FEDERALIZATION—DESIGN FOR CORPORATE REFORM IN A NATIONAL ECONOMY

HAROLD GILL REUSCHEIN

I. THE SCHOOLS OF CORPORATE REFORM—A HISTORY OF FAILURE

The corporation has long been regarded as the sick man of our economy—so much so, that its evil ways have been the subject of every man's economic table talk. It has been singled out by social engineers and social tinkerers (including lawyers) for special study. A list of the ills and symptoms besetting the corporate device would make a bulky catalogue indeed. Among those which have most disturbed the sociologists, economists and even the lawyers are: (1) the unhappy divorce of corporate control from corporate ownership, (2) the activities of promoters who profit unfairly, (3) the presence of directors who do not direct, (4) the use of the one man company, (5) the cancerous growth of intercorporate shareholding, (6) the practice of stock watering, (7) the curse of bigness with its attendant concentration of economic power, (8) more or less irresponsible charter-mongering, and (9) the unsatisfactory relations with labor. The vicious thing about these and other ills is that they make the corporation a bearer of contagion through all our economy.

Much has been written about how to treat, if not cure, the corporation. If *anything* characterizes the many proposals looking in the direction of corporate reform, it is that the proponents have invariably been unable to focus at any given time upon the larger aspects of their problem. They have not seen or have refused to see that the corporation is pretty much sick all over. The reformers have proposed all kinds

† A.B., 1927, University of Iowa; LL.B., 1933, Yale University; J.S.D., 1934, Cornell University; Professor of Law in Georgetown University; author of *Aluminum and Monopoly: A Phase of an Unsolved Problem* (1939) 87 U. of Pa. L. Rev. 509; *Roscoe Pound, the Judge* (1942) 89 U. of Pa. L. Rev. 292; *Who Wrote the Mirror of Justices?* (1942) 58 L. Q. Rev. 265; and other articles in legal periodicals.
of treatment for local sore spots, but when any one or several of these proposals have been tried, the result invariably has been the healing, complete or partial, of the local sore, but the sick man still remained very sick generally.

Proposals for the cure of corporate ills seem to group themselves into a number of recognizable schools.

One school, arguing that the major ill besetting the corporation is in the divorce of ownership from control,¹ has leveled its guns at the system of proxy-voting in the belief that the present system of proxy-voting is the principal device by which management is perpetuated.² Reform in this direction is best illustrated by the Proxy Rules of the Securities and Exchange Commission, requiring adequate disclosures in connection with the solicitation of general proxies, and compelling the corporation to mail opposition proxies furnished by a security holder.³

These efforts of the SEC to reform proxy-voting are most certainly to be commended. It is difficult to find anything in the revised proxy rules that ought not to be there; the significant criticism is that there is not enough there. Unless the picture embraces a thoroughly articulate opposition group, the best the shareholder gets under the SEC disclosure requirements is a one-sided presentation subject to possible censorship and minimum standards with reference to information. Moreover, there can be little doubt but that the small stockholders, who are incapable of understanding even those corporate transactions of

¹. DIMOCK AND HYDE, BUREAUCRACY AND TRUSTEESHIP IN LARGE CORPORATIONS, T. N. E. C. Monograph No. II (1940) 19-35. "... the assumption that the owners of common or voting stock control a company is for the most part a fiction so far as the large corporations listed on exchanges are concerned." Id. at 19; BEILE AND MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932) chs. V, VI; I LYON, WATKINS AND ABRAMSON, GOVERNMENT AND ECONOMIC LIFE (1939) 56-66.

². "... the management of the modern corporation had made of the proxy machinery a self-perpetuation and a self-approval device, creating what might be described as an 'illiterate' corporate membership. So that the use of the proxy machinery was deemed a privilege to be exercised at the expense of the corporation solely by its managers. In this corporate drama the corporate meeting and the proxy device did not play the role purportedly cast for them by state statutes." Bernstein and Fischer, The Regulation of the Solicitation of Proxies; Some Reflections on Corporate Democracy (1940) 7 U. of CHI. L. Rev. 226, 227; DIMOCK AND HYDE, BUREAUCRACY AND TRUSTEESHIP IN LARGE CORPORATIONS, T. E. N. C. Monograph No. II (1940) 20; Comment, Regulation of Proxy Solicitation by the Securities and Exchange Commission (1939) 33 ILL. L. Rev. 914, 915-922.

³. The Commission's Proxy Rules are promulgated under authority of Section 14 (a) of the Securities Exchange Act of 1934 forbidding the solicitation of proxies of any securities registered on a national exchange unless in conformity to such regulations as the Commission might make. The first rules promulgated by the Commission, in dealing with the solicitation of general proxies, forbade the use of misleading statements, required that the identity of the solicitor be made known, likewise the person or persons for whom he was acting, whether or not he was to receive the compensation, a description of the use to which the proxy was to be put and what line of conduct the proxy holders intended to pursue. In 1938, a new regulation increased the material to be furnished the Commission and enumerated certain matters in which the information was required to be highly specific. Regulation X-14, Securities Exchange Act of 1934, Release No. 1823, Aug. 11, 1938, as amended by Securities Exchange Act of 1934, Release No. 2376, Jan. 12, 1940. The Commission is now reported to be considering another general revision of the regulations.
which they are informed, must be protected. For their benefit, we
need legislation providing for the appointment of bona fide representa-
tives of each class of security holders and imposing limitations on the
right of management to solicit proxies from persons affected by pro-
posed plans. Such approval or disapproval of a proposed plan, coming
from persons similarly situated, should prove to be a fairly reliable
guide to the shareholder, who finds difficulty in knowing what proposed
maneuvers are all about.

It is still too early to evaluate the new proxy rules in operation.
As now conceived, we may expect much from them, but they will fall far
short of divorcing corporate control from corporate ownership. To be
really effective, the proxy-solicitation-rectifying machinery must provide
for representatives for the stockholder whose investment is appreciated
but whose business acumen is none too great. Conceivably that activity
might be added to the work of the SEC, but there are signs that that
hard-working agency is handling about all it can do. The legislation of
some fifteen states, implementing the SEC proxy regulations by circum-
scribing the issuance of non-voting common stock, and the New York
Stock Exchange rule discontinuing the listing of further issues of such
common stock are commendable. They would be even more effective
if given the sanctions attendant upon an all-pervasive federal scheme.

Another school of corporate reformers believes that major cor-
porate ills are due to the fact that the influential corporations are too
big. Their proposals are bottomed upon the idea that there is grave
danger to the public inhering in bigness as such and that such blessings
as increased market competition will spring from the atomization of
industry. This group of reformers has tackled their problem both by
direct and indirect methods. Historically, the most important direct
action has been the atomization activity under the Sherman Act. A
more modern form of direct action is legislation expressly designed to
limit the size of corporations. To date this has been tried in the public
utility field and has been directed at the holding company as the device
which enabled the great utilities to build their empires. The Public

4. For a rather illuminating illustration of failure to comprehend and resulting dis-
interest on the part of a shareholder, see TIME, Jan. 29, 1940, p. 59, col. 2.
5. Note (1940) 53 Harv. L. Rev. 1165, 1173.
6. For a discussion of circumscribing legislation of this type and for the arguments
for and against non-voting shares, see Stevens, Corporations (1936) 452-456.
7. Report of the Committee on Stock List, New York Stock Exchange, to
the Committee on Interstate Commerce of the United States Senate, Jan. 25,
1937 (Published by the Stock Exchange). “In contrast to non-voting preferred, the
use of non-voting common stock has met with considerable disfavor. Both the New
York Stock Exchange and the New York Curb have refused to list new issues of non-
voting common stock; for practical purposes, this would seem to have eliminated the
use of this device on any large scale in the immediate future.” Berle and Means,
The Modern Corporation and Private Property (1935) 76.
8. Brandeis, The Curse of Bigness (1934); Brandeis, Other People’s Money
(1914).
Utilities Holding Company Act was written into law, in response to a call for a *Quia Emptores* applicable to at least one important segment of modern corporate life, with the hope that it would mitigate the complexities and injustices due to the formation by the parent corporation of a maze of subsidiaries and affiliates. The principal indirect means employed to limit the size of corporations has been “discriminatory” taxation, best seen in the attempts to limit the number of units in chain store systems. State chain store taxes may follow one of three patterns. The most common takes the form of a license tax on each store of the chain located in the state, the tax being graduated according to the number of stores operated by the chain within the state. A second type assumes the form of a graduated fee based upon gross receipts. A third type of tax provides for a graduated tax on chain stores measured by the total number of stores in the chain whether situated within or outside the state.

