OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 82-1766

TITLE SECURITIES INDUSTRY ASSOCIATION, ET AL., Petitioners
v. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, ET AL.

PLACE Washington, D. C.

DATE March 21, 1984

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IN THE SUPREME COURT OF THE UNITED STATES

SECURITIES INDUSTRY ASSOCIATION, ET AL., Petitioners v. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, ET AL. : No. 82-1766

Washington, D.C.

Wednesday, March 21, 1984

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 11:12 a.m.

APPEARANCES:

HARVEY L. PITT, ESQ., Washington, D.C.; on behalf of Petitioners

LOUIS F. CLAIBORNE, ESQ., Washington, D.C.; on behalf of Respondents.

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C O N T E N T S

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P R O C E E D I N G S

CHIEF JUSTICE BURGER: W we will hear arguments next in Securities Industry Association against the Board of Governors of the Federal Reserve System.

Mr. Pitt, I think you may proceed whenever you're ready.

ORAL ARGUMENT OF HARVEY L. PITT, ESQ.,

ON BEHALF OF PETITIONERS

MR. PITT: Mr. Chief Justice, and may it please the Court:

At issue in this case is a dividing holding of the Court of Appeals for the District of Columbia Circuit which upheld a Federal Reserve Board ruling permitting Bankers Trust Company to market and corporate commercial paper notes for the first time since the Glass-Steagall Act was passed nearly 50 years ago.

Both the Federal Reserve Board and the Court of Appeals concluded that the Glass-Steagall Act should be given a narrower reading than the literal language or its unmistakable legislative purposes would dictate. The court below in essence directed that the Federal Reserve Board should be free on a case by case basis to adapt the Glass-Steagall Act's flat prohibitions to current business reality and changing financial needs of

our economy.

It is our contention in this Court that that decision should be reversed, first because it ignores the plain language and leaves our financial system open to precisely the hazards that Congress had in mind when it enacted the Glass-Steagall Act over 50 years ago. Second, it's inconsistent with the specific policy choice that Congress made.

When Congress considered the Glass-Steagall Act and the dangers that had given rise to that statute, it had before it the choice of absolute prohibition or case by case regulation with delegation to an administrative agency. Congress rejected regulation and chose absolute prohibition, as this Court has twice noted. For that reason, the court below erred in undoing the specific policy choice the Congress had made.

And finally, the decision below represents a bad policy choice that not only is not justified by the statute and by its legislative history, but that, as recent events have shown, will substitute litigation and case by case administrative revisionism for resolving what bank activities are appropriate. This would mark the first time in our history as a country and as a nation that any court has done so.

The factual background of this case is relatively simple and straightforward. In 1978 Bankers Trust Company, which is a state bank which is a member of the Federal Reserve System, began underwriting commercial paper notes issued by third party corporations. The Federal Reserve Board ruled that this was legal, not because the statute didn't cover it, but because the statute shouldn't be read to cover it even though its literal terms so provided.

The court said -- the Federal Reserve Board said that commercial paper is more like a bank loan, even though it is conceded that the bank is not lending anyone any money in the activity of distributing and underwriting commercial paper.

QUESTION: Had the Board ever expressly forbidden such a thing before?

MR. PITT: The Board has never expressly forbidden such a thing, because the statute has forbidden it.

QUESTION: And because no one has ever asked them before?

MR. PITT: That is correct. But I might point out that since the passage of the Glass-Steagall Act no bank has ever underwritten commercial paper?

QUESTION: Or even asked to be permitted to?

MR. PITT: No bank has asked the Federal Reserve Board to be permitted to do so.

QUESTION: Were banks even doing that at the time of the enactment of the Glass-Steagall Act? I kind of sensed in reading the briefs that the Glass-Steagall Act was not directed in its terms to that practice, and I wondered if banks say in the twenties, before the Glass-Steagall Act was passed, actually were doing that.

MR. PITT: There were some isolated instances of banks underwriting commercial paper. But by and large, the overwhelming function at the time of the passage of the Glass-Steagall Act was for banks to purchase commercial paper, which is the equivalent of making a loan, and of course there is express authority for banks to do that.

In our system banks are permitted to do that which is expressly provided, and they may not do that which is not expressly permitted. In this case, the Glass-Steagall Act takes that regime a step further and says that banks, particularly state member banks and national banks and all banks, may not underwrite commercial paper notes.

It is unmistakable from the language of the statute that the statute prohibits the underwriting of

notes, and no one disputes that issue in this case. The question is whether the Board is free to say that some notes will be treated in accordance with the literal language of the statute and other notes will not be treated in accordance with the literal language of the statute.

QUESTION: Mr. Pitt, you agree with the Government that commercial paper is not an investment security as that term is used in Section 16?

MR. PITT: Your Honor, I would state that the Government is correct that commercial paper is not presently defined as an investment security. And I might add here that Section 16 of the Glass-Steagall Act --

QUESTION: I'm a little unclear. Is commercial paper an investment security in the meaning of the term in Section 16?

MR. PITT: The point I am making, Your Honor, is that the term is not -- that within the meaning of that term, commercial paper is not an investment security because the Comptroller of the Currency, an entity that is not involved in this case, has never defined commercial paper as an investment security.

QUESTION: But how about the statute? I mean, was it intended that investment security incorporate

commercial paper by Congress?

MR. PITT: There is no indication that the statute need exclude commercial paper from that context. It is simply not -- it is not discussed.

