in such decree and order. An appeal may be taken from the final order of the court as in other chancery cases. An appeal by the superintendent from a final order dismissing such proceedings shall operate as a supersedeas thereof. The perfecting of such an appeal by the superintendent shall be governed by section 2505.12 of the Revised Code.

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1 Id.
2 Id.
3 Id.
4 Id.
Insolvency of a building and loan association must be proved to the court by a preponderance of the evidence. The building and loan association is deemed to be insolvent only when the totality of its assets are insufficient to meet the claims of general creditors or are insufficient to repay the contribution of association stockholders. In this respect, savings and loans differ from other corporations. In general, the solvency of a corporation is determined without regard to the liability of the corporation to its stockholders on its capital stock. A savings and loan, on the other hand, has few creditors other than the shareholders. Thus, "[a]n insolvent association is one that, after paying its general creditors, cannot pay back its shareholders, dollar for dollar, the amount of contributions."

In determining whether or not sufficient grounds exist for taking possession of a savings and loan association, the superintendent may not substitute his business judgment for the judgment of the association's elected officers. The association officers also have discretion to determine what expenses shall be incurred in carrying out the association's business affairs. An example of such an expense would be the commissions paid to the procurer of a profitable loan. This "exception" to the superintendent's normal judgmental discretion applies only as long as the incurred expense does not result in the insolvency of the association or in impairment of its capital.

To escape a determination of insolvency, a building and loan association need not have liquid assets to meet possible demand; it need only be a "going concern," which will eventually pay off its indebtedness. A logical corollary is that an association should not be required to hold its assets in immediately available cash simply to meet all conceivable obligations. Therefore, when considering a building and loan association's in-

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12 North Fairmont Bldg. & Sav. Co. v. Rehn, 6 Ohio N.P. 185, 193 (Sup. Ct. 1898).

These associations are essentially corporate copartnerships. They have no function except to gather together, from small, stated contributions, sums large enough to justify loans ... They have no debtors or creditors except the stockholders, and whether a stockholder is creditor or debtor depends on whether he has exercised his privilege of borrowing money from the common fund. The insolvency of such an institution is sui generis. There can be, strictly speaking, no insolvency, for the only creditors are the stockholders by virtue of their stock. The so-called insolvency is such a condition of the affairs of the association as reduces the available and collectable funds below the amount of the stock already paid in.
solvency, all of its assets and resources should be taken into consideration, not simply the money in the association treasury.

In Ohio, the superintendent of building and loan associations has exclusive control over the process of liquidation. This control is subject to judicial review only if the association challenges the process pursuant to the provisions of the Ohio Revised Code.²⁰

A careful study of all of the legislation relative to the Superintendent of Building and Loan Association convinces us that the process of liquidation have been properly conferred upon him and the procedure has been made exclusive in that the legislation sets up definite procedure to be followed by all parties interested in a building and loan association properly within the control of the superintendent for the purposes of liquidation.²⁰

Only parties with a claim against the association may intervene in the liquidation proceedings under section 1157.02 of the Ohio Revised Code. Parties entitled to intervene are: creditors, stockholders, depositors, or claimants of any kind against the association being liquidated. Generally, this intervention right cannot be based on an alleged title acquired by purchase. An example of an individual who would be ineligible to intervene would be a buyer of the association's assets at liquidation by the superintendent.²¹

When a building and loan association's board of directors contest the action of the superintendent in taking possession of the association, the board's attorneys' fees may be recovered from the assets of the association. This rule holds true regardless of whether the superintendent already has possession of the business or not. Attorneys' fees are recoverable as long as the board of directors' action was based upon reasonable grounds and taken in good faith. Such fees are considered an integral part of the administrative expenses of the building and loan association, even if the contested action against the superintendent ultimately proves unsuccessful.²²

If an association's board of directors, officers, shareholders, agents, and attorneys were restrained or enjoined from doing anything which might directly or indirectly affect the association's assets after a takeover, the association and its directors would be deprived of all power and authority to enter into any type of contract. This would necessarily bar them from employing an attorney to represent the association in a good faith

contest of a takeover by the superintendent. To prevent such an abuse, the superintendent’s discretion is subject to the control of the courts. 23

Liquidation proceedings against insolvent savings and loans have been analogized to liquidation proceedings instituted against delinquent insurance companies by the Insurance Commissioner, 24 whose duties as conservator are in the nature of those of a trustee or receiver. 25 Since, in that setting, attorneys’ fees are recoverable against the assets of the insurance company, they may be recovered in a liquidation proceeding against a savings and loan association.

When the association becomes insolvent and is taken over by the superintendent, whose duties are analogous to those of a receiver, the rights and liabilities of the members or stockholders are affected. The insolvency of a building and loan association reduces available and collectable assets below the level of stock paid in by its shareholders. Therefore, the association may be able to pay its debts but it is unable to repay the contributions of its shareholders. 26 Once the association is dissolved, the shareholders, have no hope that their contributions might be returned through the investments and reinvestments of the association.

The stockholder has no further duty to make regular stock payments since all membership duties end with the association. 27 However, if members have borrowed money from the association and are repaying it in installments, they may be compelled to pay immediately the balance due when the association is deemed insolvent and dissolution proceedings are commenced. 28

This accelerated liability to association members could have staggering consequences because many association members might be unable to pay back unpaid balances on notes payable to the association. It appears, however, that the debts of the members become immediately due and collectible regardless of the time payments specified in their contracts.

If an association has assets which will permit an interest payment to depositing creditors at the time of liquidation, such payment will not be made under the terms of the original contract. The association’s insolvency renders the original contract null and void. The payments will, however, be made under the general statute governing the rate of interest payable on claims such as the depositors have against the association. 29

23 Id. at 30 (citing Assets Realization Co. v. Defrees, 225 Ill. 508, 512, 80 N.E. 263, 264 (1907)).
24 Id. (citing Anderson v. Great Republic Ins. Co., 41 Cal. App. 2d 181, 106 P.2d 75 (1940)).
26 Id. at 45, 190 N.E. at 147.
27 Id.
28 Id.
This will be true even if the rate of interest stated in the contract is less than the statutory rate. Recent economic conditions, however, make this situation unlikely to occur.

If a building and loan association cannot pay interest to depositing creditors because of insufficient assets, such payments will be sacrificed. Furthermore, the creditors may be forced to relinquish their investment if the association lacks deposit insurance.

A building and loan association stockholder may also be a depositor with the same association. After association insolvency, the superintendent could attempt to hold such a stockholder liable for the unpaid part of his stock subscription. Should such an event occur, the stockholder could be entitled to set off this claim with a claim for the money he has deposited with the association. This could be an effective limitation on stockholder liability for unpaid stock subscriptions.

The Ohio Revised Code indicates that an immediate transfer of title and possession of all association assets occurs when the superintendent posts takeover notices on the building and loan association’s doors. The possession of association assets and title is immediately transferred to the superintendent. The notice posting itself, without the execution or delivery of any instruments of conveyance, assignment, transfer, or endorsement, vests the title to all such assets in the superintendent of building and loan associations. This vesting of title operates as a bar to any attachment, garnishment, execution, or other proceeding against the association or its assets or liabilities.

Insolvency of a building and loan association does not affect prior completed transactions. Subsequent to the takeover, however, it does prevent withdrawal by a member, as well as barring perfection of an imperfect withdrawal.

The privilege of withdrawing stock deposits or matured stock shall cease as of the time of such posting and all withdrawal values shall be then fixed; and interest on deposits shall thereupon cease to accrue at the rate specified in the contracts of deposit, but without prejudice to the rights of depositors to receive interest, with other creditors, from the date of such posting, out of the funds produced by the liquidation of such association, before distribution thereof is made to shareholders on their shares. Such posting shall also terminate the authority of such building and loan association to issue or sell

30 Weinreich v. Franklin Sav. & Loan Co. 77 Ohio App. 1, 9-10, 63 N.E.2d 38, 41 (1945), appeal dismissed, 146 Ohio St. 127, 64 N.E.2d 322 (1945).
31 Niles v. Olszak, 87 Ohio St. 229, 237, 100 N.E. 820, 823 (1912).
33 Id.
34 Id.
its stock or receive subscriptions therefore or payments thereon, or to receive deposits.36

After insolvency, a member's notice of withdrawal to a building and loan association has no effect.37 This prevents a stockholder in an insolvent association from attempting to change his status from stockholder to creditor by withdrawing from the association. Any attempt to withdraw must be started and completed before the superintendent posts notice of takeover on the doors of the building and loan association.38 If the withdrawal is effected before insolvency, the rule precluding the withdrawing association member from assuming the position of a creditor does not come into effect.39 In a suit by the shareholder on a withdrawal certificate, insolvency of the association can be a bar to the shareholders' full recovery.40 After an association has made payments to a withdrawing member or an obligation due by the association, the money paid cannot be recovered. Any right of action for recovery rests in the association's remaining stockholders.41

An interesting situation occurs when the liquidated building and loan association has ample assets to pay dividends to the depositors and creditors equal to the principal sum of their respective claims.42 These depositors and creditors are also entitled to interest on their principals which they have already been paid. This interest is payable out of the assets still remaining in the hands of the liquidating agent (superintendent) before distribution may be made to the stockholders. If the extra funds are present because of payments of super-added liability by the stockholders, equity would require that the stockholders participate in the distribution of the funds made available by the reason of payment of their liability. At least one Ohio court however has decided the issue differently:

The provisions of the Constitution impose an additional liability against stockholders of corporations authorized to receive money on deposit to the extent of the par value of stock, in addition to the amount invested "for all contracts, debts, and engagements of said corporation."

The relationship between the depositors and the bank is that of creditor and debtor. The general interest statute provides that the creditor shall be entitled to interest at the rate of six percent per annum, and the provisions of the statute are broad and inconclusive in their terms. The amounts due and owing by the bank to its depositors and creditors, when it is taken for legislation, are debts within the meaning of the Constitutional provision. The fund having been

35 OHIO GEN. CODE § 687-3 (current version at OHIO REV. CODE ANN. § 1157.04).
37 Id.
38 Id.
39 Id.
40 In re Nat'l Bldg., Loan & Provident Ass'n, 12 Del. Ch. 93, 107 A. 453 (1919).
41 Young v. Stevenson, 180 Ill. 608, 54 N.E. 562 (1899).
created by the stockholders, not as a voluntary contribution, but by reason of an obligation imposed upon them by law and for the purpose of satisfying and discharging all contracts, debts, and engagements of the bank, it seems quite clear that no doctrine of equity is applicable here requiring a refund to the stockholders until the claims of the depositors and creditors have been satisfied in full, including interest authorized to be paid under the terms of the general interest statute. 3

As previously stated, when the superintendent takes over a building and loan association for liquidation, any contract between certificate of deposit holders and the association regarding the rate of interest paid by the association of the certificate is rescinded. Thereafter, the general interest statute takes effect. Any resolution adopted by the association during liquidation, calling for the payment of the balance due depositors with interest at the respective contract rates on all claims of deposit to be effective as of a certain date, cannot reinstate any of the contract rates of interest entered into by the association prior to its original insolvency. 3

An association under liquidation can offer partial payment to its certificate of deposit holders. Partial payment would be any payment less than the full amount due the holder. The holders can accept the partial payment, but such acceptance will not be treated as an accord and satisfaction. This will not prevent the creditor from proceeding to recover the full balance of his claim. If a contract has been executed pursuant to the partial payment agreement, however, there would be an accord and satisfaction which would release the association from liability on the balance. 4 A creditor may repudiate this contract to avoid the recovery limitations of an accord and satisfaction.

Prior to 1975, section 1151.33 of the Ohio Revised Code provided that a building and loan association could accumulate reserves from its earnings for the payment of losses and an undivided profit fund. This accumulated reserve could be loaned and invested in the same manner as the associate's other funds. This section was amended in 1975. It now requires that a building and loan association implement and maintain loss reserves and net worth accounts in adequate amounts to assure the association's solvency.

After an association has been in corporate existence for twenty years, it is required to maintain a minimum balance of five percent of its aggre-

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41 Id. at 520.
43 Weinreich v. Franklin Sav. & Loan Ass'n, 77 Ohio App. 1, 7, 63 N.E.2d 38, 42 (1945).
44 Id.
45 Id.
gate savings account balances. The aggregate balances are determined on the annual closing date after the association's twentieth year, or the average of such aggregate on such date, and the one to four consecutive closing dates immediately preceding such date. The sole purpose of maintaining this net worth account is to absorb losses that are, or could be incurred by the building and loan association.

The superintendent has the authority and the duty to issue regulations providing a uniform schedule of minimum reserve account levels to be reached by an association during the first twenty years of its existence. This schedule enables the association to achieve an orderly accumulation of the reserve account.

The superintendent appears to have discretionary power to permit an association with a reserve account deficiency to remedy the deficiency. This is accomplished by requiring the board of directors to earmark pledged savings accounts, capital stock, contributed surplus, or undivided profits as part of the reserve account in an amount necessary to compensate for the deficiency.

Unlike its predecessor, present section 1151.33 expressly prohibits an association from paying dividends or interest from the reserve account or other funds earmarked for the purpose of meeting the reserve account requirement.

Section 1151.33 (B) of the Ohio Revised Code requires each building and loan association to calculate its total net worth at each annual closing date. This is accomplished by the application of the schedule of percentages to the several categories of assets in which the association has invested its funds. The superintendent is required to issue a rule providing for a uniform schedule of percentages to be used for the purposes of this computation.

The amount of the loss reserve and other net worth accounts an association will be required to maintain will be the greater of either the required reserve of division (A) of section 1151.33 or the net worth requirements of division (B).

Maintenance of the required loss reserves and net worth accounts ac-

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50 Id. § 1151.33 (A).
51 Id.
52 Id.
53 Id.
54 Id.
55 Id.
56 Id. § 1151.33 (B).
57 Id.
58 Id.
cording to the superintendent's percentage schedules appears to be crucial to maintaining the statutory solvency of the building and loan association itself. Lack of the required reserves quickly indicates to the superintendent an association's financial health.

If a superintendent finds that a building and loan association is in an "unsafe or unsound condition, or that it is conducting its business in whole or in substantial part contrary to law," he has two alternatives to taking possession and control. He may order the association to self-liquidate, or he may require rehabilitation and reorganization.

Section 1157.23 of the Ohio Revised Code authorizes self-liquidation by order of the superintendent. The issuance of such an order has the effect of an election by all association stockholders to dissolve. After such action, the association can no longer accept deposits, issue stock, or pay withdrawals of stockholders or creditors. During self-liquidation, the board of directors is still entitled to exercise all other powers vested by sections 1701.01 to 1701.98 inclusive, of the Ohio Revised Code, in the directors of a corporation electing to dissolve. The written consent of the superintendent must be secured by the board to validate the exercise of any other such power, except the collection of debts due the association.

The superintendent supervises the self-liquidation process and, at his discretion, may require periodic progress reports from the association. Should the superintendent discover that the self-liquidation is being accomplished improperly, he may take possession of the association's business and property and complete the liquidation himself, as provided in sections 1157.01 to 1157.29 inclusive, of the Ohio Revised Code. All expenses incurred by the superintendent in supervising the self-liquidation are assessed to, and payable by, the association.

If the affairs of an association could be put back in a "safe and sound condition" by adjusting or sustaining the association's capital structure, the superintendent could order the association to reorganize or rehabilitate as provided in sections 1157.24, 1157.25, and 1151.61 of the Ohio Revised Code. Upon the issuance of such an order, the association would no longer be authorized to receive deposits. A trustee, however, could be appointed by the superintendent to preserve deposits if the association so elected.

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69 Id. § 1157.01.
60 Id. § 1157.23 (Page 1968).
61 Id.
62 Id.
63 Id.
64 Id.
65 Id.
66 Id.
67 Id.
The superintendent must approve a plan for rehabilitation or reorganization submitted by the board of directors. If the superintendent approves the plan, the board is required to carry it into execution. If the board of directors fails to execute a rehabilitation plan during the time fixed by the superintendent, he may institute proceedings for the liquidation of the association under sections 1157.01 to 1157.29 inclusive of the Ohio Revised Code, without any further examination. Regardless of the implementation of either of these two options by the association, the superintendent may still take possession of the association business and property at any time.