The “big is bad” school of reform, believing that salvation lies in the atomization of corporations, like each of the other schools of reform, magnifies the importance of the particular evil at which its fire is directed. But, conceding its importance, the atomization activity under the Sherman Act never has satisfied the disciples of Brandeis, because of the limitations placed upon the Sherman Act by the Courts. Before you can atomize an industry you must find not only a monopoly such as would satisfy an economist, but you must find some monopolizing—

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11. Typical is the Indiana Law. IND. STAT. ANN. (Burns, 1933) tit. 42, c. 3, providing a tax rate of $7 for the first store, $10 each for the second to the fifth, $20 each for the sixth to the tenth, $30 for the eleventh to the twentieth, $50 for the twenty-first and beyond, together with the filing fee of fifty cents to be paid annually.
12. The Kentucky statute was invalidated in Stewart Dry Goods Co. v. Lewis, 294 U. S. 550 (1935), as denying the equal protection of the laws. The Iowa statute, IOWA CODE (Reichmann, 1939) c. 329.5, provided for both a gross sales tax and a graduated license tax. The Supreme Court on the basis of the Stewart case upheld the license tax but invalidated the gross receipts tax. Valentine v. The Great Atlantic and Pacific Tea Co., 299 U. S. 32 (1936). Similar legislation has been declared invalid in Schuster v. Henry, 218 Wis. 506, 261 N. W. 20 (1935), and in The Great Atlantic and Pacific Tea Co. v. Harvey, 107 Vt. 215, 177 Atl. 423 (1935).
13. LA. GEN. STAT. ANN. (Dart, 1932) §§ 8564-8674. This statute was upheld in The Great Atlantic and Pacific Tea Co. v. Grosjean, 301 U. S. 412 (1937), where the classification was said to be based not upon the location of the stores within or without the state, but upon the size of the business and the advantages attendant upon such size. The case was noted in 1937 37 COL. L. REV. 1231; (1937) 26 GEORGETOWN L. J. 163; (1937) 21 MINN. L. REV. 847; (1937) 23 WASH. U. L. Q. 136.
14. Mason, *Monopoly in Law and Economics* (1937) 47 YALE L. J. 34. When economists have talked about monopoly, they have been talking about something very different from what the lawyer has traditionally understood by the term. An examination of the literature cannot fail to reveal that the economist is capable of very nearly as much "wousening" (see FRANK, *LAW AND THE MODERN MIND* (1930) 60 et seq.) as the lawyer. Nevertheless it must be said to the economist's credit that they seem
in other words, you must find not merely bigness but a considerable amount of bad behavior accompanying the bigness. You are backed right up against the "fatuous distinction between good and bad trusts." There are other obstacles. Not all behavior which appears prima facie bad is really bad. You must test its badness by a "rule of reason." Among other difficulties encountered is the variety of treatment accorded to "loose" as distinguished from "integrated" combinations, and then there is the oft-repeated dogma that mere size is no offense.

finally to have reduced their definition of monopoly to this essential—"control of the market", i. e., control in the realistic sense, without regard to particular methods employed in achieving such control. Economists have a way of agreeing upon definitions which is perhaps more than lawyers do, but one cannot rely upon them when they attempt to go beyond the stage of diagnosing ills. When economists attempt to cure, they seem, mirabile dictu, emotional people; they are inclined to disagree, sometimes violently. The composite prescription of almost any dozen economists for any given ill seems to read: "Do something, do anything, try this." To appreciate all this, one need only read the suggestions made by various economists in Handler, The Federal Antitrust Laws, A Symposium (1932).

15. Much of the difficulty lies in the interpretation the courts have put upon the language of the Sherman Act. There is, so the lawyers tell us, a difference between "monopoly" and "monopolizing". The provisions of §§ 1 and 2 of the Sherman Act are as follows:

§1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal. . . . 26 STAT. 209 (1890), 15 U. S. C. A. § 1 (1941).

§2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor. . . . 26 STAT. 209 (1890), 15 U. S. C. A. § 2 (1941).

16. The phrase is Mr. E. D. Kennedy's. Kennedy, Dividends to Pay (1939) 45. See Kales, Good and Bad Trusts (1917) 30 Harv. L. Rev. 830, 845.

17. Standard Oil Co. of New Jersey v. United States, 221 U. S. 1, 60 (1911). "... it inevitably follows that the provision necessarily called for the exercise of judgment which it is necessary to make in determining whether the prohibitions contained in the statute had or had not in any given case been violated. Thus not specifying but indubitably contemplating and requiring a standard, it follows that it was intended that the standard of reason which had been applied at the common law and in this country in dealing with subjects of the character embraced by the statute, was intended to be the measure used for the purpose of determining whether in a given case a particular act had or had not brought about the wrong against which the statute provided." (Italics supplied.) The import of the Standard Oil decision was more fully defined in the American Tobacco Company case. The court held that there has been a violation of the Sherman Act by a combination which, although employing a very complicated method of stock ownership, had engaged in predatory practices to stifle competition and achieve to all intents and purposes a monopoly. In making the decision the Court elaborated further upon "the rule of reason" and declared that the record before the Court, "... if possible serves to strengthen our conviction as to the correctness of the rule of construction, the rule of reason, which was applied in the Standard Oil case, the application of which rule to the statute we now, in the most unequivocal terms, re-express and re-affirm." American Tobacco Co. v. United States, 221 U. S. 105, 180 (1911).

18. See United States v. Trenton Potteries Co., 273 U. S. 392 (1927), where the trade association, said to be a "loose" combination seemed to constitute an exception to that class of combinations which is measured by the "rule of reason."

19. Under certain circumstances, size may give rise to a prima facie presumption of illegality. See Standard Oil Company of New Jersey v. United States, 221 U. S. 1 (1911). This presumption, however, may be rebutted. It was Mr. Justice Brandeis who said that "the essence of restraint is power" and that "power may arise merely out of position." Dissent in American Column and Lumber Co. v. United States, 257 U. S. 377, 414 (1921).
Further difficulty with the anti-trust laws inheres in the vacillating attitude of the Roosevelt Administration. During the early days of the Administration the anti-trust laws were relegated to oblivion in the interests of the self-regulation of industry. Then came Mr. Arnold to rescue them from oblivion and to sell them as the white-hope of our ailing economy. Come then Messrs. Knudsen and Hillman to put the white-hope back in the closet in the interests of total defense.

But all the difficulties encountered by the atomization advocates do not lie with the vagaries of the Sherman Act and its judicial construction. American economic thought is not yet willing to condemn bigness *per se*, nor are we yet ready or able to fix any differentiating line. And were we ready to unscramble the big companies, what would we do with them? It would be difficult, to say the least, to divide the cash and securities of General Motors among its operating units. And, where the profits of a large company are dependent upon its size, stockholders' investments would be jeopardized. Moreover, it does not follow that competition would be restored, for the ownership of the new companies would remain the same as the ownership of the old. We know that large companies in which there is no community of ownership get along with a minimum of competition. Is anyone so naive as to suppose that companies having the same stockholders will compete with each other?

Furthermore, admitting the legality of chain-store taxation, there is grave doubt as to the social wisdom of this indirect means of attacking corporate bigness. Destroying the chain store may have unfortunate results for the ultimate consumer. There is evidence that some of the state courts have seen some desirability in preserving the admitted economies to consumers of the chain store system of distribution. Admitting that the chain stores have been guilty of practices prejudicial to the rights of others, a means should be sought whereby these problems can be met directly, avoiding resort to the subterfuge of tax laws.

