CONSTITUTIONAL LAW-NATIONAL POWER OVER NAVIGABLE STREAMS - PROPERTY CLAUSE - CORPORATIONS - STOCKHOLDERS' SUIT
CONSTITUTIONAL LAW — NATIONAL POWER OVER NAVIGABLE
STREAMS — PROPERTY CLAUSE — CORPORATIONS — STOCKHOLDERS' SUIT — The recent decision of the Supreme Court in the TVA case ¹ raises issues of extreme importance not only in regard to the interpretation of the property clause of the federal Constitution, but also in regard to the requisites for a suit by minority stockholders of a corporation questioning the actions of the corporate management.

¹ Ashwander v. Tennessee Valley Authority, (U. S. 1936) 56 S. Ct. 466.
The suit involves the sale by the Federal Government of electric power generated at Wilson Dam on the Tennessee River in the State of Alabama. In 1916, in the emergency of threatened war, Congress authorized the President, for the improvement of navigation and for the purpose of securing power necessary for the manufacture of munitions, to acquire such a site as he should deem suitable upon either a navigable or a non-navigable stream or upon the public lands, and to erect there a dam for the generation of power. By virtue of this authority, President Wilson started the erection of a dam at Muscle Shoals and the nearby nitrate and power plants in 1917. The construction of these properties was completed in 1926. In the succeeding years, their disposition has provided a problem of primary importance among contemporary political issues.

It is not necessary for present purposes to detail the legislative history of Muscle Shoals. It is sufficient to say that the needs of national defense precluded, in the minds of many legislators, any private operation of the nitrate or power plants. Allied with this problem, however, was another. The growing importance of electric power, both for industrial and for domestic uses, brought with it a dissatisfaction with the electric power companies, both as to capital structure and as to rates. This dissatisfaction gave rise to a demand for public operation of the Muscle Shoals properties not only as a war necessity, but also to extend the benefits of cheap electricity to the rural regions of the Tennessee valley, and as a first step towards the ultimate goal of government operation of all utilities. It was in the light of this history that the Tennessee Valley Authority Act was passed on May 18, 1933.

The act provided that

"For the purpose of maintaining and operating the properties now owned by the United States in the vicinity of Muscle Shoals, Alabama, in the interest of the national defense and for agricultural and industrial development, and to improve navigation in the Tennessee River and to control the destructive floods in the Tennessee River and Mississippi River Basins, there is

---

4 See N. Y. Times, p. 2:3 (April 9, 1930); p. 3:5 (July 3, 1930); p. 18:8 (Aug. 14, 1930); p. 4:2 (Nov. 12, 1930); § 10, p. 3:2 (Nov. 30, 1930); p. 1:1 (March 12, 1931); p. 16 (Sept. 22, 1932).
5 See N. Y. Times, p. 12:1 (March 2, 1931); p. 21:2 (April 7, 1931); p. 6:3 (Feb. 8, 1932); p. 1:1 (Jan. 22, 1933); 67 Cong. Rec. 4913-4914 (1926); 69 Cong. Rec. 3760 (1928).
hereby created a body corporate by the name of the 'Tennessee Valley Authority.'

This body was given comprehensive powers relating to the operation and maintenance of the existing government properties in the region, and in addition the corporation was empowered

"to construct such dams and reservoirs in the Tennessee River and its tributaries, as in conjunction with Wilson Dam, and Norris, Wheeler, and Pickwick Landing Dams, now under construction, will provide a nine-foot channel in the said river . . . and control destructive flood waters in the Tennessee and Mississippi River drainage basins; and shall have power to acquire or construct power houses, power structures, transmission lines, navigation projects and incidental works in the Tennessee River and its tributaries, and to unite the various power installations into one or more systems by transmission lines. . . ."

Of particular importance in the present inquiry are these sections:

"The board is hereby empowered and authorized to sell the surplus power not used in its operations, and for operation of locks and other works generated by it, to States, counties, municipalities, corporations, partnerships or individuals, according to the policies hereinafter set forth; and to carry out said authority, the board is authorized to enter into contracts for such sale for a term not exceeding twenty years, and in the sale of such current by the board it shall give preference to States, counties, municipalities, and cooperative organizations of citizens or farmers, not organized or doing business for profit, primarily for the purpose of supplying electricity to its own citizens or members. . . ."

