

A Consideration of Federal Incorporation

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A CONSIDERATION OF FEDERAL INCORPORATION.

The growth of corporations has proceeded without the participation of the government in any special capacity. One of the great reasons for this is the fact that there has been a dual concept of power—state and federal. Recently, however, there has been a reversion to the argument for federal incorporation of corporations. Proponents of this type of incorporation urge it as a device for procuring certainty and of restoring to Congress the control it should have over interstate commerce.

It is not the purpose of this note to consider federal ownership of corporations, but rather the incorporation by Congress of privately owned corporations to carry on the function of interstate commerce. This is not a new idea. The Bank of the United States was incorporated by Congress in 1791, and in 1816 the Second Bank of the United States was incorporated by act of Congress. In both these banks the United States owned only a minority interest.

Much has been written of the era of trust-busting in American history. Out of this era came anti-trust laws and commissions created by Congress for the purpose of regulating general business corporations. There was no general monetary interest of the government in these corporations; regulation was based on preservation of the proper functioning of interstate commerce. Federal incorporation received considerable discussion during this period. In a special message to the Congress President Taft urged passage of the federal incorporation bill which Attorney-General Wickersham had prepared at his direction.¹ Under the provisions of this bill federal incorporation would be optional, not compulsory. However, the bill was not passed and after the creation of the Federal Trade Commission in 1914 the general discussion of this subject lapsed.

With the advent of the New Deal and its avowed purposes to control and limit the conduct of large corporations as manifested by the Securities Act of 1933 and the Securities and Exchange Act of 1934² and others, the question of the use of federal incorporation as a complement to such legislation, as a means of preventing corporate abuse, received consideration.

Would federal incorporation be too unwieldy? Would it be impractical? Much of this discussion is caused by the fact that many government-owned corporations have been incorporated under state laws. For instance, in the sweep toward government-owned corpo-

¹ Special message of President Taft to Congress, January 7, 1910. The bill was introduced on February 7, 1910, in the Senate (S. 6816) and in the House of Representatives (H. R. 20142).

² 48 STAT. 74, 15 U. S. C. A. §§ 77a, 77aa (1935); 48 STAT. 881, 885, U. S. C. A. § 78(F) (1935); PRASHKER, CASES AND MATERIALS ON PRIVATE CORPORATIONS, *Note on Securities Exchange Act of 1933* (1937) Part II, 611; PRASHKER, *op. cit.*, *Note on Securities Exchange Act of 1934* (1937) Part II, 619.

rations that characterized the World War period, the United States Grain Corporation was organized under the laws of Delaware; the United States Spruce Corporation under the laws of the state of Washington; the United States Housing Corporation under the laws of New York; the United States Equalization Board under the laws of Delaware and the War Trade Board under the laws of Connecticut.³ Many question why Congress itself took advantage of competing state laws. In the first place, there was not and is not as yet a national incorporation law. Much of the legislation of the World War period and of the New Deal era is of emergency type. Therefore much comfort was found in the existing state statutes. Then again the federal system intervened. The states are jealous of their powers of incorporation and much dispute was avoided by state incorporation of government-owned agencies.⁴ This cannot be referred to as an avoidance of federal incorporation as an impractical device. A single corporation law makes for simplification, certainty and exactitude. The question of what should be included in such a law is a debatable one. But one thing is certain: forty-eight competing systems never make for certainty or order.

As a means of preventing the evils of charter-peddling by states and of effecting responsible corporate ownership and control, it has been proposed that corporations which are to engage in interstate commerce be incorporated by the federal government, or, if they are already incorporated, that they obtain a federal license.⁵ In accor-

³ See DORN, GOVERNMENT-OWNED CORPORATIONS (1926). For further discussion of government-owned corporations see STEPHENS, A TREATISE ON THE LAW OF CORPORATIONS (1936) 76. For reference material on this subject see PRASHEK, CASES AND MATERIALS ON PRIVATE CORPORATIONS (1937) Part I, pp. 116-119.