20. See note 47 infra.

21. "The distinguishing characteristic of a monopolized industry is that, although it may have more than one large corporate member, it does not have many large corporate members. There are only two large sulphur companies, three large copper companies, four large cigarette companies, hardly a dozen large steel companies and so on. These companies are not regulated. No outsider dictates their prices. They pose as exponents of individual enterprises and free competition. They are not the products of individual enterprise—they are the product of pooled capital. They cherish each other's profits almost as dearly as they cherish their own. And competition, particularly price competition, is to them an abhorrent term. But whenever they are accused of being monopolies they can always cite the presence of a competitor in the same field. The public does not yet realize that the so-called competitor does not necessarily compete. I suppose it imagines that 'standard priced' cigarettes always sell for close to 15 cents a pack, regardless of the cost of the tobacco that goes into them, merely through a coincidence. Even the anti-trust laws are based on the principle that a company cannot be considered a 'trust' unless its methods of doing business have made the existence of competitive companies difficult and impossible." Kennedy, DIVIDENDS TO PAY (1939) 77-78.
There are those who believe that the most prominent role in corporate reform should be played by the judicial process in the formulation of stricter standards of fiduciary responsibility upon corporate officers and directors. "The Common Law", we are told, "has at its command tools adequate to meet the situation in sufficiently competent hands." Basic to the preachments of this third school of reform is the conception of corporation law as fundamentally a branch of the law of trusts. From that assumption it follows that all corporate powers are properly "exercisable only for the ratable benefit of all of the stockholders as their interest appears." The Utopian quality of the aspirations of this school is fully demonstrated by a study of the cases construing director and officer liability in connection with the abuses of corporate authority to (1) issue stock as related to pre-emptive rights, (2) to declare or withhold dividends, (3) to acquire stock in other corporations, (4) to amend the charter, and (5) to transfer the corporate enterprise to another enterprise by merger, exchange of stock, sale of assets or otherwise.

There are two principal difficulties in utilizing for corporate reform the concept of corporate powers as powers in trust. One difficulty lies in the obstinate fact that judges are what they are; the other lies in the woeful inadequacy of the means developed to enforce these so-called trust duties.

It has been argued that, despite the fact that intricacies and expenses of litigation may leave the individual shareholder virtually helpless, and despite the fact that any considerable improvement via the judicial process would be slow and uncertain, greater flexibility will be available so that management may pursue whatever policies are best fitted to the varying circumstances upon which business judgments must be grounded. That presupposes that judges no longer worship stare

23. "A study of corporate powers ... indicates the necessity of an underlying thesis in corporation law which could be applied to each and every power in the whole corporate galaxy. Succinctly stated, the thesis appears to be that all powers granted to a corporation or to the management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears. That in consequence, the use of the power is subject to equitable limitation when the power has been exercised to the detriment of their interest, however absolute the grant of power may be in terms, and however correct the technical exercise of it may have been ... in every case, corporate action must be twice tested; first by the technical rules having to do with the existence and proper exercise of the power; second, by equitable rules somewhat analogous to those which apply in favor of a cestui que trust to the trustee's exercise of wide powers granted to him in the instrument making him a fiduciary." Id. at 248. See further the articles comprising the debate between Professors Berle and Dodd; Berle, Corporate Powers as Powers in Trust (1931) 44 HARV. L. REV. 1040; Dodd, For Whom Are Corporate Managers Trustees? (1932) 45 HARV. L. REV. 1165; Dodd, Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable? (1935) 2 U. OF CHI. L. REV. 104.
24. ILYON, WATKINS AND ABRAMSON, GOVERNMENT AND ECONOMIC LIFE (1939) 75-76.
decisis; it also presupposes that judges are reasonably expert in handling complicated corporate matters. The pages of history, the recent past and the picture today show these presuppositions to be a pleasant, but a dangerous bit of self-delusion.

So thoroughly have the shortcomings of the derivative suit as an effective means for the enforcement of directors' fiduciary duties been recognized, that a considerable amount of the ingenuity of legal scholarship has been devoted to devising means to supplement or to replace the derivative suit. These suggestions include the union of investors throughout the country to form an agency to investigate and prosecute charges of wrongdoing by officers and directors, the creation of a government bureau exercising similar functions, the substitution in most instances of the visitatorial power of equity for the stockholder's suit, and even the frequent use of judicial winding-up proceedings as a kind of death sentence for corporations which deal unfairly with a minority, the creation of judicial departments within individual corporations, and finally, that, in so far as possible, we abandon judicial handling of the problem and substitute therefor administrative supervision.

The number of suggestions advanced, the unusual attributes of some of them, their diverse character and the fervor with which their proponents champion them stand as eloquent testimony to the inade-
quacy—almost futility—of our present methods of enforcing the duties incident to the trusteeship of corporate management. And even if Mr. Berle's theory of trusteeship should find immediate favor with the courts, it is a trusteeship for the stockholders only. But the need is for something far more pervasive than a square deal for stockholders. The trusteeship theory takes little or no account of the corporation as an economic problem of great magnitude affecting not only investors, but consumers, labor and the entire public as well. The interests of these various groups must be integrated with the demands of stockholders and the profit and service functions and potentialities of particular corporations. The trusteeship-for-stockholders theory distorts and minimizes the problem.

From Dean Pound comes still another proposal to control corporate abuse. He asks that the visitatorial power of the courts of equity be resorted to by the prosecuting authorities of the state. The principal objection to pinning hopes upon the visitatorial power is that equity has rarely ever shown any disposition to exercise the power, so much so that statutory enactment would seem necessary to force its use. It has been suggested that one of the virtues that would result from strengthening the visitatorial power of equity would be the forestalling of control of private corporations by administrative bodies. But it is too late to hope that any such device will delay, much less stop, the advance of the administrative process even if such a result were desirable. It would be useless to repeat here the advantages and disadvantages inherent in regulation by administrative process—that has too often been gone into. It must be mentioned in passing, however, that one of the strong points of the administrative system is that an expert body is charged with enforcement of the particular policy desired by the legislature. The expansion of the visitatorial power of equity will have a diametrically opposite effect.

33. The equity courts have exercised such visitatorial power over corporations generally only in three instances: (1) where it is a public service corporation, (2) where it is a charitable corporation, and (3) where it is a public corporation. Now, while it is arguable that equity has visitatorial jurisdiction over private corporations, that it has exercised such jurisdiction in a few cases, and that it ought to exercise it, as a practical matter it has not done so very frequently.
35. Dean Landis expresses the chief benefit of administrative control when he says that expertness "springs only from that continuity of interest, that ability and desire to devote fifty-two weeks a year, year after year, to a particular problem. With the rise of regulation, the need for expertness became dominant; for the art of regulating an industry requires knowledge of the details of its operation, ability to shift requirements as the condition of the industry may dictate, the pursuit of energetic measures upon the appearance of an emergency, and the power through enforcement to realize conclusions as to policy." LANDIS, *The Administrative Process* (1938) 23-24.
Further, the prosecuting authorities are not fit to determine which policies of a private corporation are bad for the general public or the stockholders. At best, the efforts of the attorney general would be disjointed; the office changes too frequently to build up a consistent policy. Moreover, the attorney general's office is usually closely connected with politics, much more so than an administrative body. The supervision of corporations would be just one of many of the attorney general's duties, while the administrative body has that task as its sole duty.\(^{36}\)

The personnel of still another school are specialists, each of whom is primarily concerned with a particular evil, for which he has adopted a preventative. Of course, this scheme must allow for more or less frequent lapses in the efficacy of the prophylactic technique, and when such lapses occur there must be some one ready to salve the injured and to punish those responsible. The devotees of this school point to the inadequacy of judicial relief to serve as a sufficiently pervasive prophylactic agent. In short, these men, for the most part, believe in the efficacy of effort; most of them believe in the efficacy of administrative effort. By way of illustration one thinks immediately of the Securities and Exchange Commission and the successively firm hands of Kennedy, Landis, Douglas and Frank,\(^{37}\) of that grizzled and honorable veteran, the Interstate Commerce Commission, and sturdy fledglings such as the Federal Communications Commission and the Civil Aeronautics Authority. And, by all means, one thinks of the more pervasive activities of that apostle of effort's efficacy, Mr. Thurman Arnold,\(^{38}\) particularly his efforts to build up a system of codes of fair competition through the consent decree.\(^{39}\)

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36. Id. at 27. See also I. Lyon, Watkins and Abramson, Government and Economic Life (1939) 78.
38. Mr. Arnold has devoted years and volumes to preaching the doctrine of salvation or near salvation through fair and efficient enforcement of the anti-trust laws. See Arnold, The Bottle-necks of Business (1941) chs. 7, 8, 9. See also the following articles by Mr. Arnold: Fair and Effective Use of Present Anti-trust Procedure (1938) 47 Yale L. J. 1294; Anti-trust Activities and the Department of Justice (1939) 19 Ore. L. Rev. 22; Prosecution Policy Under the Sherman Act (1938) 24 A. B. A. J. 417; Enforcement of the Sherman Act (1938) 9 Mo. B. J. 220; Anti-trust Law Enforcement, Past and Future (1940) 7 Law & Contemp. Prob. 5; Anti-trust Laws and the Consumer (1940) 12 Miss. L. J. 579.
39. It has been pointed out that the Anti-trust Division of the Department of Justice is attempting to promulgate codes of fair trade practice by use of the consent decree. The procedure can be justifiably criticized since often there is an indictment hanging over the head of the company during the time that the terms of the consent decree are being worked out. There is also room for criticism of such attempts to exercise planning functions usually exercised by administrative agencies by a trained personnel including economists, sociologists, lawyers and various technical experts and even, some times, someone who has had some experience in business. The Anti-trust Division is lawyer-laden and lawyers, even socially-minded ones, are not the most satisfactory socio-economic planners. See Isenbergh and Rubin, Anti-trust Enforcement Through Consent Decrees (1940) 53 Harv. L. Rev. 386; Katz, The Consent
For the most part they have done an admirable job, but each of these agencies is hamstrung by the very narrow confines of its authority. The work of each suffers from lack of coordination and the absence of an over-all plan. It may be an heroic job to plug up one hole in a big dike; but one well-plugged hole will do little to stop the onrush of dirty water if good sized holes remain unplugged.

