Chevron Deference and Corporate Concentration in the American Financial System, 1968-1987

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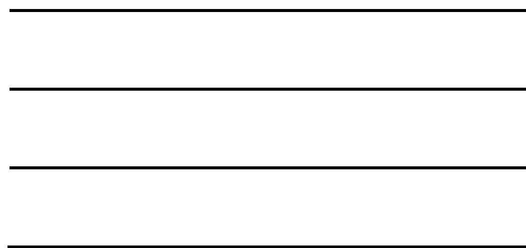

Introduction

Over the course of the twentieth century judicial scrutiny of federal agencies has fluctuated between competing intellectual tendencies. In the 1940s Justice Felix Frankfurter declared that the "seasoned wisdom of administrative experts" was "incontestable," and that courts should defer to New Deal administrators provided their actions contained some rational basis and were not blatant abuses of bureaucratic authority. Inexpert courts, Frankfurter believed, could puncture agency discretion only if administrative orders failed basic procedural safeguards. A wide body of American jurists shared this penchant for judicial restraint. Legal thinkers generally agreed that courts lacked the scientific capacities of the growing administrative state and should assign themselves to a relatively inert role in the practice of bureaucratic lawmaking.[1]

By the 1970s, however, judges were done rubber-stamping orders that sprung from federal agencies. Regulatory capture and bureaucratic cover-ups sullied faith in expert administration. There emerged a countervailing effort to open up the bureaucratic process and make government machinery more accountable. The courts began to police agencies that had become accustomed to ample latitude. The judiciary upended New Deal deference and became more than just a basic check against arbitrary bureaucratic orders – it began to embrace a heavily supervisory role for the courts. The move from New Deal deference to a "New Partnership"

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[1]See Frankfurter's opinions in *Board of Trade of Kansas City v. United States* (1942) 314 U.S. 534, and *National Broadcasting Co. v. United States* (1943) 319 U.S. 190; the 1946 Administrative Procedure Act codified the basic procedural requirements for administrative orders, for more on the APA see Ronald A. Cass, "Models of Administrative Action," *Virginia Law Review*, 72.2 (1986): 363-398, and Martin Shapiro, "APA: Past, Present and Future," *Virginia Law Review*, 72.2 (1986): 447-492; it should also be noted that judicial deference was a rallying cry for the left prior the New Deal, for more on how Holmes, Brandeis, and other Progressive-Era legal thinkers thought about judicial restraint see the early chapters of Edward Purcell, *Brandeis and the Progressive Constitution: Erie, the Judicial Power, and the Politics of Federal Courts in Twentieth-Century America*, New Haven: Yale University Press, 2000; New Deal deference to agencies was aptly characterized by Sidney Milkis in *The President and the Parties*. Milkis coined the phrase "administrative loft" to describe the autonomous sphere of administrative policymaking capacity forged by Franklin Roosevelt in the 1930s. Administrators would stand above judges in this "loft" and be insulated from exacting judicial scrutiny

between agencies and courts made it hard for legal scholars to discern consistent standards of review for bureaucratic orders. Administrative law had been saturated with a confusing array of cross-cutting doctrines.[2]

Chevron U.S.A., Inc. v. Natural Resources Defense Council (1984) attempted to clarify this "blur of decisions" regarding the proper scope of the judicial role. In his *Chevron* opinion Justice Stevens sought to create a replicable formula all judges could use when evaluating administrative decisions. At issue was whether administrative agencies were allowed to fill the interpretive holes left by Congress. If the legislative history did not address "the precise question at issue," should agencies or courts be entrusted to interpret the relevant statute? Stevens established a two-step test to evaluate administrative statutory interpretations. The first job for a reviewing court was to gauge congressional intent. If intent was unambiguous, the court's only job was to ensure the agency adhered to the legislative mandate. If, however, Congress had not been explicit, the agency, not the court, was charged with interpreting the statutory provision. The only job left for judges was to ensure these agency readings were "permissible" or "reasonable." *Chevron* implied that judges could not alter bureaucratic statutory constructions in any significant capacity. They would merely ensure agency interpretations had some reasonable basis and stayed within the basic parameters of administrative due process.[3]

Were courts reverting to the humbler institutional role they had adopted in the early twentieth century? Some legal scholars thought *Chevron* might move administrative law to an extreme beyond even New Deal deference. The holding, some worried, could be employed as a

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[2]For more on the reengagement of federal courts in the 1970s see generally chapters 8 and 9 of Reuel Edward Schiller, "Policy Ideals and Judicial Action: Expertise, Group Pluralism, and Participatory Democracy in Intellectual Thought and Legal Decision-making, 1932-1970," Doctoral Dissertation, University of Virginia, Charlottesville, VA, 1997; and for a written opinion that epitomizes this trend see Judge Bazelson's ruling in *Environmental Defense Fund v. Ruckelhaus* (1971) 439 F.2d 584.
[3]*Chevron U.S.A, Inc. v. Natural Resources Defense Council* (1984) 467 U.S. 837

“counter-*Marbury*” to abrogate judicial review of the federal bureaucracy. Many thought *Chevron* advanced a wholesale reinterpretation of the judicial function that privileged administrative lawmaking, and, in turn, would nullify the ability of the judiciary to “say what the law is.” The case was billed as a dramatic reassertion of judicial deference – an attempt to moderate the heightened scrutiny of the 1970s and inject restraint back into judging. The preliminary forecast was that the decision would have far-reaching effects.[4]

But the *Chevron* revolution many anticipated largely failed to materialize. While *Chevron’s* formalistic two-step test was intended as a coherent formula for review, it posed more questions than it did offer answers. It sanctioned restraint in a very broad sense, but its mechanics were not particularly straightforward. What degree of legislative ambiguity moved a reviewing court to *Chevron* step two? What, exactly, constituted a “permissible” statutory construction? Stevens’ test, like many in American public law, was intended as an intelligible formula but added little real precision. Courts disagreed on how to apply *Chevron* deference when faced with the tough questions in subsequent cases. They attempted to clarify the holding with new doctrinal formulas, but these often limited *Chevron’s* reach and departed from the two-step framework. As a result, some scholars have posited only a “spotty” commitment to the original decision. Empirical studies have confirmed that the ruling did not dramatically curb the judicial function as some feared. The consensus is that *Chevron* has been more of a paper tiger than a real counterweight to *Marbury v. Madison*.[5]

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[4]For these reactions to *Chevron* see Cass Sunstein, “Beyond *Marbury*: The Executive’s Power to Say What the Law Is,” *Yale Law Journal*, 115.9 (2006): 2580-2610 and Michael Spicer and Larry Terry, “Administrative Interpretation of Statutes: A Constitutional View of the ‘New World Order’ of Public Administration,” *Public Administration Review*, 56.1 (1996): 38-47

[5]The most prominent cases that demarcated *Chevron’s* reach were *INS v. Cardoza-Fonseca* (1987) 480 U.S. 421 and *United States v. Mead Corp* (2001) 533 U.S. 218; for more evidence on how these cases and other legal developments precluded a “*Chevron* revolution” see Thomas Merrill, “Judicial Deference to Executive Precedent,” *Yale Law Journal*, 101.5 (1992): 969-1041, Cass Sunstein, “Law and Administration After *Chevron*,” *Columbia Law Review*, 90.8 (1990): 2071-2020, Cass Sunstein, “*Chevron* Step Zero,” *Virginia Law Review*, 92.2 (2006): 187-

Legal scholars have fiercely debated whether *Chevron* has made courts more deferential to administrative agencies, but they have missed the decision's unlikely impact on one of the fundamental pillars of political economy: financial regulation. This paper reasserts the importance of the decision not by uncovering a "*Chevron* revolution" others have failed to locate, but by highlighting how the case was appropriated to transform the American financial system. *Chevron* featured prominently in a battle over the law of banking fought during the 1980s. Judicial deference to agency discretion bore heavily on a number of cases concerning the makeup of financial institutions in the American economic system. This battle began in 1978 when the Federal Reserve Board approved applications from several commercial banks that had petitioned to deal in certain types of financial securities. The Securities Industry Association (SIA), a trade group representing Wall Street, sued the Fed two years later by arguing that the Board's orders were illegal under the New Deal banking laws that separated commercial banks that engaged in depository lending from investment banks that dealt in a wider range of speculative financial instruments. Four sections of the 1933 National Banking Act (collectively referred to as Glass-Steagall) enacted this wall between commercial banks and Wall Street.[6] The goal of bifurcating the business of banking was to keep deposits safe. In the wake of the Great Depression the 1932 Pecora Commission unveiled bank speculation in financial securities that

249, David Barron and Elena Kagan, "*Chevron's* Nondelegation Doctrine," *The Supreme Court Review*, Vol. 2001 (2001): 201-265, Stephen M. Lynch, "A Framework for Judicial Review of an Agency's Statutory Interpretation: *Chevron, U.S.A., Inc. v. Natural Resources Defense Council*," *Duke Law Journal*, Vol. 2 (1985): 469-496, and "The Two Faces of Chevron," *Harvard Law Review*, 120.6 (2007): 1562-1584.

[6]Section 16 limited bank dealings in securities to "the purchase and sale of such securities, without recourse, solely upon the order and for the account of customers," and stipulated that "no member bank shall underwrite any issue of securities." Section 20 mandated that "no member bank shall be affiliated with a securities corporation." The penalty for doing so would be a penalty of $1,000/day, and a forfeiture of Federal Reserve membership if the violation continued for over six months. Section 21 made it unlawful "for any person, corporation or other organization engaged in the issue, underwriting or selling of securities to receive deposits subject to check or to repayment upon presentation of a pass book or certificate." Lastly, Section 32 required that "no officer or director of a member bank shall be an officer, director or manager of an organization engaged primarily in the securities business" and prohibited "correspondent relationships between member banks and securities organizations."

led to the great squandering of consumer savings. The commission's findings built broad public support for regulations that shielded bank deposits from the vagaries of Wall Street investments. The Glass-Steagall partition was reinforced by the 1956 Bank Holding Company Act that prevented holding companies from acquiring subsidiaries that dealt in non-banking activities such as securities trading. These were some of the most important laws governing what banks could and could not do in the United States. The dispute that erupted in 1978 tested their legal durability. The stakes of the clash were high. The SIA was asking federal judges to police some of America's biggest banks, but the Board's bureaucratic autonomy was also on trial. Could the Federal Reserve allow some of its member banks to bend the rules the agency was charged with applying? At the heart of the SIA cases was the important question of how much the judiciary should respect a federal agency's administrative authority. Should judges look behind the wisdom of the Board's orders and challenge bank entry into securities? Or did the Fed's special competence in the field of banking command judicial deference?

In the 1980s conservative jurists used *Chevron* to precipitate financial deregulation. Reagan partisans sitting on the DC Court of Appeals realized that enhancing bureaucratic autonomy through the new deference doctrine would give the Federal Reserve effective immunity to chip away at New Deal banking regulations. Judges who disparaged the regulatory state invoked *Chevron* to diminish their own role and insulate administrative readings that emasculated old regulatory regimes. The decision allowed the Board to revise long-standing rules that would transform American political economy without Congressional authorization. It was a catalyst that helped commercial banks enter new financial realms, put consumer money into a broader range of financial products, and blur the legal distinctions established in the 1930s. The fissures that opened in the New Deal regulatory state might have been less pronounced if

Chevron had not strengthened the independence of already-powerful agencies like the Federal Reserve.