⁴ Government-owned corporations recently created include some organized under state laws and others by special act of Congress. Among these are the Reconstruction Finance Corporation, Home Owners' Loan Corporation, Federal Farm Mortgage Corporation, Federal Deposit Insurance Corporation, the Tennessee Valley Authority, the Electric Farm and Home Authority, Inc. and the Commodity Credit Corporation. There is thus manifested a tendency toward centralized activity.

⁵ For a rather complete discussion of the problem see *Hearings before Senate Committee on the Judiciary*, pt. 1, 75th Cong., 1st Sess., Jan. 25, 1937.

See the O'Mahoney Bill, S. 10, introduced January 6, 1937 and referred to the Committee on the Judiciary. It is entitled: "A Bill to regulate interstate and foreign commerce by prescribing the condition under which corporations may engage or may be formed to engage in interstate commerce, to provide for and define additional powers and duties of the Federal Trade Commission, to assist the States in improving labor conditions and enlarging purchasing power for goods sold in such commerce, and for other purposes. The general scheme of the bill is as follows:

Every corporation engaged in interstate commerce and incidental *intra-state business* would be required to take out either a Federal charter or a Federal license; that is, Federal charters would be for corporations yet to be created—Federal licenses for corporations already created. This *license* would not be a revocable permission but an authority subject only to dissolution by the *government*. Title I, Section I, builds up a

dance with the terms of a bill introduced by Senator O'Mahoney of the state of Wyoming, such action would be compulsory.⁶

The important question arises: Does federal incorporation stand the test of legal theory? It is axiomatic that Congress, in certain cases, has the power to create federal corporations to engage in interstate commerce.⁷ Although the Constitution does not specifically invest Congress with this authority, in cases of this sort the Supreme Court has held that corporations were a legitimate means of accomplishing some power reserved to Congress under the Constitution; therefore their creation was within the discretion of Congress. The language of the Court in the *North River Bridge* case⁸ of 1894 not only substantiates the statement made above, but also opens the way for an extension of the principle.

case showing how the concentration of economic power and the consequent maldistribution of wealth constitutes such a substantial and restrictive effect on interstate commerce as to call for government regulation of the terms and conditions on which corporations may produce and distribute commodities for the purpose of interstate commerce.

Title I, § II of the bill provides that the Act shall not apply (a) to the production of any agricultural article or commodity; (b) to any common carrier of property, persons or messages; (c) to any licensee subject to the Communications Act of 1934 insofar as engaged in radio broadcasting; (d) to any banking corporation; (e) to any insurance corporation; (f) to any corporation engaged in publishing newspapers; (g) to any corporation organized under the China Trade Act of 1922; (h) to any corporation the majority of stock in which is held by the United States. However, if any corporation is exempted by virtue of this section, but nevertheless has a controlling interest in a corporation subject to the Act, it too is made subject to the Act. Control is thereby penalized.

⁶The O'Mahoney Bill, Title III, Section 301, vests jurisdiction over the licensing and chartering of corporations engaged in interstate commerce in the Federal Trade Commission, to be known in this connection as the "Bureau of Corporations". For this purpose the membership of the Commission would be increased from five to nine members. Title I, § 3(A).

⁷*McCulloch v. Maryland*, 4 Wheat. 316 (U. S. 1819) (In 1816 Congress incorporated the Bank of the United States, and one of its branches was, in 1817, established in Baltimore. In 1818, a Maryland statute subjected all banks in that state not chartered by the legislature to a stamp tax upon their note issues. The tax was declared unconstitutional. Here it was asserted that the act incorporating the bank was constitutional and that the power of establishing a branch bank in the state of Maryland might be properly exercised by the bank itself. The bank could be established under the doctrine of implied powers to do whatever is "necessary and proper" to carry into execution the powers of Congress).

In the case of *Gibbons v. Ogden*, 9 Wheat. 1 (U. S. 1824) there was involved an act of Congress passed to license ships engaged in the coasting trade and fisheries; the Court asserted the authority of Congress to do so under the "necessary and proper" clause, U. S. CONST. Art. I, § 8, cl. 18.

The *McCulloch* case was the basis of the decision in *First Nat. Bank v. Union Trust Co.*, 244 U. S. 416, 37 Sup. Ct. 734 (1917), in which it was held that the power to authorize a general banking business is incidental to the power to utilize the bank for banking purposes.