But the term "investment security", Your Honor, does not have any relevance to the issue in this case. The reason I state that is that we are here dealing with a specific bar. In Section 21 the statute says that it is unlawful for any entity that engages in issuing, underwriting, selling or distributing funds, notes, debentures securities, and other securities from also taking deposits.

The term "notes" is specifically used in Section 21 without any qualifier and without any reference to investment securities or otherwise, and thus for this purpose it's irrelevant whether one deems commercial paper to be an investment security or not.

Section 16 of the Glass-Steagall Act has a flat prohibition. It says that it shall be unlawful for any national bank to underwrite any issue of securities or stock. There is absolutely no qualification whatsoever in that prohibition.

There are provisions in Section 16, however, which indicate -- and this is the critical facet of the structure of the Glass-Steagall Act -- that when

Congress wanted to permit banks to underwrite specific securities, it knew how to do so. Appended to Section 16 is a laundry list of 15 securities that are in the form of notes that the Congress has directed banks may underwrite.

In Section 21, in 1935 Congress amended the provisions of Section 21 specifically to provide that banks might underwrite mortgage notes, because there had been the claim that mortgage notes would be encompassed within the broad prohibition against underwriting any notes. Congress responded in '35 and gave banks that authority and said that the section should not prohibit that.

QUESTION: Do you disagree, then, with Judge Wilkie's opinion's reading of the word "notes" in Section 21?

MR. PITT: Absolutely, Your Honor. Judge Wilkie's reading, which I think was a narrowing, and he conceded it was a narrowing, of the literal language, suggested that when one looks at the various entities that precede the word "notes" -- the statute reads "stocks, bonds, debentures, notes and other securities" -- that one ought to view "notes" as potentially meaning notes for the raising of capital for permanent purposes for corporations.

Where he found those words we are not certain, but they don't appear on the face of the statute. Moreover, he seized upon three factors which he indicated would determine when a note would be within the statute and not. The three factors that he alluded to and that the Board has alluded to in this case are the denominations of the notes, the nature of the purchasers, and whether the notes were of prime quality.

None of those things have to do with whether the note is being used to raise capital or not. So that after having totally taken the statute out of context and then relying on factors that bear no resemblance to the specific criteria he applied, he concluded that commercial paper notes were not within the statute.

QUESTION: This is his functional analysis?

MR. PITT: This is his functional analysis and the Board's functional analysis. And I might add that that functional analysis is precisely what the evil in this case is, because it substitutes a regime of case by case regulation for what Congress decided ought to be an absolute prohibition.

This is one of the instances in that period of legislation in which Congress said: We will not rely on Government regulation; we want prohibition; and when we

think a bank ought to be able to engage in activity, we will so specify. And there have been numerous examples of those specifications.

As I have indicated, in the relevant universe of the statute, Sections 21 and 16, there are two major categories that Congress deals with in the Glass-Steagall Act. One are the instruments to which the Glass-Steagall relates, and second are the activities which are prohibited.

A careful review of the statute shows that both the instruments to which the statute relates and the activities prohibited are all-encompassing. There are no activities that are not governed by this statute.

One need only look at the listing of terms -- stocks, bonds, debentures, notes, and other securities -- to understand that Congress had in mind all instruments by which corporations obtain any form of capital.

Second, when one looks at the specific activities in the statute, it is equally clear that Congress parsed out and covered every conceivable activity that a bank could engage in in the context of these instruments. It dealt with purchasing, selling, issuing, underwriting, distributing.

The statute is unmistakable in terms of its breadth and its scope.

QUESTION: Mr. Pitt, very naturally you're emphasizing the language that's found in Section 21, rather than the language in Section 16. In your view, is Section 16 totally redundant?

MR. PITT: No, Your Honor, it is not totally redundant. Section 16 by its terms applies only to national banks. Section 21 applies to any deposit-taking institution. Both contain co-equal prohibitions on underwriting, but Sections 16 and 21 have different formulations with respect to certain activities of banks that are not involved in this case. For example, with respect to investment securities, there are distinctions that are made in Section 16 that are not made in Section 21 for different types of entities.

But both provisions are unmistakable in providing the universe of deposit-taking institutions, that they may not underwrite notes or other securities.

QUESTION: Well, 16 doesn't refer to notes?

MR. PITT: I'm sorry, Your Honor?

QUESTION: 16 doesn't refer to notes, does it?

MR. PITT: 16 refers to the broader term of

securities.

QUESTION: Right.

MR. PITT: And one need only look to Section 21 to indicate that the term "securities" obviously must include notes by virtue of the form of Section 21, which starts with stocks, bonds, debentures, notes, and then says "and other securities." It is clear that Congress intended a note to be a security within the meaning of both provisions.

QUESTION: But certainly not all notes, though, are included?

MR. PITT: I'm sorry?

QUESTION: I assume that all notes are not covered by Section 21. Certificates of deposit or loan participations or bankers acceptances, maybe even cash, they're not included, are they?

MR. PITT: Your Honor, this case only involves commercial paper. But the scope of the term "notes" means any notes. For things like certificates of deposits and other legitimate banking functions, there are specific and permissible activities. All of the normal functions that banks have always performed, even with respect to commercial paper, are provided for in the banking laws.

But the term "notes" used in Section 21 is as

broad as any note. Witness the exemption for mortgage notes.

QUESTION: No, but if you were right there would then be conflicts with other sections of the banking laws, I suppose.

