

# The Efficiency of Liberalizing Branch Banking in Indiana

## I. INTRODUCTION

The Great Depression and its bank runs resulted in approximately five thousand bank failures between 1929 and 1933 and the loss of nine million customer savings accounts.<sup>1</sup> Fearing a recurrence of the catastrophic set of circumstances which led to this result, state legislatures passed remedial legislation to deal with the evils of the banking industry.<sup>2</sup> The main thrust of this legislation was to protect the economy and the public from bank failures and their side-effects.<sup>3</sup> The prevailing view of the era during and following the Great Depression attributed bank failures to "excessive competition among banks and imprudent banking practices."<sup>4</sup> Accordingly, the power of state banking regulatory authorities to police the banking industry and prohibit or restrict entry into the banking field was strengthened.<sup>5</sup> Although not all states chose to restrict branch banking,<sup>6</sup> the majority of states imposed restrictions upon a bank's right to establish a branch bank.<sup>7</sup>

In passing restrictive bank branching laws, the legislatures impliedly chose to give consumers fewer banking alternatives. This legislative choice was made during the Depression Era when safety and not efficiency was the pressing need in the banking industry. Consequently, many states, including Indiana, imposed geographical

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<sup>1</sup>Central Bank v. State Banking Bd., 509 S.W.2d 175, 183 (Mo. Ct. App. 1974) (citing W. LEUCHTENBURG, FRANKLIN D. ROOSEVELT AND THE NEW DEAL 18 (1963)).

<sup>2</sup>On the federal level, remedies included the creation of the Federal Deposit Insurance Corporation which functioned as an insurer of depositors' accounts up to a specified level. Federal Deposit Insurance Act, 12 U.S.C. § 1811 (1976). The insurance was intended to relieve the anguish of small depositors, protect circulating money, and help sustain a system of small unit banks. W. LEUCHTENBURG, *supra* note 1, at 60.

<sup>3</sup>Central Bank v. State Banking Bd., 509 S.W.2d 175, 183 (Mo. Ct. App. 1974).

<sup>4</sup>*Id.* See generally Kreps, *Modernizing Banking Regulations*, 31 LAW & CONTEMP. PROB. 648, 651 (1966); Stokes, *Public Convenience and Advantage in Applications for New Banks and Branches*, 74 BANKING L.J. 921, 922-23 (1957).

<sup>5</sup>Central Bank v. State Banking Bd., 509 S.W.2d 175, 184 (Mo. Ct. App. 1974).

<sup>6</sup>Branch banking is generally said to exist when a bank conducts its banking operations at two or more places. See E. REED, R. COTTER, E. GILL, & R. SMITH, *COMMERCIAL BANKING* 16 (1976).

<sup>7</sup>For an overview of the various state branch banking laws, see generally Gup, *A Review of State Laws on Branch Banking*, 88 BANKING L.J. 675 (1971); Hablutzel, *State Regulation of Branch Banking*, 16 DUQ. U. L. REV. 679 (1978); Note, *Branch Banking—Restrictive State Laws Considered in Light of the Public Interest—Extension of National Power Over Banking*, 38 NOTRE DAME LAW. 315 (1963) [hereinafter cited as Note, *Branch Banking*].

restrictions upon a bank's right to establish a branch bank and required a showing that the proposed branch would promote the public convenience or advantage.<sup>8</sup>

The bank branching statute in Indiana<sup>9</sup> imposes six requirements upon a bank seeking to establish a branch: (1) the proposed branch must be within the county in which the bank's main office is located; (2) the bank must have sufficient capital to support the proposed branch; (3) the proposed branch must subserve and promote

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<sup>8</sup>See IND. CODE § 28-1-17-1 (1976).

<sup>9</sup>IND. CODE § 28-1-17-1 (1976) provides:

Branch banks.—In all counties having a population of less than five hundred thousand [500,000] inhabitants, according to the last preceding decennial United States census, or in counties having three [3] or more cities of the second class, except as hereinafter otherwise provided, any bank or trust company may open or establish a branch bank in any city or town within the limits of the county in which the principal office of such bank or trust company is located, if there is no bank or trust company located in such city or town. In all counties, any bank or trust company may open one [1] branch bank for each two hundred thousand dollars [\$200,000] of the capital and surplus of such bank or trust company, actually paid in and unimpaired. In all counties having a population in excess of five hundred thousand [500,000] inhabitants according to the last preceding decennial United States census, and not having three [3] or more cities of the second class, any bank or trust company may open or establish a branch bank in any city or town within the limits of the county in which the principal office of such bank or trust company is located.

No branch bank shall be opened or established without first having obtained the written approval of the department. The location of any branch bank may be changed at any time when such change of location is authorized by the board of directors of the bank or trust company and approved by the department. Any bank or trust company desiring to establish one or more branches shall file a written application therefore, in such form, and containing such information as may be prescribed by the department. The department is hereby authorized, in its discretion, to approve or disapprove any application. Before the department shall approve or disapprove any application for the establishment of a branch bank, as herein authorized, it shall ascertain and determine to its satisfaction that the public convenience and advantage will be subserved and promoted by the opening or establishment of a branch bank in the community in which it is proposed to establish such branch bank; in the case of counties having a population of less than five hundred thousand [500,000] according to the last preceding decennial United States census, or in counties having three [3] or more cities of the second class, that there is no bank or trust company located in the city or town in which it is proposed to establish such branch bank, if the application is for a permit to open or establish a branch bank in a city or town other than that within which the applicant bank or trust company is located; that the applicant bank or trust company has satisfied the capital and surplus requirements, as hereinabove provided. No branch bank may be opened if the real estate (as defined in IC 1971, 28-1-11-5) of the bank or trust company establishing such branch bank will thereby exceed the capital and surplus of such bank or trust company actually paid in and unimpaired.

the "public convenience and advantage;" (4) the location of the proposed branch must be a "city or town;" (5) the proposed branch may not be located in a town in which another bank's main office is located unless the city or town is also where the main office of the applicant bank is located (the "home office protection" provision); and (6) the bank's investment in real estate, including the proposed branch, must be within certain limits.<sup>10</sup>

These statutory requirements regarding branch banking have changed little since the enactment of the branching statute in 1933.<sup>11</sup> Although legislative policy still favors safety in the banking industry, the courts now are also emphasizing greater efficiency in the banking industry. Indeed, branch banking has the virtue of promoting greater competition among banks, thereby encouraging better bank services and lower costs for these services.<sup>12</sup> This judicial movement emphasizing efficiency is logical because the banking system is no longer threatened by the evils which almost destroyed it nearly a half-century ago. The Indiana courts have achieved greater efficiency by liberally construing "city or town" for purposes of locating a proposed branch, by narrowly construing "city or town" for purposes of applying the home office protection provision, and by pragmatically defining "public convenience and advantage."