"It is hereby declared to be the policy of the Government so far as practical to distribute and sell the surplus power generated at Muscle Shoals equitably among the States, counties, and municipalities within transmission distance. This policy is further declared to be that the projects herein provided for shall be considered primarily as for the benefit of the people of the section as a whole and particularly the domestic and rural consumers to whom the power can economically be made available, and accordingly that sale to and use by industry shall be a secondary purpose. . . ."

"In order to place the board upon a fair basis for making such

---

7 Sec. 1.
9 48 Stat. L. 58, § 10 (1933).
10 Sec. 11.
contracts and for receiving bids for the sale of such power, it is hereby expressly authorized, either from appropriations made by Congress or from funds secured from the sale of such power, or from funds secured by the sale of bonds hereafter provided for, to construct, lease, purchase, or authorize the construction of transmission lines within transmission distance from the place where generated, and to interconnect with other systems. . . .”

Under the authority of section 12 of the act, the board on January 4, 1934, made with the Alabama Power Company the contract involved in this suit. This contract provided for the sale by the power company to the Authority of land in the vicinity of Wilson and Wheeler Dams, and of certain described transmission lines and their auxiliary properties, for a consideration of $1,150,000; for an “interchange” of power, under certain limitations; and for a territorial division of services between the two parties, with an agreement by the Authority not to sell energy in the area outside that served by the transmission lines sold. The last two provisions were to remain in effect for approximately five years.

Protesting against the action of the corporate management in this sale of transmission lines and territory, with its good will, the plaintiffs, preferred stockholders, brought this minority suit against the power company, the Authority, the cities to be served by the Authority under the terms of the agreement, and others, asking for the cancellation of the contract as one made under the duress of threats of destructive and illegal competition, and as ultra vires the Authority; a further prayer asked a declaratory judgment that the Authority had no constitutional power to engage in the electric business or to engage in future competition with the power company.

I.

More than the usual difficulties appear in this case in regard to the preliminary question of jurisdiction. The Court held unanimously that the prayer for declaratory relief did not present a justiciable controversy. The sole threat of competition between the Authority and the power company was a threat of competition after five years, when the period named in the contract had expired. At best, therefore, this was a potential and contingent threat, bringing the case within the rule of United States v. West Virginia. Further, as the Chief Justice pointed out, the limitations of the plaintiffs' rights, as stockholders, to sue in

11 Sec. 12.

the name of the corporation, would prevent a more comprehensive
decree, for those rights are limited to a demand only in regard to par-
ticular transactions affecting the corporation peculiarly and directly,
and do not embrace a demand for a general determination of the legal
rights of all who deal with it, important as those rights may be.

The serious problem presented is one of the right of the plaintiffs
to sue as preferred stockholders for the cancellation of the contract
between the power company and the Authority. The problem, as
Justice Brandeis said, is not merely one of formal compliance with the
procedural requirements of Hawes v. Oakland, and of Equity Rule
27, but rather of the showing of injury made by the plaintiffs and of
the conclusiveness of a policy determination made by the corporate
management. On this issue, the Court split five to four.

The general rule must be conceded that a court will not interfere
in the internal management of a corporation; an extraordinary equit-
able showing must be made if the court is to interfere with the rule of
the majority. But it has been held that if the corporate directors
have breached a duty to the shareholders, the latter may sue in equity
for the specific performance of that duty. The question is primarily
one of definition of the term "breach of duty." In the leading case,
Dodge v. Woolsey, the Court, without attempting a conclusive defi-
nition, enumerated acts ultra vires of the corporation or the corporate
directors, fraudulent acts crippling the corporation or the interests of
the shareholders, or acts by which the corporate directors or the ma-

13 104 U. S. 450 (1881).

14 United Copper Securities Co. v. Amalgamated Copper Co., 244 U. S. 261 at
264, 37 S. Ct. 509 (1917); Corbus v. Alaska Treadwell Gold Mining Co., 187 U. S.
455 at 463, 23 S. Ct. 157 (1902); Hawes v. Oakland, 104 U. S. 450 at 462 (1881);
Southern Pacific Ry., (C. C. A. 2d, 1922) 279 F. 832, certiorari denied 258 U. S.
628, 42 S. Ct. 461 (1922); Dunphy v. Traveller Newspaper Assn., 146 Mass. 495,

15 18 How. (59 U. S.) 331 at 341-344 (1855).

16 18 How. (59 U. S.) 331 at 341-344 (1855).