MR. PITT: No, that is not correct. There are no legitimate banking functions -- and the Government has not referred to any. The Government has in the context of this case attempted to establish that certain activities, some of which are questionable, may be foreclosed by this Court's decision. I think there are two simple answers to that.

First, this case only involves commercial paper, notes that are clearly within the meaning of the statutory term, not only because they fit literally but because there's contemporaneous Congressional evidence that Congress intended commercial paper to be included within the scope of that statute.

QUESTION: What about a bank which, instead of underwriting notes in the language of Section 21, were to simply issue -- is a certificate of deposit a note that's issued by the bank?

MR. PITT: A certificate of deposit is, and banks have express authority to issue notes.

QUESTION: So that the prohibition against

them issuing notes in Section 21 somehow doesn't prevail over the other language?

MR. PITT: The prohibition in Section 21 has to be read with respect to the express authority that banks are also granted, and banks are granted the authority to discount and --

QUESTION: Well, perhaps I haven't adequately read the briefs. Where else are these express authorities granted, and what's the point of having Section 21, which prohibits a bunch of stuff, if it's all granted somewhere else?

MR. PITT: Well, first of all, with respect to national banks Section 16 sets forth the express powers of those banks. With respect to state member banks, many of the restrictions and provisions of Section 16 are provided to state member banks.

Section 21, which deals with any depository institution, is basically silent as to the affirmative powers of depository institutions, and that means that whatever affirmative powers they have, as this Court has --

QUESTION: But it's not silent as to what it prohibits, I take it.

MR. PITT: That is correct.

QUESTION: It prohibits any organization

engaged in the business of issuing notes from taking deposits.

MR. PITT: Section 21 defines a depository institution within its terms as one that may issue certificates of deposits and other instruments for the conduct of banking business. If you look at the precise language of Section 21, Your Honor, it defines the term "deposit-taking institution" as an institution that receives deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt.

Within Section 21 itself, it expressly recognizes that these are traditional banking functions and uses them to define the entities that are within its prohibition.

QUESTION: Well, but then a bank that does that sort of business, that receives deposits, along those lines, can't issue a certificate of deposit?

MR. PITT: That is correct. A bank that receives deposits may issue a certificate of deposit, but it may not -- one of the questions is it may not engage in a marketing scheme. It may obtain funds from individual investors, individual depositors in return for a certificate of deposit which bears interest. That is expressly contemplated by Section 21 and it's

expressly within the purview of other affirmative banking statutes.

QUESTION: Did I understand you to say that they must hold that certificate, then? The relationship between the bank and the holder of the CD, what about that?

MR. PITT: Whether they need to hold that --

QUESTION: Can you describe that relationship other than, obviously, a debt?

MR. PITT: Well, the certificate of deposit in that case is held of course by the depositors.

QUESTION: Did you describe that as a note in response to Justice Rehnquist?

MR. PITT: I'm not certain I'm following Your Honor.

QUESTION: Is it a note of the bank when it's held?

MR. PITT: It is in form a note of the bank when it is held by the depositor. In form it is. But it is not a note that the bank is underwriting or engaging in any prohibited activity, because banks raise capital by issuing notes and that is a permissible activity within Section 21.

The contemporaneous legislative history of the Glass-Steagall Act I think makes quite clear that

commercial paper is both a note and a security for purposes of these prohibitions. We start with this Court's decision in the Camp case, which held that the term "security" should be construed broadly, not just literally but broadly and flexibly to accomplish its purpose.

Indeed, in the four decisions of this Court that have defined terms in the Glass-Steagall Act this Court has continually urged that those terms are not to be given a narrow or restrictive reading, but are to be given a broad reading. In this case, we simply urge that they be given at a minimum their literal reading, as well as accomplishing the regulatory purposes.

The structure of the Glass-Steagall Act, as I've indicated, confirms that "notes" were intended to have its plain meaning. In addition, if one looks at other legislation, both contemporaneously and other banking legislation, it is clear that when Congress wanted to qualify the types of notes that it was restricting it knew how to do so.

For example, there are statutes in which Congress refers to capital notes. Section 16 itself refers to notes commonly known as investment securities, for which there is a limited authorization of purchase. The fact of the matter is that in every instance in

which Congress wanted to restrict the scope of its prohibitions it said so and it did so plainly.

Moreover, one need look at the securities laws, which were enacted at exactly the same time and by exactly the same Congress and by exactly the same committees to understand that Congress clearly understood commercial paper to be a note. In the Securities Act of 1933, Congress specifically defines "security" to include any note.

Senator Glass, one of the architects of the Glass-Steagall Act, went before the committee when it was considering the '33 Act and suggested that perhaps the Congress ought to exclude commercial paper, specifically commercial paper, from the provisions of the Securities Act. Congress rejected that suggestion, but adopted a narrow prohibition against requiring registration. It exempted commercial paper for the registration requirements of the federal securities laws.

QUESTION: Well, Mr. Pitt, do you contend that the definitional provisions of the Securities Acts of '33 and '34 carry over to the Glass-Steagall Act, which really doesn't have any definitional sections like that?

MR. PITT: The answer is they are most

certainly relevant, Your Honor. They clearly evidence --

QUESTION: Well, does that mean they do or do not carry over?

MR. PITT: They -- let me say this, that both statutes were enacted to deal with the same abuses and evils, and they approach the problem from different ends. With respect to the Glass-Steagall Act, the Glass-Steagall Act prohibits banks from engaging in the securities business.

One presumably would look to the federal securities laws to define what the securities business is. It was the same committee and the same Congress, dealing with the same evils, that adopted both statutes.

