CONSTITUTIONALITY OF STATEMENT OF OBJECTIVES IN BANKING ACT OF 1935

The proposed Banking Act of 1935, as originally introduced, contained no statement of objectives to be sought by the Federal Reserve Board in exercising the powers of credit control granted to it. It was argued, however, that Congress was delegating to the Board some of its legislative power to coin money and regulate the value thereof, and, accordingly, that a guiding principle or statement of objectives should be included in the bill in order to eliminate any question as to the constitutionality of the delegation of power. As a result, H.R. 7617, when it passed the House on May 9, 1935, contained the following statement of objectives in section 204(b) of the bill:

> "It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses in such manner as to promote conditions conducive to business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action and credit administration."

It was argued in the House that, even with the inclusion of the above provision, the bill constituted an unconstitutional delegation of power. An examination of the Congressional Record for May 4, 1935, pages 7219 to 7221, indicates, however, that this argument was made not on behalf of guardians of the Constitution but rather by supporters of the Goldsborough amendment, who hoped to substitute that amendment for the provision of section 204(b) as a legislative mandate.

Sent by Gov Eccles to Senators Glass, Fletcher, & Bulkley + to Rep Steagall on 6/11/35

The Hot Oil Cases and the N R A Cases are Distinguishable.

The legislation involved in the so-called Hot Oil cases (Panama Refining Co. v. Ryan, 293 U. S. 388) is readily distinguishable from the proposed Banking Act of 1935 on the ground that the Supreme Court found that Congress had stated no policies or standards whatever to guide or limit the President in exercising the power granted to him by section 9(c) of the National Industrial Recovery Act but instead had left to the Executive absolute discretion as to whether or not the prohibitions of the Act should be put into effect. This entire absence of any statement of objectives places that legislation in a different category from the bill here under consideration. In this connection, the Court stated the following in its opinion in the Hot Oil cases. "The Congress left the matter to the President without standard or rule to be dealt with as he pleased."

Another point of distinction between the Banking Act and the section of the National Industrial Recovery Act involved in the Hot Oil cases is in the kind of power delegated. In the legislation considered in those cases, Congress granted to the President power to prohibit the shipment in Interstate Commerce of oil produced in violation of State quotas and attached criminal penalties to violations of the President's orders.

The only additional instrument of credit control granted to the Board by the proposed Banking Act is the power to control the

purchase and sale by Federal Reserve banks of certain securities in the open market. Although such transactions would have an influence upon the volume and cost of credit they are not matters over which Congress ordinarily exercises control and, in fact, it would be entirely impracticable for Congress to attempt to exercise detailed regulation over such matters.

The statute involved in the recent N R A cases (Schechter Poultry Corporation, et al v. United States, decided May 27, 1935) bears no resemblance whatever to the proposed Banking Act here under consideration. Not only did the Court find that there was complete absence of any guiding principle in the National Industrial Recovery Act but it also found that there was no limit whatever to the action which the President could take in formulating codes of fair competition. Not only could the President approve or prescribe a code which would prevent unfair or unlawful trade practices but he could incorporate in a code any regulations that he deemed to be advisable for the conduct of trade or industry and, thereupon, such regulations became penal statutes. The Court stated that the "discretion of the President in approving or prescribing codes, and thus enacting laws for the government of trade and industry throughout the country, is virtually unfettered".

Mr. Justice Cardozo in his concurring opinion made it even clearer that the National Industrial Recovery Act was unconstitutional

because the authority of the President to approve or prescribe codes gave him an unlimited discretion to make laws.

> "Here, in the case before us, is an attempted delegation not confined to any single act nor to any class or group of acts identified or described by reference to a standard. Here in effect is a roving commission to inquire into evils and upon discovery correct them."

In contrast to the statute before the Court, the powers granted to the Federal Reserve Board are confined to certain limits. The three most important instruments of credit control are (1) power to fix the discount rate, (2) power to establish reserve requirements, and (3) control over open-market operations. The first two of these powers are now vested in the Federal Reserve Board. The Board now has a veto power over open-market operations, and it is proposed in the Banking Act to vest full power over such operations in the Board. Certainly these powers cannot properly be described as "a roving commission to inquire into evils and upon discovery to correct them" by promulgating penal statutes. The Board can merely raise or lower discount rates or reserve requirements and can cause Federal Reserve banks to buy or sell securities. These are narrow and clearly defined powers, and the purpose for which these powers are to be exercised is definitely stated in section 204(b) of the bill.

In view of these important differences between the Banking Act and the National Industrial Recovery Act, there is no reason whatever to become alarmed by the recent decisions of the Supreme Court.

