OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 84-1274

TITLE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, Petitioner V. DIMENSION FINANCIAL CORPORATION, ET AL.

PLACE Washington, D. C.

DATE November 4, 1985

PAGES 1 thru 46

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IN THE SUPREME COURT OF THE UNITED STATES

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
Petitioner

v. No. 84-1274

DIMENSION FINANCIAL CORPORATION, et al.
Respondents

Washington, D.C.

Monday, November 4, 1985

The above entitled matter came on for oral argument before the Supreme Court of the United States at 1:47 o'clock p.m.

APPEARANCES:

MICHAEL BRADFIELD, ESQ., Board of Governors of the Federal Reserve System, 20th & C Streets, N.W., Washington, D.C. 20551; on behalf of Petitioner.

JEFFREY S. DAVIDSON, ESQ., Kirkland & Ellis, 655 Fifteenth Street, N.W., Washington, D.C. 20036; on behalf of Dimension Financial Corporation,

Daniel T. Carroll, Harold D. Dufek, William L. Mitchell, Ronald L. Shaffer, and A. Gary Shilling, Respondents.

John D. Hawke, Jr., Esq., Arnold & Porter, 1200 New Hampshire Avenue, N.W., Washington, D.C. 20036; on behalf of American Financial Services Association, Household Finance Corporation, and First Bankcorporation, Respondents.

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: We will hear arguments next in Board of Governors of the Federal Reserve System against Dimension Financial Corporation, et al. Mr. Bradfield, I think you may proceed whenever you are ready.

ORAL ARGUMENT OF MICHAEL BRADFIELD, ESQ.,

ON BEHALF OF THE PETITIONER

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

This case involves the validity of Federal Reserve Board rule applying the Bank Holding Company Act to the corporate owners of certain banks, so-called non-bank banks.

The Bank Holding Company Act applies to companies that control a bank, which the Act defines as any institution that both takes deposits the depositor has a legal right to withdraw on demand, and engages in the business of making commercial loans.

The first part of this definition concerning demand deposit was added to the Act in 1966, substituting for a broad charter test. The second half was added in 1970.

Bank holding companies may engage in only limited activities; owning banks and in activities that

are closely related to banking. The Act prohibits the commingling of banking and commerce. This policy was adopted to prevent abuses in the allocation of credit; to prevent concentration of banking resources in a few hands; and to maintain local control over local banking resources.

These companies, securities firms, insurance firms, retail firms and other commercial and industrial companies which control non-bank banks, claim that they have removed themselves from the regulation under the Act when they act through national banks, state banks and industrial banks to provide essential banking services but eschew either the taking of demand deposits or the making of commercial loans.

Beginning in 1980 there was a sudden explosion in the number of institutions that use this device, but in a new way: to achieve interstate banking and to combine banking and commerce.

The Board became concerned that these institutions which took NOW accounts and made commercial loans would become a vehicle for preferential lending and for interstate banking in violation of state policy.

In response, a unanimous board of governors, after rulemaking, defined the term "deposits" that the depositor has a legal right to withdraw on demand to

include NOW accounts.

QUESTION: Mr. Bradfield, in 1966 when Congress was considering adopting the definition, did the Board propose to Congress that, in defining demand deposits, that it include accounts which in actual practice were paid on demand?

Was that a suggestion made by the Board to Congress in '66?

MR. BRADFIELD: That was a suggestion that was made by -- The Board took the position, not in practice, but that accounts that were payable by check, the accounts that were payable on demand should be covered by the Act.

There's a bit of history that I will get to, Justice O'Connor, concerning industrial banks and their proposal and the Board's proposal to cover --

QUESTION: Yes, but my concern is to determine whether it be the essence of the present Board rule and position was one that was suggested by the Board itself to Congress in 1966 and resulted in the adoption of somewhat formalistic language by the Congress that rejected --

MR. BRADFIELD: The Board actually proposed the language was deposits payable on demand. That language later became deposits that the depositor has a

legal right to payment on demand.

I do not think that there was any significance to that change in language. The legislative history that Congress -- The committee reports specifically say that they were talking about demand deposits checking accounts, and they used for emphasis, right after demand deposits, they were using checking accounts. And I don't believe that they intended any specific technical distinction.

QUESTION: Well, can we say in concluding that Congress did not intend to pick up passbook savings accounts?

MR. BRADFIELD: Yes, I believe that that is correct, and the legislative history makes that clear.

QUESTION: Well, tell me whether you think literally the Board's new definition of a NOW account is broad enough to pick up passbook savings accounts.

MR. BRADFIELD: The Board's definition does not pick up savings accounts. It doesn't apply to savings accounts, and the legislative history makes it clear that Congress was not intending to cover savings accounts --

QUESTION: Well, does the literal language of the Board's new definition cover -- is it broad enough to conceivably cover passbook savings accounts?

