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Securities Law and the New Deal Justices

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INTRODUCTION

FRANKLIN Delano Roosevelt ("FDR") fueled his 1932 presidential campaign with populist attacks against the moneyed interests, particularly investment bankers and the New York Stock Exchange.[1] In the wake of the stock market crash of October 1929 and the depression which followed, the public sought someone to blame for the nation's economic misery. Anxious to oblige, the Senate pointed the finger at Wall Street's financiers in its 1932 Pecora investigations.[2]

The fight for social control over finance would be one of the great political battlegrounds of the New Deal and the eight men picked by Roosevelt for the Supreme Court were in the thick of it.[3] The two most prominent examples are Felix Frankfurter, a trusted advisor to Roosevelt, and William O. Douglas, the third chairman of the Securities and Exchange Commission. Frankfurter's involvement in the securities laws was pervasive: he helped "select the draftsmen of the SEC's three basic statutes, the FTC officials who enforced the Securities Act during its first year, most of the original SEC commissioners, and many of the Commission's top staff appointees."[4] Moreover, he prodded Roosevelt to take on the public utility industry and brokered a key legislative compromise enabling the passage of the Public Utility Holding Company Act of 1935 ("PUHCA"), which Joel Seligman has characterized as "the most radical reform measure of the Roosevelt administration."[5]

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[1] Joel Seligman, The Transformation of Wall Street 19–20 (3d ed. 2003).

[2] Id. at 1–2. The Pecora hearings take their name from Ferdinand Pecora, who led the Senate investigation. Pecora would later serve as one of the Security and Exchange Commission's first commissioners.

[3] Roosevelt named eight new Justices during his presidency and also elevated Stone to Chief Justice. Because James Byrnes resigned after serving only a short time on the Court, Roosevelt thus filled eight of the nine seats. Only Roberts (and Stone) carried over from the pre-New Deal Court to Truman's presidency.

[4] Seligman, supra note 1, at 57–58.

[5] Id. at 122; see also Morris L. Forer, A Postscript to the Administration of the Public Utility Holding Company Act: The Hydro-Electric System Case, 45 Va. L. Rev. 1007, 1007–08 (1959) ("Probably the most dynamic piece of New Deal legislation, [PUHCA] was revolutionary in that it required not only the immediate eradication of specific and now all too familiar abuses, but also in that it provided for the minute supervision of actions and programs then conceived as being safely reposed in management. This statute aimed not only at the remedial, but, shooting at the escaping present, had also as its target a better economic future." (footnote omitted)).

The future Justice with the greatest hands-on experience with the securities laws was William O. Douglas. His research on the bankruptcy reorganization process led to the enactment of the Chandler Act, which gave the SEC a critical role in the reorganization of insolvent public companies. As SEC Chairman, he took on the New York Stock Exchange, thereby making himself a national political figure.[6] Douglas also began the breakup of the public utility holding companies under PUHCA. But those two Justices do not begin to exhaust the securities law experience of those who would be called upon to interpret these acts. In the Senate, future Justices Hugo Black and James Byrnes played critical roles in the legislative process leading to the enactment of the securities laws. In a smaller way, Wiley Rutledge joined in the public debate. Future Justices Robert Jackson and Stanley Reed were key players in defending those laws against constitutional challenge in the courts; Frank Murphy's tenure as Attorney General thrust him into the litigation as well.

In this Article, we explore the role of the New Deal Justices in enacting, defending, and interpreting the federal securities laws.[7] Although we canvass most of the Court's securities law decisions from 1935 to 1955, we focus in particular on PUHCA, an act now lost to history for securities practitioners and scholars.[8] At the time of the New Deal, PUHCA was the key point of engagement for defining the judicial view toward New Deal securities legislation. Taming the power of Wall Street required not just the concurrence of the legislative branch, but also the Supreme Court, a body that the Roosevelt Administration generally considered hostile to its economic planning initiatives. PUHCA was enacted at a time when the constitutional scope of federal power was still very much in doubt. The statute was a major federal intervention into the free

[6] Seligman characterizes Douglas's chairmanship as "the most accomplished in the SEC's history." Seligman, supra note 1, at 157.

[7] For this project, we examined the papers of each of the eight New Deal Justices in the Library of Congress and in various other libraries where they are deposited. The records relied upon are all publicly available.

[8] PUHCA was repealed in 2005. Energy Policy Act of 2005, Pub. L. 109-58, 119 Stat. 594. We end our analysis when the last of the PUHCA reorganizations had worked their way up to the Court in the mid-1950s. Among the New Deal Justices, Justice Frankfurter would continue to serve into the 1960s and Justices Black and Douglas into the 1970s. We leave those periods for future work.

play of capitalist forces, requiring the dismantling of the utility holding companies. Thus, it stood in contrast to the other federal securities laws, which focused primarily on disclosure. At the time, PUHCA was much more important than the Exchange Act in regulating corporate finance, and more dramatic even than the Sarbanes-Oxley Act of recent vintage.[9] PUHCA "gave the SEC power to refashion the structure and the business practices of an entire industry. Except in wartime, the federal government never before had assumed such total control over any industry."[10] PUHCA provided the majority of securities cases in the Supreme Court over the first twenty years after the enactment of the securities laws,[11] but PUHCA's significance to the Court's docket was not merely quantitative. The Court's decisions on PUHCA were the most closely followed securities cases in the popular press, as they pitted the giant utility holding companies against the government in a battle for survival.

The Supreme Court's ten-year journey toward affirming that PUHCA was within the scope of Congress' commerce power reflects the shift in the Court's balance of power toward Roosevelt's appointees. The New Deal Justices shared a belief in the promise of the administrative state to tame private interest; they blamed the excesses of private ordering for the Great Depression. By 1947, the

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[9] Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745 (codified at 15 U.S.C. §§ 7201–66 (2006)).

[10] Seligman, supra note 1, at 131.

[11] PUHCA accounted for thirteen cases between 1935 and 1955, as compared to ten for all other securities law issues combined. The PUHCA cases were: *SEC v. Drexel & Co.*, 348 U.S. 341 (1955); *Gen. Protective Comm. for Holders of Options Warrants of United Corp. v. SEC*, 346 U.S. 521 (1954); *Niagara Hudson Power Co. v. Leventritt*, 340 U.S. 336 (1951); *SEC v. Cent.-Ill. Sec. Corp.*, 338 U.S. 96 (1949); *In re Elec. Power & Light Corp.*, 337 U.S. 903 (1948); *Eng'rs Pub. Serv. Co. v. SEC*, 332 U.S. 788 (1947); *SEC v. Chenery Corp. (Chenery Corp. II)*, 332 U.S. 194 (1947); *Am. Power & Light Co. v. SEC (Am. Power & Light Co. II)*, 329 U.S. 90 (1946); *N. Am. Co. v. SEC*, 327 U.S. 686 (1946); *Am. Power & Light Co. v. SEC*, 325 U.S. 385 (1945); *Otis & Co. v. SEC*, 323 U.S. 624 (1945); *SEC v. Chenery Corp.*, 318 U.S. 80 (1943); *Landis v. N. Am. Co.*, 299 U.S. 248 (1936).

The ten non-PUHCA cases were: *Wilko v. Swan*, 346 U.S. 427 (1953); *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953); *Penfield Co. of Cal. v. SEC*, 330 U.S. 585 (1947); *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946); *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943); *Edwards v. United States*, 312 U.S. 473 (1941); *A. C. Frost & Co. v. Coeur D'Alene Mines Corp.*, 312 U.S. 38 (1941); *Deckert v. Independence Shares Corp.*, 311 U.S. 282 (1940); *SEC v. U.S. Realty & Improvement Co.*, 310 U.S. 434 (1940); *Jones v. SEC*, 298 U.S. 1 (1936).

New Deal Court had established the power that the federal government now wields over corporate and securities regulation. Of equal import, the Court's decisions in PUHCA cases established a pattern of expansive interpretations of the securities laws; government regulation and the SEC enjoyed a remarkable string of victories beginning in 1940, a winning streak that would last, with minor exceptions, until 1973.[12]

PUHCA also provided the key vehicle for working out the judicial response to the inherent tension between administrative discretion and judicial review. Roosevelt's appointees to the Court all believed government power was needed to tame the excesses of business, but they split over the respective roles of courts and the SEC in implementing this vision. Would the new administrative state, built with the assistance of the future New Deal Justices, afford discretion to the experts, or would the SEC be bound by legal rules defined by judges?

Frankfurter's answer to this question put him in the minority on the New Deal Court. Although Frankfurter was a long time believer in governance by experts,[13] as a Justice he regularly sought to constrain the SEC with rules and even common law understandings of particular words. The Court majority, however, was willing to defer broadly to the expert agency. Douglas's views on this ques-

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[12] The Supreme Court gave an expansive view of the securities law and supported the SEC's position in all but a few of the securities decisions that came before the court in the first four decades after the passage of the securities act. See E. Thomas Sullivan & Robert B. Thompson, The Supreme Court and Private Law: The Vanishing Importance of Securities and Antitrust, 53 Emory L.J. 1571, 1579–86 (2004) (describing the Supreme Court's expansive holding in all but a handful of securities cases until 1973). Lewis F. Powell played the key role in reversing this trend. See A.C. Pritchard, Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Laws, 52 Duke L.J. 841 (2003).

[13] After FDR's election as Governor, Frankfurter

> sent F.D.R. a copy of the Dodge Lectures he had delivered at the Yale Law School, *The Public and Its Government*, which emphasized many key ideas of his mature political philosophy—the indispensability of the administrative process in the management of contemporary economic life; the importance of nurturing federalism and seeking state or regional solutions to social problems that were not overwhelmingly national in scope; the adaptability of the Constitution to the resolution of these conflicts; and the crucial role that could be played in modern government by trained experts recruited from the nation's universities and professional schools.

Michael E. Parrish, Felix Frankfurter and His Times: The Reform Years 200 (1982).

tion closely aligned him with the majority of his colleagues, but his influence was no greater than Frankfurter's in the field of securities law. The former SEC chairman's uncharacteristically cautious pattern of recusing himself in cases involving the agency meant that he rarely participated in securities cases. Somewhat unexpectedly, the two Justices whose pre-Court experience might have suggested they would most dramatically influence the Supreme Court's securities jurisprudence ended up with surprisingly little effect on the development of that doctrine.

We proceed as follows. Part I describes the role of the future New Deal Justices in helping to enact the federal securities laws. Part II sets forth the constitutional challenges that followed and the role played by Roosevelt's appointees, first in defending the securities laws and subsequently upholding them as members of the Court. Part III shows the tension that arose among the New Deal Justices over the conflict between judicial review and the rule of experts. Part IV explores Roosevelt's success in establishing a Court majority that gave a reliably warm reception to the SEC. We also offer some speculations on Frankfurter and Douglas's lack of influence as Justices in the field of securities law. We sum up in a brief Conclusion.

I. SOCIAL CONTROL OVER FINANCE

A. The Securities Laws of the New Deal

The fight for social control over finance was one of the great political battlegrounds of the New Deal. Most of FDR's future Supreme Court nominees would distinguish themselves in the combat. The years from 1933 to 1935 saw annual fights to enact the three laws that established the foundation of federal securities legislation; four more laws were enacted during Roosevelt's second term:

- The Securities Act of 1933 ("Securities Act") brought the federal government into the regulation of the public offering of securities, curbing the investment bankers' prior domination of that process. The law required corporate issuers to make full disclosure when selling securities in an effort to curb the speculative excesses of the 1920s.

- The Securities Exchange Act of 1934 ("Exchange Act') targeted the New York Stock Exchange, regulating trading practices and requiring disclosure of operations and results by companies listing on exchanges. The Exchange Act also created the Securities and Exchange Commission to administer the securities laws.
- The most controversial of the three securities laws from FDR's first term, however, was the Public Utility Holding Company Act of 1935, which targeted the holding companies that owned most of the public utilities in the United States at the time. PUHCA went well beyond disclosure that characterized the two earlier securities statutes and permitted the SEC to break up the pyramid structure of those holding companies and shape the corporate governance and capital structures of the reorganized firms. PUHCA's sweeping reforms would trigger a decade-long war in the courts, as the giant utilities resisted the efforts of the SEC to dismantle them.
- During FDR's second term, the Chandler Act rewrote the bankruptcy law to give the SEC a similar role in corporate reorganizations.[14]

We do not provide a comprehensive account of the legislative history behind these statutes, but instead highlight the role of the future Justices in the political fight to pass these laws.[15] The future Justice closest to the center of the conflict was Felix Frankfurter. While serving as a Harvard professor, he had ingratiated himself to Roosevelt as a legal and economic advisor during Roosevelt's tenure as governor of New York. Frankfurter and the many protégés he sent to Washington to man the Roosevelt administration were disciples of Louis Brandeis's crusade against "bigness," that is, economic concentration.[16] Frankfurter and his fellow Brandeisians

[14] The other three statutes of the second term—the Trust Indenture Act of 1939, 53 Stat. 1149; the Investment Advisers Act of 1940, 54 Stat. 847; and the Investment Company Act of 1940, 54 Stat. 789—completed the menu of New Deal securities legislation, extending government regulation to bond covenants, mutual funds, and investment advisers. These statutes produced no Supreme Court cases during our period of study.

[15] For the comprehensive account, see Seligman, supra note 1.

[16] William E. Leuchtenburg, Franklin D. Roosevelt and the New Deal 148 (1963) ("Brandeis' ideas made their way in Washington under the aegis of his chief disciple,

viewed big business as an enemy to be defeated.[17] Imposing government control over the world of finance was not merely a matter of sound policy, but the key front in the battle to save capitalism from the evil of the capitalists.[18] Frankfurter wrote to Justice Harlan Fiske Stone in early 1933: "I wish I had a tithe of Macauley's power and of Bagehot's financial capacity. I would write a series of studies entitled 'Enemies of Capitalism,' and instead of dealing with Marx, Lenin & Co., I should analyze the Charles W. Mitchells, the Samuel Insulls & Co. . . ."[19] Frankfurter

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Felix Frankfurter, and through the young men Frankfurter had sent down to be law clerks to the Justice or to staff New Deal agencies."). Brandeis's influence was not limited to his writings before becoming a Justice; he regularly sent messages on policy to Roosevelt, using Frankfurter as his emissary. Peter H. Irons, The New Deal Lawyers 20 (1982). Brandeis's use of Frankfurter for this task was a long-standing practice. See David W. Levy & Bruce Allen Murphy, Preserving the Progressive Spirit in a Conservative Time: The Joint Reform Efforts of Justice Brandeis and Professor Frankfurter, 1916–1933, 78 Mich. L. Rev. 1252, 1257, 1279 (1980).

[17] H.N. Hirsch, The Enigma of Felix Frankfurter 104 (1981) ("The ideological core of Brandeisian liberalism was its emphasis on smallness. As many of the advisors of Roosevelt's first New Deal—Tugwell, Berle, Moley—struggled to create a planned and centralized economy, the Brandeisians sought to restore the simple and decentralized market economy of the nineteenth century. Their key program was trust busting—breaking up the large banks, the large corporations, the large utility companies. To the first New Dealers, business was to be a partner; to the Brandeisians, business was the enemy.").

[18] Frankfurter wrote Roosevelt that "the real trouble with capitalism is the capitalists." Letter from Felix Frankfurter, Professor, Harvard Law Sch., to President Franklin D. Roosevelt (May 18, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 60).

Frankfurter had a similarly dim view of the lawyers and accountants who served the capitalists. See Letter from Felix Frankfurter, Professor, Harvard Law Sch., to James M. Landis, Comm'r, Fed. Trade Comm'n (Feb. 8, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 70) ("I have long had strong suspicions that these fancy accounting firms occupy a role towards financial and business immoralities comparable to that of the eminent law firms.").

[19] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Justice Harlan Fiske Stone (undated) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 3, Reel 3). Frankfurter had a sympathetic audience in Stone, who responded: "Perhaps the most astonishing manifestation of our times is the blindness of those who have the big stake in our present system to its evils. It is the story of the Bourbons over again." Letter from Justice Harlan Fiske Stone to Felix Frankfurter, Professor, Harvard Law Sch. (Feb. 17, 1933) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 3, Reel 3). Another sympathetic ear on the Court was Louis Brandeis, who was "quiet[ly] advising [the Roosevelt administration] from the sidelines." Letter from Raymond Moley to Felix Frankfurter, Professor, Harvard Law Sch. (Oct. 31, 1935) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 51).

had no doubt that stringent regulation was needed. As he wrote after the Securities Act became law:

> During the height of the greatest speculative carnival in the world's history, billions of new securities were floated, of which a large part had no relation to the country's need and which inevitably became worthless; worthless not merely for millions who had sought speculative gains, but for those other millions who sought to conserve the savings of a lifetime. By all the subtle and mesmerizing arts of modern salesmanship, the sellers of securities had so extended the field of security buyers that 55 per cent of all savings . . . went into publicly marketed securities. The resulting losses cut from under the basic supports of a considerable portion of the population, and especially of those helplessly dependent on income from savings. The enormous, easy profits from their distribution stimulated the creation and sale of billions in securities, which have burdened industry and wasted or misdirected the capital resources of the nation.[20]

B. The Securities Act

Roosevelt agreed with Frankfurter that the speculative frenzy of the 1920s had been a disaster for investors and business alike. Stock exchange and securities legislation was on Roosevelt's early list of "must" legislation, and Sam Untermyer had been drafted to work on a bill as early as December 1932.[21] The transition to the new administration was hectic, and two securities bills ended up being drafted[22] with the result that the bill regulating securities offerings that was sent to Congress was deemed a "hopeless mess."[23]

At this point, Ray Moley, one of Roosevelt's key advisors, brought Frankfurter in to sort things out.[24] Frankfurter had recently turned down Roosevelt's offer to become Solicitor General; he thought he would be more useful to Roosevelt if he maintained the

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[20] Felix Frankfurter, The Federal Securities Act: II, Fortune, Aug. 1933, at 53, 54.

[21] Raymond Moley, After Seven Years 176 (1939).

[22] See id. at 177–78. PUHCA is another example of FDR using competing drafts of securities legislation. See infra note 35 and accompanying text.

[23] Moley, supra note 21, at 179.

[24] Id.

independence afforded him as a law professor.[25] Frankfurter viewed the law schools as centers for an empirical, scientific approach to the development of social reform legislation;[26] here was an opportunity to put that theory into action and at the same time make himself useful to Roosevelt.[27] Frankfurter's success in the effort cemented his role in the administration; according to Moley, Frankfurter's involvement in the drafting of the Securities Act "was to make inevitable Felix's appointment to the Supreme Court."[28]

Frankfurter quickly made his way to Washington, enlisting his Harvard colleague, Jim Landis, and two former students, Ben Cohen and Tommy Corcoran, in the effort.[29] Frankfurter met with

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[25] Memorandum from Felix Frankfurter, Professor, Harvard Law Sch. (Mar. 15, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 60); Letter from Felix Frankfurter, Professor, Harvard Law Sch., to President Franklin D. Roosevelt (Mar. 14, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 60).

[26] Hirsch, supra note 17, at 41.

[27] Felix Frankfurter, Diary (May 8, 1933) (on file with the Felix Frankfurter Collection, Library of Congress) ("I said that having refused the request of the President for my services as Solicitor General, I could not possibly decline the President's request, these days, to do *ad hoc* jobs.").

[28] Moley, supra note 21, at 180.

[29] Felix Frankfurter, Diary (May 8, 1933) (on file with the Felix Frankfurter Collection, Library of Congress). Landis, Cohen, and Corcoran would eventually become quite influential New Deal figures in their own right, but they were all Frankfurter's protégés at that time. Frankfurter picked clerks for Brandeis, Cardozo, and Stone; Landis had clerked for Brandeis, and Corcoran for Holmes, on Frankfurter's recommendation. Joseph P. Lash, From the Diaries of Felix Frankfurter 36 (1975). Cohen and Corcoran remained squarely within Frankfurter's sphere of influence after they became part of the New Deal. As Joseph Rauh put it, "When Felix came to Washington, I was working for Ben Cohen and Tom Corcoran. They were pretty important guys, but when Felix walked in the door there wasn't any question who was boss." Joseph L. Rauh, Jr., Clerks of the Court on the Justices, *in* The Making of the New Deal: The Insiders Speak 55, 63 (Katie Louchheim ed., 1983). On Cohen and Corcoran's influence, see The Janizariat, Time, Sept. 12, 1938, at 22, available at http://www.time.com/time/magazine/article/0,9171,760147,00.html. Frankfurter's influence drew him the enmity of the Old Guard. See The Forgotten Memoir of John Knox 70 (Dennis J. Hutchinson & David J. Garrow eds., 2002) (quoting Justice McReynolds: "I also hope that you did not come under the influence of Frankfurter when you were in law school.... He is certainly one man not to be trusted! Even though he is dangerous to the welfare of this country, he evidently has a powerful influence at the White House."); id. at 114 (quoting Justice McReynolds: "Statutes [establishing the New Deal] carelessly drawn by young men just out of the Harvard Law School! Frankfurter's protégés, too, I suppose!")

Moley and Sam Rayburn, chairman of the relevant House subcommittee, on a Friday; by Monday, Landis and Cohen, under Frankfurter's supervision, had come up with a draft for the securities legislation.[30] Frankfurter supplied Rayburn with a draft of the report for the bill,[31] as well as a response to the objections made by the Investment Bankers Association[32] that captures his attitude toward the bankers: "The Investment Bankers Association and all their tribe . . . really think it is terrible that the securities business should be made a conservative business rather than a refined and intricate form of fleecing."[33] At the same time, however, a competing bill was proceeding through the Senate. Frankfurter worked diligently to lobby for Landis's and Cohen's version[34] and to stave off efforts to reconcile the two bills, arguing that reconciliation "would involve interminable delay and jeopardize passage because powerful and increasing financial lobbies against all regulation will exploit differences to defeat enactment."[35] After a good deal of legislative maneuvering, the Senate bill was killed in conference with the help of Senator James Byrnes, whom Roosevelt would later

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[30] Felix Frankfurter, Diary (May 8, 1933) (on file with the Felix Frankfurter Collection, Library of Congress).

[31] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Sam Rayburn, U.S. Rep. (Apr. 24, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 115).

[32] Memorandum Commenting Upon a Memorandum Prepared By Counsel For the Investment Bankers' Association in re H.R. 5480 (undated) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 84).

[33] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Raymond Moley (May 10, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 51).

[34] See Telegram from Felix Frankfurter, Professor, Harvard Law Sch., to Raymond Moley (Apr. 27, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 115); Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Raymond Moley (Apr. 28, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 115); Telegram from Felix Frankfurter, Professor, Harvard Law Sch., to President Franklin D. Roosevelt (Apr. 14, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 115). On Landis's role as SEC Commissioner, Chairman, and administrative law theorist, see Thomas K. McCraw, *Prophets of Regulation* 153–209 (1984).