By necessity, the superintendent of building and loan associations in Ohio performs multiple functions. Above all, the superintendent serves as an administrator. The office supervises, regulates and oversees the entire state building and loan industry. The authority and responsibility delegated to the office is awesome, given the size and importance of the industry. Every decision the superintendent makes affects the banking public. Stability of the building and loan industry is crucial to Ohio’s economy. Creditor, depositor, and stockholder confidence in the stability is of vital importance. Rising inflation, unemployment, and interest rates certainly do not make the job of the superintendent any easier. It is a monumental responsibility to make certain that a banking citizen’s reliance and confidence in his local building and loan association is not misplaced.

When the superintendent has reason to believe that an association is in an unsafe or unsound condition, or that it is conducting its affairs contrary to law, an important decision must be made. The interest of the superintendent in stability of the local institution must be balanced against the stability of the entire building and loan industry. Taking possession of a building and loan institution has an impact on the industry at large.

When the superintendent decides that circumstances dictate the taking of possession, this action must be taken decisively, quickly, and without undue delay. Due process rights of the association, its stockholders, creditors, and depositors are preserved by judicial review of the superintendent’s action after possession. Judicial review is provided for before any “final determination” that the association should be dissolved or liquidated can be made by the superintendent.

Due to recent economic developments in Ohio and nationwide, the importance of the superintendent’s actions will increase. Necessarily, the
decisions made by the office will be scrutinized much more carefully. This
scrutiny will ultimately be accomplished through the use of the courts.

B. Due Process and Judicial Review

In Ohio, the superintendent of building and loan associations is au-
thorized by statute to summarily take possession of an insolvent state-
chartered savings and loan institution. The purpose of this article is to fa-
miliarize the reader with the statutes that give the superintendent this power
and to examine the case law which interprets some of these statutes. Due
to the unique nature of the subject, however, Ohio courts have had few
opportunities to address the issues examined here and any opinions that were
written on the subject are now four or five decades old. Although the courts
have upheld the superintendent's authority to take possession of a savings
and loan without a prior hearing, changes in the field of constitutional law
over the past forty or fifty years may provide an opportunity to challenge
the superintendent's authority.

This article will analyze some of the arguments that have been used
to attack a superintendent's summary proceeding and give the reader an
idea of how the courts have treated these arguments. Also, the pertinent
Ohio statutes will be examined in order to outline the extent of the super-
intendent's power and to highlight the legislature's provisions for judicial
review of the superintendent's actions.

1. Statutory Authority

The powers of the Ohio superintendent of building and loan associations
seem, at first glance, to be clearly delineated in the statutes. The superin-
tendent's office heads the Division of Building and Loan Associations which is an agency within the Department of Commerce. The Revised
Code explicitly provides that the authority of the superintendent is not sub-
ject to that of the Director of Commerce. Rather, the legislature has man-
dated that any delegation of power to the superintendent is to come only from
the statutes.

The Code outlines some specific powers and duties of the superin-
dent. These powers include conducting special examinations of building
and loan associations at the superintendent’s discretion, requesting reports on the financial status of such associations, and making the results of these examinations available to the public. The superintendent is required by law to make an annual examination of the member associations, the results of which he must report. Under these statutes, the legislature has clearly defined the limits of the superintendent’s authority to regulate the industry.

The supervisory and enforcement powers are not as specifically defined in the statutory provision giving the superintendent the authority to take possession of an association. This lack of specificity, along with the fact that the superintendent’s action is not reviewable until after the seizure, has been the basis of many of the suits concerning this type of proceeding. The following are some of the arguments which have been tendered on behalf of savings and loan associations whose assets have been seized.

2. Due Process

It has been argued that a statute such as section 1157.01 is void because it is violative of the rights guaranteed the association, its directors, shareholders, depositors, and creditors under the due process clause. In particular, the summary nature of the superintendent’s action under this statute has come under fire. Although a hearing before a court of common pleas to contest the seizure and ensuing liquidation is provided, the legislature has not made the hearing available until after the damage is done, in other words, after the association and its assets have already been seized. Notice of the superintendent’s action is given at the time possession is taken, but there is no opportunity for the association to halt the takeover.

The United States Supreme Court has held that, in instances where an individual’s property is to be taken, the individual must first be given the “opportunity to be heard.” Furthermore, the Court has stated that the

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80 Id. § 1155.10 (Page Supp. 1981).
81 Id. § 1155.07 (Page Supp. 1981).
82 Id. § 1155.12 (Page 1968).
83 Id. § 1155.09 (Page 1968).
84 Ohio Rev. Code Ann. § 1157.01 (Page 1981), provides that:
If upon examination the superintendent of building and loan associations finds that the affairs of a domestic building and loan association are in an unsound or unsafe condition, that it is conducting its business in whole or in substantial part contrary to law, that it is failing to comply with the law, or that its affairs are not being conducted for the best interests of its depositors, shareholders, or creditors, he may forthwith take possession of the business and property of such building and loan association.
85 U.S. Const. amend. XIV.
87 Id. § 1157.02 (Page 1968). According to this section, notice of the possession and liquidation must be given to all interested parties by posting such notice on the door of the association being seized, by publication, and by filing with a court of common pleas. All persons having assets in the association must be served personally or by registered mail or telegraph.
requisite hearing must "be granted at a meaningful time and in a meaningful manner." In a recent procedural due process case, Goldberg v. Kelly, the Supreme Court interpreted this phrase to mean that the hearing must be at such a time as to allow the owner allegedly being deprived of his rights or property to present his side of the case before the other side takes any action. When something as important as a person's property is involved, the Court has found that a non-adversarial determination of the facts will not suffice under the Constitution. A decision can be reached only after both parties have had an opportunity to present evidence, make arguments on their behalf, and cross examine adverse witnesses.

 Clearly, this opportunity is not available to the savings and loan institution under chapter 1157 of the Ohio Revised Code. The due process argument has added impact in this particular situation because the decision to take possession is left to the discretion of one person. The property rights of all those owning the assets of the association are subject to the discretion of the superintendent and they may not present facts or evidence which might show that that government official was wrong.

 The counter argument in procedural due process cases is based on a balancing test. Although it may be conceded that there is a deprivation of rights or property without a hearing, the argument is that the rights of the individual are outweighed by the interest the state has in taking the property or the right. In Goldberg, which involved the termination of aid to dependent children, the state's interest was not found to outweigh that of the individual, but the Court, quoting its opinion in Cafeteria and Restaurant Workers Union v. McElroy, stated that, "consideration of what procedures due process may require under any given set of circumstances must begin with a determination of the precise nature of the government function involved as well as of the private interest that has been affected by governmental action." In another procedural due process case, Fuentes v. Shevin, the Court elaborated on the circumstances in which it felt the state's interest in upholding the challenged taking outweighed the interest of the individual. The circumstances are those in which, the seizure has been directly necessary to secure an important governmental or general public interest. Second, there has been a special

91 Id. at 266.
92 Id. at 267-268 (Harlan, J., concurring).
93 The state's interest was in easing its financial burden by not paying ineligible persons.
95 397 U.S. at 270.
need for very prompt action. Third, the State has kept very strict control over its monopoly of legitimate force: the person initiating the seizure has been a government official responsible for determining, under the standards of a narrowly drawn statute, that it was necessary and justified in the particular instance.\footnote{Id. at 91.}

This test would allow the summary seizure of an association by the superintendent under chapter 1157 of the Ohio Revised Code if Ohio courts continue to decide these cases as they have in the past. Although the Ohio opinions make no mention of procedural due process as such, the decisions are clearly the result of the courts' balancing the rights of the association against the interests of the public.

\textit{Czech Catholic Union v. East End Building and Loan Association}\footnote{140 Ohio St. 465, 45 N.E.2d 300 (1942).} illustrates the rationale Ohio courts have used in upholding summary actions by the superintendent. In \textit{Czech}, the creditors of the association attempted to enforce the double liability of the shareholders of the institution before the superintendent had taken over the institution for liquidation.\footnote{Id. at 466-67, 45 N.E.2d 301. Eight years prior to this takeover, the same association had been taken over for liquidation and subsequently restored to its corporate rights. The creditors of the association claimed they should have been paid after the first takeover.} The court held that the creditors' action would have to "give way to the superior rights of the superintendent."\footnote{Id. at 471, 45 N.E.2d at 302.} The court reasoned that,

Because of the nature of their business in dealing with the public's money, state building and loan associations and banks are quasi-public institutions. They are wholly creatures of statute and transact business by legislative sanction. They are subject to state regulation and control, not only by virtue of constitutional provisions but also because of the state's inherent police power.\footnote{Id. at 470, 45 N.E.2d at 302. \textit{See} Allen v. Shaker Heights Savings Ass'n, 68 Ohio App. 445, 39 N.E.2d 747 (1941).}

The Ohio Supreme Court's approach to the issue is similar to the \textit{Fuentes} test. The Ohio court used the concept of "police power"\footnote{Id.} to justify the state's infringement on the creditors' rights, which is what the \textit{Fuentes} Court seemed to address when it spoke of seizing property in the name of "general public interest."\footnote{Id. at 471, 45 N.E.2d at 302.} Both courts also attached great importance to the fact that the seizure was sanctioned by the legislature.\footnote{Id. 407 U.S. at 91.} This legislative sanction carries with it a presumption of constitutionality and if the statute is found to be "narrowly drawn," any allegations that the administrative agency is, in effect, acting in a judicial capacity, will likely be rejected.\footnote{Id. at 96; 140 Ohio St. at 470, 45 N.E.2d at 302. \textit{Fahey v. Mallonee}, 332 U.S. 245 (1941).}
The Fuentes requirement that there must be a "need for very prompt action" is met in a situation involving a superintendent taking over an insolvent savings and loan. When the Czech court upheld the suspension of the rights of the association's creditors, it did so because "the nature of their [savings and loan associations] business in dealing with the public's money," warranted prompt action. A summary action is necessary so that whatever assets are left in an insolvent association can be used to pay off at least some of the association's debts to its creditors. If creditors of a savings and loan are not paid, the institutions will lose the support of the creditors in the future. The loser is the public in general, which depends on savings and loan associations to finance its building ventures and its purchase of real property. This is why the courts have characterized savings and loan institutions as "quasi-public institutions" which are subject to the state's police power.

Ohio decisions such as Czech would likely stand up under a procedural due process attack today. Another possible argument, closely related to the due process argument, is that chapter 1157 is unconstitutional in that it represents an unlawful delegation by the Ohio legislature of a judicial function to an executive agency, the Division of Building and Loan Associations.

The framers of the United States Constitution were careful to provide for a separation of powers between the executive, legislative, and judicial branches of government. They sought to eliminate the possibility that any one branch would usurp the powers of the other two branches. When a legislative body enacts a law which is too broad in its effect, the law may be found to be unconstitutional because it facilitates an encroachment by the legislature upon powers traditionally unique to the courts.

The Fuentes test takes into account this concern, in that it requires that a statute be "narrowly drawn." A narrowly drawn statute is necessary in order to prevent an administrative agency from exceeding its executive powers. In particular, the concern is that a government official such as the superintendent, in a summary administrative action under chapter 1157, should be limited by the statute to the determination of legislative facts and should be prevented from taking an action based on his determination of adjudicative facts.

One commentator distinguished these two types of facts. He ex-

\textsuperscript{106} 407 U.S. at 91.

\textsuperscript{107} 140 Ohio St. at 470, 45 N.E.2d at 302.

\textsuperscript{108} Id. at 470, 45 N.E.2d at 302.

\textsuperscript{109} 407 U.S. at 91.

\textsuperscript{110} Id. at 90-91.

\textsuperscript{111} Davis, An Approach to Problems of Evidence in the Administrative Process, 55 Harv. L. Rev. 364 (1942).
plained that adjudicative facts are facts about the parties and their activities, businesses, and properties. Adjudicative facts usually answer the question of who did what, where, when, how, and why, with what motive or intent; adjudicative facts are roughly the kind of facts that go to a jury in a jury case. Legislative facts do not usually concern the immediate parties but are general facts which help the tribunal decide questions of law and policy and discretion.

It could be argued that the question of whether or not an association is in fact insolvent (thereby warranting a takeover by the superintendent) is an adjudicative fact — that is, one that is normally a question for the jury. In an action under chapter 1157, the superintendent not only sits as judge and jury but once he makes a determination of law and fact, he is empowered to enforce the law by taking possession. Although a superintendent’s power must be general enough to allow him to make decisions regarding a number of different situations, it must not be so vague as to give him relatively unlimited power to determine adjudicative facts. An argument could be made that the powers given to the superintendent in chapter 1157 are so vague as to be unconstitutional and violative of the aggrieved association’s due process rights.

Administrative agencies, however, must not only “legislatively make rules, but they must regulate and supervise and direct and control and investigate — in such ways as to defy separation-of-powers labels.” There is no clear-cut answer to the question of whether the superintendent’s powers are executive or judicial in nature, and in a challenge to the constitutionality of chapter 1157, the argument must be made that they are essentially judicial powers.

Unfortunately, for those representing savings and loans, the United States Supreme Court has held, in Fahey v. Mallonee, that a statute similar to chapter 1157 does not constitute an unconstitutional delegation of a judicial function. The Court based its decision on reasoning similar to that of the Ohio court in the Czech case. The United States Supreme Court also pointed out the importance of an explicitly drawn statute but found that the federal statute was sufficiently explicit, especially when considering the role the government traditionally had taken in the supervision of the savings and loan industry.

112 Id. at 402.
113 Id.
114 Id. at 403.
116 See Davis, supra note 111, at 366.
119 332 U.S. at 250.
The Ohio Supreme Court, in *State ex rel. Bettman v. Common Pleas Court*, added another reason for upholding the summary action, when it held that a common pleas court could not intervene in the receivership process undertaken by the superintendent. The Ohio court not only mentioned the specificity of the statute's provisions, but stressed that "the adequacy of the remedy provided to protect and preserve the interests of all concerned argues convincingly for its exclusiveness." The remedy the court speaks of is the superintendent's payment of the association's creditors.

Another factor which is considered in determining whether a summary administrative proceeding is constitutional is the extent to which decisions made during the proceeding "rest solely on inspections, tests, or elections." A federal court of appeals has held that the constitutional procedural requirements do not apply to decisions "as to which there is little room for difference of opinion, or else upon technical facts like the quality of tea or the condition of airplanes, as to which administrative hearings have long been thought unnecessary."

Whether or not a savings and loan is insolvent is not a matter which might involve a difference of opinion since the criterion for determining insolvency is well defined. The determination is broken down to a computable minimum level of reserve funds. Of course, a party might challenge on the grounds of arbitrariness the legislature's authority to set that particular level.

To summarize, any attack on the constitutionality of chapter 1157 of the Ohio Revised Code based on unlawful delegation of legislative functions most likely would be unsuccessful. The United States Supreme Court, Ohio courts, and the courts of other states have all upheld discretionary summary proceedings of this sort. Since the chances are not good that the statute enabling this type of action will be declared unconstitutional, the challenging party must resort to judicial review of the superintendent's proceeding.

3. Judicial Review

The right of an association to have the actions of the superintendent reviewed by a common pleas court is found in section 1157.03 of the Ohio Revised Code.
Revised Code. This section provides that certain steps must be taken by the association before it may have the court review the action. The process of review must be initiated by the association. Under section 1157.03, the superintendent is required to file with the court a “bill of particulars specifying the grounds named in section 1157.01” and the “operative facts found by him.” The superintendent is obliged to do this only if the association has first filed a notice of request for such bill within seven days after the superintendent has filed his notice of the takeover with the court. It is important that the association request this bill of particulars if it plans to challenge the action.

Once the association requests the bill of particulars, it may succeed in having the liquidation of the association dismissed and title to the associations property revested in the association. The former will happen if the superintendent fails to file the bill within fifteen days after the association filed its request. The latter remedy becomes a possibility if the superintendent files the bill and the association files an answer and cross-petition taking issue with the allegations made by the superintendent. The court will then set a date for an immediate hearing of the case. Liquidation proceedings will be dismissed and the title to property will be revested in the association if the court determines that the “bill of particulars is insufficient in law or that the superintendent has exceeded or abused his power and discretion . . . .”