⁸153 U. S. 525, 14 Sup. Ct. 891 (1894).

"Congress, therefore, may create corporations as appropriate means of executing the powers of government, as, for instance, a bank for the purpose of carrying on the fiscal operations of the United States, or a railroad corporation for the purpose of promoting commerce among the states."

Throughout the opinion in the *North River Bridge* case emphasis is laid upon the comprehensive doctrine that Congress has authorized the bridge as a means "to facilitate commerce". Although bank, railroad and interstate bridge enterprises are all public utilities, the broad test of "promoting commerce among the states" has been urged as a basis for the creation of interstate corporations of a general business character whenever Congress chooses so to act. Moreover, the Supreme Court has held that federal corporations may exercise the right of eminent domain within a state, if so authorized, *without the consent* of the state; that they may be exempt from state control and/or taxation in so far as that may impair their efficiency as instruments for carrying out the purposes for which they were organized; and that they have a right to sue in the federal courts.⁹

In a case wherein is presented a clear instance of "interstate commerce" there is no great difficulty. Much confusion has been brought about by many conflicting opinions on the nature of the term "interstate commerce".¹⁰ For instance, has Congress the power to give to federal corporations the right to produce, manufacture or mine commodities within a state? In other words, may Congress grant to corporations of its own creation the power to engage in intrastate trade as an incident to the business of interstate and foreign commerce?¹¹ A discussion of such matters as these is fundamentally political in

⁹ *Farmers' and Mechanics' Nat. Bank v. Dearing*, 91 U. S. 29 (1875); *Luxton v. North River Bridge Co.*, 153 U. S. 525, 14 Sup. Ct. 891 (1894); *Texas and Pacific Ry. v. Cody*, 166 U. S. 606, 17 Sup. Ct. 703 (1897); *Easton v. Iowa*, 188 U. S. 220, 23 Sup. Ct. 288 (1903).

¹⁰ An interesting statement of the whole problem of interpretation of this difficult concept is presented by Walter Hamilton, Professor of Law, Yale Law School, in the Hearings held before the Senate Judiciary Committee, on the O'Mahoney Bill, Part I, January 25 to 29, 1937. He says among other things:

"Commerce in 1787 denoted that mesh of interdependent dealings, including manufacturing which today we call business or industry. Manufacture for sale was essentially a part of commerce. The line was not between manufacture and commerce, but between the agrarian or self-sufficient economy and the commercial or moneyed economy. To the men of the eighteenth century the word 'commerce' encompassed any economic activity that was not agriculture."

He makes the point that manufacture and the sale were considered one and the same thing.

¹¹ The O'Mahoney Bill, *supra* note 5, includes in the term *commerce* "the collection of raw materials and equipment in *commerce* for the production and the production of any article or commodity to enter the flow of, or which affects commercial intercourse with foreign nations or among the several states * * * and the sale or transportation of any such articles or commodity so produced in the course of commerce."

nature and any attempt to meet a judicial solution must be accompanied by certain predispositions—social, economic, political. Professor H. L. Wilgus, of the University of Michigan, expressed the opinion that the consent of the individual states is necessary.¹² This opinion seems to be the stronger one and seems to find support in the recent Supreme Court decision in the case of *Hopkins Federal Savings and Loan Ass'n v. Cleary*.¹³ However, there is no insurmountable difficulty presented here. The probability is strong that the various states will extend to federal corporations the same intrastate privileges which they have heretofore accorded to corporations of other states.

In direct connection with this arises the question as to whether or not manufacturing is still to be considered a purely intrastate activity. Even though everyone realized that manufacture was relevant and appropriate to the conduct of a successful enterprise, it was, nevertheless, invested with a mystic halo.¹⁴ There is great doubt that the founding fathers ever intended that such a peculiar position should have been given to it. Commerce has always been treated as a succession to manufacture but not as a part thereof. Looking at it realistically, however, and this ought to be the legal approach, the greater part of interstate commerce is conducted by large industrial organizations which manufacture or produce their merchandise and then ship it to other manufacturers or consumers. Congress has the power to authorize national banks to act as trustees, executors, or registrars of stocks and bonds in instances where that is not contrary to state law.¹⁵ It is argued from this that Congress should be no less able to grant to corporations of its creation the power to manufacture, which is certainly not local in nature.

