

Winter 1976

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Recommended Citation

Kim R. Moore, *Banks and Banking--Bank Charters in Missouri--a New Approach*, 41 Mo. L. Rev. (1976)
Available at: <http://scholarship.law.missouri.edu/mlr/vol41/iss1/13>

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BANKS AND BANKING— BANK CHARTERS IN MISSOURI— A NEW APPROACH?

*Central Bank of Clayton v. State Banking Board of Missouri*¹

In October 1971, five officers of the Bank of St. Louis filed articles of agreement for the incorporation of a new bank with the Missouri Commissioner of Finance.² The bank was to be called the Central Bank of Clayton. In accordance with section 362.030, RSMo 1969,³ the Commissioner ordered an investigation to determine if the incorporators had complied with statutory requirements. After a two month investigation, the Commissioner issued a charter for the proposed bank, finding that "all the requirements of sections 362.020; 362.025; and 362.030 RSMo have been met." The Commissioner's decision was made without a contested hearing, although he did receive and include in the record letters of protest from existing Clayton banks.

An appeal to the State Banking Board was certified by the protesting Clayton banks, alleging that the convenience and needs of the community did not justify the granting of a new bank charter. The Board held a hearing on the appeal at which evidence relating to the "convenience and needs of the community to be served" by the new bank was taken. Three expert witnesses testified and two others submitted reports. The Board also received the report of the Commissioner's investigation. The Board revoked the charter, finding that the evidence did not sup-

1. 509 S.W.2d 175 (Mo. App., D. St. L. 1974).

2. The chartering procedure in Missouri is set out in sections 362.015-.040, RSMo 1969, and consists of five or more people filing articles of agreement to incorporate with the Commissioner of Finance. The Commissioner then conducts an investigation to determine if the statutory requirements of section 362.030 have been met. No hearing is required. If the Commissioner is satisfied that the requirements have been met, the charter is issued and recorded in the county or city in which the corporation is located.

3. This section provides in part:

1. When any bank or trust company has filed . . . its articles of agreement, paid all incorporation and other fees in full, as required by law, and provided the cash required by law, the commissioner . . . shall cause an examination to be made to ascertain whether the requisite capital of the bank or trust company has been subscribed in good faith and paid in actual cash and is ready for use in the transaction of business of the proposed bank or trust company, and whether the character, responsibility and general fitness of the persons named in the articles of agreement are such as to command confidence and warrant belief that the business of the proposed corporation will be conducted honestly and efficiently . . . and if the convenience and needs of the community to be served justify and warrant the opening of the bank or trust company therein, and if the probable volume of business in such locality is sufficient to insure and maintain the solvency of the new bank or trust company and the solvency of the then existing banks and trust companies in the locality, without endangering the safety of any bank. . . .

port a finding that the convenience and needs of the community would be served by granting the charter. The Board found that the applicant had failed to show a "public need" for the new bank or any complaints about, or inadequacy of, present banking services.

The Circuit Court of St. Louis County affirmed and held that this finding was supported by competent and substantial evidence on the record as a whole. Central Bank and the Commissioner appealed to the Missouri Court of Appeals for the St. Louis District. The court reversed the circuit court and the Banking Board as to the finding that "the convenience and needs of the community to be served" had not been met and reinstated the Commissioner's order.⁴

Banking has been a heavily regulated industry for many years. Bank regulation began a quarter of a century before insurance regulation and more than forty years before public utility regulation,⁵ but the regulation in the early stages was not as pervasive as today. The bank chartering process was originally the province of the legislature and all charters had to be approved by that body. A 1915 statute, which established requirements for opening branch banking offices, contained the first real statutory criteria for establishing banks or offices.⁶ In the same year, the State Banking Department was created and given some of the powers it has today. Before that year the chartering of state banks was increasing and the only ground upon which the state could decline to charter a bank when five incorporators filed an application was the dishonesty of the persons applying.⁷ Attempts to limit the granting of charters were generally unsuccessful during this period and some commentators have attributed that to a distrust by Missourians of any limitation which might permit a concentration of the money power in a few hands.⁸ In 1927 the chartering statute was amended, giving the Commissioner the authority to make an investigation to determine "if the probable volume of business in such location is sufficient to insure and maintain the solvency of the then existing bank or banks in such location, without endangering the safety of any bank in such locality as a place of deposit of public or private moneys. . . ."⁹