Although an increase in branch banks promotes greater efficiency, strong arguments have been voiced in opposition to bank branching. Some commentators have argued that branch banking not only creates a monopoly<sup>13</sup> but also leads to an impersonal bank which neglects the needs of the local community<sup>14</sup> or results in inadequate supervision, thereby reducing the safety of a banking system.<sup>15</sup> Regardless of philosophy about the virtues of branch banking, attention should be given to the current judicial trend in Indiana which

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<sup>10</sup>*Id.*

<sup>11</sup>The 1980 session of the Indiana General Assembly defeated a bill which would have allowed banks to compete on a state-wide basis. *See* H.B. 1246, 101st Ind. Gen. Ass., 2d Sess. (1980) (engrossed); S. 329, 101st Ind. Gen. Ass., 2d Sess. (1980) (engrossed). The bill would have circumvented the Indiana branch banking law by allowing a holding company to purchase up to four Indiana banks per year, regardless of their location. Thus, a bank could establish facilities outside its home county by simply buying a bank located in another county without regard to the Indiana branching restrictions. The successful opponents of the bill favored local ownership of local banks. The arguments opposing the bill were typical arguments used to oppose expansion of branching: local banks would pay larger dividends and charge lower rates than big city banks; local banks, as a "cornerstone" of the community, should be locally controlled and local banks would be driven out of business if forced to compete with big city banks. *See* Indianapolis Star, Feb. 20, 1980, at 1, col. 5.

<sup>12</sup>*See* E. REED, *supra* note 6, at 38; Hablutzel, *supra* note 7, at 724.

<sup>13</sup>*See* E. REED, *supra* note 6, at 43; Hablutzel, *supra* note 7, at 723-24.

<sup>14</sup>*See* E. REED, *supra* note 6, at 43; Hablutzel, *supra* note 7, at 723-24.

promotes efficiency in the banking system by increasing the number of branch banks while preserving the soundness of the state banking system.

## II. DEFINITION OF "CITY OR TOWN"

A branch bank in Indiana may only be located in a "city or town."<sup>16</sup> What constitutes a "city or town" is not, however, addressed by the state bank branching statute. Consequently, these terms have been defined by the courts rather than the legislature. In a 1953 opinion,<sup>17</sup> the Indiana Attorney General concluded that the word "town" should be given its usual and ordinary meaning.<sup>18</sup> The attorney general explained that this practical definition allows a town to be unincorporated or incorporated for purposes of locating a branch bank.<sup>19</sup> Although he offered no persuasive reason for this conclusion, the Supreme Court of New Jersey in *Montclair National Bank & Trust Co. v. Howell*<sup>20</sup> offered a logical basis for this definition. The court in *Montclair* rejected an argument that the New Jersey branching statute, requiring that conditions *in the locality* of the proposed branch offer the branch a reasonable chance of success, should be interpreted to require that conditions *in the political subdivision* of the proposed branch offer the branch a reasonable chance of success.<sup>21</sup> The court reasoned that banking, like other human activities, was not confined to political boundaries and that the whole area that the proposed branch would be expected to serve was a more realistic method of determining whether an area could support the branch.<sup>22</sup> In this sense the court assigned "locality" its usual meaning of "trading area."<sup>23</sup> Pennsylvania has also reached this result. In *Upper Darby National Bank v. Myers*,<sup>24</sup> the Supreme Court of Pennsylvania concluded that a "community" was not limited by municipal lines and boundaries.<sup>25</sup> Indeed, a community could also be an area with a common residential, social, business, commercial, or industrial interest. The court observed that the legislature could have used a more precise word such as "township"

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<sup>15</sup>See Note, *Branch Banking*, *supra* note 7, at 319.

<sup>16</sup>IND. CODE § 28-1-17-1 (1976).

<sup>17</sup>[1953] OP. IND. ATT'Y GEN. 152.

<sup>18</sup>*Id.* at 154-55. The attorney general observed that a city is nothing more than a large town. *Id.* at 155. Consequently attention will be focused on the definition of town.

<sup>19</sup>*Id.* at 156.

<sup>20</sup>32 N.J. 29, 159 A.2d 113 (1960).

<sup>21</sup>*Id.* at 43, 159 A.2d at 120-21.

<sup>22</sup>*Id.* at 43, 159 A.2d at 121.

<sup>23</sup>*Id.* at 45-46, 159 A.2d at 122.

<sup>24</sup>386 Pa. 12, 124 A.2d 116 (1956).

<sup>25</sup>*Id.* at 19, 124 A.2d at 119.

rather than "community" if it intended to reach the opposite result.<sup>26</sup>

Although the Indiana Attorney General concluded his opinion by advising that "the term 'town' includes an unincorporated as well as an incorporated town,"<sup>27</sup> the courts have had the difficult task of determining what characteristics an unincorporated area needs to qualify as a "town" within the meaning of the branching statute. It is the imprecision of this definition which has afforded the courts the opportunity and flexibility to promote more efficient banking operations.

The first judicial attempt to define "town" under the Indiana branching statute occurred in *First National Bank v. Camp*,<sup>28</sup> a 1971 opinion of the United States District Court for the Northern District of Indiana. The plaintiff (hereinafter First National), challenged the approval by the United States Comptroller of the Currency (hereinafter Comptroller) of an application for a certificate of authority to establish a branch bank. First National contended that the Comptroller's action violated the bank branching laws of Indiana<sup>29</sup> since the unincorporated location selected for the proposed branch was not a "city or town" as provided in the Indiana statute.