MR. BRADFIELD: Well, technically it's possible that it might cover that, but the, the specifics of the definition do not cover passbook savings accounts because they're not payable by checks. They are not payable by third-party means attainment, and that's the essence of what Congress was trying to drive at; driving at those instruments that were money.

Checks are money. When you go to the grocery store, you give the clerk a check, you are creating money at that point, and that's what Congress was concerned about; the combination of that characteristic with the combination of -- that characteristic with commercial lending.

And when the two are combined, Congress was concerned that that created great power over resources, the potential for preferential lending, and that Congress wanted to prohibit that and wanted to prohibit the owners of banks from using those facilities for their own benefit.

QUESTION: Well, Mr. Bradfield, if you turn to page 2 of your petition for certiorari, and you probably have this material at hand without turning to it, if you look at the statutory definition in 1841(c), that a bank means any institution which accepts deposits that the depositor has a legal right to withdraw on demand.

And then, if you look right below below it to the regulation, the regulation comes along and says deposits that the depositor has a legal right to withdraw on demand means any deposit that, as a matter of practice, is payable on demand.

Now, I -- that doesn't strike me as being within what Congress was talking about. Congress says you have to have a legal right to withdraw on demand, and the Board says no, it's just a practical matter.

MR. BRADFIELD: This is because in practice -- There are two aspects of that. One is that in practice the notice, it is not practical to give the notice. The notice -- this is an instrument that is passed into the hands of a third party.

When passed into the third party and notice is given, then that check is in effect dishonored by the institution; and when dishonored by the institution, it completely impairs the ability of the institution to function as a financial institution.

QUESTION: Now, perhaps that's a sensible answer to my question, but I had intended to get at another point.

It seems to me -- It seems to me when Congress has said that -- they're talking about deposits that the depositor has a legal right to withdraw on demand. And

then the Board comes along and says this language that Congress means, means any deposit that as a matter of practice is payable on demand.

And it seems to me that that's a significant alteration of Congress' meaning. Congress was talking in pretty strict terms about the legal right to withdraw on demand.

MR. BRADFIELD: I don't -- First, I would like to go back to the legislative history and point out that Congress was talking about -- I don't think they were making that technical distinction. Congress was talking about what was a commerical bank, characterized a commercial bank. That's what they said in the legislative history. They were driving at what was a commercial bank.

And this kind of instrument that creates money was one of the characteristics of the commercial bank that they were driving at. And they clearly didn't mean, when you look at the whole legislative history in perspective, they clearly didn't mean to turn on one technical aspect, to be able to undermine the whole objectives of the --

QUESTION: Well why, then, did they use the rather technical language "has a legal right to withdraw on demand?"

MR. BRADFIELD: Because they believe that that was the equivalent of the demand deposit language that was already in Board regulations at that time.

QUESTION: But, yet, they didn't take the Board regulations, they took this much stricter language.

MR. BRADFIELD: But they explained that in the legislative history. I don't think there is any technical basis for concluding that they intended something different. They looked at the Board regulation that was in effect, in effect since 1933, and what the Board had then defined, and defined a demand deposit as any instrument that was subject to withdrawal by check -- by check. Any deposit that was subject to withdrawal by check was a checking account and was a demand deposit.

And that the purpose of that was to prevent evasions of the basic prohibition of payment of interest on demand deposits, and so that any instrument that was withdrawable by check was a demand deposit. That was what was in front of the Congress in 1966 when it adopted the language.

Now, there was that shift. The Board recommended demand deposit in its recommendation to the Congress. It was changed to deposit that the, that the depositor has a legal right to withdraw on demand, but

there's no basis for concluding that they meant in that technical distinction something far different.

And I would add to that, strengthen that, by the very people who asked for this change -- the very people who asked for this change were the industrial bankers.

Now, they said we do not offer checking accounts. We take certificates, savings certificates; and we don't make commercial loans, we make consumer loans. So, we don't object to what the Board has done and the Board had earlier then within the scope of the Act. We don't object to what the Board has done with respect to checking accounts. What we object to was what the Board has done by saying that, that savings accounts that are in practice paid on demand are within the scope of the Act.

Now, that is what Congress overturned. And they overturned that in a very narrow way, intending to exempt industrial banks and savings banks, but as far as Congress was concerned, did not have any kind of a transactional account and did not make commercial loans.

So, they were completely outside the scope of what Congres was worried about.

QUESTION: How does -- Does a NOW account really differ significantly from the kind of account you

just referred to?

MR. BRADFIELD: A NOW account, yes, very significantly differs because it has a transaction capability. What those accounts that I was talking about are really savings accounts in which you need a passbook, essentially a passbook; there's no third-party transaction capability. You need a passbook, you have to go to the institution and withdraw your money. Then is when you have money.

In the case of a transaction account, when you go to the store or you make a purchase, then you have money when you actually write your check. And that's the thing that Congress -- That was the essence of banking that Congress was concerned about.