The key statutory requirement for chartering was added to section 362.030 by the Banking Act of 1941.¹⁰ The amendment required an examination into "the convenience and needs of the community." Almost all states have enacted similar provisions requiring proof of "public necessity,"

4. 509 S.W.2d at 194.

5. Davis, *Banking Regulation Today: A Banker's View*, 31 LAW & CONTEMP. PROB. 639 (1966).

6. Mo. Laws 1915, at 14, § 25.

7. See Mo. Laws 1915, at 129, § 59; State *ex rel.* Jones v. Cook, 174 Mo. 100, 73 S.W. 489 (1903).

8. F. HELM, BANKING DEVELOPMENTS IN MISSOURI 15 (1939).

9. Mo. Laws 1927, at 217, § 2.

10. Mo. Laws 1941, at 670, 674.

"public needs," "public demand," or that the "public convenience and advantage will be served" by the issuance of the charter.¹¹

The major goal and perhaps the entire justification for the rigid and pervasive regulation of banking is a sound and healthy banking system. This goal requires maximum profits, which are a function of the amount of business transacted. Generally, the greater the number of banking units in a given area, the less business each competitor will attract.¹² Therefore, unbridled competition is in some ways incompatible with a healthy banking system.¹³ Yet to the extent that competition is curbed by legislation, the consumer is forced to pay more for the services he receives.¹⁴ Normally, questions of entry and expansion are solely the choices of private entrepreneurs. However, in the banking industry, the final decision in this area has been assigned to regulatory agencies.¹⁵ Regulators are required to encourage competition while attempting to maintain a healthy and solvent banking system. This delicate balancing problem is the main issue confronted by the court in *Central Bank*.¹⁶

Cases interpreting statutes such as that in Missouri can be broadly divided into three categories of chartering policies. Although all the

11. See Note, *Bank Charter, Branching, Holding Company and Merger Laws: Competition Frustrated*, 71 YALE L.J. 502, 510-511 & nn. 72-88 (1962).

12. Generally "efficiency" is associated with competition. Under conditions of "perfect" competition profits are maximized at prices and levels of output which bring about an optimum allocation of resources. . . . Consequently, so the argument runs, the more "competitive" an industry, the more "efficient" it is.
Edwards, *The Banking Competition Controversy*, 3 NAT. BANK. REV. 1, 2 (1965).

13. Other considerations, however, make it difficult to choose between the objectives of "efficiency" and "soundness." For example, competition forces "inefficient" firms to leave the market because they cannot charge prices high enough to cover the costs. Under monopolistic conditions, high cost firms are afforded a certain degree of immunity from the forces of competition, which permits them to operate inefficiently and still survive. Thus a monopolistic industry is more compatible with the goal of maintaining a "failure-proof" banking system, while competition is more compatible with the goal of "efficiency."

Id.
14. See *Marshfield Community Bank v. State Banking Bd.*, 496 S.W.2d 17 (Mo. App., D. Spr. 1973). The court stated:

To that extent, then, public policy which encourages free competition runs counter to the public interest which requires its regulation in these cases, and some adjustments of priorities, some balancing of equities, must consequently be made. The question is: Where shall the line be drawn to avoid undue repression on the one hand and prevent unfair advantage on the other?

Id. at 29.
15. See generally Peltzman, *Bank Entry Regulation: Its Impact and Purpose*, 3 NAT. BANK. REV. 163, 174 (1965).

16. We must consider what value of (sic) Constitution and laws placed on competition, under what circumstances and for what reasons can competition be stifled by regulation for the public good, and what type of evidence will justify interference with competition by regulation for a good reason.

