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May 26, 1916.

Memorandum for the Board in re interpretation to be given to the language "substantial competition" as used in the recent amendment to the Clayton Act.

The Clayton Act is entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes".

In so far as it relates to the business of banking it provides in substance that (Section 8) -

(1) No banking association organized or operating under the laws of the United States, and located in a city of more than two hundred thousand inhabitants, shall have as an officer, director, or employee a private banker or an officer, director, or employee of another bank located in the same city.

(2) The same person shall not be an officer, director, or employee of two banking associations organized or operating under the laws of the United States if either has deposits, capital, surplus, or undivided profits aggregating more than five million dollars.

(3) That no banking association organized and operating under the laws of the United States shall have as a director a private banker or a director of a state bank

or trust company which has deposits, capital, surplus and undivided profits aggregating more than five million dollars.

There are certain exceptions contained in the original Act to the foregoing restrictions which, for the purposes of this note, it is not now necessary to consider.

Considering the general purposes of the Act it may be reasonably assumed that Congress intended to prevent the same person from exercising control over two or more banking associations by serving as an officer, director, or employee of both associations where the exercise of such control would have a tendency to destroy or restrain competition between such banks and thus to create a monopoly.

Having constitutional authority to legislate on the subject of bank "organized or operating under the laws of the United States", Congress undertook to accomplish this object by prescribing qualifications of officers, directors, and employees of such banks. It was evidently due to this fact that the particular language used in Section 8 was adopted and in considering the purpose and intent of Congress this fact should be borne in mind.

While the purpose of the Act, as its title implies and as the context shows, was to prevent unlawful restraints and monopolies, the particular language used in Section 8, if construed literally, would prevent the same person from being an officer, director, or employee of two different banks under certain circumstances whether or not such banks were in competition.

The effect of the amendment of May 15, 1916, is to restore this element of competition as a factor in determining under what circumstances the same person may serve as an officer, director, or employee of two banking associations. To illustrate, under the Act as passed the same person could not serve as a director of two national banks in the same city of two hundred thousand inhabitants even though such banks were in no sense competitors. Under the amendment of May 15, 1916, however, the Federal Reserve Board is vested in a discretion to determine first whether such banks are in substantial competition and, if not, to permit a person to serve as a director of both banks. This amendment provides in terms that -

"Nothing in this Act shall prohibit any officer, director, or employee of any member bank, or Class C director of a Federal reserve bank, who shall first procure the consent of the Federal Reserve Board * * * * from being an officer, director, or employee of not more than two other banks * * * if such other bank * * * is not in substantial competition with such member bank. "

It is, therefore, necessary for the Board to determine under what circumstances two banking associations located in a city of more than two hundred thousand inhabitants may be said to be in substantial competition, or when a banking association having more than five million dollars in deposits, capital, surplus, and undivided profits may be said to be in substantial competition with another banking association.

It must be assumed that Congress intended this language to be given its usual or ordinary interpretation. The definition given by Webster of the word " competition " and adopted in a number of cases, is

"The act of seeking or endeavoring to gain what another is endeavoring to gain at the same time; rivalry; mutual strife for the same object" (State v. Port Royal & A.Ry. Co., 23 S. E., 363, 369, 45 S. C. 413, (quoting Burke v. Big Four - Ohio.- 22 Wkly. Law. Bull. 14).

In the case of State v. Central Lumber Co. 123 N. W., 504, the court says -

> "'Monopoly' and 'competition' being the exact opposites, anything tending to destroy competition tends toward monopoly."

The Clayton Act having for its purpose the prevention of monopolies, it seems clear that it was intended, as above suggested, to prevent two banks from having the same officers or directors when such banks are competing for the same business.

The word "substantial" was incorporated in the amendment of May 15, 1916, as a qualification of the word "competition" and its inclusion was in effect a legislative sanction of the decisions of several of the courts in cases dealing with this subject. For example, in the case Kimball v. Atchison, T. & S. F. R. CO. (U. S.) 46 Fed. 888, 890, the court says -

> " * * * that when the statute speaks of competing roads it evidently means roads that are substantial competitors for business; it refers to competition of some practical importance, such as is liable to have an appreciable effect on rates, and in that sense the road to Union was not, in my judgment, a competing line."

