Federal Regulation of Corporations 1/ Under the Commerce Clause

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The constitutional grant of power to Congress is to regulate commerce among the several States, not corporations engaged in such commerce. Corporations are the creatures of the States and the instruments through which commerce, both within and among the States, is transacted. Under the Constitution, the necessary regulation of the internal affairs of a corporation belongs primarily to the State of its incorporation. The business of a corporation, to the extent that it involves the buying or selling of goods in one State for delivery into another, constitutes interstate commerce. Where interstate commerce begins and where it leaves off has been defined with some precision, and its regulation is exclusively the function of the Federal Government. This distinction between the power to regulate a corporation and the power to regulate its interstate business is elementary and important; but were it as simple in its application as it is in its definition, Federal control of corporations would be legally impossible and there would be no need for this symposium.

Before the adoption of the Constitution there were only 31 business corporations within the United States, and of these only 2 were trading companies and 1 a manufacturing company. Commerce among the States was a vision, not an actuality. Today corporations predominate in influence if not in numbers in all gainful pursuits save merchandising and personal service. Of the estimated national income of 69 billions in 1923, perhaps 33 billions, or (say) between 40% and 50%, was acquired by or through corporations. Practically all of those corporations were engaged in interstate commerce in the sense that they either bought or sold goods in States other than those in which they were located; at least two-thirds were engaged in interstate selling. The wealth produced by their interstate operations may be estimated at around 21 billions.

1/ The subject before the Academy was, "Corporation Control by the Federal Government".

Commercial corporations - the kind with which we are now concerned - are created for a single purpose - that is, the transaction of business. Business is the very life of such a corporation; without business, it dies. The connection between a corporation and its business being so vital, it follows that the one may not be regulated wholly without regard to the other. Regulation of interstate commerce, that is, the business of a corporation, necessarily implies some measure of control over corporations engaged in such commerce. Obviously there can be no adequate regulation of interstate commerce that does not extend in some degree to the instruments of such commerce. In the case of the railroads, whose business is not only largely interstate but affects directly and materially the interstate business of others, the need for unified national control has been recognized and put in force. So far as the railroads are concerned, Federal control of corporations is an accomplished fact.

Every regulation of interstate commerce involves the occupation of a jurisdiction, or the exercise of a function, formerly belonging to the States. The courts, therefore, are extremely cautious about laying down general principles dealing with the powers of Congress under the commerce clause. Since the adoption of the Constitution great progress has been made in the direction of a unified national control of the nation's business. This advance, however, has been neither steady nor unopposed. It has been accelerated or retarded, depending upon the existing state of public opinion. The boundary line between the jurisdictional spheres of the State and Federal Governments is elastic, not rigid; ragged, not straight.

Much as we would like to regard the law as an exact science, we can only speculate as to how far the courts will indulge Congress in its efforts to control industrial corporations under the commerce clause. The power to control corporations through publicity - a method recommended by the Industrial Commission and attempted to be carried out through the Bureau of Corporations and the Federal Trade Commission - still remains in doubt. The Supreme Court after two years of deliberation finds itself unable to decide whether the Federal Trade Commission has the power to compel the furnishing of reports concerning costs and profits. Recent decisions relating to the Commission hold that before its inquisitorial powers may be exerted there must be a finding, or at least a specific charge, of a violation of some Federal law on the part of the corporations to be investigated. These decisions reject the view that the preventive or prophylactic effects of publicity may serve as a justification for the exercise of inquisitorial powers. There is a growing tendency on the part of the courts to brand all investigations as fishing expeditions unless it appear that the fish are already caught.

This is but a natural manifestation of the policy of our law, derived from the common law, and has for its purpose the protection of the individual against unnecessary governmental molestation. The theory is that Governmental interference in business comes as a penalty for an infraction of the law. It is punitive, not preventive; it has to do with locking the stable after the larceny is committed. While the courts strain over the power to obtain information from industrial corporations (except under procedures established for the protection of persons accused of crime), they

do not hesitate to exert the most drastic measures of control over such corporations once they have been adjudged guilty of some purely statutory offense. According to the prevailing view the Government may not intrude upon the privacy of a corporation to ascertain whether it is obeying the law, or whether additional laws are necessary for the protection of the public; but as soon as a violation of the law is established the corporation becomes subject to the full power of the nation and the privileges and immunities conferred on it by the State will avail it nothing. Thus corporations adjudged in violation of the Sherman Antitrust Law may suffer their charters to be cancelled; their mortgages to be rewritten; and their properties to be divided and sold.

