November 19th, 1914.

My dear Governor:-

As requested, I have given consideration to the matter of discount rates to be charged by Federal reserve banks and particularly to the question of the application of State laws to such rates.

The question arises in interpreting Section 14 of the Federal Reserve Act.

Section 14, sub-section (d), in defining one of the powers of the Federal reserve banks, provided as follows:

> "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 for each class of paper, which shall be fixed with a view of accommodating commerce and business".

In interpreting this section, it is necessary to consider whether Federal reserve banks are limited in the amount of interest which may be charged and particularly whether such banks are subject to the usury laws of any State in the absence of any fixed maximum rates of interest prescribed by Congress. This involves a consideration of the questions -

First - Has Congress the constitutional right to prescribe a rate of interest to be charged by a corporation organized under an Act of Congress, which rate exceeds the statutory rate fixed by any State for persons, firms or corporations doing business within the limits of such State?

Second - If Congress has this right, may it delegate to any executive branch of the Government the right to fix such rates?

Third - If Congress fails to prescribe by statute a maximum rate of interest to be charged, will the executive branch of the Government be controlled by such State laws in fixing the interest rate to be charged?

Considering these questions in the order named:

First - The right to establish interest rates is necessarily incident to the right to create a banking corporation since the exercise of this power may be said to be fundamentally a part of the exercise of banking powers.

The right of Congress to create a bank and to vest such corporation with the necessary powers to perform its functions, is fully considered and determined in the case of McCulloch vs Maryland, 4 Wheaton, 316. In that case Chief Justice Marshall, who delivered the opinion of the Court, affirmed the right of Congress to create the Bank of the United States, the right of the Bank of the United States to establish a branch in Maryland, as an incidental power not specifically granted by its charter, and decided definitely that the State of Maryland could not tax the branch so established on the ground that such a tax would retard, impede, burden or control the operations of the laws enacted by Congress. That is, the Court having decided that the Bank of the United States was constitutional, held that the branch which was created by the bank, "being conducive to the complete accomplishment of the object" was equally constitutional. This concedes the right of the bank to exercise powers which are properly incident to the duties of the bank. See Wheaton 4, pages 424-425 A fortiori, the right to establish interest rates, equally free from State interference, is incident to the duties of the Federal reserve banks.

Without reviewing in detail the opinion rendered in this case, the following language is quoted as bearing on the subject under consideration:

> "This great principle is, that the constitution and the laws made in pursuance thereof are supreme; that they control the constitution and laws of the respective States, and cannot be controlled by them. From this, which may be almost termed an axiom, other propositions are deduced as corollaries, on the truth or error of which, and on their application to this case, the cause has been supposed to depend. These are, 1st: that a power to create implies a power to preserve: 2nd: That a power to destroy, if wielded by a different hand, is hostile to, and incompatible with these powers to create and to preserve: 3rd: That where this repugnancy exists, that authority which is supreme must control, not yield to that over which it is supreme. ***** The power of Congress to create, and of course, to continue, the bank, was the subject of the preceding part of this opinion; and is now no longer to be considered as questionable. **** It is of the very essence of supremacy to remove all obstacles

to its action within its own sphere, and so to modify every power vested in subordinate governments, as to exempt its own operations from their own influence. This effect need not be stated in terms. It is so involved in the declaration of supremacy, so necessarily implied in it, that the expression of it could not make it more certain. We must, therefore, keep it in view, while construing the constitution".

The same question was considered in the case of the Farmers & Mechanics National Bank vs Dearing, reported in 91 U. S. p.33-35, where the constitutional right of Congress to create national banks was discussed. The Court in that case says -

"The constitutionality of the Act of 1864 is not questioned. It rests on the same principle as the Act creating the Second Bank of the United States. The reasoning of Secretary Hamilton and of this court in McCulloch vs Maryland (4 Wheat.316) and in Osborne vs The Bank of the United States (9 id. 708) therefore applies. The national banks organized under the Act are instruments designed to be used to aid the government in the administration of an important branch of the public service. They are means appropriate to that end. Of the degree of the necessity which existed for creating them Congress is the sole judge."