[35] See Telegram from Felix Frankfurter, Professor, Harvard Law Sch., to President Franklin D. Roosevelt (May 8, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 115).

appoint to the Court.[36] Landis's and Cohen's draft, with amendments here and there, was adopted as the Securities Act of 1933.[37]

While the Securities Act was working its way through Congress, Yale law professor William O. Douglas initially served as a cheerleader for the effort to bring in experts to tame the power of high finance. In a letter to the *New York Times*, Douglas urged that the investor

> needs protection which bankers have not and will not give him. The reputable bankers are no exception. Even they have been known to cut corners and to be governed by the hysteria of bull markets. . . .
>
> There is a need for some agency to step in between the persons who get the money and those who supply it and to fulfill the role of protector for the latter. . . . The ideal of "rugged individualism" when applied to investors has no longer any place in the program for American high finance.[38]

After the 1933 Act was enacted, however, Douglas was less favorable, concluding that the disclosure alone would not prevent the recurrence of the scandals uncovered by Ferdinand Pecora's committee,[39] dismissing it as "of secondary importance in a comprehensive program of social control over finance."[40] Privately, he was more critical: "I think the Securities Act is a rather laborious and untimely effort to turn back the clock and quite antithetical to

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[36] Moley, supra note 21, at 182–83 (noting that Byrnes helped Senate Majority Leader Joe Robinson bury the Senate bill in conference in favor of the Frankfurter bill). Byrnes would later play a role in navigating the Exchange Act through conference. Seligman, supra note 1, at 98–99.

[37] For a firsthand account of the maneuvering, see James M. Landis, The Legislative History of the Securities Act of 1933, 28 Geo. Wash. L. Rev. 29 (1959).

[38] William O. Douglas, Letter to the Editor, N.Y. Times, Apr. 3, 1933 (on file with the Felix Frankfurter Collection, Library of Congress, Reel 116).

[39] William O. Douglas & George E. Bates, The Federal Securities Act of 1933, 43 Yale L.J. 171, 171 (1933) ("There is nothing in the Act which would control the speculative craze of the American public, or which would eliminate wholly unsound capital structures. There is nothing in the Act which would prevent a tyrannical management from playing wide and loose with scattered minorities, or which would prevent a new pyramiding of holding companies violative of the public interest and all canons of sound finance.").

[40] Id.

many of the other significant current developments."[41] Douglas favored bolder reform: federal incorporation and federal control of corporate governance.[42] Douglas was anxious to involve himself in efforts that were brewing to draft legislation to achieve those goals.[43]

In pursuing federal incorporation, Douglas was simply calling for additional liberal reforms. Yet his criticisms of the 1933 Act struck Frankfurter as echoing the reactionary drumbeat of the investment bankers and their corporate lawyers. Douglas worried that the Securities Act would chill capital formation:

> The cumulative effects of the absolute liability of the issuer, the undefined liability of stockholders, the liability of directors irrespective of the nature of their appointments, the liability of underwriters, and the increasing difficulty on the part of issuers to obtain that underwriting, make it more and more apparent that, whether rightly or wrongly, justifiably or otherwise, the Act will prevent a great amount of financing by many companies with well established businesses and will continue to deter refunding operations and reorganizations.[44]

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[41] See Letter from William O. Douglas, Professor, Yale Law Sch., to A.A. Berle, Jr., Professor, Columbia Law Sch. (Dec. 29, 1933) (on file with the William O. Douglas Collection, Library of Congress).

[42] See Letter from William O. Douglas, Professor, Yale Law Sch., to Jerome N. Frank, Gen. Counsel, Agric. Adjustment Admin. (Dec. 2, 1933) (on file with the William O. Douglas Collection, Library of Congress) ("I am particularly intrigued with your proposal for federal incorporation, as I think that only by some such beginning can genuine progress towards protection of investors get under way.").

[43] See Letter from William O. Douglas, Professor, Yale Law Sch., to A.A. Berle, Jr., Professor, Columbia Law Sch. (Jan. 3, 1934) (on file with the William O. Douglas Collection, Library of Congress) ("You can count on me to pull an oar on federal incorporation . . . . [P]erhaps we can begin to get at the really fundamental problem of the increment of power and profit inherent in our present form of organization . . . .").

[44] Douglas & Bates, supra note 39, at 192 (footnotes omitted). Douglas conceded some virtue in the ambiguities in the Securities Act, as they "would give the enforcing agency a powerful weapon . . . with which to control financial practices deemed inimical to the public interest." Id. at 211. His bottom line, however, was that the Act required amendment to correct its "ambiguities and inconsistencies" lest it "paralyz[e] . . . legitimate activity." William O. Douglas & George E. Bates, Some Effects of the Securities Act upon Investment Banking, 1 U. Chi. L. Rev. 283, 306 (1933).

Douglas's critique drew a sharp rebuke from Frankfurter.[45] Frankfurter confided to Landis that Douglas had fallen under the sway of the money people and their fellow travelers in the business schools.[46] Frankfurter's main concern was that any criticism of the law would further the conspiracy that he perceived among investment bankers and their lawyers to gut the Act:

> I happen to know in some detail what some of the leading law firms have been up to in order to create a state of mind for amendments on the plea of recovery. You know as well as I do that the notion that the Securities Act has stopped capital issues is just rubbish.[47]

In Frankfurter's view, Douglas was lending aid and comfort to the foes of the New Deal by calling for the law's amendment. "It is of course very generous of you, with everybody agin [sic] them at present, for you to champion the cause of 'the Street' and persecuted houses like J.P.Morgan [sic] and Kuhn, Loeb."[48]

Frankfurter also disagreed with some of Douglas's more ambitious ideas for the social control of finance, such as federal incorporation and direct governmental control of securities issues. Here his Brandeisian distrust of "bigness" came through, this time directed at the federal government:

> I am much more sceptical than you are, apparently, of the large schemes of which you speak for curbing corporate abuses. . . . I am not at all for federal incorporation . . . . Where do you men get your great confidence in the effectiveness of piling on everything on the back of federal administration[?] I was a hot Hamil-

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[45] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to James M. Landis, Comm'r, Fed. Trade Comm'n (Mar. 17, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 70) ("I wrote him a letter the other day, in a half-saucy, half-severe strain . . . .").

[46] Id. ("[E]ven Bill Douglas is trying to reflect too much the people in the big offices and the business schools, among whom he likes to appear as a sound and knowing fellow.").

[47] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to William O. Douglas, Professor, Yale Law Sch. (Jan. 16, 1934) (on file with the William O. Douglas Collection, Library of Congress).

[48] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to William O. Douglas, Professor, Yale Law Sch. (Feb. 5, 1934) (on file with the William O. Douglas Collection, Library of Congress).

> tonian when I went to Washington in 1911, but years in the government service and all the rest of the years watching its operations intently have made me less jaunty about devices for running a whole continent from Washington.[49]

Frankfurter instead favored graduated taxation rates to penalize "big corporations" which he believed would "prevent all sorts of nonsense that we never could touch through a federal incorporation act."[50] Frankfurter was equally skeptical of federal government control of securities issues:

> It's awfully easy to write these nice laws for control. I think your lawyer-banker friends would be glad to write them for you, but . . . when I think of the stuff that gets by even high-minded judges—well, I prefer to use the taxing power . . . to curb the mischief and abuses of corporate activities.
>
> . . . Tax 'em, my boy, tax 'em, and otherwise reduce the opportunities for bludgeoning that interrelation and concentration of money interests make possible.[51]

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[49] Letter from Felix Frankfurter to William O. Douglas (Jan. 16, 1934), supra note 47.

[50] Id.

[51] Id. Frankfurter had been pursuing a "tax on the bigness of corporations" since at least 1932. See Letter from Burton K. Wheeler, U.S. Sen., to Felix Frankfurter, Professor, Harvard Law Sch. (Mar. 30, 1932) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 67); Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Burton K. Wheeler, U.S. Sen. (Apr. 4, 1932) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 67). Roosevelt endorsed Frankfurter's legislation in January 1935. Memorandum for the Secretary of the Treasury from President Franklin D. Roosevelt (Jan. 16, 1935) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 155). Senator Burton Wheeler introduced it into Congress shortly thereafter. Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Burton Wheeler, U.S. Sen. (Mar. 12, 1935) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 67) ("I rejoice over your introduction of the tax on bigness . . . .").

Frankfurter also discouraged Roosevelt from pursuing federal incorporation. Letter from Felix Frankfurter, Professor, Harvard Law Sch., to President Franklin D. Roosevelt (Mar. 6, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 60) ("I notice also some talk of an Administration measure for federal incorporation. . . . Great difficulties are involved in such a measure, and I hope there won't be any urgency in pushing it. Of course many abuses have found shelter under our corporation laws. But the abuses that call for public protection and are essential to a healthy economic life can be dealt with by a number of specific improvements in

Douglas was most contrite in his response,[52] but he did not yield ground on the need for federal incorporation[53] and complete governmental control over investment banking[54]—goals he would continue to pursue as SEC chairman.[55]

Frankfurter's worry that the investment bankers and corporate lawyers were conspiring to undo the progress of the Securities Act was a recurring theme of his correspondence in late 1933 and early 1934.[56] At first he dismissed the notion of a "bankers strike" as mere "newspaper talk,"[57] motivated by the newspapers' interest in "profitable but socially elicit financial advertising."[58] He was dismissive of investment bankers' worries that their potential "liability under the present law is more than fifty times our average profit, even though we may make no untrue or misleading statement or leave out any material fact, merely because we may be unable to sustain the burden of proof that we have not made such er-

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federal legislation, especially through the use of the taxing power, without prematurely raising the many problems that are involved in a federal incorporation law.").

[52] Letter from William O. Douglas, Professor, Yale Law Sch., to Felix Frankfurter, Professor, Harvard Law Sch. (Feb. 19, 1934) (on file with the William O. Douglas Collection, Library of Congress) ("My heart would indeed 'bleed' if I thought I was inadvertently championing the cause of 'the Street.'").

[53] Id. ("On analysis it will be seen that federal incorporation is only one device. But it is a damn convenient one. Hooked up with the commerce and taxing powers it can be made a powerful weapon for social control.").

[54] Id. ("The Securities Act will be fully justified if it drives the government into the investment banking business.").

[55] Seligman, supra note 1, at 205–09 (discussing federal incorporation); Letter from William O. Douglas, Chairman, Sec. Exch. Comm'n, to Henry A. Wallace, Sec'y, Dep't of Agric. (Apr. 11, 1938) (on file with the William O. Douglas Collection, Library of Congress) (advocating a system of government investment banking).

[56] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to President Franklin D. Roosevelt (July 6, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 60) ("[F]ray indeed is ahead in the administration of the Securities Act. There are still too many in 'the Street' who think what Joe Cotton used to call the 'green goods business'—when he passed on securities issues for his notable clients—will flourish as of old. It is hard for some folk to realize that new social and economic standards ever come into play.").

[57] See, e.g., Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Arthur Perry (Sept. 7, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 84).

[58] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Louis Howe (Sept. 13, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 84).

rors."[59] Frankfurter believed that corporate lawyers were misrepresenting the effects of the law to their clients as part of a "concerted effort[] . . . to chloroform the Securities Act,"[60] and he lobbied Roosevelt to resist the effort.[61] In Frankfurter's view, "no clarification is needed and 'clarification' isn't what is wanted."[62] Opposition to the law was "selfish and ignorant."[63] Despite Frankfurter's resistance, however, the move to amend the Securities Act would gather steam when the administration began drafting a law to regulate the New York Stock Exchange ("NYSE").[64]

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[59] Letter from Arthur Perry to Felix Frankfurter, Professor, Harvard Law Sch. (Sept. 14, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 84). Frankfurter's response was a harbinger of the response to claims of excessive securities regulation that we hear today: "The English seem to have done very well as the money market of the world despite their stringent controls. My patriotism is somewhat offended—and I speak as an Anglophile—that ethical and fiduciary standards which are legally enforced in England should be deemed too stringent for us. I refuse to believe it." Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Arthur Perry (Sept. 18, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 84).

[60] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Justice Harlan Fiske Stone (Sept. 28, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 64); see also Letter from Felix Frankfurter, Professor, Harvard Law Sch., to George Brownell (Dec. 1, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 69) ("The leading law firms of New York and Boston . . . began a systematic campaign to undermine the essentials of the Act by attributing to it the congealing of capital investment. . . . [T]here isn't a particle of doubt that lawyers of responsibility and high standing infused clients with fears and worse than that—I know what I am talking about—actually discouraged clients, at times, from doing any financing for the present, so that the campaign against the Act, when Congress next meets, should show that the Act had prevented financing.").

[61] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to President Franklin D. Roosevelt (Dec. 19, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 155); Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Henry Stimson (Dec. 19, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 84).

[62] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to James M. Landis, Comm'r, Fed. Trade Comm'n (Jan. 10, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 70).

[63] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to James M. Landis, Chairman, Sec. Exch. Comm'n (Apr. 30, 1935) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 45).

[64] Letter from James M. Landis, Comm'r, Fed. Trade Comm'n, to Felix Frankfurter, Professor, Harvard Law Sch. (Dec. 13, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 70) ("As you know, the Securities Act has been opened pretty widely for discussion.").

C. The Securities Exchange Act of 1934

The NYSE was the second bête noire of the Pecora hearings and moved to the center of the legislative stage in the second year of the New Deal. The NYSE claimed to be self-regulated, but at least some observers felt that self-regulation lacked teeth.[65] Frankfurter heartily agreed that the Exchange was "long overdue" for governmental regulation, telling Roosevelt: "There has been more than ample time for self-regulation, and self-regulation they have shown is not in them."[66]

Frankfurter's role here was more indirect than it had been with the Securities Act because he was at Oxford for the year. Given the era's limited means of communication and transportation, his lobbying was confined to telegrams and letters. On board a ship to England, he wrote Roosevelt urging him to fight for legislation controlling the NYSE.[67]

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[65] As the Securities Act was working its way through Congress, Stone wrote to Frankfurter:

> Of course, the Stock Exchange should require precise information as to the total distribution made to officers and directors. The fact that it has never done so shows how little it performs what should be its real function to protect adequately those who deal in securities sold under its auspices. Many years ago, after I had unearthed a series of shockingly fraudulent performances by members of the Exchange, which should have been known to its Governors, I told the latter that the survival of the Exchange would depend primarily on their own willingness to take proper measures to protect adequately the interest of those who availed of its facilities.

Letter from Justice Harlan Fiske Stone to Felix Frankfurter, Professor, Harvard Law Sch. (May 15, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 64).

[66] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to President Franklin D. Roosevelt (Feb. 14, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 155).

[67] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to President Franklin D. Roosevelt (Oct. 1, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 155). Frankfurter quoted at length from a letter that he had received from Stone, which Frankfurter considered particularly apt, as Stone was "an old-line Republican, a member of Sullivan & Cromwell before he became Coolidge's Attorney General":

> The new Securities Act promises well and undoubtedly will prevent some of the fraudulent schemes which have been common in the past, especially in marketing bonds. There is another like evil that must ultimately be reached, and that is the creation of boom markets for stocks through wash sales on the Exchange.

Id.

Despite his distance from events on the ground, Frankfurter's influence was leveraged by the central role that Cohen and Corcoran played in drafting the law. Cohen revised the first version of the legislation under the influence of Pecora; the result was a draconian bill that would have fundamentally changed the operation of the NYSE.[68] The president of the NYSE, Richard Whitney, galvanized the opposition of the brokerage community, as well as the regional exchanges, which would have been crippled by the law as drafted.[69] Corcoran, as the administration's point man in lobbying for the bill, fought tenaciously to preserve it.[70] Landis, however, was somewhat more pragmatic than Frankfurter, and he recognized that the legislation would need to be modified to be enacted.[71] In an effort to preserve the core of the Securities Act, Landis took charge of the amendments to that legislation, a move that appears to have assuaged Frankfurter's concerns.[72]

The fate of the stock exchange bill, however, was still in doubt. For Frankfurter, the exchange bill was "a test of power"[73] and the campaign against it was tinged with anti-Semitism.[74] Cohen and

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[68] Seligman, supra note 1, at 85–87.

[69] Id. at 89–93.

[70] Letter from Ben Cohen to Felix Frankfurter, Professor, Harvard Law Sch. (May 11, [1934]) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 70).

[71] Letter from James M. Landis, Comm'r, Fed. Trade Comm'n, to Felix Frankfurter, Professor, Harvard Law Sch. (Mar. 6, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 70) ("The Stock Exchange Bill is receiving a terrific battering. All the corporate wealth of this country has gone into the attack and carried it all the way up to the White House. I think F.D. will stand very firm on its essentials, however.").

[72] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to James M. Landis, Comm'r, Fed. Trade Comm'n (Mar. 17, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 70) ("What you tell me as to the likely direction of amendments to the Securities Act is, of course, extremely interesting and sounds like sense.").

[73] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Raymond Moley (Apr. 24, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 71).

[74] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Tom Corcoran (May 7, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 70) ("[T]he talk against the Jews in the government comes from the powerful financial and business interests, who have given battle and will continue to give battle to the Administration on things like the Seucrites [sic] Act and stock exchange legislation. It's Wall Street that is using the Jewish stick precisely as it has used and will use any other stick . . . .").

Corcoran, drafted by Moley to revise the bill, "were in constant, almost daily, touch with Frankfurter. His function, so far as they were concerned, had come to be more inspirational than anything else. Felix was a patriarchal sorcerer to their apprentice, forever renewing their zeal for reform and their pride in fine workmanship."[75] Corcoran kept Frankfurter informed of the bill's progress through a barrage of telegrams; Frankfurter sent a few telegrams of his own to key players in the fight.[76] When the exchange bill was eventually enacted, Frankfurter was effusive in his praise of Cohen and Corcoran:

> It was an extraordinary fight, and considering the forces and resources against you, was an extraordinary achievement of a very small handful of men for decency and for honor and for the salvage of those very institutions for which the blind men of Wall Street profess to speak but which in their greed, had they a free hand, they would be speedily destroying. You and Ben in particular have shown knowledge and pertinacity and devotion and good humor and good sense .... It makes me very proud indeed of your friendships.[77]

While Frankfurter exulted in the triumph of good versus evil, taking almost paternal pleasure in the role that his protégés played in the fight, Douglas sensed opportunity. Early discussion of the proposed legislation indicated that either a new commission would be created to enforce its provisions or that the Federal Trade Commission, already tasked with administering the Securities Act, would be expanded to handle the new work.[78] Douglas's close friend, Richard Smith, a public utility lawyer in New York, took the lead in lobbying for a seat on Douglas's behalf.[79] Now that he was pursuing a job as a regulator, Douglas downplayed his earlier

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[75] Moley, supra note 21, at 285.

[76] See, e.g., Telegram from Felix Frankfurter, Professor, Harvard Law Sch., to John Dickinson, Assistant Sec'y, U.S. Treasury (Mar. 4, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 70).

[77] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Tom Corcoran (May 7, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 70).

[78] Seligman, supra note 1, at 84.

[79] See Letter from Richard Smith to Francis T. Maloney, U.S. Rep. (Mar. 23, 1934) (on file with the William O. Douglas Collection, Library of Congress).

criticisms of the Securities Act; the main thrust of his writing on the topic, he said, was that "it is necessary to have a very powerful commission fully equipped with a rather wide range of discretion to handle the job. The matter simply cannot be reduced to a code."[80] Unfortunately for Douglas, his writings could not be explained away so easily. The word from Washington was that "Landis particularly is very resentful toward you, because of your writings on the Securities Act."[81] Perhaps unsurprisingly given the rebuke he had received from Frankfurter, Douglas did not ask the Harvard professor to lobby on his behalf[82] despite Frankfurter's well-known influence in personnel matters in the Roosevelt administration.[83] In the end, Douglas was passed over for a spot on the newly created Securities and Exchange Commission.[84]

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[80] Letter from William O. Douglas, Professor, Yale Law Sch., to Richard Smith (Apr. 9, 1934) (on file with the William O. Douglas Collection, Library of Congress).

[81] Letter from Richard Smith to William O. Douglas, Professor, Yale Law Sch. (May 26, 1934) (on file with the William O. Douglas Collection, Library of Congress). This view was evidently shared by others. See Letter from Richard Smith to William O. Douglas, Professor, Yale Law Sch. (June 13, 1934) (on file with the William O. Douglas Collection, Library of Congress) ("I received a letter from Maloney in which he stated that he was running into opposition to you among the crowd who have resented your Articles.").

[82] Letter from William O. Douglas, Professor, Yale Law Sch., to Richard Smith (June 12, 1934) (on file with the William O. Douglas Collection, Library of Congress).

[83] Frankfurter denied exercising such influence, despite the overwhelming evidence to the contrary. See Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Drew Pearson (May 17, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 53).

[84] Ben Cohen, who clearly had earned a spot on the Commission through his drafting efforts, was also passed over despite Tom Corcoran's lobbying efforts on Cohen's behalf. According to Corcoran, Roosevelt was afraid to put Cohen on the newly created SEC for fear that it would provoke anti-Semitism. Telegraph from Centurion [Tom Corcoran] to Felix Frankfurter, Professor, Harvard Law Sch. (May 30, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 70). The next year, however, Frankfurter recommended that Roosevelt not appoint Cohen to the SEC because Cohen was too essential to Roosevelt's legislative efforts. See Memorandum for the President from Felix Frankfurter (Aug. 21, 1935) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 155). Cohen also lost out on the General Counsel position at the new agency when the SEC's first chairman, Joe Kennedy, picked John Burns instead. (This scarcely reduced Frankfurter's influence; Burns was a Harvard Law graduate, and he would soon be filling the SEC's ranks with candidates recommended by Frankfurter.) Telegram from John J. Burns, Gen. Counsel, Sec. Exch. Comm'n, to Felix Frankfurter, Professor, Harvard Law Sch. (May 10, 1935) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 84). Burns was also soliciting Frankfurter's views on the interpretation of the Exchange

Roosevelt pushed businessman Joseph P. Kennedy for chairman over the more obvious candidate, Landis, as part of the "truce of God" that the administration was seeking with the business community after the bitter fight over the Exchange Act.[85] Roosevelt's rapprochement with the business community was to be short-lived. Having vanquished the investment bankers and the New York Stock Exchange, FDR's next target was the utility companies.

D. The Public Utility Holding Company Act of 1935

When Frankfurter returned to the United States in the summer of 1934, he urged Roosevelt to face the "irrepressible conflict" with big business.[86] The Exchange Act amendments relaxing the Securities Act's liability provisions had produced "[o]nly a trickling little stream of private corporation finance," leading Joe Kennedy to berate the investment industry for its timidity.[87] If the capitalists were not willing to do their part to foster economic recovery, why should the administration placate business by holding back from further reforms? Frankfurter

> insisted that the attempt at business-government co-operation had failed, and urged Roosevelt to declare war on business. Once the President understood that business was the enemy, he would be free to undertake the Brandeisian program to cut the giants down to size: by dwarfing the power of holding companies, by

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Act. Letter from John J. Burns, Gen. Counsel, Sec. Exch. Comm'n, to Felix Frankfurter, Professor, Harvard Law Sch. (Aug. 8, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 115).

[85] Letter from Tom Corcoran to Felix Frankfurter, Professor, Harvard Law Sch. (May 11, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 70) ("If Ray [Moley] is any barometer of what's going on in the White House mind, the plan of battle is to avoid any further attempt at reforms that might bring down more criticism during the present Congress, arrange a 'truce of God', reorganize the machinery down here to help along business recovery this summer, and in every other way postpone all other considerations to the necessarily primary objective of winning the Congressional elections.").

[86] Parrish, supra note 13, at 244.