Faced with the issue whether the unincorporated area was a "city or town," the district court was guided by the previously discussed 1953 opinion of the Indiana Attorney General<sup>30</sup> and a line of Michigan cases construing the comparable term of "village" under the Michigan branch banking statute.<sup>31</sup> One Michigan court has stated:

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<sup>26</sup>*Id.*

<sup>27</sup>[1953] OP. IND. ATT'Y GEN. at 156.

<sup>28</sup>342 F. Supp. 871 (N.D. Ind. 1971), *aff'd*, 463 F.2d 595 (7th Cir. 1972).

<sup>29</sup>A national bank must apply to the Comptroller of the Currency for permission to establish a branch bank. 12 U.S.C. § 36(c) (1976) provides in part:

A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches: . . . (2) at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the State on State banks.

Thus a national bank may establish branch banks in any state to the extent that the state banks of that state may do so. *First Nat'l Bank v. Walker Bank & Trust Co.*, 385 U.S. 252 (1966).

<sup>30</sup>342 F. Supp. at 875 (citing [1953] OP. IND. ATT'Y GEN. 152).

<sup>31</sup>342 F. Supp. at 875-76 (citing *American Bank & Trust Co. v. Saxon*, 373 F.2d 283 (6th Cir. 1967); *Community Nat'l Bank v. Saxon*, 310 F.2d 224 (6th Cir. 1962); *National Lumberman's Bank & Trust Co. v. Camp*, Civil No. 6179 (W.D. Mich. May 4, 1970) (unreported opinion by Kent, Chief Judge, attached as Appendix A to Comptroller's Memorandum in Support of his Motion to Dismiss); *Security Bank v. Saxon*, 298 F. Supp. 991 (E.D. Mich. 1968); *Peoples Bank v. Saxon*, 244 F. Supp. 389 (E.D. Mich. 1965);

The word "village" is not a technical word, or one having a peculiar meaning, but is a common word in general usage with an ancient lineage. It is merely an assemblage or community of people, a nucleus or cluster for residential and business purposes, a collective body of inhabitants, gathered together in one group.<sup>32</sup>

This definition does not, however, furnish any clear criteria for determining the existence of a village. In *Bank of Dearborn v. Taylor*,<sup>33</sup> the Michigan Supreme Court clarified its earlier definition of "village." The court, in adopting the reasoning of the trial court that the area in question was a "village," focused upon economic rather than geographic or political factors.<sup>34</sup> The area was found to constitute a separate "trading area" with a cluster of residences and businesses.<sup>35</sup> The court also took special notice of the area's *potential* for growth.<sup>36</sup>

Such a determination based upon these factors suggests that the Michigan courts are looking for an area which is a "center" of personal and business activity. This approach is intuitively sensible, because an area possessing a "center of gravity" would benefit from the services provided by a branch. By requiring a combination of business and personal activities in the area in issue, the courts are also assuring a long-term settlement which will support the branch in future years as well as the year in which the application is filed. The validity of this observation is strengthened by the denial of a branch application in *Peoples Bank-Trenton v. Saxon*<sup>37</sup> for failure to show that the proposed location of the Michigan bank branch was a "village."<sup>38</sup> The area in question contained three separate, yet unconnected, clusters of business places.<sup>39</sup> The court also found no indication of a probable change in these conditions in the future.<sup>40</sup> Consequently, the area did not meet the Michigan definition of "village."

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Commercial State Bank v. Gidney, 174 F. Supp. 770 (D.D.C. 1959); *Bank of Dearborn v. Taylor*, 365 Mich. 567, 114 N.W.2d 210 (1962); *Wyandotte Sav. Bank v. Eveland*, 347 Mich. 33, 78 N.W.2d 612 (1956); *National Bank v. Detroit Bank & Trust Co.*, 19 Mich. App. 439, 172 N.W.2d 883 (1969)).

<sup>32</sup>*Wyandotte Sav. Bank v. Eveland*, 347 Mich. 33, 41, 78 N.W.2d 612, 617 (1956), *quoted in* *First Nat'l Bank v. Camp*, 342 F. Supp. at 876.

<sup>33</sup>365 Mich. 567, 114 N.W.2d 210 (1962).

<sup>34</sup>*Id.* at 571-72, 114 N.W.2d at 212-13.

<sup>35</sup>*Id.*

<sup>36</sup>*Id.* at 572, 114 N.W.2d at 213.

<sup>37</sup>244 F. Supp. 389 (E.D. Mich. 1965).

<sup>38</sup>*Id.* at 393.

<sup>39</sup>The court stated, "The body of people are not gathered in one group; there is no community center for a nucleus, no professional offices, no centralized populous area, no school or church and no general common residential or business activity." *Id.*

<sup>40</sup>*Id.*

The district court in *First National Bank* decided that the definition of "village" under Michigan law was "substantially in accord with the opinion of the Attorney General of Indiana . . . , and the subsequent interpretive application of it to branch banking in Indiana."<sup>41</sup> Because the Comptroller had denied a previous application by the applicant bank to establish a branch in approximately the same location three years earlier, the court stated that "[t]he only real determination the Comptroller had to make [on the bank branch application in question] was whether the area had developed to the point where it could be considered a city or town."<sup>42</sup> The Comptroller placed great weight upon a *proposed* Lake County Courthouse complex in ruling upon the second application. The Comptroller felt the proposed complex would provide "a nucleus for the establishment of new service, business and commercial establishments, in addition to the business activity which it will generate per se,"<sup>43</sup> thus taking into account "planned development of the area which would affect its character in the immediate future."<sup>44</sup> The court also noted that the Comptroller considered the increase in residential single family units and population of the area over the three-year span between the two applications.<sup>45</sup> The court found that under these facts, "the Comptroller's action in determining, as a matter of fact, that the area within which [applicant bank] wished to establish a branch bank was a town within the meaning of the Indiana statute" was acceptable.<sup>46</sup>

An important aspect of this decision is the court's reliance upon the potential growth of the area. This is a major departure from the policy of providing a safe banking system and toward a policy of providing an efficient banking system for the customer. The Indiana courts have not yet been given the opportunity to state Indiana's official position regarding the area's potential for growth, although the *First National Bank* decision offers persuasive support for choosing a more efficient banking system.