The time is approaching when the country will be confronted with Federal control of corporations as an inescapable issue. The statutes now on the books, for the most part, have to do with the regulation of the business of corporations rather than with the control of the corporations themselves. Such statutes were more nearly adequate to the protection of the public in the days when the ownership of corporations was confined to a few powerful families or groups than they are today. The great corporations today are, with few exceptions, owned by thousands of stockholders big and little; and their securities are held in every State. The protection of the competitor of a corporation and the consumer of its products is still a matter of grave concern; the protection of the investor is becoming quite as important. The diffusion in the ownership of corporate securities more than any other recent development makes Federal control an issue - perhaps a necessity.

Public opinion will not long tolerate a condition under which a few States vie with one another in creating corporations with unlimited capital and powers, without requirement that they engage in business in the States of their incorporation, and without provisions looking to the disclosure of their operations or accounts, to transact business and market their securities in other States. An effort has been made to justify these loose incorporation laws on the ground that they encourage the development of industry within the States; but the effort fails in view of the omission of any provision that the corporations shall conduct their operations in whole or in part within the States of their incorporation. The inference is irresistable that the incorporation of companies is solicited by these States because of the license fees and other revenue derived from the business. The creation of corporations has lost its dignity as an exercise of the sovereign prerogative for the furtherance of commerce and in the interest of the people of the State. What was once regarded as the conferring of a great privilege, to be limited and circumscribed by all necessary provisions for the protection of the public, has become a bargain sale, and States are advertising and competing for the business.

But even though, as is widely believed, there is an urgent need for Federal control of corporations, extension of the powers of the Federal government to that subject will meet with stubborn opposition. The consistent opponents of centralized government will repeat their time-honored, but generally disregarded, argument that the further extension of Federal power will impair, possibly destroy, our dual form of government. States' rights, by no means a forgotten slogan, will be revived. The contention will be

made that the proposal will further centralize power in administrative bodies remote from popular control. Finally the still more appealing objection will be raised that the proposal necessarily involves an increase in the existing over-supply of bureaus and bureaucrats - a disadvantage which outweighs all possible benefits.

The proponents of Federal control, on the other hand, are fortified with arguments that have carried them to victory in many bitter contests. Does not the Constitution contemplate that the powers of the Federal government shall extend to every matter that concerns the whole people and in which the States are incompetent or unwilling to act? Can it be that between the powers of the State and Federal governments there exists an air pocket which leaves the citizens of a majority of the States without proper protection from the action or inaction of a few States? And is not Federal control made necessary by the practice of a small number of States in spawning corporations with unlimited powers to transact business and market their highly speculative securities in all of the States?

If reform could be had without the further extension of Federal power, all would rejoice. The adoption by the States of a uniform and enlightened policy in chartering and dealing with corporations would afford a remedy more in keeping with our dual system of government. Self-correction on the part of the corporations also would constitute, if not a complete solution, at least a great step forward. But one must indeed be an optimist to expect action from those quarters. The self-interest that leads to the adoption of the methods complained of, would preclude their voluntary relinquishment. Possibly national prohibition could have been avoided by the observance of a certain degree of self-restraint by those engaged in the liquor traffic. But self-interest is a barrier to self-reformation, and we may not hope for any useful results from State legislation or corporate action.

Coming to a consideration of the courses open to the Federal government, the first choice is between the exertion of a direct and immediate control over the corporation itself, and the exertion of an indirect control by means of publicity. In the present state of the decisions we can hardly expect that measures of the first class will be sustained unless Congress boldly announces that it intends to occupy the entire field of regulation so far as it relates to interstate commerce, with all its incidents. Nothing short of a Federal incorporation law for all concerns engaged in interstate commerce could achieve that result. If the exertion of such measure of control is the aim of the present agitation for Federal control of corporations, then let us hope for a revival of the discussions of the last quarter of a century concerning Federal incorporation.