[87] Joseph P. Kennedy, Speech to the American Arbitration Association 4 (Mar. 19, 1935) (transcript on file with the William O. Douglas Collection, Library of Congress; Securities Act Release No. 317, Mar. 19, 1935).

> launching antitrust suits, and by taxing large corporations more stiffly than small business.[88]

Although investment banking and the NYSE had been the primary targets of the Pecora hearings, the collapse of the Insull public utility holding company was the Enron of its day.[89] The demise of the Insull empire cemented the public utility holding company structure's reputation for abuse.[90] Wiley Rutledge, then dean of the Washington University School of Law and a teacher of corporate law, agreed with Douglas on the need for federal incorporation, and he also shared the aversion to bigness held by Frankfurter and the other Brandeisians.[91] Rutledge had no experience or education in business or economics, but apparently his "brief law practice included work for a public utility that caused him to question 'the holding company set-up.'"[92] Rutledge made the case against bigness and the abuses that it facilitated in the holding company structure.[93] He argued that the "devices of share dispersion, non-voting stock, the voting trust, etc. . . . multipl[y] the power to concentrate control almost in geometric progression."[94] Worse yet, the intricate interconnections within the holding company empires frustrated effective regulation:

> The maze of "contracts" and of accounts is so intricate that no outsider (and probably few "insiders") can determine real costs or profits. Rate-making becomes a farce, and the balance sheet

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[88] Leuchtenburg, supra note 16, at 150.

[89] See David Skeel, Icarus in the Boardroom: The Fundamental Flaws in Corporate America and Where They Came From 8, 80–89 (2005) (discussing Insull); Richard D. Cudahy & William D. Henderson, From Insull to Enron: Corporate (Re)Regulation After the Rise And Fall of Two Energy Icons, 26 Energy L.J. 35, 36 (2005).

[90] Recent work by Paul Mahoney casts doubt on whether that reputation was warranted. See Paul G. Mahoney, The Public Utility Pyramids 4 (Jan. 2008) (unpublished manuscript, available at http://www2.law.columbia.edu/contracteconomics/conferences/laweconomicsS08/Mahoney%20paper.pdf).

[91] John M. Ferren, Salt of the Earth, Conscience of the Court: The Story of Justice Wiley Rutledge 93 (2004) (noting that Rutledge favored the Brandeisian notion that the "growth of corporate enterprise has been drying up individual independence and initiative, drying up the life of the big town and the small town, and the hamlet. We are becoming a nation of hired men, hired by great aggregations of capital").

[92] Id. at 89.

[93] Wiley B. Rutledge, Editorial, The Future of the Interstate Power Holding Company, St. Louis Post-Dispatch, May 5, 1935, at Editorial Section 1.

[94] Id.

> of the system a puzzle worse than Chinese. The corporate family is the only ones [sic] known which can keep alive nine generations contemporaneously.[95]

Disclosure was not enough to correct these abuses; the federal government needed to control corporate governance as well.

Frankfurter pushed FDR to make the holding company legislation a key component of the "second hundred days" legislative initiative in 1935.[96] Frankfurter had an active interest in public utilities, having taught a course on the subject from his earliest days at Harvard.[97] With his usual impatience, he had been pushing Roosevelt to introduce legislation to control public utilities since even before Roosevelt's inauguration.[98] Frankfurter's persistence was rewarded on January 4, 1935, when Roosevelt called for the "abolition of the evil of holding companies" in his State of the Union address to Congress.[99] Frankfurter was delighted; holding companies, he urged, "really have no ultimate economic and social justivication [sic]. That the national interest requires their elimination I have no doubt .... [D]rastic regulation and taxation are indispensable, both in themselves and also for insurance against the possibility of alleviating legislation by a future Congress."[100] Frank-

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[95] Id.

[96] Hirsch, supra note 17, at 116 ("The result of Frankfurter's proddings and Roosevelt's turn of mind was the second hundred days, during which the administration pushed for five major pieces of legislation: the social securities bill, the Wagner labor bill, a banking bill, a holding companies measure, and a tax plan.").

[97] See Felix Frankfurter, Lecture to Pub. Utils. Course (Sept. 28, 1914) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 3, Reel 21) (predicting that "in the immediate decades ahead, during your time and mine, there will be a continued extension of governmental activity and governmental supervision of business").

[98] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Ray Moley (Feb. 28, 1933) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 51) ("This time I am troubling you about legislation regarding the reorganization and extension of federal public utility control. This is a subject on which F.D.R. spoke to me when I saw him last, and as to which he desires, I am sure, early action.").

[99] *Quoted in* Arthur M. Schlesinger, Jr., The Age of Roosevelt: 1935–1936, The Politics of Upheaval 305 (1960).

[100] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to President Franklin D. Roosevelt (Jan. 24, 1935) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 155). Frankfurter laid the blame for the evils of the industry with the investment bankers. Felix Frankfurter, The Public & Its Government 109–10 (1930) (criticizing role of bankers in creating elaborate holding company structures that put utilities beyond the effective reach of regulation).

furter (and now Roosevelt) saw the opportunity for the elimination of holding companies; it needed to be seized, and seized quickly, lest future administrations succumb to lobbying pressure from the utility industry.

There was disagreement within the administration, however, on the means to achieve this end. Ben Cohen drafted one bill, under the direction of Robert Healy (first an FTC commissioner and subsequently an initial SEC commissioner), who had directed an exhaustive study of public utility companies by the FTC.[101] As Cohen described it in a letter to Healy:

> [T]he bill does not outlaw the holding company but regulates and restricts the use of the holding company form and provides a mechanism through which, over a period of time, existing holding company structures may be simplified, and their field limited to a sphere where their economic advantages may be demonstrable.[102]

A Treasury Department team—under the direction of future Justice Robert H. Jackson and Herman Oliphant—favored almost immediate abolition through imposition of a stiff tax on dividends paid by operating companies to the holding companies.[103] Roosevelt called the two sides together for a meeting and made it plain that he favored rapid abolition.[104] Roosevelt's decision represented a significant victory for the Brandeisians in the administration: the holding companies were perhaps the most conspicuous example of the curse of bigness.[105]

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[101] See Letter from Ben Cohen to Robert E. Healy, Comm'r, Sec. Exch. Comm'n (Nov. 23, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 113); see also Letter from Ben Cohen to Felix Frankfurter, Professor, Harvard Law Sch. (Nov. 23, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 113) (soliciting Frankfurter's comments on the draft bill).

[102] Letter from Ben Cohen to Robert E. Healy, Comm'r, Sec. Exch. Comm'n (Nov. 23, 1934) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 113).

[103] Schlesinger, supra note 99, at 305.

[104] Id.

[105] Leuchtenburg, supra note 16, at 156 ("The Public Utilities Holding Company Act was a bold stroke against bigness, and the Brandeisians were delighted. 'If F.D. carries through the Holding Company bill we shall have achieved considerable toward curbing Bigness.'" (quoting Brandeis)). The bill was a victory not only for the Brandeisians, but also Brandeis himself, who had been pushing for the abolition of the holding companies behind the scenes. Bruce Allen Murphy, Elements of Extrajudicial

The result of the meeting with Roosevelt was a clause calling for the elimination of the holding company, which came to be known as the "death sentence" provision.[106] The provision effectively limited utility holding companies to one geographic area; those that did not satisfy this requirement were to be broken up under the direction of the SEC. The death sentence provision was a major departure from the disclosure paradigm of the Securities and Exchange Acts. The holding company legislation followed those laws in requiring registration and disclosure, but it broke new ground in giving the SEC control over the utilities' capital structures and corporate governance. Thus, the legislation set a new high water mark for federal interference with business, albeit one that governed only a portion of American business—public utility holding companies. For opponents of federal economic regulation, the holding company legislation looked like a trial run for the federal control of corporate governance that Douglas and like-minded liberals had been seeking.

The public utilities industry was considerably less enthusiastic about being the subject of the federal government's experiments in corporate governance. The industry predicted economic disaster if the bill were enacted. Wendell Willkie, the president of Commonwealth and Southern (and future Republican presidential nominee), was the industry's most articulate spokesman.[107] He warned that

> the utility industry would be thrown "into a chaos of liquidation and receiverships," holders of utility stocks would suffer "practically complete" losses, and a "great bureaucracy in Washington will be regulating the internal affairs of practically all utility operating companies in the United States." The backers of the death sentence, Willkie charged, were trying "to 'nationalize' the power business of this country."[108]

Strategy: A Look at the Political Roles of Justices Brandeis and Frankfurter, 69 Geo. L.J. 101, 120 (1980).

[106] Schlesinger, supra note 99, at 306.

[107] Id. at 308.

[108] Id. at 310.

Although his rhetoric was shrill, Willkie's fears of socialism in the utility industry were not entirely unfounded.[109] More to the point, it had political resonance with the voters.[110] In a major rebuff to Roosevelt, the House rejected the death sentence provision.[111]

The industry backed up its public relations attack with a grass-roots lobbying campaign, but here the industry overreached. After allegations surfaced of a raft of telegrams opposing the bill sent by fictitious persons, a select committee chaired by then-Senator Hugo Black was appointed to investigate the utilities' lobbying against the holding company bill. Black pursued his investigation "with a fanaticism not surprising in a one-time Klan member. In his frenzy to uncover improper lobbying by certain utilities—and there was plenty of it—Black struck at the innocent as well as the guilty. Opposition to the bill became, *ipso facto*, an indication of bad faith."[112] Whatever its excesses, the revelations produced by Black's investigation gave new hope to the administration for the bill's passage.[113]

Even after the bill passed the Senate, however, it remained bottled up in conference committee. The key disagreement was over the death sentence provision. The Senate's version limited holding companies to a single "geographically and economically integrated . . . system" operating in "contiguous states," while the House version required only an "integrated public-utility system."[114] The President favored the more stringent Senate version, but Frankfurter eventually persuaded him to yield.[115] Frankfurter drafted a compromise that used the House's "integrated public-

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[109] After the enactment of PUHCA, Corcoran told Moley: "It won't come fast, but twenty years from now the government will own and operate all the electrical utilities in the country." Moley, supra note 21, at 354.

[110] But not with Douglas. Wilkie's efforts on behalf of the utility industry earned him Douglas's bitter antipathy. See William O. Douglas, Diary (Dec. 1, 1939) (on file with the William O. Douglas Collection, Library of Congress, Box 1780) ("I had had many many contacts with Wilkie at the S.E.C. I was convinced that he was one of the most unscrupulous men I had ever met, that he was interested only in power, for himself + for the vested interests, that he had no principles, and that he was the most dangerous Fascist threat on the scene.").

[111] Schlesinger, supra note 99, at 311–16.

[112] Moley, supra note 21, at 315; see also Schlesinger, supra note 99, at 318–23.

[113] Schlesinger, supra note 99, at 323–24.

[114] Parrish, supra note 13, at 250.

[115] Moley, supra note 21, at 316 & n.2.

utility system" language, but also stipulated that the system could not be "so large . . . as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation."[116] This stipulation was studiously vague; its meaning would have to be determined by the SEC, and potentially, the courts.

E. The Chandler Act of 1938

Having created the SEC to be the government's expert agent to regulate American business, FDR had a ready tool when his administration decided to make further inroads into corporate governance during his second term. The Chandler Act followed the earlier pattern of FDR's securities laws by putting the SEC into the center of important business decisions, displacing the traditional authority exercised by investment bankers.[117] It followed PUHCA in going beyond mere disclosure to give the agency a key substantive role in the reorganization of troubled firms.[118]

Bankruptcy reorganization had been on the administration's original business reform agenda. Unlike the subjects of the first term securities laws, however—public offerings, the NYSE, and the utility holding companies—the abuses of the bankruptcy reorganization process were not as obvious to the general public. Before reform could be adopted, it was necessary to build a case documenting the abuses of the protective committees and build broader support for government control.[119]

A bankruptcy reform movement had been growing through the 1920s and into the early 1930s, with well known studies headed by New York City lawyers Donovan and then Thatcher showing the inadequacies of the existing system.[120] Legislation was passed in the

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[116] Parrish, supra note 13, at 250.

[117] See David A. Skeel, Jr., Debt's Dominion: A History of Bankruptcy Law in America 125 (2001) ("Within a few years, the starring role that the Wall Street bankers had played for more than fifty years was a thing of the past.").

[118] Act of June 22, 1938, ch. 575, §§ 171–74, 52 Stat. 840, 890–91.

[119] Ralph F. de Bedts, The New Deal's SEC: The Formative Years 109 (1964) ("In his demand for studies and more studies Landis can be likened to the field general who will not unnecessarily risk his forces until sure of overwhelming superiority. But the many studies begun by Chairman Landis—and frequently used to such good advantage by his successor, William O. Douglas—were not born of timidity.").

[120] H. Comm. on the Judiciary, 71st Cong., Report on the Administration of Bankruptcy Estates (Comm. Print 1931) (Donovan Report); Att'y Gen., Strengthening of

dying days of the Hoover administration, supplemented a year later by additional legislation under the new administration, revamping the core process for bankruptcy. These measures codified the equity receivership proceedings long used in railroad reorganization for business reorganizations generally, but they did not address the role of investment bankers in reorganizations.[121] Among the provisions of the Securities Exchange Act of 1934 was a directive that the new Securities and Exchange Commission study protective committees.[122] This study would help establish the political case for fundamental changes in business reorganization. Perhaps of greater historical significance, the protective committee study would provide the entrée for a young Yale law professor into government service.

William O. Douglas, like Frankfurter, reflected the influence of Brandeis: "[Brandeis's] 'Other People's Money,' had been of course a Bible for me for years, as had his 'Curse of Bigness,' the philosophy of which was my own."[123] As one of the legal realists revolutionizing legal scholarship and education, Douglas had been pushing corporate reform for years by the time he came to the SEC. First at Columbia and then at Yale, Douglas had sought to reform a broad area of the business law curriculum. Bankruptcy, however, was always a special interest of Douglas's. He had undertaken an empirical study with a New Jersey federal judge of bankruptcy filings in several districts and had been a part of the Donovan and Thatcher reform efforts.[124]

Douglas's campaign to be chosen as one of the first five commissioners for the fledgling SEC had been stymied by Landis's opposition to him based on Douglas's critique of the Securities Act. Landis's opposition to Douglas was apparently not deep rooted, however, since Landis recruited him to conduct the study of pro-

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Procedures in the Judicial System: The Report of the Attorney General on Bankruptcy Law and Practice, S. Doc. No. 65, at 90–93 (1st Sess. 1932) (Thatcher Report).

[121] Act of Mar. 3, 1933, ch. 204, §77, 47 Stat. 1474, 1474–82; Act of June 7, 1934, ch. 424, § 77B, 48 Stat. 911, 912–22.

[122] Act of June 6, 1934, ch. 404, § 211, 48 Stat. 881, 909.

[123] William O. Douglas, Diary (Mar. 26, 1939) (on file with the William O. Douglas Collection, Library of Congress, Box 1780).

[124] Skeel, supra note 117, at 109.

tective committees in bankruptcy mandated by the 1934 Act.[125] Over the next several years Douglas split his time between Washington and New Haven, assembling a talented team to work on the study, including his future Supreme Court colleague, Abe Fortas.[126] This research would eventually catapult Douglas to the SEC chairmanship, just as he had planned.[127]

By the time the protective committee's study first report was ready (there would eventually be eight volumes), bankruptcy reform was gaining momentum in Congress.[128] Douglas had now gained his coveted seat on the Commission, and would soon succeed Landis as its chairman. He and others described the work of the protective committee study as "briefs" for Congressional action.[129] Three separate bills were under discussion, bearing the names of three House members, Sabath, Lea, and Chandler. Sabath's bill sought to name a conservator, an official employed by the government, for every bankruptcy.[130] The Lea bill, drafted as an amendment to the Securities Act of 1933, focused directly on reorganization of public corporations and targeted the central role that investment bankers played in this process.[131] Chandler's bill, proposed by the second term Congressman from Memphis, had arisen from the efforts of a group of bankruptcy lawyers (not including the elite firms that dominated reorganization work) that became

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[125] See Letter from William O. Douglas, Professor, Yale Law Sch., to James Landis, Comm'r, Fed. Trade Comm'n (July 12, 1934) (on file with the William O. Douglas Collection, Library of Congress).

[126] Letter from William O. Douglas, Professor, Yale Law Sch., to Abe Fortas, Agric. Adjustment Admin. (Aug. 2, 1934) (on file with the William O. Douglas Collection, Library of Congress).

[127] Bruce Allen Murphy, Wild Bill 107 (2003) ("To Douglas, this new appointment signaled the beginning of his rise to the top. 'Bill began telling us he would be the chairman of the SEC,' recalled Irene Hamilton.").

[128] 1–8 Sec. & Exch. Comm'n, Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (1936–40).

[129] Revision of the Bankruptcy Act: Hearings on H.R. 6439 Before the H. Comm. on the Judiciary, Reintroduced as H.R. 8046, 75th Cong. 199 (1937) (statement of William O. Douglas, Chairman, Sec. Exch. Comm'n).

[130] See Conservator in Bankruptcy, Hearing Before the Comm. on the Judiciary, H. of Rep., on H.R. 9 and H.R. 6963, 75th Cong. 69 (1937) (statement of Adolph J. Sabath).

[131] To Amend the Securities Act of 1933: Hearings on H.R. 6968 Before the H. Comm. on Interstate and Foreign Commerce, 75th Cong. (1937).

the National Bankruptcy Conference ("NBC").[132] The Chandler bill covered a host of reforms in the bankruptcy area, but did not take up corporate reorganizations.

Douglas and Fortas were not excited about Sabath's approach; they had not been consulted in its drafting. When the investment bankers took aim at the Lea bill, the SEC chose to combine its proposals with those of the Chandler bill.[133] Thus, the SEC's plan became Chapter X of the Chandler bill.[134] The bill that Congress passed the following year required a trustee in every public company reorganization and that any reorganization plan had to be "fair and equitable" to be approved by the court.[135]

To ensure that standard was met, the bill directed courts to solicit the SEC's advice in reorganizations involving over $3 million in debt, permitting its advice to be sought in smaller reorganizations.[136] Bringing the SEC in as an advisor to the court ensured that the agency's experts would be the key players in the reorganization of public companies, just as the agency played the leading role in holding company reorganizations under PUHCA. By giving the SEC a central role, Congress thwarted efforts by investment bankers to call around and pick off creditors one by one to gain approval for a reorganization. A reorganization branch of the SEC was established and Chairman Douglas appointed as its head Sam Clark, a former member of the protective committee staff and the brother of Douglas's former Yale Law dean.[137] The following year, Congress passed the Trust Indenture Act of 1939, which closed off

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[132] See H. Comm. on the Judiciary, Revision of the National Bankruptcy Act, H.R. Rep. 1409, at 1–3 (1937) (containing a chronology of the formation of the National Bankruptcy Conference).

[133] See Skeel, supra note 117, at 116–17.

[134] The NBC approved the change in the spring of 1937 in a sparsely attended meeting by a split vote of 14 of its 42 members. See Revision of the Bankruptcy Act: Hearings on H.R. 6439 Before the H. Comm. on the Judiciary, Reintroduced as H.R. 8046, supra note 129, at 364–65 (statement of John Gerdes) (recounting a meeting of the National Bankruptcy Conference in March 1937).

[135] The insertion of trustees brought broad changes in the reorganization process. See, e.g., Robert T. Swaine, "Democratization" of Corporate Reorganizations, 38 Colum. L. Rev. 256, 259 (1938) ("In the name of 'democratization' corporate securityholders are to be enlisted in a war on corporate management. Not merely are bankers to be scourged from the temple, but corporate officers and directors are to be driven out with them.").

[136] Act of June 22, 1938, ch. 575, § 172, 52 Stat. 840, 890–91.

[137] Investor's Advocate, Time, Sept. 26, 1938, at 57.

the ability of investment bankers to go outside the reorganization process to gain contractual modifications for companies in distress.

F. Summing Up

The SEC put into action the New Deal vision that administrative experts, not business leaders or the courts, should control the direction of the economy. PUHCA in particular gave the administrative agency a key role in deciding the terms of the breakup of the holding companies, a question with enormous economic implications. How strictly would the SEC enforce PUHCA's purposefully vague death sentence provision? Before that question could be resolved, PUHCA faced an uncertain judicial future. Roosevelt's appointees to the Supreme Court would eventually ensure that the securities law would pass constitutional muster, as discussed below. But, the constitutional question was not the only issue to be resolved by the Supreme Court. The rule of law required that the SEC follow the terms of the statutes that gave it life. Enforcing statutory limits on the SEC clearly was a role for the courts, but overly stringent interpretations could hamstring the efforts of the fledgling agency to reshape the utility industry. How much deference would the Court afford the SEC in the interpretation of its governing statutes?

II. THE TRIUMPH OF THE ADMINISTRATIVE STATE

Through Roosevelt's first term, his battle to tame the power of Wall Street had the strong support of Congress and the members of his administration. The third branch of government, however, looked much less hospitable circa 1935. The Supreme Court, called upon to review the New Deal initiatives, was perceived as hostile to government regulation, invoking constitutional rights of personal liberty and due process to block high profile New Deal initiatives.[138] The New Dealers were experimenting with the regulatory

[138] Felix Frankfurter, Justice Holmes Defines the Constitution (1938), *in* Law and Politics: Occasional Papers of Felix Frankfurter 61, 74 (Archibald MacLeish & E.F. Prichard, Jr. eds., 1939) ("Until after the 1936 election, the Court was back to the high tide of judicial negation reached in the Lochner case in 1905."). More recent scholars of the period have pointed out the Court's response to the administration was more

state, and they faced considerable uncertainty with respect to whether their experiments could pass constitutional muster. Joseph Rauh later recalled:

> I worked for Ben [Cohen] for a year on defending the Public Utility Holding Company Act. He taught me more about how to win a case that's unwinnable than anyone else could have. If you had asked anyone in 1935 if the Supreme Court would uphold the Public Utility Holding Company Act, you would have been laughed at.[139]

Would Roosevelt's securities laws fall under the judicial axe?

Roosevelt ultimately prevailed when he was able to appoint lawyers to the Supreme Court who had a proven record of supporting a broad role for government regulation of the economy. While waiting for enough vacancies to change the complexion of the Court, the administration stalled the consideration of more difficult constitutional issues, especially PUHCA's death sentence provision, betting that it could outlast the Court's Old Guard.[140] As events unfolded, Roosevelt's appointees would ensure the survival of the securities laws, cementing a reversal in the course of constitutional jurisprudence: the federal government now had free rein to regulate the economy. Prior to their appointment, however, these new Justices were also the key players in devising and implementing this strategy of delay. We saw in Part I that a number of the Justices appointed to the Court by Roosevelt participated in drafting and enacting the securities laws. In this section, we explore the central roles played by future Roosevelt Court appointees in defending the securities laws against the initial court challenges.

A. Delaying the Judicial Resolution of the Initial Challenges to the Securities Laws

Securities laws were part of the initial flurry of legislation in the new administration's first hundred days, but resolving the challenges to the constitutionality of the New Deal's legislative pro-

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mixed. See, e.g., Barry Cushman, The Secret Lives of the Four Horsemen, 83 Va. L. Rev. 559, 560–61 (1997).

[139] Rauh, supra note 29, at 56–57 (footnote omitted).