Perhaps least articulate of the advocates of corporate reform are those who, probably because of our recent experience with the device, give thought to cartelization. A cartel may be roughly defined as a combination of separate firms for the purpose of maintaining prices. Those who see a degree of salvation in an appreciable concentration of power under the cartel system believe that most of the evils of our business economy are to be explained by the failure to stabilize prices. Strangely, they comprise two hostile groups: industrialists who, looking with envy upon the absence of competition in the cartel system, see a way out from under the Anti-trust laws; and anti-industrialists who see the possibility of a degree of positive control over corporations that is impossible under the rather negative provisions of existing legislation. We experimented with cartelization in the form of the National Recovery Administration. There was some furtive cartelization before NRA; and though NRA is long since dead, some of the practices legalized under it have been continued.

Cartelization labors under certain handicaps. It is of foreign birth and is therefore the victim of much whispering and viewing with alarm. The possibility of its utilization as an instrument of corporate reform, even granting it some degree of effectiveness, is thus remote in the extreme. There is another difficulty; cartelization means an anti-competitive system, which, to be successful, requires governmental supervision so stringent that few business men would willingly embrace the system. One who knows told us that cartelization is playing with fire, that its use threatens the underpinnings of democracy.

The suggestion has been advanced that courts of equity have a most effective prophylactic agent for the prevention of corporate

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40. Warren et al., The State in Society (1940) 54.


42. Hearings Before the Temporary National Economic Committee, 76th Cong., 3d Sess. (1940) 13347-13353 (Testimony of Dr. Rudolf Callman). For a thorough analysis of the German experience with cartels, see Hearings before the Committee on Patents, 77th Cong., 2d Sess. (1942) 1270-1362 (Testimony of Dr. Heinrich Kronstein).
abuse in their power to wind up a corporation at the suit of a minority stockholder. It is argued that "officers of corporations will hesitate longer before committing a wrong if they face the possibility that the consequences may be dissolution of the corporation, and that they individually will lose salaries, power and prestige." The most telling criticism of the proposal is that judges have been reluctant to apply it; it is even doubtful if legislative encouragement would change their present attitude. Were we to admit the effectiveness of the remedy if generally applied, it is doubtful if there is time to experiment with it. While we are endeavoring to persuade judges of their own powers, villainy will grow apace. Then, too, the average dissatisfied stockholder is not desirous of liquidation—he likely will get more for his stock on the market than from a coerced liquidation. Corporate death may have a genuinely harmful effect upon the community in the reduction of employment and in other ways.

It may be that there is no articulate school of corporate reform recommending a generous extension of the public utility concept as an effective cure-all. But those charged with the enforcement of the anti-trust laws have threatened recalcitrants with the possibility of extension of the concept of a public business. The threats to loose the dogs of government control ebb and swell depending upon the attitude of the Administration. Sometimes the threat has assumed the form: "Regulate yourselves by mutual agreements or we come in to tell you how to operate." At other times the warning has been "Regulate yourselves effectively by competing with one another or we take over".

43. Hornstein, A Remedy for Corporate Abuse—Judicial Power to Wind Up a Corporation at the Suit of a Minority Stockholder (1940) 40 Col. L. Rev. 220.
44. Id. at 251.
46. Mr. Justice Jackson (then Solicitor General): "Hence American business must make up its mind whether it favors truly effective regulation by competition, as contemplated by the anti-trust laws or the inescapable alternative—government control. Every step to weaken those laws, or to permit price fixing or monopolistic practices, is thus a step toward direct public control of economic operations hitherto performed by private enterprise." (Italics supplied.) See Jackson and Dumbauld, Monopolies and the Courts (1938). 86 U. of Pa. L. Rev. 231, 238.
47. Within the last dozen years the present Administration has done some mystifying things to the anti-trust laws. The Assistant Attorney General, in charge of enforcement of the anti-trust laws: "... monopoly means, sooner or later, government interference in business. I am willing to face the problem when the need arises. Yet it is precisely because I do not wish those areas of necessary interference to increase and because I want to keep the government out of business that I am an advocate of the consistent enforcement of the anti-trust laws. ... The Anti-trust Act represents a public policy to keep open and free the channels of opportunity, which has never been more important than today." Arnold, Fair and Effective Use of Present Anti-trust Procedure (1938) 47 Yale L. J. 1294, 1295, 1303.
Currently the injunction seems to be: "Produce for war. All bets are off so far as compliance with the anti-trust laws goes. Produce or we take over." When Mr. Cummings said, "In this welter of things, nothing is more obvious than the fact that big business, if I may use that term, is moving blindly with accumulating acceleration down the road leading to ultimate Governmental supervision"; and when Mr. Justice Jackson, lately Attorney General, said, "American business must make up its mind whether it favors the regulation by competition contemplated by our anti-trust laws or the only probable alternative—government control", that threat became articulate.

Perhaps most articulate in suggesting creation of new kinds of public utilities when self-discipline fails has been Judge Jerome Frank, who defines public utilities as those industries "about which there is a general understanding that the competitive element in monopolistic competition must, in the social interest be suppressed because every-

monopolies or to eliminate or oppress small enterprises and will not operate to discriminate against them, and will tend to effectuate the policy of this title. [Title I.] Provided, that such code or codes shall not permit monopolies or monopolistic practices."

Section 5 of the N. I. R. A., 48 STAT. 198 (1933), 15 U. S. C. A. § 705 (1941), declared that while Title I of the Act is in effect and for sixty days thereafter, any action complying with the provisions of an approved or prescribed code "shall be exempt from the provisions of the anti-trust laws of the United States". Senator Wagner emphatically denied that Section 2 of the Sherman Act was suspended. 77 CONG. REc. 5163 (1933). Compare the statement of Professor McLaughlin, writing before the National Industrial Recovery Act had been enacted into law: "It is replete with contradictions and inconsistencies, some more patent than others. Perhaps the most patent is the provision that codes shall not permit monopolies, while it is clearly contemplated that the codes will involve market control which can only be effective on a monopolistic basis. The part of the preamble about the fullest utilization of present productive capacity was inserted after the bill was introduced. It appears to be an afterthought in the nature of window dressing, and not in keeping with the spirit of the rest of the bill. The implication that 'undue restriction of production may be temporarily required' may be attributed more to mere awkwardness than to Machiavellian design." McLAUGHLIN, CASES ON THE FEDERAL ANTI-TRUST LAWS OF THE UNITED STATES (2d ed. 1933) 719. The depression period attitude toward the anti-trust laws is illustrated by Cabot, The Vices of Free Competition (1931) 21 YALE REV. 38; John Dickinson (former Assistant Attorney General, and former Assistant Secretary of Commerce), The Anti-trust Laws and the Self-Regulation of Industry (1932) 18 A. B. A. J. 600; Jaffee and Tobriner, The Legality of Price-Fixing Agreements (1932) 45 HARV. L. REV. 1164. In the recent past business men have been bombarding the monopoly laws. Among many printed attacks, one might single out Strawn, Should the Anti-trust Laws Be Modified? (1931) 54 N. Y. S. B. A. REP. 381; Williams, The Reign of Error (1931) 147 ATLANTIC MONTHLY 787.

