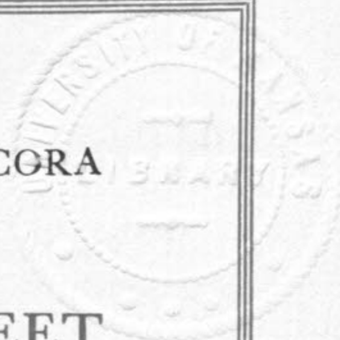
WALL STREET UNDER OATH



FERDINAND PECORA

WALL STREET UNDER OATH

THE STORY OF OUR MODERN MONEY CHANGERS

SIMON AND SCHUSTER • NEW YORK

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This book is reverently dedicated by the author to the late Senators Duncan U. Fletcher, Peter Norbeck, James Couzens, and Edward P. Costigan, whose steadfast support, as members of the U. S. Senate Committee on Banking and Currency in 1933-1934, greatly contributed to putting

WALL STREET UNDER OATH

economics

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AUTHOR'S PREFACE

UNDER the surface of the governmental regulation of the securities market, the same forces that produced the riotous speculative excesses of the "wild bull market" of 1929 still give evidences of their existence and influence. Though repressed for the present, it cannot be doubted that, given a suitable opportunity, they would spring back into pernicious activity.

Frequently we are told that this regulation has been throttling the country's prosperity. Bitterly hostile was Wall Street to the enactment of the regulatory legislation. It now looks forward to the day when it shall, as it hopes, reassume the reins of its former power.

That its leaders are eminently fitted to guide our nation, and that they would make a much better job

of it than any other body of men, Wall Street does not for a moment doubt. Indeed, if you now hearken to the oracles of The Street, you will hear now and then that the money-changers have been much maligned. You will be told that a whole group of high-minded men, innocent of social or economic wrongdoing, were expelled from the temple because of the excesses of a few. You will be assured that they had nothing to do with the misfortunes that overtook the country in 1929-1933; that they were simply scapegoats, sacrificed on the altar of unreasoning public opinion to satisfy the wrath of a howling mob blindly seeking victims.

These disingenuous protestations are, in the crisp legal phrase, "without merit." The case against the money-changers does not rest upon hearsay or surmise. It is based upon a mass of evidence, given publicly and under oath before the Banking and Currency Committee of the United States Senate in 1933-1934, by The Street's mightiest and best-informed men. Their testimony is recorded in twelve thousand printed pages. It covers all the ramifications and phases of Wall Street's manifold operations.

The public, however, is sometimes forgetful. As its memory of the unhappy market collapse of 1929 becomes blurred, it may lend at least one ear to the persuasive voices of The Street subtly pleading for a return to the "good old times." Forgotten, perhaps, by some are the shattering revelations of the Senate Committee's investigation; forgotten the practices and

ethics that The Street followed and defended when its own sway was undisputed in those good old days.

After five short years, we may now need to be reminded what Wall Street was like before Uncle Sam stationed a policeman at its corner, lest, in time to come, some attempt be made to abolish that post.

It is in the hope of rendering this service, especially for the lay reader unfamiliar with the terminology and conduct of The Street, that the author has endeavored, in the following pages, to summarize the essential story of that investigation—an inquiry which cast a vivid light upon the uninhabited mores and methods of Wall Street.

FERDINAND PECORA

New York City
February, 1939

WALL STREET UNDER OATH

I

NATIONAL ASSET OR NATIONAL DANGER

For seventeen months, from January, 1933, to July, 1934, the writer of these lines was privileged to serve as counsel for the United States Senate Committee on Banking and Currency in its investigation of stock-exchange, banking, and security markets practices. The experience was an incomparably rich and enlightening one. The Senate Committee did not concern itself with exceptional examples of personal wrongdoing or with the petty malpractice of minor individuals. On the contrary, it examined the status and conduct of precisely the most important and typical figures of the financial community.

Before it came, in imposing succession, the demigods of Wall Street, men whose names were household words, but whose personalities and affairs were frequently shrouded in deep, aristocratic mystery:

J. P. Morgan, Thomas W. Lamont and other partners of J. P. Morgan and Company; Otto H. Kahn and his partners of Kuhn, Loeb and Company; Charles E. Mitchell and his colleagues of the National City Bank; Albert H. Wiggin and his co-officers of the Chase National Bank; Clarence Dillon and his associates of Dillon, Read and Company; George Whitney, Morgan partner, and his brother, Richard E. Whitney, President of the New York Stock Exchange; O. P. Van Sweringen, former vice-president Charles G. Dawes; Owen D. Young; Edsel B. Ford; Samuel Insull, Jr.; Winthrop W. Aldrich, John J. Raskob, and still others. Never before in the history of the United States had so much wealth and power been required to render a public accounting.

Most of these witnesses were bankers of one sort or another. But there are bankers and bankers. There are private bankers and public bankers, commercial bankers and investment bankers, and there are institutions which combine these functions in various ways. Putting first things first, let us look at the mighty house of J. P. Morgan and Company.

Mr. Morgan took the stand on May 23, 1933. Public interest in his appearance was almost hysterically intense. Not for a generation, not since the elder Morgan had been examined in the Pujo Committee investigation of 1912, had the public been permitted a clear view of the man whom everybody acknowledged as a world figure. His extreme aversion to

photographers and interviewers alike was well known and unconquerable. His very features, no less than his opinions and personality, were almost unknown to the millions of his fellow citizens over whose welfare his firm and its allies exerted so extraordinary an influence.

Mr. Morgan as a witness proved to be courteous to a degree and co-operative in his attitude. He made no attempt to fence with his examiners. He was accompanied by his brilliant counsel, John W. Davis, sometime Democratic candidate for president and ex-ambassador to Great Britain. His was the attitude of a man who, far from having any guilty secrets to hide, manifested a pride in his firm and its works which was obvious and deeply genuine. And, in truth, the investigation of the Morgan firm elicited no such disclosures of glaring abuses as we shall meet with later on in connection with various other great banking institutions and personalities. Mr. Morgan was undoubtedly wholly candid when he declared at the outset of his testimony:

"I state without hesitation that I consider the private banker a national asset and not a national danger. As to the theory that he may become too powerful, it must be remembered that any power which he has comes, not from the possession of large means, but from the confidence of the people in his character and credit, and that that power, having no force to back it, would disappear at once if people thought that the character had changed or the credit had diminished—not financial credit, but that

which comes from the respect and esteem of the community."

But Mr. Morgan was not the first wielder of power to believe profoundly in the invincible rectitude of his own regime, nor does the absence of manifest scandal and impropriety exclude more subtle dangers. The investigation of the Senate Committee suggests that the truth was far more complex than Mr. Morgan was willing to admit. The great private bankers, as we shall see, did perform necessary economic functions. But the manner of their performance and the terrific concentration of power in their hands from many sources were no less threatening on that account. The bankers were neither a national asset nor a national danger—they were both.

J. P. Morgan and Company was concededly the greatest of the private bankers. It consisted of twenty partners, but ultimate power was firmly lodged in Mr. Morgan himself, although he characterized his status as semi-retired. The articles of copartnership, which were now revealed for the first time—not without something of a struggle behind the scenes—provided that all differences or disputes between members of the firm should be submitted to the decision of Mr. John Pierpont Morgan, "which shall be final"; that "the partnership may be dissolved at any time" by him; and that "it is further agreed that Mr. Morgan may, at any time, compel any partner at once to withdraw and retire from the partnership." Mr. Morgan's

valuation of the interest of a partner leaving the firm was equally final. At the end of each year, half of the profits was credited to the individual accounts of the partners, but the other half remained as undivided firm profits until Mr. Morgan saw fit to permit its distribution. In short, Mr. Morgan was the undisputed and absolute, though benevolent, monarch of his realm.

Around Mr. Morgan was grouped a highly efficient company of financiers. It was not necessary for a Morgan partner to contribute any money to the firm's treasury upon joining; the Morgans did not need to raise money in this fashion. Far more, it was the brains, personality, and promise of outstanding ability of a younger man that were likely to win him this most coveted of Wall Street's honors. Many of the partners bore names almost as famous as that of the head of the firm. Dwight Morrow, former partner, ambassador to Mexico and father-in-law of Colonel Lindbergh, was dead; Thomas S. Gates was retired; but Thomas W. Lamont, E. T. Stotesbury, Charles Steele, George Whitney, Russell C. Leffingwell, Francis D. Bartow, and S. Parker Gilbert, ex-Agent General of the Reparations Commission under the Young plan, to name a few, remained.

The offices of the firm were, and are, at 23 Wall Street, at the corner of Broad, just opposite the New York Stock Exchange on one side and the United States Sub-Treasury Building on the other. No sign on the outer door proclaimed the nature of the es-

tablishment, and even the inner door bore merely a legend telling the name of the firm. Nothing indicated that this modest-looking building—known in Wall Street as The House on the Corner—was a bank, for the New York law forbids a private banker to advertise that he is such or to solicit deposits. This is the price he pays to escape the regulation by governmental authorities to which an ordinary bank must submit. J. P. Morgan and Company, however, did not seem to have suffered from this limitation.

Senator Bulkley: You do not designate yourself as being in any particular business at all, do you?

Mr. Morgan: No.

Senator Bulkley: As I recall it, at your place of business you do not have any sign of any kind?

Mr. Morgan: We have no sign that we are a bank. We have our name on the door, that is all.

Senator Bulkley: And nothing but the name?

Mr. Morgan: Nothing but the name.

Senator Bulkley: And on your letterheads that you ordinarily use?

Mr. Morgan: The same thing.

Senator Bulkley: No business stated thereon?

Mr. Morgan: No.

Senator Couzens: Are you listed among the banks? Is your name listed among the banks?

Mr. Morgan: We hope not. We have taken every precaution to prevent it.

Mr. Pecora: Mr. Morgan, is the name of the firm on any outer door of the firm's office?

Mr. Morgan: It is not on the outer door. It is on the inner door.

Mr. Pecora: Not visible from the street to any passerby?

Mr. Morgan: No. Most of them know the address.

Mr. Pecora: You do not think the firm suffers any lack of prestige in the banking world because it does not advertise itself to the bankers, do you?

Mr. Morgan: It does not seem to.

All the members of the firm who were in New York City gathered daily, except Saturdays and Sundays, for a partnership conference. No stenographer was present at these highly confidential meetings, and no record was kept of the discussions and decisions. This was an old custom.

Mr. Morgan: This plan of having meetings was started about twenty-two or twenty-three years ago. At the first meeting it was decided that no minutes should be kept.

Mr. Pecora: Prior to that time were any minutes kept?

Mr. Morgan: We did not have any meetings.

Senator Couzens: Was your father at the head of it at that time?

Mr. Morgan: My father was the head of it at that time. But he did not usually come down early enough to get to the meetings. He never attended one.

The Chairman: Are all of the partners present at every meeting?

Mr. Morgan: Every partner, unless he has something else that he must do.

The twenty partners of J. P. Morgan and Company were likewise partners in three other closely related banking houses. One of these was Drexel and Company, of Philadelphia; this was regarded by Mr. Morgan as practically one firm with J. P. Morgan and Company, but, technically, it was a separate partnership, as it had four additional partners who were not members of the New York headquarters.

All of the Morgan partners were likewise participants in the firms of Morgan, Grenfell and Company, of London, and Morgan and Cie, of Paris. Each of these European affiliates had distinguished resident members, such as Mr. E. C. Grenfell, Member of Parliament, and director of the Bank of England, and Mr. Vivian H. Smith, head of the great Royal Exchange Assurance Corporation; men high in the financial circles of London and Paris, members of numerous directorates, and well-equipped to take care of any interests Morgan and Company might maintain in European territory. It was understood that the London partners were in charge at their end, and themselves determined the policies of the London firm, at least "mostly"; but co-ordination was smooth and constant. As Mr. Morgan said: "We are in real close touch with them all the time. I have the advantage; you see, I lived over there for eight years and worked over there for eight years, and most

of these men I know very well and have worked with. So we do not have any misunderstandings."

Such was the framework of J. P. Morgan and Company and its affiliates, national and international. But what kind of business did it do? Everyone knows the name of Morgan, but few laymen have any accurate idea of the nature or extent of the firm's activities. When the man in the street thinks of a bank, he thinks of a place where he may deposit money—if he is fortunate enough to have any—and upon which he can draw checks, and where, if he has proper collateral, he may borrow money. J. P. Morgan and Company, however, was a very different kind of institution. Unless you were within the charmed circle, as Mr. Morgan was at pains to make clear, it was not easy to do business—any kind of business—with the house of Morgan. If you were merely anybody, you not only could not borrow money from them, no matter how good your collateral, you could not even induce them to take your money.

The Chairman (Senator Fletcher): . . . You are serving the public?

Mr. Morgan: Yes; but we are serving only our own clients who are our clients by their own choice.

The Chairman: But you do not turn a man down; you do not select your clients; you do not give them tickets and pass on them?

Mr. Morgan: Yes; we do.

The Chairman: You do?

Mr. Morgan: Yes, indeed; we do.

THE CHAIRMAN: I suppose if I went there, even though I had never seen any member of the firm, and had $10,000 I wanted to leave with the bank, you would take it in, wouldn't you?

MR. MORGAN: No; we should not do it.

THE CHAIRMAN: You would not?

MR. MORGAN: No.

THE CHAIRMAN: I am quite sure then you would not——

MR. MORGAN: Not unless you came in with some introduction, Senator.

SENATOR MCADOO: Unless he were Chairman of the Banking and Currency Committee.

MR. MORGAN: That has been the rule for many, many years.

THE CHAIRMAN: Then I am quite sure I could not borrow any $10,000.

MR. MORGAN: Not without an introduction.

Assuming you were sufficiently highly recommended, however, you might hope, with reasonable confidence, to be permitted to leave your money in J. P. Morgan and Company's care, and might even borrow. It seemed to help considerably if you were, for example, the president or chairman of the board of directors of a prominent bank, or occupied a similar exalted position. Not a few individuals holding positions of trust as officers or directors of well-known national and other banks were accommodated with loans in this fashion. The list included Charles E. Mitchell, of the National City Bank, to the amount

of $10,000,000; Seward Prosser, of the Bankers Trust Company; William C. Prosser, of the Guaranty Trust Company; Mortimer Buckner, Artemus L. Gates, of the New York Trust Company; Harvey D. Gibson, of the Manufacturers Trust Co.; Charles G. Dawes, of the Central Trust Company of Chicago; Myron C. Taylor, Norman H. Davis, and many others, sixty in all. In addition, there were about one hundred officers or directors of nonbanking corporations, similarly favored.

Mr. Morgan saw no impropriety or disadvantage in this, nor did he respond favorably to the suggestion that J. P. Morgan and Company might, by putting all these powerful and strategically situated men in their debt, place itself in a position to obtain in return special favors from the banks and corporations they represented. To his mind, it was a simple, straightforward, routine matter; "We do make these loans, and we make them because we believe the people should have the money; that we should loan money if these gentlemen want it. They are friends of ours, and we know that they are good, sound, straight fellows."

As a rule, however, the Morgan firm was not interested in transactions with individuals, even "good, sound, straight fellows." It discouraged small deposits, and mostly did business with great corporations. The great communications corporations, American Telephone and Telegraph Company and International Telephone and Telegraph Corporation; many great

corporations in the railroad field, such as Atchison, Topeka and Santa Fe Railway Company, Chesapeake and Ohio Railway Company, Chicago, Burlington and Quincy Railroad Company, Erie Railroad Company, Lehigh Valley Railroad Company, and Pullman Car and Manufacturing Corporation; important oil companies such as Continental Oil Company of Delaware, Humble Oil and Refining Company, Marland Oil Company, and Standard Oil Company of New Jersey; leading utility companies, including Commonwealth and Southern Corporation, Niagara Hudson Power Corporation, and United Gas Improvement Company; E. I. Du Pont de Nemours and Company, Incorporated, General Motors Corporation, Johns-Manville Corporation, U. S. Steel Corporation, Bethlehem Steel Company, and Kennecott Copper Corporation—all of these and dozens of other leading companies found it expedient to maintain deposits with J. P. Morgan, as well as with their other ordinary banks.

Nor were these deposits minor ones. All of the foregoing firms, for example, and about thirty others, maintained an average daily deposit of over $1,000,000, for at least one of the years 1927-1932. An even longer list maintained similar average daily deposits of over $100,000: power companies, tobacco companies, food companies, copper companies, publishing companies, railroads, amusements, paper, aviation—almost every department of industry was represented. All told, J. P. Morgan and Company had

deposits at the end of 1927 of over half a billion dollars, and even at the end of the depression year 1932, of $340,000,000.

This great reservoir of "other people's money" was wholly subject to the disposition of the partners of this one private banking establishment—in the last analysis, really, to the will of one man, Mr. Morgan —to manage as they pleased, uncontrolled in any manner by the slightest vestige of governmental regulation, examination, or supervision. The firm had been in the habit, in recent years, of voluntarily furnishing the Federal Reserve Bank of New York with a more or less informal statement of its affairs "in strict confidence"; but no bank examiner darkened its doors, and no balance sheet or statement of condition was issued to the general public or to the firm's depositors. True, Mr. Morgan asserted that anybody who wanted it could have obtained such a statement for the asking; but, somehow, nobody ever asked. J. P. Morgan and Company were very private bankers, indeed.

MR. PECORA: In the course of the testimony you gave yesterday you recall that you stated that a number of corporations engaged in interstate business maintained deposit accounts with your firm which at one time or other in the five years from 1927 to 1931, both inclusive, had balances of a million dollars or more?

MR. MORGAN: Yes.

MR. PECORA: These deposits are made in your bank

without the officers of those corporations who were responsible for the making of those deposits having any knowledge of the actual financial worth of your banking firm or of its constituent members?

Mr. Morgan: They are. They are. But . . . anybody would have the right to do it—could have a statement of ours if he wanted it, if he asked for it. We would not have the slightest objection to giving it to him.

Mr. Pecora: Have you ever given any such statement before?

Mr. Morgan: They have never asked for it.

Mr. Pecora: Has any announcement ever been made before this moment by any representative or partner of your banking firm to that effect?

Mr. Morgan: Well, if you will look back at the Pujo investigation when my father was on the stand he made the same statement.

Mr. Pecora: That investigation was the one held about twenty years ago?

Mr. Morgan: Yes.

Mr. Pecora: Is that the only publication of that policy, so far as you know?

Mr. Morgan: That is the only public statement we have ever made about anything.

According to Mr. Morgan, the larger part of the firm's activities consisted of a general commercial banking business of this nature: taking deposits, making loans, arranging letters of credit, etc. But J. P. Morgan and Company was far more than a commercial bank, however select and powerful. It was also

the traditional leader among the investment bankers of the nation.

It was this department of its business, no doubt, which Mr. Morgan particularly had in mind when he told the Committee that, in his opinion, the private banker was a national asset rather than a national danger. For without the constant investment of the nation's savings in new enterprises, or in the expansion of existing enterprises, our whole economic organization would be impossible; and it is the investment banker whose business it is to promote and manage this vital and immensely important function. We shall deal in a subsequent chapter with the details of this business.

In the language of the trade, the banker "sponsors," "underwrites," and "distributes" new security issues; that is, he undertakes, on behalf of the corporation that comes to him in search of new capital, to raise the necessary funds for it by the sale of the corporation's newly issued bonds or shares of stock to the investors of the nation. In prosperous times, this is a matter of billions of dollars annually.

If this smooth flow of investment is impeded for any reason, the paralyzing effects are soon felt throughout all branches of trade and industry—as this country has painfully learned since 1929. No economist or political party of any standing, whether New Dealer or Old Dealer, Democrat or Republican, capitalist or Socialist, disputes these propositions. But they draw very different conclusions. The bankers tend to think that

they are too important to be regulated. The New Dealers thought that they were too important *not* to be regulated.

There are tens of thousands of commercial banks in the United States, but only a handful of really important investment banking concerns. Mr. Morgan mentioned half a dozen of the leaders in New York:

> There is Kuhn, Loeb and Company and Dillon, Read and Company that I believe are coming along here. And Brown Brothers, Harriman and Company. Brown Brothers have been a firm for longer than we have. Lehman Brothers—I do not remember the whole long list. There are eight or nine private banking firms in New York.

Undoubtedly, this small group of highly placed financiers, controlling the very springs of economic activity, holds more real power than any similar group in the United States. And with the possible exception of a short period in the hectic interval just preceding the crash in 1929, J. P. Morgan and Company was, and still is, far and away the most important single factor in the field.

Between January 1, 1919 and the time of Mr. Morgan's testimony in May, 1933, J. P. Morgan and Company, generally in association with other bankers, had offered to the public over six billions of dollars of new securities. This was in itself a noteworthy record. The significance of such a firm as J. P. Morgan and Company, however, is not to be measured merely by an arithmetical count of the quantity of business it has officially transacted. A half century of financial pre-eminence, giving rise to innumerable ties and "contacts," resulted in a prestige and influence wholly out of proportion to the firm's immediate size, capital, or profits, or to the personal wealth of its members, considerable as these factors may be. How extraordinarily far-flung its sphere of influence had become, and by what methods it was maintained, we shall catch some glimpse of as we proceed.

2

"SHARING THE RISK"

SPEAKING broadly, J. P. Morgan and Company was a conservative rather than a speculative concern. Even its individual members were prohibited by the terms of the articles of partnership from "speculation in stocks or anything else" (although this was not to be construed as prohibiting a partner from "investing" his private means "in such way as he may see fit"). As a firm, they were not in the habit of engaging in flighty ventures or, indeed, of touching any business that was not already quite soundly established. In spite of the fact that the formation of the giant United States Steel Corporation in 1901, and other great mergers, were largely the work of the elder Morgan, the firm had never prior to 1929 frankly held itself out as responsible for the organization of a single new corporation. In that year, however, at the height

of the New Era frenzy, even the austere standards of J. P. Morgan and Company faltered: the firm now became openly for the first time not only commercial bankers and investment bankers, but corporate promoters.

The new company promoted by J. P. Morgan and Company in January, 1929, was that United Corporation whose stock was familiar to every speculator, big or little, in the "wild bull market" of 1929. The story of its organization illustrates with striking clarity how the bankers were able in a few months simultaneously to gain control of a vast industry, to reap tremendous profits, and to solidify and extend their already immense store of good will throughout the widest fields of business and politics.

The United Corporation was a special kind of a corporation—a "holding company." That is, it did nothing but hold—and vote—stock which it owned in certain other companies. It created nothing on its own account; it neither manufactured, nor sold, nor traded, nor rendered any other independent service to the community. Its sole business was the control of other corporations.

These other corporations—in the beginning Mohawk Hudson Power Corporation, Public Service Corporation of New Jersey, and United Gas Improvement Company—were in the business of supplying electric power, light, and gas. They were themselves, in part, holding companies, controlling by stock ownership still further corporations in this increasingly

important field. The United Gas Improvement Company, for example, had sixty subsidiaries; the Public Service Corporation of New Jersey had fifty-nine subsidiaries.

J. P. Morgan and Company had already contracted to buy for itself large blocks of Mohawk Hudson, United Gas Improvement, and Public Service stock before United Corporation was organized. These blocks it turned over to the new corporation, together with some $10,700,000 in cash. The firm of Bonbright and Company, with which J. P. Morgan and Company was associated in this venture, contributed another $10,000,000 cash. In return, the corporation issued to these two banking firms great quantities of its own securities. J. P. Morgan and Company, as its share, received altogether 600,000 shares of United Corporation preferred stock, 1,200,000 shares of its common stock, and 1,714,200 so-called perpetual "option warrants"—i.e., rights to purchase additional common stock at $27.50 per share, at any time in the future the holder desired.

The new corporation was completely dominated by its banker-organizers. It had practically no staff of its own. Mr. George Howard, its president, maintained his office at 15 Broad Street, around the corner from J. P. Morgan and Company. The corporation's books of accounts were written up and physically kept in the Morgan office. All of the directors, with the exception of Mr. Howard, were members of J. P. Morgan and Company, or Drexel and Company, or Bonbright and

Company. And if, by any contingency, the stock held by the bankers and their allies should prove insufficient to ensure their control, there was always the overhanging threat of more than a million additional shares J. P. Morgan and Company could acquire, by exercising their perpetual "option warrants," to swamp any possible opposition.

The United Corporation, by means of the stock J. P. Morgan and Company had turned over to it, plus additional stock it purchased with the cash received from the bankers and raised by the sale of more of its own securities, soon built up and exercised effective working control over a mighty network of electric power companies "from Niagara to the sea."

The United system extended over twelve states east of the Mississippi, including most of the great industrial states such as New York, Pennsylvania, Michigan, Ohio, Illinois, and New Jersey. It produced thirty-eight per cent of all the electricity used in those twelve states and twenty per cent of all the electricity used by the entire nation. It served thirty-four per cent of the population of those states and fifteen per cent of the entire population of the country. In a few months, and with the investment of a relatively small amount of capital, J. P. Morgan and Company had brought under its domination a public-utility empire the gross revenues of which amounted to hundreds of millions of dollars a year.

The whole enterprise, moreover, was, for a time at least, a very lucrative one. J. P. Morgan and Company

indignantly denied that the price of the stock in the new United Corporation was put up by manipulation. But there was, in truth, no need for such tactics: as soon as the news of the organization of this superholding, superpower corporation became publicly known —and the Morgans took good care that the newspapers should carry the good word "as a matter of news"— every room in the country with a ticker and a quotation board was thick with rumors of the wonderful things in store for the stock of this great new "Morgan company." The common stock, which J. P. Morgan and Company had acquired for $22.50 per share, in a few months rose to a high of $70. The "option warrants," to buy stock at $27.50, in particular, soared.

These option warrants, the reader should note, were of no conceivable benefit to the corporation; for if the market price of the United stock was less than $27.50, no one, of course, would exercise his option rights. But if the market price was greater than $27.50, there was no advantage to the corporation, but rather the opposite, in having its stock subscribed for at that price. There was no denying, however, that these warrants were amazingly profitable to the bankers who had possessed the foresight to arrange for their distribution. When issued, they had been acquired by the bankers for $1 per warrant; within a few months they rose in the market to $47. Some idea of the bankers' potential gains may be gathered from the calculation that, if J. P. Morgan and Company had been willing, and able, to sell all their holdings of United

stock and warrants at top prices in 1929, they would have realized a profit, within less than one year, of over $122,000,000.

It is true that they did not actually realize these profits. Like everyone else, they were caught unprepared by the crash in October, 1929. But even so, they did not fare badly, for in the summer of 1929, while prices were still up, they had sold several hundred thousand "option warrants" at a profit of over $8,000,000. The balance, of more than a million warrants, was distributed to the Morgan partners as individuals.

Even as late as May, 1933, these warrants had a quoted value of $2, and were still considered by Mr. George Whitney to be a "very valuable" privilege. No doubt the Morgan profits would have been much larger, had they sold more, and sooner; but if they held on, they did so voluntarily, and presumably in the hope of eventually realizing still greater profits than were currently available. As the bankers never wearied of reminding the Senate Committee, their actions before the crash in 1929 must be judged in the light of conditions as they then appeared.

* * *

United Corporation was not the only great holding company that J. P. Morgan and Company launched in 1929. Within a few weeks of its formation, another corporation of like nature, this time in the railroad field—the Alleghany Corporation—came into being, and while J. P. Morgan and Company did not appear

here officially as the organizers, their co-operation was all-important.

Seven or eight months later, in September, 1929, Standard Brands, Incorporated, was organized, merging a group of large food companies—Fleischmann Company, Royal Baking Powder Company, Chase and Sanborn Company, and E. W. Gillette Company, into a great new corporation. The process of concentrating wealth, of creating greater and greater corporations, of combining into new and gigantic units organizations already very large in their own right, was proceeding at a fast pace, and J. P. Morgan and Company was leading the procession.

The formation of each of these corporations—United, Alleghany, and Standard Brands—involved the disposal by J. P. Morgan and Company of a quantity of stock in the new corporation. This was something of a departure; as a rule, the Morgan firm did not traffic in common stock but limited itself to the more conservative field of bonds. But this was 1929, when even conservative bankers were dazzled by the apparent stability and endless buoyancy of "equities." J. P. Morgan and Company compromised: they handled the distribution of stock in the new companies, but in a manner different from that which was customarily used by them for bonds.

They still felt it out of keeping with their standards and reputation, so they testified, to offer common stock under their own name for public sale. That "might carry with it some implication of speculations

which we would not want to be a party to." But they decided that it was quite all right to offer the stock *privately,* to a select list of purchasers, "people that we know intimately, that we believe have enough knowledge of business and general conditions to know exactly what they are buying. . . ."

This was the origin of the famous so-called "preferred lists," whose publication stirred the nation, and opened the eyes of millions of citizens to the hidden ways of Wall Street. In each case, stock was offered by J. P. Morgan and Company to the individuals on these lists at cost, or practically at cost. In each case, the offer was made with full and irrefutable knowledge that there was, or would very shortly be, a public market for the stock at a much higher figure. In effect, it was the offer of a gift of very substantial dimensions.

In the case of Alleghany Corporation, 575,000 shares of common stock were offered to the individuals on such a list at $20 a share; at the same time, the stock was selling on the New York Stock Exchange on a "when issued" basis (i.e., the Alleghany Corporation had not yet formally organized and issued its securities) at around $35 to $37 a share—a sure profit of about 15 points. Within a few months, the price rose to $50 and over.

In the case of the United Corporation, 600,000 "units," consisting of one share of United common and one share of United preferred stock each, were offered at $75 a "unit"; while the market price for

these "units" was $92-$99—a sure profit of about 20 points.

In the case of Standard Brands, some 700,000 shares of stock were offered to favored individuals at $32 a share—its cost to J. P. Morgan and Company—while trading in the new stock, as soon as it was listed, about sixty days later—opened at 40⅞ and rose in three or four days to 43⅞—a profit of about ten points. There were similar, but less extensive, "private offerings" in the sale of blocks of securities in the Johns-Manville Corporation and Niagara Hudson Power.

How much profit the favored persons who were offered this opportunity to buy at the cost to J. P. Morgan and Company eventually made, the Committee had no means of knowing. It depended on when they sold. But there were no strings attached; they could sell whenever they pleased, and presumably many of them did so in time. Mr. George Whitney himself sold 8,145 shares of the Alleghany stock in a few months, at a profit of $229,000.