[140] John D. Fassett, New Deal Justice: The Life of Stanley Reed of Kentucky 66 (1994).

gram did not follow as quickly. By the time the securities laws made their way to court in the latter half of the 1930s, the Roosevelt administration was dragging out the judicial resolution as long as possible, essentially trying to play out the clock on the Justices most hostile to federal regulation. The challenge to PUHCA, for example, required three visits to the Supreme Court before it was ultimately resolved in the government's favor. The Court first addressed whether a host of individual challenges to the statute could be stayed pending Supreme Court consideration of a test case;[141] the second case upheld only the constitutionality of the relatively uncontroversial registration and disclosure provisions of PUHCA;[142] and the last case—decided a decade after PUHCA's enactment—resolved the constitutionality of the controversial death sentence provision.[143]

Administration strategists had determined to stall in defending other parts of the New Deal legislative program as well. The strategy succeeded for a time, only to be dealt a string of defeats in 1935 and 1936.[144] The bloodiest day was Monday, May 27, 1935, when two decisions, both unanimous: (1) struck down the National Industrial Recovery Act ("N.I.R.A.");[145] and (2) held that the President could not remove members of the Federal Trade Commission without cause.[146] If there was any doubt that the Court was sending Roosevelt a message, Brandeis made it perfectly clear:

> Before Tommy Corcoran could depart, a Supreme Court page tapped him on the shoulder and said that Justice Brandeis would like to see him in the Justices' robing room. Brandeis wanted

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[141] Landis v. North American Co., 299 U.S. 248, 249 (1936).

[142] Elec. Bond & Share Co. v. SEC, 303 U.S. 419, 442–43 (1938).

[143] See N. Am. Co. v. SEC, 327 U.S. 686, 704 (1946).

[144] William E. Leuchtenburg, The Supreme Court Reborn: The Constitutional Revolution in the Age of Roosevelt 84–89 (1995) ("The [Roosevelt] Administration put off tests of the constitutionality of the legislation of the First Hundred Days as long as possible; as a result the Supreme Court did not have the opportunity to rule on a New Deal statute until 1935.").

[145] A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495, 542 (1935). McReynolds credited the *Schechter* decision with restoring business confidence. The Forgotten Memoir of John Knox, supra note 29, at 72 (quoting McReynolds: "[B]usinessmen throughout the country have become more and more confident because of the Court's [*Schechter*] decision .... The decision stimulated industry, which had been hampered by the N.R.A. laws.").

[146] Humphrey's Executor v. United States, 295 U.S. 602, 632 (1935).

> Corcoran to convey a message to the White House: "This is the end of this business of centralization, and I want you to go back and tell the President that we're not going to let this government centralize everything. It's come to an end."[147]

SEC General Counsel John Burns, in a letter to Frankfurter, noted "how stunned and gloomy the action of the court left us. . . . It appears likely that both of our statutes will be attacked with more vigor."[148] The old guard appeared skeptical of Roosevelt's "road to socialism";[149] Brandeis and the other liberals opposed regulation that fostered "bigness." The confluence of the two positions resulted in a stiff rebuke for the Roosevelt administration.[150]

1. Jones v. SEC*: The SEC as "Star Chamber"*

At the time of those Black Monday decisions, the SEC had just launched the case that would be the Supreme Court's first opportunity to pass on the new securities laws. It would not be an auspicious beginning for the SEC in the Supreme Court. On May 4, 1935, J. Edward Jones, a dealer in oil royalties, had filed a registration statement to issue certificates in producing such royalties. Just before the end of the twenty-day waiting period required before a registration statement can become effective under the Securities Act, the SEC filed notice of a stop order proceeding and subpoenaed Jones and various documents. When Jones's attorney appeared at the hearing without his client and sought to withdraw the registration statement to end the proceeding, SEC General Coun-

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[147] Irons, supra note 16, at 104.

[148] Letter from John Burns, Gen. Counsel, Sec. Exch. Comm'n, to Felix Frankfurter, Professor, Harvard Law Sch. (May 29, 1935) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 84).

[149] The Forgotten Memoir of John Knox, supra note 29, at 72 (quoting McReynolds: "[I]f it were not for the Court, this country would go too far down the road to socialism ever to return.").

[150] Frankfurter himself was not that distressed by the invalidation of the N.I.R.A. According to Moley,

> There's no doubt that Frankfurter, a Brandeis devotee, had a deep antipathy to both the A.A.A. and the N.I.R.A. He, as well as most of his young disciples in Washington, opposed the loosening up of the antitrust laws involved in the N.I.R.A. principle. As avowed enemies of bigness in business, viewing government's role as that of policeman, rather than coordinator, they looked upon N.I.R.A.'s invalidation with no little satisfaction.

Moley, supra note 21, at 306–07.

sel Burns is said to have responded "You can't go up under the gun of a stop order and then seek to avoid it"; the Commission then "ordered a U.S. marshal to go forth and fetch Mr. Jones in person."[151] The Commission's impatience led it into strategic error; at that point, Jones reversed course and announced this case to be "an excellent opportunity to test out in a clean-cut fashion the much-mooted question of the constitutionality of the securities acts."[152]

The lower federal courts upheld the SEC's refusal to permit withdrawal of the registration statement; more importantly, they affirmed the constitutionality of the Act.[153] Jones quickly appealed. After the argument of the case in the Supreme Court, Landis reported to Frankfurter that "[t]he only possibility of defeat is on a procedural point and yet I cannot see a sane bench of judges not giving us some freedom in working out our procedural technique."[154]

The Supreme Court shortly gave Landis reason to question the Justices' sanity. It ruled against the SEC on the withdrawal issue, thereby avoiding, for the moment, the constitutional issue.[155] The tenor of the opinion, however, did not bode well for the Act's constitutionality.[156] The 6-3 majority consisted of the "Four Horsemen" (Justices Butler, McReynolds, Sutherland, and Van Devanter), the key bloc overturning central parts of the New Deal, joined by Chief Justice Hughes and Justice Roberts.[157] Sutherland's opinion

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[151] Royalist's Revelations, Time, July 1, 1935, at 47, available at http://www.time.com/time/printout/0,8816,770055,00.html.

[152] Id.

[153] SEC v. Jones, 12 F. Supp. 210, 213 (S.D.N.Y. 1935), aff'd, 79 F.2d 617 (2d Cir. 1935), rev'd, 298 U.S. 1 (1936).

[154] Letter from James Landis, Chairman, Sec. Exch. Comm'n, to Felix Frankfurter, Professor, Harvard Law Sch. (Mar. 11, 1936) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 45).

[155] Jones v. SEC, 298 U.S. 1, 28 (1936).

[156] See generally id. The Court said the stop order proceeding had the effect of suspending the operation of the registration statement; the appellate court had ruled that the registration statement remained effective, since no stop order had been issued. Id. at 15.

[157] Justice Sutherland wrote the opinion for the court despite not having heard oral argument in the case, participating via the "vouch[ing in]" approach that Chief Justice Hughes employed. Letter from Justice William O. Douglas to Justice Arthur Goldberg (Jan. 18, 1964) (on file with the William O. Douglas Collection, Library of Congress).

for the Court treated the securities registration process as little more than a license to use the mails.[158] Under the common law, such a license would carry with it an absolute right to withdraw.[159] More provocatively, Sutherland characterized the SEC's investigation not based on specified grounds as infringing on the "constitutional safeguards of personal liberty."[160]

Although the government avoided a direct constitutional loss, the Court did not shrink from finding the agency was running afoul of personal liberties the Court was determined to protect.[161] Labeling the action of the Commission as "wholly unreasonable and arbitrary," the Court stressed the need to block unauthorized powers by "lesser agencies" as well as the three primary departments of the government, concluding that the Commission's action amounted to a "fishing bill." The Court's opinion lumped together the SEC's investigation, which was not based on specified grounds, with the "intolerable abuses of the Star Chamber which brought that institution to an end at the hands of the Long Parliament in 1640."[162] The Court took the occasion to announce that it stood vigilant to check such abuses: "Even the shortest step in the direction of curtailing one of these rights must be halted *in limine*, lest it serve as a precedent for further advances in the same direction, or for wrongful invasions of the others."[163]

Cardozo's dissent, joined by Stone and Brandeis, ridiculed the comparison of the SEC to the Star Chamber:

> A Commission which is without coercive power, which cannot arrest or amerce or imprison though a crime has been uncovered, or even punish for contempt, but can only inquire and report, the propriety of every question in the course of the inquiry being subject to the supervision of the ordinary courts of Justice, is lik-

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[158] *Jones*, 298 U.S. at 22.

[159] Id at 23.

[160] Id.

[161] Reed had not predicted a tougher go on the constitutional argument. He wrote Homer Cummings, the Attorney General, that "'I think that if we lose, it will be on the statutory construction point and not on the constitutional point. We may get a good result and I would be very much surprised if we got a bad result.'" Fassett, supra note 140, at 121.

[162] Jones v. SEC, 298 U.S. 1, 28 (1936).

[163] Id.

> ened with denunciatory fervor to the Star Chambers of the Stuarts. Historians may find hyperbole in the sanguinary simile.[164]

Justice Stone grumbled to Frankfurter that the opinion "was written for morons."[165] Frankfurter complained that the Court was "making a mockery of great fundamental constitutional experiences and traditions to invoke them with the silly irrelevance with which they were invoked" in *Jones*.[166] Stone responded that *Jones* was an example of the Supreme Court at its worst. He observed:

> I do not suppose the heavens will fall, whether or not Mr. J. Edward Jones, in a public hearing, surrounded by all the safeguards of the Constitution, is compelled to explain the discrepancies of his statements in the public document which he had filed, but when our Court sets at naught a plain command of Congress, without the invocation of any identifiable prohibition of the Constitution, and supports it only by platitudinous irrelevancies, it is a matter of transcendent importance.[167]

Whatever the quality (or long-term impact) of the opinion, the decision resonated in the public debate at the time.[168] Frankfurter passed on to Stone an observation from SEC general counsel Burns: "There is hardly a crook in the country whose lawyer does not come in to read juicy extracts from Sutherland's oration.... [T]his decision will be a constant source of annoyance in our enforcement activities."[169]

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[164] Id. at 33 (Cardozo, J., dissenting).

[165] Letter from Justice Harlan Fiske Stone to Felix Frankfurter, Professor, Harvard Law Sch., (Apr. 7, 1936) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 64).

[166] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Justice Harlan Fiske Stone (Apr. 7, 1936) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 64).

[167] Letter from Justice Harlan Fiske Stone to Felix Frankfurter, Professor, Harvard Law Sch. (Apr. 9, 1936) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 64).

[168] Fassett, supra note 140, at 124 ("The *Jones* decision was publicized by opponents of the New Deal as affording proof that FDR's alphabet agencies did in fact engage in 'Star Chamber' proceedings.' Enforcement actions pursuant to the securities acts particularly were seriously impeded as claims of abuse of administrative powers proliferated.").

[169] Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Justice Harlan Fiske Stone, (May 18, 1936) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 64) (quoting John Burns).

With the Court's decisions in the months on either side of the *Jones* case invalidating the Agricultural Adjustment Act[170] and the Bituminous Coal Conservation Act,[171] the constitutional fate of the securities acts remained in doubt. To face that challenge, the administration deployed a considerable array of legal talent, bringing the leading legal lights of the New Deal to bear. Solicitor General Stanley Reed argued the *Jones* case before the Court; Reed regularly consulted Frankfurter regarding litigation strategy.[172] The Roosevelt administration also brought Robert Jackson in as special counsel to aid the SEC; Jackson had been serving as assistant general counsel at the Treasury.[173]

At times the legal team and the political team overlapped. The briefs in the *North American* case,[174] addressed in the next section, for example, were prepared by the same team as *Jones*—Attorney General Homer Cummings, Solicitor General Stanley Reed, and SEC General Counsel John Burns—again reinforced by now-Assistant Attorney General Robert Jackson.[175] Also on the briefs as special counsel were Ben Cohen and Tommy Corcoran, Frankfurter's all-purpose pair who had come to Washington in 1933 to rewrite the Securities Act and stayed to fill a variety of roles in the

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[170] United States v. Butler, 297 U.S. 1, 74 (1936).

[171] Carter v. Carter Coal Co., 298 U.S. 238, 311–17 (1936).

[172] See, e.g., Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Stanley Reed, Solicitor Gen. (Feb. 15, 1936) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Reel 2); Letter from Stanley Reed, Solicitor Gen., to Felix Frankfurter, Professor, Harvard Law Sch. (Dec. 17, 1936) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 3, Reel 2) ("My own views have not chrystalized [sic]. Can you help me?"); Letter from Felix Frankfurter, Professor, Harvard Law Sch., to Stanley Reed, Solicitor Gen. (Dec. 7, 1936) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 3, Reel 2) ("I appreciate your thoughtfulness in sending me a copy of your confidential memorandum on pending matters involving administration measures."). Frankfurter also consulted with John Burns, the SEC's general counsel. See Letter from John Burns, Gen. Counsel, Sec. Exch. Comm'n, to Felix Frankfurter, Professor, Harvard Law Sch. (Oct. 18, 1935) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 115) (discussing litigation strategy with respect to constitutional issues).

[173] Letter from Robert H. Jackson, Asst. Gen. Counsel, Treasury Dept., to Herman Oliphant, Gen. Counsel, Treasury Dept. (Dec. 8, 1935) (on file with the Robert Jackson Collection, Library of Congress, Box 66).

[174] Landis v. N. Am. Co., 299 U.S. 248 (1936).

[175] Brief for the Petitioners at 97, Landis v. N. Am. Co., 299 U.S. 248 (1936) (Nos. 221–22).

New Deal, including drafting and lobbying for the Exchange Act and PUHCA.[176]

2. PUHCA's Opening Act: Finding a Test Case

During the nine months that it took for the *Jones* case to move from the SEC to a Supreme Court resolution, litigation was beginning that would lead to the Court's next two securities cases. PUHCA was enacted in August 1935, becoming effective on December 1 of that year. A flood of lawsuits quickly followed from affected companies seeking injunctions to block the enforcement of the law;[177] the government looked to litigate the case with the strongest facts.[178] *Electric Bond & Share Co. v. SEC*,[179] with its maze of subsidiaries, was that test case. The government filed a suit in New York federal court on November 26 that would eventually become the vehicle for the first Supreme Court opinion on the constitutionality of PUHCA's registration provisions.[180] On the same day, the North American Company, a large holding company, filed a suit in the District of Columbia that would first become the basis for the Supreme Court's consideration of whether a stay was permissible, and then the ultimate decision on the Act's constitutionality. That decision would come more than a decade after the suit was first filed.

In January 1936, the government persuaded the district court in the District of Columbia to grant a stay in the *North American* case, but the D.C. Circuit reversed in June, with the four judges splitting 2-1-1.[181] The Supreme Court heard the case a week after Roosevelt's smashing landslide in the 1936 election. Within a month, a unanimous court reversed the Court of Appeals, permitting a stay of the other cases until the decision of the trial court in

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[176] Lash, supra note 29, at 36.

[177] *N. Am. Co.*, 299 U.S. at 252 (noting that forty-seven other cases had been filed); Seligman, supra note 1, at 134.

[178] William O. Douglas, Go East Young Man: The Early Years 278 (1974).

[179] 303 U.S. 419 (1938).

[180] Courts in jurisdictions other than the D.C. Circuit could not compel the SEC to be a party, so the SEC could control its venue as long as it did not attempt to enforce the act. Seligman, supra note 1, at 137.

[181] N. Am. Co. v. Landis, 85 F.2d 398, 401 (D.C. Cir. 1936).

New York.[182] In contrast to the hostility toward the SEC and its processes that was visible in *Jones*, this opinion, written by Justice Cardozo for a unanimous Court, was considerably more accommodating toward agency action:

> We must be on our guard against depriving the processes of justice of their suppleness of adaptation to varying conditions. Especially in cases of extraordinary public moment, the individual may be required to submit to delay not immoderate in extent and not oppressive in its consequences if the public welfare or convenience will thereby be promoted. In these Holding Company Act cases great issues are involved, great in their complexity, great in their significance.... An application for a stay in suits so weighty and unusual will not always fit within the mold appropriate to an application for such relief in a suit upon a bill of goods.[183]

Not only did the SEC win, but the caustic language of *Jones* had also disappeared.

Despite this procedural victory, PUHCA, like other New Deal legislation, remained at risk in the shadow cast by the Supreme Court's constitutional holdings in 1935 and 1936. In the weeks immediately after *Landis*, President Roosevelt announced his Court-packing plan, which was met by a barrage of criticism that dominated political debate for the first half of 1937. The Supreme Court that would eventually uphold the constitutionality of economic regulation, including the securities laws, was not yet visible.

3. Litigating the Chosen Case: Electric Bond & Share

While the Court-packing debate was unfolding in Congress and the media, the government was litigating its chosen PUHCA case, *Electric Bond & Share*,[184] on narrow ground. In January 1937, the district court (with Circuit Judge Mack as the trial judge) ruled that

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[182] Landis v. N. Am. Co., 299 U.S. 248, 259 (1936). McReynolds concurred in the result without opinion and Stone did not participate, likely because of his prior partnership with Sullivan & Cromwell, the law firm for the company.

[183] Id. at 256. The stay approved by the Court was narrow, however, extending "[f]or the moment" only until the first district court decision in the New York litigation. Id. at 256–57.

[184] SEC v. Elec. Bond & Share Co., 18 F. Supp 131 (S.D.N.Y. 1937).

the constitutionality of the registration provisions of the legislation could be separated from the more controversial provisions permitting the SEC to impose the death sentence on a holding company; the court then upheld the constitutionality of the registration provisions.[185] The Second Circuit affirmed in a split decision.[186]

Time was on the Roosevelt administration's side. In the period between the district court and Supreme Court decisions, Roosevelt's Court-packing plan had been rebuffed by Congress, but the Court's direction had nonetheless changed radically. The *West Coast Hotel* decision upholding the Washington state minimum wage act was announced on March 29, 1937,[187] and was quickly (if erroneously) immortalized as "the switch in time that saved nine."[188] In subsequent opinions that term, the Court upheld the National Labor Relations Act[189] and the Social Security tax.[190] At the end of the term, Willis Van Devanter retired, to be replaced by Hugo Black, and by the middle of the following term when the Court heard arguments in *Electric Bond*, Sutherland had also retired. Although Justice Sutherland's replacement, Solicitor General Stanley Reed, did not participate in the decision, the departure

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[185] Id. at 147. This was friendly ground for the SEC; Mack was a friend of Frankfurter and Cohen had served as his law clerk. Seligman, supra note 1, at 136.

[186] Judge Manton's lead opinion upheld the registration provisions as akin to registration of securities. Elec. Bond & Share Co. v. SEC, 92 F.2d 580, 590 (2d Cir. 1937). Judge Swan concurred in the result without an opinion, id. at 593 (Swan, J., concurring in the result), and Learned Hand wrote separately to say he would uphold sections 4 and 5 (the registration provisions) along with sections 6, 7, 9, and 10 after doubtful portions were removed. Id. (Hand, J., concurring).

[187] West Coast Hotel Co. v. Parrish, 300 U.S. 379, 400 (1937).

[188] On the original source of the phrase, see G. Edward White, The Constitution and the New Deal 17 (2000). Scholars have recently questioned the extent to which Roberts "switched," given that he voted at the conference before the announcement of the Court-packing plan. See, e.g., Barry Cushman, Rethinking the New Deal Court: The Structure of a Constitutional Revolution 103 (1998) [hereinafter Cushman, Rethinking the New Deal Court]. At the time, however, Frankfurter viewed the switch as transparent. See Letter from Felix Frankfurter, Professor, Harvard Law Sch., to President Franklin D. Roosevelt, (Mar. 30, 1937) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Reel 155) ("And now, with the shift by Roberts, even a blind man ought to see that the Court is in politics, and understand how the Constitution is 'judicially' construed."). Professor Cushman, in his commentary in this symposium, addresses Frankfurter's later view backing away from his earlier comment. See Barry Cushman, The Securities Laws and the Mechanics of Legal Change, 95 Va. L. Rev. 927, 933 (2009).

[189] NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1, 43 (1937).

[190] Steward Machine Co. v. Davis, 301 U.S. 548, 598 (1937).

of two of the four Horsemen changed the balance of power on the Court.

Oral arguments before the Supreme Court went on for three days in early February 1938; Robert Jackson and Ben Cohen argued for the government.[191] Six weeks later, in an opinion by Chief Justice Hughes, the Court ruled 6-1 that the registration provisions were separable and that regulation requiring the submission of information was both familiar and constitutional.[192] Thus, the Court both upheld a portion of PUHCA and implicitly affirmed the constitutionality of the Securities Act and the Exchange Act. Although the Court upheld the registration provisions, it declined to consider constitutional challenges to PUHCA's much more controversial reorganization provisions.[193] Nonetheless, the SEC, under the leadership of then-Chairman William O. Douglas, took the Court's decision as a green light to begin enforcing PUHCA.[194] Frankfurter telegrammed congratulations to Jackson when the decision was announced.[195]

B. The New Deal Justices on the Court

1. U.S. Realty *and the Emergence of the Roosevelt Court*

The outcome of *U.S. Realty*[196] in May 1940 made plain the triumph of the administrative state in the securities arena and the

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[191] Letter from Stanley Reed, Solicitor Gen., to Felix Frankfurter, Professor, Harvard Law Sch., (Dec. 19, 1937) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Reel 56) ("We are filing our response in E. B. & S. tomorrow. Ben and Bob Jackson are to argue it. I think they have both earned the right . . . ."). A colleague described to Frankfurter Cohen's argument in an "electric" courtroom. Letter from Dave G[insburg] to Felix Frankfurter, Professor, Harvard Law Sch. (Feb. 12, 1938) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Reel 27).

[192] Elec. Bond & Share Co. v. SEC, 303 U.S. 419, 442–43 (1938). Hughes's opinion gained the support of Butler and Roberts from the *Jones* majority as well as Brandeis and Stone from the minority and new appointee Black (who had helped push the law through the Senate). McReynolds dissented without opinion. Reed, who was solicitor general when the case was argued below, did not participate, nor did Cardozo, who died shortly after the term ended.

[193] Id. at 443.

[194] Seligman, supra note 1, at 179–80.

[195] See Telegram from Felix Frankfurter, Professor, Harvard Law Sch., to Robert H. Jackson, Solicitor Gen. (Mar. 30, 1938) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 3, Reel 1).

[196] SEC v. U.S. Realty & Improvement Co., 310 U.S. 434 (1940).

central role the New Deal Justices played in that transformation. At issue was the SEC's authority under the Chandler Act in company reorganizations. Robert Jackson, soon to be the seventh of FDR's eight appointments to the Court, argued the case as the nation's Attorney General. By that time, the Court had already been transformed. The change is best seen by comparing the result in *U.S. Realty* with *Jones v. SEC*, the non-PUHCA securities case that had been decided four terms earlier. In *U.S. Realty*, a 5-3 majority approved a broad role for the SEC in a corporate reorganization in bankruptcy.[197] Stone (long sympathetic to the goals of the Roosevelt administration, as we have seen) joined with four new Roosevelt appointees to make a majority; the three remaining members of the *Jones* majority (Hughes, Roberts and McReynolds) were now in dissent.[198]

Like PUHCA, this act allowed the SEC an oversight role in corporate transactions, here bankruptcy reorganizations. Stone's majority opinion connects Chapter X to the other New Deal securities statutes, each of which injects the SEC's "impartial and expert administrative assistance" for the protection of the public.[199] Stone's opinion upheld the trial court's determination—following the recommendation of the SEC—that the bankrupt company should be required to reorganize under the new Chapter X provided by the Chandler Act, rather than under Chapter XI. The SEC had argued that Chapter XI did not provide the safeguards of an independent trustee or the SEC as a monitor. The Court rejected the Commission's argument that public companies always must reorganize under Chapter X because it did not find a bright-line division between public and private companies in the statutory language. Nevertheless, the Court gave the SEC broad license to police improper uses of Chapter XI, despite the fact that the Act was equally silent on this point.[200] The opinion below had concluded

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[197] Id. at 460–61.