Recent Indiana decisions indicate acceptance of the *First National Bank* criteria for a "town." The Indiana Supreme Court, in *Pendleton Banking Co. v. Department of Financial Institutions* adopted a liberal definition of "town."<sup>47</sup> The appellants had opposed an order of the Indiana Department of Financial Institutions approv-

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<sup>41</sup>342 F. Supp. at 876.

<sup>42</sup>*Id.*

<sup>43</sup>*Id.* at 877.

<sup>44</sup>*Id.*

<sup>45</sup>*Id.*

<sup>46</sup>*Id.*

<sup>47</sup>257 Ind. 363, 274 N.E.2d 705 (1971).

ing an application to establish a branch in Huntsville, Indiana. Huntsville did not have a fire department, school, or church. The appellants contended that the location of the proposed branch, an unincorporated area, did not meet the criteria of the 1953 Attorney General's opinion.<sup>48</sup> The court disagreed,<sup>49</sup> refusing to hold that every factor mentioned in the 1953 Attorney General opinion must be present in an area before the area could be considered a town:

We think it is clear that the statute as interpreted by the Attorney General uses the word "town" to include a compact area having a number of persons living in close proximity to one another with some degree of business being transacted within the area. Each case requires a factual determination as to whether or not the area can be in fact considered a town.<sup>50</sup>

The Court reasoned that sufficient evidence existed to support a finding that Huntsville was a town, observing that there were several businesses in Huntsville, that the population of Huntsville was growing, and that the area needed a branch bank.<sup>51</sup>

By this ruling, the court rejected the argument that the area must contain a minimum population before it can be a "town" within the meaning of the statute.<sup>52</sup> The 1953 opinion of the Indiana Attorney General<sup>53</sup> required at least 1500 to 1800 persons for an area to qualify as a town.<sup>54</sup> Nevertheless, the court found this requirement to be inapplicable in this situation.<sup>55</sup> The court decided that each case involving the determination of a "town" for bank branching purposes should be considered on its own facts,<sup>56</sup> thus freeing the courts from rigid standards and affording the courts the opportunity to liberalize the branching law of Indiana.

The courts have, however, continued to temper each determination with a consideration of safety. In *Albion National Bank v.*

<sup>48</sup>[1953] OP. IND. ATT'Y GEN. 152.

<sup>49</sup>The appellant's specific contention was as follows:

[T]he facts observed in the Attorney General's Opinion set forth a rigid standard which must be met before an unincorporated area may be considered to be a town; that it must have church, a school, fire department, retail stores, boarding houses and at least 500 residences located on various streets and alleys, and a population of from 1500 to 1800 persons.

257 Ind. at 367, 274 N.E.2d at 708.

<sup>50</sup>*Id.* at 367-68, 274 N.E.2d at 708.

<sup>51</sup>*Id.*

<sup>52</sup>*Id.*

<sup>53</sup>[1953] OP. IND. ATT'Y GEN. at 155.

<sup>54</sup>*Id.* (citing *Pollard v. Montana Liquor Control Bd.*, 114 Mont. 44, 131 P.2d 974 (1942)).

<sup>55</sup>257 Ind. at 367-68, 274 N.E.2d at 708.

<sup>56</sup>257 Ind. at 368, 274 N.E.2d at 708.



*Department of Financial Institutions*,<sup>57</sup> the Indiana Court of Appeals held that the proposed location of a branch was not a town.<sup>58</sup> The court applied the *Pendleton* test of "a compact area, . . . [which requires] . . . (1) a number of persons living in close proximity to one another, and (2) some degree of business being transacted,"<sup>59</sup> to determine if the proposed site was within a "town." The court found the following inadequate to qualify the area as a town: businesses consisting of appliance sales, mobile homes sales, automobile sales and service, general contractors, builders and realtors<sup>60</sup> to the east of the site; one house and a church to the immediate west; a saddle club, farmhouse, veterinarian building, and house in the immediate vicinity; and one house located upon the site.<sup>61</sup> Assessing the number of persons residing in the area, the court decided that "[t]hese few residences clearly would not constitute a number of persons living in close proximity of one another."<sup>62</sup> Examining the question of business activity, the court observed four different clusters of business activity<sup>63</sup> but found "no indication that any of the clusters have any nexus with any other so as to be considered a compact area with regard to the proposed site."<sup>64</sup> The court indicated that a dependency must exist between the different clusters of residences and businesses. Although this requirement hampers further judicial movement in liberalizing the concept of "town," some restrictions are necessary to assure a safe banking system. Without this requirement, a branch located on the outer fringes of two or more incorporated towns could fail if each fringe group did its business in its respective incorporated town. Such a result would be less likely to occur if there existed an attraction or nexus between the fringe groups and the area.

The United States Court of Appeals for the Seventh Circuit recently rendered a decision which turned upon Indiana's definition of "town" in its bank branching statute. *First Union Bank & Trust Co. v. Heimann*<sup>65</sup> involved an order of the Comptroller approving the

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<sup>57</sup>355 N.E.2d 873 (Ind. Ct. App. 1976).

<sup>58</sup>*Id.* at 877.

<sup>59</sup>*Id.*

<sup>60</sup>*Id.* at 875.

<sup>61</sup>*Id.* at 877.