A party may appeal the finding to the common pleas court. Under rule 7(B) of the Ohio Rules of Appellate Procedure, it seems that a stay of the trial court’s order may be conditioned on the posting of an appeal bond. It is unclear whether that requirement applies to both parties. Section 1157.03 states that section 2505.12 of the Revised Code, which provides that the posting of an appeal bond is not required of a governmental official, applies in the case of an appeal filed by the superintendent.

Notice should be taken of certain other sections in chapter 1157. For instance, creditors of the association should be familiar with sections 1157.10 to 1157.12, which give extensive power to the superintendent
in the liquidation of the association’s assets. A creditor should be aware of the rights he has under the statutes to protect his interests. Although the superintendent’s power under section 1157.10 is extensive, it is subject to the review of the court of common pleas and, according to the official comment to that section, “if all or a substantial part of the assets and property [of the association] are to be sold, exchanged or disposed of, the assent of the holders of two-thirds in principal amount of the claims of unsecured creditors, depositors and shareholders must be obtained.”

Under section 1157.11, regarding the requirement of hearings concerning the superintendent’s liquidation proceedings under section 1157.10, it is important to note the requirements of notice to unsecured creditors, depositors, and shareholders of an association. These parties have the right to be heard at such hearings, and the order entered at the end of the hearing is not necessarily binding on all parties. A party found to be aggrieved by the order has the statutory right, with leave of the court, to file an independent suit within ten days after the hearing, challenging the order, unless two-thirds of such unsecured creditors have already assented to the order.

Likewise, a debtor of the association should realize that the superintendent is empowered to require the debtor to provide a statement of his financial condition in order to enable the superintendent to ascertain the value of the association’s assets. The superintendent, on the other hand, must give notice of the association’s claims to the alleged debtors by filing with the court of common pleas and by publishing the notice in a local newspaper. The creditor then has fifteen days in which to file an objection to the claim or he is “forever barred from objecting.”

IV. STATE DEPOSIT GUARANTY FUNDS

A. Statutory Analysis

As a result of general public mistrust of financial institutions after 1929, the Federal Government created the Federal Savings and Loan Insurance Corporation (hereinafter FSLIC). This corporation insures the accounts of depositors up to a specified amount. Membership in the FSLIC is available for both federal and state chartered savings and loans. However, when a state chartered savings and loan becomes a member of the FSLIC, it is required to abide by the federal regulations that apply to fed-


186 OHIO REV. CODE ANN. comment to § 1157.10 (Page 1968).
189 Id. § 1157.05.
140 Id. § 1157.06.
181 Id.
erally chartered institutions. Since this federal agency was not always sensitive to the needs of the state chartered institutions, a few states opted to pass legislation enabling the formation of state guaranty associations which would be an alternative to, and sometimes a supplement to, the FSLIC.

In 1932, Massachusetts took the initiative by forming the Co-operative Central Bank, a part of which was the Share Insurance Fund. It was not until 1957, that Ohio followed the lead and formed a state guaranty association. Since that time, three other states have created state guaranty associations: Maryland (Maryland Savings-Share Insurance Corporation, hereinafter MSSIC) in 1962; North Carolina (The North Carolina Savings Guarantee Corporation, hereinafter NCSGC) in 1967; and Pennsylvania (The Pennsylvania Savings Association Insurance Corporation, hereinafter PSSAIL) in 1979.

As of 1980, only one of these state programs had experienced a loss. In Massachusetts, the losses amounted to $2.6 million and resulted from the effects of the 1929 Depression on the Industry. However, the losses were easily covered by the state insurance program despite the fact that the program had been in operation for a short time. The principal reasons for the establishment of these state institutions were many. First of all, state associations were dissatisfied with the FSLIC because some state saving institutions experienced difficulties in qualifying for membership in the FSLIC. Furthermore, there was an alleged discrimination by the FSLIC against state chartered institutions and a perceived over-regulation by the FSLIC. In addition, there was dissatisfaction with the limited liability of the FSLIC insurance. These feelings of dissatisfaction with the FSLIC were supplemented by a belief that state programs would be more responsive to the needs of both state chartered institutions and the general public.

Two types of statutory schemes were formed by the states; one which creates an entity which is referred to as the “insurance corporation” or “corporation” and the other which allows the formation of more than one insurance corporation in a state. Massachusetts, Maryland and Pennsylvania have opted to create the single insurance corporation. On the other hand, North Carolina and Ohio, allow the formation of more than one insurance corporation.

The purposes of these insurance corporations, as set forth in the statutes, are basically the same. The major purpose is three-fold: 1) promote

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2 Burns, Massachusetts’ Share Insurance Fund, 6 THE STATE ADVISOR 22 (Feb. 1979).
3 Id. at 14.
5 As of this date, however, in both Ohio and North Carolina, only one association has been formed.
the elasticity and flexibility of the resources of the members; 2) provide for
liquidity of members through a Central Reserve Fund; and 3) insure the sav-
ings accounts of members.7 The unstated purpose for the creations of these in-
surance corporations seems to be to rid the state savings and loans of federal
control by presenting them with an alternative guarantee association. Pres-
sumably, the state control allows their needs to be met with greater flexibility.

Generally, the respective state legislatures granted these insurance cor-
porations several powers to fulfill their purpose. These corporations were
granted power to: 1) give financial assistance to members; 2) buy and sell
property; 3) invest any of their funds; 4) borrow or secure credit; and 5)
except as otherwise provided, they have all the powers, privileges, and im-
munities granted to other state corporations under the law of individual
states.8

The statutory qualifications for membership differ slightly among the
insurance corporations. In Maryland, an institution may become a member
of the corporation by satisfying a two-pronged test. First, after review of
an application, the Director of the Division of Savings and Loan Associ-
ations must approve the financial affairs, solvency, management and the
board of directors of the association. In addition, the board of directors
of the corporation may deny membership for good cause shown.9

Pennsylvania’s statutory language is similar in that it allows member-
ship when the Secretary of Banking approves the quality and soundness of
the association’s financial affairs and certifies its solvency, management, and
directorship. The board of directors of the corporation must accept the
association’s formal application except that the application may be denied
for good cause shown regarding the soundness of the applicant’s financial
affairs, solvency, management or directorship.10

North Carolina will not allow membership to NCSGS unless the sav-
ings and loan is certified to the corporation by the proper supervisory au-
thority as eligible for insurance of accounts. The supervisory authority also
must not be aware of any reason why said institution should not be insured.
Furthermore, the Board of Trustees of the Corporation have the sole right
to admit additional members to membership in the Corporation on such
terms and conditions as the Board may prescribe.11 Massachusetts allows

7 N.C. GEN. STAT. §§ 54B-244 (Supp. 1981); 7 PA. CONS. STAT. ANN. § 6503(a) (Purdon
170 app. § 2-3 (West 1971).
8 See e.g. N.C. GEN. STAT. § 54B-244 (Supp. 1981); 7 PA. CONS. STAT. ANN. § 6503(b)
(Purdon Supp. 1982); Md. FINANCIAL INST. CODE ANN. § 10-104 (1980); Mass. GEN. LAWS
ANN. ch. 170 app. § 2-3 (West 1971).
members to join subject solely to the discretion of the Co-operative Central Bank and the commissioner.\textsuperscript{12}

Additional membership qualifications are enumerated in the by-laws of the individual state corporations.\textsuperscript{13} The by-laws of PSAIC indicates that that association may not become a member unless it has its principal office in the Commonwealth and has invested 75\% of its total assets in the Commonwealth. In addition no applicant can become a member until its application has been approved by a majority vote of the whole board of directors. Any applicant whose application has been rejected by the board may, upon satisfying the requirements of the Rules and Regulations, have its application reviewed by the membership of the Corporation.\textsuperscript{14}

Likewise, the MSSIC requires that the applicant maintain a principal office in Maryland and that it have invested 75\% or more of its assets in Maryland.\textsuperscript{15} The MSSIC's procedure for admission consists of an initial screening by the membership committee before the board approves or disapproves of the application.\textsuperscript{16} The application then is reviewed by the Director of Savings and Loans before being referred back to the membership committee for a final evaluation.\textsuperscript{17}

NCSGC has a similar review procedure for the admission of members. First of all, the application is reviewed by the Corporation staff under the direction and supervision of the President of the Corporation which makes its recommendation of approval or disapproval to the Board of Trustees. The applicant is given an opportunity to state its case before the Board of Trustees makes its final decision. Approval of the application requires the affirmative vote of two-thirds of the Board of Trustees. Said approval may be with or without conditions.\textsuperscript{18}

PSAIC, MSSIC, and NCSGC provide for an avenue of appeal when an application has been rejected.\textsuperscript{19} NCSGC indicates that an applicant whose application has been disapproved may appeal the decision to the Administrator of the Savings and Loan Association.\textsuperscript{20}

MSSIC's appeal procedure seems to be a stricter standard for admission
after membership is denied by the Board. The applicant may become a member of the corporation and obtain all the benefits provided thereby upon meeting the following conditions: 1) the applicant is certified as eligible for insurance by the Supervisor pursuant to the provisions of state law; 2) four members of the board of directors must issue a call for a special meeting of the membership of the corporation; 3) at this special meeting, the application is accepted by at least 60% of the members entitled to vote and by members having free share accounts equal to 75% or more of all free share accounts then insured by the Corporation. PSSAIC simply requires the applicant to satisfy the requirements of the Rules and Regulations before review will be made by the Board.

All the by-laws include a clause whereby the applicant agrees as a condition precedent to membership to abide by the rules and regulations and by-laws of each corporation. Generally, the financial institutions also agree to: 1) abide by amendments to the by-laws; 2) allow examination and audit reports; 3) allow the corporation free access to its records; 4) abide by the rulings of the supervisory authority; 5) pay all assessments; and 6) comply with all underwriting procedures.

All the states' plans call for assessments of members in order to fund the corporation. In fact, assessment is the basic means for raising money for the funds. Members of the Share Insurance Fund are required to pay one-half of one percent of all deposits and notes payable, as shown by the last annual report, and other payments dictated by the Board of Directors until the net fair value of the Fund's assets equals 3% of its aggregate liability. Both MSSIC and PSAIC call for a capital contribution of 2% of the total savings on deposits, with semi-annual adjustments. NCSGC requires an initial deposit equal to one and one-quarter percent of the member's deposit liability. Additional deposits, requested by the board of trustees, of up to a maximum of three-quarters of one percent of deposit liability, must be approved by a majority of members. None of the corporations allow additional deposits without a seventy-five percent affirmative vote of all members.

Failure to make deposits on or before the due date may subject the

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21 Rules and Regulations of MSSIC, § 3-101.
23 Id. § 2; Rules and Regulations of MSSIC, § 3-201. Standards and Procedures of NCSGC, Art. III § 1.
26 Standards and Procedures of NCSGC, Art. IV § 1.
27 Rules and Regulations of MSSIC, § 3-304; Rules and Regulations of PSAIC, Art. III § 4; Standards and Procedures of NCSGC, Art. IV § 2.
member to a penalty or termination. Usually excess deposits will be returned to the member. MSSIC allows the capital deposit to be paid in installments. One-half the total deposit is to be paid at the time of acceptance of the applicant as a member of the corporation while one-quarter shall be payable six months thereafter and the final one-quarter payable twelve months later.\(^8\)

One of the services the corporations provide for their members is financial assistance. Generally, the corporations provide financial assistance by: 1) lending money to a financial institution; 2) guaranteeing, endorsing, or acting as a surety on the obligations of the members; 3) establishing and regulating the terms and conditions of any charges or loans; 4) creating a central reserve fund; and 5) assisting financially in any other way allowable by law.

Massachusetts statutory law provides that whenever it appears to the commissioner that it is advisable or inexpedient for any member bank to continue to transact the business for which it is organized without receiving financial assistance, he may, in his discretion, notify the corporation.\(^9\) The Directors then must use their judgment to decide whether financial assistance will reduce the risk or avert a threatened loss to the corporation.\(^8\) They may, with the approval of the commissioner, do one or more of the following: 1) purchase, in whole or in part, assets of the member banks; 2) make loans to the member bank secured in whole or in part, in such amounts and upon such terms and conditions as said directors with the approval of the commissioner may determine; 3) pay to such member bank in accordance with an agreement entered into between such member bank and the corporation, with the approval of the commissioner, any amount not in excess of the difference between book value of certain or all of its assets and the fair value thereof, in consideration for which such member bank agrees to write down such assets to fair value and pay over to the corporation so much of any net proceeds realized from the sale as in excess of fair value; 4) pay into a guaranty fund or surplus account of such member bank, in accordance with an agreement entered into between such member bank and the corporation, with the approval of the commissioner, an amount not in excess of the difference between the book value of certain or all of its assets and the fair value thereof as determined by the agreement.\(^1\)

The means chosen to assist the member should coincide with the purposes of the corporation. The total financial assistance may not at anytime exceed a sum equal to the greater of five percent of the share liabilities of

\(^{28}\) RULES AND REGULATIONS OF MSSIC, § 3-303.

\(^{29}\) MASS. GEN. LAWS ANN. ch. 170 app. § 2-3(a).

\(^{30}\) Id.

\(^{31}\) Id.
such institution or five hundred thousand dollars. Moreover, Massachusetts provides for a compromise or settlement with regard to any unpaid balance left after ten years.

MSSIC may offer financial assistance in order to 1) prevent default; 2) preserve the financial integrity of a member; or 3) restore a member in default to normal operations as an insured member. The corporation may assist the troubled member by making loans, buying assets at book value notwithstanding that it may exceed the market value, or make capital contributions to such member in amount in excess of which the corporation finds to be reasonably necessary to save the expense of liquidating an institution in default or to pay the net loss of any account transferred to such association. NCSGC and PSAIC provide virtually the same methods for assisting a member.

These corporations have the power to buy or sell property to further any of its purposes. The corporations also are allowed to borrow money and otherwise incur obligations for any of its purposes. Finally, the corporations may invest any of its funds. However, the investment rights are limited to safe investments by the statutes. For example, Maryland allows the corporation to invest any of its funds in: 1) cash or deposits in checking or savings accounts with or certificates of deposits of any bank that is a member of the Federal Deposit Insurance Corporation; 2) savings accounts of any savings and loan association to the extent the accounts are insured by the FSLIC; 3) obligations of the United States, any state or any of their commissions, instrumentalities, agencies, authorities, or political subdivisions, and any corporation that is incorporated under the laws of the United States or any state; 4) readily marketable, dividend paying shares of any corporation that is incorporated under the laws of the United States or any state except that it may not invest more than 10% of its total assets in these shares nor more than 3% of its total assets in the shares of any one corporation; 5) any loan that it buys from a member if the loan is secured by a safe mortgage on otherwise encumbered fee simple real or improved leasehold property in the state; 6) ground rents in Maryland; and 7) loans secured by any of the above investments.

One of the purposes of the state guaranty corporations is to enhance the liquidity of member institutions. This purpose is critical because of the financial structure of the savings and loans usually is composed of short-term liabilities and long-term assets. The by-laws of NCSGC, PSAIC, and

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82 Id.
83 Id.
84 BY-LAWS OF MSSIC, tit. II, subtit. VII § 2-707.
85 Id. § 2-207.
86 Md. FINANCIAL INST. CODE ANN. § 10-104 (E).
MSSIC all provide for a certain amount of liquidity. MSSIC requires each member to maintain a liquidity fund equal to six percent of its total free share accounts\(^{37}\) less the unpaid balance due on loans secured by the accounts.\(^{38}\) The liquidity fund is the sum of: 1) the member's total cash and federal funds; 2) the lesser of cost or market value of any obligations to the United States or instrumentality thereof which have a maturity of ten years or less; 3) GNMA-backed modified pass-through certificates with a maturity of more than ten years, and such other instruments having a maturity of more than ten years which are guaranteed as to principal and interest by the United States, provided however that the aggregate not exceed twenty-five percent. 4) certificates of deposits issued by banks insured by the FDIC provided, a) the total investment of certificates of deposit in any one bank may not exceed one-quarter of one percent of the total deposits of that bank or one hundred thousand dollars whichever is greater, b) the bank has an aggregate net worth of at least five million dollars, c) the certificates of deposit are negotiable or may be redeemed prior to maturity by the member association at its option; 5) banker's acceptances discountable at the Federal Reserve Bank; and 6) Central Reserve Fund capital funds.\(^{39}\)

PSAIC requires an almost identical liquidity fund. However, it only requires a fund equal to five percent of its total savings accounts.\(^{40}\) It provides that the liquidity fund be composed of: 1) a member's total cash and federal fund; 2) the lesser of cost or market value of any obligations of the United States or instrumentality thereof of which not less than fifty percent shall have a maturity of one year or less and the remaining fifty percent shall have a maturity of five years or less;\(^{41}\) 3) certificates of deposit, provided they are negotiable and freely marketable or may be redeemed prior to maturity (not as many limitations as MSSIC); and 4) banker's acceptances discountable at the Federal Reserve Bank.\(^{42}\) If the board raises the percentage beyond five percent, an association may fulfill the requirements of two excess percentage points, by means of an unused line of unsecured credit, provided at least fifty percent of the total unsecured line of credit remains unused.\(^{43}\) In addition, PSAIC gives an association an opportunity, if it believes that there are appropriate existing circumstances, to present its case to the board and, upon good cause shown, have the requirements altered.\(^{44}\) The corporation may

\(^{37}\) Rules and Regulations of MSSIC § 3701 defines free share accounts "as the total interest of a member of an association in the share capital of an association . . . ."