Proposed Statement of Objectives Is More Definite Than Statements Heretofore Upheld by Supreme Court.

An examination of the decisions of the Supreme Court upon this point demonstrates conclusively that the statement of objectives contained in the proposed Banking Act of 1935 is much more definite than the statements which have heretofore been held sufficient. In this connection it is interesting to note that prior to the decision in Panama Refining Co. v. Ryan, 293 U.S. 388 (the Hot Oil cases), the Supreme Court had not invalidated any Federal statute on the ground that it contained an unconstitutional delegation of legislative power. A familiar example of the type of guiding principle which has been upheld by the Supreme Court is that found in the Interstate Commerce Act. That statute authorized the Commission to approve the purchases of stock by one railroad in another railroad "whenever the Commission is of opinion * * * that the acquisition * * * will be in the public interest." In the case of New York Central Securities Cor. v. United States, 287 U.S. 12, the Supreme Court held this statement of objective to be sufficient. On pages 24 and 25 of its opinion, the Court discussed this question as follows:

> "Appellant insists that the delegation of authority to the Commission is invalid because the stated criterion is uncertain. That criterion is the 'public interest'. It is a mistaken assumption that this is a mere general reference to public welfare without any standard to guide determinations. The purpose of the Act, the requirements it imposes, and the context of the provision in question

> show the contrary. * * * The provisions now before us were among the additions made by Transportation Act, 1920, and the term 'public interest' as thus used is not a concept without ascertainable criteria, but has direct relation to adequacy of transportation service, to its essential conditions of economy and efficiency, and to appropriate provision and best use of transportation facilities, questions to which the Interstate Commerce Commission has constantly addressed itself in the exercise of the authority conferred. So far as constitutional delegation of authority is concerned, the question is not essentially different from that which is raised by provisions with respect to reasonableness of rates, to discrimination, and to the issue of certificates of public convenience and necessity."

In the case of Field v. Clark, 143 U.S. 649, the Court considered a statute authorizing the President to suspend the free introduction of certain articles into the United States "whenever, and so often as the President shall be satisfied" that the Governments producing them imposed duties which in view of the free list established by the Act, the President "may deem to be reciprocally unequal and unreasonable". The Court upheld the statute and stated that the only discretion granted to the President related to the enforcement of the policy established by Congress.

In the above case the only principle for the guidance of the President was whether the duties were "unequal and unreasonable". These words do not express anything like as definite a principle as that contained in the proposed statement which directs the Board to promote business stability and to mitigate unstabilizing fluctuations in the general level of production, trade, prices and employment.

In Buttfield v. Stranahan, 192 U.S. 470, the Court upheld an

Act which authorized the Secretary of the Treasury to "establish uniform standards of purity, quality, and fitness for the consumption of all kinds of teas imported into the United States". In its opinion, the Court said:

> "This in effect was the fixing of a primary standard, and devolved upon the Secretary of the Treasury the mere executive duty to effectuate the legislative policy declared in the statute. * * * Congress legislated on the subject as far as was reasonably practicable, and from the necessities of the case was compelled to leave to executive officials the duty of bringing about the result pointed out by the statute. To deny the power of Congress to delegate such a duty would, in effect, amount but to declaring that the plenary power vested in Congress to regulate foreign commerce could not be efficaciously exerted."

Certainly the direction to "establish uniform standards of purity, quality, and fitness" for tea is no more definite than the direction to mitigate unstabilizing fluctuations in the general level of production, trade, prices and employment. The statement of the Court that Congress legislated on the subject "as far as was reasonably practicable" is especially significant in the present situation. It is submitted that it would be no more feasible for Congress to attempt to lay down specific and detailed directions as to the course to be followed by the Federal Reserve Board in exercising credit control than it would be for Congress to enact specific and detailed standards of purity, quality and fitness for tea.

The statute upheld in United States v. Grimaud, 220 U.S. 506,

authorized the Secretary of Agriculture to "make such rules and regulations and establish such service as will insure the objects of such reservation, namely, to regulate their occupancy and use and to preserve the forests thereon from destruction; and any violation of the provisions of this Act or such rules and regulations shall be punished"; as provided in other sections. In upholding this statute against the charge that it constituted an unlawful delegation of legislative power, the court made the following statement:

> "From the beginning of the Government various acts have been passed conferring upon executive officers power to make rules and regulations - not for the government of their departments, but for administering the laws which did govern. None of these statutes could confer legislative power. But when Congress had legislated and indicated its will, it could give to those who were to act under such general provisions 'power to fill up the details'."