509 S.W.2d at 181.

statutes are similar,¹⁷ the difference in interpretation based upon the presumed intent of the legislature has led to wide variances in each of entry and expansion.

The first policy is an outgrowth of the bank failures of the 1930's. Few states escaped massive assaults on their banking laws after the experiences of that era. The result was a framework of laws that placed a premium on solvency and, more importantly, upon protecting the weaker banking units from excessive competition from stronger, and frequently larger, banks.¹⁸ The few states which continue to follow this theory recognize that the protection of existing units and their profits is the primary and overriding goal of regulation. The method used to achieve this goal is a chartering requirement of "absolute need." No new bank can be chartered without a showing that the existing banks can continue to thrive and that the proposed new bank can become solvent and prosper without drawing business from existing banks.¹⁹ This was the rule in many states until the advent of deposit insurance, increased supervision and regulation, and the passage of time helped to restore public confidence and faith in banking institutions.²⁰

The second policy is a result of this increased confidence in banking and the recognition that competition is necessary to achieve the most advantageous prices for consumers. Although recognizing that safety and solvency are important ingredients of the statutory scheme of banking regulation, this theory balances that goal against the increased efficiency to be gained by allowing additional competitive units in an area. This intermediate approach has been favored by many courts.²¹

The third policy falls somewhat short of the complete freedom of entry which appeared in the late 1830's as a result of the "free banking"

17. See Note, *Bank Charter, Branching, Holding Company and Merger Laws: Competition Frustrated*, 71 YALE L.J. 502 (1962).

18. See generally F. HELMS, *BANKING DEVELOPMENTS IN MISSOURI* (1939); Townsend, *History of Missouri Banking Legislation*, 18 V.A.M.S. 321, 360-67 (1949).

19. See *Schaake v. Dolley*, 85 Kan. 598, 118 P. 80 (1911):

An unnecessary bank in a community is not a thing of passive uselessness only, and so merely of no benefit. It is an active disturber of the financial peace, to the detriment of the public welfare, and it is not very material whether we say that public harm will be prevented or that public good will be promoted by its suppression.

Id. at 609, 118 P. at 85.

20. Davis, *supra* note 5, at 640.

21. See *Banking Bd. v. Turner Indus. Bank*, 437 P.2d 531 (Colo. 1968); *National Bank of Tampa v. Green*, 175 So. 2d 545 (Fla. 1965); *Moran v. Nelson*, 322 Mich. 230, 33 N.W.2d 772 (1948); *Britton & Koontz First Nat'l Bank v. Biglane*, 285 So. 2d 181 (Miss. 1973); *First Fed. Sav. and Loan Ass'n v. Dep't. of Banking of Neb.*, 188 Neb. 215, 196 N.W.2d 105 (1972); *Wall v. Fenner*, 76 S.D. 252, 76 N.W.2d 722 (1956); *Chimney Rock Nat'l Bank v. State Banking Bd.*, 376 S.W.2d 595 (Tex. Civ. App. 1964). Cf. *Goldy v. Henry*, 443 P.2d 994 (Colo. 1968) (charter denied after balancing the increased competition against the resultant effect on solvency of existing banks).

acts.²² The emphasis in this theory is on encouraging competition if at all feasible, and protection of existing banks is determinative only upon a clear showing that insolvency would *actually* result from chartering the proposed bank.²³

Prior Missouri cases dealing with bank chartering have relied heavily on the findings of the Banking Board. The two major cases viewed the role of the courts as merely determining whether competent and substantial evidence on the record supports the Board's findings. In *Suburban Bank of Kansas City v. Jackson County State Bank*²⁴ the proposed bank was only the second bank to enter a growing and prosperous area. Under even the most restrictive chartering test the applicant would succeed on these facts and the court in *Suburban Bank* affirmed the issuance of the charter, pointing out that the solvency of the existing banks would not be affected and that both banks could prosper in the community. Competent and substantial evidence on the whole record was again the test in *Marshfield Community Bank v. State Banking Board*.²⁵ The court affirmed the Board's decision denying the charter. However, the court examined the evidence in somewhat greater detail than in *Suburban Bank of Kansas City*, and pointed out the need for balancing the competing considerations of bank safety and industry competition. The evidence showed that the applicant would probably be insolvent within two years, but the opinion indicated that the court's primary concern was with insuring bank safety instead of promoting competition.²⁶ The court in *Central Bank* reexamined the interpretation of the chartering statute and brought Missouri closer to the third approach.

