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COMMENT

BANK BRANCHING IN WASHINGTON: A NEED FOR REAPPRAISAL

A potentially stagnant and unresponsive commercial banking industry subsists in many areas of Washington State as a result of the combined effects of state statutory restrictions on bank branching and the enforcement of federal antitrust statutes. State law precludes a commercial bank from establishing a branch in a new geographic market outside of the city in which the bank is headquartered; the same bank alternatively seeking to expand into the new geographic market by merger with an already existing bank probably will be enjoined by federal action under section 7 of the Clayton Act. Hence, a

1. The importance of banks in economic development was noted in Comptroller of Currency, Banks and Community Progress 2-3 (1963): [T]here should also be an awareness of the important role which banks have to play in that future. . . . We have all heard the argument that the forces which lead to economic growth are certain to have their effects—and that banks will correspond to the needs as they appear, without any special public concern for the manner in which banks perform. This, we believe, is a mistaken view. Where banking facilities are inadequate, the forces of economic growth will not be fully realized. But more important, banks can assert a positive influence in exploring, fostering, supporting, and directing the economic development of a community or a nation. Where there is a failure to assert this positive influence, opportunities for economic development may long remain quiescent . . . . Unless adequate banking facilities are available at all points at which resources are needed to finance enterprise, economic development will be hampered or distorted. The greatest needs for banking facilities are precisely at the points at which prospective future growth is most promising.

Although the State of Washington has recently undergone some economic reversals, most indications are for statewide economic development in the near future. See generally State of Washington Department of Commerce and Economic Development, State of Washington Economic Review 1971 and Outlook for 1972 (1972). This predicted economic development further accentuates the need for a responsive commercial banking industry.


5. In 1971, complaints were filed by the Department of Justice under section 7 of the Clayton Act against three Washington banks seeking to expand geographically by merger. See note 55 and accompanying text infra.

The term "merger" as used in this Comment includes all transactions which bring enterprises that were previously independent under single control, whether the transaction takes the form of a statutory merger of one corporate entity into another, a consoli-
bank effectively is precluded from expanding geographically to meet the needs and demands of growing communities outside the city in which the bank has its principal place of business.\textsuperscript{6} Many communities, especially those distant from major metropolitan centers, consequently are left with one small bank in an essentially monopolistic position.\textsuperscript{7} Other communities may have more than one bank, but competition and available banking alternatives may be minimal.\textsuperscript{8} Thus, Washington is left in the anomalous position of having a demand for geographic expansion by commercial banks which cannot be met because of state and federal statutory constraints. This problem is different than the typical free branching/unit bank controversy\textsuperscript{9} because the underlying policy of the present statute to allow branching by merger is being frustrated by Justice Department antitrust enforcement. As a result, a reappraisal of Washington's bank branching policy is in order.

\textsuperscript{6} This has not been the case in the past. Several of the state's major banks have established branches in areas outside their headquarter county. \textit{See Federal Deposit Insurance Corp., Operating Banking Offices 571-82 (1972)} for a listing of cities and banking offices within those cities. This geographic expansion, however, was accomplished prior to active Justice Department intervention in the banking industry which began with \textit{United States v. Philadelphia Nat'l Bank}, 347 U.S. 321 (1963). \textit{See note 39 and accompanying text infra.}

\textsuperscript{7} \textit{See Federal Deposit Insurance Corp., Operating Banking Offices 571-82 (1972).}

\textsuperscript{8} \textit{See text accompanying note 80 infra.}

\textsuperscript{9} \textit{See generally Edwards, The Banking Competition Controversy}, reprinted in \textit{Administrator of National Banks, Studies in Banking Competition and the Banking Structure 303 (1966); Note, Present Banking Structure in Florida and Branch Banking, 20 U. Fla. L. Rev. 84 (1967); Comment, Branch Banking in Colorado—A Proposal for Reform, 48 Denver L.J. 575 (1972).}

The unit/branch banking controversy centers on the efficacy of each system. Unit banking states limit banks to one site; each bank is completely autonomous, possesses its own capital, and has its own board of directors. Bank branching allows multiple offices of the same bank. It should be pointed out that while Washington's laws are restrictive, they are far from the most restrictive in the United States. There are 15 states which allow unit banking only, although 10 of the 15 allow tellers' windows separate from the unit bank itself. These tellers' windows can accept deposits and exchange currency, but cannot make loans. The 10 are Arkansas, Florida, Illinois, Iowa, Kansas, Missouri, Montana, Nebraska, North Dakota and Oklahoma. The five with the most restrictive bank branching laws, those which allow only unit banks with no auxiliary offices, are Colorado, Minnesota, Texas, West Virginia and Wyoming.

Sixteen states have limited bank branching laws which restrict branch banking either on a county-wide, region-wide, or mileage basis. These states include Alabama, Georgia, Indiana, Kentucky, Louisiana, Massachusetts, Michigan, Mississippi, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, Tennessee, and Wisconsin.

Nineteen states allow state-wide branching either de novo or by merger. These include
Analyzing present bank branching policy and formulating a new policy are difficult because of the complex nature of the commercial banking industry. Obviously the state should work toward a banking structure which will maximize benefits for its citizens. In pursuing this goal, the state must work within a complex framework including existing state and federal regulation of commercial banking and current federal antitrust policies. In addition, the state must consider the impact of concentration in its commercial banking industry. Only after all these facets of commercial banking are considered can an effective branch banking policy be formulated.

I. THE GENERAL STRUCTURE OF COMMERCIAL BANKING

It is practical to limit discussion of bank branching to commercial banks. These banks include a wide variety of institutions which are chartered under either state or federal law, best identified as those banks which accept demand and time deposits from the public while providing numerous collateral services. Mutual savings banks, savings and loan associations, and many other institutions whose activities overlap some facets of commercial banking are not included in the classification.