There were almost five hundred persons on one or the other of these "preferred lists" (including the subsidiary lists of Drexel and Company in Philadelphia.) They were, primarily, men who were exceedingly eminent and powerful in finance, business, industry, politics, or public life. Ex-President Coolidge was on the list. General Pershing was on the list. Colonel Lindbergh was on the list. Charles Francis Adams, Secretary of the Navy under President Hoover; Newton D. Baker, Secretary of War under

President Wilson; and Senator William Gibbs McAdoo, ex-Secretary of the Treasury and himself a member of the Senate Committee on Banking conducting the investigation, were on the list. One hastens to add that Senator McAdoo explained that his participation came solely through his long-standing personal friendship with Mr. Leffingwell, a Morgan partner, and occurred ten years after he had resigned as Secretary of the Treasury and four years before he became Senator from California, and that he had never had any other transaction with J. P. Morgan and Company.

The country was dismayed to learn that one who later became a member of President Roosevelt's own Cabinet, William Woodin, Secretary of the Treasury, was on the list. To him, J. P. Morgan and Company had written a friendly note:

J. P. Morgan and Company,
February 1, 1929

MY DEAR MR. WOODIN:

You may have seen in the paper that we recently made a public offering of $35,000,000 Alleghany Corporation 15-year collateral trust convertible 5 per cent bonds, which went very well.

In this connection the Guaranty Company . . . also sold privately, some of the common stock at $24 a share.

We have kept for our own investment some of the common stock at a cost of $20 a share, and although we are making no offering of this stock, as it is not the class of security we wish to offer publicly, we are asking some of

our close friends if they would like some of this stock at the same price it is costing us, namely, $20 a share.

I believe that the stock is selling in the market around $35 to $37 a share, which means very little, except that people wish to speculate.

We are reserving for you 1,000 shares at $20 a share, if you would like to have it.

There are no strings tied to this stock, so you can sell it whenever you wish. . . . We just want you to know that we were thinking of you in this connection and thought you might like to have a little of the stock at the same price we are paying for it. . . .

Hoping you are having a pleasant trip, and with best regards,

Sincerely yours,

WILLIAM EWING

Prominent figures in the Republican and Democratic parties were impartially present. Charles D. Hilles, ex-Chairman of the Republican National Committee; Joseph R. Nutt, Treasurer of the Republican National Committee; and H. Edmund Machold, formerly Speaker of the Assembly and State Chairman of the Republican Party of the State of New York, were on the list. But equally so were John J. Raskob, Chairman of the Democratic National Committee, and John W. Davis, sometime Democratic candidate for President. Norman H. Davis, "ambassador-at-large," was on the list; so was Silas Strawn, ex-President of the U. S. Chamber of Commerce and of the American Bar Association.

The Morgans' fellow bankers were not forgotten. Charles E. Mitchell, head of the National City Bank; Albert H. Wiggin, of the Chase National Bank, and George Baker, of the First National Bank, were on the list. Richard E. Whitney, lately President of the New York Stock Exchange, was there. Bernard M. Baruch was there. The firm of Kuhn, Loeb and Company was there.

Dozens of the most prominent figures of big business, directors of leading corporations, were on the list—men such as Owen D. Young, of General Electric Company; Myron C. Taylor, of United States Steel Corporation; Walter Teagle, of Standard Oil of New Jersey; Clarence Mackay, of Postal Telegraph; S. Z. Mitchell, of Electric Bond and Share; Walter Gifford, of American Telephone and Telegraph; Sosthenes Behn, of International Telephone and Telegraph; Matthew Brush, and F. H. Ecker, head of the Metropolitan Life Insurance Company.

In the view of the partners of J. P. Morgan and Company, all this was simply "a perfectly definite business transaction." It was no more than an appropriate method of distributing common stock.

MR. WHITNEY: . . . We did not believe either it was a proper thing for us to sell those (stocks) through any hullabaloo in the general market to the general public. But we did believe that we knew certain people who had the substantial wealth, the knowledge of their securities,

and the willingness to take a risk along with us in the underwriting of these common stocks.

Mr. Whitney could not see that J. P. Morgan and Company were doing the gentlemen on the "preferred lists" any particular favor. After all, who could say with perfect assurance what would happen in the market? As Mr. Whitney somewhat quaintly put it: "They take a risk of profit; they take a risk of loss."

"They take a risk of profit"! Many there were who would gladly have helped them share that appalling peril!

Whatever J. P. Morgan and Company thought, however, the people to whom they made these offers seem to have been in no doubt that they were being let in on a good thing. Mr. Wiggin, for example—no tyro in matters financial—to whom the Morgans had offered 10,000 shares of Alleghany Corporation at $20, at a time when it was selling over the counter at $35, declared, sensibly enough, "I assumed it was a favor and I was very glad to take it." Mr. Raskob, who was offered 2,000 shares of Alleghany, replied gratefully as follows:

Whitehall, Palm Beach,
February 4, 1929

DEAR GEORGE (WHITNEY):

Many thanks for your trouble and for so kindly remembering me. My check for $40,000 is enclosed herewith in payment for the Alleghany stock. . . . I appreciate deeply

the many courtesies shown me by you and your partners, and sincerely hope the future holds opportunities for me to reciprocate. The weather is fine and I am thoroughly enjoying golf and sunshine.

Best regards and good luck.

JOHN

But J. P. Morgan and Company blandly refused to concede, even in face of such language, that they had been prompted in the selection of their lists, by any thought of future advantage to themselves.

MR. PECORA: When you received this letter from Mr. Raskob . . . what did you understand him to mean by saying . . . "And I sincerely hope the future holds opportunities for me to reciprocate"?

MR. WHITNEY: I don't remember what I thought. I thought it was just a nice, polite letter.

* * *

SENATOR COUZENS: You said the only object was that these men you distributed the stock to would make money?

MR. WHITNEY: I did not say our only object. I said we hoped they would. . . .

SENATOR COUZENS: You hoped they would reciprocate?

MR. WHITNEY: No; really.

SENATOR COUZENS: You did not give them this price so that they would reciprocate and keep on good terms?

MR. WHITNEY: No; really. That is, of course, the suggestion that has been carried in the testimony yesterday and in the papers, but I can only tell you that it is not so.

SENATOR COUZENS: I never heard of anybody quite so altruistic in my life before.

MR. WHITNEY: It is not a question of altruism; it is a question of doing a legitimate, straightforward security and banking business.

SENATOR COUZENS: I am not concerned about the illegitimacy of it, but I am concerned about the impression not going over that you only wanted these men to make a profit out of it. You had had business relations in the past with them and they were friends of yours, and you hoped it would continue by giving them an opportunity to make a profit; is not that true?

MR. WHITNEY: When you put it that way, Senator Couzens, I would hate to be put in the position of stating that this was going to make them unfriendly, by giving it to them. Certainly not. It was a continuing of relations that were existent. But your first question rather implied that we expected some direct consideration.

SENATOR COUZENS: You would naturally get direct consideration by their making deposits with your concern, by giving you their underwritings, and the opportunity to sell their securities. That is perfectly obvious.

As Senator Couzens pointed out, the important thing about these "preferred lists" is not the propriety or impropriety of the presence of certain distinguished names thereon. With few exceptions, they were not in public life at the time they accepted the Morgan largesse. The important thing is the startling revelation the lists afforded of the extent and ramifications of the House of Morgan.

Wherever J. P. Morgan and Company did business, it tended to take root and to acquire power. It did not merely make loans or bring out new issues of bonds for its corporate clients and wait passively for further business. Once installed as the corporation's banker, it was soon represented by one of its members on the corporation's board of directors, intimately leagued with the ruling stockholders, and certain of an influential voice in the corporation's management.

The members of the Morgan firm looked upon these arrangements as the most natural development in the world. What was more reasonable, they asked, than that the bankers should keep a watchful eye on corporate policies in an endeavor to protect the purchasers of the bonds they had sponsored, or that the corporaton should seek the benefit of the advice of their bankers? They scoffed at the suggestion that they thrust themselves upon their clients—forced their way into boards of directors—or that they dominated the boards upon which they sat.

SENATOR MCADOO: Mr. Morgan, does your firm have a dominating interest in the policies of these various corporations in which the members of the firm are directors?

MR. MORGAN: We have no more domination than one vote gives us, Senator McAdoo.

SENATOR GORE: Unless they are borrowers?

MR. MORGAN: Even if they are borrowers.

Mr. Morgan's idea was that they could not very

well decently refuse, when pressed, to accept these directorships and "give them financial advice when they ask for it." But the line between banker guidance and banker control is a delicate one—at times even imperceptible—and instances of serious disagreement between the Morgans and the management are rare indeed. Mr. Morgan himself realized this fact, but put his own interpretation upon it: according to him, the absence of disagreement was not a sign of the banker's domination, but the natural result of a mutual sweet reasonableness.

> Mr. Morgan: . . . I do not see that the relations between a company and its directors, no matter what their associations are, is one of antagonism and strife. I have worked with a lot of corporations, and I have always found that we have always worked together rather comfortably, and that we always came to accord very easily. I do not recall a case when there were any serious differences.

No one doubts Mr. Morgan's sincerity or the accuracy of his recollection; but the reader can judge for himself how long this remarkable harmony would have prevailed if it had not been J. P. Morgan or his partner who sat at the table.

The members of the firms of J. P. Morgan and Company and Drexel and Company held twenty directorships in fifteen great banks and trust companies, with total assets of $3,811,400,000. They held twelve directorships in ten great railroads, with total

assets of $3,430,000,000. They held nineteen directorships in thirteen public-utility holding or operating companies, with total assets of $6,222,000,000. They held six directorships in as many great insurance companies, with total assets of $337,000,000. They held no less than fifty-five directorships in thirty-eight industrial corporations, with total assets of $6,000,000,000. In grand total, they held 126 directorships in 89 corporations with total assets of twenty billions—incomparably the greatest reach of power in private hands in our entire history.

Nor was this all. On the boards of these eighty-nine corporations upon which the Morgan partners sat as directors, they came into regular and close relationship with 537 fellow directors, drawn from all fields of commerce. Many of these hundreds of fellow directors who, though not Morgan partners, were thus brought within the orbit, at least, of the Morgan influence, were themselves men of prominence, and held directorships in thousands of other banking, railroad, insurance, and industrial corporations. The list occupies thirty-three pages of fine print.

It would be ridiculous to suppose, as has sometimes been asserted, that these indirect ties conferred on J. P. Morgan and Company anything like control over all these thousands of additional corporations. But it would be equally fallacious to suppose that their intimate association with men who are apt to be leading members of the boards of these corporations, did not exert a strong effect. Altogether, it has been estimated

that the corporations in which a Morgan partner either sat on the board himself, or exerted indirect influence in one way or another, controlled about one fourth of the entire corporate wealth of the country.

J. P. Morgan and Company, of course, would not admit for a moment that it possessed any such power as was attributed to it, much less that it was a menace. Mr. Thomas W. Lamont, in fact, characterized the common belief in the great power of the house of Morgan as merely "a very strong popular delusion." Mr. Lamont, however, did concede, with suitable qualifications, that the Morgans were not totally without influence.

I don't want to make a speech here or to attempt it, but if I may point out one or two factors in the situation: we are credited with having what is known as power or influence; and we admit and are glad to admit that we hope that our counsels are of some avail in certain directions in sound finance. What is that derived from? Is it derived from money? Has the Morgan fortune ever been known as one of the great fortunes of this country? No. With all due respect to Mr. Morgan and to his father, it has not been so known.

It is quite true that the Morgan fortune is not one of the great ones, as compared, say with that of the Rockefellers or the Fords. But Mr. Lamont was equally emphatic in rejecting the suggestion that such influence as J. P. Morgan and Company did possess

was based largely upon their control of money belonging to others.

SENATOR COSTIGAN: Mr. Lamont, Mr. Justice Brandeis some years ago used an intriguing phrase as the title of a book which he published. It was *Other People's Money.* Is it fair to say that such influences as the House of Morgan exercises over the financial and industrial and political life of America, which you apparently consider very slight, which others regard as very substantial, grows out of the use by a private banking house of other people's money in America entrusted to it in one way or other for safe keeping or investment?

MR. LAMONT: No, Senator Costigan. I should not agree with that thesis, and I did not mean to intimate to you that such influence as the firm of J. P. Morgan and Company extended was necessarily slight. We hope that in sound directions it is much more than slight.

SENATOR COSTIGAN: It is in fact substantial, isn't it?

MR. LAMONT: I should think it were substantial, but it does not arise from the use of other people's money.

SENATOR COSTIGAN: Is it in any directions monopolistic or nearly so?

MR. LAMONT: I should say decidedly the contrary. On the contrary, we encourage every other house to do as much business as possible. We have frequently refrained from doing possible business in favor of our so-called "competitors." As a matter of fact, I had a long talk with Justice Brandeis at the time he was bringing out that book. We spent an afternoon together on it, and I entirely failed to convince him and he entirely failed to convince me.

SENATOR COSTIGAN: And, so far as you know, he still remains unconvinced?

MR. LAMONT: He still remains recalcitrant.

The upshot would seem to be, according to Mr. Lamont, that the power of the members of the House of Morgan does not rest upon their own money, and does not rest upon their control of anyone else's money either. Apparently, like Topsy, it "just growed."

Surely this is carrying modesty too far. The power of J. P. Morgan and Company was not "a very strong popular delusion," as Mr. Lamont would have it, but a stark fact. It was a great stream that was fed by many sources: by its deposits, by its loans, by its promotions, by its directorships, by its pre-eminent position as investment bankers, by its control of holding companies which, in turn, controlled scores of subsidiaries, and by the silken bonds of gratitude in which it skillfully enmeshed the chosen ranks of its "preferred lists." It reached into every corner of the nation and penetrated into public, as well as business affairs.

The problems raised by such an institution go far beyond banking regulation in any narrow sense. It might be a formidable rival to government itself.

3

"MERCHANTS OF SECURITIES"

NO SMALL part of the Senate Committee's investigation was occupied in unraveling the intricacies of the business of bringing out and selling new issues of corporate securities. This operation, as it is carried out by the bankers, is a remarkably involved one, and harbors many practices and tricks of the trade of which the uninitiated public has no inkling.

When a corporation issues $100,000,000 of bonds, it does not actually receive the full $100,000,000 which it has to repay. To begin with, the public rarely buys new bonds at par: usually, they are sold at a few points discount—say at 97. But the corporation does not get that figure, either. In fact, it does not really sell its bonds to the public at all. It sells the whole issue to the bankers, and it is the latter who arrange to sell to the public.

For their services in this connection, the bankers deduct a number of additional points, which may be anywhere from less than one per cent to 8 or 9 points, or more, and they pay to the corporation only this twice marked-down price. If the bonds are ultimately to sell at 97, and the bankers deduct an additional 7 points, they would pay the corporation only 90—even though, as we have said, the corporation must repay 100 cents on each dollar of face value. In other words, the corporation only gets what is left after the public has been given a discount, and after the bankers have taken off another slice for themselves. The difference between what the corporation actually gets from the bankers, and the price at which the bankers sell the securities to the public, is technically called the "spread."

This "spread" is not all absorbed by one banking house, but is customarily split up in a number of ways. To go into the full details of a typical bond issue, however, would lead us into some very complicated transactions, for bankers do not make money by their simplicity. The bankers who buy the bonds in the first place do not themselves sell to the public any more than the corporation does. Kuhn, Loeb and Company, for example, or J. P. Morgan and Company are strictly wholesalers, and pride themselves on the fact that they maintain no retail sales organization, "high-pressure" or otherwise.

Generally, the bonds reach the public only after the intervention of three successive groups, each of which

takes its own cut. First, there is the so-called "original group," consisting usually of a few prominent banking houses, then an "intermediate group"; and finally, a "selling group," as a rule consisting of hundreds of retail investment dealers throughout the country. These retail dealers—again adding on a couple points for profit—finally sell to the public. To make the setup still more bewildering, it is necessary to add that some names generally appear as members of several groups, drawing down a separate share of the profits in each capacity; that the organization of the final "selling group" is often completed in actual fact before that of the supposedly prior "intermediate group"; and there are sometimes not three, but two or four groups formed.

The long-suffering public pays the entire accumulated load of commissions, profits, "finders' fees" (to persons who have helped bring in the business in the first place), and all other charges of the whole long series of duplicated, and sometimes triplicated, services. And until recently, the public paid in blank ignorance of what the bankers were getting. Nor did the public know that, for weeks and sometimes months after a security issue was launched, the bankers carefully maintained a "trading account" to keep up the price on the Stock Exchange, until it was all safely and firmly disposed of—after which it was unceremoniously allowed to drop as it pleased. The whole machinery is very elaborate, very imposing, very con-

fusing—and very profitable. The bigger the issue, the more money the bankers make.

On "unseasoned" bonds, it was testified, the usual "spread" was 8 or 9 points; on better-known types, around 4 points. But in many cases, it was much greater. In one of the most flagrant instances that came to the Senate Committee's attention—the sale of stock of a company known as General Theatres Equipment, Incorporated, which we shall meet again later on in this chapter—the banking groups bought the stock from the corporation at $20 per share, and it was sold to the public a couple of months later at $32 per share—an increase of sixty per cent!

Is it really necessary, in order to bring together the corporation and the investing public, to follow this complicated procedure and pay the bankers such large commissions? It is much to be doubted. The bankers' profits, the investigation seemed to indicate, were to a large extent due to the fact that they would not ordinarily bid against each other. When the Interstate Commerce Commission, for example, ignoring the pleas of the bankers, decided in 1925 to institute a system of open competitive bidding in connection with what are known as equipment-trust certificates, the "spread" on this type of railroad security gradually dropped from an average of around $2 per $100 of face value, to less than 43 cents in 1931.

The great investment houses formed a tight little group, organized by custom and mutual tacit understanding. They might quarrel among themselves, but

the chances of any "outsider" successfully penetrating into their preserves, or lowering their established rates of profit, were not bright. No one house had a monopoly; but taking the group as a whole, it effectually dominated the business of investment banking. Corporations needing money, and investors seeking securities to buy, alike, had in practice to meet the bankers' terms, or go without. And the bankers' terms were apt to be stiff ones.

The principal apologist during the Senate Committee's investigation for the bankers' traditional methods was Mr. Otto H. Kahn, of Kuhn, Loeb and Company. No suaver, more fluent, and more diplomatic advocate could be conceived. If anyone could succeed in presenting the customs and functions of the private bankers in a favorable and prepossessing light, it was he.

Mr. Kahn was vehemently opposed to any system of "competitive bidding." From the point of view of the bankers, it meant an undignified scramble for business to which such a firm as Kuhn, Loeb and Company would never descend. "We would not bid. We do not do business on those lines." From the point of view of the corporation, he argued, it was a penny-wise, pound-foolish, policy. It might result in the temporary saving of a few points on the price of the bonds, but only at the expense of the invaluable advice that the reputable and experienced private bankers were prepared at all times to extend gratuitously to their

regular clients. All the intangible elements of value that go with a high-priced label would be lacking.

> MR. KAHN: . . . Just as if you have a suit of clothes to buy, you would have to pay to one tailor much more than you pay to another tailor. It is the same. The suit keeps you warm if you buy it from a cheap tailor, too. But the other tailor puts the experience and the reputation of making good suits into it, and you go to him.

Mr. Kahn considered the relationship between bankers as similar to that existing between lawyers or doctors. He would no more have dreamed of underbidding Mr. Morgan, to win a particular bit of financing, than Mr. Paul D. Cravath would attempt to get a law case away from Mr. John W. Davis by going to the latter's client and offering his services at a lesser fee. In fact, he declared, Kuhn, Loeb and Company and firms of similar standing would not even touch any new business, on any terms, if the corporation concerned was already a regular client of another banker, and had not definitely broken off relations. This, Mr. Kahn felt, was not monopoly or restraint of trade, but simple ethics. To do otherwise would be ungentlemanly and reprehensible: it would be "cut-throat competition." Indeed, Mr. Kahn likened these amiable and self-sacrificing standards of the banking world, so different from the hard-boiled practices prevailing in less polite branches of business, to the N. R. A. codes then being introduced throughout in-

dustry. The country, he thought, was just beginning to catch up ethically with the bankers.

It was undeniable, of course, that the bankers sometimes made very large profits. But, pleaded Mr. Kahn, think of the risks they ran! It was all very well if the public bought the whole issue of securities that was being offered; but suppose they failed to do so, or suppose the retail dealers in the "selling group" fell down on their obligations? Then it was the bankers, and primarily the bankers in the "original group," who had to make good.

> MR. KAHN: The originator, however many syndicates he may form, remains responsible with his entire fortune and good name to the railroad company for the contract which he has made, for the money which he has undertaken to pay, until that money is paid. He cannot say to the railroad, "I have divided that up amongst five or six hundred people; you will get your money from Tom, Brown, Smith, and Jack." They would say, "We do not know them. You are responsible to us for every one of your six hundred subparticipants, distributors, or underwriters. We look to you, and to you only."

When pressed, however, Mr. Kahn admitted that it was exceedingly rare for such dire catastrophes actually to occur.

> SENATOR COSTIGAN: You regard the risk as fifty times as great [in the case of a $50,000,000 issue] as in the case of a $1,000,000 issue?

MR. KAHN: Mathematically so, yes. Mathematically, yes. Actually we do not regard it. Actually we have by long experience gained complete confidence in that list of distributors with whom we generally do business. It happened that we stood in the breach for syndicates at the time that the *Lusitania* went down, which was a very unpleasant experience and gave us some sleepless nights. . . .

We stood in the breach for a very large issue at the time that the great panic in October, 1929, broke upon the country. Again it was not a pleasant experience.

But with few exceptions, even in the face of these unforeseen calamities, our list of tested and well selected distributors and friends all made good. And, generally speaking, we have complete confidence in them.

Other bankers, notably, Mr. Clarence Dillon, head of Dillon, Read and Company, who testified later, were even franker.

MR. PECORA: Well, conceivably no banker would underwrite a foreign issue unless he felt quite certain that he could sell it in his market?

MR. DILLON: I should not think that he would underwrite any issue unless he felt that, sir.

Mr. Dillon emphasized particularly that it was precisely the leading bankers who took the least risks. It was not the great houses, he pointed out, which, for example, financed the automobile industry in its infancy.

MR. DILLON: If you had relied on houses like ourselves you probably would not have had the automobile industry in this country. We would not have risked it, and we would have taken it upon ourselves as a virtue.

It was only after more venturesome persons had risked their own money and developed the industry to the point where it was safe, that "we, the smug, conservative bankers," as Mr. Dillon described his own group, stepped in and "are now very pleased to handle automobile securities."

What risk there was seems to have been passed on by "high-pressure" methods to the shoulders of the little fellows, the hundreds of retailers in the "selling group," with unholy speed.

MR. DILLON: . . . You offer a dealer over the telegraph wire a certain amount, and you often say that the reply should be in by twelve o'clock noon the next day. This man has so many shares or so many bonds available to him until noon of the next day, and he must telegraph in by noon of the next day if he wants them. Well, there is pressure there for this man to answer, and it would be desirable if he could have more time, I should think, in many instances.

To be sure, the little fellow could refuse to accept the allotment that was so peremptorily offered him; but this was not a very wise thing for him to do. If it happened more than once, he was very likely not to

get any more bonds to sell from the bankers, and would consequently find himself without a source of supply for his business. Mr. Dillon declared that he did not know any specific cases of this sort, but he testified, plainly enough, that "you do hear stories around that if a person does not take an offering they are offered less the next time or else they are dropped off. . . ."

Despite Mr. Kahn's persuasive tongue, the facts of the case were unmistakable. There was undoubtedly a residue of risk for the bankers, but in very many cases, this was grossly disproportionate to the size of their profits. The real yardstick by which the bankers fixed their "spread" was not a fair return for services rendered, but "all the traffic will bear," and in the end it was the public that paid the bill.

While Mr. Kahn was not to be shaken in his defense of the essentials of private-banking practice, he was anything but antagonistic to the Senate Committee's investigation, and was very free in the expression of his invariably interesting views for their benefit. "I am too old," he said, "to have axes to grind. I am trying to answer according to my best judgment and through long experience. . . . I hope you will believe me that I am going to answer the question you have asked because it is a slight embarrassment, because it affects my pocket for the next few years that I still have, but not for very, very long."

His words were grimly prophetic, for he died in

1934, while the Senate Committee's investigation was still in progress.

Mr. Kahn made no effort to absolve the private bankers from their share of blame for the speculative mania of 1928-1929, and the disaster that followed in its wake.

Mr. Pecora: Do you think that bankers are in a position to apply influence or brakes to such mania?

Mr. Kahn: They should be. . . .

Mr. Pecora: Did not private banking firms as well as commercial banks help along the development of that mania by freely making brokers' loans in unprecedented amounts?

Mr. Kahn: To put it mildly, Mr. Pecora—

Mr. Pecora: I want to be conservative.

Mr. Kahn: To put it mildly, they certainly did not do sufficient to prevent it or stop it.

But he felt that the bankers could have averted disaster, if at all, only if they had acted in time.

Mr. Kahn: I think in my own mind—and I may be all wrong—we might have been able to stop it earlier, but when it had taken full sway of the people and there was an absolute runaway feeling throughout the country, I doubt whether anyone could have stopped it before calamity overtook us. . . .

It is an exceedingly difficult thing in the face of an utter, complete, and unprecedented determination by the public to take the bit in its teeth. . . . I know that one of

my partners, Mr. Warburg, made a speech warning against what was coming, and they paid not the slightest attention. . . . The public . . . were determined that every piece of paper would be worth tomorrow twice what it was today.

Unlike Mr. Richard E. Whitney and other officials of the New York Stock Exchange, Mr. Kahn readily admitted the pernicious effects of short selling and other practices rampant on the New York Stock Exchange. "The raiding of the stock market, the violent marking up and down of other people's possessions," he declared, "is in my opinion a social evil." He had no doubt at all, despite much testimony to the contrary, that "bear raids" were able to depress the market: "Twice two makes four, and if an artificial offering of the market is created it is bound to have an effect upon the market." Indeed, Mr. Kahn at one point went so far as to stigmatize short selling as "inherently repellent to a right-thinking man." Strange language for a right-thinking denizen of Wall Street!

About the New Deal in general, he was open-minded and even tentatively sympathetic. At least, he was willing to give the New Deal a fair trial and to march with the times, which was considerably more than some other bankers were willing to concede.

Experience has shown that about every 30 years this country determines that it will change its economic pattern. It did so the last time under Theodore Roosevelt. It

has done so now within the last few months. . . . I came here in 1893, and that was just the remnant of, the last ten years of the industrial pioneer period of the country, and the law of the jungle prevailed, and things were done at that time which would never be thought of nowadays, not even by their perpetrators. . . . And ultimately Mr. Theodore Roosevelt came along and he held up a mirror to the community, and the community did not like the picture which it saw, and very important changes were made. . . .

Now, thirty years have come and gone since Mr. Theodore Roosevelt, and the New Deal is now being made. It is of the utmost consequence economically and socially. I do not believe any man is wise enough at this moment to express any views or conclusions until these new theories and laws have been tested. . . . I know a good deal must be changed. And I know the time is ripe to have it changed. Overripe in some ways.

It was not unnatural for Mr. Kahn to take this long view of things. He himself had been a banker for forty years, and a member of Kuhn, Loeb and Company since 1897. His firm, even older, had seen much history made, and watched innovations come and go without undue emotion. Some of its leading members came from families in which banking was an hereditary occupation, and it looked at things "with the accumulated experience of three generations." And while its European connections had shrunk to almost negligible proportions, it still retained enough contacts to lend a certain perspective.

THE CHAIRMAN (SENATOR FLETCHER): Your firm, or at least Kuhn, Loeb and Company, have been for some sixty-odd years engaged in banking?

MR. KAHN: Yes, Senator.

THE CHAIRMAN: And during that time you have maintained relations with foreign countries? . . .

MR. KAHN: We have maintained relations with foreign countries; not very actively. It would be perhaps more correct to say that we have for many years maintained friendly relations with the leading concerns in foreign countries, but we have never been very active. We maintain a slight, small balance with them and they maintain a small balance with us. We exchange friendly letters. We send one another cables of congratulations at the end of the year; but we have never been very active in European affairs.

THE CHAIRMAN: With what foreign countries do you now maintain these business relations?

MR. KAHN: I do not believe we are very welcome in Germany amongst the Nazis. So to a large extent close relations have ceased there. We still have relations with several banks in England, several banks in France, several banks in the Scandinavian countries, and in Holland. . . . I think, sir, that probably exhausts the list.

Like J. P. Morgan and Company, Kuhn, Loeb and Company accepted deposits from their corporate clients. But this branch of their business occupied, in their case, a far less important place in the firm's total activities. Nor could they, in general, begin to match the Morgans in size, ramifications, or power. As

against the half billion dollars of Morgan deposits, Kuhn, Loeb and Company, at the end of 1929, had approximately $89,000,000. Their capital, in 1929, did not rise above $25,000,000, as against the Morgans' $118,000,000. And their various partners held sixty-five directorships in forty-eight corporations, as against almost double that number held by members of the House of Morgan.

In the field of investment banking, however—the origination and flotation of new issues of bonds and stocks—the discrepancy between the scale of operations of the two firms was much less marked. Even more than J. P. Morgan and Company, the eleven partners of Kuhn, Loeb and Company were essentially what Mr. Morgan had called "merchants of securities." Between 1927 and 1931, this firm originated over $1,600,000,000 of bonds—a stupendous total for a single house in half a decade.

The power of Kuhn, Loeb and Company, moreover, was much more effective than these blanket figures reveal, because of the fact that the firm's activities were largely concentrated in a single area. They specialized in railroad financing, and here especially they were a very formidable factor. Once upon a time, they had, in combination with Harriman, been powerful enough and bold enough to challenge J. P. Morgan the elder, himself, in a battle for railroad supremacy, with the famous Northern Security panic of 1907 as the result; and even after three decades of growing Morgan power, they held their own in this particular

province. Indeed, from 1927 to 1931, Kuhn, Loeb and Company actually originated no less than fifty-four issues of railroad bonds, totaling $1,137,000,000—far more than J. P. Morgan and Company during the same period, and a substantial part of the entire twelve billions added to the debt of all the railroads of the United States since the World War.