<sup>62</sup>*Id.*

<sup>63</sup>These included a housing development, bowling alley, restaurant and church 1.1 miles northwest of the proposed site, the Lyll Electric complex one mile east of the proposed site, the Skinner Lake homes two miles east of the proposed site, and a supermarket, shopping center and mobile home park south of the proposed site. *Id.*

<sup>64</sup>*Id.*

<sup>65</sup>600 F.2d 91 (7th Cir. 1979).

establishment of a branch bank. The appellant contended the proposed location of the branch was not a town within the meaning of the Indiana bank branching statute. The proposed location of the branch, one-eighth of a mile north of the corporate boundaries of Winamac, Indiana,<sup>66</sup> was unincorporated and nameless.<sup>67</sup> It contained twenty-five houses and had an approximate population of thirty-eight, including eight minors.<sup>68</sup> The only businesses within one-half mile of the site which were not within the corporate boundaries of Winamac were a nursery one-quarter mile to the north of the site,<sup>69</sup> a veterinary clinic one-quarter mile north of the nursery,<sup>70</sup> a farm supply store one-half mile north of the site,<sup>71</sup> and a cattle lot immediately north of the supply store.<sup>72</sup>

Relying on *First National*, *Pendleton*, and *Albion* as authority, the court concluded:

“[T]own” denotes an area which serves to some extent as a hub for surrounding communities, that is, a population and commercial center. Thus, it need not be incorporated or have a name . . . but it at least should have a separate identity. From its use of this term, it is apparent that the Indiana legislature intended to impose a general minimum standard for the type of community that it believed could support a branch facility.<sup>73</sup>

The court decided that the Indiana legislature was imposing qualitative, rather than quantitative, restrictions upon a proposed branch site to determine if the site could support a branch.<sup>74</sup> These restrictions could be overcome by finding that the proposed branch site in the unincorporated area was an identifiable and separate community from the nearby town; a center for business, social, and educational activity; or a nucleus for new business establishments.<sup>75</sup> The court concluded that the area in issue could not constitute a “town”:

Neither, the tiny population nor the small and specialized commercial community, however, [could] attract sufficient traffic from surrounding areas to warrant a finding that the site serves as a hub for the surrounding area, or, more

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<sup>66</sup>*Id.* at 94.

<sup>67</sup>*Id.* at 95.

<sup>68</sup>*Id.*

<sup>69</sup>*Id.* at 94.

<sup>70</sup>*Id.*

<sup>71</sup>*Id.* at 94-95.

<sup>72</sup>*Id.* at 95.

<sup>73</sup>*Id.* at 96.

<sup>74</sup>*Id.*

<sup>75</sup>*Id.* at 97.

specifically, a finding that the area [could] provide any support for a full-service branch facility.<sup>76</sup>

*Heimann* endorses the principle that each determination of whether an unincorporated area is a "town" for purposes of the Indiana bank branching statute must be decided upon its own set of facts. The cases suggest the need for an "attraction" within a compact area between the residences and businesses located in the area surrounding the proposed location of the branch. A finding by the Department or the courts that the compact area has a distinct identity, marked by a degree of cohesiveness between its residences and a dependency between the residents and the local businesses is a prerequisite to the Department or the courts concluding that the unincorporated area is a "town" within the meaning of the Indiana branching statute.

By focusing upon the economic factors of the proposed branch site and not upon artificial political boundaries, Indiana courts are adopting a policy which is more concerned with increasing benefits and services to area customers and less concerned with protecting an existing bank's market. This judicial emphasis upon a bank's service area and not artificial boundaries should allow branches to be established in locations that will allow banks to offer more convenient and efficient banking services to the public.

### III. HOME OFFICE PROTECTION

The Indiana branching statute provides an existing bank, but not a branch bank, with "home office protection." This statute allows a branch to be established only when "there is no bank or trust company located in the city or town in which it is proposed to establish such branch bank," unless the proposed location is within the city or town within which the home office of the applicant bank is located.<sup>77</sup> Neither the legislature nor the courts have offered a reason for this provision. The Supreme Court of New Jersey, however, has stated a reason for the New Jersey home office protection provision.<sup>78</sup> The New Jersey court explained that this provision gave preference to local interests because a bank is generally organized by local people responding to a local need for additional banking alternatives. The home office protection provision is designed to favor these local interests as against non-local interests seeking

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<sup>76</sup>*Id.*

<sup>77</sup>IND. CODE § 28-1-17-1 (1976).

<sup>78</sup>*Montclair Nat'l Bank and Trust Co. v. Howell*, 32 N.J. 29, 159 A.2d 113 (1960).

<sup>79</sup>*Id.* at 46-47, 159 A.2d at 122.

to establish a branch in the area thereby taking advantage of the local need.<sup>80</sup>

Such a policy, while favoring local *banking* interests, may nevertheless be detrimental to the *public* interest. By shielding local banks from outside competition, the public may suffer due to lower interest rates on savings accounts, decreased availability of credit, higher interest rates on loans, and shorter hours. Such a result benefits only one group, the owners of the local bank. Apparently realizing the questionable value of this policy, courts have narrowly applied the home office protection provision.<sup>81</sup>

The 1953 Attorney General's opinion is the first indication in Indiana of dissatisfaction with the policy. The Indiana Attorney General stated that the statute should be strictly construed and the individual bank accused of violating the home protection provision should be favored over the statute whenever an ambiguity arose. The criminal sanction for violating the statute and the restrictive nature of the statute were the reasons given in the opinion for such a conclusion.<sup>82</sup>

Indiana courts have also narrowly construed the home office protection language.<sup>83</sup> *First National Bank* involved the issue whether "city or town" referred to the "economic city" for home office protection purposes.<sup>84</sup> The court dealt with this issue in a summary fashion. Because home office protection was a restriction upon the right of a bank to establish a branch, the court decided that its terms should be construed narrowly,<sup>85</sup> thereby limiting "city or town" in this context to the political and not economic "city or town."

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<sup>80</sup>*Id.* at 47, 159 A.2d at 122.

<sup>81</sup>The Indiana legislature has also taken steps to remove some aspects of home office protection. The Indiana branching law was amended in 1971 and the following protection afforded a bank's home office was deleted: "No branch bank may hereafter be established or located within one-quarter mile of another bank or trust company, nor at any location which will jeopardize the welfare of another bank or trust company already established in the city or town." An Act to amend Title 28, article 1 of the Indiana Code of 1971 Concerning Financial Institutions, Pub. L. No. 394, § 30 (codified at IND. CODE § 28-1-17-1 (1976)).

<sup>82</sup>[1953] OP. IND. ATT'Y GEN. at 154.