But all this is history and a few years later the anti-trust laws assumed an honored place in the arsenal of business morality.

Former Attorney General Cummings: "My proposition is that the Anti-trust Division of the Department of Justice should be more adequately implemented. Laws do not operate in vacuo. They do not achieve their results automatically. There must be behind them the driving force of the Government." The Unsolved Problem of Monopoly (1938) 72 U. S. L. REV. 23, 25-26.

The Assistant Attorney General: "Intelligent men of all political parties agree that unless competition can be maintained government regulation and interference with business is inevitable." Arnold, Prosecution Policy Under the Sherman Act (1938) 24 A. B. A. J. 417.

one concerned—the investor, the workers and the consumers—suffer unless it is suppressed." From this definition it necessarily follows that the category “public utility grows ever larger as our economy grows more complex.” When the “competitive element in an industry is found to be socially disvaluable”, make that industry a public utility. In the *Nebbia* case, Frank finds the long-awaited reversal of form by the Supreme Court, so that there is now “no constitutional obstacle to prevent the legislatures of the several states from enacting laws making any industry a public utility.”

The public utility comprehends some flexibility of pattern. In the case of most public utilities, government has eliminated all competition. In others, a measure of competition has been preserved or increased competition has been enforced. And enforced competition may very well result in complete governmental monopoly. It should be understood that Judge Frank advocates no hit-or-miss compelled competition or helter-skelter sponsoring of monopoly. Enforced competition must necessarily be part of a comprehensive economic plan based upon “patient appraisal of individual industries” with a view to increasing production and lowering prices.

Perhaps threats of extending the public utility concept are today designed merely to frighten the gullible. That new industries may be tagged “affected with a public interest” may be admitted, but even with the *Nebbia* decision, the process may be too slow to achieve urgently needed reforms. Moreover, Federal regulation is, of course, limited to

50. Frank, *Save America First* (1938) 312.
51. Ibid.
52. In the early cases monopoly was often named as the primary test. Munn v. Illinois, 94 U. S. 113 (1876). Hamilton, *Affectation With a Public Interest* (1930) 39 Yale L. J. 1089, 1098. But cf. McAllister, *Lord Hale and Business Affected With a Public Interest* (1930) 43 Harv. L. Rev. 759, who states that monopoly is not an essential component of Chief Justice Waite’s argument. When we think of a utility, we ordinarily think of one licensee exercising a franchise in a given area—e. g., the typical electric light and power company. See Comment, *A Re-examination of Competition in Gas and Electric Utilities* (1941) 50 Yale L. J. 875.
53. The railroads seem to afford the best example of a policy dictating the preservation of a considerable measure of competition. Under President Wilson’s policy of enforced competition the New York Central was forced to surrender its ownership of the Nickel Plate and the Pennsylvania was compelled to disgorge its ownership of the Baltimore and Ohio, with most unfortunate results.
54. Frank, *Save America First* (1938) 313.
55. Notes 46 and 47 supra. One is reminded of Professor Beard’s remarks to the effect that the Sherman Act was never “intended to mean anything save a big noise to gull the gullible.” Beard, *The Trust Problem* (1938) 96 New Republic 182.
56. Nebbia v. New York, 291 U. S. 502 (1934). “The category, public utility, is not a closed one. It has grown ever larger in the course of our history. Any time that the competitive element in an industry is found to be socially disvaluable and is wiped out, then the industry becomes a public utility. The Supreme Court, over a long period, gave decisions to the effect that, constitutionally, our legislative bodies could so deal with but a few selected industries. But in the Nebbia case, decided in 1934, it reversed that attitude, and there now seems to be no constitutional obstacle to prevent the legislatures of the several states from enacting laws making any industry a public utility.” Frank, *Save America First* (1938) 312.
industries engaged in interstate commerce and, though the states are authorized by the *Nebbia* decision to regulate intrastate transactions, there seem to be almost insurmountable difficulties in the way of satisfactory federal-state cooperation. Few see the possibility of dragooning the states into interstate compacts. One may conceive of a combination of uniform state and federal legislation as the answer, but one must be something of a starry-eyed enthusiast to envisage such a solution as being practical. Effective regulation on the public utility level through the length and breadth of the land must wait upon a Constitutional Amendment.

These, then, represent the principal schools of corporate reform. At best, each aims only at one evil or a group of related evils, and leaves, for the most part, all the other sore spots entirely untouched. Though what has been accomplished is often commendable, the reform of a particular school may not be adequate to cure even the disease at which its efforts are aimed. Significantly, such inadequacies are due primarily to the failure to coordinate with other reform efforts, or, at least, such inadequacies are aggravated by the failure to coordinate.

II. Uniformity, the Solution—Uniformity Means Federalization

Of necessity, coordination must be by a single authority, and as comprehensive a group of offenders as possible must be controlled. Past efforts have fairly well demonstrated that uniformity must mean federalization. The alternatives, the adoption of a uniform business corporation act, the signing of interstate compacts and the possibility of getting a combination of the two have mired down in the persistent unwillingness of the states to resort to any of them.

The history of the Uniform Business Corporation Act has demonstrated the futility of seeking effective legislative standardization by model uniform legislation. The act approved by the National Conference of Commissioners of Uniform Laws in 1928 is one of the most carefully considered of the many Uniform Acts. It has, during the intervening thirteen years been adopted without modification only in Idaho, Louisiana, and Washington. Meanwhile the

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Commissioners have receded from the position originally taken and what was first offered as a "Uniform Business Corporation Act" has now become merely a "Model Business Corporation Act." As a "Model Act" it has met with more gratifying success, having served as a guide to recent legislation in Illinois, Michigan, Minnesota, Ohio, and Pennsylvania. The history of the Act and the admissions of the National Conference indicate that, in the face of state competition, the job must be done by other devices. As for interstate compacts, it would seem doubtful whether, standing alone, they can ever be an adequate solution of difficult social problems which admittedly can be settled only when all the states are in agreement. Many corporate evils are bound to stick so long as there is even one holdout, and the strong likelihood of one "Corporate Reno" spells the inefficiency of interstate compacts. So far as the grim business of curing corporate abuses is concerned, the fond hope of the compact enthusiasts seems Utopian.

Proposals for granting a national charter to corporations engaged in interstate commerce and for issuing federal licenses to such corporations are not new. The advisability of such congressional charters was debated in the Constitutional Convention, and federal incorporation was recommended by Presidents Theodore Roosevelt, Taft.

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70. The phrase, "Corporate Reno" has been ascribed to Judge John J. Bruns, sometime General Counsel, Securities and Exchange Commission. Berlack, Federal Incorporation and Securities Regulation (1936) 49 Harv. L. Rev. 396, 404, n. 30.
71. "There is ample ground for believing that the number of states which will join the compact will be substantial. The opportunity to eliminate state competition and to agree upon effective reciprocal regulation of foreign corporations doing intrastate business, and the effect which a federal licensing act will have in giving to the contracting states the business of incorporating companies to carry on interstate business, are cogent inducements to this end." Stevens, Uniform Corporation Laws Through Interstate Compacts and Federal Legislation (1936) 34 Mich. L. Rev. 1063, 1092.
72. One careful student of the compact device is not quite as optimistic as Dean Stevens. "Since compacts as instruments of federal-state cooperation have been but slightly explored, their potentialities are little known. Judging from past experience with such agreements between states, the machinery of compact agreement is cumbersome, and even after it is started, does not continue to run merely of its own momentum. Difficulty has been experienced in getting the arrangement under way, for economic and political obstacles have frequently made the states reluctant to join an agreement." Clark, The Rise of a New Federalism (1938) 318.
74. 15 Messages and Papers of the Presidents 749-758. It is a bit difficult to understand Taft's insistence upon a permissive incorporation law when he seemed quite convinced of the inevitability of federal incorporation. He wrote: "No other method can be suggested which offers federal protection on the one hand, and
and Wilson. In 1935, Senator Borah climaxed his long crusade against monopoly with the introduction of a bill to license corporations engaged in interstate commerce. Senator O'Mahoney introduced a similar bill in that same year and another in January, 1937. Later, Senators Borah and O'Mahoney joined forces, introducing S. 3072, and in the first session of the last Congress the two senators introduced their revised bill, S. 330.

For forty years, then, thoughtful men have recognized the futility of dealing with nationwide corporate abuses by leaving the problem to the states. As time passes, the need for federalization of corporations increases.