\(^{38}\) Rules and Regulations of MSSIC, § 3-210.

\(^{39}\) Id. § 3-210(A)(1)-(5).

\(^{40}\) Rules and Regulations of PSAIC, Art. II § 10(a).

\(^{41}\) MSSIC allows a ten year maturity date. Rules and Regulations of MSSIC § 3-210 (A)(2)(a).

\(^{42}\) Id. § 10(a)(1)-(5).

\(^{43}\) Id. § 10(a)(5).

\(^{44}\) Id. § 10(c).
order the member to refrain from investing until it complies with the liquidity requirements.\textsuperscript{45}

NCSGC also has a liquidity fund requirement of five percent of the aggregate amount of the shares or deposits outstanding. The liquidity fund is limited to the following categories: 1) obligations of the United States or agencies thereof; 2) obligations of the government of North Carolina; 3) stock in the Federal Home Loan Bank; 4) bonds assured by the Federal Home Loan Bank; 5) certificates of deposit in the corporation; and 6) deposits in banks approved by a majority of the entire board of directors.\textsuperscript{46}

The by-laws of MSSIC and NCSGC have net worth provisions for members. Members of NCSGC are required to maintain a net worth of at least five percent of savings.\textsuperscript{47} Net worth is calculated in this section as total assets less liabilities and may consist of the general reserve for losses, undivided profits, capital stock, additional paid-in capital and mutual capital certificates.\textsuperscript{48} Any member failing to meet this requirement must advise the corporation in writing of its reasons for failing to meet the requirements and existing circumstances which may justify its position. The corporation has the discretion to take whatever action it feels necessary.\textsuperscript{49}

MSSIC requires only that its members have a total net worth equal to four percent of the aggregate withdrawal value of its free share accounts.\textsuperscript{50} If an association fails to meet the net worth requirements, the corporation has the option to impose one of the following sanctions: 1) convene a meeting of the board of directors; 2) restrict or eliminate entirely advertising by the member association; 3) increase its liquidity and maintain such increased liquidity at specified levels; 4) limit the issuance or renewal of certificate accounts; 5) reduce the rate of earnings that may be paid on savings accounts or certificate accounts; 6) limit or cease entirely the granting of new mortgage commitments and/or the purchase of mortgage loans, or participation therein; 7) limit operations expenditures to specified levels; 8) take such other actions as the corporation may deem necessary or appropriate.\textsuperscript{51} If total net worth declines to three percent, the member is required to enter into an assistance agreement.\textsuperscript{52} Just as in the PSAIC, the board of MSSIC may waive the net worth requirement for good cause shown.\textsuperscript{53}

\begin{thebibliography}{9}
\bibitem{id} Id.
\bibitem{standards} \textsc{Standards and Procedures of NCSGC}, Art. II § 13.
\bibitem{id1} Id. § 11.
\bibitem{id2} Id.
\bibitem{id3} Id.
\bibitem{rules} \textsc{Rules and Regulations of MSSIC, § 3-211(a)(1)}.
\bibitem{id4} Id. § 3-211(C)(1)(a)-(b).
\bibitem{id5} Id. § 3-211(C)(2).
\bibitem{id6} Id. § 3-211(D).
\end{thebibliography}
Another major impetus in the formation of the state guaranty associations is the insurance of accounts. The state associations sought full insurance, rather than the limited insurance offered by the FSLIC. Massachusetts does not set specific limits as to insurance of accounts. Massachusetts allows a member to become a member of the FSLIC at the same time. No member bank, however, may become a member of the FSLIC as long as any financial assistance granted by Share Insurance Fund to the member remains unpaid or has not been compromised or settled. It appears that the Share Insurance Fund covers all deposits that are above the FSLIC limit.

The statute forming the MSSIC states that the corporation may set insurance limits in the by-laws, but those limits may never exceed current FSLIC limits plus ten thousand dollars. MSSIC adopts the exact statutory language in its by-laws. MSSIC requires an “event of default” as a condition precedent to its payment of insurance. Event of default means for any member: 1) its adjudication in bankruptcy in accordance with any applicable law of the United States; 2) the appointment of a conservator for its affairs by a court of competent jurisdiction in accordance with the laws of this state or any other state in which such member is domiciled; or 3) the appointment of a receiver for its affairs.

The Pennsylvania statute makes no mention of the limit of the corporation’s liability. However the by-laws indicate that the limit of liability for which PSAIC may be required to pay for each separate account shall be the amount of the prevailing insurance available from the FSLIC. Just as in Maryland, no payments shall be made unless an event of default occurs. However, “event of default” is defined as the taking of possession of the association by the Department of Banking or the Secretary of Banking pursuant to the Code of Banking.

NCSGC insures members’ accounts up to the FSLIC limit. The liability occurs in the event of default or liquidation. Default is defined as “the inability of a member of satisfy its obligations to its depositors” as determined by the President of the Corporation, subject to the approval of the Administrator of Savings and Loan Associations.

65 Id. § 2-16.
67 By-Laws of MSSIC, § 2-702.
68 Id. § 2-703.
69 Id.
71 Id. § 3.
73 Standards and Procedures of NCSGC, Art. VII § 1(a).
74 Id. § 2(a).
Only Massachusetts mandates that the associations become members of the corporation. However, Maryland requires any state chartered institution to be a member of either MSSIC or FSLIC. The other states permit a voluntary withdrawal with a few limitations. MSSIC allows a member to withdraw after giving twelve months notice in writing. Additionally, the member may not be in default of any of its obligations at the time of notice or withdrawal. The corporation may, upon the affirmative vote of seven (of eleven) members of its Board of Directors, at a meeting called to consider a notice of withdrawal, permit the member to withdraw at the end of such period less than twelve months from the date of giving such notice as may be specified by the board. Upon resignation, the member is entitled to its proportionate share of the fund (i.e. its deposits and any interest thereon). The withdrawing member is required to notify each of its free shareholders of the termination, and the withdrawal of any assets will not be allowed until the member gives proof of such notice. In the event the member fails to give notice as required, the corporation, after sixty days, will give such notice at the expense of the withdrawing member. PSAIC provides for a procedure of withdrawal which is virtually identical to that of MSSIC.

Likewise, NCSGC requires a twelve month written notice of a member's intent to withdraw. The member must not be in default and must have repaid any obligation owing to the corporation. The withdrawal may be accelerated upon a vote of the members whose deposit liability equals seventy-five percent of the total deposit liabilities of all members. Upon said approval, the member may be permitted to withdraw after a two month period. The member must give notice to its depositors in a way and manner determined by the corporation.

All the insurance corporations provide in their by-laws for the expulsion of any member and any termination of insurance. MSSIC will expel a member if: 1) it is violating any provisions of the laws of Maryland; 2) it is conducting unsafe or unsound business practices in the practicing of its business; 3) it is in violation of any of the by-laws, rules, or regulations.
of MSSIC; or 4) it has had any insurance terminated by the FSLIC. If the corporation is contemplating expulsion of a member, it will furnish such member a statement outlining the violations. The member has thirty days to solve the problem. If a satisfactory correction has not been made, the Board will grant the member an additional thirty days to correct the problem. A hearing will be held and the member may be expelled upon the affirmative vote of seven members. The member, upon termination, is required to notify its depositors and if it fails to do so, the corporation will do so at the member's expense. PSAIC follows MSSIC's expulsion procedure verbatim except that the provision whereby a membership may be terminated if the member has had its FSLIC insurance terminated has been deleted.

The Board of Trustees of NCSGC may, by the affirmative vote of two-thirds of the entire board, terminate a member's membership in the corporation for a violation of any of the corporation's rules and regulations. The member must notify its depositors of the termination. However, it has a right to appeal to the supervisory authority.

The guaranty associations are given perpetual existence. North Carolina, Maryland, and Pennsylvania have no provisions for dissolving the associations. In Massachusetts, if eighty percent of all members who are not also members of FSLIC, vote affirmatively to dissolve the corporation, the Fund will be dissolved.

The survey of four state alternatives to FSLIC shows that there are many common areas in the schemes. Their purposes and powers are similar. Supervision by someone at the state government level is required by all four schemes. The statutes of Maryland and Pennsylvania are very similar.

In conclusion, all the state schemes attempt to be more responsive to the needs of the state chartered associations. The advantages of the dual system of regulation are that it provides an option of regulation at the federal or state level, prevents regulatory agencies from abusing their powers, and permits greater diversity within the overall national financial system. The stability and viability of the state guaranty corporations will be scrutinized by many other state legislatures. The state-authorized deposit insurance corporations represent a viable option, if the structure of the industry and the loss experience of savings institutions within the particular state indicate that the estimated risks can be covered by a structure of

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76 Rules and Regulations of MSSIC, § 3-601(A)-(D).
77 Id. § 3-602.
78 Rules and Regulations of PSAIC, Art. VI §§ 1-4.
79 Standards and Procedures of NCSGC, Art. VI § 2.
80 Id. § 2.
82 Burns, supra note 2, at 11.
assessments less than the existing charge for insurance being made by the FSLIC.\(^8\)

**B. Deposit Guaranty Funds as State Agencies**

Whether a state or federal deposit guaranty fund or insurance corporation is considered an "agency" is an important consideration the scope of review of the corporation's activity. All of the states in question and the federal government have enacted some form of an Administrative Procedure Act (hereinafter APA). The primary purpose of an APA, such as the federal APA, is to insure that the "administrative policies affecting individual rights and obligations be promulgated pursuant to certain stated procedures so as to avoid the inherently arbitrary nature of unpublished ad hoc determinations."\(^8\) Thus, most Acts have procedures for promulgating rules,\(^8\) for public disclosure of its records,\(^8\) and for giving notice of its hearings.\(^8\)

If a deposit guaranty fund or insurance corporation is an agency, its procedures necessarily will be subject to strict review under the requirements of the specific APA. If, on the other hand, it is not an agency, judicial review of its procedure might be more difficult. This segment will focus on Ohio law to determine whether the Ohio Deposit Guaranty Fund (hereinafter ODGF) is a state agency. By way of comparison, an examination of the Federal Savings and Loan Corporation (hereinafter FSLIC) and other state funds will also be made.

1. **Ohio Deposit Guarantee Fund**

If an entity in Ohio is an agency\(^8\) it must comply with Ohio's APA.\(^8\) An entity is considered an agency for purposes of the APA if it is specifically named in the definition of "agency" as given in section 119.01(A) of the Ohio Revised Code, is subjected to the APA by the entity's enabling legislation or "has the authority of issuing, suspending, revoking or cancelling licenses."\(^9\)

The Ohio courts, in determining whether an entity is an agency, have held that if an entity does not meet any of the above-mentioned criteria, it is not considered an agency.\(^1\) In *Karrick v. Bd. of Education*,\(^2\) the plain-
tiffs contended that certain rules enacted by the municipal school board were void because they were not adopted in accordance with the Administrative Procedure Act.\textsuperscript{93} The Ohio Supreme Court held that the municipal board was not an agency as defined by section 119.01(A) of the Ohio Revised Code because the "statutory language clearly indicates that only agencies at the state level of government are covered by the act."\textsuperscript{94} Hence, the municipal board was not an agency.

The Ohio court of appeals in \textit{Fair v. School Employees Retirement System},\textsuperscript{95} has held that the School Employees Retirement Board is not a state agency because it does not fall into the definition of "agency" in section 119.01(A). In \textit{Fair}, the plaintiff contended that he had a right to appeal from an order of the School Employees Retirement Board under section 119.12 of the Ohio Revised Code.\textsuperscript{96} But since the court found that the Board was not an agency for purposes of Ohio's APA, the plaintiff did not have a right of "appeal pursuant to R.C. 119.12, from any order or adjudication of the School Employees Retirement Board."\textsuperscript{97}

In \textit{General Motors Corp. v. McAvoy},\textsuperscript{98} the Ohio Supreme Court was called upon to determine whether the Environmental Board of Review was an agency for purposes of Ohio's APA.\textsuperscript{99} The court looked to the definition of agency contained in section 119.01(A) and the three alternative criteria mentioned therein. The court held that since the Board of Review is not named in the definition, and does not have the authority to issue, suspend, remove or cancel licenses, it is not an "agency" subject to the provisions of the APA.

The Ohio court of appeals has indicated that although an entity may generally be considered an "agency," it is not an agency for purposes of the APA if it does not meet any of the criteria set forth in section 119.01(A).\textsuperscript{100} In \textit{In re Lauderbach} the court stated that "although the Department of Agriculture is an agency within the broad sense of the word, it is not an agency within the definition of R.C. 119.01(A)."\textsuperscript{101} This indicates that it is necessary for an entity to come within the specific language of section 119.01(A) in order to be considered a state agency.

Thus, the ODGF is an Ohio agency only if it meets one of the three

\textsuperscript{93} Id.
\textsuperscript{94} Id. at 469, 190 N.E.2d at 257. (emphasis added).
\textsuperscript{95} 44 Ohio App. 2d 115, 335 N.E.2d 868 (1975).
\textsuperscript{96} Ohio Rev. Code Ann. § 119.12 (Page Supp. 1981) provides that "(a)ny party adversely affected by any order of an agency issued pursuant to any other adjudication may appeal to the court of common pleas of Franklin county . . ." (emphasis added).
\textsuperscript{97} 44 Ohio App. 2d at 117, 335 N.E.2d at 870.
\textsuperscript{98} 63 Ohio St. 2d 232, 407 N.E.2d 529 (1980).
\textsuperscript{99} Id.
\textsuperscript{100} Id. at 161, 410 N.E.2d at 777.
\textsuperscript{101} Id. at 161, 410 N.E.2d at 777.
definitions of an agency. The ODGF is not specifically named in the definition of agency so it cannot be considered an agency on the basis of the first definition.

The second possible way that ODGF could be considered a state agency is if its enabling legislation specifically makes the corporation subject to Ohio's APA. Nowhere in the enabling legislation is it stated that the ODGF is to be subject to the state's APA. The word "corporation" rather than "agency" is used throughout the enabling legislation which would seem to indicate that it is not to be considered an agency. Additionally, "deposit guaranty association" is defined as "an association organized under the provisions of sections 1151.81 to 1151.86, inclusive..." and not as an agency.

Therefore, the only way that the ODGF might be considered an agency is if it has the authority to issue, suspend, remove or cancel licenses. "License" as defined by Ohio's APA "means any license, permit, certificate, commission, or charter issued by the agency."

In Home Savings & Loan Association v. Boesch, the Ohio Supreme Court discussed the licensing function of the superintendent of building and loan associations. The Falls Savings and Loan Association filed an application requesting that the establishment of a new branch office in Kent be approved by the superintendent. The Home Savings and Loan Association opposed the application and appealed the approval in the Court of Common Pleas pursuant to the Administrative Procedure Act. The Court of Appeals stated that the approval of a branch office by the superintendent "is a 'licensing function' sufficient to require the procedural safeguards of the Administrative Procedure Act." The Supreme court reversed.

The court distinguished the language used in section 1151.03 of the Ohio Revised Code, which deals with the certification of a proposed building and loan association, with that used in section 1151.05, which deals with the approval required for branch offices. Section 1151.03 provides in pertinent part:

Upon receipt from the secretary of state of a copy of the articles of...