[198] Id. at 441, 461, 469. Douglas did not participate. Id. at 461.

[199] Id. at 448 n.6 ("The basic assumption of Chapter X and other acts administered by the Commission is that the investing public dissociated from control or active participation in the management, needs impartial and expert administrative assistance in the ascertainment of facts, in the detection of fraud, and in the understanding of complex financial problems.").

[200] The Court found:

that "[a] governmental agency has no general right of intervention 'in the public interest.'"[201] The Court's majority, however, located that authority in the public policy of the Act, including not just the statute's terms but also in the equity power of the bankruptcy court.[202]

Douglas did not participate in the decision. For three years he had headed the SEC's reorganization project which had culminated in Chapter X of the Chandler Act. Moreover, he was chairman of the SEC when that initiative was attached to other parts of bankruptcy reform. By his account, however, there was no basis for disqualification:

> I sat on the case[.] I was not disqualified, having nothing to do with the matter when I was at the SEC. But I discovered later that the CJ [Hughes] was very anxious to have me withdraw. Stone told me "The Chief would like to have you out of the case." "Why?" I asked. "Because your vote will make it more difficult for him to carry the Court," said Stone. So [I] spoke to the Chief, telling him that I was not disqualified but stating that perhaps I should not participate. He said he thought that would be wise, since I had been so recently connected with the SEC. If the Chief had had his way, it would be another Jones decision.[203]

Notwithstanding his formal non-participation, Douglas's views may have shaped the debate. He wrote a memorandum in the case,

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> The Commission's duty and its interest extend not only to the performance of its prescribed functions where a petition is filed under Chapter X, but to the prevention, so far as the rules of procedure permit, of interferences with their performance through improper resort to a Chapter XI proceeding in violation of the public policy of the Act . . . .

Id. at 459.

[201] In re U.S. Realty & Improvement Co., 108 F.2d 794, 798 (2d Cir. 1940).

[202] SEC v. U.S. Realty & Improvement Co., 310 U.S. 434, 448 (1940).The Court stated that "we cannot assume that Congress has disregarded well settled principles of equity." Id. at 457. The dissent, by Justice Roberts, joined by Hughes and Butler, sought to refute the SEC's argument of a bright line between chapters X and XI. Id. at 464 (Roberts, J., dissenting). The Court's majority did not draw such a line, focusing instead on a trial court's discretion to use its power in particular circumstances. Id. at 455 (majority opinion).

[203] William O. Douglas, Diary (May 27, 1940) (on file with the William O. Douglas Collection, Library of Congress, Box 1780). Douglas's account is certainly open to question; it is somewhat difficult to imagine the magisterial Hughes stooping to such a gambit, and it seems somewhat unlikely that he would use Stone as his messenger.

which he shared with Frankfurter and perhaps with Stone, which rejected the sharp line between Chapters X and XI for which the SEC had argued. Instead, Douglas suggested guidelines for the exercise of judicial discretion.[204] Douglas's guidelines are consistent with, although not identical to, the reasons offered in Stone's opinion.

With *U.S. Realty*, the triumph of the administrative state was complete. In four years, the SEC had gone from being denounced as a "Star Chamber" in *Jones* to being deemed essential to investor protection in *U.S. Realty*. This transformation was a critical part of the Roosevelt administration's overall judicial triumph.[205]

Three unanimous opinions during the term following *U.S. Realty* show the Roosevelt Court's generous approach to securities cases.

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[204] Note from Justice Felix Frankfurter to Justice William O. Douglas (undated), appended to Memorandum from William O. Douglas on *SEC v. U.S. Realty & Improvement Co.* (undated) ("Bill, Hadn't you better send a copy of this memo to Stone? FF") (on file with the William O. Douglas Collection, Library of Congress).

In overturning the Second Circuit's decision, the Supreme Court had the benefit of a strong dissenting opinion authored by Judge Charles Clark. Clark asserted that the Court of Appeals' decision "goes far to render abortive what might have proved one of the most important corporate reforms of modern times." *In re U.S. Realty & Improvement Co.*, 108 F.2d at 802 (Clark, J., dissenting). Clark, who had been Dean of Yale Law School during the decade in which Douglas split his time between New Haven and Washington, knew Douglas well. What is more, Clark's brother Sam had worked with Douglas on the protective committee report and later was named by Chairman Douglas as first head of the agency's reorganization section. Investor's Advocate, Time, Sept. 26, 1938, at 57, available at http://timeinc8-sd11.websys.aol.com/time/printout/0,8816,788825,00.html.

Douglas participated in the Court's next case addressing the securities aspect of bankruptcy, writing the opinion for the Court in *General Stores Corp. v. Shlensky*, 350 U.S. 462 (1956). That opinion tracks Douglas's earlier memo and Stone's *U.S. Realty* opinion in rejecting a bright line approach; the opinion suggests criteria, now grouped under the heading of "needs to be served" for determining when bankrupts must proceed through Chapter X. Id. at 466. Douglas's adherence to a multifactor test left the door open to public corporation reorganization through Chapter XI. That space allowed companies to avoid the SEC's role in reorganizations. The SEC's participation was largely eliminated with the bankruptcy reforms of 1978. See David A. Skeel, The Rise and Fall of the SEC in Bankruptcy 2–3 (Inst. for Law & Econ., Working Paper No. 267, 1999), available at http://papers.ssrn/paper.taf?abstract_id=172030.

[205] See Leuchtenburg, supra note 144, at 154. ("This new Court—the 'Roosevelt Court' as it was called—ruled favorably on every one of the New Deal laws whose constitutionality was challenged. It expanded the commerce power and the taxing and spending power so greatly that it soon became evident that there was almost no statute for social welfare or the regulation of business that the Court would not validate.").

Deckert v. Independence Shares Corporation, written by Murphy, overturned a court of appeals decision that had blocked relief against third parties under the Securities Act.[206] In permitting the plaintiff to go beyond express money judgment against the seller provided by Section 12(1) of the Act, the Court took a broad view of remedies (and thus anticipated the *Borak* case that arose a quarter century later[207]):

> The power *to enforce* implies the power to make effective the right of recovery afforded by the Act. And the power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to litigant according to the exigencies of the particular case.[208]

The other two securities decisions handed down that term had less lasting significance. *A.C. Frost & Co. v. Coeur D'Alene Mines Corporation*[209] was Justice McReynolds' last opinion for the Court before his midterm retirement; he was the last of the Four Horsemen to depart the Court. The Court overturned a broad Idaho Supreme Court decision that declared an agreement in violation of the Act to be void *ab initio*.[210] *Edwards v. United States*, the third case of that term and the first criminal securities case to reach the Court, was a rare, albeit mild, post-*Jones* rebuke to the government.[211] Justice Reed, writing for the Court, overturned a convic-

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[206] 311 U.S. 282 (1940). Douglas did not participate. The injured investor was unlikely to be able to recover from the asserted wrongdoer, but there were funds that had been paid to a bank which had acted as trustee. Id. at 284–85, 291.

[207] J. I. Case Co. v. Borak, 377 U.S. 426, 433–34 (1964) (discussing the "duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose" and quoting *Deckert*, 311 U.S. at 288).

[208] *Deckert*, 311 U.S. at 288 ("That it does not authorize the bill in so many words is no more significant than the fact that it does not in terms authorize execution to issue on a judgment recovered under § 12(2).").

[209] 312 U.S. 38 (1941). Douglas did not participate. Id. at 45.

[210] Id. at 44–45. The SEC was concerned that such a broad holding could thwart protections for the investing public in other situations; the Court agreed without getting into questions such as *in pari delicto*. The Court quoted extensively from a SEC memorandum expressing concern that a void *ab initio* holding would prevent an issuing company from recovering the sales proceeds from its underwriter in a transaction where there had been a violation. Id. at 43 n.2.

[211] 312 U.S. 473 (1941). Douglas did not participate. Id. at 484.

tion when the defendant had not been provided a transcript of his appearance in an SEC investigation.[212]

The remaining two non-PUHCA securities cases of this earliest period are the ones most familiar to current students of securities laws. In *SEC v. C.M. Joiner Leasing Corp.*[213] and *SEC v. W. J. Howey Co.*,[214] the Court established the test for defining a security that is still used today. *Joiner*, a 7-1 decision with Jackson writing for the majority, refused to be cabined by traditional rules of statutory interpretation, dismissing them as "com[ing] down to us from sources that were hostile toward the legislative process itself."[215] Jackson focused instead on the statute's "dominating general purpose."[216] The Court looked to an instrument's character in commerce, noting that the "exploration enterprise was woven into these leaseholds, in both an economic and legal sense."[217]

Howey, written by Murphy, digs deeper into the policy underlying the general term of investment contract, announcing a test broader than *Joiner*'s focus on speculation. W.J. Howey Co. solicited prospective investors, who were staying at a nearby resort that Howey itself owned and operated.[218] The company offered narrow

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[212] Id. at 482. The government asserted that the defendant had given no testimony of an incriminating nature and had offered a transcript to the court below, but Reed's opinion insisted on a right to cross-examine with the transcript as part of a certified record: "The refusal to permit the accused to prove his defense may prove trivial when the facts are developed. Procedural errors often are. But procedure is the skeleton which forms and supports the whole structure of a case." Id.

[213] 320 U.S. 344 (1943). Douglas did not participate, which was his practice in all of the securities cases to this point. Usually his file includes a brief memo from his secretary, Edith Walters (who had also been with Douglas at the SEC), describing the SEC's involvement with the case. In this case, the memo relates that Orval Dubois had reported that the present case had been opened quite recently and that there was an earlier investigation, described as informal which never reached the Commission and was closed by the staff in February 1936. Douglas had become a commissioner in January of 1936. SEC Historical Summary of Chairman and Commissioners (Feb. 23, 2009), http://www.sec.gov/about/sechistoricalsummary.htm.

[214] 328 U.S. 293 (1946).

[215] *Joiner*, 320 U.S. at 350.

[216] Id. at 350–51.

[217] Id. at 348. Later, Jackson returned to the importance of the enterprise in giving an example about cemetery plots. "One's cemetery lot is not ordinarily thought of as an investment and is most certainly real estate. But when such interests become the subject of speculation in connection with the cemetery enterprise, courts have held conveyances of these lots to be securities." Id. at 352 n.10.

[218] *Howey*, 328 U.S. at 296.

strips of land in orange tree groves as well as service contracts (through its Howey-in-the-Hills affiliate) to service the land, collect the oranges, and sell them at market.[219] The service contracts provided that the oranges would be pooled from all the strips of trees for which there was a similar service agreement. Profits from the pooled oranges then would be distributed to the various service contract holders.[220] Despite the presence of some investors who purchased only the land contract and not the service contract, the Court framed the issue as whether the *offers* of orange grove and service contracts constituted offers of investment contracts and therefore securities.[221] In the course of concluding that that the combination of land and services contracts was an investment contract, the Court announced what is now known as the *Howey* test: (1) investment of money, (2) in a common enterprise, (3) expectation of profits, (4) from the efforts of another.[222] This test continues to control the definition of an investment contract to this day.

Frankfurter found himself in dissent, siding with the lower courts against a contrary agency argument. Noting that the district court had found that the contracts were not a security, and that the finding had been affirmed by the court of appeals, Frankfurter invoked "the wise rule of judicial administration under which this Court does not upset concurrent findings of two lower courts in the ascertainment of facts and the relevant inferences to be drawn from them."[223] This focus on deference to the lower courts did not persuade Frankfurter's colleagues; even Reed, who had voted with Frankfurter at conference,[224] ended up joining Murphy's majority opinion. Frankfurter would level far more substantial criticism at the SEC in *Chenery* and related cases discussed in the next section.

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[219] Id. at 295–96.

[220] Id. at 299 ("They are offering an opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by respondents.").

[221] Interestingly, the focus on offers, rather than sales, a critical element of the analysis, was not in the draft that Murphy first circulated. See Memorandum from Justice Frank Murphy to the Conference re no. 843—*S.E.C.* v. *Howey Co.* (May 17, 1946) (on file with the Wiley Rutledge Collection, Library of Congress Box 141).

[222] SEC v. W. J. Howey Co., 328 U.S. 293, 298–99 (1946).

[223] Id. at 302 (Frankfurter, J., dissenting).

[224] Conference Notes of Justice Harold Burton, *SEC v. W. J. Howey Co.* (undated) (on file with the Harold Burton Collection, Library of Congress, Box 128).

2. Anticlimactic Triumph: North American v. SEC

The Supreme Court finally upheld the constitutionality of the SEC's power to break up public utility holding companies in 1946, eleven years after the statute's enactment, and almost a decade after the Court's first PUHCA decision in *Landis v. North American.*[225] By that point, doubts about the scope of the federal government's power under the commerce clause had disappeared, making the Court's unanimous decisions in these cases mere afterthoughts. SEC administrative decisions ordering the break up of the North American and Electric Bond holding companies came down in 1942. The SEC's action in *North American* under Section 11(b)(1) of the Act was affirmed by the Second Circuit in January of 1943 and the agency's action ordering dissolution of two Electric Bond subsidiaries under Section 11(b)(2) of the Act was affirmed by the First Circuit in March of 1944. The involvement of Justices Douglas, Reed, and Jackson in earlier PUHCA litigation before coming to the Court (described in the prior section), along with the involvement of Chief Justice Stone's former firm in some of the PUHCA litigation, prevented the Court from assembling the required six member quorum for many PUHCA cases until the 1945 term. Stone's decision to sit in the holding company cases to form a quorum provoked conflict among the brethren.[226] Even then,

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[225] Landis v. N. Am. Co., 299 U.S. 248, 259 (1936).

[226] See Sidney Fine, Frank Murphy: The Washington Years 250 (1984) ("When because of quorum problems in the 1943 term Stone stated in conference that he would sit in a holding company case despite having previously disqualified himself in a similar case, Roberts exploded and said that 'he would write and tell the world about Stone.' The chief justice 'turned white' and responded that no one would tell him in what cases he should disqualify himself. Although it was 'a very embarrassing situation' for him, he was 'willing to be the goat' and to participate in the two cases . . . ."); see also Alpheus Thomas Mason, Harlan Fiske Stone: Pillar of the Law 640–41 (1956) ("The Chief Justice was much disturbed that litigants, otherwise entitled to it, could not have their day in Court. His concern grew as more cases involving features of the holding company law were filed. Should not this consideration, he wondered, overbalance those that moved him initially to announce disqualification? As no former law partner or client was present in these cases, he now saw no reason to disqualify himself. When he broached the matter in conference, however, Justice Roberts objected to his sitting on the ground that similar issues were raised in all the cases, and that if he were disqualified in the one, he ought not to sit in judgment on a related case. Roberts' suggestion, apparently querying the Chief Justice's honor and implying that he would discuss in an opinion the propriety of Stone's sitting, brought on a heated debate. The accusation so angered the Chief that he had his clerk prepare a

Stone's unexpected death, just three weeks after the *North American* decision was announced, but before the *Electric Bond* decision was handed down, destroyed the fragile quorum for the second case and sent it back for reargument the following fall.[227]

When the *North American v. SEC* decision came down, it was an enthusiastic validation of the SEC's power to break up utility holding companies. Justice Murphy wrote the decision, which focused on the constitutional claims.[228] At this point in the Court's history, the commerce clause question was easily dispatched; the "relationship to interstate commerce is so clear and definite as to make any other conclusion unreasonable."[229] Murphy's opinion painted with a broad, moralistic brush, noting that limits on the commerce clause powers do not "render the nation powerless to defend itself against economic forces that Congress decrees inimical or destructive of the national economy."[230] It went directly at the "white collar" conduct as within the evil that government could pursue: "The fact that an evil may involve a corporation's financial practices, its business structure or its security portfolio does not detract from the

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memorandum of cases on which Roberts had sat although his old firm or former clients were involved." (footnotes omitted)).

[227] See Letter from Justice Frank Murphy to Chief Justice Fred Vinson (October 9, 1946) (on file with the Frank Murphy Collection, University of Michigan) ("I had finished most of the work on the *Engineers Public Service* and the *American Power & Light—Electric Power & Light* opinions and was about ready to circulate them when, unfortunately, the good Chief Justice died, destroying the necessary quorum."). The *Engineers Public Service* case was eventually dismissed as moot. Eng'rs Pub. Serv. Co. v. SEC, 332 U.S. 788, 788 (1947).

[228] N. Am. Co. v. SEC, 327 U.S. 686 (1946). Justices Douglas, Jackson and Reed did not participate. Id. at 711. Frankfurter wrote Reed during the time when the quorum problem remained unresolved:

> [Y]ou are right in not sitting in the *North American* case .... I also know that the people who were eager to have you sit were not moved by the considerations that should move a court. They counted on your deciding their way, which is precisely the reason why the other side would have had a just grievance. And you do not alleviate a grievance by showing that similar grievances that others might have had in the past were equally disregarded. Nor are feelings of injustice rendered unreasonable by having those who inflict them tell those who feel them they are really quite unreasonable in feeling them. That psychological fact is, I believe, at the core of the labor problem as it is of the race problem.

Letter from Justice Felix Frankfurter to Justice Stanley Reed (Mar. 27, 1944) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Reel 56).

[229] *N. Am. Co.*, 327 U.S. at 703.

[230] Id. at 705.

power of Congress under the commerce clause to promulgate rules in order to destroy that evil."[231]

The easy constitutional victory of 1946 should not obscure the challenge posed in 1935 and 1936. At that time, securing the Supreme Court's assent to an expert administrative agency's radical transformation of an American industry was highly uncertain. The administration's strategy "to postpone review . . . and to increase the chance that the test cases would be heard by a more receptive Supreme Court"[232] succeeded; the role of the SEC in regulating the financial community was assured. The question that remained was how much discretion the Court would afford the SEC; we explore that topic in the next section.

III. TENSION AMIDST TRIUMPH

As we have seen, by 1940 Roosevelt had succeeded in appointing a majority of Justices to the Court who shared his views on the need for governmental control over business. Given the role that the nominees had played in the front lines of the battle for regulatory supremacy over capitalism, it is hardly surprising that they consistently upheld the constitutional power of the federal government to regulate, not only the capital markets, but business generally.

Although the hurdle of constitutionality had been overcome, it remained for the Court to work out the relationship between law (and implicitly, courts) and administration (that is, the SEC). Would the Roosevelt Court defer to the SEC's expertise, or would it constrain administrative discretion through narrow interpretations of the statutes that gave the SEC its authority? Should the SEC be able to proceed through case-by-case enforcement, which would afford the agency maximum flexibility, or should it have to regulate through rulemaking, giving business prospective notice of the rules of the game? The answer to these questions had important implications, not just for securities law, but also for the legal foundations of the New Deal. Would the administrative state be the rule of experts, or would judges play the dominant role?

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[231] Id. at 706. Murphy similarly disposed of the due process clause claim, permitting Congress to balance the various considerations. Id. at 708.

[232] Fassett, supra note 140, at 66.

In between *U.S. Realty* in 1940, the Court's first securities case in which the Roosevelt appointees gave the government a majority, and the Court's unanimous upholding of the constitutionality of PUHCA in *North American* in 1946, which represented the complete triumph of administrative power, fissures began to develop along the fault line between experts and judges. Frankfurter the professor had bitterly criticized the interventions of the Supreme Court into state regulatory efforts,[233] but Frankfurter the Justice was much less willing to defer to the SEC. Beginning in the early 1940s, Frankfurter parted company with the more progressive vision of his fellow New Deal appointees, who were more willing to trust administrative expertise. The dispute was sometimes phrased as respect for administrative processes and sometimes as a respect for the trial court, but whatever the formulation, Frankfurter—who had been expected to be "the leader of the liberal wing" of the Court[234]—found himself increasingly isolated from what he perceived as a politically motivated coalition led by Black and Douglas.[235]

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[233] See Reuel E. Schiller, The Era of Deference: Courts, Expertise, and the Emergence of New Deal Administrative Law, 106 Mich. L. Rev. 399, 417–21 (2007) (describing Professor Frankfurter's views on the need for judicial deference to administrative experts). There are suggestions in Frankfurter's writing, however, of the importance that he placed on judicial review of agency action. Frankfurter laid the blame for the evils of the industry with the investment bankers. Felix Frankfurter, supra note 100, at 157–58 ("[T]he power which must more and more be lodged in administrative experts, like all power, is prone to abuse unless its exercise is properly circumscribed and zealously scrutinized. For we have greatly widened the field of administrative discretion and thus opened the doors to arbitrariness.").

[234] Rauh, supra note 29, at 64 ("When Felix went on the bench in January 1939 he had such stature as a professor, and adviser to Presidents, an articulate writer, and a liberal that he was assumed to be the leader of the liberal wing.").

[235] The split—and Frankfurter's eroding influence—may have had its roots in other areas. The first tensions in the New Deal bloc began to surface in the Flag Salute cases. In the first of these cases, *Minersville School District v. Gobitis*, 310 U.S. 586, 600 (1940), Frankfurter wrote for an eight-Justice majority upholding a Pennsylvania law requiring school children to salute the American flag. Soon thereafter, however, Frankfurter felt his leadership position slipping away. Hirsch, supra note 17, at 155. This unexpected development embittered him: by the end of the 1942 term, Frankfurter had the

> sense of being under siege. Unexpectedly, he found himself in a position of being in opposition; his leadership had been rejected. He would react in a manner that had become a familiar part of his psychological makeup. The reaction would be particularly bitter, for this time his opponents were former allies; the

A. The Rule of Experts vs. Judicial Review

The split between Frankfurter and his progressive colleagues in the field of securities law is most dramatically seen in the two *Chenery* decisions, now bedrocks of administrative law. The first came to the Supreme Court in the fall of 1942. *Chenery I*,[236] with Frankfurter writing for a slim majority, marked the SEC's first significant setback in the Supreme Court since *Jones*.[237] The case is also notable as the Court's first brush with insider trading under the federal securities laws. By looking to the common law as the basis for any insider trading ban, it foreshadows the Court's forays a generation later into the question of insider trading, when it again relied on common law concepts of fiduciary duty and fraud.[238]

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challenge was in a domain where he had every reason to anticipate complete success; and he had no choice but to remain where he was and fight it out.