Section 362.030(1), RSMo 1969, requires the Commissioner to consider several factors before issuing a certificate of incorporation to a proposed bank. Two of these factors are the most important. First, the Commissioner must determine that the "probable volume of business . . . is sufficient

22. See Davis, *supra* note 5, at 639.

23. Application of Burill, 262 Minn. 270, 114 N.W.2d 688 (1962); Application of State Bank of Plainfield, 61 N.J. Super. 150, 160 A.2d 299 (1960). In Application of Howard Sav. Inst. of Newark v. Howell, 32 N.J. 29, 159 A.2d 113 (1960), the court said:

The public should always be entitled to increased interest rates and greater service and convenience which proper competition may well bring. Mere sufficiency of existing facilities . . . is not in and of itself sufficient basis to deny establishment of a new institution or branch if the general economy of the area and its reasonable potential are such that there is room for further installation without causing excessive competition with real harm to any institution or unduly affecting the banking structure at large.

Id. at 49-50, 159 A.2d at 125.

24. 330 S.W.2d 183 (K.C. Mo. App. 1959).

25. 496 S.W.2d 17 (Mo. App., D. Spr. 1973).

26. If a storekeeper, in an excess of competitive zeal, works himself into bankruptcy, the loss is his; but if a bank fails, the domino reaction to its fall brings the whole community down with it, as those of us who survived the debacle of the Great Depression so well remember.

Id. at 29 n.13.

to insure and maintain the solvency of the new bank or trust company and the solvency of the then existing banks and trust companies in the locality. . . ." Second, the Commissioner must determine that ". . . the convenience and needs of the community to be served justify and warrant the opening of the bank or trust company. . . ."

The application of these two statutory determinates to the chartering process requires a consideration of three somewhat competing factors. Two of these are related to the test of probable volume of business, and the other is related to the convenience and needs of the community. The probable volume of business factor first anticipates proof that the new bank can look forward to solvency in the proposed location. This requires an examination of its prospects for profitable operation in the chosen locale. Almost all courts profess to be interested in the solvency of the new bank and entry is therefore permitted only when the bank can show that it can develop sufficient business to cover costs plus a certain level of profitability.

The second statutory consideration illustrates a competing interest in the probable volume test which must be considered. The Commissioner must consider whether the new bank will endanger the safety of existing banks in the locality. In those states that adopt the third approach of allowing freer entry, this consideration is relegated to a position of lesser importance. If the other requirements are met, the only protection afforded existing institutions is upon a showing that the chartering of the applicant bank will result in *actual* insolvency of existing banks.

With this in mind, the third consideration relating to "convenience and needs" is more easily placed in focus. This is determined first from the consumer's viewpoint, and in the freer entry states is limited to this perspective. Any review of the new bank's effect on competitors, except as those effects impact upon consumers, moves the inquiry from that of a freer entry approach back to the balancing approach.

An examination of the factors which the court in *Central Bank* found to be relevant in reaching its decision reflects a policy of allowing somewhat freer bank entry. In finding that the protection of the statutory criteria for chartering extended to depositors and customers but not to competing banks, the court said: "The [convenience and needs consideration] does not contemplate preventing new banks from entering a market because existing banks are rendering adequate services."²⁷ Focusing on the new bank itself is the first step. One of the leading indicators of convenience and needs among banking experts is the prospect of the new bank's profitable operation. In fact, the court in *Suburban Bank of Kansas City v. Jackson County State Bank*²⁸ indicated that substantial deposits and business projections should be enough in itself to meet the test. Accordingly, the court in *Central Bank* said that the amount of future de-

27. 509 S.W.2d at 184.

