Culture Wars: Rate Manipulation, Institutional Corruption and the Lost Underpinnings of Market Conduct Regulation

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ABSTRACT

The investigations in the manipulation of the London Interbank Offered Rate have raised significant questions of how conflicts of interest are managed for both regulated entities contributing in benchmarks and their regulators. An alternative framework is under consideration coordinated by an International Organization of Securities Commissions taskforce, which builds on a review commissioned by the British Government. This paper argues that the approach is pre-destined to fail, precisely because it ignores the lessons of history. In revisiting the initial framing for market conduct regulation, the paper illuminates the lost normative underpinnings of the disclosure paradigm. By exploring the shadows of the past, it provides and essential guide for how to fix the legitimacy crisis engendered by the Libor scandal.

A Introduction

The manipulation of the London Interbank Offered Rate and associated benchmarks has far-reaching consequences for the financial institutions involved and the integrity of the regulatory regimes charged with their oversight. The litigation risk cascades outwards from civil and criminal enforcement to individual and institutional class action claims. The structural and reputational risks are just as significant. Six years on from the August 2007 onset of the Global Financial Crisis with the vaporization of the securitization market, regulatory authorities across the globe remain mired in crisis rather than strategic management. Within that timeframe, we have moved progressively from a rubric of ‘too big to fail’ to a dawning recognition that systemically important financial firms are not only too big to manage, to regulate, to litigate effectively against, most notably through the caustic and incisive questioning of Senator Elizabeth Warren.1 We are now at a paradigmatic tipping point. Given the pricing implications of Libor, the key floating rate benchmark referencing over $350 trillion in derivative contracts, has it become too big to change? This remains very much an open question.

The chair of the Commodity Futures Trading Commission, Gary Gensler, is cognizant of the need for an urgent replacement ‘to restore market integrity and financial stability.’2 As he put it in a recent interview with the Financial Times ‘a benchmark that becomes untethered [from reality] becomes vulnerable to all sorts of misconduct…It is best that we do not fall prey to accepting that Libor or any other benchmark is too big too replace.’3 He has been given strong support from the Financial Stability Oversight Council in the United States. This umbrella network of financial regulators has

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3 Ibid.
demanded a transition to an observable transaction framework as a matter of urgency. The interventionist agenda reflects the renewed power of the United States Department of Justice to frame financial regulation discourse, a position it last accrued in the immediate aftermath of the passage of Sarbanes-Oxley in 2002. Given its centrality in leading an international investigation that to date has seen imposition of $2.6 billion in fines against three leading banks—Barclays, UBS and Royal Bank of Scotland, the emphasis of the Department of Justice on retribution, accountability and punishment matter as much as development of fair, effective and efficient markets. The investigation, which remains at an early stage, has exposed systematic and pervasive corruption in the rate-setting process.

The paucity of institutional memory in leading banks, the fact that manipulation continued even after bailouts and a baleful reality of continued compartmentalized responsibility, has made business ethics appear little more than an oxymoron. As the investigation moves inexorably towards the major Wall Street banks involved these accountability deficit debates are likely to intensify further, hence, in part, the positioning

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4 Financial Stability Oversight Council, Annual Report (Department of Treasury, Washington, DC, 25 April 2013) 14 ('The shift away from banks funding each other in an unsecured market has led to a scarcity or outright absence in longer tenors of real transactions underpinning these benchmark rates and has exacerbated vulnerabilities of these benchmarks. Yet currently, hundreds of trillions of dollars in derivatives, loans, and other financial instruments reference these benchmarks. This situation leaves the financial system with benchmarks that are prone to and provide significant incentives for misconduct. Given these vulnerabilities and the real risk that they will remain, in order to ensure market integrity and support financial stability, the Council recommends that U.S. regulators cooperate with foreign regulators, international bodies, and market participants to promptly identify alternative interest rate benchmarks that are anchored in observable transactions and are supported by appropriate governance structures, and to develop a plan to accomplish a transition to new benchmarks while such alternative benchmarks are being identified'). Observable transactions, however, is no guarantee against manipulation, see Andrew Cornell, ‘UBS Traders Tried to Game Australian Benchmark,’ Australian Financial Review, 5 March 2013. The rate was abolished on 28 March 2013, see Reuters, ‘Australia To End Inter-Bank Rate-Setting Panel After Libor Scandal,’ 28 March 2013, <http://uk.reuters.com/article/2013/03/28/australia-Libor- libor-idUKK2207085320130328>.

5 The power dissipated through a series of miscalculations that saw its authority diminish, most notably the continued prosecution of individual KPMG partners after the firm itself agreed to a negotiated prosecution, see Justin O’Brien, Redesigning Financial Regulation: The Politics of Enforcement (2007), 27-54.

6 Lanny Breuer, Assistant Attorney General, Department of Justice (Criminal Division), Interview, Frontline, PBS, 22 January 2013, http://www.pbs.org/wgbh/pages/frontline/business-economy-financial-crisis/untouchables/lanny-breuer-financial-fraud-has-not-gone-unpunished/ ('Libor will prove to be one of the largest, if not the largest white-collar case in history. It goes after financial institutions, and it goes after the most major players in Wall Street').

7 Financial Stability Oversight Council, above n 4, 137 ('Recent investigations uncovered systematic false reporting and manipulations of reference rate submissions dating back many years. This misconduct was designed to either increase the potential profit of the submitting firms or to convey a misleading picture of the relative health of the submitting banks. These actions were pervasive, occurred in multiple bank locations around the world, involved senior bank officials at several banks, and affected multiple benchmark rates and currencies, including LIBOR, EURIBOR, and the Tokyo Interbank Offered Rate (TIBOR). Each of the banks that faced charges engaged in a multi-year pattern of misconduct that involved collusion with other banks. These revelations have undermined the public's confidence in these benchmarks.')

8 Alasdair MacIntyre, ‘Why Are the Problems of Business Ethics Insoluble,’ in Bernard Baumin and Benjamin Friedman (eds.), Moral Responsibility and the Professions (1982) 358 ('Effectiveness in organizations is often both the product and the producer of an intense focus on a narrow range of specialised tasks which has as its counterpart blindness to other aspects of one’s activity'); see also Alasdair MacIntyre, ‘Social Structures and their Threats to Moral Agency’ (1999) 74 Philosophy 311 ('Compartmentalisation occurs when a 'distinct sphere of social activity comes to have its own role structure governed by its own specific norms in relative independence of other such spheres. Within each sphere those norms dictate which kinds of consideration are to be treated as relevant to decision-making and which are to be excluded': at 322).
in the United States towards a more radical approach. In the United Kingdom, by contrast, a much more nuanced approach has been adopted, marked by an extensive consultation process (albeit one dominated by insiders). Martin Wheatley, chair of the Financial Conduct Authority and a critical figure in the regulatory redesign, is as equally critical as his US counterparts on Libor’s shortcomings. He has referred to it as ‘a broken system built on flawed incentives, incompetence and the pursuit of narrow interests that are to the detriment of markets, investors and ordinary people.’ Critically, however, Wheatley concluded that Libor ‘can be fixed through a comprehensive and far-reaching programme of reform. Although the current system is broken, it is not beyond repair, and it is up to us regulators and market participants to work together towards a lasting and sustainable solution.’

At its core the reform process, which envisages a transfer towards observable transactions, is predicated on continued involvement of market participants within an ostensibly more rigorous system of oversight. It does so because of an acknowledged fear that ‘a transition to a new benchmark or benchmarks would pose an unacceptably high risk of significant financial instability, and risk large-scale litigation between parties holding contracts that reference LIBOR.’ Notwithstanding the renewed emphasis within the Financial Conduct Authority on the critical importance of culture, both renewal and reform are likely to fail unless the core ethical deficit at the heart of contemporary banking is systematically addressed. The pre-tendering process in the United Kingdom, the pronouncements of the Financial Stability Oversight Council in the United States, or indeed the consultation process coordinated by the International Organization of Securities Commissions. Failed to provide confidence that the framing will specify any normative obligation. Likewise, there has been little evidence of tangible

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9 See The Wheatley Review of Libor (HM Treasury, London, September 2012), 75 (outlining case for reform), The review recommended that Libor should no longer be administered by the British Banking Association but by a new body chosen through a tendering process: at 8. The tendering process, which opened on 26 February 2013 (a day after the British Banking Association agreed to its mandate at an extraordinary general meeting in turn, is overseen by an independent committee led by the cross-bench peer, Baroness Sarah Hogg, the chair of the Financial Reporting Council, which regulates the audit profession in the United Kingdom. Other members of the committee include Paul Fisher (Bank of England) George Handjinicolaou (Deputy CEO of the International Swaps and Derivatives Association), John Kingman (Second Permanent Secretary at the Department of Treasury), John Stewart (chair of Legal & General former head of National Australia Bank), Colin Tyler (Association of Corporate Treasurers), Martin Wheatley (Financial Conduct Authority). The terms of reference note that the tender process will result in a recommendation to the Financial Conduct Association, which will then enter a contract with the new administrator. Moreover, ‘the new administrator will be required to be authorised by the Financial Conduct Authority (FCA). The administrator will also be expected to administer and govern LIBOR in such a manner that credibility will be restored in the benchmark in accordance with any relevant FCA rules, both new and existing,’ see <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/191850/the_hogg_tendering_advisory_committee_for_Libor_terms_of_reference.pdf>. The British government expects a successor body to be in place by this northern summer.


11 Ibid.

12 Wheatley Review, above n 9, 7 (‘While Libor needs to be reformed to address the weaknesses that have been identified, it would not be appropriate for the authorities to completely take over the process of producing a benchmark which exists primarily for the benefit of market participants.’) The review, however, places within a statutory framework provided by the Financial Services Authority [now Financial Conduct Authority]’s Approved Persons regime, to provide the assurance of credible independent supervision, oversight and enforcement, both civil and criminal: at 8.

13 Wheatley Review, above n 9, 7.

14 International Organization of Securities Commissions, Principles for Financial Benchmarks Consultation Report (IOSCO, Madrid, April 2013) 5 (The majority of IOSCO members do not regulate Benchmark Administrators or Submitters. Nor does this Report make specific recommendations with respect to any
changes to deleterious cultural framing from within the entities themselves beyond handwringing.\textsuperscript{15}

It is dispiriting—but nonetheless inescapable that within the financial sector commitments to enhanced self-regulation have proved incapable of arresting a decline in its trustworthiness.\textsuperscript{16} On Wednesday 29 September 2010, for example, senior financiers based in the City of London committed to subjugating the profit motive of trading floors and financial advisors to what was termed ‘a larger social and moral purpose which governs and limits how they behave.’\textsuperscript{17} Corporate responsibility to society, it was argued, could not be shirked nor delegated by the board and senior management: ‘Ultimately, it is the responsibility of the leaders of financial institutions – not their regulators, shareholders or other stakeholders – to create, oversee and imbue their organizations with an enlightened culture based on professionalism and integrity. As leaders of financial institutions we recognize and accept this personal responsibility.’\textsuperscript{18} The pledge provided what appeared to be a demonstrable commitment to higher ethical standards. It is indicative that the key signatory was Marcus Agius, the chairman of Barclays, one of the first financial institutions to accept pervasive wrongdoing in the Libor scandal. The acceptance of financial penalties, without an admission of responsibility, renders indefensible the public commitments entered into in 2010. It is, therefore, essential to evaluate the drivers of deviance at both a descriptive and theoretical level before ascertaining whether the reform agenda proposed if going to workable.

Corporate culpability for individual ethical failures is invariably and inevitably informed by the relative strength or weakness of organizational culture (i.e. the degree to which egregious conduct is informed by a disconnect between stated and lived values).\textsuperscript{19} The disjunction can lie along a continuum. It ranges from unthinking or willful neglect, through reliance on formal but transacted around compliance programs to misaligned

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\textsuperscript{15} In evidence before the Treasury Select Committee on 9 January 2013, the head of investment banking at UBS, Andrea Arcel, conceded ‘these are industry-wide problems. We all got probably too arrogant, too self-convincing that things were correct the way they were. I think the industry needs to change,’ see Mark Scott, ‘UBS Executives Questioned By Parliament Over Rate-Rigging Case,’ \textit{New York Times}, 9 January 2013, \url{http://dealbook.nytimes.com/2013/01/09/british-parliament-questions-ubs-executives-in-wake-of-1-5-billion-fine/?src=dlbksb}; see also Mark Carney, ‘Rebuilding Trust in Global Banking,’ (Speech delivered at Western University School of Business, London, Ontario, 25 February 2013), in which the incoming Governor of the Bank of England notes ‘over the past year, the questions of competence have been supplanted by questions of conduct. Several major foreign banks and their employees have been charged with criminal activity, including the manipulation of financial benchmarks, such as LIBOR, money laundering, unlawful foreclosure and the unauthorized use of client funds. These abuses have raised fundamental doubts about the core values of financial institutions.’