And, so, those two characteristics, the ability to create instruments that are money and the ability to make commercial loans, those were the characteristics that we're worried about. And the legislative history is replete with references to that.

QUESTION: Mr. Braifield, if your position -- if the Board's position with its new definition of NOW accounts is invalid, do I understand that it would then, it would be required that some industrial loan companies go out and purchase, try to purchase FDIC insurance, which for other technical reasons they would not be able

to do?

Are we going to have a hiatus in the requirements?

MR. BRADFIELD: Justice O'Connor, you make a very excellent point that has been strongly made on the side of the respondents, that the Board's rule somehow upsets basic industry expectations, and I think I'd like to take a minute to refute that, because I think it's just simply not the case.

First, in the case of industrial banks we've made a careful survey and found only 53 industrial banks, 26 of which are in Colorado, which in fact offer NOW accounts and make commercial loans. So, those -- out of about 1,200 industrial banks in the country, only that, less than five percent would be covered by the Board's regulation.

Of those companies, only a -- we don't know how many, but not all of those 53 are owned by companies, so that they might not have to register in any event.

QUESTION: Mr. Bradfield, did these institutions change their routine practice of allowing withdrawals on demand?

MR. BRADFIELD: That's very -- that's exactly what I was getting to, Your Honor, that they --

QUESTION: Did they change their --

MR. BRADFIELD: Their traditional function has been not to offer NOW accounts. In fact, as I described the traditional activity has been to offer savings certificates and making consumer loans, and if they just simply went back --

QUESTION: If they change the practice, where would you be then? Without -- you rest quite heavily on that.

MR. BRADFIELD: Well, that is what Congress was concerned about. I rest very heavily on that because that's what Congress was concerned about. When they do offer NOW accounts, when they do make the --

QUESTION: Then it wouldn't be like an ordinary bank anymore.

MR. BRADFIELD: So then it wouldn't be covered by the Bank Holding Company Act and we wouldn't be worried. It's possible that we ought to be worried about it, and it would be up to -- and then it would be up to Congress to change that.

But that is not covered at this time in the Board's regulations. We're worried about the combination of NOW accounts, money and commercial loans, which these institutions, these 50-off institutions actually engage in now.

There's another class of institutions, which is the privately insured S&Ls, and that industry which did very recently and very rapidly like the industrial banks, those institutions have recently gone into NOW accounts and commercial loans. And as I think all the Court is aware, that industry has essentially been destroyed by the events in Ohio and Maryland. They were originally participants in this case and have withdrawn from this and no longer oppose the Board's rule.

And the fact that, the very reason that a number of them got into trouble is because they weren't subject to regulation. Their owners were able to take advantage of the institutions, make preferential loans, take the NOW accounts and other deposits that they had, make favorable commercial loans, and they effectively destroyed their institutions and destroyed those other institutions that were associated with them.

The last class of institutions that are subject to this are the, are the new non-bank banks. Those are the national banks that have been recently chartered which, which take -- would like to be able to take NOW accounts and make full commercial loans.

And they had full notice about the Board's proposed regulations, the very recent development. They, too, could conform their activities by giving up

the NOW accounts.

And so that, as far as some great revolution is concerned in the banking industry, there is no such great revolution. What the Board's regulation does is effectively preserve the industry the way Congress intended it would be with the separation. What would happen is that there would be massive evasions of this basic Congressional intention, which goes way bank in our history.

This emphasis on avoiding the combination of banking and commerce goes way bank in our history, and if we did not have that, I think you would have a very great and major change.

Another argument that is made is somehow that the Board's regulation steps upon the jurisdiction of other federal banking agencies, and that again is simply not true. The Board's regulation only regulates the owners of banks. It does not in any way regulate banks or industrial banks in any way.

QUESTION: Well, certainly other agencies have expressed disagreement with the Board's regulation, have they not?

MR. BRADFIELD: There are some who have expressed disagreement. For example, the Federal Home Loan Bank Board expresses a specific agreement with the

regulation, and there's a letter attached to our reply brief from the Home Loan Bank Board indicating that.

Another of the bank regulatory agencies disagrees with us as a policy matter but it doesn't disagree with us as a matter of law.

There are numerous -- for example, the Conference of State Bank Supervisors, in a group that represents all of the banking regulators in the states, they have filed an amicus brief in this case which fully supports the Board --

QUESTION: Well, I wasn't taking so much of a poll of all the affected parties as the fact that perhaps other federal agencies who disagree might suggest that your construction of federal law might be mistaken in a way that it wouldn't be if they didn't disagree.

MR. BRADFIELD: I didn't mean a poll, Your Honor, either. I was pointing out that, that there, that certainly there isn't unanimity. But the Board is the expert in this area; that Congress deliberately gave to the Board. It had other choices as to organizing the Bank Holding Company Act; organizing administration of the Bank Holding Company Act. But the Board, the Congress specifically gave this to the Board, and the Board has the expertise in this area.