Commercial banks play a dual role in the economy: they serve the financial and credit needs of individuals and business and they provide a circulating medium in the form of deposits. Combining these two...
functions in one institution has brought two basic philosophies into conflict. One concept, urging that financial and credit services should compete freely, logically implies that unsuccessful banks will fail in the market place.\textsuperscript{12} Countering this philosophy is concern that the circulating medium remain secure and viable, suggesting that those aspects of competition which might contribute to bank failure must be regulated.\textsuperscript{13} Throughout the history of commercial banking, this bifurcation in public policy has been reflected in extensive regulation of commercial banking coupled with demands for competition similar to those imposed on unregulated industries.\textsuperscript{14}

Regulation of commercial banking is complex and pervasive. Those national banks which are chartered by the federal government are supervised by the Comptroller of Currency; state chartered banks are supervised by state authorities. In addition, state banks which are members of the Federal Reserve System are supervised by the Federal Reserve Bank of their district, and insured state banks not members of the Federal Reserve System are supervised by the Federal Deposit Insurance Corporation. Banking regulation largely is geared to prevent destructive competition between banks and hence to preserve public confidence in a stable and viable banking system.\textsuperscript{15} All banks are prohibited from paying interest on demand deposits, and interest rates on time deposits are limited to a specified maximum.\textsuperscript{16} Price

\textsuperscript{12} THE AMERICAN BANKERS ASSOCIATION, THE COMMERCIAL BANKING INDUSTRY 52 (1962).
\textsuperscript{13} Id. See also Comptroller of Currency, A Statement of Policy, 102nd Annual Report, reprinted in ADMINISTRATOR OF NATIONAL BANKS, STUDIES IN BANKING COMPETITION AND THE BANKING STRUCTURE 401, 402 (1966), which summarizes reasons for regulatory intercession in banking.
\textsuperscript{14} Virtually every function of commercial banking is regulated by state and federal agencies. See generally WASH. REV. CODE tit. 30 (1961); U.S.C. tit. 12 (1945).
\textsuperscript{15} In contrast, see United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963), and United States v. Phillipsburg Nat'l Bank and Trust Co., 399 U.S. 350 (1970), which impose on commercial banking basically the same standard of competition that is imposed on unregulated industries.
\textsuperscript{16} Note, Federal Regulation of Bank Mergers: The Opposing Views of the Federal Banking Agencies and the Department of Justice, 75 HARV. L. REV. 756, 764 (1962).
Bank Branching in Washington

competition in the consumer and business loan market is limited by state usury laws which set the maximum interest rates and by the prime interest rate which usually represents the minimum rate available. The effect of these and other regulations is to limit the scope of price competition among commercial banks. Most competition is limited to interest rates for consumer and commercial loans and in the quality of the bank's products and services.

Banking stability and viability also is maintained by strict regulation of the number and distribution of commercial bank facilities. New banks cannot be established without a charter from the state or the federal government. Expansion of existing banking facilities by branching or merger also is closely controlled.

II. STATUTORY RESTRICTIONS ON BANK BRANCHING

Washington's bank branching policy is found in R.C.W. § 30.40.020 which prohibits de novo branching into any city or town, not the site of the branching bank's headquarters, which already has a banking facility. However, the statute does permit banks to expand into such cities and towns "by taking over or acquiring an existing

17. The American Bankers Association, The Commercial Banking Industry 54 (1962). On competition for loans, the author notes:

The very character of bank lending explains why so much emphasis is placed on quality competition in bank lending. At first glance, bank credit may seem to be the most homogenous of commodities. Actually, though, no two prospective borrowers offer the bank quite the same package of credit quality and other assurances of repayment, and of compensating balances and other commensurate advantages of making the loan. Thus each customer loan, and especially each business loan, a separately negotiated transaction, is a custom made product with its own special costs and must be separately priced.

Id. at 53.

18. Id. at 53.


A bank or trust company having a paid-in capital of not less than $500,000 may, with the approval of the supervisor, establish and operate branches in any city or town within the state. A bank or trust company having a paid-in capital of not less than $200,000 may, with the approval of the supervisor, establish and operate branches within the limits of the county in which its principal place of business is located. The supervisor's approval shall be conditioned on a finding that the resources in the neighborhood of the proposed location and in the surrounding county offer a reasonable promise of adequate support for the proposed branch and that the proposed branch is not being formed for other than the legitimate objects covered by this title.

The aggregate paid-in capital stock of every bank or trust company operating branches shall at no time be less than the aggregate of the minimum capital required by law for the establishment of any number of banks or trust companies in
bank, trust company or national banking association operating in such a city or town." Thus, while a bank cannot expand by branching into another city which has an existing bank, it can merge with the existing bank and thereby acquire the monopolistic position of its predecessor. This ability to expand by merger, however, may be precluded by application of either federal bank merger statutes or antitrust laws.

There are several theories which explain the policy underlying Washington’s restrictions on bank branching. The major historical justification was to prevent another rash of bank failures similar to those subsequent to the crash of 1929 on the assumption that "overbanking" and excessive competition caused the failure of many banks after the crash. Restrictive bank branching laws placed limitations on larger banks and prevented them from overexpansion. A second reason for the restrictions, and perhaps the major current impetus against liberalization of bank branching laws, is the fear that small, local banks cannot withstand increased competition from larger institutions. Advocates of this position believe small banks should continue

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20. *Id.*

21. This would have been the situation in the attempted merger of Old National Bank and the Bank of Oroville, which was the only bank in Oroville. The closest competitor, Old National Bank itself, was in Tonasket, 17 miles away. *See* Complaint, United States v. Washington Bancshares, Inc., Old Nat'l Bank of Washington and Oroville State Bank, Civil No. 3505 (E.D. Wash. filed May 25, 1971) at 5.