\textsuperscript{17} Marcus Agius et al, ‘Financial Leaders Pledge Excellence and Integrity,’ \textit{Financial Times}, 29 September 2010, \url{http://www.ft.com/intl/cms/s/0/eb26484e-cb2d-11df-95c0-00144feab49a.html#axzz2C8HKL1jb}.

\textsuperscript{18} Ibid.

\textsuperscript{19} Jesper Sorensen, ‘The Strength of Corporate Culture and the Reliability of Firm Performance’ (2002) 47 \textit{Administrative Science Quarterly} 70 (defining culture narrowly as a system of shared values (that define what is important) and norms that define appropriate attitudes and behaviors for organizational members (how to feel and behave): at 72); see also Linda Smircich, ‘Concepts of Culture and Organizational Analysis’ (1983) 28 \textit{Administrative Science Quarterly} 339 (noting that research into corporate culture is an inquiry into the social order: at 341).
incentives. These corporate agendas take place within broader governance and legal frameworks. Recent legislative innovations, particularly in the United States, have resulted in the design of sub-optimal regulatory structures; sub-optimal, that is, to society if not the financial sector itself, ostensibly the target but ultimately the beneficiary of flawed legislative framing and implementation. The deception at the heart of the multifaceted Libor scandal, therefore, points to patterns of conduct that have institutionalized inefficient and unfair markets, a diametrically opposed outcome to that envisaged in market conduct legislation. As such, on both a descriptive and analytical level within both individual entities and the broader regulatory ‘regime’, it represents what Lawrence Lessig has termed a form of ‘institutional corruption’ (i.e. it ‘describes an influence, financial or otherwise, within an economy of influence, that weakens the effectiveness of an institution, especially by weakening public trust in that institution’).

Credible ongoing reform needs to demonstrate that the dangers of institutional corruption have been addressed. In the aftermath of the extent of the failure of British banking, approved standing by a regulatory agency is no longer sufficient bulwark to ethical commitment, a fact explicitly acknowledged by the Parliamentary Commission on Banking Standards. This criticism of regulatory effectiveness can be transcended, however, if one recalls the original emphasis of the disclosure paradigm—the quintessential tool in market conduct regulation. It did not rest on technicalities that can be transacted around. At its core it is normative demand; a point explicitly made by its original framers. Demanding truth in securities is in essence a moral claim. Seen from this perspective, what is required is not the retirement of the paradigm but its

20 Gideon Rossouw and Leon van Vuuren, ‘Modes of Managing Morality: A Descriptive Model of Strategies for Managing Ethics’ (2003) 46 Journal of Business Ethics 389 (noting a five stage process in which corporate activity moves from ‘(1) immorality; (2) reactivity; (3) compliance; (4) integrity; (5) total alignment: at 391).
22 Christopher Hood, Henry Rothstein and Robert Baldwin, The Government of Risk (2001) 8 (describing a regulatory regime as a ‘complex of institutional [physical and social] geography, rules, practice and animating ideas that are associated with the regulation of a particular risk or hazard’).
23 Lawrence Lessig, Institutional Corruption (Speech delivered at Harvard Law School, Cambridge, MA, 12 October 2009), <http://www.youtube.com/watch?v=0-IEDiUFYUK>. See more generally, Lawrence Lessig, Republic Lost: How Money Corrupts Congress and a Plan to Stop It (2011). For analysis of interaction between legislative design and regulatory policy, see Fred McChesney, Money for Nothing (1987) 157 (characterising politicians ‘not as mere brokers redistributing wealth in response to competing private demands but as independent actors making their own demands to which private actors respond’).
24 It is indicative that Sir James Crosby, the former chief executive of HBOS, who stewarded the bank to the brink of collapse before its bailout in 2008, received a knighthood for his services to the financial services and served as Deputy Chairman of the Financial Services Authority following his departure from the bank until forced to resign in 2009, see Parliamentary Commission on Banking Standards, HBOS: An Accident Waiting to Happen (HM Parliament, London, 4 April 2013) 52 (‘In the view of this Commission, it is right and proper that the primary responsibility for the downfall of HBOS should rest with Sir James Crosby, architect of the strategy that set the course for disaster, with Andy Hornby [his successor as Chief Executive Officer], who proved unable or unwilling to change course, and Lord Stevenson [the Chairman], who presided over the bank’s board from its birth to its death. Lord Stevenson, in particular, has shown himself incapable of facing the realities of what placed the bank in jeopardy from that time until now. Apart from allowing their Approved Persons status at HBOS to lapse as their posts were wound up, the FSA appears to have taken no steps to establish whether they are fit and proper persons to hold Approved Persons status elsewhere in the UK financial sector. In cases of this importance the Commission believes that simply allowing Approved Persons status to lapse is insufficient. The Commission therefore considers that the FSA should examine, as part of its forthcoming review of the failure of HBOS, whether these three individuals should be barred from undertaking any role in the financial sector.’).
25 Baldwin B. Bane, ‘The Securities Act of 1933’ (1933) 1 The Certified Public Accountant 587, 592 (reprinting address to Annual Meeting of the American Society, Milwaukee, Wisconsin, September 19, 1933).
rejuvenation. The paper, therefore, explores how the ethical deficit can be addressed by revisiting the debates that accompanied the passage of the New Deal architecture in the United States.

The New Deal remains the paradigmatic and most sophisticated, holistic attempt to shift cultural mores by imposing external restraints on capital market governance. As with the contemporary manifestation of financial crisis, the designers of the New Deal were forced to confront questions associated with opacity and complexity in the design and marketing of financial products, how to embed restraint and how to define and limit systemic risk? Despite the similarities in terms of scale and societal impact, there is one fundamental difference. In sharp contrast to the piecemeal reforms of today, the architectural design of the New Deal was based on a fundamental rethinking of corporate and regulatory purpose. Disentangling the ideational roots of these disputes, then and now, provides critical evidence as to why the New Deal was so transformational and why Libor reform has to date proved so ineffective. It does so primarily through a reappraisal of James M. Landis, an outstanding theoretician and practitioner of regulatory design.26 Reaching into history of market conduct is far from being an esoteric exercise. It is critical to understanding current problems. As Lambright and Quinn have highlighted, ‘better understanding of the practice of administrative leadership advances theory. Application of theory by those in positions of authority raises the level of practice. Reading about leaders who truly make a difference for others can inspire, teach, and help attract the best and brightest of a new generation to public service.’27 Indeed, it is an approach favored by Landis himself as he pondered a return to Harvard after establishing and then leading the Securities and Exchange Commission.28

The paper is structured as follows. Section B examines the critical importance of Landis in providing practical and theoretical justification for state intervention in the regulation of securities markets. The review draws on a series of interviews provided to the Columbia University Oral History Project by James M Landis.29 It is also informed by additional personal papers deposited with the Harvard Law School and Harvard University Archives made available to scholars for the first time in January 2013. Section C details the extent of the corruption uncovered by the Libor investigation. Section D sets out concrete steps capable of changing the incentive culture by revisiting the strategies initially used by Landis as both a practitioner and theoretician of regulatory policy. Revitalizing this approach would provide the basis to restore much needed confidence in market conduct and in regulatory authority. Section E concludes.

B  James M. Landis and the Administrative Process

An appreciation in the Harvard Law Review on his death in 1964 noted that James M.

28 James M. Landis, ‘Address Before the Third Annual Eastern Law Students Conference’ (Speech delivered at the School of Law, The Catholic University of America, Washington, DC, 20 March 1937), 1 (‘One grasps for shadows, the better to comprehend sunlight. One reaches into the past, more clearly to know today and tomorrow. It is the privilege of all who care about education to test the depth and quality of that shadow for there, perhaps more than anywhere, one must try to pierce the brilliance of continuing dawns’).
Landis was ‘on fire’ as a student. This may well be taken to epitomize his public career.\textsuperscript{30} Landis was to become a critical architect of the \textit{Securities Act} (1933), governing new issuance, and the \textit{Securities Exchange Act} (1934), which extended regulatory oversight to existing securities, demanded regular financial reporting and mandated associational governance through the establishment of the Securities and Exchange Commission (SEC).\textsuperscript{31} He served on the SEC’s inaugural board, becoming its chair following the departure of Joseph Kennedy in 1934, with the public endorsement of his predecessor.\textsuperscript{32} As Joseph Kennedy left the SEC headquarters he interrupted the first Landis press conference by calling out ‘Good-bye Jim. Good luck to you. Knock ‘em over.’\textsuperscript{33} The author of an influential book on regulatory rule-making, legitimacy and authority that retrospectively provided theoretical justification for the proposition that law is made not found,\textsuperscript{34} two decades later Landis prepared a seminal study for the president-elect, John F. Kennedy, on how and why the regulatory apparatus he was so instrumental in designing, predicated on rule by experts, had failed.\textsuperscript{35} Notwithstanding the personal tragedy of Landis’ subsequent suspension for failing to file income tax returns,\textsuperscript{36} the Columbia interviews, read in conjunction with the Columbia interviews, read in conjunction with the

\textsuperscript{30} Erwin Griswold, ‘James McCauley Landis 1899-1964’ 78 \textit{Harvard Law Review} 313 at 316 (‘Surely a man who has done so much should be judged by the best that he can do; and Landis at his best was a great lawyer and legal scholar:’ at 316).


\textsuperscript{32} ‘Landis Heads SEC; Succeeds Kennedy,’ \textit{New York Times}, 24 September 1935, 1, 37 (quoting Kennedy saying ‘I see no reason in the world why any business interests need have the slightest misgiving that he will not give them the fairest and squarest deal a man can get. I would deem it an honor to have him as a trustee of anything I owned. He is thoroughly cognizant of the important of the successful administration of these acts in helping to revive the business of the country:’ at 1). It was to be a life-long association, see David Nasaw, \textit{The Patriarch: The Remarkable Life and Turbulent Times of Joseph P. Kennedy} (1980) 769 (noting appointment of Landis as special advisor to John F. Kennedy, the president-elect, in 1960 and articulating that next to family Joseph Kennedy ‘trusted no one to watch out for his son as he did Jim Landis’).

\textsuperscript{33} \textit{New York Times}, above n32, 37. The position allowed Landis to experiment with a regulatory design he had first articulated in 1931. Critical in this context was the decision on which ‘device for enforcement’ is to be used, see also James M. Landis, ‘The Study of Legislation at Law Schools: An Imaginary Inaugural Lecture’ (1931) 39 \textit{Harvard Graduates Magazine} 433 (‘The criminal penalty, the civil penalty, the resort to the injunctive side of equity, the tripling of damage claims, the informers share, the penalizing force of pure publicity, the license as a condition of pursuing certain conduct, the confiscation of offending property – these are the samples of the thousand and one devices that the ingenuity of many legislatures has produced. Their effectiveness to control one field and their ineffectiveness to control others, remains yet to be explored:’ at 437).

\textsuperscript{34} James M. Landis, \textit{The Administrative Process} (1938).

\textsuperscript{35} James M. Landis, \textit{Report on Regulatory Agencies to the President-Elect} (21 December 1960), <http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1960/1960_1221_Landis_report.pdf>; see also Landis, above n24, 638 (noting that ‘routine business before these administrative agencies was much too heavy to permit them to do the broad kind of policymaking that was essential. They didn’t have the power to delegate enough of their duties, so that they could keep, in a sense, their desks clean and their minds free to think about the major problems they faced.’). The arguments foreshadowed many made by regulatory capture theorists, see George Stigler, ‘Public Regulation of the Securities Markets (1964) 37 \textit{Journal of Business} 117; for review see Reuel Schiller, ‘Rulemaking’s Promise: Administrative Law and Legal Culture in the 1960s and 1970s’ (2001) 53 \textit{Administrative Law Review} 1139.