The Board carefully considered all of these comments from the other agencies, from private parties, and after a formal rule -- an informal rulemaking, carefully considered in a more than 40-page opinion, analyzed all these comments and in a reasoned opinion came to the conclusion that this regulation is necessary in order to carry out the purposes of the Act and prevent evasions of the Act, both powers which Congress has given to the Board.

QUESTION: Mr. Bradfield, Justice Rehnquist emphasized the word "legal right" in dealing with deposits, and I was also interested in your comments on the second statutory requirement, and particularly the word "making," in the business of making commercial loans.

Are you going to address yourself to that? It seems to me that your regulation expands that concept rather dramatically.

MR. BRADFIELD: It -- the regulation -- Let me start by saying that the statute uses a very general term, "commercial loan."

QUESTION: Making commercial loans.

MR. BRADFIELD: Making commercial loans, and clearly if you're a business and you are in the business of accepting commercial paper against your deposits, why

that is certainly a commercial loan. If you do it once a week or you do it twice a week, it is certainly in the business.

Now, I don't have any question, and I don't think the Board had any question that an institution that engages in those practices would -- was in the business of making commercial loans.

Now, I imagine there could be such circumstances where you did one such transaction a year, and I think, then, your point would be well taken. But I don't think that this was addressed to that. This was addressed to the situation where an institution regularly -- and I think that that's what's necessary for a depository institution -- It regularly engages in this kind of activity; commercial paper, banker's acceptances, CDs. Those all are loans from one business to another.

I would also point out that the Congress -- this is a very important point -- that in, in adopting that commercial loan test, that Congress thought it was exempting a single trust company. It didn't know anything about its activities other than that which that entity represented to the Congress, and that was that it was a fiduciary institution, a trust company and primarily engaged in fiduciary activities.

And the House conferees, in their manager's report, said specifically that that provision should be narrowly construed as well as other specific exemptions that were then -- like, for example, the grandfather clause. That clause, and this clause on commercial lending, where there was a specific injunction that, that that, uh, that that exception, the commercial lending exception, be narrowly construed; the specific statutory language -- not statutory -- specific legislative history that covers that.

I'd like to emphasize that the Board has the independence of judgment and a broad perspective gained from its responsibilities for monetary policy and for the regulation of the banking industry. It's the country's central bank. It regulates the money supply. It's the lender of last resort; the regulator of the payment system, and a regulator of over a thousand member bank.

The point is that, that these broad responsibilities give the Board a perspective and a special expertise in administering the Act. The Board used this expertise in the case before you. It engaged in detailed rulemaking. It carefully analyzed the facts and articulated the reasons for its conclusions, and in a comprehensive and thoroughly reasoned opinion

concluded that those definitions are necessary to carry out the Act's purposes of separating banking and commerce.

This is clearly a case in which the doctrine of administrative deference is applicable.

Mr. Chief Justice, with your permission I'd like to reserve the remainder of my time --

QUESTION: Mr. Bradfield, the question here is, of course, not what is the sensible and scund thing to do. We could concede that the Board has come to very sensible conclusions. The question is more narrowly whether we can -- whether the Board can construe the statute that way.

MR. BRADFIELD: Well, if I may just offer as the reasons for that conclusion, Mr. Chief Justice, is one that the Board's definition fit the literal language of the Act. The NOW account is an instrument that is payable on demand. The statute doesn't say notice, and so that it is an instrument that is payable on demand.

The instruments that the Board defined as commercial loans are commercial loans. It's a broad term, and the, and the Board clearly has the discretion to give that term meaning. There is no rigid industry definition. It is the Board that is responsible for giving that term a definition.

And the third point is that the Board has broad power. The statute specifically said the Board is charged with administering the Act, carrying out its purposes, and preventing evasions.

Now, that -- we're not asking in this case, saying that that is the sole authority. We fit within the legislative language. The legislative history indicates that those two provisions were intended to be narrowly construed. You combine those two, two elements, narrow construction and literal language, together with the broad authority of the Board to prevent evasions.

And this Court has held that where that kind of broad authority -- and it isn't usually given -- where you have that kind of broad authority, then in that case you can even go beyond. In Mourning v. Family Publications, this Court said you can even go beyond the literal coverage of the statute in order to accomplish an objective, to carry out the purposes of the underlying objective of the statutory purpose.

Now, when you have those three elements, I think you clearly, and you have an expert agency, it's clearly a matter for administrative, to give deference to an administrative agency.

Thank you.

CHIEF JUSTICE BURGER: Mr. Davidson.

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

I represent a group of petitioners whose primary concern is with the commercial loan aspect of the Board's new definition bank in regulation Y. Counsel who will speak after me represents the group of petitioners who is primarily concerned with the demand part of that definition.

With respect to the commercial loan aspect of the definition, I wanted to discuss two points with the Court this afternoon. First, that the Board's new regulation seeks to expand the Bank Holding Company Act beyond the entire area of business that Congress intended to regulate with that statute.