22. *See* notes 34-66 and accompanying text *infra.*

23. The fall of the stock market in October of 1929 set off a chain reaction of bank failures throughout the United States. The result of this chain reaction was the failure of some 5000 banks with an additional 1200 being absorbed by stronger banks. Due to these numerous bank failures, many governors declared bank holidays in their respective states. When Roosevelt took office in 1933, one of his first acts was to declare a National Banking Holiday. After the holiday only the stronger banks were allowed to open their doors for business. *See* J. Cochran, *Money, Banking, and the Economy*, 67 (1967).

24. 135 AMERICAN BANKER 4 (June 4, 1970). This justification no longer seems so cogent in view of the controls placed on banking operations by appropriate state and federal agencies. *See* notes 15-17 and accompanying text *supra.*
Bank Branching in Washington

to have an important place in the nation's financial structure, arguing that the collapse of small banks increases concentration in state banking which, in turn, precipitates additional adverse consequences.

There are two additional theories justifying limitations on bank branching. First, de novo branching probably would significantly reduce the value of local banks, whose value is preserved and probably enhanced by the restriction of bank expansion. Because the local bank is often in the enviable position of having little or no competition, restrictive statutes guarantee the option to sell out to another bank at a substantial premium. Second, the restrictive branching laws benefit acquiring banks seeking to enter local markets. Being legally required to expand by merger allows the expanding bank to avoid the initial entry costs of establishing a branch; the expanding bank also reaps the benefits of established customers and good will: Further, expansion by merger is less likely to cut into profit margins than is expansion by branching, as the merging bank does not have to compete with an already established local bank.

25. E. Kohn, The Future of Small Banks 3 (1966). This was especially appropriate in the state of Washington in the late thirties and forties when the legislature was controlled by the rural areas of the state. One can imagine how an eastern Washington legislator felt about having the banking activities in his district controlled by a bank based in Seattle, whose directors knew little about such rural communities. Such understandably adverse feelings probably constituted one of the reasons for Wash. Rev. Code § 30.40.020 (Supp. 1972).

The countervailing argument is highlighted by E. Kohn, The Future of Small Banks 3 (1966):

On the other hand, those favoring some liberalization of branching laws have raised the question as to whether it is in the public's interest to provide small banks special protection if they cannot provide the kinds of banking services the public needs and wants, at competitive prices.


27. Some have argued that in a town where there are very few banks, the addition of one more bank does not significantly affect the price of money or the services offered, because in such a community interdependence among the banks is great. Thus, in a two-or-three-bank town "it seems reasonable to believe that mutually advantageous agreements, implicit or explicit are prevalent," especially where price is concerned. Id. at 833.

However, there are current indications that when larger banks have branched into new suburban areas where relatively small or consumer-oriented banks are already established, these larger banks have reduced their prices on consumer installment credit in order to compete. Such a reduction in price probably is reflected in the profit margin. E. Kohn, Branch Banking, Bank Mergers and the Public Interest (1964).
The importance of rigid state restrictions on bank branching is magnified by the fact that the limitations are binding on both state-chartered commercial banks and national banks. Although the Comptroller of Currency once contended that state law only applies to national banks in matters of capitalization and bank location requirements, the Supreme Court recently concluded, after reviewing the legislative history of the National Banking Act, that Congress intended "to place national and state banks on a basis of competitive equality insofar as branch banking was concerned." In order to deprive national banks of an unfair competitive advantage over state banks, national banks must be subject to all the rights and limitations which state laws place on branching by state banks. This view has been applied subsequently by several lower courts.

III. FEDERAL REGULATION OF BANK MERGERS

Washington's restrictions on bank branching invite commercial banks to expand geographically by merger. This, in turn, subjects the mergers to regulation under the provisions of the Bank Merger Acts of 1960 and 1966, and ultimately invites violation of section 7 of the Clayton Act.

32. Id. at 261.
33. Citing Walker as controlling, the court in First-Citizens Bank & Trust Co. v. Camp, 409 F.2d 1086 (4th Cir. 1969), found that the comptroller not only must consider the capitalization and state location requirements (which the comptroller contended were the only requirements that he was bound to follow), but he also must consider the needs and convenience criteria which state law imposes on the branch approving authorities. The court, however, implied that if these criteria are not specifically defined, then the comptroller may interpret these standards in the way he sees fit. Id. at 1091. The court in Clermont Nat'l Bank v. Citizensbank Nat'l Ass'n, 329 F. Supp. 1331 (S.D. Ohio 1971) agreed with the Fourth Circuit's conclusion in First-Citizens when it stated that "all of the tests and standards provided by state law must be regarded by and are applicable to the comptroller in any decision of his on whether or not to authorize a branch to a national bank." Id. at 1335. By expressing its conclusion in such language, the Ohio court seems to have inferred that if state law provides standards or requirements that must be applied before a branch for a state bank can be approved, national banks also are subject to such standards or requirements.
35. 15 U.S.C. § 18 (1970). Section 7 of the Bank Merger Act of 1966 requires the courts to apply the standards of section 5 of the Act in all judicial proceedings chal-
The foundation of federal policy toward banking competition is found in the Bank Merger Acts. The 1960 Act signaled a congressional reaction to the large number of bank mergers which had caused increased concentration in the banking industry during the late 1950's. Congress also wanted to dispel the notion that bank mergers were exempt from the antitrust laws. Under the 1960 Act, the appropriate bank supervisory agency must consider the following factors in deciding whether to approve a proposed merger: (1) the financial history and conditions of each of the banks involved; (2) the adequacy of their capital structures and their prospects of future earnings; (3) the general character of their management; (4) the convenience and needs of the community to be served; and (5) the effect of the merger on competition. The effect on competition was only one of several relevant factors considered and was determined largely through the non-controlling, advisory opinion of the Attorney General.