What is the significance of the Wagner Labor Act cases in their

¹² Wilgus, *Federal License or Incorporation* (1905) 3 MICH. L. REV. 279.

¹³ The *Hopkins* case, 296 U. S. 315, 56 Sup. Ct. 235 (1935), arose out of a controversy as to the validity of Section 5 of the Home Owners' Loan Act of 1933, as amended; by this section building and loan associations organized under the laws of a state could be converted into federal savings and loan associations upon the vote of the majority of the stockholders present at a meeting legally convened. *Held*: This provision of the Act constitutes an unconstitutional encroachment upon the reserved power of the states. It is to be noted that the O'Mahoney Bill does not attempt to convert state corporations engaging in purely intrastate activities into federal corporations. It concerns itself with corporations doing interstate business. It really declares that the internal affairs of corporations engaging in interstate commerce are also affairs of government concern.

¹⁴ A group of interesting cases demonstrating this are: *Kidd v. Pearson*, 128 U. S. 1, 9 Sup. Ct. 6 (1888); *United States v. E. C. Knight Co.*, 156 U. S. 1, 15 Sup. Ct. 249 (1894); *Heisler v. Thomas Colliery Co.*, 260 U. S. 245, 43 Sup. Ct. 83 (1922); *Oliver Iron Co. v. Lord*, 262 U. S. 172, 43 Sup. Ct. 526 (1923); *Utah Power and L. Co. v. Pfost*, 286 U. S. 165, 52 Sup. Ct. 548 (1932); *Champlin Rfg. Co. v. Corporation Commission*, 286 U. S. 210, 52 Sup. Ct. 559 (1932); *Chassaniol v. Greenwood*, 291 U. S. 584, 54 Sup. Ct. 541 (1934); *Carter v. Carter Coal Co.*, 298 U. S. 238, 56 Sup. Ct. 855 (1936).

¹⁵ *Burnes Nat. Bank v. Duncan*, 265 U. S. 17, 44 Sup. Ct. 427 (1924).

relation to the power of Congress over *manufacture* as an incident to interstate commerce? In *National Labor Relations Board vs. Jones & McLaughlin Steel Co.*,¹⁶ the Court says:

"Though activities may be intrastate in character when *separately considered*, if they have such a close and substantial relation to interstate commerce and their control is essential or appropriate to protect that commerce from burdens and obstructions, Congress has the power to exercise that control."

This seems to indicate a definite trend away from the narrowness of customary definition to a rather enlightened appreciation of engrossing realities. Some may find it hard to approve the statement of the Court in the same case to the effect that what affects commerce remotely is beyond the power of Congress; when the effect is proximate it is within the federal sphere. It might be mentioned that the Court is here elaborating nothing new; such has always been the case.

In the event that a corporation engaging or about to engage in interstate commerce does not obtain a federal license or a federal charter, may Congress prohibit it from functioning? There appears to be no doubt that Congress can do so constitutionally. In *Crutcher v. Kentucky*¹⁷ the Supreme Court said:

"To carry on interstate commerce is not a franchise or a privilege granted by the State; it is a right which every citizen is entitled to exercise under the Constitution and laws of the United States; and the accession of mere corporate facilities, as a matter of convenience in carrying on their business, cannot have the effect of depriving them of such right, *unless Congress should see fit to interpose some contrary regulations on the subject.*"

And in the *Northern Securities* case¹⁸ the Court refused to permit the state of New Jersey to project its authority into other states, and across the continent, so as to prevent Congress from exerting the power it possesses under the Constitution over interstate and international commerce. As further instances of prohibition, it is seen that Congress may deny the privileges of interstate commerce to persons guilty of maintaining a monopoly,¹⁹ of operating lotteries,²⁰ and of

¹⁶ *National Labor Relations Board v. Jones and McLaughlin Steel Co.*, 301 U. S. 1, 57 Sup. Ct. 615 (1937).