Id. at 176. The erosion of his influence became quite obvious when *Gobitis* was overruled only three years after being handed down by *West Virginia State Board of Education v. Barnette*, 319 U.S. 624 (1943). Frankfurter was angered by the switch of Black, Douglas, and Murphy and appalled by what he saw as their political motivation. Edward F. Prichard, Jr., Clerks of the Court on the Justices, *in* The Making of the New Deal: The Insiders Speak, supra note 29, at 47–71 ("Frankfurter . . . . had great contempt for Murphy, Black, and Douglas, because they voted with him in the first case and then changed their minds. He always said he didn't believe they had reread the Constitution, they had just read the newspapers."); Rauh, supra note 29, at 64 ("When Frankfurter asked Douglas whether Hugo Black had any new insight into the case, Douglas said, 'No, but he's read the papers.' Felix thought that was terrible!"). Whatever motivated the Progressive trio to switch, Frankfurter's leadership role on the Court had quite publicly disappeared with the Flag Salute cases. See Hirsch, supra note 17, at 155 ("The term that began the fall of 1941 was a turning point. The liberal trio solidified in its opposition to Frankfurter, and personnel changes brought a new unsettledness to inter-Court relations. Suddenly, Frankfurter found himself watching a calm Court, amenable to his influence and leadership, slip away from him.").

[236] SEC v. Chenery Corp. (*Chenery I*), 318 U.S. 80 (1943).

[237] The vote was 4-3 with Jackson, Roberts and Stone joining Frankfurter's majority; Douglas was not participating as usual and Rutledge had not yet taken Byrnes' seat.

[238] See generally A.C. Pritchard, *United States v. O'Hagan*: Agency Law and Justice Powell's Legacy for the Law of Insider Trading, 78 B.U. L. Rev. 13 (1998) (detailing Powell's reliance on common law concepts in insider trading cases). Jackson, in a letter to Frankfurter two days before the decision was released, suggested that the insider trading may well have helped the shareholders, a view that was also to appear in later debates about insider trading. He argued that "if, as is frequently the case, they were selling under compulsion, the bids of these directors may well have sustained their market, and they may well have benefited therefrom as against the terms they must have accepted in the absence of such bids." Letter from Justice Robert H. Jack-

The alleged insider traders were officers, directors, and controlling stockholders of the Federal Water Service Corporation, who had acquired preferred stock in Federal during the course of a PUHCA reorganization.[239] As Frankfurter characterized the rule of decision applied by the SEC, "respondents, as Federal's managers, were fiduciaries and hence under a 'duty of fair dealing' not to trade in the securities of the corporation while plans for its reorganization were before the Commission."[240] As a sanction for the violation of that duty, the SEC refused to approve a plan put forward by the company that called for their preferred stock to be converted into common stock in the reorganized entity, thus depriving the managers of their gains from trading.[241]

The SEC's invocation of the term "fiduciary" provoked a now well known lecture from Frankfurter on legal reasoning:

> But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge those obligations? And what are the consequences of his deviation from duty?[242]

Frankfurter, of course, knew the answers to these questions; the SEC had failed in its analysis. Frankfurter did not need to defer to the SEC as the expert on questions of corporate and securities law; *he* was the expert! In Frankfurter's view, an important principle of administrative law was at stake: the agency needed to be forthright with respect to the basis of its determination in order for the court to discharge its review function.[243] Here the SEC made a strategic error: it had not found that the insiders "acted covertly or traded on inside knowledge," but nonetheless found that they had violated "broad equitable principles" recognized in earlier judicial decisions.[244] Its reliance on earlier judicial decisions meant that it

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son to Justice Felix Frankfurter (Jan. 30, 1943) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 1, Reel 7).

[239] *Chenery I*, 318 U.S. at 81–82.

[240] Id. at 85.

[241] Id.

[242] Id. at 85–86.

[243] This is clearly set out in Frankfurter's exchange with Reed just prior to the issuance of the *Chenery I* decision. See infra notes 252–261 and accompanying text.

[244] *Chenery I*, 318 U.S. at 86–87.

could also be constrained by those decisions, which Frankfurter then proceeded to distinguish as inapposite.

The SEC would not necessarily be bound by these precedents, Frankfurter conceded, had the agency promulgated new rules reflecting its experience gained in working with the statute: "Congress certainly did not mean to preclude the formulation by the Commission of standards expressing a more sensitive regard for what is right and what is wrong than those prevalent at the time the Public Utility Holding Company Act of 1935 became law."[245] But having "professed to decide that case before it according to settled judicial doctrines, its action must be judged by [those] standards . . . ."[246] Having dismantled the Commission's reasoning derived from fiduciary duty, Frankfurter blocked any rescue based on judicially supplied alternatives by announcing the bedrock principle for which *Chenery I* is known in administrative law: "[A]n administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained."[247]

Frankfurter's opinion broached another core issue of administrative law in suggesting an agency would be afforded greater free-

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[245] Id. at 89. Indeed, Frankfurter favored more demanding standards for fiduciaries. See Felix Frankfurter, Social Issues before the Supreme Court (1933), *reprinted in* Law and Politics: Occasional Papers of Felix Frankfurter, supra note 138, at 48, 50 ("[T]he law must become more sophisticated in its conception of trustees' obligations. It must sharpen and extend the duties incident to the fiduciary relations of corporate directors and officers.").

[246] *Chenery I*, 318 U.S. at 89.

[247] Id. at 95. For a discussion of this principle and the explanations that have been given for it, see Kevin M. Stack, The Constitutional Foundations of *Chenery*, 116 Yale L.J. 952 (2007) (arguing that *Chenery I* is best explained by the nondelegation doctrine). This bedrock principle of administrative law may not have had the strongest of foundations. Jackson, the fourth vote in a 4-3 decision, had written a draft concurrence in which he said, "where the administrative order depends upon legal grounds I should think it our duty to sustain an order that is right on correct legal principles even if the administrative body has assigned incorrect ones." Draft Concurrence of Justice Jackson, SEC v. Chenery Corp., No. 254, October Term, 1942, at 1 (on file with the Papers of Robert H. Jackson, Library of Congress, Box 126). Nevertheless, Jackson joined the four-Justice majority without a separate concurrence.

Jackson's more fundamental legal point in the draft concurrence was that the SEC's order was unsustainable because the insiders had not received notice that their conduct was illegal: "Surprise law is sometimes inevitable, but it seems almost bromidic to say that citizens are entitled to have some way of learning the general principles that they will suffer in person or property for transgressing." Id. at 6.

dom in rulemaking than in formal adjudication. He suggested a willingness to defer to the SEC's "experience and insight" accumulated through its involvement in reorganization proceedings, but hinted that deference would only be given if the SEC "promulgated a general rule" proscribing the conduct in question.[248] Indeed, in an earlier draft of the opinion, Frankfurter had gone further to suggest that deference to the agency rule-making authority required the invalidation of its administrative order if it had not previously adopted a rule.[249]

Here was the dividing line between Frankfurter and his more liberal colleagues. Black's dissent, joined by Murphy and Reed, rejected "[t]he intimation . . . that the Commission can act only

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[248] *Chenery I*, 318 U.S. at 92. Chief Justice Stone suggested a more explicit endorsement of rulemaking by the SEC was in order. Handwritten Note from Chief Justice Harlan Fiske Stone to Justice Felix Frankfurter (undated) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 1, Reel 7). Frankfurter demurred:

> Of course I agree with you that had the SEC summarized their experience by putting the specific ruling in the *Chenery* case into a generalized rule, a totally different situation would have been created. But I thought it wiser to indicate that by innuendo rather than explicitly. To do the latter might be read by the Commission as a broad hint from us to issue a regulation. Thereby we would be stimulating new problems.

Letter from Justice Felix Frankfurter to Chief Justice Harlan Fiske Stone (Jan. 23, 1943) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 1, Reel 7).

[249] Draft Opinion, SEC v. Chenery Corp., at 8–9 (undated) (on file with the Hugo Black Papers, Library of Congress, Box 270) ("But whether it is 'necessary or appropriate in the public interest or for the protection of investors or consumers' that a general rule or regulation be adopted to prohibit reorganization managers from participating equally with others with respect to stock acquired by them during the course of the reorganization is for the Commission to determine. Where an administrative order is valid only if it rests upon a determination which the agency alone is authorized to make, its failure to make such a determination cannot be remedied by the fact that the agency might properly have made such a determination. It is not for us to determine independently what is 'detrimental to the public interest or the interest of investors or consumers' or 'fair and equitable' within the meaning of §§ 7 and 11 of the Public Utility Holding Company Act of 1935.").

In his final opinion, Frankfurter merely asserted that,

> [B]efore transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority.

Chenery I, 318 U.S. at 92–93.

through general formulae rigidly adhered to."[250] In Black's view, PUHCA gave the SEC "wide powers to evolve policy standards, and this may well be done case by case."[251] Black's position would prevail in *Chenery II* and give rise to a second bedrock principle of administrative law.

Frankfurter's commitment to judicial review was diametrically opposed by Black's commitment to administrative discretion. Frankfurter's difference with the dissenters is more starkly visible in correspondence between Frankfurter and Reed leading up to issuance of majority and minority opinions. Frankfurter had been courting Reed since his appointment to the Court—with some success[252]—but Frankfurter could not hold back his impatience with Reed for having joined Black's opinion.

> Were I still at Cambridge I would be saddened to note that you underwrote an opinion like Black's dissent in the *Chenery* case. I don't think I should be less saddened because I am your colleague. I hate to see you "bogged down in the quagmire" of Populist rhetoric unrelated to fact.[253]

This condescending introduction—so typical of Frankfurter in his relations with his colleagues—was merely the preface of an extended explication by Frankfurter on the distinction between the fiduciary duties of corporate directors and trustees and, more importantly, Frankfurter's views on administrative law. Frankfurter conceded that the SEC had the authority to depart from the common law rule, but in his view, the agency "made the purest kind of an *ad hoc* decision without any reason whatever for its conclusion except that these respondents were reorganization managers."[254] The Commission's conclusion "affords no possible basis for a reviewing court to say that that which the Commission did was right. And so the case must be remanded to the Commission unless court review simply means rubber stamping what the Commission

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[250] *Chenery I*, 318 U.S. at 99 (Black, J., dissenting).

[251] Id. at 100.

[252] See Fassett, supra note 140, at 347 (noting that, over the course of the 1942 and 1943 terms, Reed voted most frequently with Frankfurter).

[253] Letter from Justice Felix Frankfurter to Justice Stanley Reed, at 1 (Jan. 29, 1943) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 1, Reel 7).

[254] Id. at 2.

does."[255] Frankfurter urged that the standards he expected from the SEC and other administrative agencies were essential to their long term viability:

> Administrative agencies have two major functions. They exercise delegated legislation through their rule-making power, that is, they formulate general standards of conduct based on their experience and their expertness. The broadest leeway should be given to them in the exercise of this legislative function. Secondly, they exercise an adjudicatory function in disposing of specific controversies that come before them, much as courts would do if the jurisdiction in these matters were given to them. The *Chenery* case is such an exercise of the administrative adjudicatory process. And it is subject, therefore, to the requirement that the reviewing courts be enabled to know the basis of the determination of the administrative [sic] in order to discharge the court's function of review. I have spent most of my professional life in trying to get recognition for the indispensability of the administrative process. I do not want slipshodness and, still worse, lust for power[, to] lead to curtailment of these administrative powers by determinations without reason or by appeals to rules of law for which there is no warrant.[256]

Frankfurter believed passionately in the administrative state—but he was equally fervent in his belief that the rule of law must apply to administrative agencies. Those values would be enforced by judges, if necessary. Frankfurter had devoted much of his career to arguing for the proposition that courts should not rely on the Constitution to interfere with economic regulation by legislatures.[257] He did not equally believe in judicial restraint, however, when it came to holding administrative agencies to statutory standards. They were required to follow the rules set down for them by the legislature.

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[255] Id. at 3.

[256] Id. at 3–4.

[257] See Felix Frankfurter, Does Law Obstruct Government?, *in* The Public & Its Government, supra note 100, at 36, 47 (expressing dismay at Supreme Court's increasing tendency to strike down economic regulation: "And always by a divided Court, always over the protest of its most distinguished minds!").

Frankfurter's positioning of himself as the defender of the rule of law was calculated to annoy his colleagues. Reed by this time had grown tired of the professor's lectures and he believed that agencies should be given much broader latitude. In his reply, Reed argued that "[y]ou [Frankfurter] say the Commission from its experience may fashion a new 'general' rule of conduct. I say, it has done just that.... [I]t said that fiduciary reorganization managers may not deal in stock of companies being reorganized."[258] In Reed's view, the SEC was not required to promulgate a formal rule: "A few such ad hoc decisions will result in a regulation—that is the way regulations grow."[259] Reed was content to leave the SEC considerable space in which to grow its regulations:

> Every decision must be an ad hoc ruling, as I see it. An application of the Commission's idea as to "fair and equitable." Such application should be guided by precedents and regulations but may depart from them. If it does not go too far (arbitrary, capricious and unreasonable), it should be upheld. This is the essence of administrative law.[260]

Reed's incremental vision of administrative lawmaking, in stark contrast to Frankfurter's, required very little involvement from courts; indeed, it mirrored the rulemaking process of common law courts. Reed's position was the one that would ultimately prevail in the New Deal Court's approach to securities law.[261]

In between the time *Chenery* was remanded to the SEC in 1943 and its return in 1946, the divisions that had begun to develop among the Justices had devolved into open warfare. Jurisprudential differences were now exacerbated by intense personal animosity. The tensions on the Court flared with the retirement of Roberts in the summer of 1945. Black refused to sign the customary

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[258] Letter from Justice Stanley Reed to Justice Felix Frankfurter (Jan. 29, 1943) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 1, Reel 7).

[259] Id.

[260] Id.

[261] The SEC, for its part, ameliorated some of the surprise element of its pronouncements by making liberal use of informal guidance, a practice that has developed into its current "No Action" letters. See Thomas K. McCraw, Prophets of Regulation 215 (1984) (discussing the SEC's use of General Counsel opinions to elucidate its views on the securities laws).

letter from the Justices thanking him for his services, and Stone's best efforts were unable to broker a compromise.[262] The result was a very ungracious departure for the last of the old guard.

These resentments spilled into public view when Chief Justice Stone died on April 22, 1946. Five of the sitting associate Justices would have been delighted to be elevated to the center seat,[263] with Douglas actively campaigning for the seat (and Corcoran assisting behind the scenes).[264] Black and Jackson, however, were the primary contenders, with Jackson having been promised the spot by Roosevelt before his death.[265] The Washington scuttlebutt was that neither would be willing to serve under the other.[266] Moreover, Drew Pearson wrote in his prominent column that two members of the Court (implicitly, Black and Douglas), had threatened to resign if Jackson were made Chief Justice.[267] In an effort to avoid the ramifications of choosing between Black and Jackson, Truman instead appointed his Secretary of the Treasury, Fred Vinson. Truman's desire to keep the peace on the Court was not entirely successful; Jackson, bitter at having been passed over, sent a cable to the President and letters to the congressional judiciary committees denouncing Black for having declined to recuse himself in a case involving a former law partner.[268]

Thus, it was a Court with extremely frayed personal relations that heard *Chenery* when the case returned in the October 1946 term. The SEC had responded to the Court's earlier remand by reaching the same result, basing it on a different rationale. Frankfurter complained to Black:

> With every impulse to sustain the Commission, . . . I cannot escape the conviction that the Commission has decided this case *ad*

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[262] Barry Cushman, Lost Fidelities, 41 Wm. & Mary L. Rev. 95, 98 (1999).

[263] Fassett, supra note 140, at 405 (noting that, on Stone's death, "it is quite clear that five of the associate justices each seriously aspired to, or at least would wholeheartedly have welcomed, becoming chief justice").

[264] See Ferren, supra note 91, at 326.

[265] See id. at 325.

[266] Murphy, supra note 127, at 244.

[267] Id.

[268] Cable from Justice Robert H. Jackson to President Harry Truman (June 8, 1946), *discussed in* Melvin I. Urofsky, Division and Discord: The Supreme Court Under Stone and Vinson 1941–1953, at 143–44 (1997). The case was *Jewel Ridge Coal Corp. v. Local No. 6167, United Mine Workers of Am.*, 325 U.S. 161 (1945).

> *hoc* without any reference to considerations that would govern it in the same case tomorrow. . . .
>
> . . . The SEC is not a Kadi sitting under a tree, dispensing judgment in each case, unrelated to general considerations.[269]

Chenery I presented two possible separate strands of administrative law and judicial review. One focused on the importance of the courts being able to review the reasons stated by an administrative agency in an adjudication; the other suggested administrative action done by rule-making would enjoy less intrusive judicial review. *Chenery I* was ambiguous as to which administrative law message would control going forward.[270]

In *Chenery II*, Murphy, Black, and Reed, who had dissented in *Chenery I*, were now joined by new Justices Wiley Rutledge and Harold Burton to form a majority upholding the SEC's action. This majority explicitly rejected Frankfurter's suggestion in *Chenery I* that the agency should proceed by rulemaking: "[T]he choice made between proceeding by general rule or by individual, *ad hoc* litigation is one that lies primarily in the informed discretion of the administrative agency"[271]—a holding that endures as a core principle of modern administrative law. Only Jackson joined Frankfurter in voting to overturn the SEC's decision.[272] The Court was now committed to deference to agency discretion; Frankfurter's concerns about judicial review of the agency performing an adjudicatory function were brushed aside.

Frankfurter circulated a dissent that threatened another public blow-up. The case was argued in December and assigned to Burton, but it was reassigned to Murphy in early June[273] because Burton had not been able to produce an opinion and Murphy had

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[269] Letter from Justice Felix Frankfurter to Justice Hugo Black (Dec. 23, 1946) (on file with the Robert Jackson Collection, Library of Congress, Box 138). The "Kadi" reference made its way into a published dissent a few years later. See Terminiello v. Chicago, 337 U.S. 1, 11 (1949) (Frankfurter, J., dissenting) ("This is a court of review, not a tribunal unbounded by rules. We do not sit like a kadi under a tree dispensing justice according to considerations of individual expediency.").

[270] We thank Kevin Stack for pointing out this difference.

[271] SEC v. Chenery Corp. (*Chenery II*), 332 U.S. 194, 203 (1947).

[272] Douglas, as usual, had recused himself. Chief Justice Vinson did not participate. Id. at 209.

[273] James E. St. Clair & Linda C. Gugin, Chief Justice Fred M. Vinson of Kentucky: A Political Biography 180 (2002).

completed all of his opinions for the term.[274] Murphy's law clerk scrambled to draft an opinion in about a week's time.[275] Frankfurter did not have time for a full-blown dissent at that late point in the term, so he circulated a draft dissent: "The Court's opinion in this case was not circulated until Tuesday, June 17th. Obviously that precluded opportunity before adjournment for the preparation, printing, circulation and consideration by the whole Court of a response adequate to the issues raised by the opinion."[276] Frankfurter's inartful choice of language provoked a gentle scolding from Rutledge for "disclos[ing] the confidential routines of the Court."[277] Moreover, Rutledge felt that Frankfurter's opinion put Murphy in a bad light: "[Murphy] will appear, if your circulation goes down, in the light of having caused all the delay. I do not think [that] implication is fair . . . ."[278] Frankfurter responded by deleting the reference to the date of circulation, instead attributing his failure to publish a full dissent to the "unavoidable lateness of the decision."[279] Frankfurter's second choice of words fared little better, provoking an angry response from Murphy:

> I am asking Justice Frankfurter to delete all reference in his remarks to the "unavoidable lateness of the decision in this case." So far as the public is concerned, any decision rendered in the same term as that in which the case is argued is not "unavoidably" late. It is not unknown for cases to be argued early and decided late in the term. To say that such a decision is "unavoid-

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[274] Telephone Interview with Eugene Gressman, Law Clerk to Justice Frank Murphy 1943–48 (Sept. 6, 2008) (notes on file with the authors).

[275] Id.

[276] Justice Felix Frankfurter, Memorandum to the Conference in Nos. 81 and 82, Oct. Term, 1946 (June 23, 1947) (on file with the Hugo Black Collection, Library of Congress, Box 283).

[277] Letter from Justice Wiley Rutledge to Justice Felix Frankfurter (June 18, 1947) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 3, Reel 3).

[278] Id. Rutledge was sufficiently distressed by Frankfurter's opinion that he wrote a draft concurrence exonerating Murphy of any blame for the lateness of the opinion. Draft Concurrence of Justice Rutledge, *SEC v. Chenery Corp.*, Nos. 81 and 82, Oct. Term, 1946 (June 23, 1947) (on file with the Wiley Rutledge Collection, Library of Congress, Box 155).

[279] Justice Felix Frankfurter, Memorandum to the Conference in Nos. 81 and 82 (June 18, 1947) (on file with the Wiley Rutledge Collection, Library of Congress, Box 155).

> ably" late is thus to stir up needless speculation and comment by the public.[280]

A chastised Frankfurter attempted to apologize:

> It must be due to naivete that it never occurred to me that the simple statement of an obvious fact could ever be deemed a departure, however remote, from the Court's tradition, or that it would touch anybody's sensitiveness. . . .
>
> I am sorry even if unwittingly I should have touched the sensibilities of any of my brethren. In any event, long before the memorandum by brother Murphy reached me, I sent a revised phrasing of my notice of dissent to the printer. It says precisely what I believe it is appropriate to say, and says it in a way that does not, so far as I am able to judge, lend itself even to tortured misinterpretation.[281]

Frankfurter had a rare gift, allowing him to offend—with his reference to "tortured misinterpretation"—even in the course of an attempted apology. His actual opinion, however, was inoffensive.[282]

It was Jackson, however, who took on the task of writing the full dissent for Frankfurter and himself. His dissent is a sarcastic attack (characterized by Frankfurter as a "rip-snorter"[283]) on the Court's reasoning and the SEC's lawlessness. "The Court's reasoning adds up to this: The Commission must be sustained because of its accumulated experience in solving a problem with which it had never before been confronted!"[284] Jackson's strident tone provoked an anxious memorandum from Vinson's law clerk, who worried that "it includes such ridicule of the majority position as possibly to intimate lack of integrity when applied to the product of able minds. . . . In view of publicity recently given to 'feuds' within the

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[280] Justice Frank Murphy, Memorandum to the Conference (June 18, 1947) (on file with the Hugo Black Collection, Library of Congress, Box 283).

[281] Justice Felix Frankfurter, Memorandum for the Conference Nos. 81 and 82 (June 18, 1947) (on file with the Hugo Black Collection, Library of Congress, Box 281).

[282] Letter from Justice Frank Murphy to Justice Felix Frankfurter (June 18, 1947) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 1, Reel 17) ("Thanks for your last circulation in the Chenery case. It is entirely satisfactory to me now.").

[283] Letter from Justice Felix Frankfurter to Justice Robert H. Jackson (July 23, [1947]) (on file with the Robert Jackson Collection, Library of Congress, Box 138).

[284] SEC v. Chenery Corp., 332 U.S. 194, 213 (1947) (Jackson, J., dissenting).