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104 Id. § 1151.80 (Page 1968) (emphasis added).
105 Id. § 119.01(A) (Page Supp. 1981).
106 Id. § 119.01(B) (Page Supp. 1981).
107 41 Ohio St. 2d 115, 322 N.E.2d 878 (1975).
108 Id.
109 Id. at 117, 322 N.E.2d at 879.
110 OHIO REV. CODE ANN. § 1151.03 (Page 1968).
111 Id. § 1151.05 (Page 1968).
incorporation of a proposed building and loan association, the superintendent of building and loan associations shall immediately examine into all the facts connected with the formation of such proposed corporation . . . and if it appears that such corporation, if formed, will be entitled to commence the business for which it is organized, the superintendent shall so certify to the secretary of state, who shall thereupon record such articles.

Section 1151.05 provides in pertinent part, "No building and loan association shall establish more than one office . . . except with the approval of the superintendent of building and loan associations . . . (Emphasis added).

The court held that since the word "certify" is used in section 1151.03 and the word "certificate" appears within the definition of license in R.C. 119.01(B) . . . it is the certification to do business that invokes the application of R.C. Chapter 119." Therefore, when the superintendent certifies the articles of incorporation pursuant to section 1151.03, he performs an agency function. Section 1151.05, however, does not use language contained in the definition of "license." "[T]he absence of that language in R.C. 1151.05 leads . . . to the conclusion that the General Assembly did not intend that the superintendent's approval of a branch application be a licensing function."

Following the reasoning of Boesch, the superintendent may be said to carry on a licensing function and thus be considered an agency for purposes of Ohio's APA by virtue of his duties to examine and certify the articles of incorporation of a proposed deposit guaranty association.

Section 1151.82 of the Ohio Revised Code provides in pertinent part:

Upon receipt from the secretary of state of a copy of the articles of incorporation of a proposed guaranty association the superintendent . . . shall at once examine into all the facts connected with the formation if such proposed corporation. In the event . . . the examination shows that such corporation, if formed, would be entitled to commence the business of a deposit guaranty association, the superintendent shall so certify to the secretary of state.

The emphasized language is similar to that used in section 1151.03 which was interpreted to mean a "licensing function" for purposes of the state's APA. Since section 1151.82 gives the superintendent power to certify

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112 Id. § 1151.03 (Page 1968) (emphasis added).
113 Id. § 1151.05 (Page 1968) (emphasis added).
114 41 Ohio St. 2d at 118, 322 N.E.2d at 880.
116 41 Ohio St. 2d at 119, 322 N.E.2d at 880.
117 Ohio REV. CODE ANN. § 1151.82 (Page 1968).
118 Id. (emphasis added).
the deposit guaranty association's articles of incorporation which would entitle the association to commence business, and since the "right to commence operations is the subject of the licensing function," the superintendent is engaged in a licensing function when exercising powers pursuant to section 1151.82 and is, therefore, an agency for purposes of the Administrative Procedure Act.120

If the ODGF performed similar licensing functions it too, by analogy, would be considered an agency. However, none of the provisions of ODGF's enabling legislation121 give ODGF the authority to issue, suspend, revoke, or cancel licenses or to certify any of its members to commence business.122 Rather, the purpose of a deposit guaranty association has been held to be simply "to guaranty the liquidity of its member associations."123

The Board of Trustees of ODGF124 does have the power to suspend a member association from membership in the Fund.125 But, even though an association's membership may be terminated, it can still carry on its business as a building and loan association; suspension or expulsion of an association's membership in the Fund merely prevents the association from availing itself of "any of the benefits of membership in the Fund."126 Thus, the power of ODGF to terminate an association's membership is not analogous to the superintendent's power to refuse certification of a deposit guaranty association's articles of incorporation. In the former situation, the member may still carry on its business; in the latter, the association may not commence business. ODGF does not certify its member associations to do business and therefore, is not engaged in a licensing function and cannot be brought within the definition of "agency" as used in the APA.

Although it does not appear that the ODGF can be brought within the definition of "agency" as used in 119.01 (A), perhaps ODGF could be considered a state agency by analogy to the FSLIC. ODGF is a state-offered alternative to the FSLIC which was established to "insure the

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120 Home Sav. & Loan Ass'n v. Boesch, 41 Ohio St. 2d at 119, 322 N.E.2d at 880.
121 Ohio Rev. Code Ann. § 119.01(A) (Page Supp. 1981) provides that "sections 119.01 to 119.13 of the Revised Code do not apply to . . . the superintendent of building and loan associations . . . in the taking possession of, and rehabilitation or liquidation of, the business and property of bands, building and loan associations . . ." Section 1151.82 does not provide for the taking possession or liquidation of any building and loan association business or property. Therefore, the superintendent is not expressly exempted from the provisions of the Ohio APA in this instance.
122 The powers of the deposit guaranty association are enumerated in Ohio Rev. Code Ann. § 1151.87 (Page 1968).
124 "ODGF" and "Fund" are used interchangeably for purposes of this note.
accounts of institutions eligible for insurance.""127 If ODGF is analogous to the FSLIC and if the FSLIC is a federal agency, it could be argued that the state guaranty association should likewise be considered a governmental agency.

2. Federal Savings and Loan Insurance Corporation

The federal courts have held that the FSLIC is a federal agency.128 In Guardian Federal Savings & Loan Ass'n v. Federal Savings & Loan Insurance Corp.,129 Guardian challenged certain regulations which were issued by the FSLIC without prior notice and comment as required by the federal Administrative Procedure Act.130 While the court held that the particular regulations came under an exception to the APA's requirement of prior notice and comment, the court stated that "the FSLIC is an agency of the United States as defined by APA subsection 551(1)."131

The purpose of ODGF, is to "assure the liquidity of member building and loan associations"132 and to "guaranty moneys on deposit,"133 while the purpose of the FSLIC is to insure accounts.134 However, "insure" and "assure" appear to have the same meaning when used in connection with a deposit guaranty fund: "A building and loan association may also obtain the insurance of its stock and deposits either by the Federal Savings and Loan Insurance Corporation, by a deposit guaranty association, or as may be otherwise provided by law."135 Although ODGF's enabling legislation136 uses the word "assure," the purpose of the deposit guaranty fund is viewed as insuring deposits of a building and loan association.137 Since "assure" and "insure" are used interchangeably, the use of "assure" instead of "insure" is not a significant difference between ODGF and FSLIC.

The ODGF is under the control of a nine to fifteen member board of trustees138 and the superintendent of building and loan associations.139 The

129 589 F.2d 658 (D.C. Cir. 1978).
131 589 F.2d at 661.
132 OHIO REV. CODE ANN. § 1151.87 (A) (Page 1968) (emphasis added).
133 Id. § 1151.87(B) (Page 1968). According to Art. III of the Constitution of the ODGF, "the purpose of the corporation shall be to use the full extent of its powers, authority and resources to provide for the liquidity of its members and to guarantee the moneys on deposit in member associations. . . ."
137 Id.
138 OHIO DEPOSIT GUARANTEE FUND CONSTITUTION, § 1.
139 OHIO REV. CODE ANN. §§ 1151.82, 1151.85, 1151.89, 1151.90 & 1151.91 (Page 1968):
superintendent must examine and certify the articles of incorporation before the deposit guaranty fund may commence business,\textsuperscript{140} make an annual examination of the deposit guaranty association,\textsuperscript{141} and has the power to make special examinations of the association if he deems it necessary.\textsuperscript{142} The FSLIC is under the direction of a five-member board of trustees.\textsuperscript{143} Both corporations, therefore, are subject to the rules and regulations prescribed by their respective boards of trustees.

While the specific powers and duties of the ODGF and FSLIC are not coterminous, the purpose of the corporations is similar. The FSLIC has the duty to insure the accounts of federal savings and loan associations and may insure the accounts of building and loan associations organized under state laws.\textsuperscript{144} The purpose of the ODGF is to assure the liquidity of its members and guarantee the moneys on deposit with the members.\textsuperscript{145} In \textit{Maryland Savings-Share Insurance Corp. v. United States},\textsuperscript{146} the court stated that the Maryland corporation "is essentially identical to the Ohio Deposit Guaranty Fund"\textsuperscript{147} and that the primary purpose of the corporation is to insure the accounts of its members.\textsuperscript{148} Even though the wording in their respective enabling legislations is different, the purpose of the FSLIC and ODGF is considered the same. It seems possible, therefore, to argue that, because the function and duties of the ODGF essentially are identical to those of the FSLIC, and because the FSLIC is a federal agency, ODGF should be considered an agency subject to Ohio's APA. Whether such an argument will succeed, however, is questionable, given the restrictive definition of "agency" in section 119.01(A) of the Ohio Revised Code and its interpretation in \textit{Boesch}.

3. North Carolina Savings Guaranty Association

The North Carolina Savings Guaranty Association (hereinafter NCSGA) is subject to the control of the Administrator of the Savings and Loan Division of the state.\textsuperscript{149} Prior to 1973, the NCSGA was under the control of the Commissioner of Insurance of North Carolina.\textsuperscript{150} In 1973 the NCSGA enabling legislation was amended and "Administrator" was substituted for "Commissioner" indicating that the NCSGA was not to be

\begin{thebibliography}{9}
\bibitem{140} Id. \textsection 1151.82 (Page 1968).
\bibitem{141} Id. \textsection 1151.89 (Page 1968).
\bibitem{142} Id. \textsection\textsection 1151.90 & 1151.91 (Page 1968).
\bibitem{143} 12 U.S.C. \textsection 1725(a) (1976).
\bibitem{144} 12 U.S.C. \textsection 1726(a) (1976).
\bibitem{145} \textit{Ohio Rev. Code Ann.} \textsection 1151.87 (Page 1968).
\bibitem{147} Id. at 768.
\bibitem{148} Id. at 763.
\bibitem{149} \textit{N.C. Gen. Stat.} \textsection\textsection 54B-238, 54B-246, 54B-247 & 54B-248 (Supp. 1981).
\end{thebibliography}
subject to the control of the Commissioner of Insurance but subject only to the control of the Savings and Loan Division of the state. The purpose of the NCSGA is to “[a]ssure the liquidity of a member institution” and to “[g]uarantee the withdrawable accounts, shares of deposits of member institutions.”

North Carolina’s definition of “agency” is broad and does not expressly exclude NCSGA from its definition. While the Department of Insurance has been held to be an agency of North Carolina for purposes of the state’s APA, the NCSGA has not. Since the NCSGA has been expressly removed from the control of the Commissioner of Insurance of North Carolina, it can be argued that it is not made a state agency by North Carolina case law. In addition, the NCGSA enabling legislation consistently avoids referring to the entity as an “agency” but rather uses the term “guaranty association.” The absence of the use of the term “agency” coupled with the 1973 amendments deleting the word “Commissioner” and substituting “Administrator” may indicate the legislative desire to prevent the NCSGA from being considered a state agency for purposes of the state APA.

4. Maryland Savings Share Insurance Corporation

The Maryland Savings-Share Insurance Corporation (hereinafter MSSIC) was established in 1962 to “insure the savings accounts of members.” The Director of the Division of Savings and Loan has the power along with the board of directors of the MSSIC to certify that a savings and loan association qualifies for membership in the MSSIC. However, in the MSSIC enabling legislation, the Maryland legislature did not provide for examination or control of the state’s guaranty association by the savings and loan or financial director as do North Carolina, Ohio, Massachusetts, and Pennsylvania. Nor is there any indication that the MSSIC is subject to the control of the Director of the State Insurance Department of Maryland. Since the Director of Savings and Loans has no power of examination over

152 Id. § 54B-244(a)(2) (Supp. 1981). Note the use of the word “assure.” See supra text accompanying notes 52-57.
154 Id.
155 Commissioner of Ins. v. Rate Bureau, 300 N.C. 381, 269 S.E.2d 547 (1980).
158 Id. § 10-107(a) (1980).
160 OHIO REV. CODE ANN. §§ 1151.89-.90 (Page 1968).
161 MASS. GEN. LAWS ANN. ch. 170 app. §§ 2-1 & 2-8 (West 1971).
the MSSIC as in other state schemes, there is no reason to infer that the insurance director would have such power.

The broad definition of "agency" in Maryland is limited by specific exceptions. The State Insurance Department of Maryland is specifically excepted from the definition of agency and is not subject to Maryland's APA. Whether the MSSIC is a part of the State Insurance Department of Maryland and therefore exempt from the Maryland APA or not is not settled in Maryland.

Maryland case law indicates that an entity will be considered a state agency if the entity is authorized to make rules or adjudicate cases but not if the entity's regulations concern "only the internal management of the agency" and do not directly affect the "rights of or procedures available to the public."

Nothing in the enabling legislation gives the MSSIC the power to adjudicate contested cases, so if the corporation is to be considered an agency it must be authorized by law to make rules. The MSSIC, as a corporation, has the power to promulgate bylaws, rules, and regulations with which the member associations must comply. Whether such rules concern only the internal management of MSSIC or whether they affect the rights or procedures available to the public is not clear. Unless MSSIC is considered a branch of the State Insurance Department of Maryland and thus exempt from the provisions of the Maryland APA, the broad definition of "agency" in Maryland leaves open the question of whether MSSIC is an agency.

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163 Md. Ann. Code art. 41 § 244(a) (Supp. 1981) provides:

"Agency" means any State board, commission, department or officer authorized by law to make rules or to adjudicate contested cases, except those in the legislative or judicial branches, and the Governor, and except the Maryland Parole Commission. . . the State Insurance Department of Maryland, the Public Service Commission. . . "Agency" also includes any agency created by general law, which operates in two or more political subdivisions. (Emphasis added).

164 Id. art. 41 § 244-56 (Supp. 1981).


167 Id. § 244(b) (Supp. 1981).

168 Id.

169 "Contested case" means a proceeding before an agency in which the legal rights, duties, statutory entitlements, or privileges of specific parties are required by law or constitutional right to be determined after an agency hearing." Id. § 244(c) (Supp. 1981).

170 "Rule" includes every regulation, standard, guideline, or statement of policy or interpretation of general application and future effect, including the amendment or repeal thereof, adopted by an agency, whether with or without prior hearing, to implement or make specific the law enforced or administered by it or to govern its organization, procedure, or the practice before such agency, but does not include regulations concerning only the internal management of the agency and not directly affecting the rights of or procedures available to the public. . .

171 Id. § 244(b) (Supp. 1981).
5. Massachusetts Share Insurance Fund

The Massachusetts Share Insurance Fund (hereinafter MSIF) was established to insure the shares of the member banks and is under the supervision of the commissioner of banks. The enabling legislation refers to the entity as a corporation and does not expressly state that the MSIF is an agency of the state. Therefore, to be considered a state agency for purposes of Massachusetts’ APA, the MSIF must fall within the definition of “agency” and must not be a mentioned exception. The definition of “agency” is similar to that in Maryland, but does not except the Department of Insurance. The Massachusetts courts have held that if an entity makes regulations or conducts adjudicatory proceedings, it is an agency for purposes of the state APA. Since there are no cases indicating whether MSIF is a state agency, again, the question is open.

6. Pennsylvania Savings Association Insurance Corporation

The Pennsylvania Savings Association Insurance Corporation (PSAIC) is subject to the control of the Secretary of Banking and was established to “provide for the liquidity of member associations” and to “insure the savings accounts in member associations.” The use of the word “insure” does not mean that PSAIC is a branch of the Pennsylvania Insurance Department, since its enabling legislation provides that it is not subject to the control of Pennsylvania Insurance laws.