Extant narratives on deregulation underscore the importance of the Presidency and Congress. The names of Ford, Carter, and Reagan appear frequently in accounts that highlight presidential initiatives. Reagan's executive order 12291 is perhaps the most important event in current histories of deregulation. The order made good on the administration's goal of "regulatory relief" by centralizing presidential control over bureaucratic rulemaking in the Office of Management and Budget. Scholars have also paid great attention to legislative breakthroughs in airlines, trucking, and telecommunications. Ted Kennedy's leadership of the Senate Judiciary Committee in the mid-1970s helped galvanize congressional support for a host of deregulatory initiatives. Overall, scholars have painted the executive and legislative branches as the primary drivers of regulatory change. The judiciary is always on the outside looking in – consigned to a peripheral role while the other governing institutions perform all the work. While judges and cases have token appearances in existing accounts, law is rarely portrayed as an autonomous force that helped bring about regulatory change.[7]

This paper argues that administrative law was crucial to regulatory restructuring. Scholars of American Political Development have expressed recent interest in the rise of a "New American State" reliant on administrative expertise, but this subset of historical scholarship has

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[7]Shane Hamilton recently showed in *Trucking Country* how independent associations of long-haul truckers were important proponents of anti-statist economic policies, but the more typical treatments of deregulation I refer to include: Martha Derthick and Paul Quirk, *The Politics of Deregulation*, Washington, D.C.: Brookings Institution, 1985, Sidney Milkis and Richard Harris, T*he Politics of Regulatory Change: A Tale of Two Agencies,* New York: Oxford University Press, 1996, Daniel Yergin and Joseph Stanislaw, *The Commanding Heights: the Battle for the World Economy,* New York: Simon & Schuster, 2002, see Chapter 12 "The Delayed Revolution," and Robert Collins, *Transforming America: Politics and Culture during the Reagan Years*, New York: Columbia University Press, 2007; one exception to this trend is the work of political scientist R. Shep Melnick, see particularly *Regulation and the Courts: the Case of the Clean Air Act.* Washington, D.C.: Brookings Institution, 1983, and *Between the Lines: Interpreting Welfare Rights,* Washington, D.C.: Brookings Institution, 1994

not adequately explored the legal rules that govern the *operation* of this administrative state. Much work has been done on the origins and development of the state's political and institutional capabilities. Indeed, scholars have made significant strides to "bring the state back in," but have largely neglected the body of law that manages the exertion of state authority. Judges, particularly those sitting on the DC Circuit, have great control over the administrative state and yet are rarely depicted as critical actors in regulatory politics. What follows is a story of how administrative law was used as an additional tool to change the rules framing economic activity. The *Chevron* decision recalibrated the legal landscape in favor of agency discretion, and empowered the Federal Reserve to weaken New Deal financial regulations through statutory interpretation. The irony is that the decision expanded statist means, but was deployed to serve anti-statist ends. The judicial act of augmenting administrative autonomy led to paradoxical curtailments in other aspects of bureaucratic governance.[8]

Highlighting the influence of the judiciary will force political institutionalists to think more broadly about the interaction between the three governing branches. My focus on the judiciary aims at a more holistic understanding of how regulatory policy goals are often achieved. The federal agencies empowered by *Chevron* were firmly under executive control. How courts fashion administrative deference therefore has important ramifications for the fulfillment of presidential policy agendas. The case was a boon to agency interpretations

[8]Prominent examples of this trend in the literature on the administrative state include Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol, *Bringing the State Back In,* Cambridge: Cambridge University Press, 1985, Stephen Skowronek, *Building a New American State: the Expansion of National Administrative Capacities, 1877-1920*, Cambridge: Cambridge University Press, 1982, Daniel Carpenter, *The Forging of Bureaucratic Autonomy: Reputations, Networks, and Policy Innovation in Executive Agencies, 1862-1928*, and Brian Balogh, *Chain Reaction: Public Debate and Expert Participation in American Commercial Nuclear Power, 1945-1975*, Cambridge: Cambridge University Press, 1991; I hope to build on an argument made by Sidney Milkis and Richard Harris in *The Politics of Regulatory Change*. Policymakers who antagonize big government, they claim, have often had to empower government to achieve their anti-statist ends. The Reagan administration's use of the OMB is but one example. My examination of *Chevron's* effect on the law of banking only confirms this political irony.

sanctioned by the executive, and administrative lawmaking was the chosen means of political action precisely because of legislative inertia. For a number of reasons banking reform stalled in Congress during the 1980s, leaving proponents of deregulation fishing for additional policy devices. By examining their eventual appropriation of *Chevron* deference, this paper seeks to expand how scholars think about law, deregulation, and the modern administrative state.

The paper begins by contextualizing the SIA cases. What prompted a Wall Street trade association to bring suit against the Federal Reserve? Part one argues that inflation unleashed competitive incentives that kicked off the legal dispute. Price instability made commercial banks less appealing repositories for consumer money, and Wall Street firms devised new financial products that took advantage of the disaffection felt by thousands of Americans with bank deposits. The dissemination of Money Market Mutual Funds threatened the traditional business of depository lending and prompted a counterattack from the banking industry. This counterattack is the subject of part two. Banks responded to turf encroachments by attempting to claw back their lost business. What emerged was a game of tit for tat – a form of market jockeying in which financial institutions responded to new competitive pressures by challenging entrenched legal distinctions. Both commercial banks and Wall Street firms began offering services that had been prohibited to them since the New Deal. Ultimately courts would be asked to mediate between the "animal spirits" reverberating in financial markets. Parts three and four ask how *Chevron* helped resolve the battle between bankers and brokers in the late 1980s.

The First Punch: Price Instability and the Creation of Money Market Mutual Funds

Inflation first bubbled to the surface in 1968 when President Johnson proved unwilling to sacrifice "guns" or "butter." Johnson's fiscal intransigence overheated the American economy,

helping set off an inflationary spiral that oil shocks, speculation against the dollar, and balance-of-payments deficits only exacerbated throughout the 1970s. Price instability tarnished some of the central tenets of the postwar order. Keynesian economists, who had declared the virtual extinction of business cycles, were baffled that their trusted stabilization techniques repeatedly failed to mitigate rising prices. The coexistence of inflation and unemployment was something Keynesians could neither explain nor solve because it cut against the intellectual foundations of economic orthodoxy. The team of policymakers that had steered postwar prosperity no longer looked so omnipotent. Prices rose unabated resulting in strained pocketbooks, shortages, and an atmosphere of general anxiety. Americans had grown accustomed to stable prices, uninterrupted growth, and an interventionist federal government that greased the wheels of the postwar boom. But inflation cast doubt on these articles of faith.

The effects of price volatility were also felt in the regulatory state. Inflation reverberated through the web of rules and orders propagated by the federal bureaucracy. It effectively compromised Regulation Q – one of the many banking regulations devised during the 1930s in response to the Great Depression. Regulation Q capped the interest that commercial banks could offer on deposits. In economics a higher rate of interest denotes higher risk. Secured transactions that promise low interest rates are not very lucrative, but are more likely to be safe and make good on scheduled payments. High-interest loans have the potential to be more profitable, but are also more likely to go belly up. In the 1930s regulators worried that banks would compete for deposits by making riskier loans. This kind of ruinous competition contributed to hundreds of bank failures and thousands of depositors losing their savings. Rate ceilings were designed to temper the competitive pressures that might trigger insolvencies and put the “people’s money” at risk. These restrictions were perfectly logical to Americans whose economic experiences had

been colored primarily by market failure. Lower interest was a small price to pay for stability and security in what had proven to be a very turbulent financial world.

Inflation unsettled this regulatory arrangement in the 1970s. The growing disparity between prices and the paltry rates mandated by Regulation Q meant Americans saw lower returns on their savings. By allowing banks to avoid indexing interest to fluctuating price levels, rate ceilings made negligible real interest a legal requirement. Americans began to question the basic utility of deposits as they saw their disposable funds atrophy in time, savings, and passbook banking accounts. What incentive did they have to keep their money in banks any longer? Their discontent, if not their nest egg, was compounded by the fact that market returns on other financial instruments were creeping steadily upward. In the early 1970s short-term Treasury bills and certificates of deposit grossed rates at or above ten percent. These market yields only rose after Paul Volcker took the reins of the Federal Reserve and raised the federal funds rate to combat price volatility. Bank deposits, however, continued to earn meager returns because they were hemmed in by regulatory constraints.[9]

In 1977 the nation's largest Wall Street brokerage firm devised an ingenious financial product that freed savings from the fetters of regulated interest. Merrill Lynch called the innovation a "Cash Management Account." The CMA brought together a collection of different financial products under one umbrella. It took a portfolio of stocks and bonds, a money market account, a checking account, and a credit card, and pooled them into a single fund. The device unified financial services that brokerage houses, mutual funds, and banks had always offered

[9]Matthew Fink interview, *Securities and Exchange Commission Historical Society*, conducted on March 9th, 2006 by Dr. Kenneth Durr, "Developments in the Mutual Fund Industry – Money Market Mutual Funds," Interview with John McGonigle, Robert Plaze, and David Silver, *Securities and Exchange Commission Historical Society*, March 29th, 2005, conducted by Martin Lybecker. Both oral histories bring together leaders of investment trade associations to discuss inflation and the impetus for money market mutual funds.

separately – it combined accounts that had been compartmentalized. Merrill required a starting balance of $20,000 in either stocks, bonds, or cash.[10] Funds were then invested in a variety of financial securities like certificates of deposit, Treasury bills, and commercial paper. The instruments were always short-term debt obligations with maturities of 30 days or less – the logic being that the most liquid financial assets offered the highest and most current market yields, and carried less risk than a long-term note or bond. This was the money market component of the CMA. It that was very similar to Merrill's normal assortment of offerings. The innovative component was that customers could write checks and draw credit on the new fund. Checks and credit cards had been the exclusive purview of commercial banks, but the CMA combined them with a securities account. The separate spheres of banking were beginning to merge.

Merrill first introduced CMAs in 1977 to six test markets in Georgia, Ohio, and Colorado. In roughly a year they attracted over 200,000 customers whose contributions to the new funds totaled over $4 billion. Soon, other regions were demanding the product, and Merrill commenced plans to expand cash management vehicles nationwide. CMAs were so popular so quickly that a "thundering herd" of financial institutions followed in Merrill's bullish wake. By the end of 1977 almost every major brokerage house was prepared to release its own version of a money market mutual fund (MMMF). By 1981 assets in MMMFs totaled $35 billion. The market, which had been immediately flooded with new entrants, had grown eightfold in only four years.

The bonanza was easy to explain. MMMFs were enticing because they retained the functionality of regular bank accounts, but earned the returns precluded to banks by Regulation Q. They became the obvious means of recourse for those irked by the low yields on their

[10]This obviously meant CMAs were out of reach to many Americans with comparatively less disposable income.

savings. The fervor was also attributable to Merrill's sophisticated computer module that automatically "swept" excess funds back into new investments. Money made on a 30-day T-bill would automatically buy up new T-bills and continue to grow on itself. Traditional brokerage accounts let excess cash idle at the whims of an investment advisor, but Merrill's computer system ensured monetary gains would be compounded continuously. Ordinary bank accounts looked increasingly archaic by comparison.