<sup>83</sup>The result-oriented approach utilized by the courts has created a gross inconsistency in the construction of the words "city or town" as used in the Indiana branching statute. The courts narrowly construe the same term when determining if an unincorporated area is a city or town. 342 F. Supp. at 877. This inconsistency is irremediable unless the legislature repeals the home office provision or the judiciary retreats to a less competitive and therefore less efficient position by applying a single, strict definition to "city or town" for purposes of locating a branch bank and providing home office protection.

<sup>84</sup>342 F. Supp. at 877.

<sup>85</sup>*Id.*

The court reasoned further that the criminal penalties imposed for violating the branching statute<sup>86</sup> dictated a narrow construction of the home office provision.<sup>87</sup> The court stated that an anomaly would result if a bank could be penalized under the above statute for establishing a branch pursuant to authorization by the proper banking regulation authorities.<sup>88</sup> Such a result could be reached, however, if a court held that the branch location was within the economic city or town, although located outside the corporate boundaries. To prevent this dilemma, the court explained the need to identify precisely the area within the sweep of home office protection.<sup>89</sup> Therefore, the court concluded that the words "city or town" in the home office protection provision should be read as the incorporated city or town and not the economic city or town.<sup>90</sup>

The Indiana Supreme Court in *Pendleton*<sup>91</sup> also construed the home office provision narrowly. Faced with the contention that an area outside the corporate limits of Pendleton should be considered a part of the town for home office protection purposes, the court held that the area was a "town." The one-half mile distance and the clear demarcation shown by aerial photographs between the two communities, plus Huntsville's existence beyond Pendleton's corporate borders, was sufficient evidence to support the trial court's finding that Huntsville was a community separate from Pendleton.<sup>92</sup> Although the court never stated that the statute should be limited by a narrow interpretation, its narrow application of the statute certainly implies a narrow construction.

An interesting situation occurred in Michigan which could conceivably occur in Indiana. In *Bank of Dearborn*,<sup>93</sup> the Michigan Supreme Court was faced with a situation in which the bank claiming home office protection was located in an unincorporated area. The bank, claiming protection, appealed a decision that its location and the site of the competitor bank's proposed branch were in two separate unincorporated villages. The appellant contended that the area in which the two sites were located was continuous and homogeneous without physical or geographic dividing lines and that therefore the two sites were in the same village. The court rejected

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<sup>86</sup>IND. CODE § 28-1-17-3 (1971). This section was amended in 1978, but still provides that any person violating IND. CODE § 28-1-17-1 shall be guilty of a misdemeanor. See IND. CODE § 28-1-17-3 (Supp. 1979).

<sup>87</sup>342 F. Supp. at 877-78.

<sup>88</sup>*Id.*

<sup>89</sup>*Id.* at 877.

<sup>90</sup>*Id.* at 878.

<sup>91</sup>257 Ind. at 363, 274 N.E.2d at 705.

<sup>92</sup>*Id.* at 368-69, 274 N.E.2d at 709.

<sup>93</sup>365 Mich. 567, 114 N.W.2d 210 (1962).

this argument, noting that each of the two areas met the Michigan definition of village, which focused on economic factors.<sup>94</sup> If the court had agreed with the appellant that continuity and homogeneity were restrictive factors, then it is conceivable, as the court noted, that large unincorporated suburban areas could be deprived of close and convenient banking facilities, in direct contravention of the public interest.

Because a new bank may be established in an unincorporated area in Indiana,<sup>95</sup> the situation in *Bank of Dearborn* might occur in this state. However, given the judicial disposition in Indiana to narrowly construe the home office protection provision, the Indiana courts are likely to decide that the two locations are in different towns if the proposed branch location could qualify as a town without including too much of the established bank's "territory." Also, the courts' reluctance to apply the criminal sanctions of the Indiana branching statute in narrowly construing the home office protection provision<sup>96</sup> provides an adequate basis for refusing to allow a bank which established its home office in an unincorporated area to claim the benefits of home office protection.

In short, the Indiana courts, restrained by a statutory home office provision which restricts banking for the apparent benefit of the local *banking* interest at the expense of the local *public* interest, have admirably limited this provision to its narrowest terms to improve efficiency. There is little left for the judiciary to do in this area. The ultimate solution rests with the legislature which may repeal the provision, thereby increasing bank efficiency and convenience.

#### IV. PUBLIC CONVENIENCE AND ADVANTAGE

Prior to the approval of any branch bank application, the Department of Financial Institutions must find that the proposed branch will subserve and promote the "public convenience and advantage."<sup>97</sup> "Public convenience and advantage" is not defined in the bank branching statute. Consequently, the courts have construed the term. As with other statutory terms, the Indiana courts have used their powers of construction and interpretation to encourage greater efficiency in the Indiana banking industry.

The only case in Indiana analyzing the meaning of "public convenience and advantage" is *Department of Financial Institutions*

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<sup>94</sup>*Id.* at 571-73, 114 N.W.2d at 212-13. See text accompanying notes 33-35 *supra*.

<sup>95</sup>[1959] OP. IND. ATT'Y GEN. 119, 123-24.

<sup>96</sup>See *First Nat'l Bank v. Camp*, 342 F. Supp. 871 (N.D. Ind. 1971), *aff'd*, 463 F.2d 595 (7th Cir. 1972).

<sup>97</sup>IND. CODE § 28-1-17-1 (1976).

*v. Wayne Bank and Trust Co.*<sup>98</sup> *Wayne Bank* represents a clear attempt by the Indiana courts to increase the number of branch banks by adopting a pragmatic test of determining whether a branch promotes "public convenience and advantage" without creating a threat to its customers. In applying this test, the court discussed the virtues of permitting more competition in the banking industry.