\textsuperscript{36} Following an investigation by the Department of Justice he was charged and sentenced to one month in prison, commuted to hospitalization, see Edward Ranzal, ‘Landis Jailed for Tax Delays,’ \textit{New York Times}, 30 August 1963, 1. He was subsequently suspended from practice. It was an ignominious end to an illustrious career. The most complete account to date can be found in Victor Navasky, \textit{Kennedy Justice} (1971) 427-440; see also Nicholas Katzenbach, \textit{Some of It Was Fun: Working With RFK and LBJ} (2008). In a promotional interview for the book Katzenbach, the Deputy Attorney General at the time of the Landis
recently released Harvard material, contemporary scholarly debates and media interventions,37 make clear that in design and application, the normative question of why one regulates trumps the technical considerations of how one regulates, which is a second-order consideration. The critical argument advanced here is that unless this lost dimension is restored, regulatory intervention will be incapable of changing practice. Not for the first time in regulatory design, progress necessitates going back to the future. In this section we do so through a three-stage process: first, we trace the rationale for intervention; second, we detail the explicit normative foundation of the underpinning legislation; and, third, evaluate the basis on which this was theoretically justified.

The Rationale for Intervention in Capital Markets

For the progenitors of the original administrative state the aim was not to operate within accepted paradigms, legal, institutional and theoretical, but to destabilize them by creating an alternative reality, one that legitimated state intervention. Extending far beyond the narrow realm of banking and securities regulation, the New Deal was

prosecution, describes it as something that had to be done (which he argued Landis himself was aware of and accepted) but which did not amount to a row of beans,’<http://bigthink.com/users/nicholaskatzenbach#!/video_idea_id=5612>. Katzenbach’s video account, much more forceful and remorseful than the written version is predicated on the belief that politics can and does result in brutal outcomes. The political calculation is contained in a secret recording John F Kennedy made of a conversation with Katzenbach immediately prior to the admission of guilt, see John F. Kennedy Transcripts, The White House, Washington, DC, 25 July 1963, Dictation Belt 23D.5 ‘James Landis and the IRS,’ JFK Presidential Library, Boston, MA, <http://www.jfklibrary.org/Asset-Viewer/Archives/JFKPOF-TPH-23D-5.aspx>:

JFK: If anybody ever gets the idea that the president’s friends can get away with it …gosh I think it would be an awful morale cracker to the internal revenue, ahh to taxpayers, the next time that anyone got arrested they’d say well what the hell about Landis?

NDK: That’s, right. That’s right. I’m afraid that’s right. But I don’t think…I think we’d take it into court and it could done quickly…and.

JFK: How quickly and quietly could it be done?

NDK: It can’t be done absolutely quietly but I think that if Dean [William] Warren [of Columbia Law School] who’s his counsel would cooperate, I think we could get it all over with maybe in one session.

A deal was struck that Landis would plead guilty but the sentencing judge recused himself to be replaced by the Chief Justice, Sylvester Ryan. Katzenbach described imprisonment as an exercise in ‘judicial ego,’ see Katzenbach, Some of It Was Fun (2008), 102. This claim was already rejected by Chief Justice Ryan, who in 1981 maintained the verdict was fair not cruel, see Milton Gould, Studies in Hubris, New York Law Journal, 14 December 1981 (‘Cruel. What was so cruel? Here is a man who has enjoyed every advantage life can offer; while poor Irish and Jewish and Italian and colored kids were clawing their way out of the gutter, this guy was getting every break. Now, when he has been caught, the Government slobbers over him, the Dean of Columbia Law [William Warren] slobbers over him and everybody in the courthouse is falling over himself to make it easy for him. I had to do my duty and my duty was to show that Landis was no better than anyone else,’ see Milton Gould, Landis, New York Law Journal, 14 December 1981. This leaves unexplained the level of discrepancy as why the initial judge recused himself. According to Navasky, it was based on a conflict arising from an association with Landis’ law partner, Justin Feldman (at 437). The real reason, however, is more problematic. In an interview with the author, the prosecutor in the case, Robert Morgenthau, maintained the case was a tragedy of Greek proportions, with Landis’ fate sealed when Thomas Corcoran went to the sentencing judge after the initial hearing to argue that the administration expected leniency. This deliberate and inexcusable attempt to influence the outcome by Corcoran, an exceptionally senior lawyer and close confidante of Oliver Wendell Holmes, for whom he clerked, Roosevelt and Lyndon B. Johnson, was communicated directly to Judge Ryan. The Chief Justice, already personally slighted because the Kennedy Administration had passed him over for a vacancy in the Court of Appeals, was furious and determined to send a clear message to the administration. Interview New York, 25 January 2013. A full account is forthcoming in Justin O’Brien, A Life on Fire: The Triumph, Tragedy and Lost Legacy of James M. Landis (2014).

designed to recalibrate society itself through the guidance of neutral experts. The scale of the ambition, as outlined in Franklin D. Roosevelt's speech accepting the Democratic nomination for the presidency in 1932, remains as breathtaking in its audacity as eerily apposite to contemporary problems in financial services:

Out of every crisis, every tribulation, every disaster, mankind rises with some share of greater knowledge, of higher decency, of purer purpose. Today we shall have come through a period of loose thinking, descending morals, an era of selfishness, among individual men and women and among Nations. Blame not Governments alone for this. Blame ourselves in equal share. Let us be frank in acknowledgment of the truth that many amongst us have made obeisance to Mammon, that the profits of speculation, the easy road without toil, have lured us from the old barricades. To return to higher standards we must abandon the false prophets and seek new leaders of our own choosing.\(^{38}\)

The debates that the New Deal engendered were as much political as judicial, practical as theoretical. They took place in the context of domestic industrial and financial failure and looming conflagration in Europe – the rise of the Soviet Union, the emergence of Fascism in Italy and Nazism in Germany. Experience, experiment and avowed faith in the rule of experts to solve the complexity of modern society underpinned a powerful inter-disciplinary intellectual movement. Given the opportunity to simultaneously translate theory into practice and generate theory from practice, the crisis also revealed significant conceptual shortcomings in prior policy design. The power to effect change was exponentially increased by the temporary fracturing of previously powerful electoral and ideational coalitions.\(^{39}\) In the legal realm it was informed by Justice Oliver Wendell Holmes’ pithy comment that ‘the life of law is not logic but experience’\(^{40}\)

As with their economic counterparts, legal realists and pragmatists used the institutions created by the New Deal as a laboratory to explore how an alliance between

\(^{38}\) Franklin D. Roosevelt, ‘The New Deal’ (Speech delivered at the Democratic National Convention, 2 July 1932). The rhetoric intensified by the time of the inauguration, see Franklin D. Roosevelt, Inaugural Address (Speech delivered at Washington, DC, 7 March 1933 (‘The moneychangers have fled from their high seats in the temple of our civilization. We may now restore that temple to the ancient truths. The measure of the restoration lies in the extent to which we apply social values more noble than mere monetary profit…. There must be an end to a conduct in banking and in business, which too often has given to a sacred trust the likeness of callous and selfish wrongdoing. Small wonder that confidence languishes, for it thrives only on honesty, on honor, on the sacredness of obligations, on faithful protection, on unselfish performance; without them it cannot live. Restoration calls, however, not for changes in ethics alone. This Nation asks for action, and action now.’).

\(^{39}\) Academics played a critical role in this process, most notably Adolf A. Berle at Columbia, see Jordan Schwarz, Liberal: Adolf A. Berle and the Vision of an American Era (1987), 70-75 (noting the recruitment of Berle as a founding member in 1931 of then Governor Franklin D. Roosevelt’s Brains Trust). Harvard was also a critical source of ideas on the shaping of regulatory purpose, in particular Felix Frankfurter, who was irritated by the degree to which Berle influenced economic policy, see James Srodes, On Dupont Circle: Franklin and Eleanor Roosevelt and the Progressives Who Shaped Our World (2012), 198. It is indicative of Frankfurter’s standing that his elevation to the Supreme Court could be deemed a demotion, see ‘Profile: Felix Frankfurter,’ The New Yorker, 30 November 1940; for Landis’ criticism of Berle as too cautious, see Landis above n24, 237 (noting Berle’s caution in relation to the establishment of the Securities and Exchange Commission, Landis recalled that ‘it was perfectly honest on the part of Berle, no question about that. It would not be fair to accuse him of trying to favor the other side. That would be the wrong way of looking at it. But the approach was that of gradualism, not jumping in headlong.’).

\(^{40}\) Oliver Wendell Holmes, The Common Law (1881), 1 (for Holmes ‘state interference is an evil, where it cannot be shown to be a good’: 89). Holmes provided a signed copy to the British social scientist Harold Laski, who in turn returned it via diplomatic pouch to Landis as Dean of Harvard Law School for safekeeping, see JM Landis to Harold Laski 28 October 1940, Harvard University Archive, Deans Office UAV.512.20: 1940-47 Correspondence Box 15 (‘What worries me is the irreplaceable loss that will occur if men lose the vision of liberty that alone has been the moving force to bring about the idea of civilization. To speak freely, to write freely and to think freely – give us these and we can rebuild our libraries; but if those liberties are destroyed, libraries are but recitals of a dead past which may not be inquired into.’).
government and business could best institutionalize restraint. The critical objective was not, however, the overthrow of capitalism or the financial system but rather credible ongoing sustainable reform in which the regulatory authority could guide a given industry as a whole towards socially beneficial outcomes. As could be expected it also prompted concern that democracy itself could be threatened.\(^{41}\)

James M. Landis was the critical figure in the academic and policy debates over the rise and justification for the administrative process.\(^{42}\) He was steeped in the administrative process as both an academic and policymaker. As early as 1930 he had dismissed any restrictions on agency discretion as little more than an attempt to curtail the legitimate exercise of public power for the public good.\(^{43}\) Asked by his long-term confident Professor Felix Frankfurter to help the Roosevelt administration transform an initial election pledge to regulate securities in 1932 into credible legislation, Landis began a commute from Cambridge to Washington that was to transform the governance of Wall Street and American society through the auspices and example of the Securities and Exchange Commission. Putting into practice the ideas developed in his innovative course on legislation at Harvard, he became one of the most significant policy actors of his generation (and arguably in the history of regulatory design). Landis steward the agency through early legitimacy and accountability firefights with the financial sector, showing as much acumen in navigating the complexity of political contingency and judicial gamesmanship as in legislative drafting.\(^{44}\) Although the enforcement methods used by the SEC had come under attack from a Supreme Court and a legal profession deeply troubled by the expansion of the administrative rule, it had been deemed constitutional, if potentially dangerous. In *Jones v SEC*, a case that ostensibly centered on subpoena power over withdrawn securities offerings, the Supreme Court had publicly questioned the methods used by the SEC. Justice Sutherland noted that its demands were both wholly arbitrary and unreasonable invoking by analogy the notorious Star Chamber.

Arbitrary power and the rule of the Constitution cannot coexist. They are antagonistic and incompatible forces; and one or the other must of necessity perish whenever they are brought into conflict…Out institutions must be kept free from the appropriation of unauthorized power by lesser agencies as well. If the various administrative bureaus and commissions, necessarily called and being called into existence by the increasing complexities of our modern business and political affairs, are permitted gradually to extend their powers by encroachments-even petty encroachments-upon the fundamental rights, taking steps that will inevitably lead to totalitarianism in the name of saving Democracy indicates to me that our republican form of Government is on the way out. If they have not the courage to stand up and try to preserve Democracy in times of a crisis, or an alleged crisis, how can they expect the uneducated to do so?\(^{45}\). For discussion of competing ideational perspectives, see Ira Katznelson, *Fear Itself: The New Deal and the Origins of Our Times* (2013), 29-57.

\(^{41}\) These pressures intensified as the United States made preparations for entry to World War Two, fracturing in the process old alliances. Typical, for example, was an exchange between Senator Burton Wheeler to JM Landis on 4 February 1941, Harvard University Archive, Deans Office UAV.512.20: 1940-47 Correspondence, Box 24 (‘I am quite frank in saying to you, that I cannot understand how any intelligent person, including yourself, can possibly be for giving these wide powers to the President…For College professors and Deans to taking steps that will inevitably lead to totalitarianism in the name of saving Democracy indicates to me that our republican form of Government is on the way out. If they have not the courage to stand up and try to preserve Democracy in times of a crisis, or an alleged crisis, how can they expect the uneducated to do so.’). For discussion of competing ideational perspectives, see Ira Katznelson, *Fear Itself: The New Deal and the Origins of Our Times* (2013), 29-57.