Money market funds embodied Merrill's expansionary ambitions that went beyond the typical brokerage functions. Merrill had dominated the industry throughout the 1970s. In 1974 the firm grossed over $800 million in revenue – four times that of its next largest competitor – and accounted for over ten percent of total activity on the New York Stock Exchange. CEO Don Regan was legendary for his bullish personality and aggressive shows of "financial muscle." But his sights were set on more than trades and commissions. The brokerage industry was volatile. Merrill's business waxed and waned with the fate of the stock market. Brokerage could be hot one month and sluggish the next, depending on the volume of shares traded. The business also hinged on the momentum of market forces. The stock market had shown itself to be a fickle beast after stagflation ended the steady march of postwar prosperity. Regan wanted to accumulate a wider array of financial assets that would "even out the ups and downs" of the industry – to stabilize the boom and bust of the major market indexes. Regan wanted some of the banking business. Merrill had achieved notoriety as the nation's most prominent wirehouse, and was now using CMAs to vacuum up the bank deposits languishing under Regulation Q.

MMMFs made the business of commercial banking virtually untenable. Americans' savings, once bottlenecked by rate ceilings, cascaded out of banks and migrated to sweeter pastures. Brokerage houses pilfered bank balance sheets with new financial products made

irresistible by price volatility and made convenient by an emerging digital capacity. The average starting balance for a CMA was around $70,000 – a figure that represented a commensurate loss for commercial banks. Wall Street was draining banks of their commercial lifeblood by swallowing up huge denominations of disposable funds. Economists termed this process disintermediation. It constituted the first major blow in what would become a heated battle between some of America's most powerful financial intermediaries.[11]

Commercial bankers reeling from disintermediation began to fight back. Regan insisted there was nothing illegal about the money market funds. Merrill had merely put "very legal things" together, and had carefully separated the checking and credit card component. The Ohio-based City National Bank and Trust Company administered checks and cards on Merrill's behalf. Merrill believed delegating these banking responsibilities would deflect criticism that the firm was explicitly violating Glass-Steagall. SIA president Edward O'Brien insisted that CMAs were rooted in securities accounts and therefore permitted under federal law because they were only peripherally connected to banking.[12] Bankers were not convinced. They argued that MMMFs, however packaged, amounted to investment houses accepting deposits in ways that ran roughshod on the legal barriers demarcating financial institutions. The president-elect of the American Bankers Association insisted that bankers would use "whatever powers they possessed" to prevent future turf encroachments. Bankers set their sights on many different

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[11]For more on the history of Merrill Lynch prior to the introduction of the CMA see chapters six and eight of Joseph Nocera, *A Piece of the Action: How the Middle Class Joined the Money Class,* New York: Simon & Schuster, 1994; see also Robert Bennett, "A Bank, by Any Other Name…" *New York Times*, Dec. 27th, 1981, F1, Linda Grant, "It Looks Like a Bank, Acts Like a Bank But Its Name is Merrill Lynch," *Los Angeles Times*, Mar. 15th, 1981, G1, Harvey Shapiro, "Putting All Your Assets in One Basket," *New York Times*, Nov. 20th, 1983, F11, and Deborah Rankin, "Lure of Money Management Accounts," *New York Times*, Sep. 19th, 1982, pp. 151.

[12]"Corporate Securities Underwriting and Broker-Dealer Services By Banks: A Panel Discussion," *Annual Review of Banking Law*, Vol. 2 (1983): 111-121, Moderated by John D. Hawke Jr. (former general counsel to the Board of Governors of the Federal Reserve), Panel participants included: Robert Bevan (American Bankers Association), Edward O'Brien (SIA), John Phelan (president of the NYSE), Danny Wall (Senate Committee on Banking, Housing, and Urban Affairs), and Peter Wallison (general counsel at the US Treasury).

avenues of resistance. Some targeted the very regulations they saw brokerage firms violating. Citicorp CEO Walter Wriston thought industry lobbyists should prod Congress to revise the statutes that kept banks out of securities trading. Others wanted to challenge Merrill in court. Although the Federal Reserve Board had affirmed the legality of CMAs, the Board said it would continue to monitor the new funds to prevent any future violations. The Board's initial ruling may have placated Merrill in the interim, but it left banking law fundamentally unchanged. Some bankers thought this left the door open to litigation. Others, still, merely wanted to equalize the playing field. Money market funds were de-facto banking accounts, but were in a regulatory black box shielded from the normal banking rules, Regulation Q in particular.[13] Chase Manhattan CEO David Rockefeller welcomed competition from MMMFs, but wanted them to be legally treated as deposits.[14]

Whichever path of resistance bankers favored, there was universal agreement that finance was rapidly changing, and that commercial banks would get left behind if they failed to act. The traditional business of banking, predicated on the difference between the cost of lending and borrowing, looked increasingly outmoded – like an old foundation decaying under new market forces. By offering a "virtual smorgasbord" of financial services, Merrill and its imitators had carved out a more expansive vision for financial intermediaries. MMMFs sapped commercial banks by slicing through the legal divisions of the American financial system. Lines had been blurred before. Commercial banks had made piecemeal entries into securities beginning in the

[13]The biggest worries were that CMAs were skirting reserve requirements and FDIC deposit insurance.
[14]"Bankers See Possibility of a Challenge to Merrill Lynch Plan," *Wall Street Journal*, Oct. 17th, 1977, pp. 39, "Merrill Lynch Takes on the Banks," *Washington Post*, Jul. 3rd, 1977, pp. 115, "Fed to Monitor Merrill Lynch's Cash-Management-Account Plan," *American Bankers Association Journal*, Dec. 1977, pp. 10, "Merrill Lynch to Merge Checking, Stock Accounts," *Los Angeles Times*, Jun. 22nd, 1977, pp. G13, "Chase Assails Broker's Plan," *Chicago Tribune*, Jun 28th, 1977, pp. C7, "Merrill is Barred by Oregon From Offer of Cash Management," *Wall Street Journal*, Jun. 2nd, 1978, pp. 13

early 1960s, but these were minor turf violations at best.[15] MMMFs were a different animal. Their invention represented the first time one end of the financial services industry threatened the other in any serious way. Jimmy Carter's Comptroller of the Currency rightly argued that money market funds were not intended to "poach" bank's business on a sporadic basis – they were designed to weaken commercial banks in a "pervasive, permanent" way.

Legal barriers were increasingly muddied as the 1970s drew to a close. Other financial institutions adopted the trailblazing approach pioneered by Merrill. Insurance companies bought wirehouses. Mutual funds bought banks. Mortgage companies bought credit card providers. Even non-financial organizations began selling their own money market funds, insurance, and real-estate. The "financial department store" looked like the way of the future. Combination and conglomeration seemed like the new keys to a competitive edge. Financial markets were being revolutionized, but the laws that governed them were stuck in neutral. The mixing of different financial cocktails had precipitated a regulatory hangover. It was unclear if long-held distinctions had been rendered obsolete by market pressures because neither the regulatory agencies nor Congress had codified new interpretations of federal banking statutes. Financiers continued to jostle for disposable funds as the legal landscape remained nebulous.[16]

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[15]Banks had begun offering private placement services, and some fee-based merger, acquisition, and divestiture investment advice. The biggest banks set up subsidiaries in London to conduct these activities in order to avoid blowback related to Glass-Steagall in the US. Since the mid-1960s banks had also lobbied to underwrite municipal revenue bonds, and the proliferation of state initiatives modeled off Prop-13 after 1978 strengthened these arguments. See generally Arnold Sametz, Michael Keenan, Ernest Bloch, and Lawrence Goldberg, "Securities Activities of Commercial Banks: An Evaluation of Current Developments and Regulatory Issues," *Journal of Comparative Corporate Law and Securities Regulation*, Vol. 2 (1979): 155-193, Melanie L. Fein, "Commercial Bank Private Placement Activity," *Catholic University Law Review*, Vol. 27 (1977-1978): 743-766, John R. Evans, "Regulation of Bank Securities Activities," *Banking Law Journal*, 91.7 (1974): 611-623, The New York Clearing House Association, "Commercial Bank Private Placement Advisory Services: The Legal and Public Policy Issues," *Banking Law Journal*, 95.3 (1978): 333-361, Lee B. Spencer Jr., "Regulation of Bank Securities Activities: The Effects of the SEC Bank Study," *Banking Law Journal*, Vol. 95 (1978): 616-633, and "The Legality of Bank-Sponsored Investment Services," *Yale Law Journal*, 84.7 (1975): 1477-1504.

[16]Grant, "It Looks Like a Bank," Bennett, "A Bank, by Any Other Name," Joe Asher, "Special Report: International Banking – Merchant Banking is Alive and Well," *American Bankers Association Journal*, Nov. 1978, pp. 44-51, "Special Report: Trust – Chipping Away at Glass-Steagall?" *American Bankers Association Journal*, May 1979, pp.

The new rules of engagement raised important questions for bankers. How would they rein in brokerage firms offering such hot financial products? Could they stop the flood of deposits into the new money market funds? And how would they deal with the other financial institutions swallowing up their business? They needed to act quickly. Soon enough, banks would widen their gaze beyond commercial lending. They would abandon the decaying foundation that had supported them for decades, and, like the brokerage firms offering MMMFs, discover the advantages of financial conglomeration. They would move from playing defense, to a wide-open offensive style that anticipated the rise of one-stop financial shopping.

Tit for Tat: Bank Entry into Securities Trading and the Emergence of the SIA Cases

In 1986 the employees at Bankers Trust gathered for a corporate dinner that featured performances from an improv troupe named Chicago City Limits. The entertainers, looking out on a packed gala ballroom in the heart of New York City's financial district, performed comedic skits that caricatured the bank's strategic vision. "And so it was, it did come to me – the dream," said one of the actresses, dressed as a medieval bard or gypsy. "The only thing I could dream about," she continued, "was the evil Glass-Steagall. From yonder kingdom, I did have these visions. Do come hither and listen to me Lord Fast Go, oh I call your name!" Evil Lord Steagall later appeared on stage dressed in all black. He was ultimately thwarted by Lord Fast Go, who was named after a new unit of securities traders at Bankers Trust.[17] Chicago City Limits, it appeared, knew a thing or two about the bank's limitations under Glass-Steagall.