The 1960 Act did not settle the dispute between the Justice Department and the banking regulatory bodies over who should control the approval of bank mergers. In its 1963 decision, United States v. Philadelphia National Bank, the Supreme Court held that a bank merger between two metropolitan banks violated section 7 of the Clayton Act, even though the merger was consummated pursuant to the Comptroller's approval under the Bank Merger Act of 1960. This decision, plus greater concentration in the banking industry resulting
from the approval of nearly 800 mergers between 1960 and 1965, prompted enactment of the Bank Merger Act of 1966.40 Focusing on the effects of a merger on competition, the 1966 Act essentially combined the 1960 Act and the antitrust laws.41 A merger having “substantial” anticompetitive effects cannot be approved unless “public interest” benefits “clearly outweigh” the anticompetitive effects.42 The 1966 Act placed bank mergers under intense scrutiny by requiring the responsible agency to obtain opinions on the efficacy of the proposed merger from the other banking agencies and from the Department of Justice before making any decision.43 It also gave the Department of Justice the prerogative of enjoining consummation of such mergers if the Attorney General felt the anticompetitive effects of the merger outweighed the 1966 Act’s public interest, convenience, and needs exception to section 7 of the Clayton Act.44

Despite efforts of Congress through the Bank Merger Acts to settle the power struggle between the Comptroller of Currency, other bank regulatory agencies and the Department of Justice, the Justice Department continues to expand the trend set in Philadelphia National Bank, actively opposing many bank mergers. Between the enactment of the Bank Merger Act of 1966 and July, 1972, over 45 bank merger complaints were filed by the Justice Department. Possessing the power to stay bank mergers by filing a complaint within thirty days after the Comptroller’s approval, the Justice Department has the final say on mergers even marginally anticompetitive. In most cases where merger has been stayed as the result of Justice Department intervention, the merging banks have elected to terminate merger plans rather than litigate.45

Justice Department opposition to many bank mergers is designed to counter trends toward increased concentration of the banking industry

42. Id. § 1828(c)(5)(B).
43. Id. § 1828(c)(4).
44. Id. § 1828(c)(7)(A).
in both local and statewide markets. The Court in the 1963 *Philadelphia National Bank* case adopted similar reasoning, holding that any bank merger which caused increased concentration in the relevant market was likely to lessen competition and thus should be enjoined unless it could be shown that the merger would have no anticompetitive effects.

The first Supreme Court decision under the Bank Merger Act of 1966 was *United States v. Third National Bank*. The Court indicated that a merger resulting in a bank with 38.4 percent of the total assets within the relevant market was unlawful because it resulted in a bank which controlled an "undue percentage share of the relevant market," causing a "significant increase" in concentration in the relevant market. The Court construed the "convenience and needs" exception of the 1966 Act as follows:

If a merger posed a choice between preserving competition and satisfying the requirements of convenience and need, the injury and benefit were to be weighed and the decision was to rest on which alternative better served the public interest.

The Court went on to hold that in order for the "convenience and needs" exception to apply, the defendants must have received sub-

46. Donald I. Baker, Director of Policy and Planning for the Antitrust Division, United States Department of Justice, expressed the Justice Department's position when he stated:

Bank mergers have been subject to active antitrust enforcement. The Department of Justice has brought about forty bank cases since the Philadelphia decision in 1963, and over half of these have been within the last three years. The great majority of these cases involve so-called "horizontal" mergers between direct competitors in the same community or market area. Antitrust enforcement against such local bank mergers has rested on two economic goals: to prevent elimination of significant and viable competitive alternatives, and to preserve the opportunities for new entry. . . .

In addition, the Department has a more general goal in our merger program—to prevent the largest banks in a state from attaining a position of overwhelming statewide dominance by systematic acquisition of the leading banks in the local markets.


47. 374 U.S. 321 (1963). This is the leading case on bank mergers. The Court held that bank mergers are subject to section 7 of the Clayton Act and established standards for judging legality of bank mergers under section 7. See note 39 and accompanying text supra.


49. *Id.* at 185 (emphasis added).
stantial benefits which could not be obtained under an alternative method. 50

United States v. Phillipsburg National Bank and Trust Co. 51 is the latest case decided by the Supreme Court under the Bank Merger Act of 1966. Phillipsburg extended the Philadelphia National Bank doctrine to small banks by subjecting the merger of two small banks in a small community to the stringent antitrust standards of section 7 of the Clayton Act, as modified by the public interest exception of the 1966 Bank Merger Act. 52

These cases demonstrate that bank mergers will continue to be subject to stringent enforcement of section 7 of the Clayton Act and that the "public interest" exception of the 1966 Bank Merger Act has not changed matters significantly. 53 In addition, these cases have encouraged greater Justice Department scrutiny of bank mergers—a development which has a direct effect on Washington's bank branching policy of encouraging geographic expansion by merger.