\(^{42}\) See McCraw, above n31, 172 (noting that Landis ‘persistently emphasized the necessity of using all the incentives potentially inherent in the industry to give every person involved — executive, accountant, broker, banker — a stake in helping to enforce the law.’). For explicit justification of associational endeavor, see Landis, *The Administrative Process*, above n34 (noting that increased complexity calls ‘for greater surveillance by government of the appropriate use of these resources to further the admittedly dim but recognizable aims of our society:’ at 4). See also Braithwaite and Drahos, above n19 (noting the ‘regulatory brilliance’ of the partnership model).


privileges and immunities of the people, we shall in the end, while avoiding the fatal consequences of a supreme autocracy, become submerged by a multitude of minor invasions of personal rights, less destructive but no less violative of constitutional guarantees.45

Tracing the rationale from initial framing of the Securities Act (1933) and Securities and Exchange Act (1934) to the publication of The Administrative Process (1938) indicates the centrality of specifying regulatory purpose. It was essential in legitimating a new approach to governance. It was predicated on a dual interlocking framework. First, it limited the grounds for judicial challenge on constitutionality. Second, it limited suspicion of the exercise of arbitrary power. Rules and decisions would only be developed on the basis of rigorous evaluation. Within this framework, the specific forms of disclosure were designed to inform the investing public of actual practice. So doing, it was argued, made it possible to incrementally change the boundaries of what could be constituted as acceptable. It was predicated on industry’s acceptance of responsibility for past excesses and a concomitant by it to mindfulness in the exercise of leadership. It is in this context that the abiding strength (and limitations) of the Landis approach to governance becomes clear.

The combination of elite wisdom and capacity to both capture and utilize populist sentiment necessitates demonstrable evidence of judgment, courage and integrity. At the heart of the compromise lies an uneasy compact on how to evaluate expertise. In the initial framing, this was conceived as the remit of impartial career-driven bureaucrats, prepared to forgo personal material advancement in exchange for societal improvement. The critical flaw pivots on what happens when claims to expertise are evaluated according to different criteria, explored more fully below. First, however, it is essential to highlight the ingenuity of the design.

The Normative Foundations of the Disclosure Paradigm

Primary responsibility for the 1932 electoral promise to introduce securities regulation was initially provided to Houston Thompson, a former Federal Trade Commissioner, whose carriage of it was, according to Landis, ‘a complete debacle.’46 The problem was that rather than implementing ‘what Mr. Roosevelt had set forth in his message [his electoral pledge, Thompson] sought to introduce a standard of qualification. As Landis observed, ‘by qualification I mean that some federal agency would determine whether securities themselves, no matter how truthfully they might be described, nevertheless not be sold on the basis that they didn’t meet certain standards of qualification. These standards were never well described.’47 For Landis such an approach

45 Jones v Securities and Exchange Commission 298 US 1, 24-25 (1936). Dissenting, Justice Cardozo noted that ‘a commission which is without coercive powers, which cannot arrest or amerce or imprison though a crime has been uncovered, or even punish for contempt, but can only inquire and report, the propriety of every question in the course of the inquiry being subject to the supervision of the ordinary course of justice, is lined with denunciatory fervor to the Star Chamber of the Stuarts. Historians may find hyperbole in this sanguinary simile.’ Correspondence between Felix Frankfurter and Supreme Court Justice Harlan Stone revealed profound skepticism with the reasoning. According to Frankfurter, ‘Sutherland writes as though he were still a United States senator making partisan speech.’ Stone was even more caustic in reply; the judgment, he maintained, ‘was written for morons and such will no doubt take comfort from it,’ cited in Mark Tushnet, ‘Administrative Law in the 1930s: The Supreme Court’s Accommodation of Progressive Legal Theory’ (2011) 60 Duke Law Journal 1565 at 1608 (quoting an exchange of letters dated 7 April 1936, on file with Harvard Law School Special Collections Library).
46 Landis, above n29, 158.
47 Ibid, 157 (Brandeis said to me, “Houston Thompson has every great quality that makes a great lawyer, except one. He’s got a great bearing, he’s got a good presence.” I said, “What quality does he lack, Mr. Justice?” Brandeis replied, “Brains.”).
– based on the very predilections and bias he identified in the decisions of the Supreme Court from *Lochner* onwards – was doomed to fail. Poor drafting and excessive deference combined to make the approach unworkable. ‘It was a terribly poorly drafted piece of legislation. In the first place it didn’t carry out the President’s ideas. In the second place, it introduced sanctions and responsibilities on the federal government for the quality of securities that were being sold, which even today [1963] I don’t believe the federal government and I don’t believe even a state agency ought to exercise,’ he reasoned. 48 This reasoning represented a clear limit to what regulators should do. As Landis explained it:

My fundamental belief is that if the truth is told about these things, then it is up to the parties to decide whether they want to buy them or not. If they want to buy them, and speculate, well, let them go ahead and speculate. I’ve always felt that the furthest that practical administration could go was to call for a statement of the truth about any enterprise; but that some governmental agency should say you shouldn’t buy stock in ABC company – I don’t know who can decide a thing like that. 49

None of this is to suggest that Landis was in any way either enamored by or trustful of Wall Street; rather his strategy was based on explicit enrolment and sustained attempt to leverage the restraining power of reputation, a commodity devalued because of how sections of the industry had operated. Reliance on truth and reputation were narrower and more easily communicable frameworks. In conjunction with Benjamin Cohen, another Frankfurter connection, and assisted by Tommy Corcoran, a Wall Street veteran brilliant academician and consummate lobbyist, the trio “knocked this thing out in two days.” 50 This thing was to be the initial draft for the *Securities Act* (1933), which Cohen and Landis were to serve as consultants on, under the direction of the legislative draftsman of the House of Representatives, Middleton Beaman. Landis’ taped interviews provide a revealing insight into how the process unfolded:

For two days, Beaman wouldn’t allow you to put a pencil to paper. He wanted you to know just exactly what you wanted to do, before you started writing. I know that both Cohen and I were a little suspicious of him, as to whether he didn’t want to kill this whole thing, with all these dilatory tactics. But within four or five days, we began to appreciate his work and his method of approach. I guess we worked for three or four weeks perfecting the draft, and with his help…we put this thing together. In my opinion and the opinions of a great many other people, it’s about as good a piece of legislative draftsmanship as you can find in federal legislation. 51

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49 Ibid, 158. It was a formulation that was to stand the test of time; see *Securities and Exchange Commission v Capital Gains Research Bureau* 375 US 180 (Goldberg J) (1963) (‘A fundamental purpose common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry’: at 186). This necessitates, however, balancing valid and spurious claims, see Justin O’Brien, *Redesigning Financial Regulation* (2007), 66-67 (citing Judge Milton Pollack’s argument that the federal securities laws are not meant ‘to underwrite, subsidize and encourage…rash speculation in joining a free-wheeling casino that lured thousands obsessed with the fantasy of Olympian riches but which delivered such riches to only a scant handful of lucky winners’). Increasingly, however, there are suggestions that the SEC should be given the power to ban either specific products or access to them, see Saule Omarova, ‘From Reaction to Prevention: Product Approval as a Model of Derivatives Regulation’ (2013) 3 *Harvard Business Law Review* 98; License to Deal: Mandatory Approval of Complex Financial Products’ (2012) 90 *Washington University Law Review* 63. For comparative review of how this is achieved with pharmaceutical products, see Daniel Carpenter, *Reputation and Power: Organizational Image and Pharmaceutical Regulation at the FDA* (2010).
50 Landis, above n29, 160
51 Ibid, 162-63.
Once enacted, Landis was soon called upon to return to Washington as a consultant to the Federal Trade Commission, where he found the agency ‘had no conception about how to administer this act... They had no sympathy with this legislation. It was pretty much damned by Wall Street and regarded as one of these crackpot New Deal measures.’\footnote{Ibid, 173.} Subsequently promoted to commissioner Landis recalled an early meeting with Roosevelt, in which the president recounted ‘the Republicans never want to do anything, so they’re always united. But we Democrats want to do things, and we get disunited in wanting to do things.’\footnote{Ibid, 178.} Thereafter, according to Landis, he assumed leadership. ‘I didn’t bother him. I mean I assumed the responsibility of deciding things that I felt I had the right to decide.’\footnote{Ibid, 187.} As Landis recounts the history of the passage of the \textit{Securities Exchange Act} (1934), the extent of that delegation becomes clear. Along with Ferdinand Pecora, whose congressional investigations had created the contingency for fulfilling electoral pledges in relation to regulating securities, separating investment and commercial banking and replacing caveat emptor with a disclosure philosophy,\footnote{Michael Perino, \textit{The Hellhound of Wall Street: How Ferdinand Pecora’s Investigation of the Great Crash Forever Changed American Finance} (2010), 292-294 (noting how the Securities Exchange Act had finally put a cop on Wall Street).} Landis was invited to the White House:

Roosevelt met us – well he was in bed when he interviewed us, gave us an interview. He had stacks of papers around him, I know. I recall that. Well Ferdi didn’t know anything about the Boss. Great investigator the guy was, really a great investigator, but from the standpoint of a creative artist, he just didn’t have that quality. Of course, we built on his work. We built completely on his work. But he just doesn’t have that quality of putting together the work in the form of draft legislation. But we both went up to you him, to see the President and the President asked a few questions about the bill. I don’t think we spent more than 20 or 30 minutes. We covered this, we covered that – quite intelligent questions – and he hadn’t read the bill. The he said, “All right. Go ahead.”\footnote{Landis, above n29, 199. This freedom to act is a constant refrain in the reminiscences. Recalling another meeting Landis noted ‘he might not have helped you at all. He might have just thrown the problem right back at you. The feeling of joviality that he gave you, the stimulation and what not – then you’d go back and solve the damn problem yourself, without too much advice from the President: at 244.}

Landis was always alert to the possibility that congressional amendments were in fact traps for the unwary. Proposed amendments in the Senate to the corporate ‘death sentence’ provision of the \textit{Public Utility Holding Company} legislation, for example, were ostensibly designed to provide SEC additional discretion on whether to exercise that power. For Landis, however, the reforms would have made it ‘completely impossible for any commission to administer a statute of that nature because the pressures on the commission should be insufferable. Physical standards such as were proposed – that was capable of administration. But to draw a distinction between good and bad holding companies seemed an impossible thing.’\footnote{Landis, above n29, 217.} Again, here is evidence of good regulatory design: clearly enunciated legislative power, linked to equally clear objectives and discretion only applied after careful and intensive scrutiny that was capable of surviving legal challenge. Throughout his career Landis was determined to ensure flexibility without subjecting the agency to accusations of economic or ideological bias, a leitmotif that underpins \textit{The Administrative Process} (1938), the retrospective theoretical justification.
for what amounted to a new form of government. It remains the defining text of the field.\textsuperscript{58}

\textit{The Legitimacy of the Administrative Process}

As with the classic Berle and Means treatise on the implications of the separation of ownership and control in major corporations, \textit{The Modern Corporation and Private Property} (1932), Landis’ book was designed to inform an increasingly polarized debate over corporate purpose and responsibility.\textsuperscript{59} Its central premise and critical thrust was to position regulatory lawmaking as an essential pre-condition for democracy.\textsuperscript{60} In a critical passage Landis argued ‘if the doctrine of the separation of power implies division, it also implies balance, and balance calls for equality. The creation of administrative power may be the means for that balance, so that paradoxically enough, though it may seem in theoretic violation of the doctrine of the separation of power, it may in matter of fact be

\textsuperscript{58} Landis dedicated the book to Senator Sam Rayburn, the charismatic Democrat who facilitated the passage of the securities legislation. The gesture was greatly appreciated by the lawmaker, see Senator Sam Rayburn to JM Landis, 26 September 1938. Harvard University Archive, Deans Office 1937-39 UAV.512.20: Correspondence, Box 4 (‘It will remain of course one of my very prized possessions as my admiration of the author is as much as it should be for any man and to have you dedicate this volume to me is an honor that I will appreciate to my last day’).

\textsuperscript{59} See JM Landis to Professor Paul Sayre, University of Iowa Law School 14 February 1939 (‘Some day I hope I can get time to really explore and extend some of the ideas that were there advanced in a rather tentative manner, or better, I hope that someone else will do it.’), Harvard University Archive, Deans Office 1937-39 UAV512.20 Correspondence, Box 5. It is important to note, however, that notwithstanding the intensity of the debate, there was acceptance from within business that Landis had generated an original third way, see Frank Scheffey, Co-Director of Investment Banking Conference to JM Landis, 16 January 1939, Harvard University Archive, Deans Office 1937-39 UAV512.20 Correspondence, Box 5 (‘I have read with a great deal of interest and profit your lectures, \textit{The Administrative Process}. …Your explanation of the place in Government of commissions would go a long way towards eliminating some of the misunderstandings in regards to their functions. I am particularly impressed with the emphasis you develop as a basic principle underlying the Administrative Process to take care of and foster and develop the well being of the industry over which it has jurisdiction….Investors cannot have much confidence in going into public utilities or other securities if they have the feeling, whether or not justified, that Government agencies are giving more attention to policing and punishing than to fostering.’ Landis replied on January 25 1939 that ‘the quarrel that I have with some of the administrative process is that many of the administrator think of their duties purely in terms of police. A person of George Mathews [an original SEC commissioner] stamp was not only a sincere and courageous policeman, but he readily saw that to leave any permanent impress upon the industry something would have to be done to get into the inside of it as well as the outside. I only hope that the small efforts we participated in in this connection won’t go completely on the rocks.’)