At the outset of this paper nine major ills besetting corporate structure were listed. There are others, but those enumerated are particularly vicious and widespread. No one of them has been successfully attacked by remedies known to date, and there seems little hope in permitting forty-eight timid physicians with limited powers, resources and equipment to try more. No one can guarantee a perfect solution of these difficulties by federalization, but much more effective work in prevention of the abuses may be expected if such work is grounded upon a comprehensive federal plan.

The SEC's proxy rules and such practices as the refusal to list non-voting common stock are not going to solve the problem of the unhappy divorce of corporate control from corporate ownership. It will require a federal incorporation or licensing bill which attempts a plan more bold and incisive than either the new proxy rules or the provisions of S. 330 contemplate. Senator O'Mahoney's current bill recognizes the persistent problem of the uninformed shareholder and attempts to answer his perplexities by supplying him with a supposedly unprejudiced representative. Of course the stockholder always did have the right to choose such a representative. Now the stockholder is provided with readily accessible representatives, who have

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75. See FEDERAL TRADE COMMISSION REPORT No. 69-A. This report contains a valuable collection of proposals for and against federal incorporation.
79. Id., at § 20.
80. "The old theory which seemed to dominate the earlier writers to the effect that every stockholder in a corporation is entitled to have the benefit of the judgment of every other stockholder in the selection of a board of directors, has necessarily been rendered obsolete because of our modern business being conducted by large corporations with thousands of stockholders located in all parts of the country. Manifestly a meeting of the stockholders of such organizations would be not only impracticable but impossible." Mackin v. Nicolet Hotel, Inc., 25 F. (2d) 783, 786 (C. C. A. 8th, 1928); cf. Fisher v. Bush, 35 Hun. 641, 644 (N. Y., 1885), stating that a contract not to give a proxy would be pernicious as tending to concentrate control in a few persons.
been certified by the Civil Service Commission only after meeting certain preliminary qualifications. The plan seems to be worth a try though one wonders who is to pay the representative. Presumably the shareholder will pay him. But, only the naive will expect to find a corps of certified corporation representatives who are incorruptible. Sometimes the only step forward is the step backward, and it may well be that the only way to eliminate proxy abuses directly and effectively lies in reverting to the old rule forbidding the transfer of voting rights apart from ownership.\(^8^1\) In other words, the solution may have to be found in permitting only the owners themselves to vote stock and in implementing that highly personal right with an absentee ballot system. Under such a system, management would be required to furnish in writing the several questions to be voted upon, with necessary comment to the stockholders. The votes of the shareholders would be duly certified and independent auditors would check the final ballot. Such a provision might effectively be substituted for what is now in Senator O'Mahoney's bill.

The curse of Bigness would not be removed, as if by magic, by federalization; but, if the anti-trust laws could be enforced against creatures of but one sovereign, something would be gained. A federal incorporation act could serve as a preventive by redefining monopoly; it could do what no court has yet been willing to do—define monopoly in terms of market economics.\(^8^2\) The current attempts to reduce corporate size—“trust-busting” and discriminatory taxation—are too arbitrary. They ignore the great diversity of conditions in different enterprises. Moreover, if there is a chain-store problem it is nationwide in scope, and ought to be dealt with by the federal government, though not so viciously as by Representative Patman in his “Bill to Curb Absentee Owned Interstate Chain Stores”.\(^8^3\) The problem of corporate size deserves sincere and thoughtful federal planning.

For generations judicial remedies for promoters' frauds and the recovery of secret profits have stood as a monument to judicial ineptitude. There can be no doubt that SEC activity, though at times indirect, has set standards that have gone toward revolutionizing the whole process of corporate promotion. It has demonstrated not only the efficacy of administrative effort, but also the efficacy of treatment

\(^8^1\) “The obligation and the duty of corporators to attend in person and execute the trust or franchise, reposed in or granted to them, is implied in and forms a part of every charter in which the contrary is not expressed.” Taylor v. Griswold, 14 N. J. Law 222, 232 (1834); People ex rel. Chritzman v. Crossley, 69 Ill. 195 (1873); Philips v. Wickham, 1 Paige, 590, 598 (N. Y., 1829); People v. Twdell, 18 Hun. 427 (N. Y., 1879); Com. ex rel. Verree v. Brinburst, 103 Pa. 134 (1883); Harben v. Phillips, 23 Ch. Div. 14 (Eng., 1883).


\(^8^3\) H. R. 1, 76th Cong., 3d Sess. (1939).
of the problems upon the federal plane.\textsuperscript{84} Of course both the commission and its work should be made part and parcel of a scheme of federal incorporation or licensing. It should not be a mere auxiliary, as would be the case were the O'Mahoney bill reintroduced and enacted.

If federal regulation of the issuance and purchase of securities is to content itself with insistence upon the complete disclosure of all material facts, federal incorporation could add but little to the effectiveness of present procedures. But there are many who believe that it may not be "economically wise, or morally right, that men should be permitted to add to the producing facilities of an industry which is already suffering from overcapacity."\textsuperscript{85} The O'Mahoney bill does not provide specially for security regulation, but if we are to do more to protect investors than require a disclosure, we must apply to corporate business generally a type of security regulation similar to that now applicable to public utilities. That means a fling at economic planning in the form of a Capital Investment Act. I do not know that I like the prospect, but such planning of the issuance of securities seems to be in the cards. When it comes it would seem to make federal incorporation inevitable, for any plan to control the investment of capital in industry must be coordinated with each and every other effort at corporate reform.

It cannot be gainsaid that we must replace directors who do not direct with directors who do. It is not enough to direct prohibitions at directors;\textsuperscript{86} we must tell them what they must do. Mr. Joseph P. Kennedy and Mr. Justice Douglas have been much impressed by the English system\textsuperscript{87} which develops a professional class of directors, paid salaries commensurate with the services they render. If the English practice were followed, such paid director would ordinarily be expected to serve but one corporation. As Mr. Justice Douglas says: "His job would not be to represent the management or to represent himself. It would be primarily to represent the stockholder—to return to the stockholder the protection which today's stockholder has too frequently lost. In a larger sense, he would not be so much a paid


\textsuperscript{85} Mr. Justice Brandeis, dissenting in New State Ice Co. v. Liebmann, 285 U. S. 262, 307, 308 (1931).

\textsuperscript{86} The O'Mahoney Bill forbids directors of the licensee from owning stock in or accepting directorship, officership or employment from a corporation which has loaned money or property to a licensee. S. 330, 76th Cong., 1st Sess. (1939) \S 18.

\textsuperscript{87} \textit{Douglas, Democracy and Finance} (1940) 47-55. Mr. Justice Douglas quotes Mr. Joseph P. Kennedy on the English experience.
director or a professional director as a public director, representing not only the present but the potential stockholder, and representing the general public as well? 88

Corporations could staff their boards with paid, professional directors of their own motion. But no one seriously believes they will, and none but the naive believe that the forty-eight states will require such a move. If a system of paid directors is to be made mandatory, the command will have to come from the Federal government. When Justice Douglas said that “Today it is generally recognized that all corporations possess an element of public interest”, he might have added that such “public interest” is invariably nationwide in scope. And when he says “A corporation director must think not only of the stockholder but also of the laborer, the supplier, the purchaser, and the ultimate consumer”, that means, almost always, throughout the nation. And so, a system of paid directors must come as one of the prescriptions of a system of national incorporation or licensing.

Those who have been advocating federal incorporation in the recent past have realized that any effective handling of the problems incident to the cancerous growth of intercorporate shareholding must be based upon uniform safeguards. It will not do to find rigid safeguards in one jurisdiction and loose practices blessed by the next. Under the O'Mahoney bill, the licensee, unless it enjoyed the power prior to the enactment of the Act, is denied the power to hold the stock of any other corporation unless such corporation is a subsidiary of the licensee. 89 This is typical of the technique employed by the bill. To approve prohibitions contrary to the provisions of recent state statutes and established doctrine, one must either maintain that all intercorporate shareholding is evil, or that the practice is beyond power of regulation and therefore legitimate acquisitions of stock must be prohibited along with inter-corporate shareholding of the undesirable variety. To say that the holding company device has been abused does not argue its utter wickedness. But, admitting that the holding company must go and not be merely regulated as at present, the problem of acquisition of stock by one corporation in another transcends the narrower limits of the holding company problem. It is doubtful whether we ought to say that inter-corporate shareholding is vicious per se. It is, of course, arguable that the prohibition is sufficiently qualified by permitting stock ownership in a subsidiary 90 and

88. "Furthermore, the paid director would revive and strengthen the tradition of trusteeship." Id. at 53.
90. Ibid. Does "subsidiary" as used in the Bill include "affiliated corporations?" On the distinction between "subsidiary" and "affiliate" see LATTY, SUBSIDIARIES AND AFFILIATED CORPORATIONS (1936) 304.
by the exemption of banks and insurance companies from the licensing bill.\textsuperscript{91} This much, however, is certain: there will be no uniform treatment of the problem of inter-corporate shareholding unless that uniformity emanates from federal authority. And again, we ought not to multiply the number of our present administrative difficulties by the enactment of legislation designed to cure but one of many corporate abuses.

