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CONSTITUTIONAL LAW-PUBLIC UTILITY HOLDING COMPANY ACT--VALIDITY OF HOLDING COMPANY "DEATH SENTENCE" CLAUSE

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CONSTITUTIONAL LAW—PUBLIC UTILITY HOLDING COMPANY ACT—VALIDITY OF HOLDING COMPANY "DEATH SENTENCE" CLAUSE—Petitioner was the topmost holding company in a public utility holding company system which included eighty subsidiaries and served three million customers in seventeen states. By provision of section 11(b)(1) of the Public Utility Holding Company Act of 1935,[1] the Securities and Exchange Commission was empowered to limit the operations of a holding company registered with it under the act to "a single integrated public utility system." Acting under this authority,

[1] 49 Stat. L. 803 (1935), 15 U.S.C. (1940) §§ 79a et seq.

the commission ordered petitioner, a registered company, to divest itself of all its subsidiary holdings excepting certain interests regarded by the commission as a single integrated system within the meaning of the act.[2] In seeking to have the order of the commission set aside, petitioner contended that the measures provided by section 11(b)(1) were without the power of Congress under the commerce clause of the Constitution and violated due process secured by the Fifth Amendment. *Held,* the challenged measures are constitutional. *The North American Company v. Securities and Exchange Commission,* (U.S. 1946) [3] 66 S. Ct. 785.

The significance of the decision in the principal case is disclosed not so much in the constitutional interpretations it announces as in the nature of the legislation it upholds. The act was designed to cure five broad categories of abuses "injurious to investors, consumers and the general public" [4] and to that end imposes a close system of regulation on holding companies registered with the enforcing commission with respect to the issuing of securities, the acquisition of assets or securities, the reorganization or dissolution of the companies themselves [section 11(b)], the conduct of various financial transactions and the performance of various contracts.[5] The key to the constitutional basis of this broad scheme of regulation is found in the provisions for registration with the commission; for while registration is in terms permissive,[6] unregistered companies are forbidden to use the mails or any of the instrumentalities of commerce to distribute power or gas, to negotiate contracts with other utility or holding companies or to perform such contracts, to sell or acquire securities, or to engage in any business generally.[7] It is thus apparent that the legislation proceeds upon the assumption that the use of the mails or the channels of commerce for business purposes may be conditioned upon submission to regulation undefined in extent.[8]

[2] Holding Company Act Release No. 3405 (April 12, 1942), CCH FED. SECURITIES LAW SERV., ¶75,271. The system retained by petitioner under the commission's order consisted principally of the Union Electric Co. of Missouri and certain of its subsidiaries.

[3] The circuit court of appeals in its decision below had upheld the legislation. North American Company v. Securities and Exchange Commission, (C.C.A. 2d, 1943) 133 F. (2d) 148. Other lower court decisions sustaining § 11(b)(1) or the related provisions of § 11(b)(2) are Commonwealth & Southern Corp. v. Securities and Exchange Comm., (C.C.A. 3d, 1943) 134 F. (2d) 747; United Gas Improvement Co. v. Securities and Exchange Comm., (C.C.A. 3d., 1943) 138 F. (2d) 1010; American Power and Light Co. v. Securities and Exchange Comm., (C.C.A. 1st, 1944) 141 F. (2d) 606.

[4] 49 Stat. L. 803, § 1(c) (1935), 15 U.S.C. (1940) §§ 79a. The five categories appear in § 1(b) and detail such matters as the issuance of securities upon unsound values, over-capitalization, excessive charges to subsidiaries for various services, the employment of accounting systems and financial policies which hamper state regulation, the growth of holding company systems unrelated to business economies, and inefficiency and inadequacy of service.

[5] The more important regulatory provisions are contained in §§ 6 to 13 inclusive.

[6] 49 Stat. L. 803, § 5 (1935), 15 U.S.C. (1940) §§ 79a et seq. By the language of this section any holding company "may" register with the commission.

[7] Id. § 4(a).

[8] It should be recognized at this point that while the power of Congress over commerce arises from Art. 1, Sec. 8, Cl. 3 of the Constitution, its power over the mails is implied from the authority to establish post offices and roads contained in Art. 1, Sec. 8,

In this the Holding Company Act differs materially from most legislation regulating economic activity previously held valid under the commerce clause. Most of such legislation has gone upon the theory that the conditions or practices over which control was sought burdened or obstructed commerce,[9] and in upholding it the Court has felt required to find that there was a reasonable basis for the belief that the conditions or practices in question in each instance did in fact affect commerce; and it has then proceeded to justify federal control on the basis that Congress is authorized to reach such matters as a function of its power under the commerce clause "to prescribe the rule by which commerce is to be governed." [10] While language reminiscent of the earlier cases is found in the present decision, it is clear that the Court sustains the act on principles as simple as the act intends.[11] The decision establishes the interstate character of petitioner's business by the control it exerted over its subsidiaries, by its use of the mails and the instrumentalities of commerce to effect this control, and by the fact that several of its immediate subsidiaries were operating utilities in interstate commerce.[12] Without further argument at this point, the Court concludes that the petitioner ". . . is thus subject to appropriate regulatory measures adopted by Congress under its commerce power." [13] The company's stock holdings are readily identified as the vital element in its operations and the divestment order therefore justi-

Cl. 7. If there is a difference in the reach of these powers it is not noticed in the principal case, where the issue is treated as a matter of the commerce power. In this connection, see note 19, infra.

