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February 24, 1936.

TO: Board of Governors

FROM: Mr. Dreibelbis, Assistant General Counsel

SUBJECT: Election of representatives of Federal Reserve banks to Federal Open Market Committee with limited authority.

My opinion has been requested as to whether representatives of the Federal Reserve banks upon the Federal Open Market Committee, as provided for in section 12A of the Federal Reserve Act, as amended, may be elected with limited authority and subject to the condition that they will, as members of the Committee, act in accordance with the instructions of the boards of directors electing them.

OPINION

In my opinion representatives of the Federal Reserve banks upon the Federal Open Market Committee may not be elected with limited authority to act only in accordance with the instructions of the boards of directors electing such members.

DISCUSSION

The primary purpose of Congress in creating the Federal Open Market Committee was to fix responsibility for open market operations in one body with a national viewpoint. As a compromise between the views of those who believed such responsibility should be fixed exclusively in the Board of Governors of the Federal Reserve System and those who believed that it should be fixed in a committee consisting exclusively of the then Governors of the Federal Reserve banks, section 12A, as amended by the Banking Act of 1935, provided for a committee composed of the members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks. None the less, however, was the Committee created as a body charged with the entire responsibility for the conduct of open-market operations in accordance with the governing principles of the Act.

It is significant that section 12A provides that the Committee "shall consist of the members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks", and provides that such representatives shall be elected "one by the boards of directors of the Federal Reserve Banks of Boston and New York", etc. The representatives of the banks are elected by the several boards of directors of the Federal Reserve banks as grouped in section 12A, as amended; but, when elected, they are representatives of all of the Federal Reserve banks and not

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representatives of the particular banks whose directors elected them. Had Congress intended that each representative should be elected as a representative of the group of banks electing such member, it would have so stated rather than to have provided that such members should constitute "representatives of the Federal Reserve banks". It follows, therefore, that the duties and obligations of the Federal Reserve bank representatives upon the Federal Open Market Committee are to the country at large and not to any one or group of Federal Reserve banks.

Among other things, section 12A of the Federal Reserve Act, as amended, provides that "No Federal Reserve bank shall engage or decline to engage in open-market transactions under section 14 of this Act, except in accordance with the direction of and regulations adopted by the Committee. The Committee shall consider, adopt, and transmit to the several Federal Reserve banks, regulations relating to the open-market transactions of such banks." Thus, rather than receiving directions from the Federal Reserve banks or the boards of directors of the Federal Reserve banks, members of the Federal Open Market Committee are charged by law with giving directions to the Federal Reserve banks, and the Federal Reserve banks are charged by law with the duty of following such directions. Certainly it cannot be said, therefore, that representatives of the banks on the Federal Open Market Committee are subject to instructions given by the banks electing them when, by the plain terms of the Act, they are charged with the duty of directing the banks in the performance of this particular function.

Thus, members of the Federal Open Market Committee are public officers charged with the duty of conducting open-market operations of the Federal Reserve System "with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country". Of necessity their deliberations and actions must be confidential. To disseminate information as to open-market policies while being formulated or while in the process of being executed might defeat the results sought in the execution of such policies. Congress must have so considered when it provided in section 10 of the Federal Reserve Act that the Board of Governors of the Federal Reserve System should keep a complete record of the action taken by the Federal Open Market Committee upon all questions of policy relating to open-market operations and should record therein the votes taken in connection with the determination of such policies and the reasons underlying the action of the Committee and should include in its annual report to Congress a full account of the action so taken during the preceding year. Had Congress intended that the consideration and execution of open-market policies be matters of public and current information there would have been no necessity for requiring such report to it.

The very fact that Congress provided for the report to be made to it rather than to the Federal Reserve banks or their boards of directors, is significant. Section 12A of the Federal Reserve Act, as amended, requires open-market operations to be conducted "with regard to their bearing upon the general credit situation of the country". Congress, and not the boards of directors of the several Federal Reserve banks, is the body which represents the public interest and Congress, while recognizing the confidential character of open-market operations, has provided for reports to be made to it as the body representing the general welfare of the country. Had Congress intended that the Federal Open Market Committee or any of its members should owe a duty or responsibility to report to the boards of directors of the Federal Reserve banks such duties would have been included in section 10 of the Federal Reserve Act.

With respect to public officers it has long been held that any contract or agreement tending to hamper or restrict such officer in the due performance of his duty or which seeks to impose upon such officer a restriction in connection with the exercise of his discretion is illegal and against public policy.

In the case of Schneider v. Local Union, 40 So. 700, the court, quoting from Greenhood on Public Policy, stated:

> "Any contract which contemplates conduct which will amount to an imposition upon a public officer in the exercise of his discretion is void. * * * * Any contract by one acting in a representative capacity, which restricts the free exercise of a discretion vested in him for the public good, is void."

In the case of Campbell v. Offutt, 151 S. W. 403, the court stated:

> "* * * * The law requires of a public officer that he shall use his best skill and judgment for the protection of the public interest, and an agreement before his appointment to divide the fees of the office with an attorney, if sustained, might seriously cripple the public service: * * * *."

Clearly, any effort to restrict a member of the Federal Open Market Committee in the free exercise of his discretion in the public interest and for the public welfare, by contract or otherwise, would be illegal and against public policy.

In the law of corporations, it is well settled that the discretion of directors in performing their duties cannot be limited or

restricted by agreements aginst the interest of the corporation with the stockholders or otherwise.

Thus, in Manson v. Curtis, 223 N. Y. 313, 119 N. E. 559, it is stated:

> "* * * * In corporate bodies, the powers of the board of directors are, in a very important sense, original and undelegated. The stockholders do not confer, nor can they revoke those powers. * * * * As a general rule, the stockholders cannot act in relation to the ordinary business of the corporation, nor can they control the directors in the exercise of the judgment vested in them by virtue of their office. * * * * Clearly the law does not permit the stockholders to create a sterilized board of directors. * * * *"

In the case of West v. Camden, 135 U. S. 507, the Supreme Court of the United States held that an agreement by a stockholder of a corporation to keep another person permanently in place as an officer of a corporation was void as against public policy, since such an agreement might require a stockholder as a director to act contrary to the true interest of a corporation.

In Haldeman v. Haldeman, 197 S. W. 376, the court said:

> "* * * * And he (a stockholder) has the further right to demand that each director discharge his duty as such, not in accordance with his personal contract, but in the best interests of the corporation they represent. * * * *"

Other cases to the same effect are Lamb v. Lehmann, 143 N. E. 276, Ohio (1924); Rush v. Aunspaugh, 179 Ala. 542, 60 So. 802 (1912); Scripps v. Sweeney, 160 Mich. 148, 125 N. W. 72 (1910).

It is inconceivable that Congress, in creating the Federal Open Market Committee, for the avowed purpose of conducting open-market operations "with regard to their bearing upon the general credit situation of the country", intended to create a body, five members of which might be made obedient to the will of a body or bodies concerned primarily with local interests.

It is my conclusion, therefore, that representatives of the Federal Reserve banks upon the Federal Open Market Committee may not be elected with limited authority to act in accordance with instructions of the boards of directors electing such members and that in the

conduct of their office such members are public officers exercising public functions in the interest of the public as a whole, and not necessarily in the interest of the particular group electing them.

Respectfully submitted,

(Signed) J. P. Dreibelbis

J. P. Dreibelbis,
Assistant General Counsel.

I have given careful consideration to the above opinion and concur in it completely.

(Signed) Walter Wyatt

Walter Wyatt,
General Counsel.