There is no case law indicating that the PSAIC is a state agency, and PSAIC’s enabling legislation does not subject it to the state APA. The definition of “agency” in Pennsylvania is so broad that it is difficult

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171 MASS. GEN. LAWS ANN. ch. 170 app. § 2-1 (West 1971).
172 Id. ch. 170 app. § 2-8 (West 1971).
173 Id. ch. 30A § 1 (West 1979).
174 “Agency,” any department, board, commission, division or authority of the state government or subdivision of any of the foregoing, or official of the state government, authorized by law to make regulations or to conduct adjudicatory proceedings, but does not include the following: the legislative and judicial departments...” Id. ch. 30A § 1(2) (West 1979).
175 Md. ANN. CODE art. 41 § 244(a) (Supp. 1981).
180 Id. § 6503(b)(2) (Purdon Supp. 1981).
181 For a discussion of the significance of the use of “insure,” see supra text accompanying notes 52-57.
184 “Agency.” A government agency.
“Commonwealth agency.” Any executive agency or independent agency.
“Government agency.” Any Commonwealth agency or any political subdivision or other local authority, or any officer of any such political subdivision or local authority.
“Local agency.” A government agency other than a Commonwealth agency.
to determine whether PSAIC would fall under the definition. Pennsylvania's previous definitional statute defined agency as "any department . . . empowered to determine or affect private rights . . . by regulation or adjudication . . . ." Since that language is no longer contained in the definition, an entity need not necessarily affect private rights in order to be deemed an agency. Since the present definition of agency is somewhat circular, it is unclear what criteria will be used to determine an entity's status. Hence, without further clarification, it is difficult to predict whether the PSAIC would be considered a state agency.

Although there are some differences among the various deposit guaranty funds, the main purpose is to assure or insure the members' accounts and provide for the members' liquidity. No state guaranty funds have been held to be state agencies. Case law in the individual states indicates that in order for an entity to be considered a state agency it must conform to the definition of "agency" as set forth in their respective Administrative Procedure Acts.

Only the FSLIC has been held to be an agency; none of the states with deposit guaranty funds have ruled on this precise question. It is not clear, however, that the fact that the FSLIC is an agency is determinative of the issue. Although the various states' definitions of "agency" differ greatly, those definitions shall control. Thus, whether an individual guaranty fund will be considered a state agency depends more on whether it conforms to the requirements set forth in the respective definitional statutes and less on the fact that the federal counterpart is considered a federal agency.

V. STATE LIABILITY FOR NEGLIGENT SUPERVISION OF AN INSOLVENT SAVINGS AND LOAN

Once a savings and loan association is finally declared insolvent, its shareholders and depositors will undoubtedly seek to recover their losses. One possibility is to maintain an action against the state for the negligent supervision of the insolvent savings and loan association.

The question of whether the state may be held liable for negligent supervision is an important one in a state like Ohio, which has a large number of state-chartered savings and loan associations. In two states, Illinois and Arizona, courts have found the state liable for failing to adequately supervise a savings and loan. This part will examine these decisions and the respective statutory framework under which they were decided. The Ohio statutory scheme for the supervision of savings and loan associations

189 Id.

the Ohio Court of Claims Act\(^2\) will be analyzed to determine the extent, if any, of Ohio's potential liability. Finally, alternative means of recovery against the state will be explored.

A. Illinois: Tcherepnin v. Franz\(^3\)

1. Facts

The litigation, which took place in the federal district court,\(^4\) involved the events surrounding the collapse of City Savings Association (City Savings), a savings and loan association chartered by the State of Illinois.\(^5\) Involved in the collapse was the "blatant" disregard of the rights of City Savings' depositors by both state and City Savings' officials. The result of this misconduct cost the depositors nearly $23,000,000.\(^6\)

City Savings was founded in 1908 in Chicago, Illinois.\(^7\) It issued to its depositors withdrawable capital shares pursuant to the Illinois Savings and Loan Act.\(^8\) In 1942, C. Oran Mensik emerged as president of City Savings and with his emergence began a period of economic growth. City Savings' assets grew from $147,000 in 1942 to $12,000,000 in 1952 and by 1957 the assets were over $35,000,000.\(^9\)

However, in 1957, the Auditor of Public Accounts for the State of Illinois, who was in charge of the supervision of the state-chartered savings and loan association, completed his third examination of books and records of City Savings within a two-year period.\(^10\) The results of these findings revealed that the capital of City Savings was severely impaired, that favored companies staffed by associates and relatives of Mensik had received a disproportionate amount of mortgage loans, and that properties securing mortgage loans were greatly overappraised.\(^11\)

These results were released to the press in April of 1957 causing a run on City Savings. Two days later the Auditor, pursuant to statute,\(^12\) declared an emergency, took custody of City Savings and closed its doors to the public.

In response, Mensik filed suit charging the Auditor and five of his associates with conspiracy to steal Mensik's association from him.\(^13\) The

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\(^2\) Id. ch. 2743 (Page Supp. 1981).
\(^3\) 570 F.2d 187 (7th Cir. 1978), cert. denied, 439 U.S. 876 (1978).
\(^4\) 393 F. Supp. 1197 (N.D. Ill. 1975).
\(^5\) Id. at 1200.
\(^6\) Id.
\(^7\) Id. at 1201.
\(^9\) 393 F. Supp. at 1201.
\(^10\) Id.
\(^11\) Id.
\(^12\) ILL. ANN. STAT. ch. 32 § 848 (Smith-Hurd 1970).
\(^13\) 393 F. Supp. at 1201.
case went before a Master who concluded that the emergency was chargeable to the Auditor because of his release of the confidential report and therefore the state seizure was illegal. The trial judge subsequently adopted the Master's findings and returned control of City Savings to Mensik. The Supreme Court of Illinois ultimately affirmed the decision.

After being reopened to the public, City Savings embarked on an extensive advertising campaign pursuant to Illinois Savings and Loan Act. Offering expensive prizes to induce new depositors, City Savings advertised that the program was "under state government supervision." However, from 1959 to 1964, the affairs of City Savings were not conducted in accordance with the Illinois Savings and Loan Act. During this period, City Savings loaned over $21,000,000 to entities controlled by Mensik or his nominees. These loans were secured by fraudulently over-valued property. These inflated mortgage loans, together with unacceptable accounting and management practices, led to a capital impairment of more than $14,000,000.

In January of 1964, the State Department of Financial Institutions, to whom supervisory authority over state-chartered Savings and Loan Associations had been transferred, began an examination of City Savings. It was not until June of 1964, however, after an independent audit revealed the full extent of City Savings' capital impairment, that the association was closed.

Following the closing, the depositors of City Savings approved a plan which placed the assets of the association in the hands of three voluntary liquidators, one nominated by Mensik and two by the State of Illinois. After the association's collapse on July 29, 1964, Alexander Tcherepnin and other holders of capital shares of City Savings filed a complaint alleging that state officials, the voluntary liquidators and others had violated the Securities Exchange Act of 1934. The plaintiffs moved for the appointment of...
of a receiver and the court, finding the state supervised plan to be tainted with fraud, ordered an end to the voluntary liquidation and appointed two receivers.\(^{25}\)

The receivers first cross-complaint charged named state officials, including Joseph Knight, the Director of Financial Institutions for the State of Illinois, with breaching their statutory duties to City Savings thereby rendering themselves, the State of Illinois and their surety liable for damage to the depositors.\(^{26}\) The State of Illinois and the receivers subsequently entered into settlement negotiations which culminated in the legislative appropriation of $12,467,500 for the reimbursement of the City Savings’ depositors.\(^ {27}\)

The receivers then filed a motion for summary judgment against the remaining cross-defendants. Count I alleged that Knight had maliciously breached a statutory duty to supervise the affairs of City Savings. Count II alleged that Knight had either fraudently participated in foisting the illegal plan of voluntary liquidation upon the depositors of City Savings or, alternatively, negligently breached certain ministerial duties in connection with the adoption of that plan.\(^ {28}\)

2. Statutory Framework

The Illinois Savings and Loan Act\(^ {29}\) imposes a comprehensive duty on the director of the Department of Financial Institutions and its officers and employees to supervise the affairs of all savings and loan associations within the state and to ensure that these businesses are operated “only by the association organized and conducted in accordance with the authority provided in this act.”\(^ {30}\)

Section 842(a) of the Act requires the director to conduct an examination of every savings and loan association in the state every eighteen months.\(^ {31}\) To facilitate the examination, section 842(b) gives the director or his examiners access to the books and records of every savings and loan association.\(^ {32}\)

Section 843 empowers the director to order, without prior notice, an audit of the books of any association,\(^ {33}\) while section 844 requires every

\(^{25}\) 393 F. Supp. at 1207.
\(^{26}\) Id. at 1204.
\(^{27}\) Id.
\(^{28}\) Id. at 1205.
\(^{30}\) Id. § 792(b).
\(^{31}\) Id. § 842(a).
\(^{32}\) Id. § 842(b).
\(^{33}\) Id. § 843.
association to file with the Department of Financial Institutions a statement of its financial condition at the close of the fiscal year. 84

Finally, under section 848 the director is empowered to take custody of the books, records and assets of any association if, among other reasons, the association's capital is seriously impaired, or its business is being conducted in a fraudulent, illegal or unsafe manner. 85

The powers of the director of the Department are comprehensive and supervisory in nature. They allow the director to insure that every savings and loan association within the State of Illinois is being conducted in accordance with the Illinois Savings and Loan Act.

3. Count I

The plaintiffs alleged in Count I "that the affairs of City Savings were being so grossly mismanaged during the years 1959 to 1964 that no reasonable person could have made even the most cursory examination of City Savings and reasonably believed it to be sound or that the management should not be removed." 86 The second allegation was "that there were either no meaningful examinations of City Savings or that the examinations were made and the results were ignored or concealed by the Department of Financial Institutions." 87

The primary question centered around Knight's claim that he acted within the scope of his statutory authority and thus, because of his special status as a public official, was immune from liability. Although Illinois courts recognize the principle that public officials are immune from liability for errors in judgment in the performance of discretionary duties, 88 the immunity is limited. A public official is liable for his negligent conduct in the performance of ministerial duties or malicious and corrupt conduct in the performance of discretionary duties. 89 Having found that Knight's statutory duties to supervise the affairs of City Savings were discretionary in nature, the court focused its discussion on whether Knight's failure to conduct the required examinations of City Savings and his concealment of the results constituted and malicious breach of those duties.

The court noted that the term malicious connotes something more than mere negligence. 40 Malicious has been defined by the Illinois courts

84 Id. § 844.
85 Id. § 848.
86 393 F. Supp. at 1207.
87 Id.
to mean the intentional commission of a tortious act, the willful and reckless disregard of another’s rights, and the wanton and deliberate commission of a wrongful act.\textsuperscript{41}

With this in mind, the court noted that Knight became aware of City Saving’s financial straits in January of 1964 when Justin Hulman advised him that City Savings was “in trouble”.\textsuperscript{42} In the course of his investigation Hulman, a salaried technical advisor to Knight, noticed evidence suggesting that City Savings had made inflated mortgage loans on overvalued property.\textsuperscript{43} He also discovered that City Savings had listed among its assets $799,000 used to purchase promotional premiums that had already been given away to entice new depositors and that City Savings had recorded as income commissions refinanced loans that were never collected. If these assets were given proper accounting treatment the reserves of the association would have been insufficient to cover even a minor loss.\textsuperscript{44}

In addition to findings of Hulman, Knight was aware that in 1963 City Savings’ contingent reserves were less than the statutory minimum of 7\%\textsuperscript{45}. However, Knight permitted City Savings to declare a dividend in December of 1963 in clear violation of the Illinois Savings and Loan Act.\textsuperscript{46} Hulman explained that City Savings was permitted to operate under the lower standards established for associations insured by the Federal Savings and Loan Corporation.\textsuperscript{47} (hereinafter FSLIC). But, City Savings was not and never had been insured by FSLIC. As a result, any losses of City Savings would fall directly on the depositors.\textsuperscript{48}

Furthermore, Knight in 1963 was aware that most of City Savings’ loans were made to corporations having the same group of individuals as officers and directors which was in violation of the Act.\textsuperscript{49}

Despite all this — the absence of insurance, the evidence of excessive loans on overvalued property, the dangerously low reserves — Knight failed to take any corrective action until June 26, 1964. The district court noted that Knight’s failure to act is rendered even more inexcusable by the fact that he was aware that Mensik and City Savings had encountered serious financial difficulties in 1957-59.\textsuperscript{50}

\textsuperscript{42} 393 F. Supp. at 1211.
\textsuperscript{43} Id. at 1210.
\textsuperscript{44} Id. at 1211.
\textsuperscript{45} ILL. ANN. STAT. ch. 32 § 779(a) (Smith-Hurd 1970).
\textsuperscript{46} Id. § 780(b)(1) (Smith-Hurd Supp. 1981).
\textsuperscript{47} 393 F. Supp. at 1212.
\textsuperscript{48} Id.
\textsuperscript{49} ILL. ANN. STAT. ch. 32 § 801 (Smith-Hurd 1970).
\textsuperscript{50} 393 F. Supp. at 1213.
In light of the aforementioned undisputed facts the district court held that Knight had maliciously breached his statutory duty to supervise the affairs of City Savings and that his estate was liable to the depositors for the resulting loss.

4. Count II

The gravamen of Count II is that Knight and Hulman permitted Mensik to foist a fraudulent and illegal plan of voluntary liquidation upon the City Savings' depositors. As a result no judicial supervision occurred from June of 1964 until Judge Campbell terminated the voluntary liquidation and appointed federal receivers on September 7, 1968. The plaintiffs alleged that Knight was liable under one of two theories: (1) that the adoption of the voluntary plan of liquidation constituted fraud, in which Knight was an active participant; or (2) that permitting the adoption of the plan constituted a breach of Knight's ministerial duties, for which he was not immune.

The plaintiffs claimed that both Knight and Hulman read the transcripts of Mensik's representations to the depositors of City Savings and that they (the depositors) would receive 100 cents on the dollar plus interest as a result of a voluntary liquidation. The plaintiffs further contended that both Knight and Hulman knew these representations were grossly fraudulent, but neither attempted to correctly advise the depositors.

The district court determined that Knight's acquiescence in the fraudulent representations did indeed constitute actual fraud. The court noted that the law is clear in Illinois that a person who by his conduct contributes to the misrepresentation of a material matter to another and intentionally fails to correct the misrepresentation is guilty of fraud.

At issue in the plaintiff's statutory violation theory were the duties imposed on the director of the Department of Financial Institutions by sections 921 and 922 of the Illinois Savings and Loan Act. Section 921 provides in part:

If the Commissioner, after taking custody of an association . . . finds that any one or more of the reasons for taking custody continues to exist through the period of his custody, then he shall appoint any qualified person, firm or corporation as receiver or co-receiver of such association or trust for the purpose of liquidation.
Section 922 provides:

After so appointing a receiver, the Commissioner shall direct the Attorney General to file a complaint in equity in the name of the director in the circuit or superior court of the county in which such association or trust is located and against the association or trustees or liquidators, as the case may be, for the orderly liquidation and dissolution of the association or trust and for an injunction restraining the officers, directors, trustees, or liquidators, from continuing the operation of the association or trust.\(^5\)

The primary issue in the statutory violation theory was whether Knight's duties under these sections properly could be characterized as ministerial. This characterization is important because, under Illinois law, the failure to perform\(^5\) or the negligent performance\(^6\) of ministerial duties is actionable. The court looked to the Illinois Supreme Court's definition of ministerial in Munson v. Bartels:

Official duty is ministerial when it is absolute, certain and imperative involving merely the execution of a set task, and when the law which imposes it prescribes and defines the time, mode, and occasion of its performance with such certainty that nothing remains for judgment or discretion.\(^6\)

Applying that definition to sections 921 and 922 of the Act, the appellate court found that these provisions call for the execution of set tasks and define the time, mode, and occasion of performance leaving nothing for judgment or discretion.\(^6\) The court held that in disregard of sections 921 and 922, Knight failed to (1) appoint a receiver for City Savings, (2) direct the Attorney General to file a complaint against City Savings, or (3) direct the Attorney General to seek an injunction restraining the officers and directors of City Savings from continuing operations.\(^6\) Thus, the court held that the failure to perform these acts by a public official constitutes a breach of a ministerial duty,\(^6\) for which Knight's estate was liable.

Since the court of appeals found "ample grounds" to affirm the statutory violation theory of Count II,\(^6\) it did not determine the validity of the lower court's holding on the defendant's alleged fraud. In addition the court of appeals affirmed the grant of summary judgment on Count I of the complaint.