Court, I think the opinion may invite newspaper attention . . . ."[285] The clerk's concern was justified; the newspaper headlines read "Jackson Says High Court Encourages Lawlessness."[286]

Jackson scored polemical points, but Frankfurter passed up an opportunity to flesh out his vision of the rule of law in the administrative state. In the months before *Chenery II* was decided, Congress finally passed the Administrative Procedure Act, a project long delayed because of the war effort, and in doing provided a partial response to Frankfurter's earlier concerns. The new statute imposed additional requirements of "substantial evidence" and judicial restraint of "arbitrary" and "capricious" actions,[287] and sought to reverse what Congress may have perceived as "overly deferential judicial examination of agency factfinding."[288] The Act itself reflected something of a political compromise,[289] with the most restrictive and detailed provisions applicable to formal adjudications, leaving rulemaking with less intrusive and vague provisions.[290] Over time administrative law would move further in Frankfurter's direction. Judicial deference to administrative expertise may have already begun to recede from its high point by the time

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[285] Memo on dissenting opinion in S.E.C. v. Chenery from JT to Chief Justice Fred Vinson (Oct. 4, 1947) (on file with the Fred Vinson Collection, University of Kentucky).

[286] Jackson Says High Court Encourages Lawlessness, Minneapolis Morning Tribune, Oct. 7, 1947, at 2 (newspaper clipping on file with the Robert Jackson Collection, Library of Congress, Box 138).

[287] See generally Administrative Procedure Act, 5 U.S.C. §§ 551–59, 701–06 (2000).

[288] M. Elizabeth Magill, Agency Choice of Policymaking Form, 71 U. Chi. L. Rev. 1383, 1427 (2004).

[289] On the long struggle by conservatives to rein in the New Deal agencies, see George B. Shepherd, Fierce Compromise: The Administrative Procedure Act Emerges from New Deal Politics, 90 Nw. U. L. Rev. 1557 (1996).

[290] Lisa Schultz Bressman, Procedures as Politics in Administrative Law, 107 Colum. L. Rev. 1749, 1756 (2007) (describing how "New Deal Democrats fought to unleash agencies from rigid procedural control, while Republicans pushed in the opposite direction, particularly in the context of adjudication, which was a prevalent form of agency decisionmaking at the time").

of *Chenery II*.[291] At no point, however, would the Court require an agency to proceed through rulemaking.[292]

A similar division over the intensity of judicial review of SEC action is visible in two other decisions of this period (and one non-decision). *Otis & Co. v. SEC*,[293] decided between the two *Chenery* cases, arose from the liquidation of a holding company in which the SEC declined to apply a liquidation preference for preferred shareholders contained in the holding company's charter. Applying the preference would have had the effect of giving all of the equity to the preferred shareholders and excluding the common shareholders entirely.[294] In deciding whether such a result was "fair and equitable," as required by PUHCA Section 11(e), Frankfurter focused on the Court's prior insistence in a bankruptcy proceeding that violations of the absolute priority rule among securities holders were unfair and inequitable.[295] As Frankfurter pointed out in a letter to Reed, there was little reason for construing the identical language "fair and equitable" one way for the Bankruptcy Act, adopted in 1934, and another way for PUHCA, adopted in 1935.[296] Chief Justice Stone argued at the Court's conference that affirming the SEC would be tantamount to saying that the "Commission is

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[291] See Schiller, supra note 233, at 441 ("The profound deference of New Deal-era administrative law was not to last long, but it firmly defined the role of expertise in the administrative state and created the model of judicial deference that would be both emulated and reacted against as administrative law developed during the rest of the twentieth century." (footnote omitted)).

[292] The bedrock holding of *Chenery II* as to agency choice would come into question after one point after Frankfurter's retirement. *NLRB v. Wyman-Gordon*, 394 U.S. 759 (1969), suggested "that a doctrine policing agency choice of procedure might be on the horizon," Magill, supra note 288 at 1407, but as Professor Magill has developed, the doctrine thereafter evolved to emphasize the breadth of an agency's discretion to choose between rulemaking and adjudication. See generally id.

[293] 323 U.S. 624 (1945). The preference purported to apply to "liquidation of the corporation, whether voluntary or involuntary." Id. at 630 n.6 (quoting the United Light and Power Company's charter).

[294] Id. The SEC chose instead to value the preferred stock on a going concern basis and awarded a small percentage of the value of the liquidated company to the common stockholders. Id. at 629–32.

[295] Case v. Los Angeles Lumber Co., 308 U.S. 106, 114–16 (1939); see also Consol. Rock Prod. Co. v. DuBois, 312 U.S. 510, 530–31 (1941).

[296] Letter from Justice Felix Frankfurter to Justice Stanley Reed (Nov. 21, 1944) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 56).

God."[297] A majority of the Court was persuaded by the SEC's arguments, however, with Stone, Roberts, and Frankfurter dissenting. The Court majority was giving the SEC a clean slate, unencumbered by judicial interpretations of analogous laws. It also established a pattern of affording the SEC latitude in valuing the interests of securities holders in holding company reorganizations.[298]

American Power II, decided in 1946, reflected both the Court's unanimity on questions of constitutional power discussed in the last section and its division on the question of judicial review of expert decisions.[299] Not surprisingly, Murphy's opinion for the Court in *American Power II* tracked his *North American* opinion of a few months earlier with respect to the commerce clause and due process challenges. The Court concluded that "the federal commerce power is as broad as the economic needs of the nation."[300] Implicit in this holding was that it was Congress—not the Court—that

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[297] Handwritten Notes from Conference, No. 81, OT 1944 (undated) (on file with the Frank Murphy Collection, Bentley Library, University of Michigan, Reel 131).

[298] In *SEC v. Cent. Ill. Sec. Corp.*, 338 U.S. 96, 155 (1949), the Justices were unanimous (with Douglas and Jackson not participating) in deferring to the SEC's choice to award preferred shareholders the call value of their securities rather than their involuntary liquidation value. The Court characterized the "principle of the *Otis* case . . . that the measure of equitable equivalence for purposes of simplification proceedings compelled by the Holding Company Act is the value of the securities 'on the basis of a going business and not as though a liquidation were taking place.'" Id. at 131 (citation omitted).

Niagara Hudson Power Corp. v. Leventritt, 340 U.S. 336 (1951), represents the complete triumph of administrative expertise over the wisdom of the marketplace. There, the Court upheld the SEC's determination to afford no value to outstanding stock option warrants, despite the fact that the warrants had no time limit for their exercise and were trading for a positive value in the marketplace. The Court deferred to the SEC's determination that "there is no ground for a reasonable expectation that, within the foreseeable future" the warrants would be in the money. Id. at 344. "Where the line is to be drawn is a matter for the expert judgment of the Commission." Id. The Court's opinion drew a dissent from the odd couple of Frankfurter and Black, but Frankfurter rested his objection on the reasoning of the court below. Id. at 348 (Frankfurter, J., dissenting).

[299] Am. Power & Light Co. v. SEC (*American Power II*), 329 U.S. 90 (1946). The case resolved the lingering constitutional issues left after *North American* at the end of the Court's previous term. Under review was the SEC's order breaking up the largest single public utility holding company system registered under the Act.

[300] Id. at 104.

would determine the nation's "economic needs."[301] The Court happily ceded broad latitude to agency expertise, emphatically rejecting the challenge raised to the Commission's insistence on dissolution. "[T]he Commission here has accumulated experience and knowledge which no court can hope to attain,"[302] Murphy wrote. The agency's judgment was accorded "greatest weight"; courts would intervene only if the agency's action was unwarranted by law or without justification in fact.[303]

A third case reflecting similar divisions ended up with no published opinion after Frankfurter's change of heart erased a majority for an opinion that Murphy had been preparing.[304] The SEC had found Pacific Gas & Electric Company ("PG&E") to be a subsidiary of the North American Company ("North American"), thereby subjecting PG&E to regulation as a subsidiary under PUHCA. Murphy had no difficulty upholding the SEC's order: "The judicial function on review . . . ceases when it becomes clear that the inferences and conclusions drawn by the administrative agency have

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[301] The Court used equally broad strokes in addressing the utility's argument of an unconstitutional delegation of legislative power to the SEC. "The judicial approval accorded these 'broad' standards for administrative action is a reflection of the necessities of modern legislation dealing with complex economic and social problems." Id. at 104–05.

[302] Id. at 112.

[303] Murphy's broad trust of the agency extended to the SEC's refusal to hold a hearing on the company's alternative plan proposed under § 11(e) of the act, but here he lost the Court's unanimity. Id. at 112, 118. Justice Rutledge wrote separately to say he viewed the statue as requiring the Commission to provide for notice and hearing, the absence of which would have been grounds for reversal had the companies not effectively waived their rights in this case. Id. at 121–22 (Rutledge, J., concurring). Frankfurter inserted a written statement as to his belief that the consideration of notice and hearing does not arise given the particular circumstances of this case in what he hoped would be a message to the agency. Id. at 121 (opinion of Frankfurter, J.). Frankfurter noted his initial opposition to the discussion of the notice issue, and his willingness to let it go so that the decision might be unanimous, but with the filing of Rutledge's separate opinion, he sought to pursue the issue: "[This] gives the SEC a hint to reconsider fully the proper construction of § 11(e) and . . . leave the matter for future disposition here by what one has a right to hope may be a full court." Letter from Justice Felix Frankfurter to Justice Frank Murphy (Nov. 23, 1946) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 52).

[304] Pac. Gas & Elec. Co. v. SEC, 324 U.S. 826 (1945) (per curiam) (affirming judgment below by an equally divided Court).

warrant in the record and a reasonable basis in law."[305] North American's ownership of seventeen percent of PG&E's voting securities and representation on PG&E's board were a sufficient basis for Murphy to conclude that North American controlled PG&E, despite the lack of evidence of any influence by North American over PG&E's policies.[306] Murphy's opinion, however, failed to persuade Frankfurter, who switched his earlier vote to uphold the SEC's action. He explained to Murphy:

> After much travail I am constrained to conclude that the S.E.C. made its decision in the case on unsustainable legal criteria. That they could have reached the same result exclusively on their allowable interpretation of the facts, or that they may hereafter reach the same conclusion on such an appraisal of the facts, can not from my point of view justify our approval of erroneous criteria laid down by the Commission. You see you have educated me to keep these agencies within the legal bounds prescribed by Congress. This is for me fundamentally another *Chenery* situation.[307]

Once again, the SEC had not lived up to the exacting standards that Frankfurter expected from the agency.[308]

Murphy's trust of the experts was sufficiently great that he was willing to construe standing narrowly in PUHCA reorganizations because of a worry that minority shareholders might harass the SEC. The Court majority, however, was not willing to go so far. In *American Power & Light Co. v. SEC* (consolidated with *SEC v.*

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[305] Draft Opinion of Justice Murphy, Pac. Gas and Elec. v. SEC, No. 55, Oct. Term, 1944, at 6 (on file with the Felix Frankfurter Collection, Library of Congress, Reel 52).

[306] Id. at 6–11.

[307] Letter from Justice Felix Frankfurter to Justice Frank Murphy (Feb. 22, 1945) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 52).

[308] Murphy was not happy with Frankfurter's switch, as it deprived him of his majority, and with Douglas recused as usual, the SEC's action would be upheld by an equally divided court, rendering Murphy's "many long hours . . . spent on the P.G.&E. opinion" a waste. Letter from Justice Frank Murphy to Justice Felix Frankfurter (Feb. 23, 1945) (on file with the Felix Frankfurter Collection, Library of Congress, Reel 52). Murphy was prepared to write that off, but he was more impatient with Frankfurter's explanation (or lack thereof) for his switch: "I am . . . at a loss to know what it is that has made you change your mind. If, as you say, it is the erroneous criteria used by the SEC, I ask you to reread my opinion and tell me what you think is wrong." Id.

Okin),[309] Justice Roberts, writing for the Court, held that Section 24(a)[310] conferred standing on: (1) American Power & Light, as the sole stockholder of Florida Power & Light Company, to challenge an order by the SEC "requir[ing] Florida to make certain accounting entries which will result in taking out of surplus moneys which would otherwise be available to pay dividends to [American Power],"[311] and (2) Samuel Okin, a small shareholder in Electric Bond & Share Company, who sought to challenge a loan from Electric Bond & Share to its subsidiary, American and Foreign Power Company.[312] The Court announced a broad standard for those seeking review that ignored formal distinctions between direct and derivative claims: "a stockholder having a substantial financial or economic interest from that of the corporation which is directly and adversely affected by an order of the Commission, irrespective of any effect the order may have on the corporation, is a 'person aggrieved' within the meaning of § 24(a)."[313] Murphy, anxious to avoid interference with the administrative process, dissented, arguing that if American's "remote economic interest" was sufficient to confer standing, "there is no limit to which minority stockholders may harass the Commission and their respective corporations by challenging orders of the Commission directed to the corporations."[314]

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[309] Am. Power & Light Co. v. SEC (*American Power I*), 325 U.S. 385, 386 & n.1 (1945).

[310] 15 U.S.C. § 79x(a) (1940).

[311] *American Power I*, 325 U.S. at 386–88.

[312] Id. at 392 (noting that Okin challenged the loan as illegal and fraudulent, notwithstanding its approval by the SEC).

[313] Id. at 388.

[314] Id. at 396 (Murphy, J., dissenting). Murphy's concern about the efficiency of the administrative process here is a little difficult to square with his position in *In re Electric Power & Light Corp.*, in which he joined Frankfurter in dissenting from the denial of stay of execution of a plan of dissolution pending appeal. 337 U.S. 903, 904 (1949) (per curiam) (Frankfurter & Murphy, JJ., dissenting).

Murphy was also skeptical of Okin's claim of fraud. "Such frivolous claims of fraud are insufficient to warrant making an exception to the general rule that a stockholder cannot appeal an administrative order which involves only the corporation as such." *American Power I*, 325 U.S. at 398 (Murphy, J., dissenting).

Murphy was joined by Black and Reed in arguing to deny standing to American Power, a holding company, but not in reaching the same conclusion with respect to Okin, a small investor. Black, ever the champion of the underdog, expressed concern "that courts should not put insuperable obstacles in the way of stockholders whose interests might be sacrificed by management." Letter from Justice Hugo Black to Jus-

Although the Court read Section 24(a) broadly in *American Power*, it subsequently gave the SEC some control over where a challenge could be brought. In *General Protective Committee for Holders of Option Warrants of United Corp. v. SEC*,[315] the Court held that the district court, rather than the court of appeals, had jurisdiction over elements of the plan of reorganization that the SEC made subject to approval by the district court in an enforcement proceeding. The case was unanimous, notable only in that it was Douglas's first opinion in a PUHCA case, almost fifteen years after he left the SEC.[316]

Douglas again wrote for the Court a year later when the Court upheld the reservation of jurisdiction of the SEC to pass on the reasonableness and allocation of fees and expenses paid to underwriters in connection with the reorganization of Electric Bond & Share.[317] Douglas surely drew from experience when he wrote:

> Payment of excessive fees was one of the historic abuses of the reorganization procedure whereby utility companies were milked, an abuse the Public Utility Holding Company Act sought to correct. . . .
>
> . . . Congress had before it the detailed record of holding company activities and knew that many of them had a proclivity for predatory practices. The fees were not only large; they were often loaded on affiliated companies and concealed in intrasystem accounts.[318]

SEC oversight was essential to eliminate those abuses, in Douglas's view. Douglas had now—belatedly—placed himself with the Court's majority in giving the SEC free rein.

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tice Frank Murphy (May 30, 1945) (on file with the Frank Murphy Collection, Bentley Library, University of Michigan).

[315] 346 U.S. 521 (1954).

[316] The Court was more generous to the SEC's interest in finality in *SEC v. Louisiana Public Service Comm'n*, 353 U.S. 368, 372 (1957) (per curiam), in which it held that a decision by the SEC not to reopen a prior proceeding was not subject to review in the court of appeals. The decision attracted little interest from the Justices; it was decided in a short per curiam by Whitaker. See Letter from Chief Justice Earl Warren to Justice Charles Evans Whitaker (May 9, 1957) (on file with the Earl Warren Papers, Library of Congress, Box 633).

[317] SEC v. Drexel & Co., 348 U.S. 341 (1955).

[318] Id. at 348–49 (footnote omitted).

Frankfurter again found himself in dissent, this time joined by Burton.[319] Frankfurter was fighting a lonely fight to keep the SEC to what he saw as the letter of the law that he had helped to enact. A majority of the Court was consistently willing to afford the agency latitude to fight the abuses that had led to the adoption of the federal securities laws.

IV. A RELIABLE COURT

From a twenty-first century perspective, perhaps the most striking feature of the New Deal Court's work in the field of securities law is how reliable the Court was in accomplishing Roosevelt's agenda—there were no surprises for the President. The intervening decades have seen a number of appointments that have caused Presidents to regret their choices. Roosevelt's nominees gave him no cause for similar regret, at least in the field of securities law, a legislative priority for the Roosevelt administration. The New Deal Court delivered in validating political control over finance.

Why was there such a consistent pattern of deference to the SEC? No individual Justice was leading the fight for the SEC. The two Justices who might have led the Court based on their deep experience in the area, Frankfurter and Douglas, exercised very little influence. Murphy, largely by default, ended up with a recurring role. Given his lack of experience in the area and the low regard that his brethren had for his abilities, it is difficult to say that he dramatically shaped the jurisprudence or led the Court in this area. Rather, his opinions reflect a broad consensus—based on similar experiences that the New Deal Justices brought to the Court—that judges should defer to the SEC.

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[319] Frankfurter wrote:

> Congress effectively equipped the Commission with power to regulate fees in the various proceedings which required approval by the Commission. But Congress particularized. It did not vest this fee-fixing authority of the Commission in a comprehensive provision. It dealt with the problem distributively. It was explicit in relating the power to fix fees to the particular proceeding.
>
> . . . .
>
> The [Public Utility] Holding Company Act of 1935 is a reticulated statute, not a hodge-podge. To observe its explicit provisions is to respect the purpose of Congress and the care with which it was formulated.

Id. at 349–50 (Frankfurter, J., dissenting).

A. Reliability

Over the last half century, Presidents regularly have set out to mold the Supreme Court to implement the administration's goals, with varying degrees of success. For Franklin Roosevelt, the challenge was more salient than for his successors because he initially faced a Court that was perceived to be hostile to the New Deal agenda. The eight men Roosevelt named to the Court each accepted Roosevelt's new role for government in the nation's economy. Stone's elevation to Chief Justice was no exception to this pattern; although a Republican holdover, he shared his new colleagues' belief in judicial deference to political control over finance. Collectively, Roosevelt's appointments produced a Court that quickly abandoned the old Court's inclination to strike down New Deal initiatives. The Court boldly announced its willingness to give Congress and the administration a wide berth in economic regulation. That well known and lasting legacy of deference has continued to this day.

Less well known is the New Deal Court's deference to the SEC as it asserted governmental control over finance, displacing broad areas of private ordering that had previously dominated the field. After the *Jones* case in 1936, it was almost four decades before the Supreme Court made any concerted effort to rein in the SEC and the reach of the securities laws. Frankfurter found no consistent support in his effort to bring judicial scrutiny to bear on the agency. The forty years after *Jones* saw a string of three dozen outcomes supportive of the agency and an expansive view of securities laws, interrupted only sporadically by a restrictive decision.[320]

In retrospect, Roosevelt's triumph with the New Deal Court in the field of securities law is all the more impressive in light of the subsequent political repudiation of his administration's two most expansive governmental intrusions into business. PUHCA and the Chandler Act are all but invisible to modern securities lawyers. PUHCA, which allowed the SEC to dictate corporate governance standards to an industry vital to the economy, faded in importance as all of the nation's public utility holding companies were broken up by the 1950s. A generation later, narrow interpretations and regulatory exemptions undid much of the work accomplished by

[320] Sullivan & Thompson, supra note 12, at 1580.

the SEC in breaking up the holding companies. New utility conglomerates emerged, such as Enron, with diverse business interests and sprawling operations. PUHCA's purpose—the Brandeisian assault on "bigness"—was largely repudiated, and the Act itself was repealed in 2005.[321] The Chandler Act, which afforded the SEC a key role in reorganization plans, was replaced by the 1978 Bankruptcy Reform Act, which did not provide any role for the SEC.[322] The SEC supported the move. As a result of the repeal of these two laws, the SEC was deprived of the two roles that gave it an important say in corporate governance, leaving the agency with the disclosure-focused regulation of the 1933 and 1934 Acts. The Sarbanes-Oxley Act has recently increased the role of the securities laws in corporate governance, but its incremental reforms hardly portend a move toward federal incorporation like PUHCA and the Chandler Act.

Why did Roosevelt have such success with his appointees? They shared several key characteristics. First, most had had prior advocacy positions in the executive branch, which proved to be a reliable barometer of a Justice's future leanings. Douglas headed the SEC, Murphy served as Attorney General, Jackson as both Solicitor General and Attorney General, among other high level positions, and Reed as general counsel to the Reconstruction Finance Corporation and then Solicitor General. All enthusiastically endorsed FDR's new role for government in managing the economy ravaged by the Great Depression. Black's record in the Senate (including his bitter attack on the utility industry) provided a reliable predictor of his future judicial attitudes.[323] Frankfurter was the most skeptical of the Justices toward the SEC, but he never showed anything like the hostility of the Old Guard in *Jones*. He had served briefly in government before undertaking an academic career, and his steady informal roles produced at least some bonding effect similar to that produced by more formal service in the executive branch.[324] Only Rutledge came from the appellate court, the typical

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[321] See supra note 8.

[322] The story of this evolution and William O. Douglas's unintentional contribution to it is well told by Skeel, supra note 117, at 125–28.

[323] Byrnes's Senate service would likely have served as an equally accurate predictor of his judicial judgments, had he stayed long enough on the Court to render any.

[324] Notably, Frankfurter disclaimed the title of New Deal Justice:

path for modern Justices, after serving as a professor. In short, Roosevelt's appointees overwhelmingly bought into the New Deal agenda.

Second, Roosevelt clearly had a "litmus test": he picked nominees who had already proved their loyalty on the Court-packing plan, the fulcrum of the dispute between the administration and the "old" Court. Reed helped draft the bill;[325] Jackson was a key administration witness in the Congressional hearings;[326] Black was a principal lieutenant to the Senate's majority leader Robinson in this debate;[327] Byrnes, also a Senator, likewise supported the plan;[328] Douglas quickly enlisted in the administration's efforts to push the plan.[329] Frankfurter was silent in the face of overwhelming pressure to speak against the plan, including from his own wife. His silence may have ensured his appointment.[330] A willingness to stomach the deeply controversial Court-packing plan demonstrated a real commitment to constraining judicial power.

Third, Roosevelt knew his nominees personally. They were trusted advisors, both in the strategy for defending the New Deal against judicial attack,[331] and on the question of whom to add to the Court. By and large they were a mutual admiration society before their appointment to the Court. Frankfurter and Douglas, who would become bitter enemies on the Court, each pushed for the

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> I'm incurably academic and cannot rid myself of the conviction that it is of the very essence of the function of this Court that when a man comes on it, he leaves all party feelings as well as affiliations behind. I certainly do not and have not since January 30, 1939 for one split second felt like or deemed myself, or deemed it right for anyone else to think of me, as a "New Deal" Justice.

Copy of Handwritten Note from Justice Felix Frankfurter to Justice Owen Roberts (Feb. 4, 1943) (on file with the Felix Frankfurter Collection, Harvard Law School Library, Part 3, Reel 3).

[325] Lash, supra note 29, at 53; Fassett, supra note 140, at 174 (describing Reed's public support).

[326] Cushman, Rethinking the New Deal Court, supra note 188, at 18.

[327] Ferren, supra note 91, at 133–35 (describing a prominent radio address given by Black).