The Board itself in its ruling indicated that the definitions and provisions of the Securities Act were clearly relevant. They have argued that they are not dispositive.

I am raising the Securities Act in this Court simply to indicate that Congress understood that when it used the term "notes" and when it used the term "securities" that that would include commercial paper unless it exempted it.

When one goes back to the Glass-Steagall Act

and sees the broad definitional terms that were used, and that literally encompass commercial paper, one has to go a long way to find a basis for excluding out of the statute that which Congress has expressly recognized would otherwise be included.

Beyond that, in 1935 when Congress amended the Glass-Steagall Act with some technical amendments, Congress did put in an amendment to Section 21 of the Glass-Steagall Act, as I have indicated, allowing banks to underwrite mortgage notes. Again, if "notes" did not mean all notes and certainly not long-term capital raising notes, there would have been no need for the exemption for mortgage notes.

Congress a day earlier amended -- adopted the Public Utility Holding Company Act of 1935. In that statute Congress said that public utility holding companies were prohibited from purchasing securities. However, it excepted such commercial paper and other securities as the SEC might permit by regulation.

In each instance, both in '33 and in '35, when Congress dealt with the terms "notes" and "securities", it understood that commercial paper would be included unless it was specifically excluded. There was no specific exclusion here, and so the Board has relegated -- arrogated to itself the capacity to exclude it on its

own. That we submit is what the Board may not do.

QUESTION: Mr. Pitt, let me ask you a question. I think it may be similar to one Justice Rehnquist asked. Supposing a bank issues a group of unsecured notes, not mortgage notes. Somebody borrows money from the bank and they get notes in exchange. Can they discount those notes to another bank?

MR. PITT: Yes. Banks specifically have the authority --

QUESTION: There's an express statutory provision?

MR. PITT: -- to discount and negotiate notes.

QUESTION: There's an express statutory provision?

MR. PITT: Expressed in Section 16, yes.

The Board's efforts basically to avoid the plain language really relate not so much to any reliance on the literal language of the statute, but to a disagreement with the policy that Congress formulated -- an effort, in essence, to change the structure of the statute.

The Board adopted a functional analysis in which it suggested that any instrument which might be functionally similar to a traditional commercial banking

operation or which displayed the economic characteristics of a commercial loan should be permissible for the Board to exempt out of the statute. There are two immediate problems with that.

The first is that the statute does not say this and it gives the Board absolutely no regulatory power under either Section 16 or 21. I want to stress that the Board of Governors has absolutely no power to regulate under either of those two provisions.

QUESTION: I suppose, though, that a regulatory agency's interpretation of a statute is of some significance for us?

MR. PITT: Your Honor, there is no doubt that an agency's interpretation of a statute which it is charged with administering is entitled to some deference.

QUESTION: Particularly in a field as complicated and specific as this one is.

MR. PITT: There is no doubt, Your Honor, that that general policy certainly obtains, but it does not obtain here for the simple reason that the Board is not engaged in interpretation here. The Board is engaged in regulation.

I say that because if the Court refers to not only the Board's statement, but also its lawyers'

explanations of that statement before the courts below -- and particularly I am referring to pages 136 and 192 of the joint appendix -- the Board has continually said that it reserves the right -- and I may now quote:

"The Board did not say that any one particular fact was determinative. The Board did not say that all short-term notes were not securities. It did not say that all non-speculative notes were not securities. The Board's determination is based on this particular combination of the factors involved. If the factors change, then the Board's conclusion is very likely to change."

I submit, Your Honor, that that's not interpretation, that's regulation.

I would like to reserve the rest --

QUESTION: Your contention is that Glass-Steagall didn't set up the sort of regulatory regimen that the SEC did, where you have an agency actively policing and perhaps changing definitions? Glass-Steagall is just a set of prohibitions?

MR. PITT: That is correct. That is precisely our contention.

CHIEF JUSTICE BURGER: Mr. Claiborne.

ORAL ARGUMENT OF LOUIS F. CLAIBORNE, ESQ.,

ON BEHALF OF RESPONDENTS

MR. CLAIBORNE: Mr. Chief Justice, may it please the Court:

All those of us who have persevered through the several briefs filed on both sides and by the allies of Petitioners and Respondents must come away with the sense that two quite different statutes are being discussed, both purporting to be the Glass-Steagall Act.

The one that is pictured by Petitioners and their allies is an uncompromising ban on the marketing of anything by commercial banks. All the emphasis in their briefs is on the activity or the transaction which the Act prohibits, with no attention to the character of the instrument that is being dealt with.

But unsurprisingly, the Glass-Steagall Act is not quite that simple. To be sure, sometimes the prohibitions of the Act do turn on the kind of business activity involved. For instance, where stock is the security in question, banks may act as brokers for their customers, but they may not purchase stock, shares of stock, for their own account.

That indeed is the difference, as we read it, between the two most relevant decisions of this Court, ICI I and ICI II, as they're referred to.

QUESTION: Mr. Claiborne, it would help if

you'd raise your voice a little.

MR. CLAIBORNE: I'm sorry, Your Honor.

But on the other hand, as often, the prohibitions of the Act depend on the character of the instrument, and the most obvious example is shown in the provision which exempts Government bonds and Government insured bonds from any of the prohibitions of the Act. They may be underwritten, they may be sold, they may be distributed, they may be purchased without limit by a commercial bank. Not so with respect to bonds not issued by Government or not insured by Government.