56, "Banks Yearn to Underwrite Municipal Bonds," *Chicago Tribune*, Jun. 17th, 1979, F3, Joe Asher, "The New Comptroller: What's On His Mind?" *American Bankers Association Journal*, Mar. 1978, pp. 35-36

[17]"Banking on the Future," Copyright © 1986 Bankers Trust, produced by Galan and Associates Productions Inc., http://www.youtube.com/watch?v=O38lPLrMfTg

The skit accurately reflected the demonization of federal law at Bankers Trust. Merrill Lynch and its imitators had pushed the Glass-Steagall envelope by combining checking with a securities account, and Bankers Trust was retaliating in kind. BT was hacking away at the same legal barricade from the other side of the teller's window In the mid-1980s BT executives spoke about the firm's "continued emergence in all areas of the securities business" irrespective of the Depression-era law. When asked about the act's prohibitions, CEO Charlie Sanford Jr. scoffed; "words are just symbolic, and you have to break down that symbolism to change behavior." BT, wrote *The American Banker*, was channeling Goldman Sachs and striving for the image of a risk-taking investment house. If brokerage firms were going to infiltrate the business of banking, banks were going to respond by entering the securities industry. By the time Chicago City Limits performed in 1986, BT employees were ensconced in a clash with Wall Street's financial titans.[18]

The bank's first provocative move came in the summer of 1978 when it began selling commercial paper[19] to investors. The market for commercial paper exploded in the mid-1970s, ballooning from $50 billion in 1976 to $300 billion in 1986. It was an increasingly important source of corporate funds, and was one of the short-term investments at the heart of MMMFs. Money market accounts could attract deposits precisely because of the returns offered by financial products like commercial paper. BT was making an important choice by entering the commercial paper market. The bank would not watch from the sidelines as savings poured into money market funds tied to short-term investments – it would compete alongside investment houses by getting in on the money market directly. BT knew the intrusion was risky, but thought

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[18]Robert Bennett, "Sanford's New Banking Vision," *New York Times*, Mar. 17th, 1985, F1, Andrew Albert, "Bankers Trust Puts Virtually All of Its Businesses Under One Big Financial Tent," *The American Banker*, April 23rd, 1986, pp. 2

[19]Commercial paper is a money market instrument corporations issue to fund short-term obligations like payroll. Its promissory notes are unsecured, meaning they are backed only by the company's promise of repayment, not by collateral

it was worth a shot. While the bank might face an impending lawsuit from Wall Street, nothing in federal financial regulations *explicitly prohibited* banks from selling commercial paper. Glass-Steagall had enacted broad prohibitions on bank involvement in financial securities, but these often failed to mention specific products. BT might be allowed to sell commercial paper in the absence of any express limitation.

The move prompted the first resort to non-market mechanisms in the turf war developing between bankers and brokers. There was less legal grey area with the commercial paper program. BT was not running its operation through an investment house in the way that Merrill had administered cards and checks through an Ohio bank. Encroachment into the commercial paper market was clear and direct – lacking any hint of ambiguity. Investment houses thought the bank's audacity would give them a leg-up in a lawsuit. Instead of responding with another invasion into the realm of banking, Wall Street enlisted the long arm of the administrative state to adjudicate the dispute. The SIA and A.G. Becker (a big commercial paper underwriter) petitioned the Federal Reserve to review the legality of BT's new program. They hoped the preeminent banking regulators would uphold the statutes they administered and invalidate BT's dealings in financial securities. The SIA and Becker were asking the most powerful financial regulatory body to bring order to American financial markets.[20]

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[20]While the Federal Reserve had become one of the most influential government agencies by 1978, it was not particularly autonomous in its infancy. The story of the Fed's institutional development is ridden with twists, turns, and contingencies unanticipated by the agency's original architects. The 1913 Federal Reserve Act granted the agency ample statutory authority over the money supply, interest rates, emergency lending, and the regulation of financial institutions. The act expanded bureaucratic control of the national economy in a very broad sense, but it left the Fed's administrative authority highly decentralized, and did not allow for much independent agency discretion. While the bill gave the Fed all the trappings of a central bank, it fractured the Fed's administrative power in a public-private organizational structure composed of twelve semi-autonomous reserve banks. Further limiting the agency's administrative flexibility was the Fed's location inside the Treasury Department. The central bank remained a relatively unassertive federal agency until the New Deal banking laws permanently consolidated bureaucratic authority in the Board of Governors. The Banking Acts of 1933 and 1935 curbed the autonomy of the twelve reserve branches because of their perceived involvement in financial speculation that contributed to Depression-era bank failures. The Board was not uninvolved in the blunders that led to the Great Crash, but the locus of power increasingly shifted to central authorities in Washington as the federal government became

In June, 1979 the Fed's chief legal officer determined that banks could sell commercial paper with minor restrictions. The SIA and Becker were perturbed by the initial verdict, and quickly demanded the Board revisit the issue altogether. A year later, after conducting an "on-site investigation" at BT, the Board affirmed bank entry into commercial paper under Glass-Steagall. The Board reasoned that commercial paper was functionally similar to traditional banking services. It operated more like an ordinary loan than a security, and therefore lay outside the act's prohibitions. The Board added that its decision was non-reviewable. The claim to absolute discretion was the Board's attempt to insulate itself from future legal challenges. Both the SIA and Becker had whined about the initial ruling, and the Board was hoping to silence them once and for all by blunting all future proceedings. The assertion of complete administrative autonomy harkened back to the New Deal when many agencies successfully invoked preclusion to augment their authority. Unlike in the 1930s, however, absolute discretion was not so easily attainable. The SIA and Becker took the challenge to the courts. They would fight hard to puncture the Fed's bureaucratic authority and extirpate banks from the commercial paper market. Wall Street's battle against BT was shaping up to be very important, but it was not

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progressively active in stabilization policy. The new banking laws also increased the sheer amount of statutes the Board was charged with administering. The New Deal carved out room for a more powerful central bank, but the Fed continued to bicker with Treasury, and had to sacrifice much of its newfound independence to collaborate with other agencies on wartime finance. Not until a formal accord with Treasury in 1951 did the Fed finally achieve the degree of administrative independence sanctioned by the New Deal. Case law, too, began to reflect the Fed's ascent up the bureaucratic totem-pole. In a concurrence penned by Justice Rutledge in 1947, the Supreme Court acknowledged the Fed's special competence and administrative expertise. When asked if the Board's policy decisions should be questioned by the other governing branches, Rutledge proclaimed, "I do not think this Court or any other branch should undertake to reconsider, as an independent judgment, the Board's determinations." While not conceived as such, the Board had risen to prominence as a special kind of public authority in the United States. For more on the origins and creation of the Federal Reserve System see James Livingston, *Origins of the Federal Reserve System: Money, Class, and Corporate Capitalism, 1890-1913,* Ithaca: Cornell University Press, 1986; good historical treatments of the Fed's later institutional development include the first two volumes of Allan H. Meltzer, *A History of the Federal Reserve,* Chicago: University of Chicago Press, 2003, Donald F. Kettl, *Leadership At the Fed,* New Haven: Yale University Press, 1986, and Carl H. Moore, *The Federal Reserve System: a History of the First 75 Years,* Jefferson, N.C.: McFarland & Co., 1990; the Rutledge concurrence can also be found in *Board of Governors of the Federal Reserve System v. Agnew*, 329 U.S. 441, 1947.

the only legal struggle over the power of banking regulators to shape the American financial system and manage the burgeoning feud between commercial banks and securities traders. One other skirmish presented the same kinds of legal quandaries.[21]

Bank acquisition of discount brokerage firms also caught the attention of the SIA's litigation team. Discount brokerage had exploded after trading commissions were deregulated in 1975. New competitors like Charles Schwab & Co. offered rock-bottom rates and captured more and more of the business once reserved to a small cartel of participants.[22] Banks eyed the success of discount brokerage houses. BankAmerica Corp., the holding company for the nation's second largest bank, announced plans to acquire Schwab in 1981. BankAmerica Corp. was taking the offensive to Wall Street in the mold of BT. Like commercial paper, discount brokerage was not *expressly barred* to commercial banks in financial regulatory statutes. If bank holding companies were not forbade from discount brokerage unequivocally, BankAmerica Corp. might be able to level the second successful blow against Wall Street. Commercial paper and discount brokerage comprised the two prongs of the banking counterattack.

In 1983 the Fed approved the acquisition of Schwab. Like in its commercial paper ruling, the Fed claimed its statutory readings were wholly within its regulatory discretion and were therefore entitled to deference. If the expert financial regulators said bank holding companies could legally acquire discount brokerage firms, then that was the end of the matter. But the SIA did not give in so easy. The trade group now had two different lawsuits on its hands, both of

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[21]Factual background drawn from the opinion in *A.G. Becker Inc. v. Board of Governors of the Federal Reserve System* (1982) 693 F.2d 136, William Hall, "Money Centre Banks Challenge Rules On Commercial Paper Business," *Financial Times*, Jun. 11th, 1986, pp. 34, and *A.G. Becker v. Board of Governors of the Federal Reserve System* (1981) 519 F. Supp. 602

[22]Until 1975 the American brokerage industry was controlled a small number of firms. The New York Stock Exchange was an "old boys' club" with barriers to entry that ensured that only a few member firms could buy and sell stock. Being shielded from competition allowed these firms to fix commissions at artificially high rates. For a number of reasons, however, these collusive market practices came under attack in the mid-1970s. For more on the emergence of discount brokers see Nocera ch. 6.

which asked how much judges should trust the agencies charged with regulating the financial system. Could the Board of Governors allow banks into types of securities trading that were not explicitly mentioned in the laws that separated banks from investment houses? Would the new administrative interpretations stand in court? Eventually, the *Chevron* decision would elucidate the permissible scope of agency discretion.[23]

Pre-*Chevron* Confusion: How Much Deference?

The commercial paper case first went to the DC District Court where Judge Joyce Green penned a decision favorable to both the SIA and Becker. Green immediately rebutted the Board's contention that its administrative order was non-reviewable. The Fed maintained it was immune from judicial oversight under the Administrative Procedure Act because its order was not "arbitrary, capricious, or irrational." The decision was untouchable, the Board argued, because it met the baseline requirement as a "reasonable" construction of Glass-Steagall. But Green contended that all administrative orders were reviewable unless Congress had explicitly precluded review. The Board's order, like most administrative decisions, was subject to the "normal presumption" of judicial scrutiny.

Green proceeded to replace the Board's reading with her own. The act's literal language, she said, demonstrated that Congress "intended to pass a *flat prohibition* against any single type of institution commercial or investment banking from engaging in *any* of the badges incident to the others' enterprise." It did not matter that the act did not explicitly prohibit sales of commercial paper. It "drew broad lines" that were wide enough to preclude the Fed's administrative amendment. The overarching purpose of Glass-Steagall was unambiguous, and

[23] *Securities Industry Association v. Comptroller of the Currency* (1983) 577 F. Supp. 252, *Securities Industry Association v. Board of Governors of the Federal Reserve System*, (1983) 716 F.2d 92

there was no room for exceptions to the act's sweeping limitations. Green had punctured the Board's administrative independence and then overturned its ruling. The district court had asserted itself vis-à-vis the Fed.[24]

In 1982 the DC Court of Appeals reversed, spurning the path taken by Green. Judge Malcolm Wilkey agreed that the Board's action was reviewable, but had major qualms with Green's second interpretive move. Her analysis of the statutory language, Wilkey wrote, had "given insufficient weight" to the expertise of the Board. She had discounted the Board's bureaucratic authority and improperly calibrated the depth of her analytic rigor. Wilkey found support for this argument in a recent precedent involving the Fed. A year earlier in *Board of Governors v. Investment Company Institute* (henceforth *ICI*) Justice Stevens approved a Board order that had allowed bank holding companies to acquire subsidiaries that acted as "investment advisers." Stevens based his decision on the assertion that the Board was "entitled to the greatest deference."[25] Stevens, who would later write for the court in *Chevron*, had suggested in *ICI* that the Fed was a special kind of agency that might be guarded from normal administrative procedure. Wilkey invoked Stevens' language to challenge Green. The issue at hand was different – the question before Wilkey did not involve bank holding companies – but he drew on the *ICI* precedent to show the district court had not given due deference to the Board.

