FEDERAL RESERVE BOARD

WASHINGTON

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X-3603

January 2, 1923.

SUBJECT: Administration of the Clayton Act.

Dear Sir:

In the Fall of 1920, when it contemplated reviewing the Clayton Act situation, the Federal Reserve Board addressed a letter to each Federal Reserve Agent, under date of November 22, 1920, requesting him to make a general survey of the situation in his district and to report to the Board all cases where there was a possibility that the banks involved in interlocking directorates covered by existing permits had come into substantial competition since the granting of such permits.

In order to provide a uniform basis for the proposed review of the Clayton Act situation, it was deemed advisable to suggest some sort of a test by which it might be determined whether or not any two banks were in substantial competition. After a thorough study of the entire subject had been made, the Board adopted the following statement, which was incorporated in the above mentioned letter:

> "In the opinion of the Board, if two banks are generally engaged in the same character of business and are so situated as to appeal to the same customers or would-be customers, they must be deemed to be in substantial competition within the meaning of the Kern Amendment, regardless of whether or not it is probable or possible that an interlocking directorate between the banks would result in injury to the public by making credit less available, and regardless of the relation of the volume of business transacted by the banks to the total volume of the banking business transacted in that community."

That statement was not intended to be a rigid and inflexible definition of the term "substantial competition", however, and has not been applied literally by the Board in cases where it would lead to absurd results. Thus, where two banks were found to be generally engaged in the same class of business and to be so situated as to appeal to the same customers or

would-be customers, they were held not to be in substantial competition where it was also found that actual competition between them had been eliminated by common ownership of stock or where it was found that as a matter of fact they served different classes of customers. In such cases they might be deemed to be in theoretical or fanciful competition, but not in actual or substantial competition.

As you know, the proposed review of the Clayton Act situation was deferred, but the above statement of what the Board conceived to be the proper meaning of substantial competition has served as a guide to Federal Reserve Agents in making investigations and reports of cases where the Board's permission for interlocking directorates has been applied for.

The Board has recently reviewed this question again and has reached the conclusion that, while the above statement of the meaning of substantial competition is essentially correct in principle, it is not sufficiently capable of easy and uniform application to the widely varying facts which are inevitably encountered in the administration of the Clayton Act. The Board has accordingly adopted the following new statement of general principles for the guidance of the Federal Reserve Agents as well as the Board itself in determining whether banks are in substantial competition within the meaning of the Kern Amendment to the Clayton Act:

> "In general, two banks will be deemed to be in substantial competition if they actually compete for a considerable amount of business, i.e., if a considerable portion of the business of each is of the same character and in doing or seeking such business they actually compete for the same customers or prospective customers, regardless of whether or not it is probable or possible that an interlocking directorate between them would result in injury to the public by making credit less available. If the statements of two banks show that each has a considerable amount of the same class of deposits or loans and it appears from the evidence submitted that they are so located as to be in a position to serve the same customers conveniently, the Board will presume, in the absence of evidence to the contrary, that they are in substantial competition. This presumption may be rebutted, however, by any evidence showing that they are not actually competing for such business, e. g., that they actually serve different classes of customers, that the business in question is not actually sought by one bank but is merely incidental to its other business, or that competition has already been eliminated through common stock ownership. The existence of substantial competition, however, may be shown by evidence other than that described above."

This is not intended as a precise definition of the term "substantial competition" but merely as a broad statement of the general principles which will be observed by the Federal Reserve Board in determining whether banks are in substantial competition; and it must be remembered that, "Whether or not 'substantial competition' exists between banks controlled by the act involves investigation and consideration of matters of fact and the decision in each case must of necessity turn upon the particular facts affecting it".

As a result of its recent study of this subject, the Board has also decided to adopt a slightly different procedure in acting upon applications under the Kern Amendment. The present practice is to approve or refuse an application on the basis of the evidence originally submitted; and when an application is refused the Board notifies the applicant that his application has been refused but that it will grant him a re-hearing, if he so desires, at which he may submit additional evidence or arguments tending to show that the banks involved are not in substantial competition. This must seem to the applicant to be a rather arbitrary and harsh procedure. Furthermore, it commits the Board to a decision which it may have to reverse after considering additional arguments and evidence. It is obvious that most applicants do not realize exactly what they are trying to prove but feel that in filling out the forms they are merely complying with "governmental red tape", the result being that they frequently fail to submit very important evidence favorable to their applications. The Board recently adopted new forms of applications and statements which were designed to correct this situation to some extent; but it is believed that a slightly different procedure, by which the applicant would be advised of the deficiency in his arguments and evidence and would be given an opportunity to submit additional arguments and evidence before any final decision is made as to his application, would be helpful. The Board has decided, therefore, that whenever it appears from the evidence submitted with an application that the banks involved are in substantial competition it will, before taking final action on such application, address a letter to the applicant explaining the situation and inviting him to submit any additional facts or arguments tending to prove that the banks involved are not in substantial competition.

The Board believes, however, that much of this supplemental investigation can be avoided if Federal Reserve Agents will see to it that all applications are completely and intelligently filled out before being forwarded to the Board. You are requested, therefore, to scrutinize carefully all Clayton Act applications passing through your hands, to see that they are complete and in order, and in cases where it seems advisable, to

acquaint the applicant with the purpose and necessity of the application so that he will fill it out intelligently and in such detail as to inform the Board of all the facts in the case.

For your further confidential information, the Board has also had under consideration the question of what policy it should adopt as to revoking Clayton Act permits heretofore granted, particularly in cases where the banks involved have come into substantial competition since the time when permission was granted to serve them. With regard to this question, the Board is advised by Counsel that it is not required by law to revoke any such permits, but that the power to revoke them is discretionary. After careful study, the Board has decided not to revoke permits in cases where the interlocking directorates have resulted in the growth of competition between the banks involved. It is true that in such cases the Board has no power to permit additional common directors between the banks involved; but the Board does not feel that the apparent discrimination resulting from this lack of power is of sufficient gravity to warrant it in penalizing directors who have permitted their banks to come into substantial competition and have thus acted in harmony with the spirit and purpose of the law. The Board, however, is ready to consider the revocation of permits in cases where existing interlocking directorates have had the effect of lessening or stifling competition between banks which, but for the common directorate, would freely compete, and you are requested to report all such cases to the Board in full detail.

By order of the Federal Reserve Board.

Wm. W. Hoxton,
Secretary.

To all Federal Reserve Agents.