\textsuperscript{60} For his critics, foremost among them his predecessor as Dean at Harvard, Roscoe Pound, the rise of the administrative state was something to be feared, Morton Horwitz, \textit{The Transformation of American Law 1870-1960} (1992), 219. The political disagreements were matched by personal rivalries, see Landis, above n24, 150-151 (noting ‘faculty politics is about as dirty politics as can evolve.’); see also JM Landis to Walter Gellhorn, 22 February 1946 (JML to Walter Gellhorn, Columbia Law School, 22 February 1946, Harvard University Archive, Deans Office UAV.512.20: 1940-47 Correspondence Box 11. (‘It is curious how much the New Deal has been tied in with the development of administrative law and how frequently men who damn it are really doing so because they hate to see effective instrumentalities evolve to achieve the policies of the New Deal. Pound’s attacks, for example, seem to me to have two prime sources: one of them is a Republicanism that saw no good in the rise of populism despite the scholarly mind that knew it was inevitable, and the second is an experience with the administration of prohibition. I often tell my class that they have to discount my views on administrative law because they have been formulated as a result of contact with fairly high level commissions, but for the same reason they must discount Pound’s ideas because they have been fashioned out of experiences with prohibition agents, than which I suppose it would be difficult to get a lower class of administrative officials.’).
the means for the preservation of the content of that doctrine. For Landis, therefore, the rise of the administrative state was an exercise in modernization, legitimated by 'the inadequacy of a simply tripartite form of government to deal with modern problems.' Legitimacy originated for Landis on how the initial granting of authority was framed. This must 'specify not only the subject matter of the regulation but also the end which the regulation seeks to attain.' Once delegated, regulatory rulemaking like law itself was merely 'an instrument, or a social institution, if you will for the advancement of the health of society as a whole.' According to the legal historian Jessica Wang the formulation 'reflected legal pragmatism's view of law as a process and ongoing experiment, rather than a set body of rules.' For Landis, however, it was a much more complete agenda. 'The expansion of regulatory activity is, of course, the most outstanding characteristic of the nature of twentieth century governmental development,' which is founded on the 'creation rather than the restriction of liberties,' he wrote in 1939. This framing was a critical response to a concerted campaign led by the American Bar Association to defenestrate the commissions. This campaign ended only with the passage of the Administrative Procedure Act (1946), which opened regulatory decision-making to extensive judicial review. By that stage, Landis, however, had already faced an existential moment in handling the deportation hearing for Harry R Bridges at Angel Island in San Francisco Bay, a hearing that tested and demonstrated his integrity and the strength of the paradigm of administrative law.

61 Landis, above n34, 46; for contemporary review, see Chester Rorhlch, 'Business Administration and the Law,' New York Times, 16 October 1938, 3, 29 (noting support for Landis' admonition that 'governmental administration should be determined by needs rather than numerology: at 29). Academic colleagues had noted that the book was in fact a manifesto, see Charles Clark, Dean of Yale Law School to JM Landis, 27 January 1938, Harvard University Archive, Deans Office UAV.512.20: 1940-47 Correspondence Box 9 (on the lectures that were to be published as The Administrative Process, 'they state positively, with force and reasoned argument, what to date has been so generally said only by way of defense from attacks. I think they well might prove a Bible for the Washington departments').

62 Landis, above n34, 1; see also Edward Glaeser and Andrei Shleifer, The Rise of the Regulatory State (2003) 41 Journal of Economic Literature 401 (noting 'the regulation of markets was a response to the dissatisfaction with litigation as a mechanism of social control of business: at 402).

63 Landis, above n34, 51.


65 Ibid, 265. The following two chairmen of the SEC, William O. Douglas and Jerome Frank both of whom were academic lawyers mirrored this approach, taking a much more aggressive view of enforcement. Wang underscores the extent to which Landis was constrained by initial legitimacy battles. Without clearing the space it is unlikely that Douglas could have adopted his more aggressive approach.


69 In the Matter of Harry R. Bridges: Findings and Conclusions of the Trial Examiner (Government Printing Office Washington, 28 December 1939. Released 30 December 1939), 133 ('The Bridges aims are energetically radical may be admitted but the proof fails to establish that the methods he seeks to employ to realize them are other than those that the framework of democratic and constitutional government permits.'). See also Charles Wyzinski to JM Landis, 10 December 1940, Harvard University Archive, Deans Office UAV.512.20: 1940-47 Correspondence Box 24 ('Quite apart from the political and social factors which made this case so important in the history of this country, this report is certain to become famous as an example of the administrative process as a whole. There is perhaps no task more difficult for a lawyer, or judge than to make an impartial statement of facts in a case where emotion runs high, perjury abounds and economic and social forces clash. But you have done it. And every citizen has reason to be grateful not merely for your labor, but more particularly for the sacrifice of your personal interests which the job involved.'); see also JM Landis to Julius Smith, 8 February 1940, Harvard University Archives, Deans
What becomes clear from this necessarily truncated review is that the battle over
the authority to intervene was fought and won as early as 1937. Moreover, ongoing
deviation to agency power has been recognized in cases that date back to the 1940s and
where definitively ruled upon in 1984 in the landmark *Chevron U.S.A. Inc. v. Natural
Resources Defense Council, Inc.* ruling. Judicial deference to agency interpretations was
based on pragmatism. Courts would give deference to agency interpretations depending
upon ‘the thoroughness evident in [the agency’s] consideration, the validity of its
reasoning, its consistency with earlier and later pronouncements, and all those factors
which give it power to persuade, if lacking power to control.’ Additionally, courts
looked to see if the agency, opinion had ‘warrant in the record and a reasonable basis in
law.’ Accordingly, while some deference was accorded to agencies, the amount of
deviation varied considerably, based on the facts surrounding the interpretation. *Chevron*
changed the basis for deference. It laid out a two-step process for determining the
validity of an agency’s statutory construction. First, if the intent of Congress in enacting
a statute is clear, then the court must ensure that the agency has given effect to the
unambiguously expressed intent of Congress. If, however, a statute is silent or
ambiguous with respect to the specific issue, then a court must apply a second step,
which is to ask whether the agency’s interpretation is based on a permissible construction
of the statute. In developing its two-step framework, the Court articulated three reasons
to justify its decision to defer to the agency: implicit delegation, agency expertise, and
political accountability. First, with respect to the ‘implicit delegation’ rationale, the
Court reasoned that with the power to administer a congressionally created program
comes the power to formulate policy and make ‘rules to fill any gap left, whether
implicitly or explicitly, by Congress.’ When Congress explicitly leaves a gap for an
agency to fill, the agency’s interpretation controls, so long as it is not arbitrary,
capricious, or manifestly contrary to the statute. And when delegation is implicit, ‘a
court may not substitute its own construction of a statutory provision for a reasonable
interpretation made by the administrator of an agency.’ This interpretation effectively
expanded the powers of legitimate agency rulemaking. Second, while the Court had
previously alluded to ‘agency expertise’ in the decisions of *Skidmore* and *Hearst,* in

Office UAV.512.20: 1940-47 Correspondence Box 21 (‘I do not think that our Administrative agencies are
best manned by men who do not believe in the content of the rights which it is their sworn duty to
maintain. I make no claim – and I think that is clear from my writings – that officials of the Labor board,
to take a specific example, should be partial to employees as against employers; I do claim that officials of
the Labor Board should be zealous in their sworn duty to maintain the right to collective bargaining against
unfair, labor practices. Yet it is the former you accuse me of, not the latter’).


125, 146 (1939)).

Colin S. Diver, ‘Statutory Interpretation in the Administrative State’ (1985) 133 University of Pennsylvania
Law Review 549 (‘The decision whether to grant deference depends on various attributes of the agency’s
legal authority and functions and of the administrative interpretation at issue: at 562).


*Ibid*, at 843-44.

*Ibid*, at 844.


*Ibid*, at 844.
Chevron it clarified that ‘[j]udges are not experts,’ at least not in these technical areas.84
Agency personnel are highly qualified to make technical determinations and are charged
with making these determinations.85 Regardless of whether Congress actually intended to
delate to the agency, it simply makes sense to defer to such expertise.86 Third, the
Court was of the view that the Executive, unlike the judicial branch of government, is
accountable to the public.87 It is therefore more appropriate for the political branch of
the government to resolve conflicting policies ‘in light of everyday realities.’88 In a pointed
reference, the Court held that ‘Federal judges, who have no constituency, have a duty to
respect legitimate policy choices made by those who do.’89 The reasoning and logic
mirrors the rationale first outlined by Landis in the maelstrom of the battle over the
constitutionality of the administrative process.

Deference, however, is only half of the story. The other half focuses on how that
dereference is deployed. This has a large impact on the extent to which the regulatory
agency enjoys bipartisan political or broader community support, which in part is
determined by the performance of the market, in part by the exercise of authority. Here
again revisiting the thought and practice of Landis on regulatory design pays dividends,
most notably his work as a hearing examiner in 1940, in which he faced an existential
choice between bowing to populism or demonstrating the efficacy of independence,
based on integrity and evidence.90 This process was essential in demonstrating the
efficacy of the administrative process, critical to securing its legitimacy and essential in
upholding the rule of law.91 All of this poses a critical question. What happened to the

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85 Ibid.
86 Ibid.
87 Ibid.
88 Ibid, 865-66.
89 Ibid, 866. The recent activism of the DC circuit against SEC rulemaking questions the stability of this
framework however, see Jill Fisch, ‘The Long Road Back: Business Roundtable and the Future of SEC
Rulemaking’ (2013) 36 Seattle University Law Review 695 (‘By substituting its own policy judgment for that of
Congress, the D.C. Circuit threatens not just the ability of administrative agencies to formulate regulatory
policy, but also the ability of Congress to direct agency policymaking. Explicit congressional
determinations regarding regulatory policy warrant greater judicial deference than the courts have given to
them’: at 698).
90 This was explicitly recognized by the two men who helped draft the original framework, Benjamin
Cohen and Thomas Corcoran, see, for example, Benjamin Cohen to JM Landis, 18 January 1940, Harvard
University Archive, Dean's Subject Files, 1932-1946 UAV.512.25 Benjamin Cohen [1937-1940] Box 2 ('As
I wrote you last summer, I thought it was a fine and courageous thing for you to take on, a job which was
bound to involve stepping on a number of toes. Nonethless you have done it with rare distinction and I
think it should give you great satisfaction to know you have performed a most difficult public service with
suburb tact, skill and ability'); see also Thomas Corcoran to JM Landis, 11 January 1940, Harvard
University Archives, Dean's Subject Files c. 1932-1946 UAV.512.25, 1937-1940, Box 2 ('I do want to tell
you belatedly, just to relieve the monotony of the brickbats I suppose you'll get for months that I think
your courage to speak the truth in the Bridges matter was worthy of you and the hopes of many of us in
you and the traditions of the greatest job in the United States which you now hold [as Dean of Harvard
Law School]. The more I see of these shifting sands and the endless irreconcilability of political ambition,
the more I know you were a million times wise in choosing to build where you were entirely your own
master').
91 There are contemporary and uncanny resonances in the exercise of discretion in the dispute between
Judge Jed Rakoff and the Securities and Exchange Commission over its preference for settlements over
litigation to a conclusion, see SEC v Bank of America 09 Civ. 6829 (SDNY, 14 September 2009) 8 (Judge Jed
Rakoff held 'the proposed settlement in relation to the claim that Bank of America had misled investors
over the payment of bonuses to executives within Merrill Lynch is described as 'a contrivance designed to
provide the SEC with the facade of enforcement and the management of the Bank with a quick resolution
New Deal paradigm? The shorthand answer is changed definitions of expertise along with a lack of meaningful acceptance by industry of the moral obligations associated with the disclosure paradigm, which has how reached a tipping point. This is not, however, new. Indeed, it was evident as early as 1960 and identified by Landis himself in what was to be his last public intervention in regulatory politics. In late 1960 Landis provided an extraordinary report to the president elect John F. Kennedy.\footnote{Landis, above n34, 4.} The report highlighted both the ambition and the intrinsic flaws associated with the delegation of discretion. The delegation he still maintained was necessary and rendered even more persuasive given the increased complexity of modern society, the incapacity of Congress to devote the time or the resources to deal with them and a conviction that ‘the issues involved were different from those that theretofore had been traditionally handled by courts and thus were not suited for judicial determination.’\footnote{Ibid.} The policy problem was that once ceded it had become impossible to limit or retract authority. Indeed ‘on the contrary, the tendency is to expand them as more and more complex problems arise. The legislative standards under which the delegations are made are similarly increasingly loosened so that not infrequently the guide in the determination of problems that faces the agencies in not much more than their conception of the public interest.’\footnote{Ibid, 4.}