The short of it is that there is no universal prohibition in the Glass-Steagall Act against underwriting or marketing. It depends on what sort of instrument is at stake.

The question here as we view it is whether commercial paper is wholly outside the prohibitions of the Glass-Steagall Act. We do not claim an exception, an exemption in the Act. Our straightforward position is, the Glass-Steagall Act has nothing whatever to do with commercial paper. It was not intended to.

So far as the Glass-Steagall Act is concerned, commercial paper can be bought, sold, underwritten, marketed, framed, used for kindling, absolutely indifferent to the Act.

QUESTION: Well, you do suggest that the word "notes" doesn't include commercial paper.

MR. CLAIBORNE: Indeed, and because the word "notes" --

QUESTION: You mean it doesn't include the kind of notes represented by commercial paper?

MR. CLAIBORNE: It doesn't include the kind of notes represented by commercial paper any more than it includes the kind of notes represented by bankers acceptances or certificates of deposit.

As I say, the Act is --

QUESTION: Well now, if you're right the limitations placed on the type of commercial paper that can be marketed are irrelevant, because they wouldn't have to impose those limitations to make commercial paper marketable.

MR. CLAIBORNE: Justice O'Connor, when I say commercial paper is not covered I focus on the kind of commercial paper issued in very large denominations, not to the public but to sophisticated buyers, and for very short term, which is involved in this case --

QUESTION: Well, but if --

MR. CLAIBORNE: -- and which is the only kind of commercial paper that banks, that any bank has sought to deal in.

QUESTION: Sure. But it appears that your argument would reach any kind of commercial paper.

MR. CLAIBORNE: It may, and it may be that the guidelines which the Board has issued in this case, which are not guidelines issued under the Glass-Steagall Act -- those are guidelines issued under the power of the Federal Reserve Board to assure against unsafe and unsound banking practices.

Those guidelines, as the Court of Appeals said in the last footnote of its opinion, are not limitations under the Glass-Steagall Act, but they are assurances that, since the Board invoking other authority will not permit banks to go beyond the kind of dealing involved here, the Court need not reach the question whether the Glass-Steagall Act of its own would indeed prohibit some different kind of dealing in some different kind of commercial paper.

QUESTION: So the term "notes" in Section 21 is kind of an accordion-like thing, depending on what authority the Federal Reserve Bank gives to people like the bank here?

MR. CLAIBORNE: Justice Rehnquist, no, the word "notes" in Section 21 must mean the same thing. But if the word "note" does not encompass commercial notes beyond those involved in this case, the Federal

Reserve Board is nevertheless entitled as a matter of its policing authority over banks to prohibit dealing in those other kind of notes, even though they're not covered by Section 21.

QUESTION: Well, why shouldn't the word "notes" in the language of Section 21 of the Glass-Steagall Act be given its normal meaning?

MR. CLAIBORNE: Well, "normal" is perhaps jumping to the conclusion too quickly, Justice Rehnquist. The word "note" appears in Section 21 in a list which includes bonds and debentures and stocks. Bonds and debentures, as we know, are long-term notes. The perhaps most natural way to read Section 21 is to say to oneself, the word "note" must include something like a bond or a debenture, something of relatively long term --

QUESTION: Well, why is that logical? It seems to me if you have three words and two of them are long term, it would be perfectly reasonable to say, well, they must have put the third term in to mean short term.

MR. CLAIBORNE: I'm only suggesting that one of the ways of construing an enumeration of words is to define each by the company it keeps, and not to suppose that there's a sudden jump to an entirely different sort

of financial instrument.

QUESTION: But in that sequence of words, the first word is "stocks", which of course are very disparate from bonds or debentures.

MR. CLAIBORNE: But there is this in common between stocks and the bonds and the debentures: they are all things in which it is customary to view investment activity, whereas short-term commercial paper is not the sort of thing in which people invest.

They are not, also, offered to the general public, unlike bonds, debentures and stocks, which have that in common, that there are public offerings.

But this is not the only reason why "notes" in Section 21 ought not be given the broad reading. Section 21, after all, is not the section addressed directly to banks; it's Section 16. And we oughtn't to read into Section 21 anything that isn't in Section 16 as a prohibition.

Indeed, there's a proviso to Section 21 which tells us precisely that: Nothing which is permitted in Section 16 is prohibited by this section, notwithstanding, in effect, the broadness of the terms as some untutored person might read it.

It is natural to attempt to avoid a clash between the two sections. Now, when we look at Section

16, we cannot reach the conclusion that commercial paper is a security within the meaning of that section, and the demonstration is quite simple.

We know that commercial paper is not an investment security. We know that as a matter of common sense, but we also know it because those words are derived from the McFadden Act and we have the legislative history of the McFadden Act, in which there is an express exchange in which the Congressman said, no, commercial paper is not viewed by anybody as an investment security, and when we are legislating about investment securities we do not mean to include commercial paper.

QUESTION: Mr. Claiborne, that really sounds amazingly simple, clear as a bell, and I just can't understand why it took bright bank lawyers so many years to discover that Glass-Steagall Sections 25 or 21 had absolutely nothing to do with this.

MR. CLAIBORNE: Your Honor, it didn't take bright lawyers so long to come to this conclusion. The fact is that banks had been purchasing commercial paper since long before Glass-Steagall.

QUESTION: But they haven't been underwriting?

MR. CLAIBORNE: No.

QUESTION: Well then, as a matter of fact no other bank had the nerve to start underwriting until this one.