17 Venner v. Southern Pacific Ry., (C. C. A. 2d, 1922) 279 F. 832 (1922),
certiorari denied 258 U. S. 628, 42 S. Ct. 461 (1922); Post v. Buck's Stove Co.,
(C. C. A. 8th, 1912) 200 F. 918.
but it has also been held to be the exercise of an honest and a reasonable discretion. So, where the corporation has declined to sue on the advice of competent attorneys that a suit would be unsuccessful, the stockholder may not maintain his bill.\(^{18}\) But where the corporation has refused to sue, perhaps through a fear of antagonizing the public or the enforcement officials, although admitting the unconstitutionality of a tax imposed,\(^{19}\) or of the repeal of the corporate charter,\(^{20}\) or of the regulatory statute imposed,\(^{21}\) the refusal partakes more of an abdication of discretion than its exercise, and the bill has been entertained. But the rule of those cases is not applicable to the present case, for here the corporate management disclaimed any opinion as to the validity of the act, and defended the contract as a desirable sale of territory. In this respect, the present case resembles much more closely Pollock v. Farmers' Loan & Trust Co.,\(^{22}\) Brushaber v. Union Pacific R. R.,\(^{23}\) and Smith v. Kansas City Title & Trust Co.\(^{24}\)

It is upon the authority of the Pollock and Brushaber cases that the Court here holds that the breach of duty \"may consist in yielding, without appropriate resistance, to governmental demands which are without warrant of law or are in violation of constitutional restrictions.\"\(^{25}\) It must be remembered, however, that the duty of the management is one of protection of the corporation from injury. It would seem to follow, therefore, that that duty is not breached where the failure of the management to assert a corporate cause of action has not injured the corporation.\(^{26}\) It is easy to find an injury to the corporation through the payment of funds for taxes which are not constitutionally valid, as in the Pollock and Brushaber cases; and it is equally easy to see such an injury if the corporation buys bonds which are invalid, as was alleged in Smith v. Kansas City Title & Trust Co. But in the present case, the problem of injury to the corporation is much more acute. It cannot be maintained that all legal injuries affect the pocket-book; thus, it is unnecessary to cite cases to prove that pecuniary injury is not necessary for the avoidance of a contract obtained by duress or fraud. And the Court treats this as a case of duress—at least to the extent of determining whether or not the Authority's threats of com-

\(^{19}\) Dodge v. Woolsey, 18 How. (59 U. S.) 331 (1855).
\(^{22}\) 157 U. S. 429 at 553-554, 15 S. Ct. 673 (1895).
\(^{23}\) 240 U. S. 1, 36 S. Ct. 236 (1915).
\(^{24}\) 255 U. S. 180, 41 S. Ct. 243 (1921).
\(^{25}\) 56 S. Ct. 467 at 470 (1936).
\(^{26}\) Waters v. Horace Waters & Co., 201 N. Y. 184, 94 N. E. 602 (1911).
petition related to acts which the Authority could constitutionally perform. If those threats and demands related to unconstitutional acts, we may concede that the company suffered an injury to its right to contract free from duress. But, unless some further injury is shown, is it necessarily an abuse of discretion for the management to refuse suit to protect that intangible right? In the present case, for example, the company secured a large consideration in exchange for its equipment and good will. Can it be said that the action of the directors in refusing to bring suit was unreasonable, whether or not the consideration received was large enough to make the sale a profitable one for the company? There are indications in the opinion of the Chief Justice that he did not assume that this consideration was adequate; but there was no express finding in the lower courts as to the adequacy of the consideration, although the plaintiffs alleged inadequacy.

The jurisdictional discussion of the Court raises a further issue. If a stockholder is to be permitted to question the decisions of the corporate management, he must show not only that those decisions constitute a breach of trust towards the stockholders, and that unsuccessful efforts have been made to secure remedial action by the directors or the majority of the shareholders, but also that he himself has been injured thereby. And it is established that one who questions the constitutionality of a governmental act must show that he himself is damaged. It was contended that these requirements were not met in the instant case.

In this connection, of course, one question involves the showing of injury to the corporation itself. Assuming that injury to the corporation, however, it was contended that the plaintiff shareholders had shown no injury to themselves, because their interests were preferred, and therefore limited interests. It is entirely true, of course, that "Acts may be innocuous to the preferred which conceivably might injure common stockholders." But it might be urged that the distinction, if any, between common and preferred stockholders must be based upon the character of their respective rights. Thus, the injury might well depend upon whether or not the preferred stockholders are entitled to cumulative or noncumulative dividends; whether or not they are entitled to participation in profits over and above the flat dividend rate; and upon the character of their dissolution rights.