[9] The "burden and obstruct" terminology is found in the National Labor Relations Act, 49 Stat. L. 449 (1935), 29 U.S.C. (1940) §§ 151 et seq. and in the Agricultural Adjustment Act, 52 Stat. L. 31 (1938), 35 U.S.C. (1940) §§ 1281 et seq., for example. The Fair Labor Standards Act, 52 Stat. L. 1060 (1938), 29 U.S.C. (1940) §§ 201 et seq., though containing the same language, is in part similar to the present legislation and is treated specially below in the text. The Securities Exchange Act, 48 Stat. L. 881 (1934), 15 U.S.C. (1940) §§ 78 et seq. employs (§ 5) as the basis for control a registration requirement similar to that provided in §§ 4 and 5 of the Holding Company Act, but it is so much narrower in scope as not to constitute economic legislation of the same class as the other statutes under consideration.

[10] Gibbons v. Ogden, 9 Wheat. (22 U.S.) 1 at 196 (1824). The familiar quotation from Chief Justice Marshall is used by the Court in the principal case. For cases illustrating this approach: Board of Trade of City of Chicago v. Olsen, 262 U.S. 1 at 40, 43 S. Ct. 470 (1923); National Labor Relations Board v. Jones & Laughlin Steel Corp., 301 U.S. 1 at 37, 57 S. Ct. 615 (1936); Wickard v. Filburn, 317 U.S. 111 at 125, 63 S. Ct. 82 (1942).

[11] Lower court decisions sustaining the provisions of § 11(b) have sometimes resorted to the more familiar terminology to support their determinations. See for example Commonwealth & Southern Corp. v. Securities and Exchange Commission, (C.C.A. 3d, 1943) 134 F. (2d) 747 at 752. A principal cause of this difficulty is the wording of § 1(c) of the act where it is stated that the purpose of the legislation is to meet the problems connected with holding companies "which are engaged in interstate commerce or in activities which affect or burden interstate commerce." 49 Stat. L. 803, § 1(c) (1935), 15 U.S.C. (1940) §§ 79a et seq. But since the scope of the act is limited with such precision by the registration provisions, §§4 and 5, to the companies that actually employ the mails or the means of interstate commerce, the second clause above quoted would seem to be deprived of any effect.

[12] Principal case at 790, 791.

[13] Principal case at 792.

fied as an appropriate means of effecting the Congressional purpose. The Court counters the charge that the divestment order violated due process by depriving holding company investors of the valuable right to pool their investments by declaring that considerations of private interest are of no avail where Congress has determined a conflicting public interest to be paramount; but the holding adds that under the controlling provisions of the act it was not necessary to assume that private investors would suffer material losses in the divestment procedure.[14] The Court's acquiescence in the regulative scheme set up by the act necessarily implies that Congress may condition the right to use commerce and the mails upon submission to whatever regulation it deems necessary to impose. The constitutional theory for such a power is suggested in those cases which hold that Congress may prevent commerce and the mails from being employed to effect or spread harmful social conditions,[15] and the Court in the principal case speaks largely in those terms, citing *Brooks v. United States*[16] as representative of that line of authority.[17] In this respect the controlling issue in the principal case was decided in *Electric Bond & Share Co. v. Securities and Exchange Commission*[18] where the specific sections conditioning the use of the mails and the instrumentalities of commerce upon registration with the commission were upheld.[19] At that time the Court expressly deferred judgment on the validity of other regulative sections of the act.[20] The present decision, however,

[14] Principal case at 798. Petitioner argued that a forced sale of securities might impose severe losses on the holders; but the Court answered that much of the divestment might be accomplished by the exchange of securities rather than by sale and pointed out further that under the provisions of the act petitioner was allowed a year, and upon special showing two years, in which to complete the operation, thus allowing a gradual disposition of securities.

[15] Champion v. Ames, 188 U.S. 321, 23 S. Ct. 321 (1903); Public Clearing House v. Coyne, 194 U.S. 497, 24 S. Ct. 789 (1904); Hipolite Egg Co. v. United States, 220 U.S. 45, 31 S. Ct. 364 (1911); Reid v. Colorado, 187 U.S. 137, 23 S. Ct. 92 (1902); Hoke v. United States, 227 U.S. 308, 33 S. Ct. 281 (1913); Brooks v. United States, 267 U.S. 432, 45 S. Ct. 345 (1925).

[16] 267 U.S. 432, 45 S. Ct. 345 (1925). Congress had found, states the decision in the principal case, that holding company practices were "polluting" the channels of interstate commerce. Principal case at 797.

[17] The suggestion is made in Lesser, "Constitutional Powers of the Securities and Exchange Commission over Public Utility Holding Companies," 8 GEO. WASH. L. REV. 1128 at 1141 (1940), that the power of Congress to impose the regulations of the Holding Company Act could derive from its authority to charter corporations to engage in interstate commerce and thus to permit corporations not chartered by it to engage in interstate commerce on the terms it prescribes.