The case involved an appeal by the Department of Financial Institutions, of the trial court's decision vacating the Department's order disapproving Wayne Bank's branch application and remanding the case back to the Department. The Indiana Court of Appeals affirmed the trial court.<sup>99</sup> The court of appeals stated that the Department based its denial of the branch application solely upon the basis that the existing Richmond banks were providing adequate service to the people in the area to be served by the proposed Wayne Bank branch,<sup>100</sup> and therefore the proposed branch would not promote the "public convenience and advantage." The court held, however, that the record revealed that all of the evidence "point[ed] to the fact that the public convenience and advantage would be served by the establishment of a branch of Wayne Bank in Spring Grove."<sup>101</sup> The court decided that Wayne Bank posed no threat of imprudent banking practices because it was adequately capitalized and well-managed.<sup>102</sup> The court also held that the existence of competitor banks, having appropriately located facilities and providing adequate and sufficient banking services, was an insufficient basis upon which to refuse to approve a branch application.<sup>103</sup> This holding is, however, subject to the condition that the economy and potential of the area are adequate to support another bank without resulting in excessive competition and danger to existing banks and the banking structure at large.<sup>104</sup>

The court of appeals also held that the public need or interest in a branch would be furthered when a branch proposes to pay higher rates or offer greater services or advantages to customers than are presently being offered.<sup>105</sup> Moreover, the court found that "the only

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<sup>98</sup>381 N.E.2d 1100, 1105-07 (Ind. Ct. App. 1978), *rehearing denied*, 385 N.E.2d 482 (Ind. Ct. App. 1979), *transfer denied*, No. 1-1277 A 303 (Ind. Ct. App. June 27, 1979) (70 Ind. Dec. No. 2, vii).

<sup>99</sup>381 N.E.2d at 1107.

<sup>100</sup>*Id.* at 1105.

<sup>101</sup>*Id.* at 1106.

<sup>102</sup>*Id.*

<sup>103</sup>*Id.* at 1105.

<sup>104</sup>*Id.* (citing *Clermont Nat'l Bank v. Citizensbank Nat'l Ass'n*, 329 F. Supp. 1331 (S.D. Ohio 1971); *Goldy v. Gerber*, 151 Colo. 180, 377 P.2d 111 (1962); *Montclair Nat'l Bank and Trust Co. v. Howell*, 32 N.J. 29, 159 A.2d 113 (1960); *Chimney Rock Nat'l Bank v. State Bank Bd.*, 376 S.W.2d 595 (Tex. Civ. App. 1964)).

<sup>105</sup>381 N.E.2d at 1106.

interest which would be served in excluding a bank which offers higher interest on deposits, lower interest on certain loans, and longer banking hours is that of the Richmond banks, not that of the people in the proposed service area."<sup>106</sup>

Discussing the advantages of promoting competition by increasing bank branches, the court explained that the Department's purpose is not to protect nor create monopolistic situations.<sup>107</sup> The Department's purpose, according to the court, is to protect the public from imprudent banking practices.<sup>108</sup> The court, however, did not totally negate competition's effect upon an existing bank. Competition should be a predominant factor in considering a branch application, but only when the effect of the competition would create the possibility of an existing bank collapsing or its business being severely damaged.<sup>109</sup> In that situation, competition's effect must be considered controlling; the collapse or severe damage of an existing bank would prove detrimental to the public convenience and advantage.<sup>110</sup> A collapse or near collapse of a bank would shake public confidence in the banking industry and perhaps result in runs on healthy banks. The court decided that minor losses of bank business resulting from competition were not controlling factors in determining whether to permit a branch to be established in an area served by an existing bank.<sup>111</sup>

The court also rejected any contention that banks have some right to be free from competition, unless statutory protection from this competition is provided. Quoting the trial court, the court of appeals found: "Competition is the life blood of a free enterprise economic system, and competition serves both the convenience and needs of the public. Banks have no right to be free of competition except as otherwise provided by statute."<sup>112</sup>

Rejecting a subsequent request for rehearing in the *Wayne Bank* case,<sup>113</sup> the court of appeals distinguished between "public con-

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<sup>106</sup>*Id.* See also *First Nat'l Bank v. Camp*, 471 F.2d 1322 (5th Cir. 1973); *Grenada Bank v. Watson*, 361 F. Supp. 728 (N.D. Miss. 1973); *Clermont Nat'l Bank v. Citizensbank Nat'l Ass'n*, 329 F. Supp. 1331 (S.D. Ohio 1971); *Ciety v. Green*, 300 A.2d 227 (Del. Super. Ct. 1972); *In re Howard Sav. Inst. v. Howell*, 32 N.J. 29, 159 A.2d 113 (1960); *Gerst v. Cain*, 388 S.W.2d 168 (Tex. 1965).

<sup>107</sup>381 N.E.2d at 1106.

<sup>108</sup>*Id.*

<sup>109</sup>*Id.* at 1107.

<sup>110</sup>*Id.*

<sup>111</sup>*Id.*

<sup>112</sup>*Id.* The trial court relied on the following cases:

*Clermont Nat'l Bank v. Citizensbank Nat'l Ass'n*, 329 F. Supp. 1331 (S.D. Ohio 1971); *Hoosier State Bank v. Saxon*, 248 F. Supp. 233 (N.D. Ind. 1965); *First Fed. Sav. and Loan Ass'n v. Department of Banking*, 188 Neb. 215, 196 N.W.2d 105 (1972); *Gerst v. Cain*, 388 S.W.2d 168 (Tex. 1965).

<sup>113</sup>385 N.E.2d 482 (Ind. Ct. App. 1979).



venience and advantage" and "public necessity." The Department contended that a conflict existed between the court's original opinion in *Wayne Bank*<sup>114</sup> and another decision rendered by the court in the same year.<sup>115</sup> The Department argued that the court of appeals incorrectly considered only the competitive situation in determining whether the public convenience and advantage would be promoted and subserved. The Department relied on *Department of Financial Institutions v. Colonial Bank and Trust Co.*,<sup>116</sup> in which it was held that it was improper for the trial court to make a determination whether a proposed new bank would be a "public necessity" solely upon the competitive impact of the proposed new bank.<sup>117</sup>

Although the court of appeals in *Wayne Bank* ruled it had considered more than the effect of competition in its original opinion,<sup>118</sup> it distinguished the original *Wayne Bank* decision from the one in *Colonial Bank*. The most obvious distinction was the governing statutes in each case. The applicable statute in *Colonial Bank* required a finding of "public necessity" before a *new bank* could be established.<sup>119</sup> The governing statute in *Wayne Bank*, however, required a finding of "public convenience and advantage" before a branch bank could be established.<sup>120</sup> The court concluded that the use of the different terms in the two statutes was not an unnoticed or unplanned result of legislative action.<sup>121</sup> The court reasoned that

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<sup>114</sup>381 N.E.2d 1100 (Ind. Ct. App. 1978).