Not only in the quantity of railroad securities handled, but in the broader field of influence and control in the railroad world, as well, they were rivals, on practically even terms, of the Morgans. They started no wars, but within what they considered their own legitimate territory their grip was firm and they were ready and able to defend their interests as aggressively and efficiently as any of their competitors. Of course, the issue of new securities and general railroad financial strategy are far from unrelated matters, for railroad wars, like all other kinds, cannot be waged without money, and that is where the bankers come in.

SENATOR BARKLEY: Do you think that this twelve billion dollars increase in the bonded indebtedness of railroads since the war was reflected in the purchase of equipment or in physical benefits?

MR. KAHN: Not all of it, I am afraid, Senator.

SENATOR BARKLEY: That would represent at least half of the total value of all the railroads, and it is not my observation that they spent anything like that amount of money on equipment.

MR. KAHN: I am afraid I cannot contradict you.

SENATOR BARKLEY: What were they doing with the rest of the money?

MR. KAHN: You see, there happened from 1926 to 1929, and particularly in 1929, a perfect mania of everybody trying to buy everybody else's property, and the railroads were not excluded from that. New organizations sprang up. Money was so easy to get. . . .

The result was that many of the railroads became fearful, and with good reason, that lest somebody should imperil their just interests in their own territory many of them felt either like being aggressors or like defending themselves against aggressors, very much the European situation all over again, only instead of leading to warfare it led to expenditures.

In this mixture of unbridled financial speculation and cutthroat railroad strategy, culminating in 1929, the Morgans' chief instrument was the Alleghany Corporation, the holding company whose organization, as the reader will remember, had afforded so convenient an occasion for one of the famous Morgan "preferred lists." By means of this intricately involved corporate structure, the amazing story of which we shall narrate in a later chapter, the interests sponsored by J. P. Morgan and Company were seeking to build up a great new railroad system. In the process, they were intent upon buying up certain independent railroads which the Pennsylvania Railroad, Kuhn, Loeb and Company's chief railroad client, considered necessary to its own health. At least, the Pennsylvania Rail-

road felt that it would be decidedly unhealthy to let them be acquired by so powerful a rival.

To meet this and similar threats, the Pennsylvania Railroad, acting with the advice of Kuhn, Loeb and Company, promptly organized a holding company of its own, which was called the Pennroad Corporation. By this means they hoped to build a "defensive organization" which would be "strong enough financially," and "elastic enough constitutionally," to buy "strategically important pieces of railroad before somebody else snatched it away from them."

Throughout the period of Pennroad's formation, Kuhn, Loeb and Company played a leading part as financial guide, philosopher, and friend. In accordance with Mr. Kahn's advice, the stock of the new corporation was not offered to the public, but to the 157,000 stockholders of the Pennsylvania Railroad; and about ninety-seven per cent of its first stock issue was in fact purchased by these people.

One must not suppose, however, that the Pennsylvania Railroad stockholders were permitted to control the new corporation, merely because they had just purchased ninety-seven per cent of its stock. To suppose anything so simple would indicate a stark unfamiliarity with the practices of some of our best banking circles. These stockholders may have put up the money for the new corporation, but they did not really receive its stock. Instead they were prevailed upon to accept "voting trust certificates"; that is, certificates showing that they were the real owners of the

stock, but that they consented to let certain trustees hold it and vote it for them. The trustees, three in number, were, of course, leading figures like General Atterbury, but once they had been installed in office, they stayed there for ten years, and during that time they could vote the stock they held in trust in any way they pleased. These three men, and not the 157,000 stockholders, were in complete control.

In fact, these three men eventually controlled not only the $87,000,000 raised by the sale of the first issue of stock, but an additional $45,000,000 raised by a subsequent sale of further stock, this time to the public, under the aegis of Kuhn, Loeb and Company—about $132,000,000 in all.

Theoretically, and in the light of after-acquired wisdom, Mr. Kahn denounced all such devices by which the mass of stockholders is deprived of control —and they are very common—as, in general, "inventions of the devil." Nevertheless, by his own testimony, it was Kuhn, Loeb and Company, and Mr. Kahn himself, who were chiefly responsible for the manner in which Pennroad Corporation was organized.

Once the necessary funds had been raised in this fashion, the masters of the new corporation were in a position to bid, and bid high, against the Alleghany Corporation and other systems for the railroads they wanted to acquire.

One of the principal prizes at stake was the control

of the Pittsburgh and West Virginia Railroad Company. This was a story in itself. About seventy-three per cent of the stock of this railroad was owned or controlled by Mr. Frank E. Taplin, an astute railroader, with dreams of building a railroad empire of his own. Early in the 1920's, while he was still in the coal-mining business, he saw the trend of affairs, and thoughtfully began to buy up control of certain railroads, among them the Pittsburgh and West Virginia, partly for himself, and partly for a syndicate of gentlemen who had confidence in his judgment. He bought as much as he could:

MR. TAPLIN: [I tried] to get as much stock as I could under control. The more I could get under control the better.

MR. PECORA: The better for whom?

MR. TAPLIN: Better for me.

Mr. Taplin's judgment was brilliantly vindicated: all the great Eastern systems—the New York Central, the Van Sweringens (Alleghany Corporation), the Pennsylvania, the B. & O.—found the Pittsburgh and West Virginia Railroad strategically important in their respective plans for expansion. Mr. Taplin was in the agreeable position of having something that everybody wanted; and he certainly made the most of his fortunate situation.

His talks with the New York Central interests and with the Van Sweringens regarding the sale of his

holdings were not, however, very encouraging and ultimately petered out. Negotiations with the Pennsylvania Railroad people, on the other hand, were much more fruitful. Here his connections were close and friendly and of long standing, but apparently friendship did not interfere with business. Mr. Taplin had acquired his stock at low prices, much of it around 52½. In the meantime, the quotation for the stock had risen sharply in the market. But Mr. Taplin would not think of selling, even at the current market price. He had "big ideas"; for three years, from 1926 to 1929, he insisted on nothing less than $200 a share. "It was always $200 a share or I was not interested."

Mr. Taplin did not get his $200 a share, but he did well enough. The market quotation for his stock, at its highest, was 165; in 1929, it did not exceed 145 and fell at one time to 110; and at the time the sale of his block of 223,000 shares to Pennroad was finally agreed on, in September, 1929, it stood somewhere in the 140's. Nevertheless, he received $170 a share—an advance of about 30 points over the market, and—on about half the block—a clear profit of 118 points!

To the end, Mr. Taplin stoutly maintained that he had not "held up" the Pennsylvania Railroad. According to him, he had really let the stock go too cheaply. The market price might not show it, but it was actually worth $200 a share, after all. At any rate, it was worth it to the Pennsylvania, and that was what counted.

Mr. Pecora: You didn't think the price you asked represented the actual value of the stock, did you?

Mr. Taplin: Well, it occupied a very strategic position in Pittsburgh, and it was worth a lot of money to some railroads.

Mr. Pecora: Didn't you think the $200 a share was the holdup value for control?

Mr. Taplin: No, sir. I thought it was worth it.

This single purchase cost the Pennroad Corporation about $38,000,000—almost half of its original capital. Subsequently, it bought large interests in several other roads it considered necessary for its protection, or desirable to round out its system: in the Boston and Maine Railroad, the New York, New Haven and Hartford, and others. By these means, it was well able to block any serious invasion of its territory, either by the Morgan-controlled Alleghany Corporation or any other intruder. The Pennroad Corporation may, therefore, from a banker's standpoint, be considered to have been a success. If its shares, which were issued to stockholders of the Pennsylvania Railroad at $15, and which were later bought by many trusting and unwary souls at prices ranging up to $30 and more in the open market, subsequently fell to 1⅝, it would surely not be fair to blame Kuhn, Loeb and Company for that.

For their services in connection with the various stages of Pennroad financing, Kuhn, Loeb and Company received a total profit of $5,470,000. Some of this

was a regular banker's fee for their share in "underwriting"—i.e., guaranteeing the successful sale—of one of the later Pennroad stock issues; and some of it was profit from the sale at a higher price of several hundred thousand shares of Pennroad stock, which the Pennsylvania Railroad stockholders had declined to purchase, and which Kuhn, Loeb and Company had duly taken up, in accordance with their agreement.

These items did involve, at least theoretically, a certain amount of risk, though, as Mr. Kahn put it, "By the grace of God we got a profit when we stood the risk of a very heavy loss." But a large part of it came to Kuhn, Loeb and Company without the tiniest particle of risk on their part. It represented profits realized from the exercise of certain options to buy Pennroad stock which they had received at the time of the corporation's organization "in consideration of your having acted in an advisory capacity and having given the organizers of this corporation the benefit of your experience and judgment." The options were to buy Pennroad stock at $16 and $17 per share. The day after they were granted, Pennroad stock was selling on the open market at $25 per share. Kuhn, Loeb and Company eventually realized from the exercise of these options a profit of $2,701,000.

Mr. Kahn protested, very eloquently, that this profit was well earned, because the advice which Kuhn, Loeb and Company had given was very good advice, "almost the most valuable piece of advice we ever gave them," and the fruit of many years' intimate

knowledge of, and experience in, the subject. No doubt this was so, and Mr. Kahn and his partners were to be congratulated on the soundness of their financial judgment. But is any advice, even the most excellent, dispensed without risk to the giver, worth $2,701,000? And what of Mr. Kahn's argument that one of the special glories of the private banker is the financial advice to his regular clients, which he is accustomed to render for nothing, and which would be destroyed by a system of impersonal competitive bidding? ($2,-701,000 is not exactly nothing.)

It was a sad fact that not all banking houses, at all times, lived up to the ideal standards which Mr. Kahn had set forth as governing their conduct. Sometimes they so far forgot themselves as to "indulge in cut-throat competition and steal things away, the one from the other." Mr. Kahn recalled with a shudder, for example, "the kind of competition which we had between 1926 and 1928, when, to my own knowledge, fifteen American bankers sat in Belgrade, Jugoslavia, making bids, and a dozen American bankers sat in a half a dozen South and Central American States, or in the Balkan States . . . cutthroat competition, one out-bidding the other, foolishly, recklessly. . . ."

But it was not only in Jugoslavia or such places that American bankers fell into these lapses. It can happen here, too. Kuhn, Loeb and Company, itself, had on occasion suffered the loss of several customers by similar predatory means. There were often, in consequence of such tactics, bitter quarrels between groups

of financial titans, as well as lesser fry, all intent on the same coveted piece of business.

A famous example, involving half a dozen leading firms, was the struggle for control of the motion-picture companies formerly dominated by William Fox. The latter had seriously overextended his resources in purchasing control of a large amount of Loew Corporation stock and certain English properties, and in December, 1929, after the panic, he found it necessary to seek help from the bankers. What subsequently occurred between him and them is a matter of great controversy. Mr. Fox, who testified at length before the Committee, asserted that he was the victim of a bankers' conspiracy. We shall not here enter upon this controversy, about which books could be—in fact, have been—written. But the testimony before the Committee gave graphic evidence of the real relationship between the bankers themselves.

At first, there were various attempts to straighten out Mr. Fox's tangled finances. Mr. Fox repudiated his regular bankers, Halsey, Stuart and Company, and for a time the Bancamerica-Blair Corporation, Dillon, Read and Company, and Lehman Brothers came into the picture. But the Halsey, Stuart interests would not give way. The bankers completely forgot that they were all supposed to be members of a friendly guild. There were lawsuits and counterlawsuits "in almost every court in New York City. . . . Until finally . . . the situation became such that both the bankers were

willing to withdraw because they could not come to any agreement."

In the end, Mr. Fox sold his interests for approximately $21,000,000 to a company known as General Theatres Equipment, Incorporated, which had banking affiliation not only with Halsey, Stuart and Company, but with the Chase National Bank interests, Pynchon and Company, and certain other concerns.

The Chase Bank acted, at first, as a peacemaker: it wanted the trouble between the bankers settled amicably, so that public confidence in the Fox companies should be restored, after the weeks "of newspaper publicity and fights that had been going on." There was a great deal of financing to be done, in connection with the new setup, both for General Theatres Equipment, Incorporated, and for the various Fox companies, control of which it had purchased. The Chase Bank wanted everybody to be happy, and it so managed that when a $55,000,000 bond issue was brought out for the Fox Film Company, in April, 1930, Halsey, Stuart and Company, Bancamerica-Blair Corporation, Lehman Brothers, Chase Securities Corporation, and Dillon, Read and Company each had a share.

Halsey, Stuart and Company, however, won a partial victory, for it retained a preferential right to do the financing for General Theatres Equipment, Incorporated. But by the following year, in April, 1931, it found itself unable to handle the situation, and had to abandon its hope of controlling the corporation.

Its attempts to extract some profit for itself, even though it was not strong enough to meet the banking needs of the company, were unsuccessful, and it was gently replaced by Chase National Bank interests.

At this stage, Mr. Dodge, Vice-President of the Chase Securities Corporation, addressed a confidential memorandum to Mr. Wiggin, the bank's head officer, neatly summarizing the situation as follows:

> With Halsey, Stuart out, it is possible for me to discuss the whole financing with Kuhn, Loeb again, a thing that I am loath to do unless necessary, as the split-up of the gravy would hurt my feelings.

When the cryptic term "gravy" was first employed in questioning Mr. Dodge, he professed to be unable to understand its meaning. Upon being confronted with the language quoted above from his own hand, Mr. Dodge did the best he could: he made a brave attempt to maintain that "gravy" meant "prestige."

> MR. DODGE: Mr. Pecora, I would say that you had one on me. I would also like to explain that.
>
> MR. PECORA: So that my use of the term "gravy" as applied to these profits is not a violent or a harsh use, is it?
>
> MR. DODGE: No, sir.
>
> MR. PECORA: It is one that you yourself used long before I ever did?
>
> MR. DODGE: . . . What I really meant was that I anticipated that going to Kuhn, Loeb and Company after Halsey, Stuart had withdrawn that we would be on the defen-

sive, and that therefore what I called "gravy" was a certain amount of——

(*The witness hesitated.*)

SENATOR COUZENS: It is a difficult explanation, isn't it?

MR. DODGE: It is a difficult explanation, but I would say that it was the prestige—that was the word I was trying to think of.

SENATOR ADAMS: In a culinary sense you were getting into the soup.

MR. DODGE: I meant prestige.

SENATOR COUZENS: I think you are not making it any better. You had better stop.

MR. PECORA: Stick to gravy. . . .

MR. DODGE: All right, sir. The gravy will stick to me.

As it happened, it would have been better for the Chase Bank if its appetite for "gravy" had in this instance been less voracious. The business of these motion-picture companies went from bad to worse; several of them went into the hands of receivers, and it was at one time estimated that the Chase Bank, which had loaned out vast sums in an attempt to support them, would sustain a loss of over $50,000,000. A stockholders' suit for damages was brought in 1934 against the management, largely based upon the evidence as to these and certain other transactions presented to the Senate Committee. And in the end, even though a referee found that there was no loss, but a gain, to the Chase Bank on all the General Theatres financings, taken as a whole, Mr. Wiggin personally had to pay $2,000,000, and representatives of certain

of his colleagues had to pay an additional $500,000 to secure a settlement of the claim. In the words of the poet, "The best laid schemes o' mice an' men, Gang aft a-gley."

4

SUPER-BANK

THE examination before the Senate Committee of the officers of the National City Bank took place under most dramatic circumstances. It began on February 21, 1933, eleven days prior to the first inauguration of President Roosevelt. It lasted until March 2, 1933—just nine days, but in those nine days a whole era of American financial life passed away. It was the nadir of the depression. The leading officials of the National City testified against a background of collapsing banks, with "holidays" and moratoria spreading from state to state, and an ever-mounting public hysteria and panic. On March 7, 1933, three days after Roosevelt's inauguration, every bank in the land, including the National City, closed its doors.

These striking circumstances were not merely coincidences. They were in a way a grim commentary

upon the ultimate effects on the national economic system of the very methods and practices the Senate Committee was bringing to light—methods and practices of which the banks themselves were shown to be leading exponents. The National City was one of the very largest banks in the world, and had but recently been surpassed in this country only by the Chase National. The prestige and reputation of these institutions were enormous. They stood, in the mind of the financially unsophisticated public, for safety, strength, prudence, and high-mindedness, and they were supposed to be captained by men of unimpeachable integrity, possessing almost mythical business genius and foresight. Yet from the very mouths of these trusted leaders, there came forth an amazing recital of practices, to which the catastrophic collapse of the entire banking structure of the country seemed but the natural climax.

The first to take the stand was Charles E. Mitchell himself, Chairman of the Board of the National City Bank. He was an impressive figure, forceful, self-confident, and persuasive. He was then about fifty-six years old, a self-made man in the American tradition, raised to the financial heights by his innate capacity and will, and a dominant and attractive personality. He had first become connected with the National City organization in 1916, and had risen rapidly to its leadership. While he insisted that he was by no means all-powerful, he admitted that "my associates

considered that anything could not have been done if I had opposed it."

Under his sway the watchword was expansion to the limit. The National City Bank's branches in Greater New York rose to seventy-five; it also had branches scattered around the world in various countries. Its capital stock was increased to $110,000,000 par value. Its affiliate, the National City Company, grew by itself into a vast organization, "an institution within itself with buyers, with engineers, with accountants, with a large bookkeeping and clerical force, telephone operators, telegraph operators, office boys, policemen."

In 1929, the affiliate had, on its own account, no less than nineteen hundred employees and sixty-nine branch offices in at least fifty-eight cities, in addition to twenty-six branches of the Bank which acted as adjuncts to its sales force. It had 11,300 miles of private wire between its various offices, "up and down the coast . . . across the continent, with loops to Minneapolis and St. Paul, and so forth." The Company did business with hundreds of smaller investment dealers throughout the country, and used these too as channels for the distribution of its products. Many of these dealers were themselves banks with investment departments, out-of-town correspondents of the National City Bank. It had branches in London, Amsterdam, Geneva, Berlin, and a large number of correspondents in other countries. It was interested deeply in sugar, copper, and oil. It arranged mergers and

dissolutions. It did an astonishing amount and variety of business.

Mr. Mitchell assumed, throughout his testimony, the loftiest moral tone, no matter how questionable the transactions were with respect to which he was interrogated. Yes, he was only human, "filled with error," and had made many mistakes; but so had everyone else. The bank, under his direction, had pursued some policies he now viewed as unsound—but hindsight was wiser than foresight. The public, it is true, had perhaps not in all cases been treated with maximum frankness—but the National City was itself spontaneously remedying all this, and "blazing a trail" to more adequate safeguards for the investor.

MR. PECORA: The National City Company is the biggest investment house in the country, isn't it? Do you know of any bigger?

MR. MITCHELL: Well, I think that it has a very large producing organization; that is, as an issuing house its own originations are large. I do not think they are as large perhaps in dollars as some others.

THE CHAIRMAN: He has previously testified to this committee that his bank is the largest bank in the world.

MR. PECORA: Yes; but isn't the National City Company the largest investment company selling securities to the public?

MR. MITCHELL: I should think probably; but I would not want to make any boast about that, Mr. Pecora.

MR. PECORA: It would not have been unbecoming for the National City Company to have taken the lead in

bringing about a change in custom with regard to putting out fuller information to the public?

Mr. Mitchell: We are doing it every day. We are issuing to the public today more complete information regarding the condition of the companies that we finance than we ever have in our history, and we are trying to go a very long way. We are trying to blaze a trail with respect to that.

Mr. Pecora: When did you commence to blaze that trail?

Mr. Mitchell: I should say a year and a half ago. We have learned much. We have all made mistakes, and a man that cannot profit by it certainly is not very worthy. We are trying to blaze the way for investment finance into a higher ground than it has been.

Yes, there had been a great gambling mania in 1927-1929, but the National City had nothing to reproach itself for in this respect: it had "tried to prevent overspeculation." Actions which others might find highly improper seemed to Mr. Mitchell to present "nothing criticizable." At all times, he was merely doing his "duty as a banker."

Mr. Mitchell's conception of his "duty as a banker," however, was a far different thing from the standards of that profession as they existed in previous times. To a large extent, of course, it was not a question of Mr. Mitchell's or any other individual's standards, but rather of a revolutionary change in the character of American banking itself. When the National City Bank, for example, was founded in 1812, and for a

century thereafter, the bank's business consisted principally of receiving deposits and making loans to businessmen for legitimate business purposes and for short terms only. As the businessman—or, in country districts, the farmer—cleared his stock of merchandise or sold his crops, the bank's loan was repaid. Banks did not gamble in stocks or bonds; they did not even "invest" heavily in stocks or bonds; and they did not underwrite or issue stocks or bonds. These things, and the risks and profits attendant thereon, they left to houses like J. P. Morgan and Company, to Kuhn, Loeb and Company, to the gentlemen on the Stock Exchange, and to the ever-hopeful public.

Beginning with the World War, all this gradually became changed. When Louis D. Brandeis—not then a Justice of the United States Supreme Court—published *Other People's Money,* his classical analysis of the American financial structure, in 1914, he had found the basic evils of the system concentrated in the overwhelming figure of the private investment banker. He it was who dominated the scene. Ordinary commercial banks, as well as great insurance companies and huge industrial corporations, were mere satellites, ministering to his glory and profit. And two decades later, as we have seen, the Senate Committee found that the private bankers had anything but shrunk in stature. The House of Morgan was still the House of Morgan, only more vast in every way: more deposits, more securities issued, more profits, more directorates in other corporations,

more ramifications in influence, national and international.

But by 1929, great metropolitan banks, such as the National City or the Chase National, were no longer content merely to follow the pace. They had looked with hungry eyes upon the savory meats that had hitherto been the virtual monopoly of the private investment banker, and they had decided to share more liberally in the feast. Even in 1914, Mr. Justice Brandeis had noted the beginnings of this process. But its proportions then were embryonic compared with the growth that came with the ensuing years. It was indeed estimated that these banks became responsible at one time for about fifty per cent of the total volume of long-term credit business of the country.

The National City alone, under Mr. Mitchell's pioneering direction, came to sell not less than $1,000,000,000 of securities per year, and sometimes $2,000,000,000—aggregating the enormous total of at least $20,000,000,000 in securities which the National City manufactured, or in the manufacture of which it participated, for the ten years preceding the Senate investigation. And the National City not only "manufactured" (the phrase is Mr. Mitchell's) these huge quantities of securities, "suitable for public distribution"—it likewise sold these securities like so many pounds of coffee to the public. (This analogy likewise is Mr. Mitchell's.) Under his leadership, the National City grew to be not merely a bank in the

old-fashioned sense, but essentially a factory for the manufacture of stocks and bonds, a wholesaler and retailer for their sale, and a stock speculator and gambler participating in some of the most notorious pools of the "wild bull market" of 1929.

But how was this possible? For surely, the layman will protest, the law does not permit a bank to engage in such activities. A bank, especially a national bank, is, or is supposed to be, sacrosanct, its power strictly limited by Act of Congress, and its activities carefully and regularly examined by skilled examiners.

The layman is right. But he has reckoned without the ingenuity of the legal technicians and the complaisance of governmental authorities toward powerful financial and business groups during the lamented pre-New Deal era. With their superior advantages, a method was worked out whereby a bank could assume a veritable dual personality. In one aspect—the aspect which it presented to the bank examiner and as to which it was subject to governmental control—it observed strictly all the proprieties of a properly managed bank. In the other aspect, it knew no regulation and no limitations: it could, and did, engage in the most diverse, risky and unbanklike operations.

The technical instrument which enabled the bank to carry on in this Dr. Jekyll-Mr. Hyde fashion was known as the "banking affiliate." How the scheme was worked out may best be explained by telling the story of the organization of the National City *Company*—as distinguished from the National City *Bank*.

The Bank was founded in 1812; the Company, only in 1911. At the time of the inception of the Company, its capital stock was fixed, for the time being, at $10,000,000. The certificate of incorporation, obtained from the State of New York, permitted the new Company to be almost *anything but a bank*, a railroad or an educational institution. It was theoretically an entirely separate institution. But the beneficial title in the stock of this new, nonbanking corporation was owned by the very same persons who were the stockholders of the National City Bank, and they held their interests in the old and the new corporations in identical proportions.

And where did the $10,000,000 capital of the new corporation come from? It came from the proceeds of a special forty per cent dividend declared upon the stock of the Bank itself. Not a penny of new money was contributed by anyone. All the shareholders of the Bank, the recipients of this extraordinary dividend, agreed by mutual consent that the proceeds should go, not into their own pockets, but to the uses of the new Company. Now, who was to direct the destinies of this new Company? Not its real stockholders directly (who were identical with the stockholders of the Bank); instead, a "trust agreement" was set up, that is, an arrangement whereby the legal title and the voting control of the stock were vested in three individuals, who held the stock in trust for the real, ultimate beneficiaries—viz., the stockholders of the Bank.

And who were these three all-powerful "trustees" of the new Company? Originally, James Stillman, Sr., then the Chairman of the National City Bank; Frank A. Vanderlip, then President of the Bank, and Stephen S. Palmer, a director of the Bank. What is more, if one of the three trustees resigned or died, the other two could pick his successor, *but only from the ranks of officers or directors of the Bank*. If a trustee ceased to be an officer or director of the Bank, he ceased automatically to be a trustee of the Company, "it being intended that only officers or directors of the Bank shall act as trustees."

Each stockholder of the Bank was thus simultaneously the owner of a proportionate beneficial interest in the Company, through the trustees who had legal title to the Company's entire capital stock. Nor could a stockholder sell his interest in the Bank, without at the same time selling his interest in the Company, for it was provided that the two were inseparable. The very certificates of stock ownership in the Bank and of beneficial interest in the Company were printed on the reverse sides of the same sheet of paper, physically as well as legally indivisible. In brief, the two corporations—the Bank and the Company—were in all but name, one institution. The Company was sprung from the loins of the Bank, derived its initial capital from the surplus of the Bank, was owned by the same people, managed by the same people, and made perpetually indivisible the one from the other. Yet the

effect of the technical legal devices employed was to set at naught all the elaborate restrictions which the National Banking Act imposed upon a national bank. Surely the suave legerdemain of the corporation lawyer in the service of high finance has scarcely, if ever, achieved a more hairsplitting triumph!

To be fair to the legal profession, not all of its members concurred in this sort of sophistry. The National City Company had hardly been born in 1911, when it was thoroughly studied by the Department of Justice, and Frederick W. Lehmann, then United States Solicitor General, rendered two opinions condemning its legality. In the clearest and most convincing fashion, he pointed out that this scheme was an obvious attempt to circumvent the National Banking Act, which severely restricted the activities in which a national bank might engage; that, indeed, its openly declared purpose was to enable the officers and stockholders of the Bank to make investments not permitted to the Bank itself.

His opinion states that it was prepared at the request of President Taft as expressed to George W. Wickersham, then Attorney General, and that General Wickersham agreed with his analysis. Yet nothing whatsoever came of all this. The National City Company, and similar "banking affiliates" of other national banks, went on their way unmolested. Solicitor General Lehmann's opinion as to their illegality was buried in the files of the Department of Justice—

buried so deeply that even Charles E. Mitchell, though he vaguely remembered having read it years ago, could not recall its contents: buried so deeply that when in behalf of the Senate Committee, this writer sought in February, 1933, to obtain the original signed opinion, it could not even be found. It had disappeared—*spurlos versenkt,* to borrow a wartime phrase—leaving only a carbon copy as a ghost to haunt the conscience of the Bank.

Not that the Bank's officials betrayed any noticeable remorse in this regard. Far from it. Mr. Mitchell conceded that such Bank affiliates ought perhaps to be regulated by the government, but as for a complete divorce from the Bank, a real elimination from these tempting, if perilous, fields of speculation—no! Similarly, Mr. Hugh Baker, the President of the National City Company, stoutly maintained the position that such an affiliate, with interlocking directors, was "good banking practice." Under pressure, it is true, Mr. Mitchell did admit, though with extreme reluctance, that the affiliate and the Bank were one institution:

MR. PECORA: But the company is inseparably interwoven with the bank, is it not?

MR. MITCHELL: Yes it is; but it would not——

MR. PECORA (interposing): It is like one body with two heads, isn't it? It has the same body; it has the same blood, meaning the capital derived from the sale of capital stock of the bank to the Bank's shareholders. But instead of hav-

ing one head it has two heads, and the two heads seem to be the one head in your personality. You were the Chairman of both institutions. But in form it had two heads, didn't it?

MR. MITCHELL: Yes.

MR. PECORA: Inseparably interwoven with the bank, virtually as one entity?

MR. MITCHELL: One entity, institutional entity, yes.

But he nevertheless maintained that directors of the Bank, when they had to function as directors of the Company, in some mysterious manner completely stepped out of their roles as Bank directors and acted solely as impartial individuals.

In practice, of course, there was no such pretense. The Bank and the Company were treated, quite simply, as two departments of a single organization. Over both these departments, as well as over the City Bank Farmers' Trust Company (which resulted from the merger in 1929 of the National City and the Farmers Loan and Trust Company, and functioned thereafter as the trust department of the Bank), Mr. Mitchell reigned undisputed. He had become President of the Company in 1916; in 1921, he became President of the Bank as well; in 1929, he became Chairman of the Board of the Bank, the Company, and the Trust Company.

The National City, Bank and Company, at its zenith, was a gigantic monument to Mr. Mitchell's supersalesmanship, his limitless energy, and driving

genius. But its sensational expansion was not attained without bringing with it equally sensational abuses, as the following chapters will reveal. At the root of most of the mischief there was always present, in some form or other, the influence of the banking affiliate—a ready facility for financial misadventure.

5

THE PATH OF ERROR

MR. EDGAR D. BROWN was a resident of Pottsville, Pennsylvania. In 1927, he had $100,000 and was looking forward to a trip to California for his health. In 1933, he had nothing, and was clerking for the poor board of Pottsville. Here is his story, typical of those of a great many others, as graphically told to the Senate Committee:

In a national magazine, he saw a persuasive advertisement, reading:

> Are you thinking of a lengthy trip? If you are, it will pay you to get in touch with our institution, because you will be leaving the advice of your local banker and we will be able to keep you closely guided as regards your investments.

The advertisement was signed by the National City

Bank. It struck Mr. Brown that this just suited his needs, and he made haste to answer it. Soon a representative of the National City Company called upon him. Mr. Brown put himself unreservedly in the latter's hands. He was not suspicious or overcautious, for he had confidence and trust. After all, he was not dealing with some fly-by-night bucket shop or itinerant gold-mining stock peddler, but with the greatest and soundest bank in the world—or so he thought. His one insistence was, that he did not want to buy stocks, but only bonds—fixed interest securities. He was naturally not indifferent to the possibility of profit; but chiefly he wanted safety.