The cases upholding the grant of authority to the Secretary of War to determine whether bridges constitute unreasonable obstructions to navigation illustrate the extent to which the courts have gone in upholding the sufficiency of statements of policy for the guidance of the Executive branch of the Government. The only principle for the guidance of the Secretary of War is that he "shall have reason to believe" that any bridge "is an unreasonable obstruction to the free navigation of such waters". Union Bridge Company v. United States, 204 U. S. 364. Likewise, the grant of authority to the interstate

Commerce Commission to enforce reasonable rates is accompanied by a statement of policy much less specific than that contained in the proposed Banking Act. The principle established for the guidance of the Interstate Commerce Commission is that rates shall be just and reasonable considering the service given, and not discriminatory. The Supreme Court, however, has repeatedly upheld the validity of the Interstate Commerce Act against charges that it contained an unconstitutional delegation of legislative power. St. Louis & Iron Mountain Railway v. Taylor, 210 U. S. 281. Intermountain Rate Cases, 234, U. S. 476.

Other statements of objective which have been held to be sufficient by the Supreme Court are as follows: "In the public interest", Avent v. United States, 266 U. S. 127, and United States v. Chemical Foundation, 272, U.S. 1; "Public convenience, interest or necessity", Federal Radio Commission v. Nelson Bros. Bond & Mortgage Co., 289 U.S. 266; "Just and reasonable commissions", Tagg Bros. and Moorhead v. United States, 280 U.S. 420.

The conclusion is inescapable that the proposed guiding principle is fully as definite and comprehensive as any of the above statements of principle and, accordingly, that the grant of power in the bill is in accord with the principles of the Constitution as construed by the Supreme Court.

The Bill Contains No New Grant of Power

Section 205 of H.R. 7617 which vests in the Federal Reserve Board control over the open-market operations of the Federal Reserve banks is the section which critics of the bill have attacked as containing an unconstitutional delegation of power. The arguments on this point sometimes indicate that this section contains some new delegation of power. However, an examination of the existing law and of the provisions of section 205 of the bill clearly demonstrate that there is no grant of power in the bill different in principle from that now contained in the present law and that the only change is in the group to which the power is granted.

Section 12A of the existing Federal Reserve Act, as interpreted by the Board's Regulation M, provides that the open-market operations of the Federal Reserve System must be initiated by the Federal Open Market Committee through the recommendation of a particular open-market policy to the Federal Reserve Board. Such a recommendation becomes effective only when and to the extent that it is approved by the Board. When an open-market operation has been recommended by the Federal Open Market Committee and approved by the Federal Reserve Board, each Federal Reserve bank then has the right to decide whether or not it will participate in such operation. As will be seen, the above arrangement constitutes a grant of the power to carry on open-market operations to three different groups.

Although the Federal Reserve Board does not have exclusive control of open-market operations under existing law, it nevertheless does have such control that no open-market operation can be carried on without its approval.

Under the provisions of section 205 of the proposed bill, the Federal Reserve Board would have complete control over the open-market operations of the Federal Reserve System with one qualification, that the Board must consult the Open Market Advisory Committee, consisting of five representatives of the Federal Reserve banks, before making any change on its own initiative in the open-market policy. It thus appears that the power to engage in open-market operations is changed from the Federal Reserve Board and two other groups to the Federal Reserve Board alone. If this can properly be called a delegation of legislative power, it certainly cannot be called a new or different delegation. Accordingly, it seems that the charge of unconstitutionality should be directed against the existing Federal Reserve Act rather than against the proposed Banking Act which embodies no change from the existing law in the amount or kind of power delegated.

It should be observed that the open-market operations of the Federal Reserve System constitute only one of three instruments of credit control exercised by that body. The Board's power to fix discount rates and its power to establish reserve requirements are also important instruments of credit policy. The case of Raichle v. Federal Reserve Bank of New York, 34 Fed. (2d) 910 (C.C.A. 2d, 1929) brings out

clearly the relation of control of open-market operations and the fixing of the discount rate as instruments of credit control and upholds the constitutionality of the grant of these powers to the Federal Reserve Board and the Federal Reserve banks. In that case, the plaintiff brought suit on August 6, 1928 to restrain the Federal Reserve Bank of New York from engaging in open-market operations and raising the discount rate alleging that such action by the bank was an unlawful violation of plaintiff's rights. The Court dismissed plaintiff's bill and held that the action of the Federal Reserve bank was lawful. In its opinion, the Court stated:

> "The foregoing provisions enable the Federal Reserve Banks, without waiting for applications from their member banks for loans or rediscounts to adjust the general credit situation by purchasing and selling in the open market the class of securities that they are permitted to deal in. The power 'to establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal Reserve Bank,' appears in the act (12 USCA Sec. 357) with the open market powers. The two powers are correlative and enable the Federal Reserve Banks to make their rediscount rates effective.
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> "Certainly it was lawful to engage in open market transactions by the sale of securities, to fix the rediscount rate, and to decline to rediscount eligible paper. Purchases and sales in the open market are specifically authorized by the act."