During 1971 the United States Department of Justice through its Antitrust Division filed three complaints against Washington State

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52. Phillipsburg involved the proposed merger of two Phillipsburg banks. The merger was approved pursuant to the Bank Merger Act by the Comptroller over the adverse advisory opinions of the Federal Reserve Board, the FDIC, and the Attorney General. The Court found the relevant geographic market to be Phillipsburg-Eaton, with a population of 88,500 in 1967. The market was served by seven banks with 16 locations. These banks were relatively small banks with 1967 assets ranging from $13,200,000 to $75,600,000. The banks involved were the third and fifth largest in the market, and the resulting bank would have been second in size among the six remaining commercial banks. The Court found the merger violated section 7 of the Clayton Act, remanding for further findings under the "public interest" exception of the Bank Merger Act. For comment on the standards utilized in Phillipsburg, see Note, United States v. Phillipsburg National Bank: A Consideration of Commercial Banking as the Relevant Line of Commerce in Small Bank Situations, 46 Indiana L.J. 348 (1971).
53. Edwards, Bank Merger and the Public Interest: A Legal and Economic Analysis of the 1966 Bank Merger Act, 85 Banking L.J. 753, 795-96 (1968), summarizes the effect of the public interest exception as follows: The Supreme Court's recent interpretation of the 1966 Bank Merger Act... leads to the conclusion that the Act has made no practical substantive changes in the law applicable to bank mergers. The legal standard is still that of Section 7 of the Clayton Act, just as it was prior to the 1966 Act. Upon close analysis neither the convenience and needs defenses nor the floundering bank defense prove to be supportable in cases where the merger violates the standards of Section 7... It may not be an exaggeration, therefore, to say that all the 1966 Act accomplished was to end the controversy over which law should be applied to bank mergers by making the Clayton Act and the Bank Merger Act one and the same.
banks attempting to merge. Each complaint alleged that the proposed merger was a violation of section 7 of the Clayton Act because each merger would cause a lessening of competition within the local areas affected by the merger, thereby contributing to the already high concentration of banking operations in the State of Washington.

In its application to the Comptroller of the Currency for approval of its merger with First National Bank of Ferndale, Seattle-First National Bank contended that because of state law, merger was the only way it could obtain a branch in the Ferndale area. Despite the obstacles that Washington State law may present to branching, the Department of Justice apparently is determined that some degree of competition shall remain in Washington’s banking industry. Therefore, any mergers involving the larger banks in the state probably will be opposed by the Justice Department.

54. United States v. Washington Bancshares Inc., Old Nat'l Bank of Washington and Oroville State Bank, Civil No. 3505 (E.D. Wash. filed May 25, 1971); United States v. Marine Bank Inc., Nat'l Bank of Commerce and Washington Trust Bank, Civil No. 237-7102 (W.D. Wash., filed Oct. 22, 1971); United States v. Seattle-First Nat'l Bank and First Nat'l Bank of Ferndale, Civil No. 313-7102 (W.D. Wash., filed Nov. 24, 1971). In 1971 two mergers were allowed to be consummated in the state of Washington. Puget Sound National Bank merged with National Bank of Mason County and Peoples National Bank merged with the Bank of Vancouver. Puget Sound National Bank is not among the top five banks in the state and thus its merger with the National Bank of Mason County was probably not considered of sufficient impact on concentration to warrant action by the Justice Department. The Bank of Vancouver was closely related with Peoples National Bank from its inception which is probably why there was no objection to the merger.


56. At the present time in the state of Washington banking is highly concentrated. Seattle-First National Bank alone holds over 31% of all commercial bank deposits in the state. The two largest banks, Seattle-First National and National Bank of Commerce, hold about 53% of the commercial deposits, and the five major banks in the state in combination hold over 75% of all commercial bank deposits. Of the 658 commercial banking offices in the state, 140 are banking offices of Seattle-First National Bank, 101 are offices of National Bank of Commerce, 61 are offices of Pacific National Bank, 52 are offices of Peoples National Bank, and 44 are offices of Old National Bank of Washington. This means that as of May 1971, 398 of the 658 commercial banking offices were run by the top five banks in the state. In other words, approximately 60% of all commercial banking offices are controlled by the top five national banks in the state, which means that the remaining 89 state and national banks in the state only account for 40% of the banking offices in the state. See Washington Supervisor of Banking, Sixty-Fifth Annual Report for the Year 1971 29-40 (1972); Comptroller of the Currency, Annual Report 1970, at 6 (1971); Application of Seattle-First National Bank to Purchase Assets of First National Bank of Ferndale, to Comptroller of the Currency, May 1971, at 118. If mergers such as the one between National Bank of Commerce, the second largest bank in the state, and Washington Trust Bank, the sixth largest, are approved, banking in the state would become even more concentrated.


58. See note 46 supra.
Opposition to bank mergers by the Justice Department, reinforced by the Supreme Court in the *Philadelphia National Bank, Third National Bank,* and *Phillipsburg* cases, is based on the effects of high concentration on pricing in the banking industry. Studies have shown that high market concentration in the banking industry often is associated with higher interest rates charged on loans, lower interest paid on time deposits, higher service charges on demand deposits, and lower ratios of loans to assets and time deposits to total deposits.59 One study showed that a ten percent increase in concentration "results on the average, in a decrease of approximately six basis points in the average interest rate which banks pay on time and savings deposits, and an increase of ten basis points in the average interest rate they charge on loans."60 Thus one might conclude that high concentration of banking tends to hurt the consumer, justifying the Court's strong position on preventing mergers in a highly concentrated market.

High concentration not only results in higher loan rates and lower savings interest rates, but also tends to have a dampening effect on possible development of competitive pricing.61 Merger, the instrument most often used to achieve high concentration, prevents price competition by eliminating competitors. Thus, mergers are highly attractive to a banking industry understandably eager to avoid price competition.62 Banks know that because of the small number of competitors, if one bank in the community drops its prices, the others usually will have to follow. Rarely have banks participated in price wars, and if price wars did take place, they would be extremely costly to the banks involved.63

One argument advanced in defense of merger and concentration is that mergers result in banks better able to provide larger loan limits and more specialized products, such as trust services and credit cards.64

The Court in *United States v. Phillipsburg National Bank*65 recog-
Bank Branching in Washington

nized that such advantages often do result from a merger, but indicated the "convenience and needs" exception of the 1966 Bank Merger Act will be very narrowly construed.66 The Court stated that the merger would not be approved if there are alternative methods for serving the needs of the relevant market; there must also be general benefit rather than benefit only for "those interested in large loan and trust services."67

IV. PRESENT ALTERNATIVES FOR SATISFYING BANKING NEEDS

Since de novo branching is foreclosed to Washington banks and merger in many instances will be opposed by the Justice Department because of potential anticompetitive effects, Washington banks and communities in need of additional banking facilities must look to other alternatives for geographic expansion.