Well, Mr. Brown had asked for bonds, and bonds he got. But not United States Government bonds, such as he had originally owned ($75,000 of his $100,000 was in fact in cash)—these the National City advised him were "all wrong." So they put him, instead, into a bewildering array of Viennese, German, Greek, Peruvian, Chilean, Rhenish, Hungarian, and Irish governmental obligations, as well as bonds of various private American corporations. These were represented as affording so profitable an opportunity that Mr. Brown was induced not only to risk all of his own $100,000, but to borrow scores of thousands more in order to make additional purchases, until finally his "investments" totaled about $250,000. When these bonds, purchased mostly with borrowed money, declined—instead of enhancing in

value, as Mr. Brown had been confidently assured they would do—he complained:

Mr. Pecora: You complained to whom?

Mr. Brown: Mr. Rummel [the National City Company representative].

Mr. Pecora: Yes?

Mr. Brown: And he said, "Well, that is your fault for insisting upon bonds. *Why don't you let me sell you some stock?*"

Well, the stock market had been continually moving up. So then I took hook, line, and sinker and said, "Very well, buy stock."

Mr. Pecora: Did you tell him what stocks to buy?

Mr. Brown: Never.

Mr. Pecora: Did he buy stocks then for your account?

Mr. Brown: Might I answer that facetiously? *Did he buy stocks!* (*Great and prolonged laughter.*)

Yes, great and prolonged laughter, but it had proved no laughing matter for Mr. Brown. His faith in the National City was complete: "I bought thousands of shares of stock on their suggestion which I did not know whether the companies they represented made cake, candy, or automobiles." And the National City bought for him so many stocks, and traded in them so violently, that even the unsuspecting Mr. Brown finally complained to the main office of the National City Company in New York. So far as he could tell, he seemed, in spite of all this activity, to be still losing money. He was listened to sympa-

thetically, and once again his portfolio was changed, this time mostly to National City Bank stock and to Anaconda Copper. Still, his stocks kept declining. About October 4, 1929, he took his courage in both hands, went into the National City bank branch in Los Angeles, and "asked them to sell out everything."

Mr. Brown: I was placed in the category of the man who seeks to put his own mother out of his house. I was surrounded at once by all of the salesmen in the place, and made to know that that was a very, very foolish thing to do.

Mr. Pecora: That is, to sell your stocks?

Mr. Brown: Especially to sell the National City Bank stocks. . . . I then received an unsolicited wire from their agent in the East . . . (*reading*) "National City Bank now 525. Sit tight."

Once again, Mr. Brown allowed himself to be overpersuaded. The rest of the story is soon told. A few weeks later came the crash. Mr. Brown was naturally sold out, most of his capital irretrievably gone. His efforts to borrow money from the bank in which he had placed such confidence were met with the suave reply that a loan was impossible "unless the borrower has assured earning power and could pay off the loan within six months." But Mr. Brown then had no such earning power, he was "forty years of age—tubercular—almost totally deaf—my wife and family are depending on me solely and alone and because of my abiding

faith in the advice of your company I am today a pauper."

Just another little man wiped out, a victim of high-pressure salesmanship!

The National City moguls did not find this sort of thing very much to their liking. Mr. Mitchell, though still advocating the investment affiliate, confessed: "But it is this contact with the public that disturbs me, coming as it does through the investment affiliate, and I think we have got to find some different means of distribution." It was one thing to manipulate great blocks of stock on the Exchange, to float great bond issues, dealing only with impersonal financial machinery, or professional dealers. It was quite another to be brought face to face with responsibility for the ultimate damage to individual human beings.

To be sure, the retroactive distaste which Mr. Mitchell and his associates developed for these activities, came too late to be of any service to the Mr. Browns who received the benefit of what Mr. Mitchell euphemistically styled "contact with the public." In their heyday they were not hampered by such inordinate delicacy. From coast to coast, literally from house to house, sales were pushed in every possible manner. In 1928, the head office sent out the names of 122,332 "prospects"—a fair sized army. Mr. Brown was no isolated specimen. There were thousands and thousands of his kind, people with their surplus safely in cash or good, sound bonds, who were lured into disaster by similar means. They did not deal at arm's length, because they were dealing with a bank. A bank was supposed to occupy a fiduciary relationship and to protect its clients, not to lead them into dubious ventures; to offer sound, conservative financial advice, not a salesman's puffing patter.

But the introduction and growth of the investment affiliate had corrupted the very heart of these old-fashioned banking ethics. Because it had wares of its own to sell, the National City was no longer an impartial adviser. It did not scruple to use its own depositors, who came, like Mr. Brown, seeking investment advice, as "prospects" for the busy salesmen of the Company—"prospects" who were more than ordinarily gullible, just because these salesmen came to them clothed with all the authority and prestige of the magic name "National City."

MR. PECORA: Do you know that many depositors of the Bank who had never been customers of the Company or buyers of its securities were approached directly by representatives of the company and their business solicited for the Company?

MR. BAKER (President of National City Company): That might possibly be, but the way the name might have come to the attention of the salesmen does not necessarily follow, Mr. Pecora. . . .

MR. PECORA: Would it surprise you to know that many of the Bank's depositors who never before had had any business with the Company were approached directly by salesmen or representatives of the Company and greeted

with the remark that the salesman knew that they were depositors of the Bank?

MR. BAKER: Well, that could still be possible. . . . A customer of the Bank, let us say, in talking to some officer in the Bank indicates that he is interested in making some investments. That would be transmitted to the National City Company, and that name would be called upon immediately.

MR. PECORA: So that when a depositor of the Bank went to the Bank seeking advice on matters of investments, the name of that customer or depositor would be transmitted by the Bank's representative to the company?

MR. BAKER: The probabilities are that it would; yes, sir. . . .

MR. PECORA: And . . . it was not an unusual thing for the National City Company to suggest investment in securities that the Company was sponsoring, was it?

MR. BAKER: That is right. . . .

MR. PECORA: And do you consider, as a director of the Bank, that that was a disinterested and unselfish way for the Bank to advise a depositor concerning the making of investments generally?

MR. BAKER: Well, as I told you yesterday, Mr. Pecora, the reason I say I do feel that is the proper way to do is because of the facilities which we had in the National City Company for a study of investments. . . .

MR. PECORA: Do you still think that is good banking practice?

MR. BAKER: Yes; I think that is good banking practice.

MR. PECORA: And you would approve of its continuation, would you?

MR. BAKER: Yes, sir.

To stimulate business, and to "keep the salesmen upon their toes," the Company sent out to them a constant stream of advice, exhortation, and "pep talks" which were known as "flashes." When the occasion merited, more material encouragement was offered by way of elaborate "sales contests." Liberal prizes were offered to the salesmen who sold the most stocks and bonds, and especially high premiums were awarded for the sale of foreign bonds, which the National City was anxious to dispose of. Here is the text of one such announcement:

FLASHES ON THE INTERCONTROL

CONTEST FLASH 5033

September 27, 1929

We are pleased to announce this morning the beginning of one of the greatest sales contests ever held by the National City Company. There will be liberal cash prizes for a large number of men in every part of the organization and higher premium schedules. Contest will be organized and operated between control organizations and six contesting units, being territories controlled from San Francisco, Chicago, Philadelphia, Boston, New York metropolitan, and New York control offices outside New York City. Security issue with premium schedule and point ratings for prizes are as follows. . . . This premium schedule will hold straight through entire contest. Total prize money for entire organization will be $25,000 divided among various controls in proportion to the

work done and to be subsequently divided among the highest ranking men in the various controls according to the rules set forth below. . . .

GENERAL SALES

The atmosphere, one notes, was precisely like that of any nonbanking large-scale sales organization. There was not even a hint of recognition that, after all, these were not tangible goods such as automobiles or aluminum ware or Fuller brushes that were being sold, but securities, the true value of which the public was in no position to judge, and which it purchased largely on faith in the integrity and presumed conservatism of the National City Bank.

Many of the securities sold in this manner were bonds "manufactured" by the National City Company itself. But there were other securities. There was no advantage in developing such a tremendous sales organization and not making the maximum use of it. Why, for example, sell only bonds, when the public was clamoring for common stocks? Mr. Mitchell could see no good reason for such self-restraint, so a vast stock-selling campaign was set in motion. One of the most widely sold and ruthlessly pushed securities was National City Bank stock—of which more hereafter. Another greatly touted stock, not originated by the Company, was Anaconda Copper.

The reader may remember that there had been a sensational increase in the price of copper, prior to

1929, and the quotation of Anaconda stock, like that of other copper companies, had risen sky-high on the New York Stock Exchange. During this prosperous period, the National City Company had accumulated for its own portfolio as an investment, about 300,000 shares of Anaconda. Its officers were in an excellent position to judge the value of the stock; they did not have to indulge in hazardous guesswork, as did the uninitiated public, for Mr. John D. Ryan, the Chairman of the Board of Anaconda, was happily also a member of the board of directors of the National City Company. More than that, the National City was itself Anaconda's banker.

Copper kept climbing, and in March, 1929, it reached a price of 24 cents a pound. But from this high, it fell in the following month to 18 cents a pound—a drop of 25 per cent. Shortly after, the National City came to the conclusion that it no longer wanted its 300,000 shares of Anaconda for itself, and prepared to utilize its sales organization to unload them on the public. Mr. Mitchell, needless to say, would not admit for a moment that the Company was getting rid of the stock because it was no longer considered safe by insiders, or that he was influenced by so trivial a development as a 25 per cent drop in the price of copper in a single month.

MR. PECORA: So the common stock of a company dealing in a commodity the price of which could slump in the world's market by one third within a month's period was

the kind of stock that your Company, through its officers, marketed as a good sound investment security?

MR. MITCHELL: Oh, I do not think that had anything to do with it, Mr. Pecora. If one is working on the basis of a long-term average, why should one be concerned with violent fluctuations that are away above the base?

MR. PECORA: Because it would tend to indicate a tendency to instability in commodity prices, would it not?

MR. MITCHELL: Instability at the moment, certainly.

MR. PECORA: Well, your decision to sell Anaconda common stock to the public was made very shortly after the fluctuations, and the price of copper had fallen from 24 cents a pound to 18 cents a pound within a month; is that not so?

MR. MITCHELL: I will take your word for that. It did not influence my judgment, I can assure you of that.

For whatever reason, the Company did push the sale of 300,000 shares. But the market for Anaconda was still very active. The stock had once sold as high as 170, now it was forty or fifty points below that figure, and the public still lived in eager hope that soon it would skyrocket again. Why, then, stop selling it, when customers were still buying so merrily? So the National City Company purchased in the open market about 1,000,000 additional shares of Anaconda and these, too, it sold, entirely through its own sales organization—"a syndicate all by yourselves," as Senator Brookhart called it.

These operations likewise appeared in Mr. Mitchell's unsuspecting mind as merely another il-

lustration of the faithful performance of the duties of a banker. Said he:

> But being bankers for the Company, even though we promptly sold that 300,000 shares which we owned and had under option, it became our duty, or so we conceived it, so long as our customers viewed that stock as an investment stock, to buy in the market and to sell additional shares to them. Which we did.

Mr. Mitchell, however, volunteered no opinion as to the extent to which their "customers' " view of the stock "as an investment stock" was encouraged by his Company's selling propaganda. The total number of shares of Anaconda sold by the National City was 1,315,830. They were all sold in two short months, August and September, 1929, on the very eve of the crash. At the time of the Senate investigation, they were selling at $7 to $10. They cost the National City around $100 a share, and they were sold by it to the public, on the average, at around $120 to $130 per share, making a total profit of over $20,000,000—in two months! It will readily be seen that there exists no real incompatibility between the strict performance of one's duty as a banker, as conceived by Mr. Mitchell, and the making of a handsome profit.

This sort of activity—selling securities directly to the ultimate retail purchaser—accounted for a large part of the National City Company's business, and

it was the side of their far-flung organization which was best known to the public. But it was by no means the whole story. As Mr. Mitchell was at pains to emphasize, the selling end, though more conspicuous, could not function without the "manufacturing" end. Hence, the real center of the National City Company's business—and perhaps its major economic function—continued to be the origination of security issues. This phase of its activities was, of course, an invasion, albeit a relatively friendly one, into the territory of investment bankers such as J. P. Morgan and Company, Kuhn, Loeb and Company, etc. Here, the National City naturally practiced all the customs of the trade as developed by the private bankers, and added new devices of its own. Eventually it outstripped its models: the National City Company, in 1929, sold more securities than were floated by J. P. Morgan and Company and Kuhn, Loeb and Company combined.

It was not to be expected that the Company could manufacture such a volume of new issues, and pay much heed to the quality of its product. Let us see how much substance there was in Mr. Mitchell's stress on the pains which the Company took to find securities which it would be "safe and proper" to issue. Consider, for example, the methods employed in the marketing of the $16,500,000 bond issues originated by the National City Company in 1928 and 1929, on behalf of Minas Geraes, one of the states in

the Republic of Brazil. These particular issues were small, as the National City in those days measured size, but the standards revealed were representative of its operations in those halycon times; and the total amount of Latin American bonds the American public was induced to buy by similar methods, from the National City and its competitors, ran into the billions.

What did the average investor know of Minas Geraes? Nothing, not even its name. But the National City Company knew a great deal. It knew that prior to 1928 the State of Minas Geraes had obtained loans mostly from French bankers, and that it had been necessary for bondholders to bring suit against Minas Geraes in the French courts in order to obtain payment in gold, as per the terms of the bonds. It knew that one of its own experts on South American finances, Mr. Train, had reported by letter in 1927 to Mr. Ronald M. Byrnes, Vice-President of the National City Company in charge of its foreign bond department, that *"the laxness of the State authorities* (of Minas Geraes) *borders on the fantastic. . . .* It would be hard to find anywhere a sadder confession of inefficiency and ineptitude than that displayed by the various State officials on the several occasions. . . . The foregoing recital serves to show the complete ignorance, carelessness and negligence of the former State officials in respect to external long-term borrowing."

Yet with such a report in its files, the National City

did not hesitate to float an issue of $8,500,000 bonds for Minas Geraes, and thereby introduced the obligations of that State for the first time into the American market. The "fantastic laxness" of the State officials, when translated into the bankers' language of the prospectus, appeared as a dignified and reassuring declaration that:

> Prudent and careful administration of the States' finances has been axiomatic with successive administrations in Minas Geraes.

When this language was questioned by another gentleman in the National City organization, as possibly "subject to criticism"—in plain language, too raw—the Company made a concession: it changed the word "axiomatic" to "characteristic." Otherwise, the language stood, for the enlightenment of bond buyers who did not have private experts and confidential reports of their own. This prospectus was, indeed, prepared by the same Mr. Train who had reported that "the laxness of the State authorities borders on the fantastic." But Mr. Train saw no inconsistency therein. Some other wording might have been more accurate, but he could see nothing seriously amiss with it, from a banker's point of view, as it stood.

The higher executives of the Company soon found reason to entertain "a considerable degree of uneasiness . . . over the question of the State's [Minas Geraes'] willingness to meet its obligations." But just

about this time—1929—Kuhn, Loeb and Company began to compete for the position of bankers to Minas Geraes. The National City and its allies deemed it "rather disconcerting to find that, after having sponsored a loan for the State in the New York market in 1928, that someone else . . . should come in and endeavor to 'chisel in.' " (It is to be hoped that the reader's sensibilities will not be unduly jangled by this employment of the racketeer's jargon by our eminent bankers.) To avoid such an unpleasantness, the National City hastily extended further short-term credits to the Minas Geraes authorities, of about $4,000,000, and arranged for a second bond issue of $8,000,000. The $4,000,000 the National City had advanced was then repaid out of the proceeds of this second bond issue. The publicity department knew its business too well, however, to put obstacles in the way of the sales organization by mentioning this fact. Instead, the public was told that the proceeds would be used "for purposes designed to increase the economic productivity of the State." Bailing out the National City from $4,000,000 unsecured loans, cannot, to be sure, be very easily brought under such a classification. But the Company's officials, when questioned before the Senate Committee, dismissed the discrepancy as merely technical. No banker would be misled by it, naturally.

At the time of the Senate hearing, the bonds, totaling $16,500,000, which had originally been sold at 97½ and 87 had fallen to around 21-22. The bankers

and selling houses had pocketed a profit of approximately $600,000, and the public had lost approximately $13,000,000.

* * *

Even more spectacular in its disregard of elementary fair play to investors was an earlier adventure of the National City in the field of South American financing, in 1927 and 1928. At that time the National City Company, in collaboration with certain other investment banking houses, floated three bond issues, totaling $90,000,000, for the Republic of Peru. The idea of acting as banker to Peru was not a new one to the National City. It had been tempted ever since 1921 by the rich possibilities of profit from this source. But it had received such black reports from its experts that it had reluctantly abstained.

There was no question as to the wisdom of that decision. Its experts had reported in writing at various times from 1921 on, that Peru was notoriously "careless in the fulfillment of contractual obligations," that the interest on many of its bonds had not been paid until long after the due date, that its bad debt record made it "an adverse moral and political risk," that it had a "bad internal-debt situation," that its "whole taxation system was a hodgepodge," that it had a perennially unbalanced budget. As late as July, 1927, Vice-President Durrell had written to Mr. Mitchell informing him that there were two factors which would long retard the economic development of Peru: first, the very large Indian population, most of

whom lived in primitive conditions and used no manufactured products; and second, the foreign absentee ownership of the country's principal sources of wealth. "As a whole," he wrote, "I have no great faith in any material betterment of Peru's economic condition in the near future. The country's political situation is equally uncertain."

The London *Times* spoke of Peru's "frequent unobservance of her undertakings," her "broken pledges," her "flagrant disregard of guarantees." One especially illuminating report, dated 1921, declared that "the condition of Government finances is positively distressing, treasury obligations are almost impossible to collect. Government officials and employees are months in arrears in their salaries, and, as one businessman expressed it, the Government treasury is 'flat on its back and gasping for breath.' "

Discouraged by all these highly adverse data, the National City for six years properly declined to aid the Government of Peru in obtaining money from the American investor. As reasons they "cited the history of Peruvian credit, the political situation in Peru, and our feeling that the moral risk was not satisfactory." But as the great bull market grew greater and greater, as the careless "New Era" psychology grew more and more pervasive, the National City suddenly found nebulous reasons to justify a complete change of attitude. In 1927, a sort of exploratory Peruvian issue of $15,000,000 was floated with ease. When it was found that the public was

perfectly ready to buy Peruvian bonds at nearly par, it was shortly followed by a much larger loan of $50,000,000. So anxious were they to secure this business, that the sum of about $450,000 was paid to Juan Leguía, the son of the President of Peru, as an ambiguous "gratuity." The following year still a third issue of $25,000,000 bonds was brought out.

These bonds were sold, some at 91½, and some at 96½. The bankers received a "spread" of about 5 points, which means that there was a profit of about $4,500,000 realized by their various groups. The National City itself made a net profit of over $680,000. By 1933, the bonds had fallen to 8, 7, and, at one time, as low as 4⅝. All three issues went into default in 1931.

The public never had a chance. The prospectus prepared for its benefit contained an impressive list of the various Peruvian governmental borrowings, but never even mentioned that there had ever been a default on any of these debts: There was not one syllable, not one hint of warning of the whole long series of adverse circumstances, almost any one of which would have frightened investors far, far away. As the testimony of Mr. Baker, its President, showed, the officers of the National City were not unaware of such considerations:

Mr. Pecora: Do you think that the public here would have subscribed at 91½ for these bonds if they had been given the information that was given to your Company by its overseas manager and Vice-President, that "there are two factors that will long retard the economic importance of Peru"? . . .

Mr. Baker: I doubt if they would.

Mr. Pecora: And do you think that the public would have subscribed to these bonds at 91½ if they had been told in the circular that Mr. Durrell in July, 1927 advised the company that "Peru's political situation is equally uncertain. I have no great faith in any material betterment of Peru's economic condition in the near future"?

Mr. Baker: I doubt if they would.

It was, indeed, a careful draftsman, who cautioned at the bottom of the prospectus that "The above statements are based on information received partly by cable from official and other sources. While not guaranteed, we believe them to be reliable, but they are in no event to be construed as representations by us."

The public received the same sort of information in the other cases. When the National City Company in 1924 floated $15,000,000 of bonds for the Cuban Dominican Sugar Company, for example, it did not feel in any way called upon to inform the public that the Cuban sugar industry had collapsed in 1920 and had shown only a minor flurry of improvement in later years. When the National City Company floated an issue of $32,000,000 bonds for the Lautaro Nitrate Company of Chile in 1929, it knew that the future of the Chilean nitrate industry, of which the Lautaro Company was a part, was greatly jeopardized by the

development of synthetic nitrogen. But it neither passed on its information to the public, nor, when the bonds dropped precipitously from 99 to 2½, did it feel any tremors of remorse or responsibility.

To reach a point where it more than rivalled J. P. Morgan and Company and Kuhn, Loeb and Company in the origination of securities, and, in addition, to build up a world-wide sales organization that sold many millions of shares annually directly to the public, might have seemed enough to satisfy anyone's lust for expansion. But the National City did not stop in its course even at this point. Finally, it must have dawned on Mr. Mitchell and his associates that after all the true purpose of the Company was neither to make bonds, nor to make sales of bonds, but to make money. And here, ready to hand, was the New York Stock Exchange, the very best place in the world to serve such an ambition. What if it were rather an unprecedented and forbidden thing for a national bank to be "in the market," to gamble, and to manipulate, like any fevered Wall Street speculator? It was not, in legal technicality, the "Bank" that was speculating, it was the "Company."

The development of the National City was, in this respect, a logical progression. Step by step, the affiliate had led the Bank into stranger and stranger pastures. Originally, when organized in 1911, it was to be used merely to hold certain investments that the Bank legally could not. From this, it expanded into an in-

vestment banking "house of issue," manufacturing bonds in imitation of the great private bankers. Under Mr. Mitchell's dynamic rule, it developed its immense machinery for selling those bonds to the general public.

When it went still further, and used this machinery to distribute millions of securities not originated by itself, millions of the same stocks that were being traded in upon the floor of the Exchange, it already had one foot deep in the market; and its success and profits had become inextricably interwoven with the daily plus and minus signs of the stock quotations on the financial pages. It was only a short step from this, to complete and unrestricted speculation directly on the Exchange.

Thus it came about that in the four months, December, 1928, to March, 1929—a time when Federal Reserve authorities were doing everything in their power to restrain the further growth of the wild speculative excesses of the market—the National City Company was a principal participant in and financed three separate "pools" trading in copper stocks on the Exchange. All three were subsidiaries of Anaconda. One was in Andes Copper, one in Chile copper, and the third in Greene Cananea. In some cases, the National City itself "ran the account"; in others, other members of the group did so. Almost 500,000 shares of these various companies were accumulated in these pool operations. About 115,000 shares were retained as profit. The rest were sold to the public by

trading on the Exchange in the usual manner. The National City's share of the profits was $167,000 in cash, plus about 66,000 shares of Anaconda stock, which, at the quotations then prevailing, were worth approximately $9,000,000.

The National City, to be sure, ran little risk in taking these "flyers" and making these huge profits. Greene Cananea, for example, was a famous "mystery stock" at the time; its price was rising sensationally—but did this represent real value, or merely manipulation? The National City did not have to guess, for its fellow pool members were none other than John D. Ryan, Chairman of the Board of Anaconda, which controlled Greene Cananea, and Cornelius Kelley, the President of Anaconda. The fact that this whole operation depended on the use by directors and insiders of their confidential knowledge of their corporation's business for their own personal profit, did not deter them in the least.

Towards all this, Mr. Mitchell maintained on the witness stand an unwavering opinion of its complete propriety. He flatly denied that the National City had ever been a party to a "pool" or "syndicate" on the Exchange. Indeed he professed to know little of such things as "pools," had never been in one and scarcely even knew the meaning of such wicked words. (Such rude terms are taboo in the more rarefied Wall Street strata: the well-bred financier never "manipulates" a stock—he merely "makes a market"

or effects a "distribution," or "provides purchasing power.")

Mr. Pecora: Did you ever, either individually or in behalf of the National City Company, take part in any pools or syndicate accounts in the common stock of Anaconda Copper Mining Company or any of its subsidiary companies?

Mr. Mitchell: No, sir.

Mr. Pecora: Did the National City Company ever participate in any syndicate accounts trading in the common stock of any of the subsidiaries of Anaconda Copper?

Mr. Mitchell: Of course, I just don't quite—you mean a joint syndicate or a pool? If I remember correctly, my testimony——

Mr. Pecora (interposing): In my last question I referred to syndicate accounts.

Mr. Mitchell: If you are referring to what we generally know as pool accounts, and what the public understands as pool accounts, my answer is distinctly no. I think there were times when, as recorded in the previous testimony, probably—and I state this from recollection—when there was some accumulation for one purpose or another in connection with some entity of Anaconda Copper Company directly. But as far as pool operations, no....

Mr. Pecora: I again ask you if the National City Company ever participated in any syndicate account which traded in the common stock of any Anaconda Copper Company subsidiary?

Mr. Mitchell: Well, as I understand what you mean by a syndicate account, I should say no.

Mr. Pecora: I simply used the term "syndicate account," Mr. Mitchell, in my question without any defini-

tion of it. I have simply used the phrase "syndicate account," haven't I?

MR. MITCHELL: Yes.

MR. PECORA: Now, will you please answer the question as to whether or not the National City Company at any time participated in any syndicate account which traded in the common stock of any Anaconda Copper Company subsidiary?

MR. MITCHELL: If it did, my previous testimony will make it perfectly clear.

MR. PECORA: Have you any present recollection of the subject?

MR. MITCHELL: Not in what I would conceive to be a syndicate account, I should say, no, Mr. Pecora.

Under further questioning, however, Mr. Mitchell did admit that the Company had engaged in group operations with Ryan, Kelley, and the Messrs. Guggenheim, accumulating and selling hundreds of thousands of shares. But these, he insisted, were not "pools"; they were "joint accounts." The proprieties of language thus duly preserved, he testified readily enough to the details.

He even expressed, eventually, a tempered recognition that perhaps the National City ought not to have engaged in this sort of transaction:

MR. PECORA: The National City Company's capital and surplus were derived from the sale of stock of the National City Bank in the first instance, isn't that correct?

MR. MITCHELL: Yes. . . .

MR. PECORA: So the National City Bank indirectly and through the use of its funds procured in the manner indicated through the sale of stock in the National City Company was financing this joint account?

MR. MITCHELL: The money came from the shareholders of the National City Bank. . . .

MR. PECORA: Do you think, Mr. Mitchell, that it is a proper or a sound banking function for a national bank, either directly or indirectly, to participate in joint stock-market accounts?

MR. MITCHELL: If you ask me on the back-look I think this kind of an account that was set up by the shareholders' money and with their full knowledge and consent, and through which particular accounts were operated, *finding ourselves often in what would be termed stock-market operations, is unfortunate, and I would not do it again*. As a matter of fact, I would rather look to the time when we would be completely out of that sort of thing. I do not believe that it is a thing that we should be doing, Mr. Pecora.

MR. PECORA: When did you first reach that conclusion?

MR. MITCHELL: Oh, at the same time that many of us began to feel the headache from that which had gone before.

MR. PECORA: Well, the headaches of some people have been so extensive they have forgotten when they commenced.

MR. MITCHELL: That is right.

MR. PECORA: What was the date when you reached the conclusion?

MR. MITCHELL: Oh, I should say in recent months, Mr. Pecora.

One might think that the National City had now finally reached the limit, but there is more to come. Perhaps the most extraordinary of its activities during those frenzied years was the orgy of trading by the Company in the stock of the Bank itself. It is, of course, strictly against the law for a national bank to purchase its own stock. It cannot even lend money on its own stock. Legal technicalities aside, it is obvious that wild advances and recessions in the price at which a bank stock is quoted, cannot fail to affect gravely the stability and reputation of the institution. Of all stocks, bank stocks ought least to be the football of speculation.

Solemnly the National City gave lip service to this doctrine. Its officers went so far in 1928 as to have the stock of the Bank stricken from the New York Stock Exchange, where it had been listed for many years, because they professed to be able to detect microscopic signs of manipulation in its price. This they considered to be "distinctly disadvantageous, and probably at times might even be dangerous." Yet mark what follows: in the next two years, National City Bank stock, which had a par value of $100, was pushed up and up until it reached dizzy heights. In January, 1928, when it was taken off the Exchange, it sold at $785. In June, 1928, it stood at $940; in January, 1929, it climbed to $1,450; a few months later, it reached the fantastic price of $2,925 (actually, $585 per share, after a 5 for 1 split-up). The highest book value ever ascribed to it was only $70. And

the National City, which had removed the stock from the Exchange "to prevent manipulation," was itself the principal trader!

Altogether, in the three-and-a-half-year period ending December 31, 1930, the National City Company sold almost 2,000,000 shares of the stock of its Bank, and even then it had about 100,000 shares left over. In the single year 1929 it sold more than 1,300,000 shares. For the proud privilege of owning these shares, worth $140,000,000 at their highest book value, the public paid the stupendous sum of $650,000,000. Most of this inflated value was, of course, wiped out during the years of depression, when National City fell from 585 to 21. Mr. Mitchell himself was a heavy loser—according to his own statement, the heaviest individual loser of all.

The campaign to sell National City Bank stock was carried on by every means available. It was sold at these exorbitant prices by the hundreds of thousands of shares by National City salesmen, stimulated by special premiums. It was sold "over the counter" through regular brokerage houses, with fifteen or twenty of whom the Company maintained direct wires. The Company was by far the largest customer of the "specialist" in this stock, and kept in telephonic touch with him, on busy days, "maybe every three or four minutes." The Company not only accumulated and sold for its own account—at times as many as 30,000 or 40,000 shares in a single day—but it encouraged others to fan the flame, giving, free of

charge, an option on 30,000 shares as the basis of operations for a syndicate headed by the well-known brokerage firm of Dominick and Dominick. It was making so much money selling the Bank's stock that it even sold more shares than it owned—i. e., it "went short"—and had to borrow 30,000 shares from Mr. Mitchell's private holdings to cover its sales. Greed and irresponsible banking could go no further.