Wilkey believed the Court of Appeals should be constrained in the absence of congressional intent. Silence on commercial paper curbed the judicial function. If the legislative history was indecisive, judges reviewing administrative action had the narrower job of determining whether agency decisions were "sufficiently reasonable." The Board's interpretation

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[24] *A.G. Becker v. Board of Governors of the Federal Reserve System* (1981) 519 F. Supp. 602
[25] *Board of Governors of the Federal Reserve System v. Investment Company Institute* (1981) 450 U.S. 46

need not be the *only* permissible reading – it merely had to be one among reasonable options.[26] Green had not applied this high level of deference. She had argued that the general thrust of Glass-Steagall prevented the sale of commercial paper. Wilkey was saying something very different – his argument was that exacting scrutiny was appropriate only if backed by a very detailed legislative history. If the congressional record could not serve as a guide, judges had to step back. The regulators that administered the nation's banking laws had the special competence to come up with an answer. The Board could be trusted because it knew the ins and outs of the laws it was charged with applying. If it came up with some reason that justified the sale of commercial paper, courts had to follow. Unsurprisingly, Wilkey found some basis for the order in the Board's "functional analysis." Wilkey had cleverly maneuvered around what Green viewed as flat prohibitions. Green had argued that the point of the act's broad language was to cover all bases – to swallow up every kind of security in the statutory framework. Wilkey read this broad language very differently. In his eyes, it meant that Congress had failed to enumerate something very specific and limited the appeals court's ability to fill in the blanks. Without such specific language, the Board, because of its presumed expertise, became the only legitimate interpreter of the statute. For the moment the Board's ruling that commercial paper was not defined as a "security" under the reach of Glass-Steagall was the law of the land.[27]

The ruling on discount brokerage evinced support for Wilkey's approach. Judge J. Edward Lumbard of the DC Court of Appeals leaned on the same *ICI* precedent and agreed that the Board was "entitled to the greatest deference." He pointed to Wilkey's opinion as a model for

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[26]In addition to the *ICI* precedent, Wilkey identified four reasons for affording a high level of judicial deference: 1) The Board had broad powers to formulate national banking policy. 2) The Board had expertise in commercial banking, and its specialized knowledge gave it advantages unattainable to federal judges. 3) The Board had given tangible meaning to statutory terms that needed to be updated to current financial realities. 4) The Board's decision was based on a thorough and extensive investigation of the relevant facts.

[27]*A.G. Becker Inc. v. Board of Governors of the Federal Reserve System* (1982) 693 F.2d 136

judicial treatment of the Board's administrative decree. Like Wilkey, Lumbard believed the Board's legal conclusions only needed to be "reasonable." Unsurprisingly, Lumbard sided with the Fed and approved BankAmerica's merger with Schwab.[28]

Wilkey and Lumbard had similar views of the judicial power, but there was no clear answer on what level of scrutiny should govern judicial treatment of agency interpretations. The level of deference in the SIA cases had vacillated between Green's rigor and the appellate court's more reluctant posture. The disagreement hinged on the proper scope of judicial authority when legislative intent was ambiguous. Wilkey and Lumbard suggested that judges only needed to ensure bureaucratic constructions were "reasonable." Green, however, required a higher burden of proof for administrative agencies. Deference calibrated the degree to which judges examined the Board's decisions. Different conceptions of the judicial function explained the conflicting verdicts over the breadth of the Fed's bureaucratic authority. The dispute in the first round of banking decisions was just the kind of debate *Chevron* would help resolve.

While the lower courts argued over the scope of review for agency discretion congressional lawmakers squabbled over the prospect of banking reform. The market trend towards financial diversification that precipitated the SIA cases had also stirred interest in legislative revisions to the nation's banking laws. Just as they summoned the Fed and the courts as mediators in a rapidly-changing financial marketplace, political actors encouraged Congress to pass comprehensive banking legislation in the early 1980s. The Reagan administration wanted to crack the Glass-Steagall partition. Don Regan, former Merrill CEO and now Treasury Secretary for the new administration, urged Congress to amend the law and let commercial banks underwrite MMMFs, municipal revenue bonds, and real estate. Regan had seen consumers

[28]*Securities Industry Association v. Board of Governors of the Federal Reserve System* (1983) 716 F.2d 92

benefit from products like CMAs that brought more institutions into direct competition. While he came from Wall Street, he supported bank entry into securities for its potential to lower costs for the general public. Senate Banking Committee chairman Jake Garn (R-UT) looked most friendly to the administration's proposed overhaul. He, too, was jarred by the "speed and vigor" of market conglomeration, and was eager to spearhead deregulation to accommodate the great changes occurring in American financial markets. In 1981 there was some optimism for reform. Congress was eager to aid struggling thrift institutions, and Garn was hopeful that he could supplement the emergency package for S&Ls with far-reaching provisions that unshackled commercial banks. But his opportunism faded quickly. Garn was forced to retreat from his bold proposals and compromise with the more cautious House Banking Committee chairman Fernand St. Germain (D-RI). St. Germain favored a more "methodical" approach to banking deregulation. He thought Congress should deliberate more thoroughly before changing the basic laws governing financial services. The Democratic congressmen forced Garn to drop his audacious proposals from the law that passed in 1982. The Garn-St. Germain Depository Institutions Act deregulated S&Ls, but lacked any hint of consensus beyond the narrow issue of emergency aid to thrifts. Garn had failed to layer Glass-Steagall reform atop the S&L rescue.[29]

The roadblock Garn and the administration encountered on the House Banking Committee was indicative of broader fissures that would plague banking reform for the remainder of the 1980s. Existing regulations sliced and diced the American financial system so that commercial banks, securities traders, insurance companies, and other intermediaries were segmented into "discrete interest groups." All banking legislation had to placate a number of

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[29]"Revolutionizing Finance," *Christian Science Monitor*, Apr. 24th, 1981, Brooks Jackson, "Major Bill to Decontrol Banking is Seen Getting Before Congress This Year," *Wall Street Journal*, Sep. 15th, 1981, pp. 7, Kenneth H. Bacon, "Treasury Secretary Regan: Q&A," *Wall Street Journal*, Oct. 19th, 1981, pp. 28

different financial lobbies that were sealed off from one another in hermetically distinct commercial domains. Middle ground was inherently elusive when a gain for one part of the financial services industry represented an equivalent loss for another. This difficulty had derailed Garn in debates over thrifts. Interest group conflict continued to hurt the prospects for regulatory change as he and the administration tried to reawaken support for wide-ranging financial reform. At the start of the next Congress Garn re-opened the debate by ordering hearings over the administration's new legislative blueprint. This time the Reagan team favored bank entry through the subsidiaries of holding companies, but, as the old version had in the previous legislative session, the administration's bill precipitated a political stalemate. Warring interests were quickly at each other's throats over the new face of Glass-Steagall reform. The American Bankers Association predictably loved the proposal, but Wall Street proved itself a resilient political foe. Coalitions of securities traders poured huge amounts of money into elected officials on the House Banking Committee. Wall Street had become accustomed to regulatory stasis for over four decades. Intruders had always been kept out of Wall Street's private reserve, and the resurgent prospect of congressional action prompted unseen levels of political giving. Rep. St. Germain was one beneficiary of the largesse. In 1983 he effectively stonewalled Garn and the administration's new bill by declining to initiate committee hearings in the House. His reluctance to move on banking deregulation was a product of Wall Street's intransigence. Collective action proved difficult when the regulatory order carved up narrow political coalitions all with the means to inhibit legislative change.

A few other factors contributed to legislative inertia in the early 1980s. The securities industry used Glass-Steagall's 50th anniversary in 1983 to reawaken fears of financial calamity. "Lest we forget" was a tagline repeated by industry representatives during many of Garn's

committee hearings. Banking reform also lacked the 'sex appeal' of other political issues. While it certainly stirred the interest of the financial lobbies, it awakened little public fervor. Plus, Congress had passed banking legislation as recently as 1982, so lawmakers were hesitant to take up the issue of Glass-Steagall reform. There emerged a feeling that new legislation was a non-starter. "Congress," remarked one newspaper, "is not going to take the lead…but it will eventually come along and validate what has already happened." Garn and the White House kept pushing for a comprehensive revision of the nation's financial regulatory laws, but political realities stood in the way of their pleas. It was becoming clear that market forces "were still in the saddle," and that deregulation would hinge not on elected officials in Congress, but on regulators and judges. At this point, however, judges had provided little direction. They had disagreed on the legality of the Board's administrative constructions. The Board's autonomy remained in limbo as the commercial paper and discount brokerage cases headed to the Supreme Court. Would the nine justices supply a definitive answer and put an end to the commotion in the financial marketplace? It remained to be seen how they would balance administrative expertise with the obligation of judicial review.[30]

The Supreme Court handed down the pair of SIA cases three days after it delivered its *Chevron* opinion. Many things could be inferred from the proximity of the three rulings. One might have expected the two-step test to be a silver-bullet. After all, *Chevron* was meant to standardize judicial treatment of administrative statutory constructions. Then again, it might be presumptuous to have expected such an immediate commitment to a new doctrinal test. Would

[30]"Banking on Deregulation," *Wall Street Journal*, Feb. 12th, 1982, pp. 28, "Smorgasbord of Competitors: How Big a Threat to Banks?" *Christian Science Monitor*, Feb. 23rd, 1982, "Brokers Engage in a Three-Front War For Turf," *Christian Science Monitor*, Jun. 14th, 1982, "Securities Industry May Bid For New Banking Rules," *Christian Science Monitor*, Nov. 29th, 1982, "Battle to Regulate Bank Expansion Stirs in Congress," *Wall Street Journal*, Jun. 17th, 1983, pp. 33, Christopher Conte, "Financial Morass: Deregulation of Banks Stirs Confusion," *Wall Street Journal*, Jul. 1st, 1983, pp. 1, "Reagan Sends Congress Proposed Banking Bill," *Wall Street Journal*, Jul. 11th, 1983, pp. 4, "Issue in Deregulation: Memories of the 1920s," *Wall Street Journal*, Jul. 18th, 1983, pp. 1

Chevron be invoked three days after becoming law? The justices could have also written both SIA decisions prior to the *Chevron* holding and been plagued by the same disagreements over administrative authority seen in the lower courts.

Neither case invoked *Chevron* directly. Briefs submitted to the court in the commercial paper case suggested that the scope of review was the central legal issue. Court documents showcased bitter disagreements over the meaning of statutory phrases, but undergirding each of these arguments was the issue of discretionary authority. “The Board’s case has little left to it,” wrote the Investment Company Institute in an amicus brief, if “deprived of its administrative deference prop.”[31] Arguments over statutory interpretation mattered less than the degree to which those interpretations would be scrutinized. Ironically, neither case applied *Chevron* even though each appeared to hinge on the issue of deference.

Justice Blackmun spoke for the court in the commercial paper case. Blackmun acknowledged that the Board’s ruling was entitled to deference. Administrative statutory interpretations that followed legislative intent could not be invalidated by a reviewing court. But Blackmun also stated that deference did not vitiate judicial oversight. “Deference,” he wrote, “is not to be a device that emasculates the significance of review.” While it “sets the framework” for judicial analysis, it is never so great to displace that analysis. Blackmun acknowledged that legislative intent was unclear, but believed a textualist reading of the statute’s “ordinary meaning” should trump the Board’s “functional analysis.” He was taking the path blazed by Green at the district court. Like Green, he reasoned that the general purpose of Glass-Steagall was unequivocal, and that nothing should allow a narrowing of the act’s capacious language.