In its effort to eradicate the evils of watered stock the O'Mahoney bill divests the directors of their discretion in the valuation of property or services for which such stock is issued. The social and legal experience of decades would seem to demonstrate the necessity of this. By the terms of the bill, it is proposed to issue such stock only when the issuance "has been authorized upon application to a competent court and under its order finding upon competent and specific proof that such stock has been or is to be issued on a fair valuation of such property or services."\textsuperscript{92} Frequently the time element is important in the issuance of securities, and appealing to a court for approval may prove much too slow. The discretionary authority to pass upon valuations should be vested in a commission expert upon such matters. Such bodies are in possession of the necessary technical equipment and a trained personnel. Furthermore, it would seem that its membership could be trusted to deal just as fairly with such matters as would a judicial tribunal. This, too, should be part of an all-pervasive federal scheme.

It is generally agreed that the progressive removal of restrictions upon corporations has largely been the result of constantly increasing competition among the states for the benefit of corporate business. The first need of a program of corporate reform is to kill this practice of charter mongering. The O'Mahoney bill seeks to strike at the "Corporate Renos" by requiring each licensee organized after enactment to have its chief place of business and hold its directors' meetings within the state of incorporation. That provision does not cover presently operating corporations and it may work hardship in certain instances, particularly in the case of manufacturing and mining companies whose production centers are in different sections of the country from their sales outlets. This difficulty would probably be lessened if federal incorporation rather than licensing were insisted upon.

No small part of our present difficulties is to be found in the unsatisfactory relations between business and labor, and the events of the last few weeks have demonstrated the need of a firm hand in handling labor relations. Even the firmest hand can show little strength

\textsuperscript{91} S. 330, 76th Cong., 1st Sess. (1939) § 14.
\textsuperscript{92} Id. at § 5 (I).
when grasping at slippery and elusive persons. Federalization of business corporations and incorporation of labor unions under Federal charters would give the national government a direct control over an ever-growing sore spot in our economy.

Even in the field of procedure possible gains from the federalization of corporations are discernible. By way of example, Rule 23 (b) of The Federal Rules of Civil Procedure provides in part that in a stockholder’s suit “the complaint shall be verified by oath and shall aver (1) That the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law. . . .” In a number of jurisdictions, including New York, no such requirement is made as to suits in the state courts. Is this a matter of substance, on which the federal courts must follow state law since Erie Railroad Company v. Tompkins, or is it a matter of procedure, so that they must follow Rule 23 (b)? In Piccard v. Sperry Corp., the rule was held to be one of procedure. In Gallup v. Cadwell, Judge Goodrich, although refusing to pass upon the question of prior ownership because it was not presented, indicated that there was considerable basis for holding the rule substantive.

That effective regulation of corporate abuses calls for regulation upon the Federal plane seems clearly demonstrated. It is not claimed that the federalization of corporate business will banish all evil from the land, nor is it clearly predictable how successful a program of federal incorporation or licensing would be in respect of particular abuses. The century and a half history of state failure has been the story of a battle between corporate giants and legal pygmies. With due

94. 304 U. S. 64 (1938). In Wichita Royalty Co. v. City Nat. Bank of Wichita Falls, 310 U. S. 644 (1939), it was held that when litigation is removed from a state court to a federal court, the federal court is substituted for the state court and is under duty to apply the State law as defined by the state courts.
96. 36 F. Supp. 1006 (S. D. N. Y. 1941).
98. 120 F. (2d) 90 (C. C. A. 3d, 1941).
100. See Chart, “Total Assessed Valuation of States (1937) compared with Total Assets of Thirty ‘Billion-Dollar’ Corporations (1935)”, Final Statement of Senator O’Mahoney, Chairman of T. N. E. C. at Closing Public Session (1941) p. 17. In submitting the chart, Senator O’Mahoney said: “Let me present here a chart which compares the total assessed valuation of all the property in each of the states of the Federal Union as of 1937 with the total reported assets of the thirty ‘billion-dollar’ corporations of 1935. It will be observed that there are only ten sovereign states which have within their respective borders property valued at more than the assets of either the Metropolitan Life Insurance Company or the American Telegraph and Telephone Company. Stated in another way, each of these two corporations is richer than any one of thirty-eight sovereign states. At the other end of the scale there are eighteen states the taxable wealth of each of which is less than the total assets of the smallest of the thirty ‘billion-dollar’ corporations. Of these eighteen states which rank so low
deference to David of Biblical fame and Jack the Giant Killer, it usually takes a giant to cope with a giant. It begins to look as though the forty-eight states as we know them are doomed to slow death, what with the expansion of the interstate commerce power to hitherto unheard of proportions. This I regret—their very existence alone spells one important difference between ourselves as a nation and any large European nation.

The demand for federalization impliedly admits the fine records made by the several Federal administrative bodies charged with supervision of various segments of corporate activity from ICC to SEC. But though we admit the national character of the business and institutions to be regulated, it will not do to go on multiplying commissions indefinitely. The highly specialized commissions geared to fire at a particular evil or group of closely allied evils have gone far toward solving some problems; but the problem remains unsolved. For the most part those who wished to avoid the objectives of highly specialized regulation were usually able through the corporate charter of some state to find a way around the law. A federal system of charters or licenses can put regulation on a cover-every-corner basis; it will serve to coordinate present efforts and should make it unnecessary to create new boards and commissions.

When Senator O'Mahoney introduced S. 330 he seemed quite convinced that new corporate regulation should take the form of national licensing rather than national incorporation. Today, he seems to feel that it makes little difference. In his final statement at the closing public session of the Temporary National Economic Committee, Senator O'Mahoney said: "It is idle to think that the huge collective institutions which carry on our modern business can continue to operate without more definite responsibility toward all the people of the nation than they now have. To do this it will be necessary, in my judgment, to have a national charter system for all national corporations. Whether this system should operate through licenses or through direct charters seems to be of little importance. One thing is certain: we cannot hope to stop the processes of concentration if we are willing to continue to allow the states to create the agencies through and by which the concentration has been brought about."

among the sisterhood in property values and far below the smallest of the billion dollar giants, some have been particularly active in creating interstate corporations, large and small, to carry on this national commerce upon which the economic life of the nation depends, although none of the states has the constitutional power to regulate the activities of the artificial agencies they launch upon the sea of national commerce."

Id. at 5.

But there do seem to be valid reasons for preferring a federal licensing scheme over a system of direct charters. In the first place, the licensing device provides regulation, not only of corporations (admittedly the principal offenders) but also of the large unincorporated forms of business units—the association, trust, joint-stock company, limited partnership and syndicate. This means regulation of all offenders, for the individual and the general partnership seem covered to an adequate degree by existing regulation on the part of the Federal Trade Commission or, if they are not, the licensing program may readily be broadened at some future time to embrace them.

Secondly, there has been a widespread fear among the states that if they should be deprived of the authority to charter corporations engaged in interstate commerce, they would suffer serious diminution of revenue. It is true that such a fear is entirely unwarranted for even federal incorporation would leave the great bulk of the states' revenues unaffected except in a very small number of states which now specialize in chartering corporations. But warranted or not, this fear of loss of revenue by the states is very real. A licensing scheme, while affecting state revenues in two important particulars, does not engender so great a fear of their loss.