MR. CLAIBORNE: Well, that's a matter of economic history, not a matter of legal slowness.

QUESTION: Well, I know. But don't you suppose that if the understanding was that banks could underwrite commercial paper they would have been doing it all this time?

MR. CLAIBORNE: No. It's against their interests to underwrite when they could earn more by making the loan. Underwriting is the least attractive activity for the bank, in that it's merely getting an agent's fee instead of deriving the much more substantial discount if it were to make the loan itself.

So it was with reluctance that banks came to acting as dealers in commercial paper. They much preferred being the issuer, the purchaser, of the commercial paper. It's only when those who were issuing the commercial paper found that banks were unable to provide them the funds that they went elsewhere, found a market elsewhere to sell their paper. And banks gradually, realizing that the business had gone from them, decided the next best thing to do was to attempt

to get something out of the transaction by inserting themselves as a dealer.

But that is a matter of slow economic reality, not a matter of dull lawyers.

QUESTION: Mr. Claiborne, why did that come about all of a sudden?

MR. CLAIBORNE: I am not very good at financial history, Justice Blackmun. But my understanding is --

QUESTION: You sound pretty good.

(Laughter.)

MR. CLAIBORNE: -- that because of regulations by the Federal Reserve Board limiting the interest that could be paid by banks, the deposits which they had to lend were limited, and accordingly the demand for funds had to find a source elsewhere and did find it elsewhere, so the banks were no longer the almost sole purchasers of the paper, but insurance companies and others began lending on commercial paper.

QUESTION: Well, they wanted to compete with the investment banking industry too, didn't they?

MR. CLAIBORNE: As we view it, Justice Blackmun, this is not an investment banking operation. It is an arrangement of a loan, something which is proper for commercial banks to be doing, something

traditionally which they have done. It is functionally no different than a sale of a participation in a loan. It is therefore an attempt to recapture some small part of a very traditional commercial banking activity.

Now, in our view there are at least three independent supports for the conclusion we draw. First, the literal passing of the statute leads us to the conclusion that, since commercial paper is not an investment security, it therefore must be, if covered, a security. And yet, we know that commercial banks are forbidden to purchase securities, except investment securities. And yet, we know that commercial banks have and may continue to purchase commercial paper. Therefore, commercial paper cannot be a security within the meaning of Section 16.

Now, the answer given to this seemingly unanswerable argument is that the purchase of commercial paper is authorized by the first portion of Section 16, which is in fact a holdover from the Banking Act of 1864. That is a very awkward way to look about it. It appears that the Glass-Steagall Act was not amending the Banking Act and changing the traditional activities of banks. It was simply turning to a wholly new subject and saying, as the text suggests, now with respect to something else, dealing in securities, the rules shall

be the following.

And it appears that that category of dealing in securities is nothing to do with the discounting or negotiation of promissory notes, an activity which before and since has been authorized to banks.

The legislative history of Glass-Steagall again leads us to the same conclusion. It is no inadvertence that the text fails to deal with commercial paper dealings, because bank purchases of commercial paper were common long before Glass-Steagall and continued to be so afterwards and were so at the time it was enacted.

Congress had occasion to focus if it wished to deal with commercial paper, but did not do so. On the contrary, the only mention of commercial paper in the legislative history of Glass-Steagall is a regret that banks have abandoned their good old habits of loaning on commercial paper and have turned to dealing, underwriting, and otherwise involving themselves with speculative securities. And it was against that danger, which had in the view of Congress caused the bank failures, that Congress now turned its face in 1933.

QUESTION: Mr. Claiborne, is it possible that a bank could end up in a position of conflict of interest if, for example, take the Penn Central case,

banks had lent Penn Central money and also had underwritten and sold its commercial paper, and after the sale of the commercial paper the bank began to think, well, after all, Penn Central is not such a super risk and perhaps we better call the loan? Would it not be then in a conflict of interest position?

MR. CLAIBORNE: Justice Powell, one can conceive, of course, of situations in which a bank might --

QUESTION: And would an investment banking house have a similar possibility of conflict?

MR. CLAIBORNE: It seems to us that when the bank is merely the agent for the sale, with no obligation to take up any portion of the issue which is unsold, that its involvement with the commercial paper is at its minimum, far less than when it's the purchaser of the commercial paper and then has a real interest in assuring that there isn't a default because it will be the loser, whereas when it's the agent someone else will be the loser and the reputation of the bank may be marginally at stake, but at least it will not be its depositors who are directly injured.

QUESTION: Well, Mr. Claiborne --

MR. CLAIBORNE: All this is -- excuse me.

QUESTION: No, you go ahead and finish with

Justice Powell.

MR. CLAIBORNE: But all this is supposing that there is a serious risk in dealing in commercial paper, and since the Penn Central failure there has been no significant failure in commercial paper, and indeed measures have been taken to assure that that is not so. Commercial paper is the safest conceivable instrument in which to deal, safer than an ordinary commercial loan.

QUESTION: Well, suppose it was not non-recourse, or suppose that the bank did undertake what underwriters frequently do, some obligation to buy what wasn't sold. I would think your position would still be that Glass-Steagall had nothing to do with that; if the bank couldn't do that, it would be for some other reason?

MR. CLAIBORNE: Since --

QUESTION: Am I right?

MR. CLAIBORNE: That is so. Since the bank can and did and continues to be able to purchase it.

QUESTION: So you would say even that Glass-Steagall would not prevent a bank from underwriting and having an obligation to buy whatever wasn't sold?