And second, that the Board's new definition of commercial loan is contrary to common usage and to Congressional intent and therfore cannot be justified on the grounds of agency deference or its evasion authority.

On the first point, the statute -- the language of the statute and its legislative history, and I think just as indicated by counsel for the Board, shows that the Bank Holding Company Act is a statute designed for the regulation of the business of commercial banking. It does so by authorizing the Board

to regulate companies which own or control subsidiaries that are commercial banks.

Now, commercial banks are institutions which accept deposits which commercial enterprises are eligible to maintain, in other words corporate checking accounts, and which engage in the business of lending those deposits back to businesses in the form of commercial loans.

The Board's briefs to this Court have stressed the importance of both aspects of those defining characteristics of the business of commercial banking. In the Board's original brief, the Board has pointed out that corporate checking accounts typically constitute a very substantial proportion of the total demand aspect of demand deposits of a commercial bank.

And in the Board's reply brief, the Board argues that the foremost obligation of a commercial bank is to supply the credit needs of business enterprises in its community.

Now there are, and there always have been, other kinds of providers of financial services which are not engaged in the business of commecial banking as that term has indicated. Prominent among them are institutions that are more consumer oriented, which are engaged in the business of providing financial services

to individuals, including the service of consumer lending.

Now, one key example is the whole category of industrial banks, and as the Court brief itself notes, industrial banks historically are consumer-oriented institutions which serve industrial workers and similar customers who can't obtain credit from commercial banks.

And there still is a need for such commercial banks today, and that's precisely -- such consumer banks today -- and that is precisely why the Comptroller found that the Dimension proposal -- and respondent mentioned Financial Corporation here before the Court -- to open consumer-oriented national banks not engaged in the business of commercial banking was warranted by the needs of the local communities where Dimension seeks to operate.

In light of some of the comments which we have heard this afternoon, I think it is important to point out that these consumer banks, and for that matter their affiliates, are regulated to insure their safety and soundness; some of them by the states, some of them, like the proposed Dimension banks, by federal agencies like the Comptroller of the Currency and the Federal Deposit Insurance Corporation.

And there is no evidence that the existence of

consumer banks or the fact that they are supervised under regulatory regimes apart from the particular one which is here at issue in this case, the Bank Holding Company Act, has ever posed a threat to the soundness of this nation's financial structure or the banking industry in general.

That is the view of other government agencies which have been expressed to this Court in this case, which are as equally concerned as the Board with the soundness of the nation's financial structure and banking system. And that's the conclusion of a major empirical study published this year, performed by the staff of the Federal Reserve Bank of Chicago.

And I might note that the same arguments which the Board makes here, in its briefs and in oral argument, are the same arguments it has been making to Congress for the last few years, and Congress itself has not perceived the need for any particular emergency here and sought -- thought that it was necessary to expand the definition of bank under the Bank Holding Company Act in the manner in which the Board now seeks to accomplish through its regulation.

QUESTION: Nonaction, nonaction by the Congress is hardly a very weighty consideration with the Courts.

MR. DAVIDSON: I'm not suggesting that nonaction by Congress is a mechanism by which to interpret the statutory language. What I am suggesting is that the Board's arguments to the Court that are basically -- there's something bad about to happen to the banking industry, there is some emergency situation that compels the Board to step in and to expand the scope of its jurisdiction -- is undercut by the fact that those same arguments have been made to Congress and that Congress has not seen fit to act to give the Board that authority.

But when we turn to the specific issue of statutory construction, then I think we need to look at the language of the statute and the legislative history on what Congress has done, I would agree, as to what Congress has not done.

And I believe that the Bank Holding Company Act --

QUESTION: Mr. Davidson, now the Board's new definition of commercial loan seems to boil down, basically, to saying that it covers any extension of credit between two parties where neither is a consumer, and that strikes me as perhaps consistent with the broad general term commercial loan, which Congress did not choose to define very specifically.

MR. DAVIDSON: I think that the important point to think about in terms of the commercial loan language that Congress put into the statute with the 1970 amendment is that the commercial loan language, at that time the term commercial loan, is a phrase of common usage. It has a commonly understood meaning in the banking industry.

And at that time, in 1970 when Congress put that phrase into the statute, and for that matter to this day, the term commercial loan, as a matter of common usage, excludes money market and inter-bank transactions which financial institutions, including banks, use for day-to-day asset, liability or liquidity management.

It's a fact that money market and inter-bank transactions are distinct from what people commonly understand by the term commercial loan, and indeed have different characteristics from commercial loans is something that has been demonstrated in a long string of Board decisions --

QUESTION: Well, how about some of these other items that are included in the definition?

MR. DAVIDSON: The only -- the things that the Board has included in the definition of commercial loan which we are challenging is the money market and

inter-bank transactions; commercial paper, banker's acceptances, broker car loans, purchase and sale of federal funds, and so forth.