Small wonder that Mr. Mitchell confessed that the bank had trod "the path of error," or that he penitently declared:

"I would not do it again!"

6

"ALL TREATED EXACTLY ALIKE"

"Give me deeper darkness. Money is not made in the light."
—George Bernard Shaw

What motives animated Mr. Mitchell and his associates to commit such excesses? Why should they, the august heads of a great fiduciary institution, have so played upon the public's trust and confidence? Was it merely due to an overzealous devotion to the interests of stockholders? Or did the reason lie, as Mr. Mitchell pleaded in extenuation, in the inherent fallibility of the human intellect?

The facts brought to light before the Senate Committee suggest another and far different conclusion. They suggest, in the strongest possible fashion, that these men were not actuated solely by mistaken loyalty or honest error, but by a lively interest in their own financial profits as well.

From the point of view of Mitchell, *et al.*—that legally nonexistent but nonetheless all-powerful or-

ganization of "key men," "insiders," and "higher-ups"—the Bank's affiliate was a gigantic, foolproof device for gambling freely with the stockholders' money, taking huge profits when the gambles won, and risking not one penny of their own money if they lost. The manner in which these men, so highly placed and so respected, profited personally not only from the public's confidence but from the treasury of their own institution, forms one of the most revealing stories presented to the Committee.

How was it done? Primarily, by means of the so-called "management funds." The President and each of the many vice-presidents of the National City Company received a basic salary of $25,000. But these were no mere $25,000-a-year men, least of all, Mr. Mitchell himself. They were high-powered executives; men, according to Mr. Mitchell, who "would normally be of the type to hold partnerships in private banking and investment companies . . . which partnerships were often extremely lucrative." So to meet this competition, and to induce himself and his marshals to continue their good works, it was deemed necessary to give themselves over and above their salaries, "some share in the profits that they should make" for the Company. The amount of profits thus diverted from the treasury of the Company and the pockets of ordinary, run-of-the-mill stockholders, was called the "management fund."

This management fund was fixed at twenty per cent of the total net operating profits for the year,

after deducting eight per cent on the capital stock, surplus, and "undivided profits." That is, with the exception of this first charge of eight per cent on capital, etc., for every $5 the Company earned, the management levied a toll of $1. And since the Company's profits were very large, the "management fund" ran into the millions.

Next came the delicate business of dividing these millions among the favored individuals permitted to share in them. For this purpose, the fund was theoretically divided into halves. The distribution of one of the halves was determined in advance at the beginning of each year, by the board of directors, each of the participants getting a greater or lesser percentage, according to their judgment of his standing and importance. This was politely called "the forward look." The distribution of the remaining one-half of the fund for any given year was determined semi-annually, in July of that year and in January of the following year, by vote of all the participating officers. First there was a secret ballot, Mr. Mitchell not participating, to determine Mr. Mitchell's share. Then there was a signed ballot to determine the distribution of the balance, each officer leaving himself out of consideration. These figures were then submitted to the board of directors, and "they determined then just what that distribution should be."

Essentially the same arrangements prevailed in the Bank. Here, too, there was a "management fund" of twenty per cent of the net profits for each year, after

deducting eight per cent on capital, etc., and this fund was divided among the Bank's officers in much the same fashion as the Company's fund was, except that there was no "forward look."

Mr. Mitchell not unnaturally stressed the fact that he did not fix his own share, but left that to the judgment of his subordinate officers. "My only insistence to the executive committee of the bank," he said, "has been that I shall never receive in excess of the proportion voted me by the officers." He considered that in consenting to this secret referendum on his own compensation, he was doing rather a "bold thing," by placing himself "on a pedestal where the officers can throw all the stones that they will at me without my knowing from whom the stone comes, and I take their final net as the maximum which I will receive."

But apparently, despite this opportunity, none of the officers wanted to cast the first stone at Mr. Mitchell, perhaps for the Biblical reason that no one considered himself free from sin. One might be tempted to say that Mr. Mitchell asked for stones, but was given bread. Less metaphorically, he was given, for the three years of 1927, 1928 and 1929, a total of $3,481,732 from the "management funds" of the Bank and the Company. In 1927, he had received $529,000 from the Bank's fund, and $527,000 from the Company, a total of $1,056,000. In 1928, the banner year, he had received $566,000 from the Bank, and $750,000 from the Company, a total of $1,366,000.

Even in 1929, when the Company sustained heavy losses in the stock market crash, he received $608,000 from the Bank's fund and approximately $500,000 from the Company, a total of $1,108,000. All this, of course, was over and above his regular salaries.

Mr. Mitchell's share was customarily about one-third of these funds. Other "higher-ups" were treated with commensurate generosity. Mr. Baker, the President of the Company, for example, received, in addition to his salary, $185,000 in 1927, $266,000 in 1928, and $225,000 in 1929. Mr. Rentschler, then Vice-President of the Bank, received, in addition to his salary (which was, in his case, $50,000), $154,000 in 1927, and $125,000 in 1928. Mr. Schoepperle, Vice-President of the Company and mostly concerned with foreign loans, received, in 1928, $70,000 in addition to his salary of about $20,000.

In view of these arrangements, it may become quite easy to understand the reckless, anything-for-a-profit mood in which the National City was operating. The officers had nothing to gain and everything to lose, individually, by a conservative policy. Merely to make eight per cent on the stockholders' money—surely an adequate return for a banking institution eschewing unsound and speculative ventures—would have left them, under these arrangements, with a bare $25,000 or $50,000 a year as salary. Their own participation was only in the superprofits. No superprofits, no "management fund." It needs no psychol-

ogist to see how, under such an arrangement, the officers must have been under the most alluring temptation to produce, in some fashion, those super-profits from which alone their own gains flowed. And bear in mind that there was no possible risk of loss of their own money to deter them. To produce and to sell securities in the greatest possible quantity—that was accordingly the desideratum. Bonds from Peru, sugar from Cuba, copper from Mexico, nitrates from Chile—the wide world was searched for sources of supply.

Rather astonishingly, Mr. Mitchell, even after the debacle of 1929-1933, could see nothing but good in these arrangements:

SENATOR COUZENS: And, as you look at it in retrospect, do you think that was a good system to set up for a financial institution?

MR. MITCHELL: Yes; I think so, and I would really feel quite strongly about that. I have seen it apply in the bank where it was established after I became President of the Bank, and it establishes an esprit de corps and an interest in one officer in another officer's work that is to me most noticeable.

SENATOR COUZENS: Does it not also inspire a lack of care in the handling and sale of securities to the public, because each individual officer has a split?

MR. MITCHELL: I can readily see, from your point of view, that that it would seem so, and I must grant that it must have some influence, Senator Couzens. At the same time, I do not recall seeing it operate in that way.

SENATOR COUZENS: You would not see it. Only the customers would see it after they had gotten the securities.

Mr. Mitchell had a very strong sense of the right of the officers to these stupendous bonuses. In July, 1929, he had received about $500,000 from the management fund of the Company, and the other officers in proportion, based upon the profits of the first six months of that year. But when, at the end of 1929, the Company showed a loss for the entire year, they felt no obligation to return any part of this money. Their heads-I-win-tails-you-lose ethics did not encompass such painful restitution of these premature and over-optimistic self-awards. Mr. Mitchell insisted that, once received, the money was legally theirs for keeps. As a concession to possible differences of opinion on this point, however, he deemed it wise for the officers to consent to treat these payments "purely as an advance," to be deducted from their share of future accumulations in the management fund. This proved a very inexpensive gesture, as there were no subsequent management funds. The depression ended all that.

Mr. Mitchell's whole attitude was not that of the servant, but of the master, of his institution. He and his associates looked upon themselves as something more than mere corporate officials—in Mr. Mitchell's own words, as "the equivalent of partners in a private banking or investment firm." The stockholders

were almost wholly without real power or even knowledge of what was going on. They knew nothing of these management funds, of Mr. Mitchell's huge personal profits, of the Company's market operations, or of its trading in the Bank's own stock. Even the employees of the Bank did not know how much the Bank's officers received out of the Bank's management fund, for these amounts were paid by checks on other institutions:

MR. PECORA: What is the reason for it?

MR. RENTSCHLER: Well, the same reason that any other payroll or any other salary roll is kept in a confidential relationship in the organization. . . .

MR. PECORA: To boil it down to a sentence: Is the reason for it to avoid disclosure?

MR. RENTSCHLER: Quite so.

The affairs of the National City Company were shrouded in even more mystery than the affairs of the Bank. At the very inception of the Company in 1911, the reader will remember, it had been arranged that the stockholders of the Bank should hold only the "beneficial interest" in the stock of the Company. The legal title to that stock, the voting power, all the control, was vested in the self-perpetuating board of three trustees from the chosen circle of the Bank's "insiders." These trustees never rendered any account of their stewardship. They kept no minutes of their meetings, they made no reports. True, the annual report submitted by the management of the

Bank to its stockholders contained some information about the Company as well, but this report was of a very sketchy and inadequate character. Prior to 1931, no balance sheet and no statement of earnings were given out.

The secrecy which veiled the entire management of the Bank and the Company was strikingly illustrated in 1927, when the Bank found itself in a very embarrassing position growing out of certain large loans it had made years before to several Cuban sugar companies. The loans aggregated more than $30,000,000, and when the Cuban sugar industry collapsed, the loans had become practically worthless. In an effort to protect its investment, the Bank had taken over the management of the underlying properties, but instead of making a profit, these operations showed a loss of several millions per year. The national bank examiners began to complain: "It is questionable whether or not the management is according stockholders and depositors the proper protection. . . ."

The officers were in a quandary: they wanted to rid the Bank of these bad loans, but it would never do openly to admit such a heavy loss. Accordingly, the lawyers were called in, and this is what happened: the stockholders of the Bank were asked to subscribe, and did subscribe, to an additional issue of $50,000,000 of capital stock. This was equally divided between the Bank and the Company. Next, the Com-

pany used its $25,000,000 of this additional capital to buy all the shares of a newly organized corporation, known as the General Sugar Corporation. Then the General Sugar Corporation—which was now just an alias for the National City Company—used this $25,000,000, or most of it, to buy from the Bank all of the bad sugar loans which that institution was trying so desperately to get rid of.

Thus the bad the loans of the Bank were cleared from its books. In due course, the National City Company wrote down its investment in the stock of the General Sugar Corporation to the munificent sum of exactly $1. All this is a complicated, if typical, legal corporate manipulation, but the net effect is plain enough. The Bank was "bailed out" of $25,000,000 of bad loans by its affiliate, with money supplied by the stockholders themselves. The point is, that this was done without giving the stockholders the least inkling of what their money was going to be used for:

Mr. Pecora: One moment right there. You say the $25,000,000 was furnished by the shareholders. You do not mean by that that when the shareholders put up that $25,000,000 they knew it was going to be used to finance this sugar transaction, do you?

Mr. Mitchell: They knew it was going to go into the National City Company.

Mr. Pecora: But they did not know what the National City Company did with that $25,000,000 the very day it was received, did they?

Mr. Mitchell: I hardly think there was any necessity for it.

In Mr. Mitchell's view, apparently, the stockholder's function was to put up the money, and it was none of the stockholder's business what was to be done with it thereafter.

* * *

Being an "insider" in the National City organization was, in those prosperous days, a lucrative business. Salaries of $25,000 and $50,000, participations of hundreds of thousands of dollars in "management funds"—these were not the only sources of profit. There were also opportunities, which were grasped with both hands, for getting in on the ground floor of particularly profitable flotations like the Boeing Airplane and United Aircraft offerings of 1928 and 1929, which were considered too good to be handled in quite the ordinary manner.

The Boeing Airplane and Transport Corporation was a holding company, controlling three subsidiaries successfully engaged in manufacturing airplanes and carrying mail and passengers. In January, 1929, its name was changed to United Aircraft and Transport, Incorporated, and under that name its stock became one of the most familiar tokens of the torrid Wall Street gambles of that period. But before the general public was allowed to enter the game, Mr. Mitchell and his friends had already used their position as officers and directors of the National City to

supply themselves with a full set of these tokens or chips at reduced rates.

When the Boeing Airplane and Transport Corporation was organized in October, 1928, the National City Company bought from it for $5,013,000 a large block of various kinds of the Boeing Corporation's stock. In the ordinary routine of its business as an investment banking house, this stock would have been passed on to the public as promptly as possible, with the usual "spread" of a few points as banker's profits. But in this case, Mr. Mitchell and the other "insiders" vetoed a public offering, ostensibly for the praiseworthy reason that aviation stocks were too speculative as yet for the National City (which had but recently foisted without hesitation those famous Peruvian and Brazilian bond issues discussed in the previous chapter), to sponsor to the public.

They were not too speculative, however, for Mr. Mitchell and his associates, or for the National City Company. The latter retained a large block for itself, and the remainder of its purchase was allotted in "units" of assorted common and preferred stock, to Mr. Mitchell and a select list of "officers, directors, key men, and special friends," including Mr. Swenson, then Chairman of the National City Bank; Mr. Rentschler, President of the Bank; Mr. Percy Rockefeller and Colonel Stewart, directors of the Bank; various members of the firm of Shearman and Sterling, lawyers for the Bank; Colonel Sosthenes Behn, of the International Telephone and Telegraph Com-

pany; and so forth. The largest allotment of all, it is interesting to note, went neither to Mr. Mitchell nor to any of his fellow officers, but to Mr. Bartow, a partner of J. P. Morgan and Company.

Having now safely secured the stock in their own hands at favored prices, Mitchell, *et al.* experienced an abrupt change of heart regarding its suitability for public distribution. The decision not to make a public offering because aviation stock was too speculative, was made on October 22, 1928. On October 31, only nine days later, request was made to list the stock on the New York Curb Exchange. On the following day, November 1, an advertisement appeared in the newspapers of New York, Chicago, San Francisco, and Seattle, announcing that the National City had sponsored and privately sold these issues of common and preferred Boeing stock. This advertisement was, of course, well calculated to excite the greatest public attention. Everybody felt that when the "insiders" of the National City bought at private offering, they bought plums, not lemons.

Trading in Boeing stock, common and preferred, opened on the Curb the very next day, November 2, 1928. Even the opening prices were far above what the Company or the "key men" to whom it had allotted shares had paid, and the prices rose in after months to much higher figures. The National City Company itself, within five months, realized on its investment of $5,013,000, a profit of over $1,659,000 in cash, plus certain stock warrants showing a paper

profit of $840,000. How much the "insiders" on the preferred list actually realized, could not be ascertained definitely, but even at the opening prices of November 2, which were the lowest for many months, the profit to this group was $1,629,000. In all probability the real profits were a great deal more.

A few months later, at the end of January, 1929, the National City Company acquired another block of common and preferred stock of the airplane company, now called United Aircraft. This cost it about $13,000,000 and it was soon sold for a total profit to the Company of $1,447,000. Most of this was sold to the public, but once again the "insiders" kept a block of stock for their own use. There was not even a pretense of any special reason this time, other than the obvious reason that it was a fine chance for the directors and officers to make some more money. This time the block allotted consisted of 13,000 shares of United Aircraft common. It had cost the Company $70 per share; it was sold to Mr. Mitchell and a second list of select officers at $80 per share; and within two days it was selling on the market at $96 per share. Mr. Mitchell himself had received, this time, an allotment of 1,000 shares: if he had sold immediately, he would therefore have made $160,000. If he waited, but sold within four or five months, he made much more, for United Aircraft reached a high of 160 the following May.

* * *

If the National City was indeed kind to its officers —or perhaps it may be that the officers were kind to themselves—in times of prosperity, they were not less kind in times of adversity. When the big stock-market break came in October, 1929, the officers of the National City, who had been speculating heavily on their own account, largely in National City Bank stock, were caught in the crash, like everybody else. But, unlike everybody else, they were in the fortunate position of being on the inside of a bank. The advantages of this position soon became apparent. Within a few weeks, a large fund was set up, the so-called "morale loan fund," to be used for making loans with or without collateral, and without interest, to embarrassed officers "in the present emergency, and thereby sustaining the morale of the organization." Under the thin cover of this pretext, $2,400,000 of the stockholders' money was "loaned" to about 100 officers of the Bank and its affiliates.

To obviate, at least superficially, the appearance of having made unsecured loans, or loans without interest to its own officers, the "morale fund" was not technically loaned directly to the embarrassed officers, but was handed over to two directors of the Bank, who were designated as trustees to make such loans. The practical effect was precisely the same, but the Bank's lawyers assured them that everything was now perfectly legal.

Only about five per cent of this money had been repaid at the time of the inquiry before the Senate

Committee in February, 1933. The balance was either written off as a loss by the Bank, or "taken over" by the National City Company in December, 1930, and either written off as a loss by it, or formally kept on the books at a reduced amount. One officer "borrowed" $296,000 and paid back $11,000. Another "borrowed" $345,000 and paid back nothing. There was no attempt to collect any part of the money from the very substantial salaries of the officers, which continued to be regularly paid.

The morale of the "higher-ups" was thus sustained —at their stockholders' expense. Far different was the lot of the rank-and-file employees of the Bank. Their morale was also important, but it was sustained in quite a different manner. In 1927, the Bank had put into effect a stock purchase plan under which officers and higher employees were permitted to buy National City Bank stock. In December, 1929, after the crash, at the same time that the officers were being "loaned" the $2,400,000 to help them out of their difficulties, this stock-purchase plan was extended to take in the lower ranks of National City employees. Since they were presumably too poor to buy outright, the Bank permitted them to pay on the installment plan, over a four-year period, deducting the installments from their monthly salary checks.

The employees could now pride themselves on being stockholders of the Bank, just like Mr. Mitchell, and Mr. Rentschler and Mr. Percy Rockefeller. For this privilege the Bank charged them $200

and $220 a share, although, let us remember, the book value of the stock was never above $70. Soon their stock declined to $100, then to below $100, then to $25. At the time of the Senate hearings it stood at $40. The luckless employees were still paying for their shares, month by month, and they still owed much more on it than the stock was worth in the market. Under the terms of the installment purchase, the employees could escape their obligations only by resigning—which was practically equivalent, in those years of depression, to voluntarily enlisting in the ranks of the unemployed. There were, for them, no "morale loans," no "management fund," no convenient write-offs, no indefinite extensions. They were not even relieved of the interest. "To him that hath shall it be given, and from him that hath not shall it be taken away," says Scripture.

Mr. Rentschler, nevertheless, felt certain that "the employees are, far and wide, entirely well satisfied with the fact of their part in this plan." Some of the officers, too, he pointed out, had also bought stock on the installment plan, and had, for once, not been relieved of their obligation. In his opinion, "They were all treated exactly alike."

It is not recorded what the faithful employees, in the privacy of their own hearts, thought of these noble and equalitarian sentiments.

Indeed, Mr. Mitchell and his colleagues seem at times to have been no more concerned about protecting the interests of the rank-and-file employees

than they were to protect the interests of the rank-and-file stockholders or of the public. The Senate Committee's investigation of the National City revealed, from start to finish, shocking lapses from the devotion to the high fiduciary standards that should always govern the conduct of officers and directors. It revealed scarcely a trace of recognition that a bank, in particular, performs a public function, that it is what lawyers call a "business affected with a public use"—one where the public interest must be held paramount.

The excesses and abuses revealed sprang from many sources. But the Committee's investigation showed clearly that the two chief instruments which facilitated these abuses were the investment affiliate and the secrecy with which the management was allowed to operate. Without the affiliate to act as an *alter ego* of the Bank, free from the wise restrictions of the National Banking Act, most of the mischief could not even have been initiated. And had there been full disclosure of what was being done in furtherance of these schemes, they could not long have survived the fierce light of publicity and criticism. Legal chicanery and beneficent darkness were the banker's stoutest allies.

7

"THE MOST POPULAR BANKER IN WALL STREET"

"MY PRIDE in the Chase National Bank," wrote Albert H. Wiggin in his letter of resignation of December 21, 1932, "is the supreme satisfaction of my business life."

And there was much in the record to justify that pride. Mr. Wiggin in the course of the years had earned for himself a position as one of the very biggest and most important financiers in the United States at the very zenith of its business prosperity. He first came to the Chase Bank in 1904. The bank was, even then, an important and leading financial institution, but it was far from the titanic organization that it subsequently became.

When Mr. Wiggin first joined the bank in 1904, for example, it had twenty stockholders. When the Senate Committee investigated its affairs in October

and November, 1933, it had no less than 89,000 stockholders. In 1904, it had a capital of $1,000,000, a surplus of $1,000,000, and deposits of $54,000,000. In 1930, following its merger with the Equitable Trust Company, it attained a capital of $148,000,000, a surplus of $148,000,000, and deposits of over two billion dollars. "It was at that time," testified Mr. Wiggin, "the largest bank in the world; and it is today one of the largest banks in the world, and the largest bank in the United States. And its ramifications are many. It is known in every town in the country, and in a great deal of the rest of the world. It has business in Panama. It has business in Cuba. It has business in London, in Paris, and in the Far East."

During all of this great development in size and power, Wiggin stood at the head of the institution, which he dominated as overwhelmingly as Charles E. Mitchell dominated the National City. To quote again from his letter of resignation: "During my twenty-nine years' association with the Chase I have been privileged to play an intimate part in its growth. . . . My heart and my energies have been concentrated for many years in promoting the growth, welfare and usefulness of the Chase National Bank. I have seen it develop into an institution whose public service is commensurate with its magnitude."

At one time Mr. Wiggin was the bank's largest stockholder. At all times it was admittedly under his general direction. When he became associated with

the bank in 1904, he was Vice-President. In 1911, he became President. In 1918, he became Chairman of the Board of Directors. In 1930, due to the merger with the Rockefeller-controlled Equitable Trust Company, the ultimate control of the Chase Bank passed to the Rockefellers; John D. Rockefeller, Jr., became its largest stockholder, and Mr. Winthrop W. Aldrich, his brother-in-law, became President of the bank.

The bank became known, in the parlance of Wall Street, as the "Rockefeller Bank." But Mr. Wiggin still remained the active head and guiding spirit, with the exalted title of Chairman of the Governing Board—an inner "superboard" outranking the mere rank-and-file members of the board of directors proper.

The reputations of the bank and of Mr. Wiggin were as high and spotless as the bank was great and powerful. Mr. Wiggin's prestige and influence were, in fact, international. When a man was needed to represent American interests in connection with more than half a billion dollars of frozen German credits, he was the one selected. He was a member of the board of directors of Armour and Company, American Locomotive Company, Brooklyn-Manhattan Transit Corporation, Interborough Rapid Transit Company, International Paper Company, Lawyers Title and Guaranty Company, Mack Trucks, Incorporated, Underwood Elliott Fisher Company, Western Union, Westinghouse Electric

and Manufacturing Company, and many other important corporations—no less than fifty-nine in all. He was a director and member of the executive committee of the Federal Reserve Bank of New York. He enjoyed the distinction of being one of the favored few on a Morgan "preferred list."

When he resigned his chairmanship, in December, 1932, Mr. Aldrich and the other members of the executive committee of the Chase National Bank passed what Mr. Wiggin termed a "complimentary minute" which, together with other laudatory details, declared: "The services of Mr. Wiggin not only to this institution, but to banking throughout the world, have been of a preeminent character. The Chase National Bank is in no small measure a monument to his energy, wisdom, vision and character. . . . He has also developed, with the steadily enlarging magnitude of the bank, a personnel in keeping with the high responsibilities involved in directing the affairs of so large an institution."

Even the various National Banking Examiners in 1928-1930, found it appropriate to remark that "the national banking system has a great standard bearer in the Chase National Bank," and characterized Mr. Wiggin, who "dominates the policies of this institution," as "the most popular banker in Wall Street."

Surely, all this was enough, and more than enough, to inspire Mr. Wiggin's pardonable pride and "supreme satisfaction" in the record of the bank under his direction. Yet, despite the bank's enormous prestige, and despite Mr. Wiggin's pride in its history, the Senate Committee's investigation revealed that this "great standard bearer," behind its imposing façade of unassailable might and rectitude, was not a whit better than the National City Bank itself.

The earlier examination of the latter institution had certainly proved a shocking disclosure of low standards in high places. But it soon became apparent that the National City had no monopoly on improper banking practices; that, indeed, it was a question whether the Chase Bank did not actually exceed the National City, not only in the amount of its resources, but in the magnitude of its errors as well. Most of the characteristic evils which beset the National City organization flourished here in equally glaring fashion: the use of affiliate corporations, to do indirectly that which the bank could not legally do directly; huge, overstuffed salaries; financing stock market pools; "insiders' " profits; dealings in the bank's own stock.

Unlike the National City, it is true, the Chase Bank had no extensive high-pressure retail sales division, making direct contact with ultimate purchasers, like the unfortunate Mr. Brown of Pottsville. But on the other hand, some of the private operations of the popular and pre-eminent Mr. Wiggin and his subordinates, cannot be duplicated in the record of Charles E. Mitchell.

Mr. Wiggin's personality on the witness stand was in striking contrast to Mr. Mitchell's. There was

about him nothing of the latter's aggressive supersalesmanship. At rare intervals, he permitted a strain of sharp humor to color his testimony. But, in general, his answers were terse, succinct and directly to the point, with seldom an unnecessary word. Calm, shrewd, and cynical, he would admit that which could not possibly be denied, and even then, with what must strike an observer as superabundant caution. Unlike many of the leading figures who testified before the Committee, he disdained to express more than perfunctory regret, and while he acknowledged certain past errors in judgment, he was not inclined to recognize any pressing necessity for radical change. He was most decidedly a die-hard.

Mr. Wiggin's conservatism was, indeed, too much for his own colleagues in the Chase Bank. The hearings presented at times the highly interesting spectacle of a head-on collision in opinion between the redoubtable Mr. Wiggin—for over a quarter of a century the guiding genius of the bank—and Mr. Aldrich, the representative of the new management and the new banking ethics. Mr. Aldrich, who had succeeded Mr. Wiggin as Chairman of the Governing Board, differed violently with his predecessor's ideas as to how a bank should be run, and was at great pains to repudiate flatly many practices that Mr. Wiggin persisted in defending.

These differences were of sensational interest to the country in 1933, for in the minds of the general public, Mr. Aldrich meant the Rockefellers, and his

placatory attitude was taken by the public to indicate a willingness on the part of the vast Rockefeller interests to co-operate with the still emerging New Deal. More recent pronouncements would seem to indicate that Mr. Aldrich's enthusiasm for reform has perhaps undergone a certain cooling process with the passage of the years and the change in circumstances. But at that time, at any rate, he fairly out-Heroded Herod. His whole attitude was as severely high-minded and as militantly imbued with the necessity for correcting banking abuses as Mr. Wiggin's was skeptical and unbending.

This revolution in the philosophy of the dominant Chase group was manifested first of all in the reversal of its long settled policy on the crucial question of bank affiliates. The Chase National Bank was well supplied with those useful adjuncts: whereas, as we have seen, the National City Bank had only one affiliate—the National City Company—the Chase National Bank, like the planet Jupiter, had at least five satellites. Chief among these was the Chase Securities Corporation. This corporation in its turn completely owned and controlled an important company known as the "Metpotan" Corporation, the Chase Harris Forbes Corporation, and several others of lesser importance.

The Chase Securities Corporation was organized in 1917, following the example set by the National City and other banks. The opinion was expressed by one of the nine attorneys keeping watchful guard

over the interests of the Chase Bank at the hearings, that the arrangement here was "wholly different" from that between the National City Bank and the National City Company. The fact is, however, that the intimate connection, amounting to practical identity, between the Chase Bank proper and its security affiliate did not differ, except in details, from the National City model. It was found superfluous to set up a voting trust, such as we have observed in connection with the National City Company arrangements; but, as in the latter case, each stockholder in the bank was simultaneously an equal stockholder in the Securities Corporation, the certificates of stock in the bank and in the affiliate corporation were printed on reverse sides of the same piece of paper, and the stockholder was both legally and physically unable to sell or in any way separate his share in the bank from his share in the affiliate.

MR. PECORA: . . . The Chase Securities Corporation was organized as an affiliate of the Chase National Bank in such fashion that the identity of the stockholders of the Chase Securities Corporation was the same as the stockholders of the Chase National Bank and in equal proportion?

MR. WIGGIN: That is correct.

MR. PECORA: Was that not done in order to do indirectly that which the bank could not do directly? Is that not a fair conclusion, Mr. Wiggin?

MR. WIGGIN: Well, it was done to give those same

stockholders the benefit of what we thought would be a profitable business.

MR. PECORA: And that profitable business was the investment or securities business, was it not?

MR. WIGGIN: Yes, sir.

MR. PECORA: And the stockholders of the bank would not have had the opportunity or advantage of engaging in that business except through the setup of an organization like the Chase Securities Corporation?

MR. WIGGIN: That is correct.

Neither Mr. Wiggin nor the attorneys in charge of the organization of the Chase Securities Corporation in 1917, could recall hearing anything about the opinion of Solicitor General Lehman in 1911, that such a setup was illegal. The National City had "gotten away" with it, despite that opinion; the Chase Bank would not be left behind.

Altogether, the Chase Securities Corporation floated over six billion dollars of new security issues. This, while not as staggering an amount as the twenty billions of the National City Company, was sufficiently impressive; especially in view of the fact that the Chase Securities Corporation did not "yield to the times"—as Mr. Wiggin put it—and commence to make public offerings, until 1928.

The total profits made by the Chase Securities Corporation, from 1917 to 1933, were over $41,000,000, more than $12,000,000 of which were made during the years of depression following 1929. But the activities of the Chase Securities Corporation were

by no means confined to offering new securities. Just as in the case of the National City, its affiliates gradually led the Chase Bank not only into the field of investment banking proper, but into market pools, manipulations, and other kinds of dubious transactions. Yet Mr. Wiggin, as late as January, 1933, saw no reason, so far as his own personal judgment was concerned, for requiring banks to stick to the business of banking, and forbidding them to engage, under a transparent corporate *alias,* in the business of stock gambling.

But not so Mr. Aldrich. Early in March, 1933, in the very midst of the banking crisis, Mr. Aldrich had issued a public statement advocating a complete divorce of commercial banking and investment banking, and the eradication from the management of commercial banks of "the spirit of speculation." According to his own statement, he was largely influenced in his conclusions by the disclosures that had just been made before the Senate Committee of conditions prevailing in the National City Bank. He was careful to stress the fact that he was a comparative newcomer in the banking field, and that he had only recently become the executive head of the Chase National Bank. He completely dissociated himself from the policies and works of Mr. Wiggin, and by May, 1933, he had taken the necessary legal steps to bring the bank's double aspect to an abrupt end. The Chase National Bank remained a commercial bank alone. The Chase Securities Corporation survived, under

the new name of the Chase Corporation, but only to liquidate existing investments. The "security affiliate" was no more.