In the case of the State v. Central of Georgia R. CO., 35 S. E. 37, 38, 109 Ga. 716, 48 L. R. A. 351, the court says :

> "The question is, at last, one of fact, and in its adjudication in any particular case the court should be governed by the fundamental principle as to whether there was such a creation of a monopoly or defeating of competition as would result in injury to the public. "

In the more recent case of the Standard Oil Co. v. United States, 231 U. S. , 1- 63, the court says -

> "In substance, the propositions urged by the Government are reducible to this : That the language of the statute embraces every contract, combination, etc., in restraint of trade, and hence its text leaves no room for the exercise of judgment, but simply imposes the plain duty of applying its prohibitions to every case within its literal language * * * .
>
> The merely generic enumeration which the statute makes of the acts to which it refers and the absence of any definition of restraint of trade as used in the statute leaves room for but one conclusion, which is, that it was expressly designed not to unduly limit the application of the act by precise definition, but while clearly fixing a standard, that is, by defining the ulterior boundaries which could not be transgressed with impunity, to leave it to be determined by the light of reason, guided by the principles of law and the duty to apply and enforce the public policy embodied in the statute, in every given case whether any particular act or contract was within the contemplation of the statute."See also-

Louisville & Nashville Ry. Co. v. Kentucky, 161 U. S.677,698;
Pearsall v. Great Northern Railway, 161 U. S., 646,676;
Dady v. Georgia & A. Ry., 112 Fed. 838, 844;
Rogers v. Nashville, C. & St. L. Ry. Co., 91 Fed., 299, 318;
East St. L. Connecting Ry. Co. v. Jarvis, 93 Fed., 735, 742;
E. L. & Red River Ry. Co. v. The State, 75 Tex. 434, 436.

It should be borne in mind that the purpose of the Act is to encourage , or at least to preserve, competition between banks.

The terms of the Act, however, are not applicable to all national banks but only to banks of a certain size, or banks located in cities of a certain size. For example, the director of a national bank in a city of less than two hundred thousand inhabitants may be a director of any number of other banks located in cities or towns of less than two hundred thousand inhabitants, provided, none of such banks has deposits , capital, surplus and undivided profits of more than five million dollars.

The theory of the Act appears to have been that all banks in cities of more than two hundred thousand inhabitants are presumably competing associations and that every bank with aggregate resources of more than five milmion dollars is presumably a competitor of every other bank regardless of its location. The effect of the amendment of May 15, 1916, known as the Kern amendment,is that

this presumption may be overcome by the facts in any given case. On this theory the burden is on the applicant in each case to show by some affirmative evidence that the two banks with which he wishes to be connected are not in substantial competition.

The Board is, therefore, confronted with the difficulty of determining the kind and character of evidence it will require to rebut the presumption that the banks in question are active or substantial competitors.

Generally speaking it should appear that the two institutions are not seeking the same business- that is to say, they are not seeking to make their earnings from the same sources so that the increase of the business of one should not be expected to have any appreciable effect upon the earnings of the other.

It is accordingly necessary in each case to consider whether the earnings of one bank are likely to be appreciably affected by an increase of the business of the other. This necessarily involves a consideration of the source of the earnings of each bank. As a general proposition a bank's earnings are derived from those relations which it has with its customers or patrons. The customers may be divided into general classes -

(1) The depositors, or those who furnish funds to the bank;

(2) The borrowers, or those who pay to the bank interest or discount for the use of the bank's funds.

It is in this respect that the banking business differs from that of corporations engaged in trade or commerce. A manufacturing corporation, for example, derives its profits from the use of its own funds. Such a corporation is a competitor of others in the matter of the sale of its products. A bank, however, competes first in procuring funds or deposits and also in the investment of funds so procured. To increase its earnings to any great extent it must increase its deposits.