[328] Fassett, supra note 140, at 303 (describing support of Byrnes); Leuchtenburg, supra note 144, at 135 (describing support of future Justices Byrnes, Black and Minton as senators).

[329] Seligman, supra note 1, at 155.

[330] Lash, supra note 29, at 63 ("It is doubtful . . . that Roosevelt would have appointed [Frankfurter] after Cardozo's unexpected death, had he not loyally kept his silence [in the court packing fight].").

[331] See supra Part II.

appointment of the other to the Court.[332] Jackson pushed for Frankfurter's nomination to the Court;[333] Jackson and Murphy pushed for Douglas;[334] Murphy, Black, and Douglas pushed for Rutledge,[335] although Frankfurter lobbied for Learned Hand;[336] Frankfurter had urged the appointment of Reed as Solicitor General.[337] And they did not stop advising the President when they were appointed to the Court. Frankfurter, Douglas, Murphy, and Jackson continued to advise the President,[338] and Douglas and Jackson were known to play poker in the President's game.[339]

Fourth, this was not just a politically astute, but a politically ambitious, court. The New Deal Supreme Court was like today's U.S. Senate: each member believed himself a viable national electoral candidate.[340] Douglas was active in plotting strategy to seek the vice presidency in 1944 and in 1948;[341] Black believed his prior Klan association knocked him out of the Vice Presidency in 1944;[342] Mur-

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[332] After his appointment, Douglas wrote in his diary:

> I saw Brandeis at his apartment and he told me something which gave me as great a thrill as the nomination itself. He said "You were my personal choice for my successor." He was most gracious and held my hand with great warmth as he said it. I was deeply touched. That, I felt, was the greatest compliment ever paid me. Whether he had communicated that thought to the President, I do not know. I suspect he had done so, indirectly through Felix who was most anxious that I receive the nomination.

William O. Douglas, Diary (Mar. 26, 1939) (on file with the William O. Douglas Collection, Library of Congress, Box 1780).

[333] Robert H. Jackson, Diary (Jan. 2, 1939) (on file with the Robert H. Jackson Collection, Library of Congress, Box 81); Ferren, supra note 91, at 137.

[334] Ferren, supra note 91, at 151 (describing Jackson's support); J. Woodford Howard, Jr., Mr. Justice Murphy: A Political Biography 192 (1968) (describing Murphy's support).

[335] Fine, supra note 226, at 194.

[336] Ferren, supra note 91, at 216–17.

[337] Irons, supra note 16, at 12. Frankfurter earlier had asked Reed to find spots for Cohen and Corcoran at the Reconstruction Finance Corporation. See Fassett, supra note 140, at 54.

[338] Lash, supra note 29, at 77.

[339] Murphy, supra note 127, at 185.

[340] New Deal appointees joined a court that already was more politically deep than most. Roberts was rumored as a Republican presidential candidate in 1936 and Hughes had resigned from the Court to run for President back in 1916. Leuchtenburg, supra note 144, at 43.

[341] Murphy, supra note 127, at 217–30 (discussing 1944); id. at 251–65 (discussing 1948).

[342] Leuchtenburg, supra note 144, at 207–08.

phy, the former Governor of Michigan, retained presidential ambitions after moving to Washington.[343] Contradicting the Roosevelt administration on a key aspect of the New Deal agenda would not have played well with the party faithful. Only Frankfurter was immune to the siren song of political ambition; his Austrian birth meant he could never attain the top rung of political life.

This combination of executive branch experience, trial by fire during the Court-packing battle, political advising, and political ambition produced Justices who were of one mind with the President on the central question of government control over the economy. Roosevelt's appointments ensured that the Supreme Court would not be an obstacle to government control over finance.

B. The Ephemeral Leaders as to Securities Law

The New Deal Court established a pattern of deference to the SEC in securities cases despite the absence of a strong leader on the Court. The two most obvious candidates for that role were Douglas and Frankfurter, professors from Yale and Harvard respectively. Both had already developed fairly complete views of administrative and commercial law prior to their judicial appointments. Frankfurter was a leading theorist of the administrative state and Douglas was a rising star in bankruptcy and securities law. Their pre-Court correspondence reflects mutual admiration, suggesting they might have formed a powerful coalition in securities law. The reality was far different, however, with neither Justice playing an important role.

1. Douglas

Douglas's is the murkier of the two cases. His academic interests were much more focused than Frankfurter's and he had active administrative experience with the SEC. The latter provides the most ready explanation for his lack of influence: his consistent recusals in securities cases. Having been chair of the SEC when the agency launched its enforcement of PUHCA, he did not sit on a PUHCA case for his first dozen years on the court, as the breakup of the utility holding companies dragged on and on. By the time he par-

[343] Fine, supra note 226, at 133.

ticipated, the great battles of that front had been fought and won. Douglas did not write a PUHCA opinion until 1954, the tail end of the Court's PUHCA jurisprudence. He also recused himself from all securities cases for his first six years on the Court. In the first securities case decided during his tenure, *U.S. Realty*, Douglas recused himself despite having no basis for disqualification, simply because of pressure from Chief Justice Hughes, who was wielding recusal as a strategic weapon. For other cases, the contact that could have created conflicts was very tangential. The notes in his files indicate that his secretary, Edith Waters, collected the information on the ties of the case to the time that Douglas was at the Commission. In one case, the investigation had not started until three years after Douglas left the Commission, but the mere mention of a possible earlier investigation at the staff level was sufficient to trigger recusal even though it had never reached the commissioners.[344] In the *Joiner* case heard in 1943, the case had only been opened quite recently, but mention of an earlier informal staff investigation that was closed in February 1936 (Douglas had become a commissioner on January 23) was enough to provoke recusal.[345]

Douglas left little guidance on his recusal policy, other than to say it was up to each Justice.[346] Perhaps Douglas's political ambition made him acutely sensitive to any potential charge of conflict of interest. Rutledge worried that Douglas's recusals were depriving the court of expertise.[347] Yet, his nonparticipation in securities cases does not appear to have affected their outcomes; the available evidence suggests that Douglas would have joined in the broad deference given to the SEC. Even after he ceased recusing himself, Douglas was not an active participant in securities cases, not writ-

[344] Memorandum from Edith Walters (e.w.) for the *A.C. Frost & Co. v. Coeur d'Alene's Mines Corp.* conference (Dec. 21, 1940) (on file with the William O. Douglas Papers, Library of Congress) (noting no official action by the SEC until April 1940, which was after Douglas had left the agency). The memo notes that the regional office looked into some shareholder complaints between May and August 1937 and that the agency's general counsel decided it was not a matter for action by the Commission and was never taken to a Commission meeting.

[345] Memorandum from Edith Walters (e.w.) for the *SEC v. C.M. Joiner & Co.* conference (Oct. 15, 1943) (on file with the William O. Douglas Papers, Library of Congress) (reporting information gathered from Orval duBois).

[346] William O. Douglas, The Court Years: 1939–1975, at 31 (1980).

[347] Ferren, supra note 91, at 282.

ing an opinion until *Penfield* in 1947. Indeed, most of his securities opinions show up in the last four years of his tenure, most notably his short but wide-ranging opinion for the Court in *Bankers Life,* the apogee of the reach of Rule 10b-5 as a regulator of securities transactions.[348] *Bankers Life* is remarkable for its opacity; even less significant are a string of dissents Douglas wrote in the 1970s after the Court's majority had taken a more restrictive turn in securities law. The bottom line is that Douglas had little impact on the Court's securities jurisprudence for his entire career.

His abandonment of securities is all the more peculiar in light of his very active role in other areas of private law, where he played the leadership role that one would have been expected given his background and talent. In bankruptcy, for example, he was a leader on the Court from his first term. He was instrumental in getting *Los Angeles Lumber*[349] heard by the Court:

> The CJ has a "special list" for certioraris. Those which he thinks are not even worthy of discussion in conference are placed by him on the "special list." He circulates the "special list" a day or so before conference. Case v. Los Angeles Lumber Products Co. was on his "special list." I wrote him that I wanted it discussed. So he discussed it and firmly recommended that the petition be denied. Before conference I had planted some seeds of doubt in the minds of the Brethern [sic]. As a result we got 4 votes necessary for a grant. The C.J. seemed quite upset. I later learned that this was the first time in the C.J.'s regime when a case had been removed from his "special list."[350]

Not only did Douglas succeed in getting the case heard over Hughes' opposition, he prevailed in conference as well.[351] Douglas congratulated himself in his diary when the decision came down: "The ipinion [sic] should have a healthy effect and curb the reor-

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[348] Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6 (1971).

[349] Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 113–14 (1939) (interpreting "fair and equitable" in the bankruptcy act).

[350] William O. Douglas, Diary (Oct. 18, 1939) (on file with the William O. Douglas Collection, Library of Congress, Box 1780).

[351] William O. Douglas, Diary (Oct. 21, 1939) (on file with the William O. Douglas Collection, Library of Congress, Box 1780) ("The CJ was bent on affirming the judgment below in Case v. Los Angeles Lumber Products Co. He had McR and Reed with him. Stone assigned the opinion to me.").

ganization racketeers—the holding companies and the investment bankers who want to keep their preserves inviolate and under their control."[352] Douglas again pushed bankruptcy onto the Court's agenda later that term in *Pepper v. Litton*,[353] getting that case removed from the Chief Justice's "special list."[354]

Douglas's lack of influence in securities cases may also reflect more general personality characteristics and his inability to get along well with colleagues. Cavalier work habits, colleagues' resentment of his political ambitions, and even the fallout from his divorce seemed to isolate him from his colleagues, despite early shared experiences.[355] Alternatively, the pattern of nonparticipation suggests that Douglas was finished with securities law.[356] His autobiography does not mention even a single securities case for his entire time on the court.[357] Perhaps the field had done all it could for him in terms of getting him to the SEC, and from there to the Court. Perhaps the large issues of the role of the government in the economy had been resolved and he now wanted to make his mark on the public stage in areas like civil liberties. Douglas's remaining ambitions in corporate law—federal incorporation and socialized investment banking—could be achieved only through legislative, not judicial, action.

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[352] William O. Douglas, Diary (Nov. 4, 1939) (on file with the William O. Douglas Collection, Library of Congress, Box 1780).

[353] 308 U.S. 295 (1939).

[354] William O. Douglas, Diary (Nov. 9, 1939) (on file with the William O. Douglas Collection, Library of Congress, Box 1780) ("This case had been on the C.J.'s 'special list.' I was responsible for taking it off. He was against it since it involved only a factual question, not an 'important principle.' I thought otherwise and carried the Court.").

[355] See, e.g., James F. Simon, Independent Journey: The Life of William O. Douglas 201–02 (1980) (describing a small group that gathered to celebrate Frankfurter's appointment to the court that included Douglas, Jackson, Murphy, and Harry Hopkins in Harold Ickes' office at the Department of the Interior).

[356] See Murphy, supra note 127, at 351. Walter Dellinger, then a clerk to Black (and later Acting Solicitor General in the Clinton administration), asked Douglas in 1968 if he would go on the Court if he had to do it over again. Douglas replied, "Absolutely not!" He explained that "the Court as an institution is too peripheral, too much in the backwater on the Court. You're just too far out of the action here." Id.

[357] See Douglas, supra note 346, at 417–21 ("Index of Supreme Court Cases in This Volume.").

2. Frankfurter

If Douglas was not going to assume a leadership role in the field of securities laws, why did Frankfurter not take the lead? Frankfurter was not inclined to defer to the expertise of the SEC, given his role in the enactment of the agency's key statutes. Frankfurter certainly expected to be a leader on the New Deal Court and outside observers expected it as well.[358] Moreover, Frankfurter "yearn[ed] for disciples,"[359] and he was unceasing in his efforts to bring his colleagues into line with his own well-developed views of the law.[360] This may, however, be the key to Frankfurter's lack of influence: his efforts to persuade tended to alienate.[361]

Frankfurter had two weaknesses in this regard. The first was his tendency to view those who disagreed with him as wanting either in intelligence or morals. Frankfurter and Reed were close allies from Reed's time as Solicitor General,[362] but that relationship frayed when they became colleagues on the Court. Reed told his clerks: "the trouble with Felix is that he never considers that he might be

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[358] Hirsch, supra note 17, at 141 ("It was inevitable that Frankfurter in 1939 would think of himself as the intellectual leader of the Roosevelt Court. Members of the White House circle expected him to dominate; that was why he had been appointed. He expected himself to dominate."); Lash, supra note 29, at 64 ("'If you appoint Felix,' Ickes said to Roosevelt, 'his ability and learning are such that he will dominate the Supreme Court for fifteen or twenty years to come. The result will be that probably after you are dead, it will still be your Supreme Court.").

[359] Lash, supra note 29, at 75 ("Frankfurter had come on the Court expecting that in time he would become its intellectual leader and that the authority he exercised in his seminar at Harvard would be replicated in the conferences of the Brethren. He had a yearning for disciples.").

[360] Hirsch, supra note 17, at 209 ("Although he, perhaps more than anyone, lobbied other members of the Court for votes, he never admitted doing so, but rather perceived his own actions as helpfully 'advising' his brethren; his judicial opponents, however, were, in his view, cynical and evil spreaders of their own influence.").

[361] See Eugene Gressman, Psycho-Enigmatizing Felix Frankfurter, 80 Mich. L. Rev. 731, 739 (1982) (reviewing Hirsch, supra note 17) ("Neither I nor Murphy could discover what Frankfurter hoped to accomplish with this endless chain of condescending admonishments. . . . If the notes were really designed to reform or change Murphy's ideological commitments, they were futile. If they were designed to change a Murphy vote or position in a given case, they utterly failed. But if they were written to annoy, insult, or display Frankfurter's 'personalia' techniques, perhaps they hit their mark.").

[362] See Schlesinger, supra note 99, at 228–29 ("Stanley Reed became the particular protector of the Harvard Law School crowd. RFC and, after Reed became Solicitor General in 1935, Justice served as the intelligence switchboard and the operational base for the web of Frankfurter-Corcoran relationships through the new agencies.").

wrong: if you don't agree with Felix, you must be either stupid or dishonest!"[363] Moreover, Frankfurter's self-righteous streak could lead him to be abusive toward his colleagues. According to Douglas,

> Frankfurter also indulged in histrionics in Conference. He often came in with piles of books, and on his turn to talk, would pound the table, read from the books, throw them around and create a great disturbance. His purpose was never aimless. His act was designed to get a particular Justice's vote or at least create doubts in the mind of a Justice who was thinking the other way. At times, when another was talking, he would break in, make a derisive comment and shout down the speaker.[364]

Douglas was hardly an impartial observer, given the deep-seated antipathy that developed between the two, but his views were shared by other colleagues as well.[365]

Frankfurter was also hampered in his efforts to persuade by his low opinion of a number of his colleagues, which he had difficulty hiding. Chief Justice Vinson is one example. Edward Prichard, a Vinson protégé who served as Frankfurter's law clerk, said that Frankfurter "did not have high regard for Vinson's judicial capabilities and . . . was not very adept at concealing his views on things of that sort."[366] Vinson, ordinarily an easy-going personality,[367] once had to be blocked from striking Frankfurter in conference.[368] Frankfurter's contempt for what he perceived as Black and Douglas's political maneuvering is well known. Other Justices also felt

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[363] *Quoted in* Fassett, supra note 140, at 584. See also Hirsch, supra note 17, at 190 ("Frankfurter measured every colleague by his alignment with what he regarded as the ultimate split within the Court—between his 'disinterested' and scholarly belief in judicial self-restraint, and the 'shoddy,' 'result-oriented,' 'demogogic' jurisprudence of his opponents.").

[364] Douglas, supra note 346, at 22.

[365] Howard, Jr., supra note 334, at 269 ("Justice Murphy in turn came to regard Justice Frankfurter's professorial habits as tiresome and tangential. The former law professor's campaigns for 'self-restraint' and 'law as the embodiment of reason,' he found hard not to dismiss as masks for the same use of personal convictions that Frankfurter so readily condemned in others.").

[366] St. Clair & Gugin, supra note 273, at 174.

[367] Id. ("Although Vinson was an affable man by nature, 'he could take offense if he were affronted and Frankfurter was a good affronter.'").

[368] Murphy, supra note 127, at 301.

the sting of Frankfurter's contempt.[369] Within a few years of his appointment to the Court, Frankfurter's heavy-handed manner had left him with close connections to only Jackson and Roberts.

The result of Frankfurter's alienation of his colleagues was that his message did not find a very receptive audience. He presented his colleagues with a stark choice—defer to the SEC or defer to him. For Frankfurter's New Deal colleagues, it was easier to love the SEC. As a result, Frankfurter's core message—the importance of adherence to the rule of law by the administrative state—did not draw any consistent followers. Frankfurter ended up dissenting ten times in securities cases during this period, more than any other Justice. Perhaps even more telling, however, is the fact that his small dissenting bloc was continually shifting, suggesting that Frankfurter was not delivering a consistent message.

3. Into the Void

In the absence of Douglas or Frankfurter, there was a wide dispersal of influences over the Court's securities docket. In PUHCA cases, with Douglas, Reed, Jackson, and sometimes Stone recused, the decision-writing fell to Murphy, or more accurately, to his clerk. Murphy did not have any particular interest in the area; he wrote a substantial number of opinions in the area simply because that was what he was assigned.[370] Murphy's prior exposure to public utilities was quite limited.[371] Murphy's lack of experience was in

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[369] Ferren, supra note 91, at 277 (describing how Frankfurter harangued Reed to his face and made fun of him behind his back, calling him a "vegetable"); Howard, Jr., supra note 334, at 268 ("Justice Murphy enjoyed Frankfurter's wit and acknowledged his superior intellect. Yet he felt defensive beside them. . . . Frankfurter was an excitable and scrappy intellectual who had ill-concealed contempt for the Irishman's intellect and night life . . . ."); Fine, supra note 226, at 195 (Frankfurter had similarly low regard for Burton); Hirsch, supra note 17, at 182 (noting that Frankfurter wrote to Hand that "'Hugo is a self-righteous, self-deluded part fanatic, part demagogue, who really disbelieves in law, thinks it is essentially manipulation of language. Intrinsically, the best brain in the lot, but undisciplined and 'functional' in its employment, an instrument for supporting a predetermined result, not a means for responsible inquiry").

[370] Telephone Interview with Eugene Gressman, supra note 274.

[371] Murphy's pre-Court experience with public utilities was limited and unlikely to make him sympathetic to the industry. He had a run in with the utility companies while governor of Michigan. The private utility companies were engaged in "spite line construction," the practice of building power lines in areas that had been approved for rural electric cooperatives in an effort to maintain their monopolies. Sidney Fine,

sharp contrast to the rest of the Court, which included a professor who had brokered the key legislative compromise for the Act (Frankfurter) and a Senator who had chaired key legislative hearings (Black). Also on the Court, although recusing themselves in many of the PUHCA cases, were the SEC Chairman at the time the enforcement program was begun (Douglas), the Solicitor General who argued the first case (Reed), and the Assistant Attorney General who argued the second case before the Supreme Court (Jackson).[372] The fact that Murphy wrote most frequently for the Court in this area might suggest that the Justices viewed the area as unimportant; Murphy's abilities were not well respected by his colleagues.[373]

The dearth of interest in securities law also may have reflected a dearth of legislative and regulatory initiatives. Congress passed no significant securities legislation between 1940 and 1964. The SEC went from being an activist force under Douglas to being a backwater after its wartime move to Philadelphia. (It was not returned from exile until 1948.) Private class actions, the development that fueled the Court's reactionary backlash of the 1970s in securities law, did not become a force until Federal Rule of Civil Procedure 23 was amended in 1966. Simply put, there was not much going on in securities law after the constitutionality of PUHCA was affirmed in *North American*. Douglas had made his national name as SEC

Frank Murphy: The New Deal Years 445 (1979). In response, Murphy's administration prohibited the construction of new lines by the companies without prior approval. Id.

[372] Even the Justices who had not played a role in the enactment and defense of PUHCA had some experience with corporations and utilities in their background. Rutledge was a professor of corporate law at Washington University and Iowa. See supra note 91 and accompanying text. Harold Burton, Truman's first appointee to the Court, also had extensive experience in corporate and public utilities law. He worked for a corporate law firm in Cleveland and served as general counsel of the Utah Power and Light Company and the Idaho Power Company. Mary Frances Berry, Stability, Security, and Continuity: Mr. Justice Burton and Decision-Making in the Supreme Court 1945–1958, at 4 (1978). He also "taught a corporation law course at the Western Reserve University Law School from 1923 through 1925." Id. at 5. When he returned to private practice in 1932, he "specialized in municipal law, sometimes representing communities on utility and bond issues, and was associate counsel for the city of Cleveland in its gas rate litigation." Id. at 6.

[373] Howard, Jr., supra note 334, at 411 ("Nearly all of [Murphy's] colleagues, at one time or another, had to remind him that the Court's job was not to pronounce on the reasons for policy, but merely to review power to make it.").

Chairman a decade earlier, and Frankfurter had cemented his future nomination to the Court by acting as Roosevelt's advisor in enacting the securities laws, but it was not an area to establish a reputation as a Justice.

CONCLUSION

A lynchpin of Franklin Roosevelt's political revolution was governmental control over finance, reflecting a nascent trust in administrative experts to make the crucial decisions organizing economic behavior. Securities regulation was at the heart of this change in the role of government in the 1930s. Success for this administration required not just enactment of new laws by Congress, but also an effective strategy to get these new laws past the Supreme Court. Ultimately for FDR this meant appointing Justices who believed in the new role of government in the economy. The eight men Roosevelt appointed to the Court did not disappoint. Other Presidents have sought to make over the Supreme Court for particular political goals with variable success; Roosevelt unambiguously succeeded in achieving his goal, at least in the field of securities laws.

A likely explanation for this success was that all eight of the New Deal Justices had front line experience in the earlier stages of the enactment and defense of the New Deal securities laws. Indeed, securities law formed something of a common link for the future Roosevelt appointees. Such a bonding experience may better predict judicial outlook than opinions written as an appellate court judge, more recently relied upon to handicap judicial appointments. The course for securities law set by these eight Justices continued almost unbroken for forty years.

The two Justices with the most direct securities experience, however, turned out to have played rather minor roles in the Court's securities law jurisprudence. Felix Frankfurter oversaw the drafting of the 1933 Act, brokered the key compromise for PUHCA and advised the new administration on litigation strategy, but he squandered any leadership role with an attitude toward colleagues that made it difficult for anyone to follow. But as a dissenter, Frankfurter did frame the point at which the New Deal alliance frayed, arguing for judicial control of the SEC. That debate would

reappear with the efforts of Lewis Powell to rein in the SEC's fight against insider trading,[374] and it continues to this day. William O. Douglas drove the SEC expansion into bankruptcy reorganizations, brought the New York Stock Exchange to heel, and oversaw the agency's aggressive role in public utility holding company legislation. Notwithstanding these achievements in the field, Douglas seemingly lost all interest in securities law upon his appointment to the Court.

The abdication of these leading figures, did not affect the ultimate outcomes, however, as Roosevelt's other appointees did not require forceful leadership; they were already bonded to the cause from their political (Black and Byrnes) and advocacy (Reed, Jackson, and Murphy) roles. As a Court, they were committed to governmental control over finance. The result was generous deference to the SEC, a judicial attitude that would last until the 1970s.

[374] Pritchard, supra note 238, at 15.