\(^{5}\) Id. § 922.
\(^{6\text{a}}\) Munson v. Bartels, 138 Ill. 322, 27 N.E. 1091 (1891).
\(^{6\text{b}}\) Id. at 328, 27 N.E. at 1092.
\(^{6\text{c}}\) 570 F.2d at 194.
\(^{6\text{d}}\) Id.
\(^{6\text{e}}\) Id. at 192.

https://ideaexchange.uakron.edu/akronlawreview/vol15/iss3/3
As a final note, an interesting question was raised concerning the scope of Knight’s duties. The defendant contended that his statutory duties were owed only to the public-at-large (State of Illinois) and not to the depositors of City Savings. The court agreed that official misconduct can constitute an actionable wrong only if a duty is owed to a party seeking redress. The Illinois Savings and Loan Act, however, in defining the duties of the director, makes repeated reference to the “protection of the association.” These references indicate that the association, and more specifically, its depositors, have a “vested” right in the duties prescribed.

B. Arizona: State v. Superior Court of Maricopa County

A. Facts

Plaintiffs were depositors of United States and Lincoln Savings. They filed a class action alleging that the defendants, the State of Arizona, the Arizona Department of Insurance, the Arizona Corporation Commission and their respective agents, officers and employees, fraudulently or negligently allowed the associations to defraud plaintiffs and aided or abetted the associations in committing the fraud. The complaint alleged that the associations had raised over $52,000,000 from approximately 20,000 class members and that the associations and their subsidiaries and affiliates thereafter became insolvent.

The complaint made the following contentions about the associations: (1) the associations in an attempt to obtain new investors’ funds to meet maturing obligations promulgated advertising which stressed higher interest rates, (2) the depositors were falsely told that they were insured up to $40,000 by Omaha Surety Corporation of America (hereinafter Omaha), (3) that the advertising and sales literature contained material misrepresentations and omissions and concealed the serious financial difficulties of the associations, (4) the associations used false and fraudulent financial statements in order to raise monies and to conceal their impaired financial condition.

The first of five counts alleged that the Corporation Commission officer defendants, while acting within the scope of their actual or apparent authority, made untrue statements and engaged in courses of business that operated as fraud. More specifically, the plaintiffs’ asserted that the defendants represented that the associations were well regulated by the Arizona

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66 Id. at 191.
67 State v. Maryland Casualty Co., 132 F.2d 850 (7th Cir. 1942).
69 570 F.2d at 191.
71 123 Ariz. at 328, 599 P.2d at 781.
72 Id.
73 Id.
Corporation Commission, that the associations and Omaha had made all filings required by law, that their corporate papers and insurance papers were in order, and that they were in a solvent financial condition. Finally, the plaintiff's alleged that the defendants failed to make a yearly examination of the associations as required by statute and failed to disclose that the associations were in violation of several portions of the Arizona statutes regulation of thrift institutions (hereinafter Article 17).

Count II alleged that the State of Arizona, the Arizona Corporation Commission, the Corporation Commissioner defendants, and the Corporation Commissioner officer defendants aided and abetted the associations in defrauding the plaintiffs. Specifically, the defendants failed to examine the associations on a yearly basis or failed to do so in accordance with the standards required by law. Finally, Count II alleged that the defendants failed to disclose that Omaha did not have sufficient assets to insure payments of its insurance obligations.

Count III alleged that the State of Arizona, the Arizona Corporation Commission, the Corporation Commissioner defendants and the Corporation Commissioner officer defendants were negligent in performing their statutory duties. Specifically, the defendants failed to make a yearly examination of the associations or failed to do so in accordance with the standards required by law. Furthermore, the defendants failed to properly supervise and regulate the affairs and records of the associations and permitted them to continue to issue investment certificates when the associations were in violation of the law.

Count IV asserted that the State of Arizona, the Arizona Department of Insurance, the Insurance Director and the Insurance Department officer defendants were negligent or reckless in supervising the affairs of Omaha. This count also asserted that the defendants aided and abetted the associations in defrauding the plaintiffs. Specifically, the defendants failed to examine the affairs of Omaha in the manner and within the time presented by law, and the examinations that were conducted were negligently or recklessly performed. Furthermore, the defendants were charged with violating their statutory duties when they renewed Omaha's certificate of authority and for failing to disclose that Omaha did not have sufficient assets to insure payments of its insured obligations. Finally, Count IV alleged that

74 Id.
76 123 Ariz. at 328, 599 P.2d at 781.
77 Id. at 329, 599 P.2d at 782.
78 Id.
79 Id.
80 Id.
81 Id.
the Insurance Director defendants and the Insurance Department officer defendants willfully and knowingly acted in disregard of their statutory duties.82

Count V alleged that the surety defendants were jointly and severally liable upon their official bonds for the allegations made in Counts I through IV.83

The trial court denied defendants' motion to dismiss.84 The Arizona Supreme Court took jurisdiction of defendants appeal in a special action,85 reversing in part the trial court's action.

2. Duty Question

The court noted that Counts I and II charged the defendants with fraud and aiding and abetting the associations in perpetrating a fraud. It was not alleged by the plaintiffs that these violations negligently occurred. With this in mind, the court turned to the concept of sovereign immunity for tort liability and determined that the "public duty defense" discussed in Massengill v. Yuma County86 was inapplicable.

Count III, which alleged that the Arizona Corporation Commission and its agents and employees were negligent in the performance of their statutory duties, did involve a duty question. Thus, the defendants asserted that the duty imposed upon state agencies and public officials is one owed to the public generally, and a breach of this duty does not provide an individual with a cause of action.87

The Arizona Supreme Court had previously discarded the concept of sovereign immunity for tort liability.88 Nevertheless, the plaintiff must still show all the elements of negligence to support a cause of action. Therefore there must be a duty owed to the individual plaintiff.89 The court in Massengill held that the duty imposed upon governmental agencies and public officers is ordinarily a duty owed to the public and not the individual.90 However, the Massengill court noted that an obligation owing to the

82 Id.
83 Id.
84 Id.
86 104 Ariz. 518, 456 P.2d 376 (1969). The court in Massengill held that if the duty imposed upon governmental agencies and public officers is a duty to the public, inadequate performance is a public, not a private, wrong. Id. at 522, 456 P.2d at 380. Therefore, a negligence action for breach of a public duty is doomed to failure since the plaintiff cannot show a duty owed to him. Since Counts I & II in Superior Court did not allege negligence this defense was unavailable to defendants. The issue on appeal only was whether the complaint stated a claim upon which relief could be granted. Therefore, the supreme court affirmed the lower court's denial of defendant's motion to dismiss as to Counts I and II.
87 123 Ariz. at 332, 599 P.2d at 785.
89 123 Ariz. at 332, 599 P.2d at 785.
90 104 Ariz. 522, 456 P.2d at 380.
general public sometimes can be narrowed into a specific duty to an individu-
al. Citing *Veatch v. City of Phoenix,* the court illustrated this concept:

[A] municipality has no absolute duty to provide water for fire pro-
tection purposes to its inhabitants. But, when a city assumes the re-
sponsibility of furnishing fire protection then it has the duty of giving
each person or property owner such reasonable protection as others
within a similar area within the municipality are accorded under like
circumstances.\(^92\)

The court next noted that a duty to the individual may also exist when
the governmental agency is itself the active tortfeasor. For example, if the
State of Arizona is building highways, it has a duty to the individual driver
to build safe highways,\(^93\) properly maintain its streets,\(^94\) and to remove from
its land that create a dangerous situation.\(^95\)

In the case at bar, the court did not find that the defendants were active
tortfeasors within the examples above. It did find however, that the statutory
language of Article 17 narrowed the duty of the Corporation Commission
into one requiring it to protect the injured depositors.\(^96\)

In short, the court held that Article 17 provided a detailed list of require-
ments with which all Arizona thrift associations were required to comply. It
gave the Corporation Commission and the Director of Securities compre-
hensive powers, which were designed to foster the supervision of the thrift
associations;\(^97\) it required the Commission to examine the affairs and records
of each thrift association once a year;\(^98\) and it allowed the Commission
to suspend a thrift association's registration for any violation of Article
17.\(^99\) Finally, the Director of Securities was empowered to conduct further
investigations.\(^100\)

The court held that the duties of the Corporation Commission are of
an enforcement nature, thus, the Commission's obligations are more specific
and narrow than the general enforcement duties of a police officer.\(^101\)
Whereas, the duty of the police officer is to protect the public in general,
Article 17 clearly states that the Corporation Commission's duty is to protect
the depositors of the thrift associations.\(^102\) Furthermore, whereas a police

\(^{91}\) 102 Ariz. 195, 427 P.2d 335 (1967).
\(^{92}\) Id. at 197, 427 P.2d at 337.
\(^{93}\) 123 Ariz. at 332, 599 P.2d at 785.
\(^{94}\) Vegodsky v. City of Tucson, 1 Ariz. App. 102, 399 P.2d 723 (1965).
\(^{96}\) 123 Ariz. at 332, 599 P.2d at 785.
\(^{97}\) Id.
\(^{98}\) ARIZ. REV. STAT. ANN. § 44-2064 (repealed 1976).
\(^{99}\) Id. § 44-2047 (repealed 1976).
\(^{100}\) Id. § 44-2044 (repealed 1976).
\(^{101}\) 123 Ariz. at 333, 599 P.2d at 786.
\(^{102}\) Id. at 332, 599 P.2d at 785, 786.
officer's duties require the performance of a wide scope of diversified acts, the duties of the Commission are very specific as enumerated in the statute. The court noted that to hold that Article 17 does not create a duty that extends from the Corporation Commission to the individual depositor "would be to render the article meaningless." 103

The court next turned to the decision in Tcherepnin v. Franz 104 and compared the Arizona statute with that in Illinois. The court noted that the Tcherepnin court held that references in the Illinois Savings and Loan Act to the protection of "the association" indicated that the association and, more specifically, its depositors had a vested right in the duties of the Department of Financial Institutions. 105 The court then determined that even though the specific language of the Illinois statute does not appear in the Arizona counterpart, the comprehensive nature of Article 17 and the specificity of the duties that it imposes indicated that the reasoning applied in Tcherepnin was applicable. 106

The defendants argued that the early Arizona cases did not find that the duty of a governmental agency or a public official extended to a private individual. However, the court emphasized that these early cases did not "fully consider" the distinction between public and private duty, that these distinctions could only be made on a case by case basis, and that in the case at bar the public duty had been created by statutory language that was designed to protect a particular class of persons rather than the public as a whole. 107

The court concluded its discussion of Count III by ruling that the individual Corporation Commissioners and the Director of Securities could not be held liable for the negligence of their subordinates in the absence of misfeasance or actual negligence on their part. 108 Furthermore, the court noted that if the complaint against the individual Corporation Commissioner defendants was refiled to allege negligent hiring practices, a financial inability to hire a sufficient number of skilled persons could operate as a defense to the liability of the individual commissioners. 109 However, the court stated such a defense would not circumvent the liability of the State of Arizona. 110 When the state imposes duties upon its agencies and employees, it must provide adequate resources for the implementation of those duties. 111 In ending, the

103 Id. at 333, 599 P.2d at 786.
104 See supra section A.
105 123 Ariz. at 333, 599 P.2d at 786.
106 Id.
107 Id.
108 Id.
109 Id. at 334, 599 P.2d at 787.
110 Id.
111 Id.
court stated that the state was also responsible for the torts committed by its agents and employees while acting within the scope of their authority.\footnote{112}

C. Ohio

1. Supervision of Building and Loan Associations

The statutory framework set out in chapter 1155 of the Ohio Revised Code, which describes the powers and duties of the superintendent of building and loan associations, is very similar to the statutes set forth in Illinois and Arizona.

In essence the duties and functions of the superintendent include the authority to issue cease and desist orders with regard to unauthorized loans, investments and practices and insure that the laws relating to building and loan associations and deposit guaranty associations are executed and enforced.\footnote{113}

Furthermore, the Ohio Revised Code gives the examiners, appointed by the superintendent, access to all books, papers, securities, monies and other property of an association under examination\footnote{114} and requires the office of the superintendent of building and loan associations to make an examination into the affairs of each building and loan in the state at least once each year.\footnote{115} In addition, the superintendent may, whenever he deems it necessary, conduct a special examination of any building and loan association.\footnote{116}

The Code also requires the superintendent to keep and preserve a record of his proceedings, including a concise statement of each association examined by him, and make an annual report to the Governor of the general conduct and condition of building and loan associations doing business in the state.\footnote{117} To supplement this report, the superintendent is required to make any suggestions he deems proper.\footnote{118}

Finally, the superintendent's report must include such information from the statements required of the associations as the superintendent deems

\footnote{112}{The supreme court ordered those allegations in Count III that related to the individual defendants dismissed, with leave to amend. The denial of defendant's motion to dismiss as to the rest of Count III was affirmed. As to Count IV, the court ruled that the statutes defining the obligations and powers of Department of Insurance and the Insurance Director, Ariz. Rev. Stat. Ann. §§ 20-201 to -230 (1975), were similar in scope to Article 17. 123 Ariz. at 334, 559 P.2d at 787. Therefore, the denial of the motion to dismiss as to that portion alleging negligence was affirmed. Likewise, the denial of the motion to dismiss as to that part of Count IV which alleged fraud was affirmed. See supra, note 86. Those allegations in Count V arising out of the dismissed portions of Count III were likewise dismissed; the remainder were reaffirmed.}

\footnote{113}{Ohio Rev. Code Ann. §§ 1155.01-.02 (Page Supp. 1981).}

\footnote{114}{Id. § 1155.11 (Page 1968).}

\footnote{115}{Id. § 1155.09 (Page 1968).}

\footnote{116}{Id. § 1155.10 (Page Supp. 1981).}

\footnote{117}{Id. § 1155.14 (Page 1968).}

\footnote{118}{Id.}
necessary, a statement of the associations whose business has been closed during the year, the amounts of their assets and liabilities, and the amounts paid to their creditors.\textsuperscript{119}

In a further effort to keep the superintendent abreast of the financial condition of the associations within the state, each association is required to make a report in writing of its affairs twice per year.\textsuperscript{120} This report must include the financial condition of the association for the preceding half year.\textsuperscript{121} Each association is required to establish and maintain a loss reserve and other net worth accounts adequate to assure solvency of the association.\textsuperscript{122}

The association must maintain reserve accounts with a minimum balance of five percent of the association's aggregate savings account balances as of the date of the association's twentieth anniversary of its incorporation and thereafter or the average of the aggregate of such date and the one to four consecutive closing dates immediately preceding such date.\textsuperscript{123}

During the first twenty years of the association's operation, the superintendent must issue regulations providing a uniform schedule of minimum levels to be reached.\textsuperscript{124} The superintendent may permit an association to cure a deficiency in its reserve account by requiring the association's directors to earmark pledged savings accounts, capital stock, contributed surplus, or undivided profits as part of its reserve account in such amounts as needed to cure the deficiency.\textsuperscript{125} However, no association may pay dividends or interest from the reserve account or other funds for the purpose of meeting the reserve account requirement.\textsuperscript{126}

In the alternative, each association may at its annual closing date calculate its total of net worth accounts by application of schedule of percentages applied to the several categories of assets in which the association has invested its funds.\textsuperscript{127} The superintendent must issue a rule providing for the uniform schedule of percentages which shall be used for the computation purposes.\textsuperscript{128}

If upon examination the superintendent finds that the affairs of a domestic building and loan association are in an unsound or unsafe condition, that it is conducting its business in whole or in substantial part con-

\textsuperscript{119} Id.
\textsuperscript{120} Id. § 1155.07 (Page Supp. 1981).
\textsuperscript{121} Id.
\textsuperscript{122} Id. § 1151.33 (Page Supp. 1981).
\textsuperscript{123} Id. § 1151.33 (A).
\textsuperscript{124} Id.
\textsuperscript{125} Id.
\textsuperscript{126} Id.
\textsuperscript{127} Id. § 1151.33(B).
\textsuperscript{128} Id.
trary to law, that it is failing to comply with the law, or that its affairs are not being conducted for the best interests of its depositors, shareholders, or creditors, he may take possession of the business and property of such association.\(^{129}\)

In sum, the comprehensive powers granted to the superintendent of building and loan associations are designed to enable him to supervise the affairs of savings and loan institutions within the State of Ohio and, thus, insure that every association is being conducted in accordance with the provisions of the Ohio Revised Code.