Landis warned Kennedy that in sharp distinction to the optimism that accompanied the New Deal, the ‘fires that then fed a passion for public service have burned low.’\footnote{Ibid, 9.} This, he attributed to rising cynicism, unacceptable delays, increased costs and a deterioration in the quality of staffing. The ‘prevalence is threatening to thwart hope so bravely held some two decades ago by those who believed that the administrative agency, particularly the “independent” agency, held within it the seeds for the wise and efficient solution of the many new problems posed by a growingly complex society and a growingly benevolent government.’\footnote{Ibid, 6.} Urgent action was required because ‘the spark, the desire of public service, has failed of re-ignition.’\footnote{Ibid, 10.} Complaining of sinecures and the power of practitioners to gain privileged off-the-record access to senior commission staff, he foreshadowed many of the recurrent problems associated with the

regulatory capture literature. He also complained bitterly about the failure to address ‘foreseeable problems. Absent such planning the need for ad hoc solutions to the particular manifestations of the problem precede and, indeed may preclude any basic policy formulation.’ As Landis puts it, ‘where, however, the greatest gaps exist are in the planning for foreseeable problems. Absent such planning the need for ad hoc solutions to the particular manifestations of the problem precede and, indeed, may preclude any basic policy formulation.’

This ultimately is a question of political design, a fact Landis always recognized. By 1960, however, the unease about governmental power and authority that was to transmogrify into outright opposition in the Reagan era and beyond, was already apparent. The problem intensified because the definition of what constituted expertise and where the repository of knowledge lay moved geographically from Washington, D.C. to Wall Street itself, where it was legitimated by appeals to an earlier moral order. Crucially, however, this appeal was rooted in rhetoric rather than substance. The implications of this narrow framing are now playing out in the Libor scandal, which unlike the design and marketing of sophisticated financial products is based on a straightforward (and readily understandable) fraud and deceit. It is in this broader political context that Libor and its reform has such potential programmatic and paradigmatic power. This in turn has profound implications for the conceptual frameworks that underpin contemporary regulatory practice; practice that is informed by timidity rather than audacity, inaction, and the maintained faith in what Roosevelt would have termed false prophets. It is a response that would – justifiably – have horrified both the president and his chief regulatory architect, James M. Landis. Undoubtedly, any successful proposal to extend responsibility and accountability to those involved in product design rather than clarifying the enabling conditions governing marketing and sale would constitute a seismic shift in the structure of the financial services industry. Specifically, it would breach the self-referential logic of private law. The integration of more explicit interventionist normative objectives with enabling ones may also significantly change the ethical boundaries of global finance. Before evaluating the reform agenda, it is essential to explain just how debilitating and unsustainable the ethical deficit has become.

C. The Commodification and Corruption of Knowledge

The sense of frustration and indeed despair within the British government and regulatory agencies over the behavior of Barclays and other banks in submitting patently false returns to the London Inter-Bank Offered Rate (Libor) panel that sets global interest rate benchmarks was palpable from the outset. The avuncular Business Secretary, Vince Cable, spoke of the need to clean up what he termed the ‘cesspit of British banking’

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98 The concern about moral rectitude of regulatory authorities pre-dated the passage of the Exchange Act, see Seligman, above n31, 100 (quoting Ferdinand Pecora, who ran the hearings into Wall Street abuse, saying the legislation to create a specialist agency to monitor the securities market would ‘be a good or bad law depending upon the men who administer it.’).

99 Landis, above n34, 16.

100 Ibid, 16.

101 It is more than a little ironic that Landis was to fall foul of a foreseeable problem in the non-payment of his income tax. It meant his effective retirement from public life, see McCraw, above n31, 207.

102 See Seumas Miller, ‘Institutions, Integrity Systems and Market Actors’ in J. O’Brien (ed.), Private Equity, Corporate Governance and the Dynamics of Capital Market Regulation (2007) 339 (As Miller points out, ‘even the most staunch free marketeers have normative or ethical commitments: they are committed, in particular, to the ethical value of the social institution of private property, the moral force of contractual obligations, and the human right of individual freedom’ at 342.
following the admission by Barclays in June 2012 that it had manipulated the rate.\textsuperscript{103} The Governor of the Bank of England, Mervyn King, accused the bank of ‘deceitful manipulation.’ The scandal, he said, provides evidence that ‘something went very wrong with the UK banking industry and we need to put it right.’\textsuperscript{104} Perhaps the most telling reflection, however, came from Lord Adair Turner, the outgoing chairman of the Financial Services Authority, which itself was later disbanded as a consequence of prior failure to police the market. For Lord Turner the manipulation revealed a ‘degree of cynicism and greed which is really quite shocking...and that does suggest that there are some very wide cultural issues that need to be strongly addressed.’\textsuperscript{105} This dismay also informs the findings of the United Kingdom Treasury Select Committee, which is equally dismissive of regulatory capacity.

The Barclay’s disclosure and settlement derived from a joint transatlantic investigation into how the LIBOR rate is calculated. Barclays agreed to pay $200m to the CFTC, $160m to settle related charges brought by the Department of Justice and $93.2m to the Financial Services Authority. The cumulative fines reflected the fact that the manipulation did not simply predate the crisis but continued throughout it.\textsuperscript{106} In December 2012 UBS became the next bank to settle. This time the penalty increased to $1.5 billion ($700 million for the CFTC, $500m for the Department of Justice, $260m for the FSA and $63m in disgorgement of profits for the Swiss regulatory authority, which does not have the capacity to levy direct fines). In other words, US regulatory authorities secured just under 80 per cent of the total financial penalties. The Department of Justice also announced that criminal prosecutions would proceed against two traders. Furthermore a non-prosecution agreement with the parent company was announced in exchange for a $400m fine. UBS Securities Japan, the subsidiary of the Swiss firm at the heart of the scandal agreed to plead guilty to manipulating the Libor rate in exchange for a $100m fine. In February, RBS became the third bank to settle ($150m to the Department of Justice, $325m to the CFTC and $137m to the FSA). Media reports suggest that Deutsche Bank is next to seek a settlement with its home regulator, BaFin, which like its Swiss counterpart lacks power to impose financial penalties but can either revoke a licence or demand board changes if knowledge of wrongdoing can be directly


\textsuperscript{104} Ibid.

\textsuperscript{105} Patrick Jenkins, John Gapper and Brooke Masters, ‘The Gathering Storm,’ Financial Times, 29 June 2012<http://www.ft.com/intl/cms/s/0/26d8a33c-c1e0-11e1-8c7c-00144feabde0.html#axzz2SAkFoWi5>.

\textsuperscript{106} Treasury Select Committee, Fixing Libor: Some Preliminary Findings, (HM Parliament, London, 22 August 2012); see also Financial Services Authority, Internal Audit Report: A Review of the Extent of Awareness Within the FSA of Inappropriate Libor Submissions (FSA, London March 2013), <http://www.fsa.gov.uk/static/pubs/other/ia-libor.pdf> (‘The FSA’s focus on dealing with the implications of the financial crisis for the capital and liquidity positions of individual firms, together with the fact that contributing to or administering LIBOR were not ‘regulated activities’, led to the FSA being too narrowly focused in its handling of LIBOR-related information. This was both in terms of challenging and inquiring about that information, and considering its conduct responsibilities in relation to the Principles for Businesses and any potential for consumer or market detriment’ at 9). This criticism of the FSA’s emphasis on technical compliance is even more pronounced in the findings of the Parliamentary Commission on Banking Standards as evidenced in its coruscating report of the FSA’s failure to regulate HBOS, see HBOX: An Accident Waiting to Happen, above n24 (noting ‘The FSA’s approach also encouraged the Board of HBOS to believe that they could treat the regulator as a source of interference to be pushed back, rather than an independent source of guidance and, latterly, a necessary constraint upon the company’s mistaken courses of action’: 28).

attributed. In addition, largely beneath the radar, lies an anti-trust investigation by the European Commission, which has the power to impose material fines of up to ten per cent of global turnover in cartel cases, a formulation explicitly used by the Competition Commissioner. The possibility of insurance restrictions and materiality associated with any cartel settlement has made a global settlement a priority.

In each individual case to date, the disjunction between stated and lived values is linked to the failure of internal compliance or disclosure to counteract it. The hoary

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108 In investigation by BaFin led by its Head of banking supervision, Raymond Roeseler, has found no ‘evidence of systematic crime involving management board members,’ see Madeleine Nissen and Ulrike Dauer, ‘BaFin: Bank Boards Knew Nothing of Rate-Rigging,’ Wall Street Journal, 26 April 2013 <http://blogs.wsj.com/moneybeat/2013/04/26/german-watchdog-says-bank-boards-knew-nothing-of-rate-rigging/?KEYWORDS=Raimund+Roeseler+Deutsche+Libor>; This leaves unresolved the question of whether the lack of knowledge can be attributed to willful blindness.

109 Alex Barker, ‘Brusselld Turns Up the Pressure Over Libor,’ Financial Times, 21 February 2013 <http://www.ft.com/intl/cms/s/0/8c9b61a4-7e47-11e2-91d2-00144feabde0.html#axzz2SAkFoWi5>; see also Joaquín Almunia, ‘Competition Enforcement in the Knowledge Economy’ (Speech delivered at Fordham Law School, 20 September 2012) in which the Vice President of the European Commission responsible for Competition Policy noted: ‘It is simply unacceptable that leading figures in the business behave as if it were above the law and immune from social responsibility. We need to foster a new ethics in the business using the most appropriate means’: at 2). In a speech in Paris on 22 February 2013 Almunia went further arguing that the EU would address the issue as a cartel violation of anti-trust law ‘the revelation of the Libor manipulation scandal has highlighted some of the most irresponsible behaviour ever seen in the financial industry. The time has come to push for a real cultural change in the sector,’ see Joaquín Almunia, ‘La Concurrence au Service de L’Achèvement du Marché Unique’ (Speech delivered at 4 Conférence Internationale Concurrences, 22 February 2013). Almunia has announced that the EU expects the first case to be brought by the end of 2013, see Address, American Bar Association Anti-Trust Section, New York City, 12 April 2013. Notwithstanding the fact that RBS admitted violation of anti-trust law in the United States, a class action has been dismissed in New York leaving it very much a question of public enforcement, see In Re Libor-Based Financial Instruments Anti-Trust Litigation 11 MD 2262 (SDNY 29 March 2013), 160 (While public enforcement is often supplemented by suits brought by private parties acting as “private attorneys general,” those private actions which seek damages and attorney’s fees must be examined closely to ensure that the plaintiffs who are suing are the ones properly entitled to recover and that the suit is, in fact, serving the public purposes of the laws being invoked”). The unanswered question is whether given the absence of multi-billion dollar class action settlements, public enforcement will impose sufficient additional non-financial penalties in settlement negotiations to ensure practice changes. As Judge Buchwald has made clear, at least in the Southern District of New York, they are the only ones with the authority and legitimacy to do so. In large part this was because of an earlier statement by Judge Buchwald that ‘your job as plaintiffs’ counsel looking for whopping attorneys’ fees is not to piggyback on the government. I don’t understand, as someone who has some familiarity with the plaintiffs’ bar, why you guys weren’t all over this earlier. You are not entitled to massive attorneys’ fees if all you do is wait for the government to act, jump on their back and say we want massive damages [for our clients] and we want one-third of them,’ quoted in Richard Vanderford, ‘Libor Plaintiffs Blasted by Judge for Piggybacking on DoJ,” Law 360, 3 March 2013 <http://www.law360.com/articles/421024/libor-plaintiffs-blasted-by-judge-for-piggybacking-on-doj>; For background in the judgment, see Justin O’Brien, ‘A Delayed Reckoning,’ Centre for Law Markets and Regulation Online Portal, UNSW Law, 1 April 2013 <http://clmr.unsw.edu.au/article/compliance/internal-risk-management/delayed-reckoning-us-federal-district-court-and-libor>; On 29 April 2013 a large component of the case was refiled in California, see Charles Schwab Corp, et al v Bank of America et al CGC-13-531016 (Superior Court, County of San Francisco), <http://articles.law360.com/s3.amazonaws.com/0437000/437357/schwab.pdf>. Separately, the City of Houston has approved a contingency fee payment to class action lawyers to seek to recover money allegedly lost as a consequence of Libor mispricing, see Jeremy Heallen, ‘Houston City Council Votes to Sue Over Libor Manipulation,’ Law360 (Lexis-Nexis), 3 April 2013 <http://www.law360.com/articles/429887/houston-city-council-votes-to-sue-over-libor-manipulation>; For evidence of concern about renewal strategies on professional indemnity and director and officer strategies linked to payment of litigation expenses, see Alistair Grey, ‘Protection Becomes a Scarcer Resource,’ Financial Times, 29 April 2013, <http://www.ft.com/intl/cms/s/0/515735ca-8a66-11e2-9da4-00144feabde0.html#axzz2SAkFoWi5>, quoting Charles Beresford-Davies head of UK Risk Management at Marsh saying that ‘insurers have been looking at the landscape fairly pessimistically. Every time everyone thinks its done, something else comes out [of] the woodwork."
bifurcation of whether prescriptive ‘rules’ or more granular articulation of ‘principles’ are more effective in guiding market behavior is redundant. Each had failed to address what is now widely acknowledged to be a systemic ethical deficit.\footnote{Hector Sants, ‘Delivering Intensive Supervision and Credible Deterrence’ (Speech delivered at the Reuters Newsmaker Event, London, 12 March, 2009), 2 (‘The limitation of a pure principles-based regime have to be recognized. I continue to believe the majority of market participants are decent people; however a principles-based approach does not work with people who have no principles.’).} The moral deficit underscores how ineffective the normative capacity of compliance is in embedding cultural change if perceived to be little more than a necessary minimum legal and mechanistic response to (unwarranted) external restraints.\footnote{This also informs the thinking of an otherwise anodyne independent review of Barclays, see The Salz Review: An Independent Review of Barclays Business Practices (Barclays Group, London: April 2013), 11 (‘There are increasing demands from regulators, politicians and the wider public that banks of the standing of Barclays comply with the spirit and not just the letter of the law.’ The review recommends that ‘the Board and senior leadership, as custodians of Barclays’ reputation, should promote and safeguard the trust in which it is held. They should state clearly Barclays’ purpose and report regularly on how it is fulfilling that purpose’: at 12. It does not define what that purpose is or should be beyond platitudes about the need to uphold ‘the highest standards of customer care’: at 58).} The extraordinary testimony provided by senior bankers at RBS to the British Parliamentary Commission on Banking Standards in February 2013 offers a compelling rationale to externally validate protestations of commitment to cultural reform. Following a standard script, the banking executives were, in turn, shocked at the crookedness involved in the manipulation of Libor; dismayed at the lack of moral restraint; and keen to differentiate between ethical bankers and amoral traders.