28 Dodge v. Woolsey, 18 How. (59 U. S.) 331 (1855); Ritchie v. McMullen, (C. C. A. 6th, 1897) 79 F. 522.
30 56 S. Ct. 467 at 482 (1936).
But the crux of the argument lies in the definition of injury to the "property rights" of the stockholder. Justice Brandeis evidently used the phrase with reference to the facts of this case, and in connection with the question of adequacy of consideration. But his dictum is susceptible of a broader interpretation. It may well be that the fact that the corporation has sustained no pecuniary injury should be an influential factor in the determination of whether or not the management has abused its discretion in refusing to enforce the letter of its rights, but it is an entirely different thing to say that, assuming that refusal to be a breach of duty, no stockholder may sue unless the transaction involved is reflected directly in the market price of his stock, or in the value of his dividend rights. Thus, if the use-value of property sold by the corporation had appreciated largely, it might well be a breach of trust to refuse to bring suit to avoid the sale because of duress or fraud, even though the consideration received was entirely adequate at the time of the sale, and though the injury would not immediately and directly be reflected in the balance sheet. Can it not be said that the "property interests" of the shareholder are injured by anything that injures the corporation, even though that injury be intangible, since the shareholder has a property interest in the corporation itself?

The questions mooted are not discussed in any of the opinions, but the refusal of the majority of the Court to accept Mr. Justice Brandeis' distinction between common and preferred stockholders is explainable upon any one of these suggested grounds. It must be left to future decisions to clarify the law in this field.

2.

The issue of greatest general interest, however, in the TVA case, is undoubtedly that of the constitutional validity of the Tennessee Valley Authority Act, and of its administrative interpretation. That issue depends upon two basic questions: (1) Was Wilson Dam erected in the valid exercise of a constitutional power? (2) Are there any limitations upon the power of Congress to dispose of the energy thereby created?

The Court found little difficulty in determining that Wilson Dam was erected in the valid exercise of a constitutional power. As we have seen, the dam was authorized in the period immediately before the entrance of this nation into the World War, in the realization that the dependence of the United States upon Chile for so vital a war necessity as nitrates might well be disastrous. In such a situation, it cannot be maintained that the dam, erected to secure power for the production of nitrates, was not an instrument of national defense, nor that its authorization was an unreasonable step to take under the war powers of Congress.
But the erection of the dam was also justified under the commerce power. Under the commerce clause, Congress has power to take such steps as are necessary for the improvement and control of navigation, including the improvement of navigable streams. So, if the river be navigable, Congress has the power to determine that the shoals on the Tennessee River constitute an obstruction to navigation, and to take such steps as may be necessary to remove that obstruction. And the erection of a dam to provide slack water over shoals is a proper method for the removal of such an obstruction.

By the erection of the dam, mechanical energy in the form of water power was created as an incident; that energy is property of the United States, which, within the terms of the property clause, may be disposed of by Congress. There are no limitations upon this power of disposition, save perhaps the usual limitation of reasonableness of the means adopted with reference to the constitutional end in view. Since the water power is not capable of its greatest usefulness, nor most easily marketable in that form, it is within the constitutional powers of Congress to authorize its change into electric power, in order to facilitate its disposition most advantageously to the United States. And likewise Congress may authorize the purchase or construction of distribution systems in order to bring that power to a market in which it may be sold, since it cannot be said to be wholly reasonable to sell the power at the dam, but wholly unreasonable to adopt some other method of disposition. Therefore, the purchase of transmission lines by the Tennessee Valley Authority was an exercise of valid constitutional powers.


vested in it by Congress; similarly, the risk of competition with a governmental agency was a risk which the power company was bound to run, and any threats of such competition did not constitute such duress as to invalidate the contract. Such, in outline, is the argument of the Court on the constitutional issue.

From this argument, Justice McReynolds dissented upon the ground that the purpose of Congress in authorizing the sale of power was not the mere disposition of property belonging to the United States, but the establishment of the United States in the power business, in illegal competition with the petitioners. The annual reports of the Authority, the considered statements of the President and of the more prominent sponsors of the act, and the statements and policy announcements of those charged with the administration of the act, could leave no doubt that the production and distribution of power by the Federal Government was not its least important feature.