Mr. Wiggin viewed these changes made by his successor with tolerance, but without enthusiasm:

MR. PECORA: Well, what are we to understand . . . That you were in favor of the proposals [of Mr. Aldrich] or that you were not in favor of the proposals?

MR. WIGGIN: I am absolutely in favor of backing up the management of the bank, and therefore I was in favor of it.

SENATOR COUZENS: You did not approve them with enthusiasm, though, did you?

MR. WIGGIN: I approved them.

SENATOR COUZENS: Not with enthusiasm?

THE CHAIRMAN (Senator Fletcher): With reservations.

MR. PECORA: Did you approve of these proposals in principle and apart from the question of backing up the management?

MR. WIGGIN: No; I do not think so. . . .

MR. PECORA: Will you tell the committee candidly your judgment as to whether those proposals, even though you voted for them by proxy or otherwise, represent in your opinion a beneficial change or departure from your pre-existing policies? . . .

MR. WIGGIN: Changes have come pretty rapidly in the past year, and very probably if I were still the senior officer of the bank, I would have done the same thing. . . . Of course, I do not know what I would have done.

I say the changes had been many, and I might have done exactly what Mr. Aldrich has recommended. I do not know. Up to the time that I left the bank I did not think that it was necessary to make such a separation.

For the inability of so clever a man and so experienced a banker as Mr. Wiggin to see clearly the necessity for reform which was so obvious to Mr. Aldrich, there was, of course, a reason. Mr. Aldrich could advocate reform with the best of grace, for his was not the responsibility for the abuses that were to be ended. But for Mr. Wiggin, to condemn the past was to condemn himself.

Mr. Wiggin was not accustomed to condemnation, he was accustomed to praise. And to reward! His pride in the record of the bank may have been his supreme satisfaction, but it did not exclude more tangible satisfactions as well. As head of the Chase National Bank, for example, he received a salary of $175,000 in 1928, an equal amount in 1929, $218,750 in 1930, and $250,000 in 1931. As the reader will note, the deeper the depression, the higher Mr. Wiggin's salary. In 1932, Mr. Wiggin took a "cut" in salary, and received a mere $220,300. During these same depression years Mr. Wiggin, in his report to stockholders, was confidently denouncing the theory that high wages make prosperity, and declaring firmly that American business "may reasonably ask labor to accept a moderate reduction in wages, designed to reduce costs and to increase both employment and the buying power of labor." Needless to say, Mr. Wiggin saw no inconsistency between his views on wages in general and his own remuneration.

The above figures, moreover, represent only Mr. Wiggin's *regular* salary, as head of the Chase National Bank. He, and certain other leading officers, also received large additional sums as "bonus," awarded on the same generous principle that had inspired Mr. Mitchell and his brother officers to set up the famous National City Company "management fund." From this source, Mr. Wiggin received $100,000 in 1928, $100,000 in 1929, and, even in 1930, $75,000. Still further, while he received no regular salary from the Chase Securities Corporation, the bank's affiliate, he did receive from it large bonuses, which in some years ran as high as $75,000.

These various bonuses were supposed to be a reward for the superservices of the officers in producing especially large profits. But there was no thought of commensurate deductions when profits fell away.

MR. PECORA: Will you tell the Committee, please, out of what fund those bonuses were paid by the bank? Was there, in other words, a so-called "management fund" or anything comparable to it that was established from year to year out of which these bonuses were paid?

MR. WIGGIN: No, sir: there was no special fund. . . .

SENATOR ADAMS: They credited you with being responsible for some of their added profits in the good years.

MR. WIGGIN: I think so, sir.

SENATOR ADAMS: In the bad years did they charge you in any way with responsibility for losses?

MR. WIGGIN: No, sir.

SENATOR ADAMS: It has only worked one way?

MR. WIGGIN: Only one way.

For the year 1929, for example, the bank set aside a sum of $325,000, to be distributed as bonuses among such of the senior officers, "as the Chairman of the Board of Directors [i.e., Mr. Wiggin] in his discretion shall determine, and in such amounts and at such times as he shall determine." It was, in other words, all up to Mr. Wiggin, but delicacy prevented him from autocratically fixing his own share. Instead, a nice spirit of mutual appreciation and reciprocity prevailed, with Mr. Wiggin generally winding up with about thirty per cent of the total to be distributed.

MR. PECORA: Who made that determination with regard to the portion of this fund that was set aside for additional compensation for senior officers?

MR. WIGGIN: You mean the proportion to me?

MR. PECORA: Yes, sir.

MR. WIGGIN: My associates always suggested the amount and I always took it up with the board or the committee to explain what they wanted to do.

MR. PECORA: Whom do you mean by your associates?

MR. WIGGIN: The president, vice-presidents.

MR. PECORA: Well, did you also, as chairman of the governing board, help to fix the amounts of their additional compensation?

MR. WIGGIN: Yes, sir.

MR. PECORA: You helped to fix theirs and they helped to fix yours; is that right?

MR. WIGGIN: We all sat in together.

These bonuses, to be sure, do not compare with the truly magnificent sums voted to themselves by Mr. Mitchell and his associates, out of the National City "management funds," and amounting, as the reader will remember, in Mr. Mitchell's case, to more than a million a year. As Mr. Wiggin sardonically remarked: "Our figures were small. It was a small bank."

Pity for Mr. Wiggin on this score, however, would be premature. To begin with, we must remember that being executive head of the largest bank in the country was only a part-time job for Mr. Wiggin and that in connection with his fifty-nine variegated directorships, he was a member of numerous "finance committees," "executive committees," and the like. Quite frequently, he drew down handsome sums for his service in such capacities. The Brooklyn-Manhattan Transit, of which he was Chairman of the Finance Committee, for example, paid him a salary of $20,000. Armour and Company paid him $40,000. The American Express Company paid him $3,000, Western Union, $2,000, and so on.

Many of these corporations from which Mr. Wig-

gin received these helpful additions to his regular earnings, received large loans from the Chase National Bank, dominated by the same Mr. Wiggin. Mr. Wiggin, naturally, was quite positive that decisions on making those loans were in no way influenced by these circumstances, and it may indeed have been so. Yet it is obvious that these interlocking and possibly conflicting interests did not promote a healthy state of affairs.

But all this was only the beginning of Mr. Wiggin's lucrative activities. All his salaries and bonuses put together, would not have been great enough to begin to pay even the Federal taxes on his total income. Thus, in 1928, his salary as head of the bank was $175,000 and his bonus, $100,000, a total of $275,000; but he, or certain private corporations which he and members of his family completely owned and controlled, actually had an income of over $6,800,000, and paid Federal income taxes of approximately $962,000! That is to say, his income for the year was over twenty-five times as great as the combined salary and bonus he received from the bank.

In 1929, he again received but a modest $275,000 in salary and bonus for his devoted services to the Chase National Bank; but his total income for the year, including that of the family corporations, was over $3,800,000! Altogether, during the years 1928-1932, inclusive, and after deducting heavy losses of about $4,000,000 for the depression years, 1931 and 1932, he and his family corporations still showed a

net income for the whole period of over $8,600,000. Not many Americans could look back, in 1933, upon so satisfactory a balance sheet.

How were these millions made? If an humble teller in one of the branches of the Chase Bank, earning $4,000 a year, had suddenly been revealed as living in a luxurious apartment, maintaining two automobiles and paying an income tax on an income twenty-five times as great as his salary, you may be sure the authorities of the bank would have manifested a keen interest in his activities, and would have checked over his books and general conduct very carefully indeed. The chances that he would be allowed to continue handling other people's money would be very slim.

But nobody connected with the Chase Bank, of course, would dream of insulting Mr. Wiggin in such a fashion. It was left to the Senate Committee to find the answer for itself. This took the Committee and the writer many hours of patient investigation of highly complicated corporate transactions and intricate stock market maneuvers, but the result can be stated, in essence, in a few plain words: Mr. Wiggin was able to make an income many times in excess of his salary, in large part by using his unique opportunities as the trusted and all-powerful head of a great bank, for his personal advantage.

To assist him in his private operations, Mr. Wiggin formed no less than six corporations, all of them owned and controlled by himself or members of his immediate family. Three of these were Canadian

corporations, organized in the hope that they might prove useful in reducing income taxes—and their story is told elsewhere in this book. The other three were called the Shermar Corporation, the Murlyn Corporation, and the Clingston Corporation. "There was a little sentiment," testified Mr. Wiggin, about the naming of these companies; one—the Shermar—being compounded from the first syllables in the names of Mr. Wiggin's first daughter, Marjorie, and her husband, Sherburne; and the second named after another daughter.

There was very little sentiment, though, in the subsequent careers of these corporations. They were active and useful sources of profit, not incorporated heraldic monuments. When the Chase Securities Corporation, the bank's affiliate, was involved in what promised to be some especially profitable bit of financing, for example, it was considered more tactful and proper to "cut in" the impersonal-sounding "Shermar Corporation," rather than crudely mention Mr. Wiggin by his everyday, noncorporate name. But chiefly, these corporations of Mr. Wiggin were used as the instruments through which he speculated, on a huge scale and with a minimum of risk, in the stock of the institution of which he himself was the chief fiduciary, that is, in the stock of the Chase National Bank itself.

Mr. Wiggin's private operations in Chase Bank stock for his own benefit, moreover, were intimately intertwined and synchronized with extensive and intricate manipulations of the same stock undertaken by the bank's own affiliates. The full story of these involved relationships is an incredible one. The National City Company, too, had traded on a stupendous scale in the stock of its own bank, but the lengths to which speculation and manipulation in Chase Bank stock were carried on for the benefit of "insiders," far transcended anything that was done in the National City.

Between September, 1927, and July, 1931, the Chase Securities Corporation, either directly, or through the Metpotan Corporation, which it owned, participated in and largely financed eight pools in the bank's stock. These pools were briskly conducted. One was no sooner wound up, than another was started. Sometimes several pools were in operation simultaneously. Mr. Wiggin, like other eminent financiers, did not like the term "pool," and preferred to call these operations by the more non-committal term, "trading accounts."

Mr. Pecora: . . . Now, is this such an account as you would commonly call a "pool"?

Mr. Wiggin: I do not think so.

Mr. Pecora: Well, how would you characterize it in a phrase?

Mr. Wiggin: I would call it a trading account. . . .

Senator Couzens: Don't you like the name "pool"?

Mr. Wiggin: No.

Senator Couzens: I thought you were shying away from it.

MR. WIGGIN: You are right. I don't like the name "pool."

MR. PECORA: Then if this account had been formed by a number of participants that would comply with your definition of a pool, you still would not call it a pool, even if it were a pool?

MR. WIGGIN: I would not like to call it a pool, no, sir.

MR. PECORA: What is there offensive about the term "pool," Mr. Wiggin, that causes you to shy away from it?

MR. WIGGIN: Just the reputation of the word.

MR. PECORA: Just the reputation of the word?

MR. WIGGIN: Yes.

MR. PECORA: Well, does it connote something that is reprehensible?

MR. WIGGIN: It does in some people's mind, yes.

MR. PECORA: Reprehensible in what respect?

MR. WIGGIN: I don't know. I don't know, but there is that feeling against the use of the word "pool."

However elegantly designated, the essential nature of the transactions could not be obscured. Altogether, they resulted in the purchase or sale of millions of shares of Chase Bank stock, involving $430,772,795 in purchases and $429,949,210 in sales, a total of over $860,700,000.

Mr. Wiggin could not be brought to admit that there was the slightest impropriety in the bank's encouragement of and participation in these gigantic pools in its own stock. In his opinion, they were "perfectly justified." Other participants in these pools, he conceded, like the brokerage firms of McClure,

Jones and Company, or Potter and Company, or the investment bankers Dillon, Read and Company, and J. and W. Seligman and Company, were probably participating for the purpose of making money: but the Chase Securities Corporation itself, and the Metpotan, its subsidiary, were not similarly motivated. While not indifferent to possible profit, they were primarily interested, according to Mr. Wiggin, in "stabilizing the market," in increasing the number of stockholders, in "providing purchasing power," and in exercising a "steadying effect" upon the price of Chase Bank stock.

Unfortunately, despite their best efforts, they could not prevent the stock of the Chase National Bank from rising from 575, on September 21, 1927, the day the first of these eight pools was started, to the equivalent of 1415 (the stock had been split 5 for 1, and the high for the new stock was 283), in 1929, shortly before the bubble burst, at which price it was sold in large amounts to the public. By 1933, the new, split-up stock had declined to 17¾ (the equivalent of 89 for the old stock). It is evident that as a means of "steadying the market" in Chase Bank stock, these pools were a woeful failure.

It is quite true, however, that the amount of profits ultimately realized was by no means great. The Metpotan Corporation, the chief instrument through which the bank participated in these transactions, could show only the relatively negligible profit of

$159,000 for the whole five years (1928-1932) trading in Chase Bank stock. This low figure was due in part, of course, to losses of almost two and a half million dollars incurred in 1930 and especially 1931, in such trading; in 1929, for example, Metpotan made a profit on Chase Bank stock of about $1,800,000. But even allowing for this factor, the results were small indeed, considering the vast scale of the trading.

A very different picture is presented when one turns to the private operations of Mr. Wiggin and his family corporations in the same stock and during the same period. It at once appears that Mr. Wiggin, in his private capacity, was marvelously more successful at this business of trading in Chase National Bank stock, than he was as head of the Bank. The contrast is astonishing. *Whereas Metpotan, as we have seen, in pool transactions aggregating over $860,000,000, made only a miserable $159,000 profit for the whole period of 1928-1932, Mr. Wiggin and his corporations, during substantially the same period, from trades in the same stock, actually realized a cash profit of over $10,425,000—sixty-five times as much!*

A part, but only a small part, of these millions came to Mr. Wiggin because the Chase Securities Corporation of Metpotan, obligingly "cut in" Mr. Wiggin's Shermar Corporation on some of the eight pools in the bank's stock already described. But the vast bulk of the money came from a different source, from transactions in which neither the Bank nor any of its affiliates shared a penny of profit.

Furthermore, a large part of this $10,425,000 which Mr. Wiggin made by trading in Chase National Bank stock, $4,008,538 to be exact, was reaped in the amazingly short period between September 19, 1929 and December 11, 1929, and in the very midst of the great Wall Street crash. To make four million dollars at any time is considered a brilliant achievement; to make that much money, in less than three months, and during the greatest collapse in the history of the stock market, would seem to call for a mysterious genius. But, like other mysteries, the answer, once found, was quite simple. Mr. Wiggin made all that money by selling Chase National Bank stock short.

The mechanics of "short selling" require, perhaps, a word of explanation. The short seller is one who sells stock which he does not own. Reversing the natural order of events, he sells first and buys later, expecting that in the interim the price will go down. Meanwhile, in order to satisfy the buyer to whom he has sold the stock, he borrows the necessary number of shares, generally from another broker, who keeps the purchase money as security. Mr. Wiggin, however, proceeded a little differently as will be made clear in due course. Eventually, the short seller "covers," i.e., buys the same number of shares he has already sold, delivers them to the person from whom he borrowed the stock, and receives the original purchase money. If he succeeds in "covering" at a price lower than that for which he originally sold short, the

difference between the price he paid for the stock and the price for which he sold it represents his profit.

Mr. Wiggin not only sold short before the crash, he kept on selling short right through the crash, right through the fateful days of October and November, 1929, when so many members of his own Wall Street community were frantically facing destruction, and while he himself was a leading member of the famous "bankers' consortium," organized to stabilize the market so far as possible. He did not stop until December 2, 1929, by which time he had sold 42,506 shares. Soon after, on December 11, 1929, he safely covered his short position, and realized that amazing profit of over $4,000,000.

By contrast, Mr. Mitchell looms up as an heroic and laudable figure; for Mr. Mitchell, you will remember, when the crash came, did not see in it a nice opportunity to make a few additional millions by selling his bank's stock short, and thus adding to its further demoralization and increasing the stockholders' loss; on the contrary, he testified that he bought National City stock more heavily in 1929, "in the midst of the panic," than at any other time, and "put all that I had back into this institution and for its stability." If some of his operations smacked of financial freebooting, he at least went down with his ship in the hour of crisis. But Mr. Wiggin was a businessman, and "most popular banker in Wall Street" or not, business came before sentiment, before loyalty to the institution which was the confessed pride of his

life, and to its 89,000 stockholders who trusted him so implicitly.

Bear in mind, also, that during this same period, the Chase National Bank itself, through its affiliates, was participating in a pool for the purpose of "stabilizing" the market. To the extent that this was successfully accomplished, it of course helped Mr. Wiggin by tending to hold up the market, while he was selling short. Not only this, but 5,000 of the shares which Mr. Wiggin sold short, were sold directly to this very pool.

Nor was this all that the bank did to aid Mr. Wiggin's profitable venture. Both at this time and for years previously, Mr. Wiggin's private corporations had been granted credit freely by the bank, and had borrowed many millions—sometimes as much as $5,000,000 in one week's time—which Mr. Wiggin used for his private purposes. To be sure, these loans were made on the security of ample collateral, and were duly authorized by the Chase's board of directors. In November and December, 1929, the bank in this manner loaned over $8,000,000 to one or another of Mr. Wiggin's family corporations, and it was thus this money that Mr. Wiggin used to buy the stock with which he covered his short sales, on December 11, 1929.

The Wiggin family owned more than enough shares of Chase National Bank stock, at all times, to have covered Mr. Wiggin's sale with their own holdings. Indeed, Mr. Wiggin for this reason protested

that his sales were only technically short sales—that they were really sales "against the box." He declared that in his opinion, prices of bank stocks, including Chase, had risen to a "ridiculous" height in 1929, and that he therefore wished to reduce his family holdings, and at the same time "provide purchasing power"—i.e., help break the fall by covering purchases—if and when such a fall took place. The only trouble with these innocent and meritorious explanations was that Mr. Wiggin, when the time came to cover, did not use his own family holdings of Chase stock. He did not even buy in the open market. Instead, he bought the necessary stock from Metpotan, the bank's subsidiary, itself. How such a private purchase, unknown to any but the participants, could help stabilize the market in Chase stock, Mr. Wiggin could not explain. Nor, of course, did the whole operation "reduce the family holdings" by a share. It did, however, increase the family exchequer by millions.

To make the story complete, Mr. Wiggin did not pay one cent of income tax on this $4,008,538 profit. This, too, required only a simple bit of legal juggling. Had Mr. Wiggin sold short in his own name, and covered in his own name, he would have had to pay a large tax. But it was not Mr. Wiggin personally, it was the Shermar Corporation, which sold short. When December 11, 1929, arrived, however, and Mr. Wiggin wished to cover his short sales, the Shermar Corporation, which had done the selling,

did not do the buying. Instead, Mr. Wiggin had another of his family corporations, the Murlyn, buy the stock, and *lend* it to Shermar. Shermar could now say that it had not yet realized any profit, as it had not yet completed the transaction by an actual covering *purchase*. Murlyn, on the other hand, had surely realized no profit, for it had merely purchased some stock and then *loaned* it. And Mr. Wiggin could say that he himself had not realized any profit, because in the eyes of the law, he and his corporations were entirely distinct entities from one another. Thus the matter stood, until 1931, when the Shermar and Murlyn Corporations merged. But even then, Mr. Wiggin did not have to pay any tax on these profits, for he was able to show losses for his corporations for that year great enough to absorb the $4,000,000 gain made two years before.

To summarize, when the technicalities are resolved, and the fog of subsidiary corporations surrounding the Bank and Mr. Wiggin penetrated, the record amounts to this: While Mr. Wiggin was still the all-dominant head of the Chase National Bank, he saw fit to sell short tens of thousands of shares of his own bank. While he was doing this, the bank obligingly helped him keep the price up—"kept the boat from rocking." In part, his short sales were to the bank itself. When the time came to cover, the bank furnished the necessary stock, and loaned him the necessary money with which to buy it. Finally, by legal jugglery, the technical taking of the profit

was deferred until it could be neutralized, so that no tax need be paid on it. Score: United States Government, 0; Chase National Bank, 0; Mr. Wiggin, $4,000,000.

* * *

It would, of course, have been wholly impossible for Mr. Wiggin to have carried on such extensive operations in Chase Bank stock without the knowledge and approval of his brother officers. They, however, were in no position to object to such activities, even if they had possessed any desire to do so. With admirable foresight, Mr. Wiggin had long previously taken care of that. Many of the leading figures of the bank had been made officers or directors of Shermar Corporation, and knew all about its doings at every step. Many others were the recipients of large loans from Mr. Wiggin or Shermar Corporation. Many were taken along by Mr. Wiggin and given a share in underwritings or joint-accounts, which Mr. Wiggin in his turn had obtained through sub-allotment from the bank. He stopped their mouths, and killed any possible disposition to cavil, by intermingling his private business with the bank's; by making his interests their interests too; by being generous and considerate to them, just as the bank was to him.

Thus, Mr. Robert L. Clarkson, President of Chase Securities Corporation, was a director of Shermar. Mr. Lynde Selden (Mr. Wiggin's son-in-law), a Vice-President of the Bank, was Vice-President of Shermar. Mr. William P. Holly, a Vice-President and Cashier of the bank, was a director of Shermar. Half a dozen other vice-presidents of the bank were directors of Shermar. Mr. Bisbee, head of the eminent law firm which was counsel to the bank, was a director of Shermar. On December 31, 1932, Mr. H. G. Freeman, formerly Chairman of the Executive Committee of the bank, owed Shermar Corporation $163,000. Mr. Murray Dodge, ex-Vice-President and director, owed Shermar $300,000. Gerhard M. Dahl, director, owed it over $700,000, and so on. Mr. Freeman, Mr. Dodge, and Mr. Callahan, who were a majority of the active senior officers of the Chase Securities Corporation, granting participations, or subparticipations, to Shermar, were all indebted to Shermar Corporation either for money or favors. These were hardly the men to restrain Mr. Wiggin.

MR. PECORA: Well, has there developed through the years a system whereby those executive officers of the Chase Securities Corporation, in the exercise of their judgment, gave your family corporations a subparticipation in interests, such as Chase Securities Corporation Syndicate accounts, and you and your family corporations gave to those individual officers subparticipations in some of your syndicate interests?

MR. WIGGIN: Occasionally.

MR. PECORA: What was that? A sort of log-rolling scheme?

MR. WIGGIN: No. It was that they wanted to reduce the risk.... And I also had the theory that those key men

should have, that it was wise for them to have something besides their salaries. . . . You will understand that this was not a case of heads I win and tails you lose. They took the risk. . . . That is my theory, that their self-interest made them better judges of the matter than otherwise.

For his own part, Mr. Wiggin professed to see nothing wrong in his own short selling of Chase Bank stock, or in the bank's having loaned him the money with which to cover.

MR. PECORA: Then this short position commenced about a month before the more or less famous market crash of October 26, 1929.

MR. WIGGIN: It began; yes.

MR. PECORA: I suppose you made them because you read the financial skies and concluded that the trend was going to be downward in the value of the Chase Bank stock.

MR. WIGGIN: I do not think I was wise enough for that.

MR. PECORA: You did sell it short commencing with September?

MR. WIGGIN: Yes; and I did think that the bank stock market was high and I did want a buying power for that bank stock.

MR. PECORA: And you developed that buying power through the operations of your own private corporation at what proved to be eventually a substantial profit to your corporation?

MR. WIGGIN: On that transaction; yes, sir.

MR. PECORA: Do you consider that an ethical practice for the head of a bank to engage in?

MR. WIGGIN: I think it is commendable to provide a buying power for your own stock. . . .

MR. PECORA: Do you think, Mr. Wiggin, it is a sound and ethical policy for a national bank to make loans to individuals among its officers or directors to enable those officers or directors, either individually or through the medium of private corporations, to engage in market activities in connection with the stock of the bank itself?

MR. WIGGIN: I think so, as long as the loans are properly secured. . . . *I think it is highly desirable that the officers of the bank should be interested in the stock of the bank.*

Mr. Aldrich, however, and the new management of the Bank, and the country at large, thought otherwise. When Mr. Wiggin had resigned as Chairman of the Governing Board, in December, 1932, he had been granted what was in effect a pension of $100,000 annually, with many polite encomia, in recognition of his many years of faithful service to the Bank. But when the facts of his stewardship were brought to light before the Senate Committee, the storm of popular disapproval was so great that Mr. Wiggin felt constrained to renounce the pension.

One cannot feel that any great injustice was here done to Mr. Wiggin. In the entire investigation, it is doubtful if there was another instance of a corporate executive who so thoroughly and successfully used his official and fiduciary position for private profit.

8

"MORE OR LESS OF A JOKE"

THE Chase Securities Corporation, as the reader will remember, was in one aspect an investment house, and participated in bringing out over six billion dollars of new securities. In this department of its activities, investment banking proper, as practiced by J. P. Morgan and Company or Kuhn, Loeb and Company, the Chase Securities Corporation was by no means uniformly happy in its experiences. In the general scramble among investment bankers, for example, the Chase people struggled valiantly to gain a foothold in the business of bringing out foreign bond issues. But though they actually succeeded, in Cuba, in nosing out J. P. Morgan and Company and the National City interests, they eventually derived little joy or profit from their victory.

Their difficulties on this tropical island were many and vexatious. To begin with, there was, somewhat surprisingly, the American Ambassador himself,

General Enoch Crowder. The General had been on the scene in 1922, when J. P. Morgan and Company floated a $50,000,000 Cuban loan; and while he had nothing against the Chase, he appeared to prefer the Morgan firm for handling any new financing. The situation required the most tactful treatment, for an ambassador, especially a United States Ambassador to Cuba, is not without influence in matters of this sort. The Chase representative on the ground, after conferring with General Crowder, recommended to his superiors, with fine realism, as follows:

> It is clear that the bank should preserve cordial relations with the United States Ambassador, but while not telling him anything that would damage our interests in Cuba, to be careful not to make any statements which he might easily learn were contrary to fact.

This would seem to be a practical admonition against inartistic prevarication.

Then there were tiresome legal technicalities to be dealt with, arising out of the historic Platt Amendment embodied in the Cuban Constitution. Under one of the sections of this Amendment, Cuba was bound to refrain from contracting any public debt which could not be serviced and amortized out of the "*ordinary* revenues" of the Republic. The grandiose public works projects, on the other hand, in connection with which the proposed financing was to be undertaken, were to be paid for, under the Cuban

law, out of certain taxes designated as "*special* revenues" and not forming a part of the ordinary budget. The Chase Bank, however, retained Dr. Antonio de Bustamente, leader of the Cuban bar and eminent member of the World Court, who rendered an opinion that the proposed financing was legal and valid; Rushmore, Bisbee, and Stern, the eminent New York law firm, came to the same conclusion; and in due course, the United States Department of State complacently indicated that it did not intend to raise any objections. Thus, this hurdle, too, was overcome.

It remained, however, to win over the Cuban officials themselves. President Machado was then in office and all-powerful. It so happened that one Henry W. Catlin, a lawyer on the advisory committee of the Havana branch of the bank, was one of Machado's closest friends, "running in and out of the palace" continually. He was, in fact, a business associate of the Cuban dictator, being President of a local electrical concern of which the latter was Vice-President. To Mr. Catlin the Chase Bank paid $55,000 for his labor in connection with its new financial business. It was asserted, however, most positively, that this sum was not paid to him as an intermediary or as a commission or anything of that sort, but solely to compensate him for his "legal services." The fact that he was a friend and business associate of the Cuban President assuredly had nothing to do with it. The Chase Bank, it was intimated, would not stoop to such tactics.

Mr. Catlin, none the less, received most considerate attention. In addition to the above $55,000, he was permitted to run up an overdraft at the Chase Bank which, at the time of his death in 1932, amounted to over $50,000. He also was permitted to borrow very freely on collateral security. By October, 1929, he had somehow accumulated $937,000 worth of stocks and bonds, on which the bank loaned him $766,000, a very substantial part of which was apparently lost by the Bank after the market dropped. President Machado himself was also granted loans, sometimes as high as $200,000 at a time, but these were all duly paid with interest. Dr. Carlos Miguel de Cespedes, Secretary of Public Works, an important member of Machado's Cabinet, likewise received large loans, running up to $200,000. These, too, were paid in full.

It was still further possible for the Chase Bank to show a friendly spirit. President Machado, like other fathers, had son-in-law trouble. His son-in-law, one José Obregón, was described in the testimony as "a very handsome fellow" but "from a business standpoint perfectly useless." This did not prevent him from being appointed joint manager of the Havana branch of the Chase Bank. Why this was done is indicated very clearly in the words of a confidential memorandum of the Bank, penned by an officer to his superiors in February, 1931:

> As we know, from any business standpoint he [José Obregón] is perfectly useless. He has neither any ability

for banking, nor has he the slightest ability in negotiating, which was something which we thought it might be possible to build him up to do. The only use that Joe [José] has would be to do a certain amount of entertaining of our more important customers when they come to Havana in the winter, and also to do a certain amount of contact with regard to new business, etc. . . . From what I could gather listening to some of the Cubans' talk is that Joe has very little standing with the President, and I think this is probably true. On the other hand, where the rub comes in is that if we did not pay him his salary the President would have to give him an allowance and in times as hard as these this might be fairly difficult to do. . . .

Finally, there was the press. Unlike the press of America, it was possible in Cuba to buy favorable newspaper publicity and propaganda by judicious payments; and cheaply, too, for this cost only a couple of thousand dollars extra, listed as "incidental expense."

The loans to Cuba by the Chase started modestly enough, with a $10,000,000 bankers' credit in 1927. But in 1928, the loan was increased to $60,000,000, and in 1930, to $80,000,000. In addition, there were three "minor" short-term loans, amounting to $7,500,000. Associated with the Chase National Bank and the Chase Securities Corporation in different stages of this financing, were Blair and Company, Equitable Trust Company, and the Continental National Bank and Trust Company of Chicago.