[31]Louis Loss, Matthew Fink, and Thomas Maher, “Brief of the Investment Company Institute, Amicus Curiae in Support of Reversal,” Pending Case: *Securities Industry Association v. Board of Governors of the Federal Reserve System*, submitted Nov. 17th, 1983

"The Board's interpretation," Blackmun wrote, "effectively converts a portion of the Act's broad prohibition into a system of administrative regulation." Sweeping limitations left no room for bureaucratic tinkering. Commercial paper could not be an exception to the act's wide-ranging rules.

Justice O'Connor, Brennan, and Stevens strongly dissented. They crowed that the field of banking was so technical and complex that courts were ill-equipped to gauge basic statutory meaning:

> The policies actually enacted into law are likely to be complicated and difficult for a non-specialist judiciary to discern in their proper perspective…The area of banking law in which this question arises is as specialized and technical as the financial world it governs, and the relevant statutes are far from clear or easy to interpret. The question is accordingly one on which this Court must give substantial deference to the Board's construction. Because of the Board's expertise and experience in this complicated area of law, and because of its extensive responsibility for administering the federal banking laws, the Board's interpretation of the Glass-Steagall Act must be sustained unless it is unreasonable.

The dissenters pointed to *Chevron* as the appropriate analytic lens. All statutory meaning, they argued, was lost in economic context – concealed to inexpert judges by the esoteric field of banking law in a complex financial system. O'Connor, Brennan, and Stevens discounted for these limitations and argued the Board's order should be evaluated only for its "reasonableness."[32]

Pleas for the use of *Chevron* deference may have fallen on deaf ears this time around, but the commercial paper case was not over. Blackmun had ruled that commercial paper was defined as a "security" per Glass-Steagall, but he had not ruled on whether BT's activities constituted the illegal "underwriting," "issuing," "distributing," or "selling" of securities mentioned by section 21. Put simply, he was unwilling to say if BT was dealing with the defined securities in an

[32]*Securities Industry Association v. Board of Governors of the Federal Reserve System* (1984) 468 U.S. 137

impermissible way. Section 16 of Glass-Steagall suggested that commercial banks might be able to deal in securities in very rare instances – when they acted solely as a customer's agent. If banks never took a direct ownership interest in the given securities, they would be immune from the risks associated with investment speculation and behave legally as "disinterested" advisers. The permissive language of section 16 was a potential counterweight to Glass-Steagall's more restrictive provisions. Blackmun, however, admitted he lacked the information to determine if BT was engaged in illegal "underwriting" under section 21 or was acting lawfully under section 16. There was insufficient evidence on the bank's dealings for him to make this call. He remanded these lingering statutory questions back to the Fed. The agency was asked to conduct further investigations and come up with an answer. In effect Blackmun was asking for another Board order that would undoubtedly be reviewed in court. Commercial paper was indeed a security, but there was not yet a final verdict on the bank's dealings *in* commercial paper. Blackmun had created room for the lower courts to weigh in on its sale and the scope of the Board's administrative authority. Although he had not invoked *Chevron*, there was no telling if future judges would also decline the two-step framework.

The scope of review chosen by Justice Powell in the discount brokerage ruling differed markedly from Blackmun's. While Powell, too, did not invoke *Chevron*, he relied on the familiar *ICI* precedent to justify affording "the greatest deference" to the Board's approval of the Schwab acquisition. The SIA argued that the merger failed the "closely-related to banking" standard under the laws governing bank holding companies. Section 4 of the 1956 Bank Holding Company Act prevented holding companies from acquiring non-banking entities unless the Board determined those entities were "so closely related to banking as to be a proper incident thereto." The securities industry had a narrow view of which financial services met this test.

Non-banking subsidiaries would have to "directly facilitate" banking to be "closely-related." The SIA believed discount brokerage had no such immediate link. Powell, however, sided with the Board. No part of the act's legislative history spelled out a clear definition of the "closely-related" standard. There was no explicit requirement that non-banking subsidiaries directly facilitate traditional banking functions as the SIA claimed. Powell trusted the Board's looser interpretation in the absence of original intent. The Fed had affirmed the merger because Schwab's brokerage services were "operationally and functionally very similar" to commercial bank offerings. This was an attempt by the Board to draw parallels in terms of economic functionality. It meant non-banking affiliates like Schwab needed no immediate relation to the business of depository lending. Powell deferred to this interpretation because of the gap left by Congress, and because the Board had shown there was some reasonable basis for its order. *Chevron* was never cited as the proper analytic lens, but hints of the two-step framework were undergirding the opinion – they were just couched in *ICI's* name.

Powell then refuted the SIA's second argument – that the merger violated section 20 of Glass Steagall. This provision stipulated that no member bank be "affiliated in any manner with any corporation, association, business trust, or other similar organization *engaged principally in the issue, flotation, underwriting, public sale, or distribution* of stocks, bonds, debentures, notes, or other securities." If the Board's order stood, Bank of America would be affiliated with Schwab through its holding company. A bank would be connected to a subsidiary principally engaged in the public sale of stock. The SIA claimed the Supreme Court should void the bank's acquisition because the crux of Schwab's business was selling shares to anyone for rock-bottom rates. Powell debunked this argument with a crafty display of statutory construction. He declared that "public sale" needed to be interpreted in light of the terms surrounding it in section 20.

"Issue," "flotation," "underwriting," and "distribution" all referred to financial services in which dealers put down a principal (or an ownership interest) in a given security. Congress, he reasoned, only groups terms together if they share similar meaning. "Public sale" had to be interpreted as a service requiring institutions deal in principal. Trading at Schwab fell squarely outside of this definition. Schwab acted merely as an agent for trades. While the firm took commissions, it never retained an ownership interest in the shares it sold. As long as Schwab sold stock without recourse, it could be legally affiliated with Bank of America. Powell was allowing Schwab to sell stock to the public and yet escape the "public sale" provision of section 20. Essentially, he was allowing the permissive language of section 16 to filter into section 20. He was allowing a narrow exception to Glass-Steagall's broader purpose to percolate outward into other statutory provisions. "Without recourse" had become a potential bludgeon against the New Deal financial regulatory framework.[33]

At first blush, the high court's SIA decisions appeared strikingly inconsistent. Blackmun and Powell had applied different standards of review, and, when read together, had delivered a decidedly mixed judgment on bank entry into the securities business. BT's commercial paper unit remained in limbo while BankAmerica gleefully swallowed up a lucrative Wall Street brokerage. Bank expansion had not gained comprehensive judicial ratification. Important questions remained unanswered in the wake of the court's rulings, but the decisions did, however, make three things clear. First, banks might be able to sell securities like commercial paper if they did so as "disinterested agents" claiming no ownership interest. Second, bank holding companies could acquire subsidiaries with only marginal connections to the business of banking. Both constituted important entering wedges for the banking industry. Third, and most

[33]*Securities Industry Association v. Board of Governors of the Federal Reserve System* (1984) 468 U.S. 207

importantly, the battle between bankers and brokers had not ended at the Supreme Court. Blackmun's remands guaranteed another round of judicial decisions concerning the role of financial institutions in the American economic system.

The Supreme Court's ruling on commercial paper prompted a predictable change in BT's behavior. Since its inception the bank's new department had been buying back some of the unsold commercial paper for its own account, but it quickly halted this practice after seeing Blackmun define the appropriate legal avenue for bank entry into securities. If BT stopped buying back commercial paper and limited itself to only advising its sale, the new securities unit could meet the exception outlined by section 16. The subtle adjustment would allow BT to fulfill one component of Glass-Steagall's statutory framework, and might give the securities unit a better chance in court. The bank, with the approval of the Fed, announced in 1985 that it was behaving in accordance with Glass-Steagall because it no longer took an "ownership interest" in commercial paper. This, in turn, meant BT's commercial paper services did not constitute the illegal "underwriting," "issuing," "distributing" or "selling" of securities mentioned in section 21. The bank hoped the slight modification would finally precipitate a favorable legal result.

The SIA challenged the new Board order, and the case ended up back in the hands of Judge Green at the DC district court. Her 1986 decision largely mirrored her first. "Deference owed," she said, "is not so great as to convert judicial review into a rubber stamp for Board decisions." Again, she made a broad reading of Glass-Steagall, and struck down BT's sale of commercial paper because the act flatly prohibited banks from selling securities. She said it was against the act's "[general] framework that section 16's narrow exception [had] to be gauged." The Board's interpretation converted the provision's narrow exception into an expansive authorization, and therefore vitiated the larger purpose of the law. Furthermore, Green refused to

believe that BT was immune from an “ownership” or “salesman’s interest” in commercial paper simply because the securities were purchased “without recourse.” Green called the Board’s order “flawed” and “unpersuasive,” and believed it was up to the nation’s elected representatives, not courts or bureaucrats, to alter the nation’s banking laws. “Until such time as Congress acts,” Green wrote, “the Board may not give its blessings to Bankers Trust's activities.” Green’s censure of the Federal Reserve, however principled, exhibited a genuine naiveté for her political surroundings. Congress remained deadlocked over a banking bill. Lobbying from the securities industry was a persistent thorn in the side of commercial bankers who watched new iterations of Glass-Steagall reform flounder in the House. Bank frustration mounted as the legislative process looked like an increasingly hopeless avenue for deregulation. Congressional inertia intensified political pressures on regulators and judges. More and more banks applied to the Fed begging to underwrite securities through holding company subsidiaries. Citicorp, JP Morgan, and Chase Manhattan were just some of the big banks who joined BT and Bank of America by requesting that regulators grant them new powers. The democratic process looked less fruitful the longer Congress stood still. Luckily for the mounting number of commercial banks seeking recourse at the Fed, Judge Green did not have the last word on the Board’s discretionary authority. Green’s staunch commitment to the Glass-Steagall partition would be reviewed by the DC Court of Appeals. There, the commercial paper case would be decided by a judge more sympathetic to the administrative revision of New Deal banking statutes. In fact, it would be decided by a circuit judge who embodied President Reagan’s deregulatory agenda.[34]

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[34]*Securities Industry Association v. Board of Governors of the Federal Reserve System* (1986) 627 F. Supp. 695; see also Monica Langley, “Freer Finance: US Regulators Move to Let Banks Enter Several New Businesses,” *Wall Street Journal*, Dec. 19th, 1986, pp. 1

Embracing the State to Shrink the State: Conservative Deference to Agency Discretion

Robert Bork experienced a near religious transformation in the early 1950s. His intellectual experiences in law school at the University of Chicago prompted a wholesale reevaluation of his most fundamental political beliefs. In the 1940s he had handed out political leaflets on behalf of New Deal democrats, but by the time he earned his J.D. in 1953, his outlook had changed completely. He now embraced market capitalism's ability to self-correct, and believed federal statutes needed to better reflect the logic of allocative efficiency. Bork thought American law foolishly neglected the logic of the market, and needed to be more attentive to basic microeconomic precepts. Bork and his University of Chicago mentors were swimming upstream in a political culture where even Republicans embraced Keynesian economics and a vigorous statist role in America's mixed economy.