The argument of Justice McReynolds assumes, in effect, that the motives which induced the passage of a congressional act are subject to an examination by the Court in the determination of its constitutionality. In this assumption, he appears to be supported by the dictum of Chief Justice Marshall that,

"Should Congress, in the execution of its powers, adopt measures which are prohibited by the Constitution; or should Congress, under the pretext of executing its powers, pass laws for the accomplishment of objects not entrusted to the government; it would become the painful duty of this tribunal, should a case requiring such a decision come before it, to say that such an act was not the law of the land."

It is entirely possible that Chief Justice Marshall intended, in his dictum, to announce the principle that the motives of Congress could be subject to judicial investigation, but if so, his remark has never been so understood, and it has been held again and again that the Court may not inquire into the motives of the legislature. This holding is an

---

86 Quoted in a footnote to Justice McReynolds' opinion, 56 S. Ct. 467 at 489 (1936).
87 N. Y. Times, pp. 1:8, 3:2 (Aug. 4, 1934); p. 15:1 (Sept. 28, 1934); p. 1:7 (Nov. 18, 1934); p. 39:4 (Dec. 16, 1934); see also, note 5, supra.
88 N. Y. Times, p. 23:8 (Aug. 25, 1933); p. 35:3 (Sept. 14, 1933); p. 2:7 (June 22, 1934); p. 2:2 (Dec. 15, 1934); § 4, p. 7:3 (Nov. 18, 1934); p. 1:6 (Nov. 26, 1934); p. 37:1 (May 18, 1934); § 2, p. 14:2 (July 22, 1934); p. 38:1 (Oct. 24, 1934).
89 McCulloch v. Maryland, 4 Wheat. (17 U. S.) 316 at 423 (1819).
40 It is possible, too, that Alexander Hamilton shared this view. See HAMILTON, THE FEDERALIST, Hamilton's ed., No. 78, p. 576 (1864).
essential part of the modern doctrine of implied powers. Thus, the
federal reclamation and irrigation work in the West is carried out under
the property clause and the power implied from it of improving the
public lands. The war powers were used to impose prohibition upon
the nation, and the revenue and commerce powers have been used for
a host of social purposes beyond the powers of the Federal Government
to accomplish directly. The taxing power has been used to obtain con­
control of the narcotic traffic, to limit the sale of butter substitutes, and
to drive from circulation the notes of state banks, while the control
over foreign and interstate commerce has been used to prevent the
exhibition of foreign fight films, to control the nation-wide lotteries,
to limit the traffic in women, and to impose standards of purity on the
food and drug industries. Undoubtedly, other examples could be
given. But though no one doubts that the social purposes of these acts
played a large, perhaps a controlling part, in their enactment, and
though the direct accomplishment of those social purposes was beyond
the powers of Congress, the Court refused to declare them invalid for
that reason alone.

In a recent case involving Boulder Dam, Justice Brandeis has
gone a step further. After stating the rule that the Court may not in­
quire into the motives of Congress, he said, "Whether the particular
structures proposed are reasonably necessary, is not for this Court to
determine." It is doubtful, however, if the cases support this dictum.
The rule that the Court will not go behind the words of a statute to
determine its purpose is based upon a recognition of the fact that a
judicial investigation of motive as such would be practically impossible.
But the Court can and does apply the test of reasonableness to deter­
mine whether laws have been passed "for the accomplishment of ob­
jects not intrusted to the government." The issue in each case is

106 (1919).
43 United States v. Doremus, 249 U. S. 86, 39 S. Ct. 214 (1919); Linder v.
United States, 268 U. S. 5 at 17, 45 S. Ct. 446 (1925); Nigro v. United States, 276
U. S. 332, 48 S. Ct. 388 (1928).
44 McCray v. United States, 195 U. S. 27, 24 S. Ct. 769 (1904); Magnano Co.
45 Veazie State Bank v. Fenno, 8 Wall. (75 U. S.) 533 (1869).
whether the means adopted by Congress are reasonable for the accomplishment of the constitutional ends. The TVA Act purports to be an exercise of the power of Congress to improve navigable streams and to dispose of the energy thereby incidentally created. If this analysis be correct, it would seem that Justice McReynolds has addressed himself to the wrong issue.

____________________  W. J. S.