One alternative is for an existing bank to acquire a branch of another bank which is located in the desired banking market. While the Department of Justice would oppose acquisition of a large or leading bank in such a market, it probably would not object to one major bank acquiring a branch of another.68 Although such an acquisition appears to be a permissible alternative under R.C.W. § 30.40.020, it does have serious drawbacks. In two of the three cases filed in Washington during 1971 by the Justice Department, the bank to be ac-

66. Id. at 372.
67. The fact that lending limits have been increased is actually not very beneficial even to the larger customers. According to David A. Alhadeff, Professor of Business Administration at the University of California, larger customers of banks tend to be more mobile than the average customer. This mobility gives them the opportunity to seek loans throughout the state or nation. Thus:

[1]f the only effect of the enhanced lending limits were to enhance the merging bank's ability to compete for the business of the most mobile . . . borrowers, the private gain would be greater than the social gain. The reason of course, is that the borrowers who are the intended beneficiaries of the merger already enjoy access to bank credit on reasonably competitive terms and one more supplier would not benefit them significantly any more than one less supplier would significantly undermine their position.

INSTITUTE OF BUSINESS AND ECONOMIC RESEARCH, CALIFORNIA BANKING AND COMPETITION 182 (1956).

68. This assumption is predicated on the fact that the branch being acquired does not have assets of such a quantity that the concentration level in the state would be significantly affected, nor would it leave the acquiring bank in a monopolistic position within the local market involved. As of July 1972, the Justice Department has not opposed the acquisition of the branch of another bank.
quired had no branches. In addition, any bank large enough to have branches probably will not be interested in selling one of its branches if the sale causes increased competition in the geographic market of the selling branch's other facilities. Thus, unless a bank can find another bank which has a branch that continues to lose money, this alternative may not be feasible. Further, a bank will hesitate to sell its branch knowing that present state and federal law may prevent it from reentering the market in which the branch is located at some later date. Finally, although this alternative may be helpful to a bank seeking to expand its operation, it is of absolutely no assistance to a community in need of additional banking alternatives.

Utilizing a second technique already successfully implemented by Peoples National Bank in the Vancouver, Washington area, a bank assists in the formation of a new national bank and then after a sufficient period of time merges with the new bank. Washington law requires ten years to elapse after the formation of a new bank before merger can take place, although exceptions are granted. In 1965 the Bank of Vancouver was chartered as a national bank under the sponsorship of Peoples National Bank. In 1971, after the Bank of Vancouver had been in existence for six years with the continuous assistance of Peoples National Bank, the two banks merged and the Bank of Vancouver became a branch of Peoples National Bank. Although this alternative was successful for Peoples National Bank, it has some definite limitations. R.C.W. § 30.04.230 restricts ownership of a bank by a corporation to 25 percent of the bank's capital stock. Thus, any

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69. In United States v. Seattle-First Nat'l Bank and First Nat'l Bank of Ferndale, supra note 54, the First National Bank of Ferndale had no branches, and in United States v. Washington and Oroville State Bank, supra note 54, the Oroville State Bank had no branches.

70. It is also unlikely that an acquiring bank will buy a branch that is failing unless the acquiring bank can determine that failure is due to poor management rather than an insufficient number of accounts.

71. WASH. REV. CODE § 30.08.020(7) (Supp. 1972). An exception was granted in allowing Old National Bank of Spokane, Washington to merge with North West Bank of Seattle in 1970. Old National was Washington's fifth largest bank and North West Bank had only been in business for seven years. While business was not good in the beginning, North West Bank seemed to be holding its own at the time of the merger. See Decision of the Office of the Comptroller of the Currency on the Application of Old National Bank of Washington, Aug. 12, 1970.


73. WASH. REV. CODE § 30.04.230 provides in part:

A corporation or association organized under the laws of this state, or licensed
Bank Branching in Washington

A bank wishing to create a new national bank with the intent of later merging with that bank must arrange to have other cooperative participants involved in the formation of the new bank. Since the established bank would not have control of the new bank, it would have to rely on the good faith of the other participants when it came time to recommend merger. In addition, the established bank may face opposition from the state when it requests approval of the merger from the Comptroller. The state or a competitor may seek to enjoin the merger on the ground that the established bank is attempting to circumvent the state's bank branching laws by the use of this technique; the Justice Department may also challenge the merger under section 7 of the Clayton Act. Finally, the amount of time that may elapse between the time of creation and the time of merger may discourage use of this device. Nevertheless, if the established bank can obtain the cooperation of the other participants and survive possible legal action by the state or a competitor, and if it complies with all the requirements of the National Banking Act in the formation of the new bank, the est-

to transact business in the state, shall not hereafter acquire any shares of stock of any bank, trust company or national banking association which, in the aggregate, enable it to own, hold or control more than twenty-five percent of the capital stock of such bank, trust company or national association.