28. 330 S.W.2d 183, 187 (K.C. Mo. App. 1959).

posits of the proposed bank may be considered, but the factual basis for these projections should be closely scrutinized.²⁹ The court also suggested that the new bank's impact on the economy of the community to be served is relevant and can be determined by: (1) the number of lending alternatives available to small business and consumer borrowers; (2) the actual competition among existing units in the area;³⁰ and (3) whether credit is readily available within reasonable bounds to all sectors of the local economy. Also found to be relevant was evidence which showed that deposits in existing banks were growing faster than the normal indicators of need for banking facilities. However, the court rejected the opponent's evidence on this point which showed that population and household growth rates were declining and retail sales were dropping while deposit growth was climbing at an annual rate of 13.6 percent.³¹

The court did not require the proponents to show a "need" for the bank in the community or produce evidence of complaints about existing banks. This is consistent with the approach to entry taken by the court. However, if produced, evidence of this sort would certainly be considered relevant.³²

On the other hand, the court found that much of the opponent's evidence was irrelevant to the statutory considerations: (1) evidence that the new bank would affect the growth rate of existing banks; (2) evidence that the new bank would draw deposits from the area already served by existing units; (3) evidence that the area banks may increase their promotional activity because of the new entry; and (4) evidence that the proposed bank would add little or nothing to the driving convenience of the people in the community. This is also consistent with the court's approach to chartering, because these factors focus on the effect of the entry on the profits of existing units. As mentioned earlier,

29. 509 S.W.2d at 187.

30. See 509 S.W.2d at 187. Actual competition among existing units can be a nebulous concept. It may be measured in terms of indicators such as interest rates paid on deposits held by the bank, or the interest rate which the bank charges its customers for various loans. Some experts have concluded that the concentration of banks within a given market area is a good statistical indicator of competition. Edwards, *supra* note 12, at 25, 32. Nonetheless, measuring competition in the banking industry is not readily accomplished, and this factor may be more easily stated by the courts than proven by a litigant.

31. This apparent inconsistency was explained by the facts that the opponents of the charter failed to consider the growth of the community as an office and commercial services area and that the opponents' daytime employment figures were substantially lower than those furnished by the commercial reporting agencies. 509 S.W.2d at 189.

32. Requiring evidence of this nature indicates a restricted entry approach. Evidence that there is an "absolute need" for another bank or that there are numerous complaints with existing facilities is difficult to adduce. Reliance on this evidence usually serves to protect existing units and prevent new units from entering. See Moran v. Nelson, 322 Mich. 230, 235, 33 N.W.2d 772, 777 (1948); Suburban Bank of Kansas City v. Jackson County State Bank, 330 S.W.2d 183 (K.C. Mo. App. 1959); Application of Howard Sav. Inst. of Newark v. Howell, 32 N.J. 29, 159 A.2d 113 (1960).

consideration of the effect on the profits of existing units is irrelevant unless the evidence tends to prove that *actual* insolvency will result. Even the rejection of evidence as to driving convenience can be justified on the facts of this case, although this factor is consumer-oriented and therefore normally relevant.³³ The court also discussed evidence that entry of the new bank would diminish the ability of the largest area bank to compete with the metropolitan banks. The court rejected this evidence as unsubstantiated. Such evidence should probably be deemed irrelevant, because it focused on the protection of existing banks.³⁴

The courts of other states have considered several factors in addition to those reviewed by the court in *Central Bank*. These include: (1) adequacy of services now provided compared to the needs of residents and the new services to be offered by the applicant bank;³⁵ (2) ability of existing banks to handle potential growth;³⁶ (3) number of persons in the area desiring to use the proposed bank and the amount of business they would generate;³⁷ (4) population growth;³⁸ (5) character of the community and surrounding area;³⁹ (6) the wealth and earning capacity of the residents;⁴⁰ and (7) the concentration of business establishments.⁴¹ These factors are not inclusive, and keeping in mind the policy that the chartering statute seeks to further, the relevancy

33. The analysis of driving convenience is based on the assumption that the volume of business a new bank attracts will vary proportionately with the amount of driving time customers must expend to reach the new bank. The evidence in this case tended to show that the area within a five minute radius of the new bank was also within a five minute radius of at least three other banks. Accordingly, the fact that the new bank would add little or nothing to the driving convenience of the community would not be very probative. However, where the closest bank in the community is thirty minutes from some residents and a proposed bank would be considerably more convenient in terms of driving time, such evidence should be allowed as relevant and probative of the "convenience and needs of the community."