Those are instruments which banks use for day-to-day liquidity purposes and are not within the commonly understood of the meaning of the term commercial loan. That is something that the Board itself concluded over a course of many years in looking at those specific transactions and concluding that they were not within the meaning of the term commercial loan as intended by Congress when it put those terms into the statute.

That's the real significance of the series of Board decisions. It also represents the views of other government agencies which have been expressed to this Court, who are certainly familiar with banking transactions and banking terminology. It's also consistent with the comments of the Federal Reserve Banks.

I realize that all that has been set forth before in our briefs. What I think I would like to add in the oral argument, however, is that that same common usage, same common understanding, runs right through the text cited by the Board in their reply brief.

The Board, in their reply brief, cites as

their prominent text that they rely on this book, Management Policies for Commercial Banks, the Cross and Hemphill text, to support their proposition which they quote, include the quotation that loans can supply the credit needs of business entperprises in whatever form of commercial loans.

It's interesting, that quotation appears in a chapter in the book on bank lending, which begins with a -- the chapter begins with actually the book drawing a sharp distinction between loans, bank loans, and other kinds of transactions that banks engage in for day-to-day liquidity purposes.

It's a separate chapter of that book which discusses those kinds of transactions and how they are different, and enumerates the instruments that banks use for day-to-day liquidity purposes as including federal funds, commercial paper, banker's acceptances and negotiable CDs issued by other banks.

As this book, as this text points out and as the prior decisions of even the Board and its staff has pointed out, these kinds of transactions basically do not involve the same kind of borrower-lender relationship. And if one tracks through each of the three elements of commercial loans that Congress put into the statute in 1970 -- in other words, that it be a

loan, that it be a loan to a commercial enterprise, and that the business be engaged in the business of, the enterprise be engaged in the business of making the commercial loan -- each one of these can be analyzed and you can see why the term of these particular, why the nature of the particular money market or inter-bank transaction does not fall within what people have commonly understood to constitute a commercial loan.

For those reasons we believe that because the Congress inserted language into the statute which had common meaning at the time and which the Board thought was self --

QUESTION: Mr. Davidson, can I just ask you one question?

MR. DAVIDSON: Certainly.

QUESTION: Supposing a bank does make a big loan to a manufacturer; a million dollar loan. And then after it's partially paid off, the bank -- another bank purchases that loan from the first bank. Has the second bank made a commercial loan?

MR. DAVIDSON: Assumes the second one? Sir, I believe that when we have a situation wherein one bank assumes the commercial loan entered by another, that that could very well be a commercial loan.

QUESTION: I realize it's a commercial loan.

Has the second bank made a commercial loan, in your view?

MR. DAVIDSON: No, I don't believe so. I don't believe that that would be the situation of making a commercial loan unless one could indicate that there would be some transfer of funds from the second bank to the original borrower.

In that case, which I suppose could happen in some situation where the loan would be refinanced or there would be some new relationship that would involve some face-to-face dealings and a negotiation of terms of the new loan assumption, you might be able to say that there was enough face-to-face relationship there to say that there was a making.

But, apart from that, I would suggest no.

For those reasons and for the reasons, for the reasons stated in our brief, we believe that the Board has exceeded the language of the statute and Congress' basic intent, not only with the commercial loan amendment in particular but with the whole scope and what it seeks to regulate under the Bank Holding Company Act.

And for those reasons, we believe that no amount of agency deference or deference to the agency's evasion authority can justify the Board in doing something which is to expand its jurisdiction in a

manner that Congress did not intend and, indeed, is contrary to specific limitations on that jurisdiction that Congress put into the statute when, for example, it amended the Act to include the commercial loan provision.

And for those reasons, we would urge the Court to affirm the ruling of the Tenth Circuit.

Thank you.

CHIEF JUSTICE BURGER: Mr. Hawke.

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

The issue that I wish to address is the validity of the Board's attempt in this case to expand the Bank Holding Company Act jurisdiction to cover industrial banks by the means of redefining a statutory term relating to so-called demand deposits.

Industrial bank is the name that is given to a variety of small financial institutions chartered under state law principally to provide installment credit to consumers and to small businesses.

According to data recently submitted to Congress by the Federal Reserve, industrials currently operate in about 20 states; there are about 1,200 of them in the country in existence; and their total deposits are only about five billion dollars.

Industrials typically offer two types of

deposit accounts, savings deposits and investment certificates. Virtually all states that authorize industrials prohibit them from offering true demand deposits; that is, deposits as to which the depositor has a legal right to withdraw on demand.

Ten states, however, currently authorize industrials to permit withdrawals from savings accounts by negotiable instrument. Approximately 95 industrials, according to the Board's information, offer so-called NOW accounts, although I should say that it's a fair assumption that because of the cloud of uncertainty cast over this portion of their activities by the Board's attempts to regulate industrials over the last few years, that there are many industrials who are waiting to see what the outcome of this litigation is on this issue.