74. In Camden Trust Co. v. Gidney, 301 F.2d 521 (D.C. Cir. 1962), an action was brought by Camden Trust to stop the Comptroller from approving the establishment of a new national bank within Camden Trust's local market area. Camden argued that the Comptroller could not approve creation of such a bank because it was formed to circumvent state law and thus was created for illegal purposes. Haddonfield National Bank had attempted earlier to establish a branch in the town in which Camden Trust was located, but the Comptroller had disapproved the application on the basis that New Jersey law would not permit the establishment of a branch in a town where there was already an established bank. After this rejection, some of the directors of Haddonfield National Bank together with some of the original stockholders of Haddonfield National applied to the Comptroller to open a new bank in the town where Camden Trust was located. Camden brought suit, arguing that the new bank was just a branch of the Haddonfield National Bank and that the new bank was being formed for other than the legitimate purposes covered by the National Banking Act. The court of appeals rejected this argument by pointing out that the old bank and the new were separate corporate entities with separate corporate structures, had different names, maintained separate locations, had independently determined loan limits and limits of indebtedness, and were not liable for each other's deposit obligations. The court added that:

It is not within our province to pass upon the desirability vel non of permitting a national bank to have an affiliate, as the appellant has used the term. If such an affiliate is to be denied status, Congress must clearly say so. It is sufficient for our disposition of the present controversy to observe that what was done was within the authority conferred by the existing statutes.

Id. at 525.

tablished bank will have created a branch in a market area it desires to enter.

A third alternative for a community in need of additional banking facilities is to rely upon the chartering of new banks. However, state and federal regulations establish high barriers to entry and limit the possibility of newly chartered banks satisfying the banking needs of the state. Federal banking authorities consider the following factors before authorizing a new national bank charter or deposit insurance for a state bank: The financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served by the bank, and whether or not its corporate powers are consistent with the purposes of this section.

These stringent standards apply to all new banks since virtually all banks use deposit insurance. In 1969 and 1970, only one out of five Washington applications for national bank charters was accepted by the Comptroller of Currency.

The deficiencies of these various alternatives prevent them from becoming viable solutions to the general problem of maximizing benefits from the state's commercial banking industry. A better solution to the problem would be to allow statewide de novo branching.

V. WHY DE NOVO BRANCHING?

Establishment of de novo bank branching in Washington would provide the benefits of modern commercial banking to the entire state and generally increase competition at local levels. Since the justifications for present restrictions on de novo branching have been shown to be invalid in most instances, they should no longer be used as an excuse to preserve the status quo in statewide commercial banking.

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76. WASH. REV. CODE § 30.08.010 (Supp. 1972) establishes paid-in capital requirements for bank incorporations; WASH. REV. CODE § 30.08.030 (1961) requires the supervisor to inquire into the character of the persons incorporating the bank and whether the community will support the proposed bank.


The introduction of de novo branching on a statewide basis might give the statewide consumer added financial services not presently available to him. Services such as bank credit cards, specialized checking accounts, and twenty-four hour check cashing facilities could be made available to most residents of Washington and not just those who live in the large urban areas of the state. Also, local banks which presently have either monopoly power or are part of a tight oligopoly in the local banking market will make a much more concerted effort to provide the intensive personal attention which large branch banking operations find difficult to provide.\textsuperscript{79}

Should de novo branching be allowed, one definite benefit that the average banking customer would gain would be an increase in the number of banking alternatives available to him. Presently, the average banking customer can do his banking only with those banks which are headquartered in the city where he lives, which have merged with a bank headquartered in his city, or which were fortunate enough to open operations in his city before any other bank commenced operations. De novo branching would allow any bank chartered within the State of Washington to do business in any city or town within the state. Thus more banks would move into geographic markets which at the present time offer customers few banking alternatives. For example, Spokane, which presently has a population of approximately 170,000, offers its residents six commercial banking alternatives. In California, where de novo branching is allowed on a statewide basis,\textsuperscript{80} Fresno, which has approximately 166,000 people, has nine banking alternatives available to its residents; Bakersfield, which has less than half the population of Spokane, also has nine

\textsuperscript{79} Motter, Bank Formation and the Public Interest, reprinted in ADMINISTRATOR OF NATIONAL BANKS, STUDIES IN BANKING COMPETITION AND THE BANKING STRUCTURE 233 (1966), demonstrates the competitive effects of entry of banks in markets previously served by one bank by reproducing statements of the officers of new banks. For example:

Case 1. Loans used to be granted on the basis of whether the old bank wanted to bother with them or not. Practically no consumer loans or farm machinery loans were made. It appears that the other bank is now enthusiastically striving to serve the borrowing needs of worthwhile customers. It is making small loans and we believe they are making some machinery loans. . . . [T]here has been a change in the spirit in which those services are made available. Prior to the granting of our charter, the existing bank made little effort to support community activities. We find they now enthusiastically participate and the business climate of the community is improving because of it.

\textit{Id.} at 280.

\textsuperscript{80} CAL. FIN. CODE §§ 500-506 (West 1970).
banking alternatives available to its residents. Since Fresno and Bakersfield are quite similar to Spokane in economic base and geographic isolation from other large urban areas, some Washington banks not presently doing business in Spokane probably would find it just as desirable to open branches there as California banks not headquartered in Fresno or Bakersfield found those two cities when they decided to open branches there. With an increase in the number of competing banks, the average banking customer would have more sources to draw upon for his financial needs and might find a decrease in his banking costs.

In addition, the justifications for restrictions on bank branching no longer seem valid. Restrictions based on the rationale of preventing “overbanking” and bank failures cannot be supported in view of the rigid state and federal regulation of commercial banking. Deposit insurance plus the fact that new bank branches must meet standards similar to those set for the issuance of a new charter—including a finding that the community needs additional facilities—provide more than adequate protection against bank failure as the result of overbanking.