With regard to the constitutionality of the Federal Reserve bank's power to fix the discount rate, the court said:

> "While it is alleged in the bill that the rediscount rate 'has been arbitrarily and unreasonably raised,' it was for

the defendant, subject to the supervision of the Federal Reserve Board, to determine what would be a reasonable rediscount. It is not contended that the provision for fixing rates of discount is unconstitutional, nor would it seem even reasonable to argue that it is, after such decisions as First National Bank v. Fellows ex rel. Union Trust Co., 244 U.S. 416, 37 S. Ct. 734, 61 L. Ed. 1233, L.R.A. 1918C, 283, Ann. Cas. 1918E, 1169, and Westfall v. United States, 274 U.S. 256, 47 S. Ct. 629, 71 L. Ed. 1036 as well as the Legal Tender Cases, 110 U.S. 421, 4 S. Ct. 122, 28 L. Ed. 204, Farmers' and Mechanics' National Bank v. Dearing, 91 U.S. 29, 23 L. Ed. 196, and McCulloch v. Maryland, 4 Wheat. 316, 4 L. Ed. 579.

"The act being constitutional, we are asked to hold that the bank may not sell its own securities and fix the rates at which it will discount or rediscount paper, when it is given the power by the specific terms of the Federal Reserve Act to do all of these things."

The case of First National Bank v. Fellows ex rel. Union Trust Co., 244 U.S. 416, 37 S. Ct. 734, 61 L. Ed. 1233 (1916), cited by the court in the Raichle case, involved the constitutionality of section 11(k) of the Federal Reserve Act which at that time read as follows:

"Sec. 11. The Federal Reserve Board shall be authorized and empowered:

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"(k) To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, or registrar of stocks and bonds under such rules and regulations as the said board may prescribe."

Mr. Fellows, the Attorney General of Michigan filed a proceeding in the nature of quo warranto to test the validity of the grant of authority to a national bank located in Michigan to exercise fiduciary

powers. Among other things, it was argued that section 11(k) constituted an unlawful delegation of legislative power to the Federal Reserve Board. The Supreme Court of Michigan held section 11(k) unconstitutional. The United States Supreme Court, on writ of error, reversed the decision of the Michigan court, and, in its opinion, disposed of the delegation of legislative power point as follows:

> "Before passing to the question of procedure we think it necessary to do no more than say that a contention which was pressed in argument, and which it may be was indirectly referred to in the opinion of the court below, that the authority given by the section to the Reserve Board was void because conferring legislative power on that board, is so plainly adversely disposed of by many previous adjudications as to cause it to be necessary only to refer to them. Marshall Field & Co. v. Clark, 143 U.S. 649, 36 L. ed. 294, 12 Sup. Ct. Rep. 495; Buttfield v. Stranahan, 192 U.S. 470, 48 L. ed. 525, 24 Sup. Ct. Rep. 349; United States v. Grimaud, 220 U.S. 506, 55 L. ed. 563, 31 Sup. Ct. Rep. 480; Monongahela Bridge Co. v. United States, 216 U.S. 177, 54 L. ed. 435, 30 Sup. Ct. Rep. 356; Intermountain Rate Cases (United States v. Atchison, T. & S. F. R. Co.) 234 U.S. 476, 58 L. ed. 1408, 34 Sup. Ct. Rep. 986."

The words in section 11(k) "when not in contravention of State or local law" constitute a limitation upon the authority of the Board to issue permits to exercise fiduciary powers but it seems to be clear that such words do not constitute a principle for the guidance of the Board. Even if they should be considered as a statement of a guiding principle, the statement would be much less comprehensive than that contained in section 204(b) of the Banking Act.

See also 32, Opinions of the Attorney General, page 81 holding "that the Federal Reserve Board has the right under the powers

conferred by the Federal Reserve Act, to determine what rates of discount should be charged from time to time by Federal Reserve banks, and under their powers of review and supervision, to require such rates to be put into effect by such bank". (Opinion by Acting Attorney General, Alex C. King, December 9, 1919).

It should be noted that at the time the grant of authority to the Federal Reserve Board and the Federal Reserve banks to engage in open-market operations and to fix discount rates was upheld by the courts, the only guiding principle or statement of objectives in the Federal Reserve Act was that of "accommodating commerce and business". Since the proposed Banking Act contains a much more positive statement of objectives than that in the present law, it is believed that the enactment of the bill will make the constitutionality of the Federal Reserve Act even clearer than it is at present.