34. The opinion indicated that the court considered at least seven other factors which are presumably relevant: (1) the growth of the area to be served; (2) the date the last bank was chartered in the area; (3) the business and commercial growth in the community; (4) the estimated buying power of area residents; (5) the size and deposit growth of existing banks; (6) the number of existing banks in the area; and (7) the proposed location of the new bank.

35. *Jackson v. Valley Nat'l. Bank*, 277 Minn. 293, 295, 152 N.W.2d 472, 474 (1967). This evidence would be relevant to the community need for the bank, a criterion which the court in *Central Bank* said was not required to be shown, but could nonetheless be relevant. See note 32 *supra*.

36. 277 Minn. at 293, 152 N.W.2d at 472. This factor pertains to the probability that the new bank will operate profitably.

37. *Id.*

38. See *Application of Burrill*, 262 Minn. 270, 114 N.W.2d 688 (1962), where the court suggested that public demand might be inferred from a tremendous expansion in the population and economy.

39. *Application of Millburn-Short Hills Bank*, 59 N.J. Super. 470, 158 A.2d 66 (1959).

40. *Id.*

41. *Id.*

of others can be readily ascertained. Questions remain, but *Central Bank* seems to mark a definite choice by the Missouri courts of a freer approach to the chartering process. This is certainly the trend in many other states, and according to some economists, long overdue.⁴²

In spite of the trend toward encouraging competition in the field of banking, a word of caution is appropriate. It is not clear whether the decrease in the number of bank failures since the 1930's is attributable to increased state regulation of entry or to federal legislation such as that which established deposit insurance and increased the effectiveness of the Federal Reserve System. But the failure of a bank, whether insured or not, has so great an effect on the economy of the whole community⁴³ that the important consideration is to avoid the catastrophic structure which results from excessive chartering and overbanking.

The consumer-oriented approach in *Central Bank* is commendable and possibly the most popular in the short run. However, the banking structure as a whole must be considered and concern for solvency should override considerations of immediate advantages from increased competition. Competition in the banking industry is subtle yet effective even with a smaller number of units.

The impact of *Central Bank* remains to be seen. At least on the surface the case moves Missouri closer to a freer chartering approach. The rejection of evidence that the new bank would draw deposits from existing banks and slow their growth rate reflects a greater concern for competition and increased efficiency, with a subsequent disregard of the historical concern for existing banks. Although the conservative approach of the past is being reexamined in Missouri, the banking industry is still based upon the concepts of capital investment and allocation of resources which are factors for entry in any industry. As such, entry decisions carry sanctions of their own which will help to discourage imprudent entry attempts and help maintain a stable system.⁴⁴

KIM R. MOORE

42. See Peltzman, *Bank Entry Regulation: Its Impact and Purpose*, 3 NAT. BANK. REV. 163 (1965).

43. Berle, *Banking Under the Anti-trust Laws*, 49 COLUM. L. REV. 589 (1949). A bank failure is a community disaster, however, wherever, and whenever it occurs. While competition may be desirable up to a point in deposit banking, there is a clear bottom limit to its desirability. . . . The economic and social premises of the Sherman Act in respect of other businesses are not fully accepted by the Congress, the States, or the public as the only considerations applicable to deposit banking. *Id.* at 592. See generally Jacobs, *The Framework of Commercial Bank Regulation: An Appraisal*, 1 NAT. BANK. REV. 343 (1964).

44. See generally Abramson, *Private Competition and Public Regulation*, 1 NAT. BANK. REV. 101 (1963).