2. Ohio Court of Claims Act\(^{130}\)

Section 1155.19 of the Ohio Revised Code provides:

Neither the superintendent of building and loan associations nor any employee of the division of building and loan associations shall be liable in any civil, criminal or administrative proceedings for any mistake in judgment or discretion in any action taken, or any omission made by him in good faith.\(^{131}\)

This section clarifies many of the problems raised in Tcherepnin and Superior Court.\(^{132}\) The superintendent and his employees cannot be held liable for negligent supervision of an insolvent savings and loan association in Ohio. This section, however, does not answer the question of whether the state can be held liable. This question can only be answered by examining the Ohio Court of Claims Act and the cases decided thereunder.

The liability clause of the Ohio Court of Claims Act reads in part: "The state hereby waives its immunity from liability and consents to be sued and have its liability determined . . . in accordance with the rules of law applicable to suits between private parties."\(^{133}\) Thus, the Act does not create new causes of action. The phrase "rules of law applicable to suits between private parties," is troublesome because "private parties do not ordinarily operate prisons, confine the mentally ill, or provide for the public welfare through licensing and regulation of business."\(^{134}\) Specifically, two questions are raised in regard to the activities of the superintendent of buildings and loan associations. First of all, does the fact that there is no comparable private activity, i.e., no rules relating to suits between private parties, mean that the state has not waived immunity from liability for the negligent performance of these activities? Secondly, does the fact that...
some of the superintendent's activities are discretionary provide immunity for the state under the so-called "discretionary function immunity" exception?135

The leading case on the relevant aspects of the Ohio Court of Claims Act is Devoe v. State.136 Devoe involved a claim against the state that the Division of Securities was negligent because it had been informed of certain fraudulent activities, yet failed to deny registration of the securities. The court dismissed the action for lack of subject matter jurisdiction and failure to state a claim upon which relief could be granted.137 One reason for dismissing the action was that the court found that there was no analogous activity in the private sector from which "rules of law applicable to suits between private parties" could be ascertained. "Therefore, since there could be no private party liability, rules of law could not be extracted from private parties' activities to cover the conduct complained of by plaintiffs, and no action could be maintained."138 In adopting this point, the court cited Feres v. United States.139 In Feres, the United States Supreme Court similarly interpreted a phrase in the Federal Tort Claims Act,140 dismissing an action against the United States because it could not find a private counterpart to the governmental activity complained of. The Feres holding was limited by subsequent decisions141 and has been severely criticized as limiting the scope of governmental liability too severely.142 Despite these criticisms, the "private counterpart doctrine" remains a part of Ohio law.143 Thus it is also a possible means for the State of Ohio to avoid

135 See id. at 195-200, 208-09, 246-48.
137 Id. slip op. at 21. See Wilkins, supra note 134, at 206.
138 Wilkins, supra note 134, at 209.
140 28 U.S.C. §§ 1346(b), 2671-80 (1976). The U.S. Supreme Court read the words of 28 U.S.C. § 2674, "the United States shall be liable . . . in the same manner . . . as a private individual under like circumstances" . . . to be "under the same circumstances." Wilkins, supra note 134, at 193.
142 Wilkins, supra note 134, at 211.
143 Wilkins suggests that the unworkability of this doctrine is evidenced by its inconsistent application in the courts:

The Ohio courts have adhered to the no private counterpart test despite inconsistent applications of the concept which demonstrate its unworkability. For example, private parties are not responsible for the construction and maintenance of highways, the validation of certificates of incorporation, the conferral of motor vehicle operational licenses, or the custody and control of criminal offenders, and yet the Ohio courts have found governmental liability in each instance. To proclaim that certain activities are uniquely governmental is to state the obvious. All governmental activities are in one sense or another unique. The provision of the Court of Claims Act that states that liability should be determined by reference to rules of law applicable in private lawsuits should not be viewed as a limitation upon the waiver of immunity, but rather as an opportunity by the Ohio courts to provide a remedy to persons injured by governmental activity within the controls traditionally imposed by principles of decisions in our well-developed common law tort compensation system. The Ohio courts should
liability for the negligent supervision of a savings and loan, since clearly, there is no private counterpart to the duties of the superintendent.

A second approach would be for the state to avoid liability by claiming that it is immune because the statutory duties of the superintendent are discretionary in nature. Although the Court of Claims Act contains no provision exempting discretionary functions from liability, the court of claims has read this exception into the Act by judicial gloss, apparently relying on the discretionary function exception in the Federal Tort Claims Act. The initial question, of course, is what is meant by the phrase “discretionary function.”

The court of claims has taken a very simplistic approach to this question. In Devoe, the court found the activities of the Department of Securities to be discretionary simply because the statute authorizing the regulatory activity contained directory, as opposed to mandatory language. In Results, Inc. v. Secretary of State, the court, although reaching the opposite result, adopted the same approach. In Results, Inc., the court held that the state could be liable for the Secretary of State’s issuance of a certificate of incorporation to a corporation using a corporate name already assigned, since the language of the enabling statute contained mandatory, and no directory language. Thus, it seems that in Ohio, the question of whether governmental activity is discretionary is determined solely by whether the statute uses the word “may” or “shall.”

If the duties of the superintendent are analyzed under this approach, it seems unlikely that an individual could successfully maintain an action against the state for negligent supervision of an insolvent savings and loan. Although the statute contains some mandatory language, the sections providing for the superintendent to take possession of insolvent associations contain directory language. Thus, the court probably would conclude that the duties of the superintendent are discretionary, and hold the state immune from liability for the negligent performance of these duties.

The simplistic approach of the court of claims has been criticized as

abandon the no private counterpart test as an inaccurate and unwarranted interpreta-
tion of the Court of Claims Act.

Wilkins, supra note 134, at 246. See, e.g., Adomov v. State, 46 Ohio Misc. 1, 345 N.E.2d 661 (Ct. Cl. 1975) (custody of juvenile offenders); Results, Inc. v. Secretary of State, No. 75-0295 AD (Ohio Ct. Cl. July 30, 1975) (issuance of certificates of incorporation); Denis v. Department of Transp., No. 75-0287 AD (Ohio Ct. Cl. Feb. 27, 1976) (maintenance of highways).

144 28 U.S.C. § 2680(a) (1976) states that the Act shall have no application to “[a]ny claim based upon . . . the performance or failure to . . . perform a discretionary function . . . [by government employees], whether or not the discretion is abused.”

145 No. 75-0295 AD (Ohio Ct. Cl. July 30, 1975).

146 Wilkins, supra note 134, at 216.


148 Id. § 1157.01 (Page Supp. 1981).
ignoring the reason for the discretionary function exception. One commentator suggests that the court’s approach is the result of the confusion of two separate questions: whether the duties of the government official are discretionary and whether the activities impose a duty upon the official to the particular plaintiff. He suggests that when the court of claims holds that the activity is discretionary, it means that “the ability to exercise discretion removes any duty to anyone.” To cure this confusion, he suggests a two-pronged analysis of the discretionary function exception. The first step would be to determine whether the activity is in fact the type of discretionary activity which should be excepted. The suggested approach is the policy-formulation test of Downs v. United States. Downs held that Congress, in enacting the discretionary function exception to the Federal Tort Claims Act, intended to put beyond the scope of judicial review, discretionary functions directed to the formulation of governmental policy, such as decisions representing an administrator’s exercise of quasi-legislative or quasi-judicial functions. Activities which implement policy, although discretionary in nature, do not fall within this exception. Once it is determined, however, that a particular activity does not fall within the discretionary function exception, liability is not automatically established. The plaintiff must still show that particular activity imposes a duty to him individually. In other words, the plaintiff must still establish the traditional elements of a cause of action in negligence.

The application of this approach to a fact pattern similar to those in Tcherpnin and Superior Court would most likely have had the same result as in those cases. The duties of the superintendent to supervise insolvent savings and loan associations do not fall within the policy-formulation definition of discretionary functions. If the provisions of the Ohio Revised Code can be shown to establish a duty that runs to the depositors (or shareholders) of a savings and loan, then liability of the state can be established.

149 Wilkins, supra note 134, at 211-12.
150 Id. at 211.
151 Id.
152 522 F.2d 990 (6th Cir. 1975).
154 522 F.2d at 997-98.
156 Ohio courts have generally held that statutes requiring state agencies to inspect and enforce safety standards were enacted to protect the public in general against unsafe conditions. They were not intended “nor should they be construed to create a duty toward any particular person.” Shelton v. Industrial Comm’n, 51 Ohio App. 2d 125, 127, 367 N.E.2d 51, 53-54 (1976). See also City of Oregon v. Ferguson, 57 Ohio App. 2d 95, 385 N.E.2d 1084 (1978); Smith v. Wait, 46 Ohio App. 2d 281, 340 N.E.2d 431 (1975). In Shelton, the court held that only where inspections are conducted pursuant to a contractual agreement will there be liability for negligence. 51 Ohio App. 2d at 127, 367 N.E.2d at 53.
The holdings of *Tcherepnin* and *Superior Court*, that the similar statutory schemes of Illinois and Arizona, respectively, do establish such a duty, might be persuasive in this regard. Nevertheless, the precedent from the court of claims indicates that depositors of an insolvent savings and loan association face an uphill battle in attempting to recover from the state. Other means of recovery, however, might be available.

D. **Other Alternatives of Recovery**

An alternative means of establishing the duty of the State of Ohio is to look to sections 323, 324A and 552 (3) of the Restatement (Second) of Torts. Section 323 provides that one who undertakes to render services to another is liable if the failure to exercise due care increases risk of harm or harm is suffered because of induced reliance.\(^{157}\) Section 324A states that one who undertakes to render services to another is liable for injury to a third person resulting from negligence if failure to use due care actually increased the harm, induced reliance resulting in the harm, or discharged a prior duty that another party owed to the plaintiff.\(^{158}\) Sections 323 and 324A are commonly referred to as the "good Samaritan doctrine." This doctrine recognizes the common law tort of negligence when an individual, without a duty to act, nevertheless undertakes an act and performs it without due care.\(^{159}\) The doctrine applies to inspections of private activities or property by government agents, notwithstanding regulations or statutes requiring the inspection.\(^{160}\)

The plaintiffs in *Zabala Clemente v. United States*\(^{161}\) attempted to sue the United States under the Federal Tort Claims Act by asserting sections 323 and 324A. The plaintiffs alleged that employees of the Federal Aviation Administration (FAA) negligently failed to warn passengers that the aircraft was overweight and lacked a proper flight crew. The lower court held for the plaintiffs on the issue of negligence.\(^{162}\) However, on appeal, the court reversed the decision holding that there was no statutory duty to warn the plaintiffs and sections 323 and 324(A) did not apply because the failure to inspect the aircraft did not add to the risk of an injury to the passengers and there was no evidence that anyone relied on an order issued by the director of the F.A.A. ordering surveillance of turbined powered aircraft.\(^{163}\)

\(^{157}\) *RESTATMENT (SECOND) OF TORTS* § 323 (1965).

\(^{158}\) *Id.* § 324A.


\(^{160}\) *Note, Government Liability for Negligent Inspection of Aircraft, 15 SUFFOLK L. REV. 158, 162 (1981).*

\(^{161}\) 567 F.2d 1140 (1st Cir. 1977).


\(^{163}\) 567 F.2d at 1145.
In *Blessing v. United States*, the plaintiffs had more success in asserting sections 323 and 324A to attach liability to the United States under the Federal Tort Claims Act. The plaintiffs based their claim on negligent inspections of their private employer's premises by Occupational Safety and Health Administration inspectors. The plaintiffs contended that, having undertaken to make particular inspections pursuant to OSHA, the government assumed a duty to the plaintiffs not to conduct those inspections negligently.

The court noted that the good Samaritan doctrine was recognized by the Pennsylvania courts. However, Pennsylvania law dictates that when an inspector is not under an enforceable legal or contractual duty to inspect the employer's premises, the employee can recover for a negligently performed inspection only where the inspector has physically undertaken to inspect the specific instrumentality causing the injury or the entire physical plant of which the specific instrumentality is part. The court, therefore, held that the plaintiffs' pleadings did not satisfy the essential requirements of the good Samaritan doctrine in Pennsylvania. However, the court did find that the pleadings were minimally sufficient to state a claim under the Federal Tort Claims Act against the United States and allowed the plaintiffs to amend their complaint to state a cause of action under the good Samaritan doctrine.

Sections 323 and 324A were relied on in Illinois in *Greene v. City of Chicago*. The plaintiff in *Greene* alleged that the city was negligent in failing to maintain the street lighting, which he contended was the proximate cause of his being struck by another automobile. The court held that the municipality voluntarily provided street lighting and was therefore liable for its negligence in the maintenance of such lighting.

The good Samaritan doctrine has not been adopted in Ohio, but the court in *Mercer v. United States*, considered the claims of the plaintiffs for negligent inspection by federal employees pursuant to the Federal Mine Safety Act. In *Mercer* the court stated that the rendering of services "to another," as does not encompass an inspection made pursuant to a statute. The court determined that responsibilities imposed on an inspector acting pursuant to statutory authority are "altogether different" than respon-

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165 Id. at 1187. The court looked to Pennsylvania law because whether the United States is subject to liability under the Federal Tort Claims Act depends on whether a cause of action exists where the alleged tort occurred. Id.
166 Id. at 1188.
167 Id. at 1197.
168 Id. at 1200.
170 Id. at 508, 363 N.E.2d at 389.
sibilities imposed by contract. However, the court's statement seems to be directly in contrast to Professor Prosser's notion that "the good Samaritan doctrine applies to inspections of private activities or property by government agents, notwithstanding federal regulations or statutes requiring the inspection." 

Furthermore, one could argue the Pennsylvania view; that absent a contractual duty to inspect, the plaintiff could still recover for a negligently performed inspection if the inspector has physically undertaken to inspect the specific instrumentality or the entire entity of which the specific instrumentality is a part and if the element of reliance was present.

Another alternative to establish the state's liability is section 552(3) the Restatement (Second) of Torts. Section 552(3) provides that the liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created in any of the transactions in which it is intended to protect them.

Furthermore, the comment to section 552(3) states that when there is a public duty to supply the information in question, the maker of the negligent misrepresentation becomes subject to liability to any of the class of persons for whose benefit the duty is created and for their pecuniary losses suffered in any of the general type of transactions in which they are intended to be protected.

With the prevalence of the Restatement view, the oft-cited rule of Ultramares Corp. v. Touche has been weakened. In Ultramares, Judge B. Cardozo refused to hold accountants liable to third persons who relied upon financial statements prepared by the defendants when the defendants had prepared the statements primarily for the benefit of their client and only incidentally for the benefit of third persons. Only if the malpractice amounted to fraud would the accountants be liable to third parties. However, in the case of simple negligence no liability would attach because the prospective liability was too great.

While Ohio still seems to follow the view in Ultramares, the trend,
as noted earlier is contrary. With this trend in mind, it could be argued that when the superintendent of building and loan associations, in the performance of his official duties, negligently certifies a building and loan as being in good standing, he becomes subject to liability to any shareholder or depositor who suffered pecuniary losses in reliance on that representation.

The key language in section 552(3) states that the negligent misstater is liable only to a group of people he intends to reach or knows that the recipient (the examined building and loan) intends to reach. Therefore, since the superintendent has an absolute duty to see that the laws relating to building and loan associations are executed and enforced, he is liable to the building and loan association and its depositors and shareholders when he allows a building and loan association to operate in contravention of the statutory regulations.

E. Conclusion

In Illinois and Arizona where the state was held liable for negligent supervision of a savings and loan association, the courts looked to the statutory framework. In doing so, the courts found that the duties prescribed by the statutes were of an enforcement nature and very specific. Furthermore, the courts noted that the purpose of the legislation was to protect the individual depositors of the associations.

The statutory scheme in Ohio is very similar to the statutes in Illinois and Arizona. The case law in Ohio, however, dictates that a duty prescribed by statute is owed only to the public-at-large and not to the individual depositor or shareholder. This type of thinking not only renders the regulations in Ohio's scheme for its building and loans meaningless, but also serves to destroy the people's confidence in the state's supervisory ability.

The Restatement views, therefore, become necessary alternatives for recovery against the state, despite the fact that they seldom have been recognized in Ohio as a means of recovery.

The possibility that the state might become an insurer and its coffers may become accessible for every negligent act by the sovereign or one of its agents is not a well founded reason for protecting the state. To allow the shareholders and depositors of Ohio's building and loan associations to bear the losses effectuated by the state's negligence would be to render the statutes meaningless.

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