MR. CLAIBORNE: No, since it can clearly buy directly, it can buy on condition, it can buy if no one

else buys. If it can buy straightforwardly, it can do that. There's no reason -- the other dangers, the more subtle hazards that were identified in the first ICI decision, are not implicated here.

The bank's reputation for prudence and soundness is enhanced, not at stake, when it deals in commercial paper as opposed to investment securities. The danger that the bank will have to or will be inclined to shore up the companies whose commercial paper it's dealing in because it's tied its fortunes or its reputation to the fate of that enterprise is not realistic here. Because of the absence of risk, there's less occasion to think in terms of shoring up.

And in any event, because the rate on commercial paper is lower than the rate on commercial loans, there is no incentive to making -- to accepting a loan in order to purchase commercial paper.

Now, the danger of giving disinterested advice to customers of the bank, which is one of those conflicts or potential conflicts that was identified in the ICI decision, is not present here either. The customers here are only a limited category of sophisticated investors who are in a position to judge for themselves and do not require the investment advice of the bank. The general public and the general

customers of the bank are not potential buyers of commercial paper.

The short of it is that there is no -- none of the risks identified by this Court as underlying the Glass-Steagall Act are implicated here, and indeed the Petitioners cannot identify and have not attempted to identify any such risks.

They say Congress determined there was a risk. But after all, that is the whole issue in the case, whether Congress did in fact encompass commercial paper.

Now, finally --

CHIEF JUSTICE BURGER: We will resume there at 1:00 o'clock.

(Whereupon, at 12:00 noon, the argument in the above-entitled matter was recessed, to reconvene at 1:00 p.m. the same day.)

AFTERNOON SESSION

(1:00 p.m.)

CHIEF JUSTICE BURGER: Mr. Claiborne, you may continue.

ORAL ARGUMENT OF LOUIS F. CLAIBORNE, ESQ.

ON BEHALF OF RESPONDENTS - RESUMED

MR. CLAIBORNE: Thank you, Mr. Chief Justice, and may it please the Court:

I've only one short point remaining. It is this: that commercial paper, because it is indistinguishable from a short-term commercial loan, has always been so treated by all three of the bank regulators. And if I can draw the Court's attention to the joint appendix, in which the Board's statement in this case is reproduced at page 130. The paragraph beginning at the bottom of that page, the Board says the following:

"The present attitude of the bank regulatory agencies is consistent with the view that commercial paper is properly viewed as a loan, not as an investment security. The instructions of each of the three federal banking agencies for preparation of call reports direct that commercial paper be treated as a loan. In addition, the Federal Reserve's Manual of Examination Procedures follows the same position."

That of course is relevant on a day to day basis for each bank to determine whether the limits applicable to loans or the limits applicable to investment securities are applicable when it takes in commercial paper into its inventory. From 1927 to this day, the banking fraternity, with the approval and indeed at the direction of the banking regulators, has treated commercial paper in the category of loans, not investment or security.

Now, this kind of decision as to which category commercial paper falls in is precisely one as to which there is properly owed deference to the bank regulators. It is not, as is suggested on the other side, that Congress made the Board or the Comptroller regulators in the sense that they were given discretion to waive in appropriate cases the prohibitions of the Glass-Steagall Act.

Of course they have no such discretion. But they do have a job to construe, to interpret the words of the statute which they are required to enforce. And it is in that sense that deference is due to their special expertise.

QUESTION: Well, do you think, Mr. Claiborne, that if the Board had construed it the other way, that the banks couldn't do this, that they would have been

wrong?

MR. CLAIBORNE: In hindsight, yes, Your Honor. But it doesn't --

QUESTION: Well, so that there's only one way the statute can be read as far as you're concerned? So it isn't a question of deference; it's just a question of reading the statute.

MR. CLAIBORNE: Well, I can say on the one hand that it seems the inevitable reading in light of the plain language of the statute, the result which the Board came to, but at the same time say that if I am wrong in that respect and there are two reasonable readings, so long as the Board made a reasonable reading, deference ought to be accorded to that reading.

QUESTION: But your statutory construction argument it seems to me wouldn't leave any room for the Board to go the other way.

MR. CLAIBORNE: I quite agree. But I may be wrong --

QUESTION: Do you think that you -- do you think that your position on the statute is consistent with what the Board thinks the statute means?

MR. CLAIBORNE: I see no --

QUESTION: I thought the Board would have

thought it could go either way on this case.

MR. CLAIBORNE: The Board did not, as is alleged, say that the statute literally read the other way. The Board said the statute could by the untutored eye be read to mean something different, but when we read it in context, when we read it against the legislative history, when we read Section 16 and Section 21 together, then we reach what the Board called the stronger position.

QUESTION: But it still would have been permissible in their view to go the other way, I suppose?

MR. CLAIBORNE: It's difficult to construe whether by "stronger" they meant -- they were simply being cautious or whether they were being less positive.

But in all events, we do urge that on the matter of construction the Board, if there is a doubt about it, is entitled to the deference in this peculiarly complex area.

QUESTION: Mr. Claiborne, one other question, and I hope it is in proper bounds. Has this position had an impact on the enforcement of other laws, like the securities laws? Has this construction by the Board, has it had an impact, for example, on the Securities and

Exchange Commision and their regulation?

MR. CLAIBORNE: My impression is not so because, with respect to the securities laws, it's perfectly clear that, while commercial paper is a covered security, it is exempted from the registration requirement. And the Board has looked to the definition of a peculiar kind of commercial paper in the securities laws, so the two are meshed.