[18] 303 U.S. 419, 58 S. Ct. 678 (1938).

[19] The commerce and postal powers are separately considered in this decision as constitutional basis for the registration sections with the implication that the postal power is the more limited in the support it affords legislative regulation though adequate for the provisions in question. Electric Bond & Share Co. v. Securities and Exchange Commission, 303 U.S. 419 at 442, 58 S. Ct. 678 (1938). For a discussion of the postal power in this connection, see "The Expanding Postal Power," 38 COL. L. REV. 474 (1938), where the opinion is expressed that the Holding Company Act is grounded more particularly on the commerce power.

[20] Electric Bond & Share Co. v. Securities and Exchange Commission, 303 U.S. 419 at 439, 58 S. Ct. 678 (1938). The argument of counsel in this case that a decision

validates the most far-reaching regulative measures and establishes the presumption that the entire act is constitutional.[21] The decision most nearly a precedent for the principal case is *United States v. Darby*.[22] In that case the Court sustained a provision of the Fair Labor Standards Act [23] which banned the shipment in commerce of goods produced under substandard labor conditions as defined by other sections of that act, on the authority of the *Brooks v. United States* line of decisions, notwithstanding the fact that the prohibition was designed to effect a local regulation of the wages and hours of labor.[24] In addition, however, the Court upheld the power of Congress to prescribe the wages and hours of labor in production for interstate commerce independently of the prohibition provision.[25] The distinction to be noted between the two cases is that the *Darby* decision finds the authority in the commerce clause to close the channels of commerce to products which would necessarily, in the economic theory of the legislation, spread the undesirable conditions Congress seeks to eliminate; while the principal case establishes the power to close the mails and channels of commerce to holding companies for the conduct of business of any description, regardless of the purpose or effect of particular transactions, to the end of compelling the companies to submit to general federal control. In fortifying its conclusion, the Court cites the more important cases defining the commerce power,[26] particularly those which indicate the extent to which control of local activities is

upholding the validity of the registration sections necessarily subjected the company to the regulative provisions of the act was disallowed by the Court on the ground that the decree then under review expressly reserved the right to the appellant to challenge the constitutionality of other portions of the act. For the Court in the principal case, the registration sections seem to determine the legality of the regulative provisions as a matter of course. By the operation of § 4(a) ". . . Congress has effectively applied Sec. 11(b)(1) to those holding companies that are in fact in the stream of interstate activity and that affect commerce in more states than one . . . Section 11(b)(1) is thus clearly and unmistakably applicable to companies engaged in interstate commerce." Principal case at 793. In Lesser, "Constitutional Powers of the Security and Exchange Commission over Public Utility Holding Companies," 8 GEO. WASH. L. REV. 1128 at 1135 (1940), the writer, supervising attorney for the commission, states that the holding in the Electric Bond and Share case ". . . must rest upon the premise that Congress has the power to prohibit the use of the mails or the channels of interstate commerce in connection with such matters as Congress might deem necessary for the protection of the people of the United States. . . ."

[21] There has been some suggestion that the validity of § 11(b)(2), the corporate simplification provisions of the act, must rest on a different constitutional basis than § 11(b)(1). Manoff, "Constitutionality of the Simplification and Voting Power Provisions of the Holding Company Act," 16 TEMPLE L. Q. 32 (1941). This distinction has not concerned the courts. See, for example, American Power and Light Company v. Securities and Exchange Commission, (C.C.A. 1st, 1944) 141 F. (2d) 606, where the circuit court's decision in the principal case upholding the validity of § 11(b)(1) is cited as authority for the validity of § 11(b)(2). This view is impliedly given the sanction of the Supreme Court in the principal case (at 796).

[22] 312 U.S. 100, 61 S. Ct. 451 (1941).

[23] 52 Stat. L. 1060 at 1068, § 15(a)(1) (1935), 29 U.S.C. (1940) § 215.

[24] United States v. Darby, 312 U.S. 100 at 113, 61 S. Ct. 451 (1941).

[25] Id. at 122. The section here involved is § 15(a)(2), 52 Stat. L. 1060 at 1068 (1935), 29 U.S.C. (1940) § 215(a)(2).

[26] The cases cited in note 9, supra, among others.

authorized in effectuating the policy of Congress respecting commerce; and the *Northern Securities* case is invoked as precedent for the particular measure involved in the divestment proceeding.[27] But resort to these authorities does not avoid the fact that the Court here bases the validity of extensive regulation on the sole ground that the business to be regulated is conducted by the use of the mails and the instrumentalities of commerce. It is fair to conclude that the case considered along with the regulative scheme it upholds states a constitutional rationale for federal supervision of economic activities which, if no more penetrating than hitherto realized in particular cases, may proceed on a broader front.

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[27] Northern Securities Co. v. United States, 193 U.S. 197, 24 S. Ct. 436 (1904). Similar cases under the Sherman Anti-Trust Act are also cited.