Bork's fervor for market capitalism stemmed from an anti-trust course he took at UChicago with Aaron Director. Director's thesis was that anti-trust statutes were unnecessary because market forces made monopolies "inherently unstable." Even if a few firms concentrated their market share, competitive pressures would lead to the natural 'withering away' of monopolistic arrangements. Put simply, because monopolies were always threatened by more efficient competitors, there were no economic justifications for modern anti-trust law. Regulations that protected competition were unwarranted because efforts to restrict competition would inevitably lose out. The upshot was that markets should be left to their own devices. Director imparted to his students arguments for an "anti anti-trust policy."[35]

[35]Neil Duxbury, *Patterns of American Jurisprudence,* Oxford: Clarendon Press, 1995, pp. 341-364

Director's class was an important component of a larger intellectual renaissance that took place at UChicago in the postwar period. Historians have written about the emergence of a distinctive "Chicago School" of economics led by Jacob Viner, Frank Knight, George Stigler, and Milton Friedman that revived free market ideas by extirpating the intellectual rationale for many forms of government intervention. Chicago's economists made good on Friedrich Von Hayek's request that conservative intellectuals produce and disseminate powerful ideas to combat Keynesian management. With his anti-trust course Director integrated the central tenets of the Chicago School into legal education. He spearheaded a nascent "Law and Economics" movement aimed at the "economic re-tooling" of the legal profession. With the aid of Ronald Coase, Richard Posner, and deep-pocketed philanthropists like the Olin Foundation, Director persuaded young law students like Robert Bork that federal statutes needed to be evaluated in economic terms for their capacity to promote efficiency in market models.[36]

After briefly practicing in the 1950s, Bork returned to the academy as a law professor and expounded on Director's critique of anti-trust law.[37] But Bork's desire to restrain the reach of the regulatory state was but one part of a broader jurisprudential effort to circumscribe the institutional role of the federal judiciary. Bork became perhaps the most ardent proponent of originalism – the form of constitutional interpretation that holds that judges should be guided only by the intent of the framers when deciding cases. Originalism was a kneejerk reaction to

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[36]For more on the Chicago School's role in the ascension of neoliberal ideas see generally Angus Burgin, *The Great Persuasion: Reinventing Free Markets Since the Depression,* Cambridge, Mass.: Harvard University Press, 2012, Daniel Stedman Jones, *Masters of the Universe: Hayek, Friedman, and the Birth of Neoliberal Politics,* Princeton, N.J.: Princeton University Press, 2012, Philip Mirowski and Dieter Plehwe, *The Road From Mont Pèlerin: the Making of the Neoliberal Thought Collective.* Cambridge, Mass.: Harvard University Press, 2009, and David Harvey, *A Brief History of Neoliberalism,* New York: Oxford University Press, 2005; on the Law and Economics movement see Dan Rodgers, *Age of Fracture*, Cambridge, Mass.: Belknap Press of Harvard University Press, 2011, pp. 56-63, and chapters four and six of Steven Teles, *The Rise of the Conservative Legal Movement: the Battle for Control of the Law,* Princeton, N.J.: Princeton University Press, 2008.
[37]See *The Antitrust Paradox: A Policy At War with Itself*, New York: Basic Books, 1978, and "The Goals of Anti-Trust Policy," *The American Economic Review*, 57.2 (1967), pp. 242-253.

what Bork called the Warren Court's "imperial" assertion of judicial authority. Bork worried that in the 1960s the federal judiciary had become a "result-oriented" political instrument manipulated by liberals to achieve undemocratic policy ends. Originalism tried to temper this activism by emphasizing restraint. Strict adherence to original meaning was intended to keep judges from legislating from the bench and reading new legal protections into the Constitution. To an originalist like Bork the judicial role was not to make law and policy – it was to keep law from being updated in the image of Justice Brennan's "living Constitution." This meant judges needed to exercise judicial moderation by declining the invite of overtly political judgments.[38]

Bork's legal philosophy (both on economics and the judicial power) made him an ideal candidate for a federal judgeship during the Reagan administration. Reagan was given the opportunity to replace half of the federal bench during his two terms as president, and broke with historical tradition by making appointments squarely on a partisan basis. The White House Committee on Judicial Selection subjected all candidates to an ideological litmus test that gauged conservative legal values. The committee was most interested in how a candidate approached the judicial role. Attorney General William French Smith wanted judges who would avoid the allure of judicial policymaking, and look at courts not as "mini-legislatures," but as institutional mechanisms designed to enforce the intent of the framers. Bork fit this profile perfectly. He embodied the brand of restraint the Department of Justice was trying to inculcate. It did not hurt that he had also proven himself a vehement critic of government regulation. Bork's approach to anti-trust dovetailed nicely with the administration's electoral mandate. Early in his first term Reagan made good on his campaign promise to deregulate. "Regulatory relief" was one part of a

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[38]Andrea Neal, "Robert Bork: Advocate of Judicial Restraint," *American Bar Association Journal*, Vol. 73 (1987): pp. 82-86; for an elaboration on his jurisprudence see Bork, *The Tempting of America: the Political Seduction of the Law,* New York: Free Press, 1990.

four point program for economic recovery announced in 1981. The drive for regulatory reform was conducted very prominently via the expansion of executive prerogative, but the White House wanted help from the DC Court of Appeals. After all, the Administrative Procedure Act gave the DC Circuit jurisdiction over all government conduct. The appeals court was where orders emanating from federal agencies had to pass legal muster. Reagan nominated Bork to the DC Circuit because he wanted appellate judges who conceived of a narrow judicial role, but also because Bork shared the administration's preference for private ordering over statutory rulemaking. Bork was confirmed by the Senate and joined the appeals court in early 1982. He was the first of the administration's four appointments to the DC Circuit in the 1980s.[39]

Bork quickly found himself among like-minded conservative judges intent on using judicial deference to accomplish regulatory change. Antonin Scalia and Kenneth Starr were two other Reagan appointees who joined the appeals court within a year of Bork's confirmation. Like every one of Reagan's appellate selections, they had deep ties to the Republican Party and disdain for the activism of the Warren Court. Scalia was an expert on both regulation and administrative law. He had chaired the Administrative Conference of the United States from 1972 to 1974,[40] and later taught administrative law at the University of Chicago. He had also co-edited the trade journal *Regulation* run by the right-leaning American Enterprise Institute. In 1981, a year before joining the DC Court of Appeals, Scalia published an editorial in *Regulation* directed at the new Republican majority. He chastised newly-elected conservatives for harboring a potentially destructive political tendency. "All those who seek to reverse the trend of increasing

[39]William French Smith, "Urging Judicial Restraint," *American Bar Association Journal*, Vol. 68 (1982): pp. 59-61, Debra Cassens Moss, "The Policy and Rhetoric of Edwin Meese," *American Bar Association Journal*, Vol. 73 (1987): 64-69, Graeme Browning, "Reagan Molds the Federal Court in His Own Image," *American Bar Association Journal*, Vol. 71 (1985): pp. 60-64

[40]The ACUS is an independent commission bent on streamlining and improving the operation of the federal bureaucracy.

government control," he opined, "are not only less eager than their political opponents to grasp the levers of government power, but are also inclined to view all impediments to the exercise of that power as a victory for their cause." Scalia believed this sweeping aversion to government authority could have "disastrous" consequences because impairing state authority would not always help diminish federal control. While as a governing minority Republicans had become accustomed to resisting proposals that expanded the reach of administrative agencies, they needed to realize they were now in command of the powerful American state, and could redirect the "accursed" federal bureaucracy to serve their own policy ends. If they followed raw political instincts and curtailed the discretion of administrative agencies, they would be unwisely "[obstructing] a departure from the Democratic-produced, pro-regulatory *status quo*." Preserving and perhaps increasing agency autonomy would give Republican-controlled departments the flexibility to weaken the statutes of their liberal predecessors. Scalia paradoxically urged Republicans to deregulate through the "vigorous use" of government machinery. Carter's regulators could be Reagan's deregulators, lest the GOP forget that a powerful administrative apparatus could be used to move regulatory policy in a conservative direction. Scalia was saying that Republicans needed to play the game of regulatory politics on the terms established by liberals. They needed to allow agencies to retain their authority and prestige in order to dismantle the regulatory regime that had been put in place by New Deal Democrats for over half a century. Scalia's editorial argued not for a systematic rollback of the American state, but a reclaiming of its spoils. While the piece was aimed specifically at elected officials, it implied that conservative legal thinkers on the DC Circuit thought agency discretion could be appropriated as a policy tool.[41]

[41]Antonin Scalia, "Regulatory Reform – The Game Has Changed," *Regulation*, January/February 1981, pp. 13-15

Kenneth Starr, who joined the appeals court shortly after Bork, believed that *Chevron* could be a powerful tool towards achieving these ends. In 1985, only months after the unanimous Supreme Court decision, Starr sang *Chevron's* praises in an article published in the *Yale Journal on Regulation*. He called the ruling "highly-appealing" because it would "make it easier for a new administration to oust an old regulatory order." By requiring that judges defer to agency statutory readings as long as they were not blatantly discriminatory, *Chevron* would allow agencies to "depart more easily from their predecessors' interpretations." The decision would open the floodgates on permissible statutory constructions. It would expand the range of legally permissible interpretations and free agencies from adhering to the dictates of old regulatory regimes. The case would allow executives to more thoroughly "recast the regulatory state" because the bureaucracies they controlled were not tethered to the interpretive version they inherited. Starr believed *Chevron* would improve the democratic process because it made the state more responsive to the popular will. *Chevron* would allow an incoming administration to revise existing federal statutes based on recent electoral mandates. The upshot was that bureaucratic rulemaking would become less consistent and depend more on election returns than legislative intent or judicial precedent.[42]

Few other legal scholars shared Starr's optimism in *Chevron's* aftermath. They voiced concerns in law journals that the case would free statutes from the burden of history. Traditionally agencies had been entitled to less deference if they departed from long-standing statutory interpretations. This was a way for judges to limit deviation from legislative intent and promote stability in the regulatory state. *Chevron* made statutory meaning more fluid. Under the

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[42]Kenneth Starr, "Judicial Review in the Post-*Chevron* Era," *Yale Journal on Regulation*, 3.2 (1985): 283-312; unsurprisingly (especially given his comments in the 1981 issue of *Regulation*), Scalia explicitly endorsed the *Chevron* doctrine after his appointment to the Supreme Court for many of the same reasons Starr outlined, see Scalia, "Judicial Deference to Administrative Interpretations of Law," *Duke Law Journal*, 10.2 (1989): 511-521

justification of "reasonability" *Chevron* sanctioned administrative interpretations that "blatantly defied historical precedent." The Federal Register was up for grabs because executive-run agencies had more power to adjust the laws of the historical past. Chief executives would no longer be forced to live with statutes they disliked, as *Chevron* deference expanded the permissible degree of agency tinkering. Old laws passed by democratic majorities promised to be more impermanent. Glass-Steagall, for instance, could be unhinged from its wall of separation. Some scholars grumbled, but Starr looked favorably on heightened statutory flexibility because it carved out room for the president's goal of regulatory relief. If *Chevron* meant statutes could have a variety of meanings, then strict regulatory guidelines could be weakened and veer away from the principles that had inspired their passage. The new deference doctrine presented a path forward from the broad prescriptions Scalia had outlined in the pages of *Regulation.*[43]

When the BT commercial paper case reached the DC Court of Appeals again in 1986, Bork followed the lead of his colleagues and used *Chevron* to deregulate via the expansion of administrative discretion. Bork was already sympathetic to both deregulation and judicial deference, but it could not have hurt that he sat on a court so enamored with *Chevron's* potential. "We must look to *Chevron*," Bork wrote in his opinion, "to guide our application of judicial review." Step one was easy. Congress had not explicitly addressed whether the activities conducted at BT fell under Glass-Steagall's prohibitions. Bork continued to follow the two-step framework and claimed his only remaining task was to determine if the Board had filled the