<sup>115</sup>*Department of Financial Insts. v. Colonial Bank & Trust Co.*, 375 N.E.2d 285 (Ind. Ct. App. 1978), *cert. denied*, 439 U.S. 1116 (1979).

<sup>116</sup>*Id.*

<sup>117</sup>*Colonial Bank and Trust Co.* dealt with the establishment of a new bank as opposed to a branch. Consequently, the standard required was not "public convenience and advantage" but rather "public necessity." IND. CODE § 28-1-2-26 (1976). The statute for establishing a new bank, provides:

Proposed financial institution; investigation. Upon the filing of such application, the department shall make, or cause to be made, a careful investigation and examination relative to the financial standing and character of the incorporators or organizers, the character, and qualifications and experience of the officers of the proposed financial institution, of the *public necessity* for the financial institution in the community in which such proposed financial institution is to be established, and, if the institution is to be a bank or trust company, of the adequacy of the proposed capital thereof; and if the members of the department, after the hearing, as hereinbefore provided, shall determine either of such questions unfavorably to such applicants, the application shall not be approved, and if all such questions be determined favorably, the application shall be approved.

*Id.* (emphasis added).

<sup>118</sup>385 N.E.2d at 484 (quoting *Department of Financial Insts. v. Wayne Bank & Trust Co.*, 381 N.E.2d 1100, 1106-07 (Ind. Ct. App. 1978)).

<sup>119</sup>385 N.E.2d at 484; IND. CODE § 28-1-2-26 (1976).

<sup>120</sup>385 N.E.2d at 484; IND. CODE § 28-1-17-1 (1976).

<sup>121</sup>385 N.E.2d at 485.

the legislature must have used dissimilar terminology because it intended the standard to be "separate and distinct."<sup>122</sup> The literal meaning of the words of the two standards also supported the court's contention. "'Convenience and advantage' denotes something less compelling than 'necessity.'"<sup>123</sup> Consequently, the competitive effect would be of less importance in considering the application for a branch bank than in considering the application for a new bank, although the effect of competition from the proposed branch would become a controlling factor in considering a branch application if the effect of the proposed branch would be to severely damage or cause the possible collapse of an existing bank.<sup>124</sup>

As the above discussion and analysis of "public convenience and advantage" demonstrates, the courts have taken significant steps to promote a more efficient banking system. The public will not be precluded from enjoying another banking alternative merely because existing institutions are providing adequate service, especially if the proposed branch intends to offer greater advantages to the public than are offered by the existing banks. Nor will a proposed branch be hampered by showing that it will promote the "public convenience and advantage" merely in the political subdivision within which it is located. Instead, the courts will see if the proposed branch will subserve the "public convenience and advantage" of its "economic city" or service area. The major shift toward a more efficient economic banking system is demonstrated by the language in *Wayne Bank* recognizing the value of competition in promoting the "public convenience and advantage." The courts are given greater flexibility to promote greater efficiency in the area of branch banking than in the area of new banks. Such a result, however, is necessary; new banks incur a greater risk of failure than a branch bank does, due to the new bank's lack of economies of scale. Branch banks possess more economies because the main office bears a predominant share of banking overhead expenses. Indeed, there is an inherent safety factor in the branch banks' economies of scale which makes the chance of a branch bank failure more remote than the chance of a new bank collapse.

#### IV. CONCLUSION

The courts applying Indiana bank branching law have moved the Indiana banking industry toward a more competitive and theoretic-

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<sup>122</sup>*Id.*

<sup>123</sup>*Id.*

<sup>124</sup>*Id.*

cally more efficient banking system.<sup>125</sup> The courts have discarded the old notions that competition is harmful *per se* in the banking field and have allowed banks to more actively compete.<sup>126</sup> This policy favoring competition has benefited consumers in the form of lower interest rates, longer hours, and greater services. This trend conforms with the principle that banking should be regulated to protect the *public interest* and not the *private interest* of the banks.

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<sup>125</sup>Some commentators have argued that the banking industry should be regulated under the antitrust laws as any other industry. See Baker, *Bank Expansion: Geographic Barriers*, 91 BANKING L.J. 707 (1974). This belief in the antitrust laws is founded upon views similar to those held by Mr. Justice Black:

[The Sherman Act] rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions.

Northern Pac. Ry. v. United States, 356 U.S. 1, 4 (1958).

<sup>126</sup>The United States Court of Appeals for the Seventh Circuit rendered a decision on April 23, 1980, which appears to be directly opposed to the current judicial trend in Indiana regarding bank branching. In *State Bank of Rensselaer v. Heimann*, 619 F.2d 679 (7th Cir. 1980), the Seventh Circuit reversed a decision of the Comptroller of the Currency authorizing the establishment of a branch.

The court stated that the proposed site was not a "town" within the meaning of the branching statute, although located approximately 1,000 feet south of St. Joseph's College in an unincorporated area appearing on maps as "Collegeville." Expressing serious doubts whether a campus fit the definition of town, the court stated that since the intent of the applicant bank was to open a branch to serve the incorporated town of Rensselaer, this attempt to "circumvent" the branching laws could not be allowed. This reasoning by the court is diametrically opposed to the Indiana decisions narrowly construing the home office protection provision.

In addition, the court ignored the language in *Wayne Bank* favoring healthy competition among banks. The Seventh Circuit held that Indiana allowed branches in areas not already served but did not allow branches to be used as a means of stimulating competition among banks.

Although a strong argument can be made that education is a business and Collegeville is a town within the meaning of the statute, the most disturbing aspect of the Seventh Circuit's decision is that the court has apparently decided to ignore Indiana decisions which narrowly construe home office protection, liberally construe town, and generally favor competition as a means of subserving and promoting the public convenience and advantage.