The class system that has always informed City mores was, therefore, at the fore. As the elite blamed the collusion that undermined Libor on the traders, altogether it appeared a different breed governed (if at all) by elastic conceptions of probity, a familiar refrain was evident. If the bankers, ostensibly in control, were guilty of anything it was, according to the then serving head of investment banking, John Hourican, ‘excessive trust.’\footnote{Helia Ebrahimi and Harry Wilson, ‘RBS Executive John Hourican Tells Colleagues ‘Not to Waste My Death’’, The Daily Telegraph, 11 February 2013, http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9863797/RBS-executive-John-Hourican-tells-colleagues-not-to-waste-my-death.html}. So what, if anything have the bankers remembered? It would appear not a lot, other than self-pity and special pleading. ‘I have told people who are prepared to listen that they shouldn’t waste my death,’ Mr. Hourican told the Commission. He had resigned to take ‘ultimate responsibility’ for something that he should not be necessarily blamed for. The issue was not a core concern given the fact that ‘we [presumably meaning the board and senior executives] had to deal with an existential threat to the bank.’ Instead of dealing with misaligned incentives, the bank had (it was inferred himself included) exhibited ‘blind faith’ in the actions of traders. It was message repeated by the bank’s chief executive, Stephen Hester, who will keep his job if not his bonus. The scale of the abuse, was Mr. Hestor intoned, ‘too readily redolent of a selfish and self-serving culture in banking which I think needs to be addressed and is exactly the reason for this commission’s existence.’\footnote{Ibid.}

Nodding to the authority of the Commission is not, however, the same as abiding by its recommendations. The scale of the crisis was such that, according to the bank’s chairman, Sir Philip Hampton, no useful purpose could to be served by ‘a mass series of assassinations.’ The forced departure of Mr. Hourican would suffice. But this left many uncomfortable questions, most forcibly articulated by the designate-Archbishop of Canterbury, Justin Welby, himself a former corporate executive. How many whistle-blowers had come forward in advance of regulatory inquiries asked the
Archbishop, to which Mr Hourican and his colleagues could provide only one answer. None. The Archbishop was incredulous. “Why? Was there not one person anywhere who thought this is not the right way to behave? So how do you, in the future, set a culture?”

The manner in which the bank staff reacted to this line of questioning speaks volumes about the malaise facing international banking. Mr. Hourican cautioned that he wanted to have a culture to be one of calling people to attention rather than using a whistle-blowing channel. Having lots of whistleblowing in a company is almost as bad,” he declared, without explaining what he meant by either statement. Attempts to elucidate meaning became harder to ascertain as he sought to justify the unjustifiable: ‘We want a culture where people hold each other to a high level of moral account,’ he argued, trumpeting the fact that 1,000 graduates had been appointed, without explaining how these junior level appointments could either ‘stand up and feel the anger that exists around the issue, the industry and our company,’ exert control or be protected from contamination of a pervasive culture that the executive admitted they were shocked by. Ignorance is, however, a shocking abdication of reasonability.

Hourican’s colleague, Johnny Cameron, was asked directly how to test for the moral culture of a trading floor. His answer, as reported by The Telegraph, was instructive: ‘that’s straying into philosophical territory. I do think that traders have a particular approach to life and need much tighter controls.’

By inference, bankers were, and remain, a different breed, which could be trusted by the establishment, including the Church of England, formally represented in the Commission by the Archbishop Welby who was less than impressed by the bankers reprise of the Pardoner’s refrain in the Chaucer’s classic Canterbury Tales: Radix Malorum Est Cupidas (‘Greed is at the Root of All Evil’). The crisis and its aftermath demonstrate that much more holistic approaches to risk management are required that link private rights to public duties. It is this more holistic approach that informed the early (and now partially lost) agenda of both the Federal Trade Commission and the Securities and Exchange Commission under James M. Landis.

What also becomes clear from the recently released archive is that across a whole swathe of industries, there was early recognition at the Federal Trade Commission and the Securities and Exchange Commission that far from weakening power, the acquiescence of industry to the creation of codes of conduct codes provided an opportunity to retain it. Reclaiming this history becomes essential given the apparent interest of the British Banking Association and Martin Wheatley at the Financial Conduct Authority to the development of a code of conduct, administered by either regulatory agencies or a body regulated by industry, and the fact that as from 4 April 2013 Libor

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113 Ibid.
114 Anthony Brown, Chief Executive Officer of the British Banking Association, ‘Opening Address’ (Speech delivered at International Banking Conference, 17 October 2012) 4 (advocating establishment of a ‘Banking Standards Board – a body independent of the industry, with responsibility for monitoring and upholding professional and ethical standards, and sharp enough teeth to give it bite. It is early days, but it is an idea that many in the industry are keen to pursue. However, the proof will be in the pudding. There would be no point in setting up a banking standards board if it was a whitewash – in fact, it would be totally counterproductive.’). In January 2013, the BBA submitted an options paper to the Parliamentary Banking Standards Commission canvassing support for a code of conduct administered by either the Financial Conduct Authority, its prudential counterpart or administered through what it termed the Banking Standards Review Council, see British Banking Association, ‘Raising Banking Standards’ (British Banking Association: London, 15 January 2013), <http://www.bba.org.uk/media/article/bba-publishes-options-paper-on-banking-standards-press-releases>. This code of conduct was explicitly canvassed in the Wheatley Review, see above n9, 30 (‘the Review recommends that the LIBOR administrator, through the oversight committee, should draft a code of conduct, in collaboration with contributors and market participants, which should serve as a manual for the internal governance and organisation of LIBOR
itself became a regulated activity.\textsuperscript{117}

\section*{D Regulating Culture}

The redesign of Libor takes place, however, in a conceptual vacuum. It is mired by a preference for tick-the-box compliance over ethical substance. Along with the Wheatley Review,\textsuperscript{118} the most articulated conception of responsibility lie with the release of the non-binding IOSCO principles in April 2013 related to governance, quality of data and methodology and accountability.\textsuperscript{119} Each seeks to place primary responsibility on an administering organization, with any outsourcing subject to oversight by the administrator, with the framework tailored to the disclosure of any material conflicts of interest to [non-defined] Stakeholders and any relevant Regulatory Authority along with publication of control mechanisms, such as whistleblowing.\textsuperscript{120}

The IOSCO principles, in line with Wheatley, further call for use of only ‘prices, rates, indices or values that have been formed by the competitive forces of supply and demand and be anchored by observable transactions entered into at arm’s length between buyers and sellers in the market for the Interest the Benchmark measures. This principle recognizes that bona-fide observable transactions in markets provide a level of confidence for the prices or values used as the basis of the Benchmark are credible.’\textsuperscript{121} This does not appear to take into account the fact that these too can be manipulated (as uncovered by the CFTC investigation of UBS traders’ attempts to manipulate the Australian Bank Bench Rate, heralded as a potential alternative until the Australian Financial Markets Association scrapped the process in March 2013).\textsuperscript{122} Moreover IOSCO calls for the development of a code of conduct for those involved in submitting rates but does not define what is required in this process.\textsuperscript{123} The lack of specificity is troubling given the evidence provided by the head of UBS at evidence to the Parliamentary Commission on Banking Standards in January:

Regulators monitor, and control frameworks monitor and try to catch issues, \textit{but the difference is made by the people who are on the front line} [emphasis added]. They need to change their standards and abide by certain rules, not because they are imposed on them but because they believe in them.\textsuperscript{124}

The question of warranted trust in belief is, therefore, critical and the failure to address it a fundamental flaw. While the Wheatley Review mandates that the ‘contributing banks
and the rate administrator will together establish a code of conduct outlining requirements and responsibilities of individual firms; nowhere does it articulate what is meant by responsibility. Once again, however, we find painful lessons from history in what happens when codes of conduct are presented as assurance of cultural change either by an industry seeking to protect its position or a regulator seeking to enhance its authority.

In 1933, the notoriously erratic General Hugh Johnson, the head of the National Recovery Administration (NRA) in the United States, a new agency mandated to establish codes of conduct, ignored the possibility that they can be exceptionally problematic if not designed effectively. For Johnson, the NRA, unrestrained from past restrictions on coordinated responses, marked an innovative ‘sociological experiment.’ As he told a meeting of the National Retail Dry Goods Association in New York in January 1934, the NRA was not only more nimble but it could become a vital partner, something he deemed the Federal Trade Commission (FTC) incapable of. The speech was a rearguard action against the FTC, which had increasingly come to see as the NRA itself as a failed experiment. Critically, the suspicion within the FTC coincided with the promulgation of the Code of Fair Competition for Investment Bankers, which was endorsed on 27 November 1933. The code had ensured that power to determine the extent of compliance would remain with the banks themselves. It mandated that the management committee administering the code would contain 21 voting members, 15 appointed by the president of the Investment Banking Association of America, 6 through a ‘fair method to represent employers not members of the IBA and a representative appointed without vote by the President of the United States of America.’ The effect was to lock the administration into a framework completely controlled by industry.

Landis, by then heavily embroiled in disputes over the operation of the Securities Act, was horrified by the way in which industry was behaving. ‘How truly despicable some of their tactics are. I really thought they were essentially decent though somewhat misguided people, but I have my doubts now,’ he wrote Frankfurter on 13 December 1933. Those doubts were in part informed by unease about the willingness of industry to engage in meaningful partnership. This unease was captured by an internal report prepared for Landis and the other members of the FTC on the workings of the NRA. Assigned to be the chief legal liaison to the General Johnson’s NRA, Millard Hudson was flabbergasted by what he termed the ‘chaotic conditions’ at the agency. ‘There is hardly an important form of monopolistic practices which the Federal Trade Commission and the courts have endeavored to prevent in the past, that is not authorized and more or less explicitly provided for in these codes; not of course by individuals, but what is a great deal worse, by the cooperative activities of whole industries. It would be an exaggeration to say that any remonstrances against these things have resulted in any substantial improvement,’ he reported on 6 December 1933.