[43]For these reactions to *Chevron* see Jeanne Dodd, "*Young v. Community Nutrition Institute* – The Scope of Judicial Review of Administrative Determinations of Law Following *Chevron v. NRDC*," *Northern Kentucky Law Review*, 14.1 (1987): 139- 152, Jack Landau, "*Chevron, USA v. NRDC*: The Supreme Court Declines to Burst EPA's Bubble Concept," *Environmental Law*, 15.2 (1985): 285-322, James Wasserman, "Judicial Deference to Administrative Over-Extension and the End of Environmental Control: *Chevron, USA v. Natural Resources Defense Council*," *Washington University Journal of Urban and Contemporary Law*, 29 (1985): 297-314, Susan Flieder, "Bursting the Bubble of Environmental Protection: *Chevron, USA, Inc. v. Natural Resources Defense Council, Inc*." *Depaul Law Review*, 34 (1985): 757-802

statutory void in a “reasonable” manner. To answer this Bork had to address the interplay between the permissive section 16 and the more restrictive section 21. He argued that administrative interpretations that “[impaired] one of the statute’s purposes but not others” could still be reasonable. If the Board’s order met the requirements of section 16, the job of a reviewing court was over. It need not grapple with inconsistencies if an agency order met just one component of the statutory framework. Bork was letting compliance with section 16 stand in for compliance with section 21 and the act more broadly. “Reasonable” had grown to encompass interpretations that defied some but not all legal provisions. Furthermore, Bork argued that the Board’s reading fulfilled step two because there was no irrefutable evidence that it was blatantly wrong. *Chevron* had swung the pendulum so strongly towards judicial deference that the Fed was effectively freed of explaining itself. Bork had used the wider range of statutory constructions permitted by *Chevron* to allow Glass-Steagall’s narrow exception to eviscerate the law’s bigger purpose. Bork emphasized the importance of original meaning and disparaged bureaucratic machinery later on in popular writings, but in the BT commercial paper case he had enhanced administrative capacities to pervert legislative intent. The statues that had been designed to separate depository lending from investment speculation had ironically been construed to allow subsidiaries of commercial banks to sell securities. The Supreme Court endorsed Bork’s adherence to *Chevron* by denying cert in June of the following year. Banker’s Trust was finally allowed to sell corporate debt to investors.[44]

Bork made a similar move in one of the last opinions he wrote while on the DC Circuit. His now infamous nomination to the Supreme Court in July of 1987 signaled the beginning of

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[44]*Securities Industry Association v. Board of Governors of the Federal Reserve System* (1986) 807 F.2d 1052, *Securities Industry Association v. Board of Governors of the Federal Reserve System* (1987) 483 U.S. 1005, cert denied; Bork’s purported disdain for bureaucratic authority can be found in his bestseller *Slouching Towards Gomorrah: Modern Liberalism and American Decline,* New York: Regan Books, 1996, pp. 317-331

the end of his tenure on the appeals court. The takedown orchestrated by Edward Kennedy in Senate Judiciary Committee hearings stands alone in the history of presidential judicial selection. No other high court appointee has ever faced a comparable public outcry. But the attention often given to Bork's failed confirmation obscures the significance of his jurisprudence, particularly in regards to the law of banking. Coincident with the nomination was another important banking decision that hinged on Bork's application of *Chevron*. National Westminster Bank (NatWest) was one of the firms that had petitioned the Fed for new securities powers in the interim – as Congress remained gridlocked and as the BT case hung in the balance. In August, 1985 NatWest had applied pursuant to the Bank Holding Company Act for permission to provide brokerage services through a newly-formed subsidiary called CSC. The SIA challenged the Board's approval of the application on the grounds that section 20 of Glass-Steagall prohibited the "public sale" of securities, and therefore brokerage at CSC. Again, Bork argued that *Chevron* narrowed the judicial function. Lawmakers in the 1930s had not addressed whether brokerage services were encompassed by the "public sale" provision of section 20, so Bork believed he was forced to uphold the Board's construction if it was "reasonable." He located a rational basis in Justice Powell's earlier decision involving Schwab. The term "public sale" was grouped alongside financial services that involved dealings in principal. Like Schwab, CSC took no ownership interest in the securities it sold, and therefore behaved as a "disinterested agent" that bore none of the risks commonly associated with financial speculation. The "public sale" provision of section 20 was inapplicable. Bork had used *Chevron* in conjunction with Schwab to bend the meaning of Glass-Steagall so that the "public sale" limitation could not touch bank affiliates that provided brokerage services to investors. It would be hard to claim that this statutory reading lacked *any* reasonable basis, and was arbitrary, capricious, or blatantly

discriminatory. But it would be equally difficult to show that it was consistent with the broader statutory framework. Bork knew, however, that *Chevron* had released administrative agencies from the latter obligation. Administrative orders could pass legal muster as long as they contained some inkling of rationality. The sole requirement of "reasonability" sealed the deal because it sanctioned statutory constructions that were legally permissible only in the narrowest sense. *Chevron* had ended the early disagreement between Green and Wilkey that had manifested itself in various forms. The sticking point had always been the same: was judicial deference so great that judges needed to trust agency readings that seemingly defied Glass-Steagall's broad prohibitions? *Chevron* finally provided an answer because it empowered administrative agencies to inflate their role in defining legitimate statutory meaning. Bork's use of the new deference doctrine erected a powerful shield that enabled the Fed to begin constructing a new regulatory order.[45]

The judicial path to financial deregulation was reified as the 1980s wore on. In January of 1988 the Supreme Court rubber-stamped Bork's commitment to *Chevron* by declining review of the NatWest brokerage case. The high court had originally devised the two-step framework to make the entire judiciary more deferential to federal agencies, and was giving Bork a pat on the back by denying cert. Other jurists on the DC circuit followed Bork's lead. Judge Cardamone and Buckley relied on *Chevron* to pry open financial regulatory statutes even further. They granted Citicorp, JP Morgan, and Chase Manhattan new powers to underwrite commercial paper, government bonds, and mortgage-backed securities. The Supreme Court, as it had with Bork's rulings, chose not to interfere.[46]

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[45]*Securities Industry Association v. Board of Governors of the Federal Reserve System* (1987) 821 F.2d 810
[46]*Securities Industry Association v. Board of Governors of the Federal Reserve System* (1988) 839 F.2d 47, *Securities Industry Association v. Board of Governors of the Federal Reserve System*, (1988) 847 F.2d 890

The spotlight of regulatory politics remained on the judiciary because of an additional factor contributing to congressional logjam. The 508-point drop in the Dow Jones Industrial Average on October 19th, 1987 made lawmakers more skeptical of financial market liberalization. "Black Monday" turned reform advocates into reform critics and cemented the opposition of stalwart skeptics. The crash reminded elected officials of the risks associated with financial capitalism, particularly when Wall Street investors were beguiled by new forms of computerized trading. Perhaps consumer deposits parked in commercial banks should not, in fact, be intermingled with financial market turbulency. More lawmakers became convinced that deregulation might only exacerbate the instability. They began to distance themselves from Sen. William Proxmire (D-WI), the Senate's new champion of Glass-Steagall reform, and align themselves with proposals to impose new regulations on trading. In 1987 and 1988 Proxmire insisted on the need for "broad congressional restructuring," but saw his political efforts dampened by Black Monday's aftereffects. The prospect of an upcoming presidential election only lessened the incentives for sweeping congressional action. The democratic process had hit an additional roadblock, but a "quiet revolution" had occurred in place of legislative activity. Judges and regulators had eased restrictions as Congress drifted farther away from financial liberalization. Elected officials may have had their hands tied in the 1980s, but courts and administrative agencies had already initiated the process of eroding federal banking statutes in piecemeal fashion.[47]

[47]John Yang and Bruce Ingersoll, "Banks Feel Frustrated as Congress Gets Cold Feet About Allowing Entry Into Investment Banking," *Wall Street Journal*, Jun. 24th, 1987, pp. 58, Thomas Ricks and Monica Langley, "Congress Puts on Fast Track Regulations for Wall Street," *Wall Street Journal*, Oct. 21st, 1987, pp. 27, Robert Litan, "Bank Revolution Won't Wait For Congress," *Wall Street Journal*, Nov. 10th, 1987, pp. 36, "How Senators Saw the Crash," *Toronto Star*, Feb. 3rd, 1988, pp. F1, Kerry Knobelsdorff, "Debate Over Wider Bank Powers Goes Down to the Wire," *Christian Science Monitor*, Feb. 9th, 1988, Robert E. Taylor, "Proxmire Moves to Revive Bill Allowing Banking Firms to Underwrite Securities," *Wall Street Journal*, Oct. 4th, 1988, pp. A12

Conclusion: Judicial and Administrative Routes to Formal Statutory Change

Northwestern University law professor Jide Nzelibe rose to the stage at the Federalist Society's 2013 National Lawyers Convention. He was speaking on a panel with four other legal scholars on the "rightness and limitations of *Chevron* deference." Nzelibe began by claiming that *Chevron* had been good to the conservative legal movement in an important way that many had failed to appreciate. He argued that *Chevron*, ironically, helped "cut back the leviathan" because it kept courts from scrutinizing dramatic revisions of federal statutes by administrative agencies. The decision gave bureaucracies the flexibility to change course – to, in Nzelibe's words, "pull away from definitions," "be legally inconsistent," and refuse the path taken by regulatory predecessors. If you want to chip away at the state, he argued, "you don't say to the state, 'hey you're growing, you're getting more power, please stop yourself.'" Instead, you take advantage of government machinery to further your own agenda. Nzelibe was telling a room of conservative legal thinkers that agency discretion had been, and should continue to be, used as a weapon in the perennial battle against red tape.[48]

Nzelibe could have been talking about transformations to the law of banking. The fissures that opened in the financial regulatory state in the 1980s – that enabled the creation of securities subsidiaries at depository institutions – were a direct product of strengthened administrative capacities facilitated by *Chevron*. But financial deregulation did not proceed at a lightning pace after the DC Court of Appeals buffered the Federal Reserve from legal scrutiny. The proliferation of bank holding companies selling securities did not precipitate a slingshot marriage between commercial lending and investment banking. At first subsidiaries could account for no more than 5 percent of a bank's total revenue. The initial steps toward one-stop financial

[48]"Showcase Panel III: Formalism and Deference in Administrative Law," 2013 Federalist Society National Lawyers Convention, Nov. 25th, 2013, https://www.youtube.com/watch?v=5RNXMTwaqgs

shopping were slow and measured, but with the legal threshold crossed, others soon followed. By the early 1990s securities affiliates accounted for over ten percent of bank revenue. More importantly, the subsidiaries *Chevron* had carved out of Glass-Steagall's flat prohibitions were cited by congressional lawmakers as justifications for bigger changes in regulatory policy. Comprehensive Glass-Steagall repeal resurfaced again in the late 1990s, and the eventual passage of the 1999 Financial Services Modernization Act was due in no small part to the fact that many banks already sold securities in large volumes. Elected officials saw the subsidiaries as proof that inexorable market forces had cut against procrustean regulatory statutes, and that Congress should tear down old barriers that prevented banks from offering every financial service under the sun. Before the nation's representatives tore down the wall that bifurcated the American financial system, judges had ceded their interpretive authority to federal agencies in ways that built necessary foundations for more lasting regulatory change.