The details of the financial transaction by which

these loans were effected were quite complicated. It will suffice here to say that eventually of the $80,000,000 "major" loans, $20,000,000 was advanced as a "bank credit" by the syndicate, with no attempt to pass the burden on to the public; the remaining $60,000,000 was represented by $20,000,000 short-term bonds, issued in 1928, and $40,000,000 long-term bonds, issued in 1930, which the syndicate sold, so far as they were able to do so, to private investors.

Almost from the beginning, these loans were a problem. Even when the "special revenues" set aside by law to take care of them came up to budgetary expectations, the Cubans spent money so rapidly that they were soon in hot water. When, in addition, the effects of the depression began to be felt, and revenues fell off, the bankers had to step into the breach again and again. Despite their intimate knowledge of the unenviable state of Cuban finances, however, the prospectuses which the bankers distributed, in floating these various bond issues, contained not a syllable to put an investor on his guard with respect to these factors. Some of the statements contained in them, such as the summary of the Cuban national debt, were so ambiguous, to say the least, that even after an hour's questioning, the Senate Committee itself still was uncertain as to their meaning, and still more as to their accuracy. Taken as a whole, they were unquestionably inadequate if not actually misleading.

Nor did the bankers conceive it to be any part of their duty to see that the proceeds of these bonds

were actually and properly used for the purposes stated, and not dissipated by extravagance or graft—although they admitted that it was commonly charged that these public works projects were costing 50 per cent more than their legitimate cost. In their opinion, and no doubt quite in line with banking precedents, this was no business of theirs. "A banker is not an auditor in this case."

Despite all the toil and trouble which this financing involved, the results in dollars and cents were comparatively dismal. All told, the members of all the underwriting and distributing groups, including a "selling group" of six hundred, made a net profit, including bankers' commissions, of about three million dollars. The share of the Chase Bank and its affiliates was only about $800,000, "including everything" and covering "a period of seven years." On the other hand, the bankers had to keep loaning Cuba $20,000,000 of their *own* money; they had to take over about $870,000 of short-term bonds that the Cuban Government could not meet at maturity; and they were also stuck with an indeterminate quantity of the $40,000,000 long-term bonds, which they had failed to get rid of. The Chase Bank, itself, retained $3,000,000 of these bonds in its investment portfolio, as a melancholy souvenir of its Cuban adventure.

* * *

In marked contrast to these uninspiring results, the Chase Bank seems to have succeeded much better when it mixed its underwriting of new issues with

some plain and fancy stock market speculation. Here it was in its own sphere, and it knew the technique. The writer was particularly interested in the so-called "Cutten pool" of 1928-1929, which traded in the stock of the Sinclair Consolidated Oil Corporation.

This was a most ingenious and profitable operation. Credit for its authorship belongs primarily to Mr. Harry F. Sinclair, of Teapot Dome fame. Mr. Sinclair was, in 1928, Chairman of the Board of the Sinclair Consolidated Oil Corporation, a well-known oil producer and distributor. He looked about him and meditated and came to the conclusion that his corporation did not have enough capital. It was not in straits and there was no especially pressing debt. But it is always good to have more money in the treasury, for there is much which may be done with it, if you have it.

Now, how to raise the new capital? Mr. Sinclair did not resort to any of the more orthodox methods, such as we have observed in connection with the business of J. P. Morgan and Company or Kuhn, Loeb and Company. There was no "house of issue," or triplicate series of "originating group," "banking group" and "selling group," with the aim of distributing new securities to purchasers via the regular channels of investment banking. These conventional methods might or might not have yielded satisfactory results from the point of view of the Sinclair Corporation, but it was quite clear that, whatever their re-

sult, they would have yielded no profit to Mr. Sinclair personally. This probably was not a very pleasant thought, and it did not take Mr. Sinclair long to decide to use a different method.

Instead of the more usual procedure, he went directly to Arthur W. Cutten, one of the most famous and spectacular market operators in the entire galaxy of the New Era. In conjunction with the latter a little group was formed, composed only of the two of them, and the Chase Securities Corporation and Blair and Company, and, of course, the inevitable Shermar Corporation—and this group was to purchase from the Sinclair Consolidated Oil Corporation 1,130,000 new shares of that company's stock at $30 per share. This new stock Mr. Cutten could then arrange to sell for the group directly on the floor of the Stock Exchange, for whatever the public could be induced to pay.

This was a comparatively little used method, but it had, for Mr. Sinclair and Mr. Cutten, very decided advantages. By resorting to it, they would not have to bother with a lot of intermediaries, or turn over a profitable opportunity to alien hands, or limit their own profits to the meager percentages of J. P. Morgan and Company or Kuhn, Loeb and Company.

After some demur about the price of $30 a share, which Mr. Cutten thought a bit high—reasonably enough, as the existing common stock of the Sinclair Corporation had not sold at that price for the four previous years—the deal went through. A formal

agreement between Mr. Cutten and the Corporation was officially signed on October 25, 1928. No sooner did the public hear the good news that Mr. Cutten was going to operate a huge pool in Sinclair stock than the price began to jump.

When negotiations began, the stock had been selling at 28. On October 24, the stock opened at 32 and went up almost four points before the close. On that and the succeeding day alone, almost a million shares of Sinclair Oil were traded in. The group, which eventually included certain new members, operated until April 16, 1929. During the intervening six months, they had sold, at prices fluctuating mostly between 35 and 45, not only the 1,130,000 new shares they had started out to dispose of, but 700,000 additional shares bought in the open market because the trading had turned out to be so profitable.

Altogether, this syndicate made a profit of over $12,000,000—on an issue of $33,900,000. This was beating the big investment bankers at their own game, with a vengeance.

The public which frantically bought all these shares had little thought of such things as earnings, business practices, book value or dividend record. They bought because there was magic—in those days—in the name of Cutten, and in the blind hope that a stock in which he and his associates were interested, was going to go up. Even Mr. Wiggin testified that this was, for him, the decisive factor.

MR. PECORA: What did you know about the Sinclair Consolidated Oil Corporation's common stock at the time that caused you to have your family corporation participate in this syndicate to the extent to which it did?

MR. WIGGIN: I think the participation was based more on the confidence that Cutten would handle the syndicate successfully than it was from knowledge of the stock.

MR. PECORA: What did you know about Cutten's ability to handle syndicate operations successfully?

MR. WIGGIN: Well, I knew Mr. Cutten and I knew that he had handled things successfully.

To be sure, the syndicate was far too efficient and cautious to rely solely on Mr. Cutten's prestige. It utilized as well all the resources of sophisticated market technique in support of new issues, with which we became familiar in connection with the operations of the orthodox investment bankers and underwriters.

In addition to the original syndicate which purchased the 1,130,000 new shares of common stock from the Sinclair Consolidated Oil Corporation, there was organized a second, so-called "trading group," the primary object of which was to "maintain a market" for the stock, during the months that the original syndicate was unloading its hundreds of thousands of shares on the public.

Whenever the market in Sinclair stock sagged, this secondary syndicate stepped into the breach and bought; as soon as the market recovered, it sold. Often, this secondary "trading group" bought and

sold on the same day, and at the same time as the main "purchasing group" was likewise selling. The public, of course, knew nothing of these intricate day-by-day, or rather hour-by-hour, manipulations, and accepted all this activity as genuine.

This secondary "trading group," by itself, bought and sold over 1,200,000 shares of Sinclair Corporation stock in this manner, and it incidentally made a profit of about half a million dollars, thus killing two birds with one stone. It consisted of thirty-two participants, including various persons identified with the Sinclair Corporation and with the Chase National Bank or its affiliate.

Mr. Sinclair protested most vigorously that his entire conduct in this whole transaction was dictated solely by his conception of the interests of the Sinclair Corporation, and that he was "not trying to make money" for himself:

MR. SINCLAIR: . . . I was promoting the interests of the corporation in trying to sell those shares, in trying to do that, and not trying to make money. I would have been very happy to have given all of my participation away. I came into it to help the corporation. I did not seek it.

Nevertheless, despite his altruistic and disinterested motives, Mr. Sinclair, by virtue of his 22½ per cent interest in the original "purchasing group," did realize a profit of over $2,600,000 in less than six months. It is true that he granted "subparticipations" to sev-

enteen other persons, and thereby very materially reduced his profits, but he still actually retained for himself the sum of $1,400,000. This can hardly be regarded as trivial, considering that he was "not trying to make money." One may only surmise how much he would have made, had he really tried.

Mr. Cutten did not fare badly either. He, too, had a 22½ per cent interest in the "buying group," and therefore also realized a profit of over $2,600,000. He also had granted subparticipations; but in his case, there were only two of these, amounting to about $877,000, so Mr. Cutten's final profit was about $1,755,000.

Nor did Mr. Wiggin find himself neglected. His Shermar Corporation, with a 7½ per cent interest, came in for a $877,000 share in the profits; and even after granting a number of subparticipations, he retained approximately $600,000. The Chase Securities Corporation, with a 15 per cent interest, made $1,755,000. Blair and Company made $2,632,000.

Even these luscious figures fail to reveal the full richness of the story. *For most of the members of the syndicate made these profits without actually putting up a single dollar of their own money.* The agreement of October 24, 1928, between the Sinclair Consolidated Oil Corporation and Mr. Cutten, provided, of course, that the corporation should receive the purchase price of $33,900,000; but the actual delivery of the shares and payment for them was not to take place until December.

In the meantime, however, the syndicate had already been actively trading in the stock; it had already realized a profit of $2,000,000 on its sales; and the quotation for the stock had already advanced from 30 to around 40. When the time for payment came, therefore, the syndicate already had a margin of about twenty-five per cent, and on the security of this margin, E. F. Hutton and Company, the brokers for the syndicate, itself advanced the money—largely out of funds borrowed, in turn, from the Chase National Bank. The syndicate members—with the exception of Blair and Company, which wanted to avoid interest charges, and to a limited extent, the Shermar Corporation—did not have to advance anything. As Mr. Cutten testified, "There was no real money put in then." Such are the usages of the higher finance.

Where, the reader may inquire, was the board of directors of the Sinclair Consolidated Oil Corporation all this time? Why did they consent to an arrangement that put all this profit into private pockets instead of into the corporation's treasury? It is a pertinent question. The Sinclair board of directors, however, was dominated by the very men who formed the majority of the "buying syndicate," and like innumerable other officers and directors, they did not hesitate to utilize their inside position for their own profit, or for the profit of the outside interests they represented. Mr. Sinclair himself was the chief figure in the company. Mr. Elisha Walker, the president of

Blair and Company, was a leading member of the board, and so was the representative of Chase Securities Corporation. Each of these men, it is true, had disclosed to the other directors that they were interested in the transaction, and, in accordance with the most rigid financial etiquette, had left the room during the discussion and refrained from voting. But nobody had doubted for an instant that the rest of the board would follow their lead. Indeed, the board's consent had been simply taken for granted throughout the negotiations.

Nor was one's confidence in the independence of the remaining members of the board of the Sinclair Corporation strengthened by the revelation that, less than a month after the agreement was signed, six of these disinterested directors themselves received "subparticipations"— i.e., a chance to share in the profits of the deal which they had just impartially approved!

In addition to these "subparticipations," the records showed that the syndicate gave $300,000–2½ per cent of the profits–to Mr. William S. Fitzpatrick, president of the Prairie Oil and Gas Company. This proved to be a most puzzling item. Mr. Fitzpatrick was not an officer or director of the Sinclair Corporation, nor was he connected officially with any of the members of the syndicate. He was not asked to assume any risk of loss. He was simply made a present of $300,000. When the Senate Committee sought to ascertain why a group of case-hardened syndicate

members had exercised this mysterious generosity, they were at first met by a blank wall of most amazing ignorance. Arthur Cutten's testimony, for instance, was of the vaguest nature:

MR. PECORA: . . . Now, let me ask you, why was William S. Fitzpatrick paid 2½ per cent out of the total net profits of over 12 million dollars?

MR. CUTTEN: I don't know. . . .

MR. PECORA: Upon whose suggestion was Fitzpatrick paid 2½ per cent of the total profits?

MR. CUTTEN: I could not say.

MR. PECORA: Well, you were the manager of the purchasing syndicate, weren't you?

MR. CUTTEN: Yes, sir.

MR. PECORA: Who asked you to pay Fitzpatrick 2½ per cent of the profits?

MR. CUTTEN: Nobody asked me.

MR. PECORA: Then why was it paid to him?

MR. CUTTEN: It must have been arranged among the participants.

MR. PECORA: Well, you were one of the participants.

MR. CUTTEN: Well, I was not consulted.

. . . .

MR. PECORA: You contributed to that $300,000, did you not?

MR. CUTTEN: Yes.

MR. PECORA: You had a twenty-five per cent interest in those profits . . . so that your contribution to Mr. Fitzpatrick was . . . $75,000.

MR. CUTTEN: There must have been some reason for it that I have forgotten.

Mr. Ruloff Cutten, cousin of Arthur Cutten, and a member of E. F. Hutton and Company, in charge of the actual trading on the Stock Exchange, likewise testified that he knew of no reason for the payment to Mr. Fitzpatrick. He was instructed to pay $300,000 to the latter by Blair and Company, and he simply carried out his instructions. Mr. Sinclair, too, knew positively nothing. He had cheerfully agreed to relinquish the money, because Blair and Company made the suggestion, but why, he knew not:

SENATOR COUZENS: What did Mr. Fitzpatrick do for this money? He was not a participant in the syndicate, and so what did he do for it?

MR. SINCLAIR: I don't know. He didn't do anything for me. . . .

MR. PECORA: Was this a gift to Mr. Fitzpatrick?

MR. SINCLAIR: You may call it what you wish.

MR. PECORA: What would you call it?

MR. SINCLAIR: Well, it wasn't Christmas.

. . . .

MR. PECORA: So that Blair and Company were making him some money at the expense of all the other syndicate participants?

MR. SINCLAIR: There is no doubt about that. . . .

MR. PECORA: So that you were one of the Santa Clauses? This was a Santa Claus syndicate, so far as giving Fitzpatrick $300,000 was concerned?

MR. SINCLAIR: It sounds a bit like it, doesn't it? . . .

MR. PECORA: Did you know they were hanging Santa Claus' whiskers on you at that time?

MR. SINCLAIR: Yes, sir.

MR. PECORA: You were willing to wear them?

MR. SINCLAIR: I did.

A good deal of this murky darkness, however, was dispelled by subsequent testimony. It developed that Mr. Fitzpatrick had been in the service of the Prairie Oil and Gas Company for twenty years, and that the Rockefellers, who dominated the company, were considering selling out some of their interest to a syndicate headed by Blair and Company. Thus far everyone was agreed; but from here on, there was a peculiar divergence.

According to Mr. Fitzpatrick, he had become alarmed for his financial security because of the impending possibility of loss of Rockefeller control over his company; and the $300,000 he received from the Sinclair pool came to him as the result of the Rockefeller interests' kind decision, in recognition of his many years of faithful service, to use their influence and "arrange" something that would "take care of him." True, the $300,000 did not come out of the Rockefellers' own pocket, but Mr. Fitzpatrick was too pleased about it all to allow himself to brood over such a trifling inconsistency.

This was indeed an affecting tale of virtue rewarded and of paternal solicitude. However, Mr. Bertram Cutler, financial adviser to the Rockefellers, most disappointingly failed to sustain the role. He testified, to Mr. Fitzpatrick's intense indignation,

that all this was news to him: he had "arranged" nothing of the sort, he had not even known that Mr. Fitzpatrick got the $300,000, and he would not have approved of the president of his company accepting such a sum from a syndicate including various representatives of a rival corporation, if he had known of it. All that he had consented to, or suggested, was that Fitzpatrick be permitted to buy some of the stock of the Prairie Company, on the same terms as other members of the syndicate purchasing from the Rockefellers.

Mr. Elisha Walker, formerly President of Blair and Company, had still a third version to offer. According to him, Blair and Company were acting strictly from self-interest, and not at all to oblige the Rockefellers. The arrangement to "take care" of Fitzpatrick, he said, sprang from the fact that the syndicate buying Prairie stock wanted to assure itself of the full favor and co-operation of the management of the company it was buying into. It was quite usual in such transactions, testified Mr. Walker, to accord some such privileges—a chance to acquire stock on favorable terms, or a share in the profits—to the management. Bankers and other wise investors, apparently, were somewhat reluctant to rely solely upon the stern sense of duty of corporate officials, unstimulated by such tokens of good will.

It also developed that the Prairie Oil and Gas Company and the Sinclair Consolidated Oil Corporation were, to a certain extent, competitors; that negotiations for a consolidation of the two corporations had commenced early in 1928; and that the consolidation was finally successfully consummated in 1932, Mr. Fitzpatrick becoming Vice-Chairman of the Executive Committee of the consolidated corporation. So that, at the very time Mr. Fitzpatrick was being so generously treated by the Sinclair pool, negotiations for a union were in progress between his corporation and Mr. Sinclair's—negotiations the success or failure of which might well depend upon Mr. Fitzpatrick's own attitude.

No matter whose story one believes, or whether one draws conclusions of one's own, it is not an edifying picture that the Senate Committee here discovered. It took more than this, however, to disturb Mr. Sinclair's nonchalant amusement. He admitted that it was "pretty soft" for Mr. Fitzpatrick, but the inquiry into this payment, the entire Senate investigation in fact, seemed to him, at least momentarily, "more or less of a joke."

MR. PECORA: What did you discuss this transaction for with Mr. Cutten last Saturday?

MR. SINCLAIR: . . . He was at lunch at this party's house, and as a matter of fact, I thought his testimony was a joke.

MR. PECORA: Thought his testimony was what?

MR. SINCLAIR: More or less of a joke.

MR. PECORA: More or less of a what?

MR. SINCLAIR: Joke.

MR. PECORA: Joke?

MR. SINCLAIR: Uh, huh.

MR. PECORA: Did it seem that funny to you?

MR. SINCLAIR: It did.

MR. PECORA: What was there funny about it?

MR. SINCLAIR: The whole transaction was funny.

MR. PECORA: Which transaction do you mean?

MR. SINCLAIR: I mean this investigation.

MR. PECORA: Oh, this investigation is funny?

MR. SINCLAIR: Yes.

MR. PECORA: Is it still a subject of amusement to you?

MR. SINCLAIR: Rather.

MR. PECORA: Quite a joke?

MR. SINCLAIR: A little.

MR. PECORA: Are you testifying because you think this whole thing is a joke?

MR. SINCLAIR: I am not.

MR. PECORA: Are you imbued with the spirit that it is a joke in giving your testimony?

MR. SINCLAIR: I am not. I endeavor to give my testimony as I remember it.

MR. PECORA: Do you think it is a joke for this committee to inquire into an operation whereby a small group of men engaged in stock market operations in the stock of a company in which some of those men were interested as executive officers and directors and whereby they made, in a period of six months' time, something like $12,000,000 profit at the expense of the public? Do you think that is a joke?

MR. SINCLAIR: I do not. . . . My idea of what I thought was a joke . . . was Mr. Cutten's testimony, not your meeting. . . .

MR. PECORA: I thought you said when I asked you specifically if the testimony of Mr. Cutten was a joke, you said no, the whole investigation.

MR. SINCLAIR: No; I did not mean that. . . . I would like to have it canceled from the record. . . .

SENATOR COUZENS: A good many people thought Teapot Dome was a joke at one time. I hope that they do not go through the same sentiments during this investigation.

MR. PECORA: It was a joke, but I do not know yet whom the joke was on.

SENATOR COUZENS: I think the public do.

Let us leave it at that.

* * *

The transaction in Sinclair Oil stock was only one out of many stock-market operations in which the Chase Bank or its affiliate was interested. In addition to such left-handed "underwritings" via the Stock Exchange direct, the bank or its affiliate was in 1928 and the years following, a member—and often the manager—of dozens of pools in the most diverse kinds of securities, which had nothing whatsoever to do with the business of bringing out new issues. It was wholly unhampered by any fine-spun distinction between legitimate "investment" and "speculation." To Mr. Wiggin, the distinction was merely between ability and failure to make money. "An investment that is unsuccessful," he declared, "is usually called a speculation"—a pragmatic definition that

reflects, faithfully enough, the typical Wall Street philosophy of don't-get-caught.

The Chase National Bank, through its affiliates, was a member of pools trading in, among other securities, General Gas and Electric Company stock; International Paper and Power, preferred; American Woolen Company, preferred and common; Curtis Publishing Company, preferred; Prairie Oil and Gas Company and Prairie Pipe Line Company; Transcontinental Oil Company; St. Louis, San Francisco Railway; Polish, Cuban, and East Prussian bonds; Cuba Cane Sugar Corporation warrants; Vacuum Oil Company common; Seaboard Air Line; Bethlehem Steel Corporation, and Grigsby-Grunow Company. Possibly the reader may recognize some old friends on this partial list. But the chances are that the memories they revive will not be happy ones.

Generally it was the Chase Securities Corporation that acted for the bank. Other members of these pools were equally solid, highly respectable institutions: Blair and Company, Brown Brothers, Dillon, Read and Company, Bankers Trust Company, J. and W. Seligman and Company, etc., as well as leading brokerage houses like Pynchon and Company and Hayden, Stone and Company. And, of course, Mr. Wiggin's Shermar Corporation was seldom forgotten.

There was nothing about these "trading accounts" that had anything to do with the proper functions of the Chase National Bank or any other bank. They

were simply raiding expeditions on the market in the spirit of the times. Like the National City Bank, the Chase, which should have exercised every means in its power to abate the speculative frenzy, poured oil on the flames, for its own profit.

Mr. Wiggin's ingenuity could evolve no satisfactory rationale for these pools. Nevertheless, while he would not go so far as to denounce them flatly, on principle, he did manifest a cautious respect for aroused public resentment.

MR. PECORA: As a matter of fact, the Chase Securities Corporation, during the years of its existence, participated either on its own behalf or in behalf of the Metpotan Securities Corporation, its wholly owned subsidiary, in trading accounts that dealt in common shares of many other corporations than the Chase National Bank, did it not?

MR. WIGGIN: Yes, sir; more after 1928 or 1929 than earlier.

MR. PECORA: . . . What prompted the Chase Securities Corporation to engage in these trading accounts in the open market, dealing in securities other than the Chase National Bank from 1928 down?

MR. WIGGIN: I think the times.

MR. PECORA: What do you mean by that? That is a very general statement. You say you think, the times.

MR. WIGGIN: I cannot answer that any better than that, sir.

MR. PECORA: What do you mean by "the times"? . . .

Senator Couzens: I assume you mean the speculative atmosphere?

Mr. Wiggin: I think perhaps that covers it. There was a great deal of atmosphere. . . .

Mr. Pecora: Did you yield to the temper of the times in that respect?

Mr. Wiggin: I am afraid so.

Mr. Pecora: Do you now think that it is a wholesome thing for a bank affiliate to-day to do that? . . . Whether they should indulge in the kind of speculation you mentioned in answer to Senator Couzens' question, or implied that the Chase Securities Corporation had engaged in?

Mr. Wiggin: Of course I do not think they should make any investments that do not prove profitable.

Mr. Pecora: That does not answer the question.

Mr. Wiggin: I do not mean to treat it lightly, Mr. Pecora, but as you know, speculation is a very indefinite term.

Mr. Pecora: You ascribed a certain meaning to it when you answered Senator Couzens' question a few moments ago. You must have had in your mind some definition for speculation. Do you now think that a national bank affiliate should engage in stock-market speculation of the kind that you then had in mind?

Mr. Wiggin: No, sir; if for no other reason than respect for public opinion.

Senator Couzens: Oh. That is a new one! So public opinion does have some effect upon Wall Street?

Mr. Wiggin: I think it has a pretty good effect.

Mr. Pecora: What is your own personal judgment?

Mr. Wiggin: I certainly would not do anything today

that, if it turned out unfortunately, was going to be criticized. And that is what would happen if we did make a mistake. Therefore I would not take the risk.

Senator Couzens: Then these hearings are a good thing, aren't they?

Mr. Wiggin: I hope so, Senator.

Mr. Pecora: Do you think they educate public opinion with respect to the existence of certain evils in banking and stock-market circles?

Mr. Wiggin: I hope so.

This was quite an admission, coming from Mr. Wiggin. As for Mr. Aldrich, the new head of the bank, there was no ambiguity at all in his attitude. He testified then, on November 29, 1933, that:

> No one who has observed events or who is familiar with the testimony presented to your Committee during the past year can have failed to be impressed by the necessity of change. . . . The officers of our commercial banking institutions should have constantly before them a realization of their great responsibilities to the public. The bank officer's usefulness to his bank and to the community is dependent upon public confidence in his integrity of purpose. His actions must be of such character that when they are fully exposed to public view, no doubt can arise as to his motives. If our financial institutions are to be preserved, the public is not [only] entitled to expect, but it must have absolute assurance that the business of our commercial banks is being carried out in a manner which commands complete confidence.

It would be painting the lily to attempt to add to this eloquent statement of Mr. Aldrich. All we can say is that we agreed with it most heartily in 1933, *and we still agree with every word of it, in 1939.*

9

HOW TO LIVE WELL ON NOTHING A YEAR

ALL readers of Thackeray's perennially refreshing *Vanity Fair* will recall the success of the impecunious Rawdon Crawley, guided by his charming Becky, in managing, without means, to live a life of comfort and luxury in the heart of fashionable London. But the Crawleys, brilliant exemplars that they were of the difficult art of living well on nothing a year, suffered many vexing inconveniences. They were constantly being dunned by shopkeepers, they were often painfully short of ready cash, they had practically to cheat at cards, and even worse.

Modern finance has improved on Becky Sharp. For a number of years after 1929, the Senate Committee's investigation revealed, there were quite a few gentlemen who lived in the finest of town apartments and country estates, who enjoyed automobiles and

yachts and other refinements of living—and yet, apparently, did not have one cent of income, or rather, of taxable income. We know that, because they paid no income taxes. But, unlike the luckless Crawleys, no importunate tradesmen ever dunned these gentlemen, they never seemed to be short of cash, and never once would any of them have stooped to cheat at cards. On the contrary, they were amongst the most honorable and distinguished of citizens.

Mr. J. P. Morgan, for instance, did not pay a dollar of income tax to the United States Government for the years 1930, 1931, and 1932. Neither did any of his partners—with the exception of a few who paid small amounts, totaling approximately $50,000, for the year 1930. And Mr. Otto H. Kahn paid no income tax at all for any of those three years. Undoubtedly, there were many others, only slightly less prominent, who escaped in the same fashion.

How did they manage it? There are as many answers to this question as there were loopholes in the law. No field has afforded more fertile ground for ingenious schemes and subtle technicalities. Mostly it is the lawyers who have taken the lead in this patriotic work of telling a rich client just how to arrange his affairs so as to pay the very least in taxes that is legally possible. But banks, financial "advisers," and institutions of various kinds have all contributed helpfully. Chase Harris Forbes Corporation, for example, a subsidiary of the Chase National Bank, seems to have devised schemes and offered to make them

available to customers for this purpose as a regular practice on its own initiative, "as part of their salesmanship" in selling securities. And according to Mr. Wiggin, this was "quite a common plan."

The great distinction in this field is between tax "avoidance" and tax "evasion." Tax "evasion" is considered very, very bad, very wicked and criminal, and if you get caught, you may be put in jail for it. Tax "avoidance," however, or "minimizing" taxes, as it is sometimes still more euphemistically styled, is quite respectable, and is indulged in by our best people. To be sure, it is sometimes difficult to know, in practice, when a certain devious procedure is going to be classed as tax "evasion" and when it will be considered tax "avoidance." The courts have laid down certain tests, but their application is by no means always clear. The distinction has on occasion eluded the grasp of even some very eminent attorneys, with disastrous results to their clients. If the courts subsequently throw it out as a palpable subterfuge, it is "evasion"; if the courts approve, it is a proper method of "minimizing." This description will scarcely satisfy the learned brethren of the author's own profession, but it will serve to give the layman a rough idea about it.

The Senate Committee, of course, was interested in the subject of tax avoidance only incidentally, and made no attempt at an exhaustive study. Nevertheless, there came to light quite a few striking instances of practices obtaining among the rich. We have al-

ready seen how successfully Mr. Wiggin managed to avoid paying any income on the millions he made selling Chase Bank stock short during the panic of 1929. There were many other illuminating examples.

One of the most popular ways was simply to sell stock which had been bought at higher prices. Wealthy persons during the depression had plenty of such stock, bought during the boom. Provided they did not repurchase the stock within thirty days, the law allowed them to deduct their loss on the stock in figuring their current income. Actually, there was very often no real change of position at all, for if the taxpayer selected his time carefully, he might have every reasonable expectation of picking it up again at substantially the same price, and frequently he did so.

MR. WIGGIN: . . . Of course that sort of thing goes on with millions and millions of transactions every year.

MR. PECORA: What sort of thing do you refer to?

MR. WIGGIN: Selling securities to take tax losses.

MR. PECORA: And with the intention of repurchasing them after thirty days?

MR. WIGGIN: Very likely. In some cases yes and in some no. But that is the commonest form.

MR. PECORA: The commonest form of what?

MR. WIGGIN: Of minimizing taxes.

MR. PECORA: Of avoiding income taxes?

MR. WIGGIN: Or reducing.

MR. PECORA: And you know, as a matter of personal

knowledge, that that is a very common practice, or has been?

MR. WIGGIN: Oh, I know it is a very common practice. You hear it talked about all the time. . . .

. . . .

MR. PECORA: Do you approve the ethics of that?

MR. WIGGIN: I think that you are bound to have people save taxes where they can according to law. . . . I see no reason why it is not in order.

This was a pretty good method, but there was still a certain risk about it: suppose, after all, prices happened perversely to advance during the thirty days you were not allowed to repurchase? Then you would actually have lost money, by what was merely intended as a clever maneuver to outwit the United States Treasury. This would not do at all. The problem, therefore, was how to sell your stock at a loss, but keep it too.

Insoluble as this problem appears, it was in point of fact solved to the complete satisfaction of numerous eminent financiers, and very simply, too. They merely "sold" the stock to members of their own family—their own wives or daughters, for instance—instead of in the open market. Once the necessary interval had elapsed, nothing was easier than to have the wife or daughter transfer the stock right back again. Without any risk, everything was then just as it had been in the beginning—except that, for tax purposes, the husband or father had somehow suf-

fered a great loss which he could deduct from his taxable income.