Two weeks later Hudson provided a more in-depth account of regulatory failure. ‘The industries, having got the bit in their teeth, are running amok, and are bent upon

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125 Hugh Johnson, Speech delivered at the National Retail Dry Goods Association, New York City, 24 January 1934 (‘There was – and there is about as much cooperation between the Federal Trade Commission and the Industry as there is between a lion tamer with a black-snake whip a revolver and a strong-backed chair, standing in a cage with six great jungle cats snapping and snarling on six star-spangled hassocks – that is their version of economic planning and industrial self-government,’ he proclaimed.).

126 Investment Banking Association of America, Code of Fair Competition for Investment Bankers (1933).


128 Memorandum for the Commission: Work at the NRA, Millard E Hudson, December 6, 1933, Papers of JM Landis. Harvard Law School, Box 18-8
destroying the good work accomplished by the Commission in the past and to prevent
its doing any more in the future,’ he reported on 22 December. 129 Four principal
reasons were attributed. No representative of the Commission had power to draw up and
enforce a model code. Second, legal representatives were ‘practically all young
inexperienced men, many of whom knew nothing whatever about the Commission’s
work. It was easy for the industries to put things over on them.’ 130 Third, ‘having given
the industries in the early codes practically everything they asked for, it was difficult to
refuse those which came later. But the most alarming development is the unwillingness
of the Administrator to set up any effective form of control over the administration of
the codes. He is leaving it, by his own statement, as far as possible to the boards set up
within the industries themselves. This means that matters in which they are interested
will receive attention and probably little else will.’ 131

The internal report was forwarded to Roosevelt, who in turn turned over
responsibility for evaluation of code operation to the FTC, effectively limiting the power
of the NRA long before the Supreme Court deemed it unconstitutional the following
year. The release of the new material suggests that the administration had come to the
conclusion that the partnership approach was a failure long before then, although for
very different reasons. 132 For Landis and the other designers of the disclosure paradigm,
its power, first set out in the Securities Act (1933) and reinforced by the Securities Exchange
Act the following year, lay primarily in the capacity to set, evolve and frame broader
discourse. The aim was not to mandate organizational change as some early
commentators, including William O. Douglas advocated. 133 Instead, disclosure was a

129 Hudson, above n126.
130 Ibid.
131 Ibid. The importance of Hudson’s insights cannot be overstated given the quixotic hope expressed in
the Wheatley Review that ongoing calibration can be expected, see Wheatley Review, above n 9, 31 (‘The
benefit of industry guidance is that the rate administrator can develop the code of conduct over time; as
both LIBOR and the market that it is intended to assess evolve, the requirements of its users will also
change’).
132 The loss of authority angered Johnson who embarked on an increasingly histrionic and futile campaign
to change the president’s mind. In his New York address he argued, ‘it is stated that I suppressed a report
of the Federal Trade Commission to the president on the operation of the NRA. I asked the Federal Trade
Commission to send a man over here to see if we were doing properly what we had to do. He came but he
never said a word to me. I now understand that he did report to the Commission in a paper marked
confidential – one of those X21 confidential spy reports which no one had the courtesy to discover to me.
There is suppression for you. I now learn that someone has sent it to the president. But I never heard of
that report until last night when a self-invited counter espionage agent told me about its subject matter.
There was nothing in it but a charge that we have made mistakes. Nobody is louder in that assertion than I.
Apparently the president – gentleman that he is – ignored it.’ See Johnson, above n125.
171. Douglas viewed the disclosure paradigm as insufficient. What was required, he argued, was a much
more substantive re-ordering of relations between market participants. This essentially corporatist
approach, advocated mainly by the Columbia-based members of the original Roosevelt ‘brains trust’ was
always regarded as suspect by Landis and his colleagues at Harvard, most notably Felix Frankfurter. The
personal nature of these disputes becomes clear with the release in January 2013 by Harvard Law School of
additional personal papers of James M. Landis, the driving force behind the creation and management of
the Securities and Exchange Commission. The papers include correspondence between Landis and
Frankfurter, arguably the most influential academic advisor to the Roosevelt administration. The
correspondence reflects a growing frustration by both men towards industry opposition to and academic
misunderstanding of the paradigm shift associated with the passage of the Securities Act and its corollary,
the Securities Exchange Act (1934). Most notably, this derision is directed towards Douglas himself, who,
it is clear, neither man entirely trusted from the very beginning. On 6 March 1934 Landis noted to
Frankfurter that ‘Douglas seems to me to lack a tremendous sense of the realities that are involved in this
problem and how the relentless drive for profits leads men to do things and then defend them.’ On 17
March 1934, Frankfurter replied that ‘Douglas is trying to reflect too much the people in the big offices
and the business schools, among whom he likes to appear as a sound and knowing fellow.’ Frankfurter
means to an end; a necessary response to societal obligation. It was a message repeated pressed by senior officials first at the Federal Trade Commission and then the Securities and Exchange Commission. Speaking in 1933, for example, Baldwin Bane, the chief of the securities division of the FTC, which had primary initial reasonability for administering the Securities Act, argued that the only legislation ‘that is founded upon a moral background that has been passed in the past twenty years, is the Securities Act. Its aim was to restore to a numbed national conscience some semblance of sensitivity. It was of a spirit such as this that the Securities Act was born, free of vindictiveness that might easily have been attached to it, reasonable in its demands and build upon tried experience in their formulation. It would be idle to pretend that it does not ask something of the security world, but it also promises much in return-the opportunity of creating a true and honorable profession by the assumption and adequate discharge of public responsibilities.

When responsibility was transferred to the SEC the following year its first chairman, Joseph Kennedy gave a reinforcing address in Boston:

We are seeking to recreate, rebuild, restore confidence. Confidence is an outgrowth of character. We believe that character exists strongly in the financial world, so we do not have to compel virtue; we seek to prevent vice. Our whole formula is to bar wrongdoers from operating under the aegis of those who feel a sense of ethical responsibility. We are eager to see finance as self-contained as it deserves to be when ruled by Honor and Responsibility... When abuses occur, checks and corrections arise. But the application of these processes is not the death hand that some proclaim it to be. Instead, it is the assurance of Life and Strength when Honesty and Intelligence are present. We have been brought into being to help you as part of the public, which erects government for its service. But you best can help yourselves. You can make the investing of money honest. Then you will truly become brother's keeper. And to me that is to acquire merit.

In 1937 Landis told the New York Times, somewhat optimistically, that brokers ‘are beginning to realize more clearly that their interest is tied up with the public interest. They are beginning more often to subordinate their own interest to the larger interest. People are beginning also to look upon the exchanges not so much as private institutions as public utilities.’ This linkage between private and public purpose, therefore, lay at the heart of the experiment. For Landis, ‘the art of regulating an industry requires knowledge of the details of its operations [and the] ability to shift requirements as the condition of the industry may dictate.’ The real tragedy here is not the misplaced optimism of Landis but the misplaced trust in financial services sector statements that through their disclosures they had recognized their obligations.

Landis’ early faith in governance by experts had already eroded by the time of the election of John F. Kennedy in 1960. In part this derived from what he saw as the failure of the agencies to remain focused on narrow regulatory purpose, a process that intensified because of patronage appointments at the level of the commission and declining commitments to the public service as a career. This, in turn, suggests the need for the dynamic integration of rules, principles and social norms within an interlocking responsive framework. This explicit normative foundation has been lost in a debate over

goes on to comment that Douglas had privately opined to him that ‘his public articles against us are a form of high strategy. Well its too high for my eyes to scale.’

134 Bane, above, n25.
137 Quoted in Seligman, above n31, 62.
technicalities. Interestingly, it is a foundation that is not referenced in any of the official pronouncements on Libor. It does, however, underpin a separate British Government sponsored investigation into the operation of the capital markets. As John Kay has persuasively argued, sustainable reform must be predicated on capability to ‘restore relationships of trust and confidence in the investment chain, underpinned by the application of fiduciary standards of care by all those who manage or advise on the investments of others.’ The Kay formulation builds on an insight first advanced by the recently retired managing director of the Financial Services Authority, Hector Sants. He had famously complained that it was impossible for principles-based regulation to work when those charged with informal authority to maintain the integrity of the system had no principles. This was not simply a particularly memorable aside. It reflected belated cognizance of the importance of what Oliver Williamson has termed the ‘non-calculative social contract.’

Sustainable reform must also be consistent with principles of good regulation. It must be proportionate, consistent in application, transparent and targeted. It is also clear, however, that the construction of accountability mechanisms cannot rely on self-certification alone. It demands external validation. The recent history of financial regulation has demonstrated conclusively the dangers of past self-referential framing. Ironically, the framework to measure and evaluate culture was outlined in 2010 by the then chief executive of the Financial Services Authority, Hector Sants. The regulatory executive, who now runs compliance and government and regulatory relations at Barclays argued for triadic calculation: ‘Even if you believe the regulator should and could judge culture, how would the regulator facilitate or enforce the adoption of its judgments by firms?’ Starting from the premise that society has the right to expect ethical behavior and warranted commitment to stated values, he maintained that regulators cannot avoid judging culture, a term he judged less problematic and more amenable to measurement than ethics. ‘What should matter to the regulator are the outcomes that the culture delivers and that the firm can demonstrate it has a framework for assessing and maintaining it. The regulator must focus on the actions a firm takes and whether the board has a compelling story to tell about how it ensures it has the right culture that rings true and is consistent with what the firm does.’

This framing lies at the heart of the disclosure paradigm. It must inform the operation and validation of codes of conduct. As we have seen with the leadership of British banking in particular, being an Approved Person is in itself no guarantee of integrity. The tragedy for both the banking industry and its regulators is that neither internal nor external oversight of the kind outlined by Sants was pursued until it was too late. Equally the Kay report appears unread or at least undigested. Accountability and integrity, as Sants and Kay pointed out however, are, in essence, design issues linked to

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139 Hector Sants, ‘Delivering Intensive Supervision and Credible Deterrence’ (Speech delivered at the Reuters Newsmaker Event, London, 12 March 2009) 2 (‘The limitation of a pure principles-based regime have to be recognized. I continue to believe the majority of market participants are decent people; however a principles-based approach does not work with people who have no principles’).
140 Oliver Williamson, ‘The New Institutional Economics: Taking Stock, Looking Ahead’ (2000) 38 *Journal of Economic Literature* 595 at 597. Williamson notes that analysis of this ‘level one’ component of social theory is conspicuous by its absence with regulatory studies. The other three levels comprise institutional arrangements viewed primarily through property rights and positive political theory, governance mechanisms through transaction cost economics and resource allocation frameworks generally examined through agency theory.
141 Hector Sants, ‘Can Culture Be Regulated,’ (Speech delivered at the Mansion House, London, 4 October 2010).
142 Ibid.
143 See discussion of Sir James Crosby, above n24.
normative agendas. It is time to get to work. A necessary starting point would be virtual attendance at the imaginary inaugural lecture James M. Landis offered in 1931. It is time to go back to the seminar room.

**E Conclusion**

The initial success of the New Deal experiment can be traced to the combination of five ideational and political economy factors. First, the policy imperatives of the initial Roosevelt administration (1932-36) advanced the necessity and legitimacy of state intervention. Second, the policy imperatives were predicated on a rebalancing of private rights and public duties, a strategy that was subsequently overwhelmingly endorsed at the ballot box in 1936. Third, a progressive whittling away of the influential freedom of contract model generated legitimacy. Fourth, the nascent administrative agencies, in particular the Securities and Exchange Commission, placed a ‘cop on the beat’ doing much to restore public confidence. Fifth, the initial emphasis was not on direct enforcement but changing industry practice through an associational model of governance. The model clearly specified purpose. It sought to enroll market actors within a regulatory paradigm that replaced caveat emptor with a disclosure philosophy. At its core was a belief that sustainable reform could only be achieved at an industry-wide level in which there was an internalization of responsibility. The tragedy is that there remains very little acceptance of that obligation, notwithstanding the bailouts of the financial sector. The response of industry now as then is to engage in negotiations in bad faith. We are all paying the price for that miscalculation. This paper has taken seriously the admonition by James M Landis that we should explore the shadows of the past to illuminate the present and future. It is time for this to be a corporate, regulatory and political as well as an academic task.