While Federal incorporation would vest in the National government full and direct control over corporations engaged in interstate commerce, it would have the added virtue of protecting the corporations against restrictive and discriminatory legislation by the States. The most impressive arguments that have been made in favor of a Federal incorporation law, have been made from the standpoint of the corporation. Theoretically a corporation chartered in the State is a foreigner in the 47 other States and enters those States and remains in them for the transaction of business wholly by

sufferance, and (within limitations) subject to the conditions and limitations that those States, acting individually and from the standpoint of their selfish interests, see fit to impose. While in practice the attitude of the States towards the corporations of other States has been modified by considerations of comity and tolerance, it is nevertheless true that in so far as interstate commerce is concerned one State authorizes business concerns which every other State has the right to restrict or even to destroy.

As already pointed out, the Federal government may utterly dismember a corporation that has been adjudged in violation of the Sherman Antitrust Law. But why should the Federal government withhold its hand until a combination has been formed under State law? Would it not be better for the Federal government to say in the beginning what shall be the nature of the organization that may be permitted to engage in interstate commerce? Federal incorporation would vest in the government a degree of control over corporations that would amply protect the public interest without the necessity for long and expensive litigation; and would enable the business of the nation to be conducted with a degree of certainty and stability that would more than compensate for the disadvantages inherent in the extension of Federal authority.

Indirect control of corporations by publicity of their accounts and affairs, as well as many of the objects that could be attained by Federal incorporation, may be accomplished by a system of Federal licenses. Measures for Federal license and for Federal incorporation have gone hand in hand into and sometimes through the Committees of Congress, and their respective merits and demerits have been many times discussed. Federal licenses for corporations engaged in interstate commerce have been favored by many on the ground that the enactment of such a measure would avoid many of the serious questions relating to State taxation and State police power that would be inherent in any provision for Federal incorporation. As a means of insuring publicity of corporate affairs a Federal license law would be entirely effective.

Such a law would provide that no corporation should engage in interstate commerce without first obtaining a license from the Federal government. Such licenses would be issued by an appropriate government agency, preferably the Federal Trade Commission, and would be conditioned upon compliances by the corporation with the conditions enumerated therein. Looking now to the indirect control of corporations by publicity, a condition of the license would be that the corporations should file with the issuing body annual reports of their operations, including balance sheets and income statements. The corporations would be classified, and for those corporations in which the public interest required it, particularly for the benefit of investors, the reports, or appropriate parts thereof, would be made a public record and also currently published. For the more important corporations, at least, including representative concerns in the chief branches of industry, quarterly income statements would also be required sufficient to show the volume of business and net operating income for the purpose of disclosing the trend of business during the year. For all corporations reporting the information would be compiled and published promptly in unidentified form for the purpose of guiding business development and promoting business stability.

The problem is primarily for Congress and must be faced squarely, if at all. The fundamental question is: Will the public interest be better served by the preservation of the historic division of powers between the State and Federal governments, or by a unified national control of business? The proposal to extend the power of the Federal government to corporations chartered by the States should not be undertaken without full appreciation that it involves a departure from long cherished constitutional concepts. The measures to be adopted must be plain and should clearly express their true scope and meaning. Decisions adverse to governmental authority have sometimes resulted from the fact that it was being attempted to give an effect to statutes not in the contemplation of Congress at the time of their enactment. Legislatures are too fond of enacting ill-drawn statutes and holding administrative officers and the courts to strict accountability for their enforcement. The exertion of Federal power over State corporations is too important an issue to be submitted to judicial determination upon a forced construction or even a literal application of a statute not specially designed to that end. Not only should the measures express their true scope and meaning but they should be based on Congressional findings of specific evils to be remedied.

Once the problem has been fairly met and clear measures based on adequate findings have been adopted, I believe that the power of Congress to enact such measures will be upheld by the courts. Courts in giving effect to acts of Congress are fortified by a realization, derived from the language of the statute and the proceedings attending its passage, that they are executing the will of the people. In the decision sustaining the Grain Futures Act (Board of Trade v. Olsen, 262 U.S. 1) we have an example of the importance that the Supreme Court attaches to Congressional findings as to the need for particular legislation in upholding the power of Congress to enact such measures under the Constitution. Administrative officers seeking to act under statutes of doubtful application are often turned back, not because the courts believe the Federal government impotent to empower the officers to perform such acts, but because the officers do not exhibit clear credentials from the legislative branch, the source of their authority.

And so I repeat, once Congress has decided to exert its full powers in this direction, the Constitution will be found to be a facility and not an obstacle in the harmonious adjustment of the powers of the State and Federal governments to the end that proper and necessary regulations may be provided for the protection, the prosperity and the convenience of the nation.

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