Still a third reason for preferring licensing over chartering may be found in the fear of such decisions as *Hopkins Federal Savings and Loan Association v. Cleary,* where Mr. Justice Cardozo said:

"The Home Owners Loan Act, to the extent that it permits the conversion of state associations into federal ones in contravention of the laws of the place of their creation, is an unconstitutional encroachment upon the reserved powers of the states. United States Constitution Amendment X." If non-assenting shareholders or cred-

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102. The advantages of federal incorporation are explored in *Report of the Commissioner of Corporations,* H. R. Doc. No. 165, 58th Cong., 3d Sess. (1904) 62. The Commissioner admitted a distinct advantage in the direct control which might be extended by federal incorporation but he posed four principal objections "(a) The legal uncertainty, already indicated as to the validity of a Federal franchise to produce. (b) The drastic nature of the change that would be brought about by a compulsory Federal incorporation law, and the intense opposition that would at once be aroused by the prospect that corporations of the Federal Government were to be placed in entire control of the most important part of commerce. (c) The obvious reduction of State revenue from incorporation. (d) The tremendous change toward centralization that such system would produce. This is the most important objection and a very weighty one." For a vigorous and able reply, championing federal incorporation over federal licensing, by Professor Wilgus (who had but lately drafted "An Act to Regulate National Commerce, to Prohibit Certain Companies from Engaging Therein, and to Provide for the Formation and Regulation of Corporations to Engage Therein", reprinted in *A Proposed National Incorporation Law* (1904) 2 MICH. L. REV. 501, 505-506), see Wilgus, *Federal License or National Incorporation* (1905) 3 MICH. L. REV. 264.


104. 296 U. S. 315 (1935).

105. The sovereign state of Wisconsin and Mr. Justice Cardozo seemed not too much persuaded by the spirit of the new "cooperative federalism". See generally, Strong, *Cooperative Federalism* (1938) 23 IOWA L. REV. 459.
itors were parties to these suits, the question would be urgent whether property interests may be so transformed consistently with the restraints of the Fifth Amendment".108

But, Mr. Justice Cardozo was careful to say, "No question is here as to scope of the war power or of the power of eminent domain or of the power to regulate transactions affecting interstate or foreign commerce".107 Very likely then, since Congress would be proceeding avowedly under the commerce power, the case would not be oversignificant. Be that as it may, corporate licensing would not invite a tilt with the implications of the Cleary case. Federal incorporation might.

There seems little doubt but that Senator O'Mahoney's S. 330 is quite dead. That is probably fortunate. There are many things wrong with the bill, most of them attributable to the fact that it is too much given to recitation of prohibitions. There are indications that Senator O'Mahoney himself has lost faith in S. 330, for in his final statement to the Temporary National Economic Committee he said: "This, however, is not the place to discuss the details of a federal charter system. I am concerned now only with urging the acceptance of the principle. For the details I think it would be wise to have Congress formally authorize a national conference on corporation law to suggest the form the statute should take".108 I have dwelt fully upon S. 330, feeling that with the advent of peace a new bill will be introduced. When that is done, mistakes of S. 330 should not be repeated.

Some few years ago, there was a fear among some of those who believed in the need for comprehensive federal control over corporations that, though a statute providing for direct charters or for licenses would stand the test of constitutionality, it would not cover a sufficient number of offenders. Dean Stevens thought that a charter or licensing system would have to be supplemented by interstate compacts.109 But "interstate commerce" has burst all traditional confines since the distant days when Dean Stevens wrote—days when Hammer v. Dagenhart110 was still dimly visible behind the smoke of the Schechter111 and Carter112 cases. Since Federal Trade Commission v. Bunte Brothers113 it would seem that Congress may now define inter-

107. Id. at 343.
110. 247 U. S. 251 (1918).
113. 312 U. S. 349 (1941).
state commerce in a particularized regulatory effort and make the definition stick.\textsuperscript{114}

Whatever form federalization of corporations may take, there will inevitably be some duplication of effort, which, quite likely, can only be eliminated after some period of trial and error. Any licensing or charter plan must touch intimately the activities not only of the Federal Trade Commission, but also of the National Labor Relations Board, the Wages and Hours Division, the Securities and Exchange Commission, the Anti-trust Division of the Department of Justice, the Federal Loan Agency, and others. In the O'Mahoney Bill, there seems to be really serious overlapping of the functions of FTC and SEC. One finds needless burdening of business men in requiring the same information to be filed with both agencies; and, most serious, there is the possibility of potentially serious jurisdictional disputes between the two.\textsuperscript{115}

If a licensing bill or a bill providing for federal incorporation be enacted, its administration should be entrusted to a newly conceived agency—not just one more, but one broader in scope than those now existing. It should be a Federal Licensing Administration or a Federal Charter Administration embracing a Trade Practices Division and a Securities and Exchange Division, the former to be charged with the supervision of unfair trade practices and the latter with the collection and filing of informational material. A third, the Licensing or Charter Division, would handle the actual business of granting, suspending and revoking licenses or charters.

Our economy is now upon a war footing. In the main, industry has but one customer. But when peace comes, we ought to be ready to enact a bill placing under federal control corporations engaged in interstate commerce and having, say, gross assets of $50,000.00.\textsuperscript{116} No one quite knows just what our economy will be like after this war, but the science of Geo-politics is being studied by our planning officials as never before. That should mean that we intend to bid for the markets of the world as never before. If there be such post-war activity,

\textsuperscript{114} See Note (1941) 50 Yale L. J. 1294.

\textsuperscript{115} Compare the informational disclosures exacted from applicants under Section 3 (b) with the disclosures demanded in various forms of Registration Statements required under the Securities Act of 1933, 48 Stat. 74 (1933), 15 U. S. C. A. §§77a-77aa (1941).

\textsuperscript{116} S. 330 makes it unlawful for any corporation to engage in interstate commerce without a license if the corporation "by itself or in consolidation with its subsidiaries has had, at any time during three years immediately preceding the time when it so engages in commerce, gross assets the value of which on the books of the corporation and its subsidiaries exceeded $100,000." (Section 2b.) It has been suggested that a federal licensing or incorporation act ought not to contain any such limitation because "the present condemned situation of abuses and lack of uniformity would continue as to the remaining corporations engaged in interstate commerce." Stevens, \textit{Uniform Corporation Laws Through Interstate Compacts and Federal Legislation}
it seems likely that it will be sponsored either by cartels or by the federal government. It had better be the latter.117

After the last war, Mr. Harding took us on the "smooth road back to normalcy". The fast trip down the long smooth road led straight to a crashup. One of two things may happen after our present war. We may again show the same distaste for social and economic reform as we did in the decade following 1918, in which case all reform efforts will be stifled; or we may, if the regulation is imposed in final form as part of our war effort, make serious mistakes in the direction of administrative absolutism. Despite our virtually total preoccupation with the war effort, we must now give some study to the matter of federal control of corporations. Next to winning the war, our most important job is to defend ourselves against post-war economic catastrophe. Federal incorporation would prove a stout bulwark in the defense against such catastrophe.

(1936) 34 Mich. L. Rev. 1063, 1088. The criticism seems justified only in so far as it states an ideal to strive for. It is going to be impossible from an administrative standpoint to begin by licensing every business, including the very small ones, engaged in interstate commerce. The regulatory agency, be it the Federal Trade Commission or some other, is going to have to feel its way. Until the most desirable lower limit upon the size of the business can be determined in the light of experience, the regulatory agency will likely have to settle upon some lower limit, somewhat arbitrarily perhaps, and, as the regulatory machinery is made to function efficiently, that figure should be revised downward so as to make the licensing scheme as pervasive as possible. It would seem that a lower limit of $50,000 might be a more satisfactory starting point.

117. Dr. Callman has given us his word that "Cartels ... like any other concentration of power, are a great danger to a democracy and therefore an indirect help to those who are not interested in this form of government. ... Cartels, like all other associations and cumulations of economic power, are tolerable only in a state which is strong enough to supervise them, to reconcile the profit interests of groups with the general welfare of the whole." Hearings Before the Temporary National Economic Committee, 75th Cong., 3d Sess. (1940) 13362, 13363 (Testimony of Dr. Rudolf Callman). Compare Editorial, Business in Wartime, N. Y. Times, Mar. 16, 1941, § 4, p. 10, col. 2, speaking of the British industrial war effort: "The program carries forward the cartelization of industry that was under way before the war. Even then the larger implications of a trend that runs exactly counter to the anti-trust laws of the United States were by no means clear. There was considerable criticism on the ground that the public suffered through direct price-fixing or the maintenance of inefficient plants. Such cartelization would seem, in the long run, to demand close governmental supervision if the public interest is to be served. Such supervision is apparently to be afforded in wartime. The guess may be hazarded that it will not be surrendered wholly after the peace."