The American Financial Services Association and the other petitioners that I represent have challenged the Board's efforts to bring industrials under Bank Holding Company jurisdiction not only because of their conviction that industrials were never intended by Congress to be covered under that Act because they are not by any stretch of the imagination commercial banks, but also because the Board's new treatment of industrials confronts corporate owners of these

institutions with the choice of either radically altering their own activities or causing the institutions to curtail their services to their customers in a way that would inevitably make them less useful and less competitive.

I'd like to dwell just a bit longer on the Board's earlier treatment of industrials, because I think the defect in their present position is clearly revealed by a reference to the history of the Board's attempts in the past to cover industrials.

As Mr. Bradfield said, in 1956 the sole test of bankness under the Bank Holding Company Act was whether an institution held a charter as a national bank or a state bank. In 1963, however, the fed rule that a state-chartered industrial loan company would be included under the definition of bank if it, and now I quote, "accepts deposits subject to check or otherwise accepts funds from the public that are in actual practice repaid on demand, as are demand or savings deposits held by commercial banks."

The actual practice language was a reference to the fact that savings accounts, both in industrials and in commercial banks, have historically been subject to a reserved right in the institution to require some period of notice before withdrawal, a right that is

almost never exercised even though its reservation is uniformly compelled by state and federal law.

In 1965 the Board reaffirmed its position, holding that industrials had offered investment certificates that were repaid in practice on demand were subject to the Bank Holding Company Act, and again there was no attempt to distinguish industrials on the basis of whether they offered checking accounts.

Industrials took their case to Congress, and in 1966 Congress responded by repudiating the Board's attempt to extend its jurisdiction over this type of financial institution. Congress fully recognized the difference between prior notice accounts as to which the right of notice was required but almost never exercised and true demand deposits, where no such right existed at all.

And Congress amended the Bank Holding Company Act definition to include as banks only those institutions offering deposits that were withdrawable on demand as a matter of legal right.

The Board argued at that time for a definition that used the terminology demand deposit, but Congress rejected that and used the, the very technical, rather stilted language deposits that the depositor has a legal right to withdraw on demand, and used that language for

the specific purpose of assuring that deposits that were withdrawable as a matter of practice on demand would not be covered under the Act.

Contrary to Mr. Bradfield's suggestion, the Board's definition that is in the present regulation would include passbook savings accounts, as Justice O'Connor asked if it would, if the withdrawal from the savings account was made by check.

A NOW account is really no more than an interest-bearing savings account from which withdrawals may be made by a variety of methods, either by presentation of a passbook or a withdrawal slip or by a negotiable instrument. So, a NOW account is nothing but an interest-bearing savings account, and it's distinguishable from a true demand deposit in several distinct and important respects.

First of all, and foremost, NOW accounts are not available to business customers. They're only available to individuals.

Second, NOW accounts may bear interest. True demand deposits may not. The noninterest-bearing account that is available to businesses that is the classic demand deposit account is what Congress chose as the hallmark of a commercial bank. Commercial banks still issue that kind of account; industrial banks do

not and cannot.

The Board now tries to reassert its jurisdiction over industrials by making two arguments. First, they argue that depositors do in fact have legal right to withdraw on demand until the institution actually exercises its right to acquire prior notice of withdrawal.

And second, they argue that the legal right to withdraw on demand language really doesn't mean what it says, but it was intended to apply to checking accounts.

I don't think there's any merit in either one of those arguments. The first argument simply amounts to playing with words and ignores the plain meaning of the statute. What Congress clearly meant to do by using the phraseology legal right to withdraw on demand was to exclude prior notice accounts, fully recognizing that the prior notice is almost never exercised.

The Board's argument flies in the face of the legislative history, and it would make nonsense of what Congress intended to do in 1966.

The argument also flies in the face of the Board's own longstanding interpretation of the distinction between demand deposits and savings deposits. The Board has been aware for decades that the reserved right of notice is almost never exercised with

respect to interest-bearing savings accounts that are, in practice, withdrawn on demand.

Yet, that distinction, as slim as it may appear, has always sufficed in Board regulations -- indeed, it suffices today -- to distinguish such accounts from demand deposits on which a payment of interest is prohibited.

The second argument, that the language should be read to mean checking accounts rather than what it says, is simply wishful thinking. Congress did not, in 1966 or at any time thereafter, define banks in terms of the means by which deposits could be withdrawn. It defined them in terms of depositors' legal rights.

And particularly in the context of this case it used that definition to distinguish industrial banks from commercial banks. Congress -- if Congress had really intended the method of withdrawal to distinguish between commercial banks and industrial banks, it would have been very easy for it to do so by defining that leg of the definition of bank in terms of checking accounts rather than accounts that the depositor had a legal right to withdraw on demand.

More important, the fed's expansive interpretation of 1963 and 1965 that led Congress to amend the Act to insure that industrials would not be

covered were not keyed simply to the means of withdrawal. They were based on the fact that deposits nominally subject to a right of notice were in fact paid on demand.