¹⁷ *Crutcher v. Kentucky*, 141 U. S. 47, 11 Sup. Ct. 851 (1891).

¹⁸ *Northern Securities Co. et al. v. United States*, 193 U. S. 197, 24 Sup. Ct. 436 (1904).

¹⁹ *Hale v. Henkel*, 201 U. S. 43, 26 Sup. Ct. 307 (1906).

²⁰ *Champion v. Ames*, 188 U. S. 321, 23 Sup. Ct. 321 (1903).

enslaving women for the purposes of prostitution.²¹ Since the state has not the power to regulate interstate commerce, there is no factual basis for a corporation of its creation to oppose a device set up by the federal government for regulation of such commerce.

It is doubtful whether federal incorporation concentrates too much power. If one considers the question of control of interstate commerce, he is fully aware that Congress has full power in this domain. It is without the domain of the states.²² Yet these same states have been permitted to create those corporations which serve as instrumentalities to facilitate the flow of interstate commerce. Here, indeed, is a question of misdirected power and activity. "Foreign" corporations can rather paradoxically use the clause "interstate commerce" to avoid harsh provisions of the corporation laws of other states. So that interstate commerce moves on withdrawn from the arm of Congress and serves as a smoke screen to perpetuate privileges. And again, does not Congress "regulate" the railroads, the radio, general communications and the sale of securities? Regulation is certainly more consonant with the system of federalism than is public ownership. Moreover, those who insist on reverting to the founding fathers for direction and guidance must find that on two occasions the convention which drafted the Constitution unanimously resolved that Congress should be given power "to legislate in all cases to which the states are incompetent or in which harmony of the United States may be interrupted by the exercise of individual legislation". With regard to the states, those who are wary of a purported centralization ask that they (the states) be allowed to put their own houses in order. In this they have shown marked incompetency; either they have refused to act, or they have acted in opposite directions. Corporate regulation and control is today, more than ever, a federal function. It is already too big for the states. It must not be allowed to become too big for Congress. This is not inconsistent with a federal system; in fact, it is a reaffirmation of it. In connection with this, Associate Justice Brandeis, writing the dissenting opinion in the case of *Liggett Co. v. Lee*, states:²³

"Through size, corporations, once merely an efficient tool employed by individuals in the conduct of private business, have become an institution—an institution which has brought such concentration of economic power that so-called private corporations are sometimes able to dominate the state. * * * Ownership has been separated from control; and this separation has

²¹ *Hoke v. United States*, 227 U. S. 308, 33 Sup. Ct. 281 (1913). In this matter of police power regulation of interstate commerce see *Bennett v. United States*, 194 Fed. 630, 632 (C. C. A. 6th, 1912); *Clark Distilling Co. v. Western Maryland Ry.*, 242 U. S. 311, 37 Sup. Ct. 180 (1917).

²² U. S. Const. Art. I, § 8.

²³ Dissenting opinion of Brandeis, J., in *Liggett Co. v. Lee*, 288 U. S. 517, 53 Sup. Ct. 481 (1933).

removed many of the checks which formerly operated to curb the misuse of wealth and power. * * * The changes thereby wrought in the lives of the workers, of owners and of the general public, are so fundamental and far-reaching as to lead these scholars to compare the evolving 'corporate system' with the feudal system; and to lead other men of experience and insight to assert that this 'master institution of civilized life' is committing it to the rule of a plutocracy."

The question thus arises: Is the preservation of a federal system to be effected by a tenacious conformity to traditional definition or will that same fear to depart from custom destroy the system itself?²⁴

²⁴The O'Mahoney Bill does not require the establishment of new government agencies. The proposed law is to be administered by the Federal Trade Commission with certain changes and adjustments. *Supra* note 6. Title I, § 5 (a) of the bill provides that there is to be no discrimination against women in rates of pay. Section 5 (b) prohibits employment of children under 16 years of age and establishes a minimum wage of 18 for hazardous occupations. Section 5 (c) provides that as a condition of securing a federal charter or license, corporations will agree to respect the rights of workers to organize and bargain collectively through representatives of their own choosing. It also requires compliance with the provisions of the National Labor Relations Act and to determine such compliance binds the Commission by the findings of fact and conclusions of law made by the National Labor Relations Board. Section 3 (g) provides that the Federal Trade Commission may recommend a minimum wage for the lowest-paid classes, of unskilled labor but only when it finds that abuses in the form of wage scales contrary to the public interest exist, and that such abuses have not been eliminated through collective bargaining. It is seen that in this way the bill seeks to accomplish certain social purposes through the device of the federal charter or license.