Let me say one final thing about the deference due to the Board. I need only invoke what this Court twice said, both in ICI I and in ICI II, about the deference that is indeed due to the regulators, whether the Comptroller or the Board, provided however, which is what was lacking in ICI I, that that regulator not merely announce a rule, but do so by articulating his reasons for having got there in what is certainly present here, a comprehensive and careful parsing of legislative text, the legislative history, the policy as identified by this Court which informed the passage of the Act, and only then, after this careful articulation, reach a conclusion.

In those circumstances, as the Court indicated would be true when that was done, the Board ought be entitled to this deference.

QUESTION: Mr. Claiborne, do you think it's

perfectly clear that Congress would have exempted banks from the securities regulation field if they had thought that all commercial paper was excluded from the Glass-Steagall Act provisions?

MR. CLAIBORNE: I'm sorry, Justice O'Connor. I must have missed the --

QUESTION: Well, it's your position, I take it, that banks are not considered brokers and dealers under the Securities Act, the Securities Exchange Act, right? Is that correct?

MR. CLAIBORNE: That is correct.

QUESTION: Okay. Is it perfectly clear that the banks would have been so treated if Congress had understood that all commercial paper was outside the scope of Glass-Steagall?

MR. CLAIBORNE: Well, I think that is probably so, because Congress was aware that banks were dealing in bankers acceptances, not yet in certificates of deposit. But it seems to be accepted all around that that dealing in certificates of deposit is not in any way prohibited by the Glass-Steagall Act and nevertheless the banks are not required to register as dealers under the Securities Act.

And these relatively small-scale -- huge sums, but the percentage of earnings for the banks out of

their dealings in commercial paper is a relatively small quantity, an insignificant proportion of the banks' earnings. The purpose of the banks is that it was a way of selling their other services to those for whom they perform this almost accommodation service.

CHIEF JUSTICE BURGER: Mr. Pitt, do you have anything further?

REBUTTAL ARGUMENT OF HARVEY L. PITT, ESQ.

ON BEHALF OF PETITIONERS

MR. PITT: If I may. In response to the questions both by Justice White and Justice O'Connor, I would refer the Court to page 26, note 33, of the SIA's opening brief, which indicates that both the Federal Energy Regulatory Commission and the Securities Exchange Commission had to take emergency action to obviate the impact on both the federal energy laws and the SEC's authority under the Public Utility Holding Company Act because of the Board's unprecedented ruling involving management interlocks and related issues.

Secondly, in response to Justice O'Connor's question, the SEC has recently promulgated a proposed rule which would undo the very statutory exemption to which Justice O'Connor was referring. That is to say, the federal securities laws presently exempt banks from the definition of brokers and dealers. The SEC has said

that, in light of the activity of the banking agencies -- and it's the decision in the court below which has been the mainspring from which all of these decisions have flowed -- it is necessary for that agency to reconsider whether the exemptions given to banks from these definitions are appropriate.

And so what we are faced with is a flurry of administrative revisionism. This is hardly what Congress could have intended --

QUESTION: Did the SEC let its views be known before the Board?

MR. PITT: The SEC did make its views known before the Board and it vehemently disagreed.

QUESTION: Are those views in the record?

MR. PITT: They are, Your Honor. All letters written by the SEC, first from its general counsel and then reaffirmed by the Commission, are in the record.

QUESTION: And did they take a position in the Court of Appeals? Were they allowed to?

MR. PITT: They took a position in the district court, and in the Court of Appeals they did not take a position.

QUESTION: Well, they probably didn't have --

MR. PITT: But their brief is in the record before the Court.

Finally, just one additional point. I think it's important to note that the briefs of the parties do discuss the hazards presented, and I think the questions earlier this morning indicated that it is precisely the function of a bank being both a lender to a corporation and a promoter and marketer of its corporate paper, commercial paper notes, are exactly the conflicts Glass-Steagall was designed to prohibit. And both of the briefs on the Petitioners' side are replete with instances of the precise hazards that are involved.

Beyond that, I think it's important to state --

QUESTION: Well, banks, though, are certainly regularly going around hunting participants in loans that are beyond their limits.

MR. PITT: I would say banks syndicate loans regularly and always have.

QUESTION: So this is just a loan in which the originating bank doesn't have a part.

MR. PITT: No, I disagree, Your Honor. This is --

QUESTION: Well, I know you disagree.

MR. PITT: This is a marketing activity. This is a marketing activity. Bankers Trust isn't lending anyone any money. What it is doing is it's placing its

reputation and the resources of the bank behind an investment banking effort, and that's what Glass-Steagall was designed to prevent.

CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

We'll hear arguments next in --

QUESTION: Mr. Chief Justice, may I just ask one question?

CHIEF JUSTICE BURGER: Excuse me.

QUESTION: Would you comment on Mr. Claiborne's observation as to the position taken by the three regulatory bank agencies over the years?

MR. PITT: Yes, Your Honor, and I'm pleased you asked me that, because I did want to comment that the positions taken were with respect to commercial paper as a purchase and as a loan. There has never been a position taken prior to the ones that are at issue in this case that banks could underwrite commercial paper.

And I might add that Mr. Claiborne's prior references to the Congressional history demonstrate that Congress intended for banks to purchase commercial paper, and there is clear authority for that, but not to underwrite it, and that's the essence of this case.

(Whereupon, at 1:13 p.m., argument in the above-entitled matter was submitted.)

CERTIFICATION

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