And the legislative history is absolutely clear that Congress did not consider industrials to present the same considerations as conventional commercial banks. The intention of Congress in amending the definition of a bank was to exclude industrial banks from fed jurisdiction, not to describe a particular means of withdrawal.

The fact was then, as it is now, that industrials do not and cannot issue demand deposit accounts from which a depositor has an unquenchable legal right to withdraw on demand. Unlike commercial banks, they can't issue checking accounts to businesses that can be used for commercial purposes. Their accounts are limited to consumer accounts.

In conclusion, we believe that the history of the Board's effort to assert jurisdiction over this segment of the financial services industry makes this a particular compelling case to leave to the Congress, since almost 20 years ago, Congress tried to make it clear to the Board that industrials were not to be covered under the Bank Holding Company Act.

And if the Board now believes that industrials have so changed in the nature of the services that they offer, a proposition that we vigorously dispute, it should be required to make that case to Congress and it shouldn't be permitted to use the kind of jurisdictional self-helps that it's tried to use here, with the consequence of upsetting years of settled doctrine and creating, unjustifiably, turmoil in this segment of the financial services industry.

CHIEF JUSTICE BURGER: You have five minutes remaining.

MR. BRADFIELD: Thank you, Mr. Chief Justice.

I would like to start by pointing out that the basic approach that Congress has had to this whole question of bank holding company activities is that the combination of ownership by industrial and commercial firms of banks is just too frought with the potential for abuse to be permitted.

The alternative of permitting such combinations but subjecting them to careful regulations was rejected, was considered and it was rejected by the Congress. It had decided, instead, that only a complete divorce is workable. Overturning the Board's rule would permit this incompatible marriage to take place, contrary to the intention of Congress.

So, rather than the Board extending its jurisdiction, the Board is simply implementing what Congress already intended in 1956 and 1966 and in 1970.

If you take that approach and then you look at the respondents' representations that they are just small consumer organizations, then you have to ask yourself the question whether the industrial banks and Dimension are small consumer organizations, and you have to ask yourself the question that they are -- they may be today, but will they be tomorrow? If they have this authority to combine NOW accounts and commercial loans, full commercial loans, won't they be able to use this authority in a way that's precisely the way that Congress said it shouldn't be used.

NOW accounts, I should remind you, are a very major portion of our money supply. There's over 171 billion in NOW accounts; larger than currency in circulation, and almost as large, 65 percent of the amount of demand deposits. NOW accounts are money, and that's what Congress wanted to regulate.

The respondents suggest that nothing bad is going to happen as a result of allowing this trend to continue. Congress knew that that was possible. They considered that, and I can only cite to you exactly what happened in Maryland and Ohio as examples of what bad

things can happen and how the system can be destabilized by this kind of development.

I'd like to also point out that the charge has been made there is, that there is a common usage with respect to commercial loans. I don't think that the Court should be confused by the term money market instrument, as if there's some kind of independent market in which buyers and sellers congregate and there are independent transactions.

Justice Stevens was exactly correct that if a, a commercial bank buys a loan from another commercial bank it has made a commercial loan, and if there's a problem with that loan it is responsible and has to engage in direct face-to-face negotiations with the other party in order to straighten things out. Similarly, broker car loans, a direct face-to-face negotiation. Certainly commercial paper; most commercial paper, more than 50 to 60 percent, more than half of commercial paper, is directly negotiated between the borrower and the lender.

There's a suggestion that, that the, that the Congress to repudiate the Board and the Board's definitions in, when the Board initially covered industrial banks in 1963. Well, that's hardly a conclusion that you can draw from the record.

In 1958 the Board made 20 recommendations on the Bank Holding Company Act and how the Bank Holding Company Act should be improved. The Congress adopted every one except one with just a minor provision of not great significance.

I would finally point out that the notice requirement that the respondents on NOW accounts -- the notice requirement that they propose would, is just sufficient to take an instrument, the NOW account, from outside the bank holding company, if there's notice, it's enough -- if that were true, any bank holding company, the largest bank holding company could simply put a notice on its accounts and simply escape from the Bank Holding Company Act.

That was considered in a Fifth Circuit decision and was, that kind of situation was said, that's an evasion of the Act and it should be an evasion of the Act here as well.

Finally, I'd like to point out that while these respondents claim to be small and of not great significance in doing great public good, I would like to point out that on page 1A of the appendix is a list of -- thank you, Mr. Chief Justice.

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

(Whereupon, at 2:42 o'clock p.m., the case in the above-entitled matter was submitted.)

CERTIFICATION

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#84-1274 - BOARD OF GOVERNORS OF THE FEDEPAL PESERVE SYSTEM, Petitioner V.

DIMENSION FINANCIAL CORPOPATION, ET AL.

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BY Paul A. Richardson

(REPORTER)