Preserving local banks still seems to be a worthy objective which need not be totally sacrificed by allowing de novo branching. If statewide de novo branching is allowed, certain weaknesses of the small bank will be exposed to the vagaries of competition. Small banks are normally less efficient than larger institutions, often charging higher loan rates and service charges, paying lower rates on time deposits, offering fewer services, or, alternatively, matching the prices and services of larger banks but paying the price with low profits. However, the small bank’s inefficiency often is more than offset by a large bank’s high costs of maintaining a branch system and providing numerous expensive services not normally employed at the local level. Moreover, because of their knowledge of the community, local banks often are more willing to make unsecured “character loans” to indi-

81. At the present time there is evidence that at least one major bank, National Bank of Commerce, wishes to branch into Spokane, but is foreclosed from doing so by WASH. REV. CODE § 30.40.020 (Supp. 1972) and the Justice Department.
82. See notes 15-18 and accompanying text supra.
84. Id. at 5-6.
85. Id. at 6.
Bank Branching in Washington

individuals and small businesses, and there is evidence that much of the public will not switch from small to large banks because of low prices and service differentials.

A second factor is that small banks do not have the resources, manpower or experience to match the advertising and solicitation programs of larger banks. Further, the downtown location advantage of the small local bank is being eroded by the advent of convenient shopping centers. However, the local banks long established personal and business contacts within the community, its knowledge of the community, and the preferences of many people for doing business with a locally "owned and managed institution" should "enable the small bank to hold its own in the competitive struggle."

In viewing the arguments for restricting bank branching to protect small banks, it is important to ask whether it is in the public interest to protect small banks if they cannot or do not provide the banking services that the public needs and wants at competitive prices. The state banking structure is not regulated to protect existing banks against competition. Rather, the regulations are designed to preserve public confidence in a viable banking industry. Beyond this, state policy should seek to maximize the benefits of commercial banking throughout the state.

Recent studies show that small banks exposed to branch competition generally have been able to compete with large bank branches. In view of this fact, Washington communities deserve the benefits of modern commercial banking services and a variety of banking alternatives. Since small banks have sufficient advantages to enable them to compete, they should be forced to do so.

If de novo bank branching is allowed, however, there invariably will be some local banks that will not be able to compete. This un-

86. Id. at 7.
87. Id. at 6. This factor was alluded to by the Supreme Court in United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 357 n.34 (1963), where the Court quoted from a witness' testimony that customers will keep their savings in commercial banks despite the fact that a savings and loan across the street pays significantly more on savings accounts.
89. Id. at 7.
90. Id. at 3.
doubtedly will lead to an increase in the already high level of concentration of banking in Washington.92 However, it is important to keep the disadvantages of concentration in perspective. In the first place, banking competition occurs largely at the local level.93 Thus, while de novo branching may increase statewide concentration, competition between large bank branches and local banks actually may be increased at the local level. Secondly, banking is a highly regulated industry in which avenues for direct competition are limited.94 Although there is some price competition, most direct competition between banks involves quality of services. This allows local banks to compete successfully because one of the inherent advantages of the local bank is its edge in providing personalized quality services.95

VI. A LEGISLATIVE PROPOSAL FOR DE NOVO BANK BRANCHING

Legislation providing for de novo branching should be designed to maximize the convenience and fulfill the needs of the average bank customer while preserving a high degree of competition among banks within the state. Drafting such legislation is difficult since in many cases the decision to allow branching will be determined by the singular characteristics of the local market. However, included in the legislation should be guidelines which limit subjective decision making and insure the objectivity of the approving authority. The legislature also should remember that state bank branching restrictions will be binding on national banks.96 Thus any legislation which controls concentration and regulates the anticompetitive effects of de novo branching will apply to all banks within the state. The following is a suggestion as to the form and content of such legislation.

92. See note 56 supra. In California, where state law provides for de novo branching, the largest bank in the state has 43.9% of the total deposits, and the top five banks have over 80% of the state's deposits. California State Banking Department, Total Deposits, Total Assets, Total Capital and Number of Branches, California Insured Commercial Banks, Ranked in Order of Deposits, as of June 30, 1971 (1971).

93. Discussions on the relevant geographic market in Philadelphia Nat'l Bank and Phillipsburg Nat'l Bank specifically limited the market to the immediate metropolitan area.

94. See notes 13-17 and accompanying text supra.

95. See notes 86 and 87 and accompanying text supra.

96. See notes 29-33 and accompanying text supra.
I. BANK BRANCHING COMMISSION, CREATION:

A three man board shall be created and known as the Bank Branching Commission. Its membership shall be made up of the Supervisor of Banking, an assistant Washington State Attorney General, and a member from the private sector who shall be appointed by the Governor. The Commission shall have the power to approve branch offices upon application from a bank engaged in the business of banking within the state.

II. EXAMINATION OF APPLICATION:

The Bank Branching Commission may give or withhold its approval of an application in its discretion, but no application shall be approved by the approving authority until it has been ascertained that:

(a) The convenience and needs of the community to be served will be promoted by the establishment of the proposed branch office and
(1) That allowing a branch office will both (a) result in a high degree of competition among commercial banks in the local market and (b) will not unduly increase commercial banking concentration throughout the state.
(2) The approving authority shall also consider the needs of all bank customers and not limit itself merely to the advantages to be gained by the larger customers.
(b) The application shall not be approved unless the paid in capital of the branch meets the paid in capital requirements of this chapter.
(c) The application shall not be approved unless the approving authority is able to ascertain that there is adequate support for the bank branch office within the community in which expansion is contemplated.

III. DE NOVO BRANCHING, APPROVAL:

Upon approval by the approving authority the Supervisor of Banking shall authorize the creation of the branch applied for in the community requested. Operation of this branch shall be subject in the same manner as the principal banking office is to the Supervisor of Banking.
IV. TIME FOR OPENING OF BRANCH, EFFECT OF FAILURE TO OPEN, EXTENSION OF TIME:

The branch must be open and in operation within one year after authorization by the approving authority. Failure to open within one year's time automatically terminates the application's authorization. Extensions on the one year period will be granted upon a showing of inability to begin operation due to circumstances beyond the control of the applying bank.

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