The Board must, therefore, determine first whether the two banks are seeking the same class of depositors in order to increase their loanable funds, and, secondly, whether they are making the same class of loans or investments. In either case the two banks may be competitors but it is the degree of competition that must be determined.

If one bank receives only deposits subject to check and makes short-term commercial loans and discounts

while the other receives only time deposits or savings accounts and does not make commercial loans, the case would seem to be free from difficulties. Where both banks receive checking accounts but one makes commercial loans while the other does not, the question of competition is involved but the fact that both receive the same class of deposits is by no means a conclusive test. This question can not be determined solely by the character of deposits received or the character of the loans made. It is entirely conceivable that both banks may engage in a strictly commercial banking business and yet may not be substantial competitors.

Where the banks are located in different cities or communities the character of deposits and character of loans and rediscounts may be similar and yet the two banks may not be active or substantial competitors. Where they are doing business in the same general locality, however, the character of deposits and character of loans and investments become of greater importance in determining the degree of competition.

In a city of two hundred thousand inhabitants the Board might conclude that taking into consideration

the amount of commercial business in that city every bank engaged in a purely commercial banking business is in substantial competition with every other bank engaged in the same character of business.

On the other hand, in a city of two million inhabitants the commercial business may be of such volume that the question of the degree of competition will depend upon the location of the banks in the city. Banks in the wholesale district may not come into competition to any appreciable extent with banks in the retail district.

It is manifest that each case must be determined upon the facts submitted and that no fixed rule can be prescribed by the Board to govern all cases.

In order to assist the Federal Reserve Agents in making recommendations, however, the following factors should be called to their attention.

First : As the banks organized and operating under the laws of the United States are engaged primarily in the commercial banking business, and as such bank is authorized by its charter to do a banking business in a particular city, town, or village, consideration should be given to the volume of commercial business engaged in by bank customers in the place in which the banks are located.

Second: If the two banks are doing business in the same general locality special consideration should be given -

(1) to the character of deposits received as indicated

(a) by the amount of deposits subject to check;
(b) by the amount and terms of time deposits and savings accounts;
(c) interest paid ;
(d) conditions of deposit - that is to say, whether an average balance is required;

(2) to the character of loans and investments made as indicated by

(a) amount of short term loans and discounts;
(b) investments in real estate;
(c) investments in stocks, bonds, and other long time securities.

Third: The capital and total resources of the two banks may be considered as a factor. The large bank may make loans of a size that could not be made by a bank of smaller capitalization and for this reason they may serve the same communities without coming into competition to any substantial extent.

After considering these several factors and after determining whether the two banks are actual competitors

the Board must still determine whether the extent of this competition brings them within the prohibition of the statute. To do this, it is necessary to determine what form of evil Congress intended to correct. Was it the purpose of Congress to insure to each bank an equal opportunity to increase its earnings by preventing the directors of one bank from controlling the operations of another competitive association, or was this Act intended merely to insure to the public the benefits to be derived from actually competing associations?

To illustrate by concrete example, if the same directors control two competitive banking associations they might give preference in the matter of investments and otherwise to the one in which they have the largest number of shares and may in this way deprive the stockholders of the other from their just proportion of earnings. On the other hand, viewing the matter from the standpoint of the public, if there are only two banks in a given community and both are controlled by the same directors preference may be shown to certain customers in the matter of loans made, interest charged, etc., which would not be shown if the two banks were active competitors for the same business.

Under the common law contracts in restraint of trade were void as a matter of public policy and the so-called anti-trust laws which were amended and supplemented by the Clayton Act are in a sense a development of the common law rule against those contracts which destroy competition or restrain trade.

The Board should, therefore, take into consideration the effect on the public in reaching a conclusion as to whether two banks are in substantial competition. That is to say, it should consider whether any control of one by the other can affect the public in any way, as for example, by resulting in a decrease of interest rates paid to depositors or an increase in interest rates charged on loans. It should consider in each case whether the control of the bank by the officers of another can affect the earnings of either bank, or the business of either in its relation to the public. As stated, the burden is on the applicant to show by affirmative evidence that the banks are not in substantial competition.

Respectfully,

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