Conditions of fair trade and competition, so far as this bill is concerned, really consist in conformance with the requirements specified in the bill by those corporations engaged in interstate commerce. See Title I, § 7 of the bill.

Title I, § 10 (A) provides that the Commission may require any business subject to the Act, to submit accurate reports and to make truthful and responsible answers to interrogatories.

As to corporate practices it is noted that a full accounting must be made of the affairs of the subsidiary corporations; officers and directors must be actual owners of stock in the corporations; the directors and officers are greatly limited in their right to hold stock in other corporations; every officer and director is a trustee of the stockholders; stock shall be full paid or payable in cash; it may be paid in property or services where such issuance has been authorized by application to a competent court and under its order there is a finding that such stock has been or is to be issued on a fair valuation of such property or services.

Moreover, proxies are restricted. A corporation already in existence may hold the stock of another corporation only if it has that power at the time of securing a license; no corporation formed under the Act may purchase, acquire or hold stock in any other corporation. Likewise annual reports must be filed with the Commission. All of Title III of the bill contains provisions as to the conduct of corporations which are much stricter than those of most of the states.

The necessity for some form of regulation is seen when it is considered that the majority control of America's corporate wealth is in the hands of 375

Conclusions.

The question of federal incorporation arises out of a need for certainty and the establishment of control by regulation of trade and corporate practices.

The power of Congress to charter corporations for certain purposes is established. Much sanction is found for the opinion that the power of such corporations to engage in manufacturing has a constitutional basis.

It seems that if such federal corporations should engage in purely intrastate activities which are incidental to the conduct of their business, the consent of each state would be a condition for such operation.

On the basis of precedent it would seem that Congress has the power to prohibit from interstate commerce those corporations engaging in such commerce which refuse to be federally incorporated or licensed.

Federal incorporation does not disturb the balance between the power of the states and the federal government.

It would appear, in a final analysis, that federal incorporation is not so much a policy of prohibition and restriction. It is one of guidance and leadership pointing toward a stabilized economic control.²⁵

MICHAEL J. O'REILLY.

IMMUNITY OF CHARITABLE CORPORATIONS FOR NEGLIGENCE OF THEIR SERVANTS AND AGENTS.

Origin of Immunity Doctrine.

The liability of a charitable corporation¹ for the torts of its servants has long been a favorite topic for discussion. The various

corporations which constitute less than one per cent of America's corporate enterprises. See, Hearings on the O'Mahoney Bill, *supra* note 1.

It is well to remember that the bill does not propose to stipulate the manner in which business is to be conducted. It merely *establishes a set of principles, of equitable national rules, to which business must adhere before engaging in commerce.* It is concerned with the public interest and the welfare of investors, consumers and labor.

²⁵ For further discussion of this question, reference may be made to the following: MORAWETZ, *A TREATISE ON THE LAW OF PRIVATE CORPORATIONS* (1886); WILGUS, *Federal License or Incorporation* (1905) 3 MICH. L. REV. 264-281; OLIPHANT, *CASES ON TRADE REGULATION* (1923); WILSON, *THE NEW FREEDOM* (1913); HENDRICK, *THE POWER TO REGULATE CORPORATIONS AND COMMERCE* (1906); TUGWELL, *INDUSTRY'S COMING OF AGE* (1927); COMMONS, *LEGAL FOUNDATIONS OF CAPITALISM* (1924); FRANK, *LAW AND THE MODERN MIND* (1930).

¹ HARPER, *THE LAW OF TORTS* (1933) §294. By charitable corporation is meant any corporation operated primarily for the benefit of the public rather than for private profit but which is not a direct agency of the government.