"Being such means, brought into existence for this purpose, and intended to be so employed, the States can exercise no control over them, nor in any wise affect their operation, except in so far as Congress may see proper to permit. Anything beyond this is 'an abuse, because it is the usurpation of power which a single State cannot give'. Against the national will 'the States have no power, by taxation or otherwise, to retard, impede, burthen, or in any manner control, the operation of the constitutional laws enacted by Congress to carry into execution the powers vested in the General Government'. Bank of the United States vs McCulloch, supra; Weston and Others vs Charleston, 2 Pet. 466; Brown vs Maryland, 12 Wheat. 419; Dubbins vs Erie County, id. 419."

"The power to create carries with it the power to preserve. The latter is a corollary from the former".

"The principle announced in the authorities cited is indispensable to the efficiency, the independence, and indeed to the beneficial existence, of the General Government; otherwise it would be liable, in the discharge of its most important trusts, to be annoyed and thwarted by the will or caprice of every State in the

Union. Infinite confusion would follow. The government would be reduced to a pitiable condition of weakness. The form might remain but the vital essence would have departed."

While this decision relates to national banks, the reasoning will apply with even greater force to Federal reserve banks as agents of the United States Government. This decision has been followed in the case of Haseltine vs Central Bank of Springfield (183 U. S. 135) and Schuyler National Bank vs Gadsden (191 U. S. 457) and in other cases.

It seems to be clear, therefore, that Congress has the right to establish banks with the power to fix interest rates and that these rates are controlled by the Act creating the corporation and not by the State law. In Haseltine vs Central Bank of Springfield, the court says:

"We understand it to be conceded that as the note in question was given to a national bank, the definition of usury and the penalties affixed thereto must be determined by the National Bank Act and not by the law of the State", citing Farmers' and Mechanics National Bank vs Dearing, 91 U. S., 29.

Again, in the case of Schuyler National Bank vs. Gadsden, the Court says:

"This results from the prior adjudications of this court, holding that where usurious interest has been paid to a national bank the remedy afforded by Section 5198 of the Revised Statutes is exclusive and is confined to an independent action to recover such usurious payments".

From these decisions it appears that the interest rates established by State laws apply to loans made by national banks only by reason of the fact that Section 5198 of the Revised Statutes makes such rates applicable, and without the agency of this enactment of Congress the State laws would have no application.

Second. The question of whether or not Congress may delegate to the Federal Reserve Board or to the Federal reserve banks the right to fix interest rates, seems to be clearly established by a number of decisions relating to the right of Congress to delegate to the executive department the right to exercise those powers which are necessary to carry out the purpose of the original Act. For example, in the case of Field vs Clark, 143 U.S. 693, the Court says:

"Legislative power was exercised when Congress declared that the suspension should take effect upon a named contingency. What the President was required to do was simply in execution of the Act of

"Congress. It was not the making of the law"

Again, in the case of Reagan vs. Farmers Loan and Trust Company, 154 U. S., 393, the Court says:

> "Passing from the question of jurisdiction to the act itself, there can be no doubt of the general power of a state to regulate the fares and freights which may be charged and received by railroad or other carriers, and that this regulation can be carried on by means of a commission. Such a commission is merely an administrative board created by the state for carrying into effect the will of the state as expressed by its legislation. Railroad Commission Cases, 116 U. S. 307".

In Ruttfield vs Stranahan, 192 U. S. 496, the Court says:

> "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."

In a still later case, the Union Bridge Company vs United States, 204 U. S. 387, the court says:

> "Indeed, it is not too much to say that a denial to Congress of the right, under the Constitution, to delegate the power to determine some fact or the state of things upon which the enforcement of its enactment depends would be 'to stop the wheels of government' and bring about confusion, if not paralysis, in the conduct of the public business."

In view of these decisions there seems to be no question of the right of Congress to delegate the power to fix interest rates with the view of accommodating commerce and business.

Third. In view of the decisions above recited, it seems clear that the failure of Congress to prescribe in the Act itself a maximum rate of interest to be charged will not make the usury laws of the states applicable.

(a) Because, as shown in the cases of the Farmers and Mechanics National Bank vs Dearing, Haseltine vs Central Bank of Springfield, and Schuyler vs Gadsden, supra, the

state laws have no application in such cases unless the Act of Congress provides that such laws shall be applied.

(b) Because Congress delegated to the Federal reserve banks, subject to review and determination of the Federal Reserve Board, the right to fix rates of discount to be charged by the Federal Reserve banks for each class of paper, such rates to be fixed with the view of accommodating commerce and business.

Respectfully,

Counsel.

Hon. Charles S. Hamlin,
Governor, Federal Reserve Board.