This was the technique employed by Mr. Charles E. Mitchell in 1929. Mr. Mitchell late in that year purported to sell a large quantity of National City Bank stock to his wife. The paper loss on this transaction was over two and one-half million dollars, which Mr. Mitchell duly deducted in making out his income-tax return. In consequence, he paid no tax at all for 1929—thus improving even the record of Mr. Morgan and his partners and Mr. Kahn, all of whom paid taxes for that year at least. Several years later, in 1932, when National City stock had dropped hundreds of points further, Mr. Mitchell decided, so he testified, that it was not fair for his wife to stand all that loss, so he generously repurchased the stock—at the same price at which he had sold it to her in 1929.

Mr. Mitchell readily admitted that the sale was for income-tax purposes, but claimed it was nevertheless a bona fide transaction.

MR. MITCHELL: I sold this stock, frankly, for tax purposes.

SENATOR BROOKHART: That was to avoid income tax?

MR. MITCHELL: Throwing my fortune into the breach as I did for the benefit of this institution, Senator Brookhart, in 1929 I had a definite loss in that stock which I was forced to take. . . .

SENATOR BROOKHART: And then you bought it back

MR. MITCHELL: Yes, sir. . . . The one to whom I sold this stock, a person of some means, had no ability to take the loss that existed in that stock and at the end of last year [1932]. I bought the stock back at what had been paid for it.

SENATOR BROOKHART: At the same price?

MR. MITCHELL: Yes, sir.

SENATOR BROOKHART: That sale was just really a sale of convenience, to reduce your income tax?

MR. MITCHELL: You can call it that if you will.

SENATOR BROOKHART: Well, is that right?

MR. MITCHELL: Yes; it was a sale, frankly, for that purpose, where you hope the buyer would be able to make a profit. And it was bought with the idea of making a profit. But the accumulated loss was so great that I offered, and did buy, the stock back this year at what had been paid for it.

SENATOR BROOKHART: This buyer was a friend of yours, of course. He had favored you and you wanted to favor him.

MR. MITCHELL: It was not that kind of negotiation. But I simply could not see that buyer take that loss. And I hold today that stock.

(As already noted, the buyer happened to be Mr. Mitchell's wife.)

Bona fide business transactions, of course, are not customarily carried out in this manner and a few months later criminal proceedings were brought against Mr. Mitchell for income-tax evasion. After a trial lasting six weeks, he was acquitted. But the tax

authorities thereupon brought civil proceedings against him, and although Mr. Mitchell contested the case for three years all the way up to the United States Supreme Court, his efforts were in vain. The Board of Tax Appeals and the courts to which he appealed found that his "sale" to his wife was not bona fide, and he was ordered to pay the Government over $700,000 back taxes.

(On December 28th, 1938, while the writer was reading the galley proofs of this chapter, the newspapers reported that the Government's tax lien, amounting, with interest and penalties, to $1,384,222.92, was discharged that day by payment, although the amount paid was not specified.)

Other men did not bother to wait as long a time as Mr. Mitchell did, before having the stock retransferred to themselves. Young Mr. Thomas S. Lamont, for example, sold a quantity of stock to his wife on December 30, 1930, showing a loss of $114,000, duly deducted from income. Mr. Lamont not only sold the stock to his wife, but obligingly loaned her the money—on good security—to buy it. "There was no agreement nor any understanding between us that I should any time later on repurchase these shares from her or any of them. I intended the sale to be a complete and final disposal of these shares, and she understood it to be so." Nevertheless, three months later, on April 8, 1931, he repurchased the stock from his wife at the same price she had paid him, and his wife thereupon repaid the loan to him. All this was

accomplished with the greatest of ease: there were no intermediaries, and loans and payments were accomplished by merely making the proper entries in the books of J. P. Morgan and Company.

This was not the only stock on which Mr. Lamont took a loss in somewhat unusual fashion. At the same time that he "sold" the block of stock to his wife directly—December 30, 1930—he also sold some stock publicly, to strangers. But Mrs. Lamont, it turned out, at the same time, bought exactly the same amount of the same kind—also with money borrowed from her husband. When, in April, 1930, he repurchased the stock he had sold to her directly, he also bought from her this other block. Mr. Lamont now had his stock back, at the same price he had sold it—and had also deducted his "loss" on it from his income.

If you were in a partnership, it was even easier to deduct your "loss" and still hold on to your stock. All that was necessary was to take in a new partner, or for an old partner to retire. In the eyes of the law, that ends the old partnership, and creates a new entity, and the law decrees that upon the creation of this new entity, the partners may clean the slate of former losses. All stock held by the partnership is, upon such a change in personnel, subject to be revalued. If there has been a loss, that loss can be deducted for income-tax purposes, without actually

selling the stock, or even troubling to go through the forms of selling.

This was the principal reason why none of the partners of J. P. Morgan and Company paid any tax for 1931 or 1932, and practically none for 1930. Each year, there was a change in partnership personnel and a revaluation. The tax law, moreover, allowed the losses theoretically sustained in this manner to be carried forward for two years. That is, if the loss was so great as to wipe out the profits of the next year, and still leave something over, the extra loss could be used to cut down the profits of the second year following. To squeeze the last possible morsel of legal advantage from these provisions of the law, J. P. Morgan and Company arranged that the formal taking in of a new partner should not occur until January 2, 1931, and January 2, 1932. In this way, the loss on revaluation of the partnership stocks could in each case be carried forward a year further than if Mr. S. Parker Gilbert or Mr. Charles Denston Dickey had become a partner two days previously. As in the game of golf, it is all a matter of "timing."

No doubt, this was strictly within the law. It was all done on the best legal and technical advice, and Mr. Morgan personally did not bother himself with the details. "I really do not know anything whatever about the income-tax statements of the office," he testified. In fact, he could not even remember whether he himself had personally paid any income tax for 1930. Such minor matters did not impress

themselves on his memory. If he had paid no tax, he argued, that was merely because his losses were greater than his income.

> MR. MORGAN: There was no tax to be paid. I am not responsible for these figures. I viewed them with great regret when they appeared.

What Mr. Morgan did not stress, however, was the fact that while his income had actually been received by him, the losses which he deducted from that income were only "paper" losses.

Whether Mr. Morgan knew it or not, the Internal Revenue agents of that era made little pretense of seriously questioning whatever account J. P. Morgan and Company chose to render. Only one day was spent, for example, in examining the partnership return of J. P. Morgan and Company and Drexel and Company for the year 1930. Even if the tax return was not that of a Morgan partner, but simply prepared by the Morgan office, the mere imprint of the firm's approval was likely to be final. Thus, one taxpayer's return was approved by the local revenue agent with the following comment: "Returned without examination for the reason that the return was prepared in the office of J. P. Morgan and Company and it has been our experience that any schedule made by that office is correct."

The Bible tells us that a good name is rather to be chosen than great riches. But it was vouchsafed to the

members of J. P. Morgan and Company to enjoy both.

* * *

Taking losses after the painless fashion of the Morgan partners or Mr. Mitchell was one way to "minimize" taxes. An even better expedient, if available, was not to make a profit in the first place—at least, not a profit that one has to pay taxes on.

For this purpose, the proper understanding and dexterous employment of the great legal invention of the corporation, especially the foreign corporation, has often proved invaluable. A properly organized "personal holding" company, or a well-regulated Canadian corporation, wholly owned by an American taxpayer, was a commonplace part of a rich man's equipment. These corporations were what the layman, and sometimes the lawyer, would call mere dummies, but they served their purpose none the less.

Mr. Wiggin, for example, as we have seen, in addition to owning three American family corporations, had organized three Canadian corporations. These were admittedly for the purpose of "minimizing" taxes. The entire personnel of these three Canadian corporations consisted of one man, an employee of a Canadian law firm retained by Mr. Wiggin. When Mr. Wiggin (or rather, one of the Wiggin family corporations) wished to sell stock at a profit, and not have to show a taxable profit, they simply exchanged the stock they wished to sell for some of the capital stock of one of these Canadian corporations. Such an

exchange of stock was not technically a sale and under the tax laws no gain or loss had to be reported in connection with it. The Canadian corporation—i.e., Mr. Wiggin's dummy—then sold at a profit the stock which it had received, in accordance with directions furnished by New York, and since this latter sale took place in Canada, it did not have to be reported here in America. As for the Canadian income-tax laws, there were Canadian lawyers and perhaps Canadian loopholes.

This may seem pretty ingenious to the reader, but it was no more so than the procedure followed by Mr. William Ewing, one of the partners of J. P. Morgan and Company. Mr. Ewing was trustee of four trusts, originally set up with $1,000 each, by Mrs. Ewing, one for each of their children. Mr. and Mrs. Ewing owned over 4,000 shares of Johns-Manville stock, which they had bought at 47½. In 1928, the price of Johns-Manville stock went soaring. If Mr. and Mrs. Ewing had then sold, they would have made a profit of over $450,000 and would have had to pay a tax on this of $113,000, between them.

Mr. and Mrs. Ewing, however, did not sell their stock, even though Mr. Ewing was convinced that the price had gone too high and was going to drop. Apparently he was not sufficiently interested in making money for himself. As the trustee of these four trusts, however, he did sell Johns-Manville stock short. And what is more, Mr. Ewing, *as trustee,* sold short for

$654,000 the precise number of shares that Mr. and Mrs. Ewing, as individuals, owned. He and Mrs. Ewing then, as individuals, loaned the stock to Mr. Ewing, *as trustee,* with which to make delivery; and when the $654,000 was received by him, *as trustee,* for the stock so delivered, he promptly turned it over to himself and Mrs. Ewing, *as individuals,* as security for the loan of the stock.

All this is quite in accordance with the usual practice in connection with short sales. But the rest of the story is not. Johns-Manville stock kept falling and falling, but with the exception of 1,000 shares which had been covered in 1929, before the crash, Mr. Ewing, *as trustee,* did nothing. Finally, the stock reached a low of 12¼. This represented a paper profit on the short sales of anywhere from 108 to 188 points. Surely this was time for even the most greedy and speculative of short sellers to cover and take the profit—let alone a parent trustee. But still Mr. Ewing did nothing. He was, he testified, waiting for the stock to drop even lower. At the time of his testimony before the Senate Committee, he had still not covered; he was still waiting.

If the reader will observe carefully, he will see that Mr. Ewing's inaction, *as trustee,* was anything but disadvantageous to Mr. Ewing and his wife, *as individuals.* So long as he simply did nothing, the trusts did not have to pay any tax—for there was no profit on the short sale until the transaction was closed by a covering purchase—and he and Mrs. Ewing personally did not have to pay any tax—for they had not themselves sold this stock, but had only *loaned* it to him *as trustee.* In the meantime, they were in precisely the position they would have been, if they had actually sold in the usual manner—that is, they had the unrestricted use of the money actually derived from the sale. No difficulty could possibly arise until the short sale was covered by the family trusts, and this was a matter for the discretion of the trustee, and the trustee was Mr. Ewing.

The scheme, was, indeed, so extraordinarily well thought out that the tax authorities, after first questioning it, decided that it was a perfectly legal and proper transaction.

In a number of other instances, Mr. Ewing, as trustee, sold blocks of stock short in the same manner, although never while a partner in J. P. Morgan and Company had he sold short *on his own account.* In each case, he or his wife owned either the same amount, or more than the amount, sold short by the trust. In none of these cases did Mr. Ewing, as trustee, see fit to complete the transaction by covering. In each case, the tax authorities finally approved the legality of what had been done.

Mr. Ewing, of course, was very positive that there was no tax avoidance in his conduct:

> MR. PECORA: Now, Mr. Ewing, is it amiss to say that the procedure followed by you in connection with these short sales . . . and the way they have not been covered

with respect to the major portion thereof is nothing but an artifice to avoid payment of an income tax?

MR. EWING: That is not true, sir; that statement is not true. . . . I as trustee, have a definite commitment and obligation to those trusts for the profit when they are covered. . . . Those trusts are nonrevocable trusts. They are absolutely legal. I haven't any right as an individual in any way to benefit from anything made for those trusts. None whatsoever.

MR. PECORA: That is why I marvel, Mr. Ewing, at the fact that you did not cover these short sales long ago, particularly when the price reached around $12 a share.

Very substantial sums were recovered by the United States Treasury in tax proceedings growing out of transactions testified to before the Senate Committee. Millions of dollars more, as Senator Couzens once informed the writer after inquiry at the treasury, had been voluntarily paid in as back taxes by individuals who had become frightened by the Committee's proceedings and Mr. Mitchell's indictment. As the Senator also observed at the time, this represented quite a sizable dividend upon the Government's investment of about $182,000, which was the cost of the Senate Committee's investigation during the seventeen months that the writer was its counsel.

The sensational disclosures made by the Senate Committee had, indeed, produced a very strong popular reaction. Approved by the existing tax authorities or not, the public could not see the justice or equity of financial giants paying nothing, while Tom,

Dick, and Harry scraped the bottom of their modest purses to meet their tax obligations to the Government. They indignantly contrasted Mr. Morgan's willingness to make use of whatever means the law allowed, however technical, to reduce his payments, with the public-spirited gesture of a Stanley Baldwin gratuitously contributing twenty per cent of his entire fortune to the British Government after the war. The country, in 1933, was in no mood for nice distinctions between tax "evasion" and tax "avoidance."

Since those days, many loopholes have been securely plugged up, some remain. So long as we have tax statutes, no doubt, we will have keen-eyed lawyers and accountants seeking how to circumvent them. But it is not likely that it will ever again be possible for the greatest among us, financially speaking, to contribute least to the support of the common government in the time of the nation's dire need.

10

"WE COULD HAVE TAKEN ONE HUNDRED PER CENT!"

IN YOUR hands or in the writer's hands, a dollar is only a dollar. It can buy a dollar's worth of bread, or a dollar's worth of merchandise, or a dollar's worth of corporate stock. The skilled financier, however, would not go very far in his profession if he could not do better than that. In his hands, a dollar goes a long way: it frequently buys control of ten, or twenty, or even one hundred times as much money as the financier himself invests.

In this chapter, we shall tell the story of three of the most outstanding and spectacular examples of this process encountered during the Senate Investigation: the investment trusts of Dillon, Read and Company, the railroad empire of the brothers Van Sweringen, and the ill-fated pyramid of Mr. Samuel Insull.

Like J. P. Morgan and Company and Kuhn, Loeb and Company, Dillon, Read and Company were private bankers. They did not, however, take deposits to any considerable extent, but concentrated on the creation and sale of new securities. Here they did a huge quantity of business, issuing nearly four billion dollars of government, municipal and corporate bonds and stocks for the fifteen years following the war. This was more than Kuhn, Loeb and Company, but less than J. P. Morgan and Company.

Since they took no large amount of deposits, Dillon, Read and Company did not have in their control, from this source, any great fund of "other people's money," as did the Morgans and Kuhn, Loeb. But they contrived a scheme which from their point of view was superior to the bankers' traditional technique. They were able to get control of the public's money, yet simultaneously they avoided the inconvenient necessity of keeping that money payable on demand, as is the way with ordinary deposits.

This new superior technique was an amazingly simple combination of two devices: the "investment trust" and "nonvoting stock," together with some added features of Dillon, Read and Company's own invention.

The first step, taken in 1924, was the organization of a corporation known as the United States and Foreign Securities Corporation. This was to be an investment trust, i.e., a company which invests in securities, just like any private person, but with the

asserted advantage of trained management and great capital resources. There were three classes of stock in the new corporation—first preferred, second preferred, and common. There were 250,000 shares of the first-named class, 50,000 shares of the second, and 1,000,000 shares of the common. The "first preferred" stock was so called because it was entitled to receive dividends of six per cent before the other classes of stock received anything, but in the matter of voting rights and control, it was anything but preferred. So long as dividends were regularly paid it could not vote at all, it had not the slightest voice in the management. It was, in short, what is known as "nonvoting stock," one of the devices which Mr. Otto Kahn had picturesquely denounced as "inventions of the devil." Under all ordinary conditions, only the common stock could vote, and therefore whoever controlled the common stock controlled the corporation.

The entire 250,000 shares of "first preferred stock" were sold to the public for $25,000,000. As an added attraction, the public was also given 250,000 shares of the common stock—one share of common with each share of first preferred. That left unsold the 50,000 shares of second preferred stock, and 750,000 shares of common stock. All of this Dillon, Read and Company bought for $5,100,000. Thus, although it invested only one fifth as much as the public, Dillon, Read and Company, owning three fourths of the

common stock, the only stock that could vote, completely controlled the corporation.

The United States and Foreign Securities Corporation, ably managed and operated during an era of rising stock prices, prospered greatly. By 1928 there was a cash surplus of $10,000,000. What had the public, who contributed $25,000,000 of the corporation's $30,000,000, gotten out of this prosperity? They had gotten their six per cent dividends on their first preferred stock—and that is all.

True, they also owned 250,000 shares of common stock, but in spite of the $10,000,000 cash surplus, there had never been any dividend declared on the common stock. To anticipate a little, there never was any dividend on this stock.

What had Dillon, Read and Company realized? In the first place, it had, like the public, been regularly receiving by way of dividends on its second preferred stock, six per cent on the money it had invested. In the second place, it had made about $340,000 as its share of the bankers' "spread" in the sale of the corporation securities to the public. In the third place, it now had complete control, unhampered by any possibility of withdrawal, not only of the original $25,000,000 public contribution, but also of the $10,000,000 cash surplus which had been earned by the use of that money. The Dillon, Read and Company investment, which had originally controlled an additional $25,000,000, now controlled $35,000,000. The best part of the whole transaction, moreover,

was that Dillon, Read and Company and individual members of that firm still retained practically all their 750,000 shares of common stock; and this common stock, which at the time of its original acquisition had been assigned a nominal value of 20 cents per share and according to Mr. Dillon, "was worthless," with a book value of "a million dollars less than nothing," had risen greatly, eventually going as high as $72 a share. Hence, an investment of, at the most, a few hundred thousand dollars, had brought in potential profits of thirty to forty million dollars for the bankers.

Mr. Pecora: This common stock which had a minus value at the time of its issuance in October, 1924, by the end of 1928 or 1929, reached a market value on the New York Stock Exchange of as high as $72 a share, did it not?

Mr. Dillon: That is correct, and had a book value of . . . $48 I am told. . . .

Mr. Pecora: So this infant which was born with practically no life assumed the lusty proportions of a $72 stock within four years' time?

Mr. Dillon: And had a book value, they tell me, of $48. We do not want to claim any magician's power. It was in that very rapidly advancing market that those great profits accrued.

Even these astonishingly fortunate developments did not satisfy Dillon, Read and Company. There was still that $10,000,000 cash surplus fairly asking to be put to work. How employ it better than by repeating

on a larger scale the same operation that had already worked out so well?

So a second corporation, a second investment trust, was formed. This one was called the United States and *International* Securities Corporation. Like the United States and Foreign Securities Corporation, it had three classes of stock, first preferred, second preferred and common. As in the first corporation, all voting power under ordinary circumstances was exercised by the common stock. As in the first case, too, the public was allowed to buy—this time for $50,000,000—only the "nonvoting" preferred stock with only a minority of the common stock added in. But there was one salient difference: this time, Dillon, Read and Company did not have to invest a single dollar of its own. Instead, it was the United States and Foreign Securities Corporation, which, with its $10,000,000 cash surplus, now put up the money to secure complete control.

There were now two investment corporations—the second with a $60,000,000 capital, controlled by the first with a $30,000,000 capital; and the whole $90,000,000 controlled by Dillon, Read and Company, which had four years before invested $5,100,000.

Did we say that the organization of this new corporation, bringing with it control of an additional $50,000,000 of the public's money did not cost Dillon, Read and Company a dollar? It was a gross understatement: Dillon, Read and Company not only

did not pay, they were themselves paid—over a million dollars—for their share in the arduous labor of organizing the company and floating its securities.

The following year, 1929, prices went still higher, and some of the members of Dillon, Read and Company thought it an opportune time to let the public share a little of their good fortune. They therefore consented to sell about 75,000 shares of their United States and Foreign common stock, at $47.50 or better per share, to certain pools organized by Dominick and Dominick, who disposed of it after their own fashion. They also sold another 45,000 shares through Dillon, Read and Company, to the firm's own customers at around $56 per share. Altogether, for these approximately 120,000 shares (not enough of the original 750,000 to disturb Dillon, Read's control), they received over $6,800,000. This in itself was over $1,500,000 more than the whole firm's entire original investment, and it was realized from only a petty fraction of their total common-stock holdings.

After the stock-market crash in 1929, things did not go so well. The United States and International Securities in particular, sustained large losses amounting at one time to about $26,000,000. The stock in which Dillon, Read and Company had seen fit to invest the $10,000,000 cash surplus of the first corporation in 1928 was completely wiped out.

To Senator Couzens, the taking of this $10,000,000 "out of an investment trust you own, or which you control, rather, its ownership being in the public

hands," and putting it "in another investment trust to further augment your own profits," seemed "rotten ethics," and "reprehensible." To Mr. Clarence Dillon this and all the rest of the story seemed perfectly proper even in retrospect.

SENATOR COUZENS: May I ask you, Mr. Dillon, if you were to organize two investment trusts again, would you, in view of the disclosures, follow the same procedure?

MR. DILLON: Yes; I do not think I should vary it, except that when I subscribe the junior money I might not have different classes of stock. . . .

Mr. Dillon thought in terms of Wall Street usage and legality, and from that point of view he even considered that the public had been treated with rare generosity and fairness. True, the public had contributed five times as much as Dillon, Read and Company to the United States and Foreign Securities Corporation, and had received only one third as much of its common stock in return, but Mr. Dillon pointed out—and who can deny it—there was nothing to stop Dillon, Read and Company from having taken, not only 750,000 shares of this common stock, but the whole 1,000,000. Giving the public any interest at all in these shares, even a minority interest, was a sheer act of grace. In his own words:

We could have taken 100 per cent. We could have taken all that profit. We could have bought all the common stock for $5,000,000.

To which perhaps the only fitting response is that of Senator Adams, who replied:

> Do you remember what Lord Clive said? "When I consider my opportunities, I marvel at my moderation."

* * *

We come now to a far more lengthy and complicated, but essentially similar story: the rise of O. P. and M. J. Van Sweringen. The reader will have to "watch closely," as the conjurer says, or he will not understand by what magic a system comprising eight Class I railroads, with a large number of smaller subsidiaries, having combined assets of more than two billion dollars, and extending over 29,431 miles of track, was captured by two brothers who originally put in $1,000,000 of their own money.

> MR. O. P. VAN SWERINGEN: Mr. Pecora, just as we adjourned on yesterday, you asked the question as to how many dollars my brother and I and our associates had put into these railroad ventures, if you will, our own money to start with, not borrowed, not obtained by the sale of securities. I read, and we read, your question last evening, and I am pleased that it is in a form I can answer frankly. That amount of dollars, to come straight to the point, was $1,000,000. . . .
>
> MR. PECORA: Do you mean by that, Mr. Van Sweringen, among other things, that the total amount of cash, constituting the personal means of you and your brother and your immediate associates in these various railroad

> enterprises that have been described by you, was $1,000,000?
>
> MR. VAN SWERINGEN: At the start, that was the amount of dollars that we put in, and others grew. You might say that that starting was a shoestring, and I think I would be inclined to agree with you that that is so. Nevertheless, we made of that shoestring what we have today.

Strictly speaking, the Van Sweringen brothers did not put in even this $1,000,000, but only $500,000, the remainder having been contributed by their associates, and, strictly speaking, even this $500,000 was not actually their cash, but money borrowed from the bank on collateral which they owned.

This $1,000,000, which was the original investment of the Van Sweringens and their associates, was first employed in 1916 in the following manner: The Van Sweringens were then Cleveland real-estate operators, not railroad men, but at this time their attention was directed to what looked like a good opportunity to enter the railroad world. The New York, Chicago and St. Louis Railroad, commonly known as the "Nickel Plate," which ran through Cleveland, was owned by the New York Central, and the Van Sweringens had heard that it might be willing to sell at what seemed very advantageous terms. They made an offer and finally succeeded in purchasing for $8,500,000 a controlling interest in the stock of the Nickel Plate Railroad Company.

Of course, the Van Sweringens and their associates

did not have $8,500,000 to put into the transaction, but in dealing with this difficulty, they manifested the same resourcefulness which was characteristic of the course of all their future dealings. They borrowed $2,000,000 from a bank on the security of their interest in the stock which they were purchasing, and this cash they paid to the New York Central. For the balance of $6,500,000 they induced the New York Central to take promissory notes maturing over a period of ten years. The Van Sweringens and their associates now owned the Nickel Plate Railroad, without as yet having put one dollar of their own money into it.

But they had borrowed $2,000,000, which had to be repaid. It was at this point that the Van Sweringens and their associates made their one and only cash contribution. They formed a new corporation, the Nickel Plate Securities Corporation, and turned over to this company their interest in the stock which they had just purchased in the Nickel Plate Railroad, and the new company on its part agreed to take over the $2,000,000 loan and the obligation on the remaining $6,500,000 notes. The Van Sweringens and their associates then bought a quantity of preferred stock in the new corporation for $1,000,000, and another $1,000,000 was raised by selling an equal quantity of preferred stock to other persons. In this way, the $2,000,000 was obtained to pay off the immediately pressing bank loan.

The Van Sweringens, however, not only received

one half of the preferred stock, but all of the common stock, and just as in the case of the Dillon, Read-controlled United States and Foreign Securities Corporation, normally it was only the common stock that could vote. They therefore completely controlled the Nickel Plate Securities Corporation, which in its turn completely controlled the Nickel Plate Railroad. So, for $500,000 of their own money, plus $500,000 of their associates' money, plus certain other properties which they contributed to the Nickel Plate Securities Company, the Van Sweringens now owned the railroad.

But they still owed $6,500,000 to the New York Central. To be sure, these were very long-term obligations, and with so much time in which to operate, presented no insuperable obstacle to the Van Sweringens' financial genius. Several million dollars were in fact paid off out of the earnings of the Nickel Plate System, but the bulk, about $4,500,000, was once again supplied by an unwitting public. The Nickel Plate Railroad was combined with two other lines acquired in much the same manner as the Nickel Plate was acquired—that is, without any cash contribution by the Van Sweringens themselves—and with much deferred debt. The Nickel Plate Securities Corporation, in place of the stock which it had held in the old Nickel Plate Railroad, received in the new setup stock of the combined new system. Some of this stock was common, some preferred. Once again it was the common stock which had the voting

power. So nothing was easier than for the Nickel Plate Securities Company to sell a large amount of the preferred stock to the public, pay off the $4,500,000 still owed to the New York Central, with the proceeds, and still, through its continued ownership of the common stock, retain all its control.

Thus, within a few years, the Van Sweringen power over the Nickel Plate Railroad was consolidated, and their title to the stock, which during the interim had remained in pledge as security for the debts, was now made absolute.

We have now traced in rough outline the manner in which the Van Sweringens acquired their first railroad. The same methods and devices were used over and over again, with ever-growing complexity, in the years that followed. Starting with a small contribution of their own to tide over the first perilous stages with the aid of friendly bankers, eventually paying off their debt by the public sale of large security issues, stripped of voting rights—these were their customary tactics. In each instance it was the public, with its ever ready coffers, which in the end was permitted to bail them out.

The Nickel Plate Securities Corporation was one of the first of a long series of holding companies organized and controlled by the Van Sweringens in the following decade. It would be literally impossible to enumerate and explain the scores of minor corporations of this character, some of which had a life of several years, while others were active only for very

brief periods. Whenever there was a new railroad—or perhaps a coal mine or a real-estate company—control of which was to be acquired, there was likely to be a new holding company to do the job. Sometimes for one reason or another, possibly for the purpose of "minimizing taxes," there were two or three holding companies organized in connection with the acquisition of the stock of a single railroad company. In the maze of corporations, no uniform pattern was employed. The railroad companies were themselves often used for holding stock of other railroads. One holding company would frequently be used to hold stock of another holding company. Paradoxically enough, some of the stock of a holding company would be held by a railroad.

Among the welter of holding companies, there were certain so-called "top holding companies," which for different periods had a special and predominant position in the system. The Nickel Plate Securities Corporation, which was the first in this series, lasted until 1924, when it was dissolved. Several years prior to this, however, in 1922, the position of central importance which it occupied had already shifted to another holding company known as the "Vaness" Corporation, a euphonious abbreviation of the Van Sweringen family name. This new top holding corporation which Mr. O. P. Van Sweringen described as "our own personal basket," was completely owned at the outset by the Van Sweringens and their associates, and all the Van Sweringen holdings in the

Nickel Plate Securities Corporation were transferred to it. It long remained the keystone of the Van Sweringen system.

Since the early days of the Nickel Plate acquisition, the aims and ambitions of the Van Sweringens had greatly broadened. The Transportation Act of 1920 directed the Interstate Commerce Commission to provide for the consolidation of the railroads into a limited number of systems, designed to rationalize and insure free competition in the railroad industry. The Van Sweringens decided that there should be but four great systems east of the Mississippi, and that their own Nickel Plate Railroad ought to be the nucleus of one of these. To further their ambition, it was necessary to acquire interests in many roads and to run counter to the plans of the great established systems—the Pennsylvania, the New York Central and the Baltimore and Ohio. By 1925 the Van Sweringens had acquired large, controlling, and in some cases majority, interests in five key railroads—the Nickel Plate, the Chesapeake and Ohio, the latter's subsidiary—the Hocking Valley, the Erie, and the Pere Marquette. To do so it was of course necessary for them to engage in extensive financing, but the Van Sweringens were fortunate in having behind them the experience and support of J. P. Morgan and Company.

MR. O. P. VAN SWERINGEN: We talked with J. P. Morgan and Company, whom we regarded, as does the world, as wise counselors in matters of finance.

As a matter of fact, the Morgans had become acquainted with the Van Sweringens as far back as 1916, and from 1920 on had had, in Mr. George Whitney's language: "A great faith in their aims of trying to build this railroad system. . . . We . . . had business relations with them for a great many years. We have believed in them . . . and we have gone along as bankers with them."

In 1925 a formal application was made to the Interstate Commerce Commission, for leave to form such a system under unified corporate control. The Commission, however, refused its permission primarily on the ground that the whole plan "was arranged with the intention of keeping the control in the hands of its proponents, even though their interest is a minority one in fact."

The adverse decision of the Interstate Commerce Commission did not, however, discourage the Van Sweringens. Instead, they acquired additional stocks in the companies in which they already had an interest, and continued the process of organizing holding companies in the main dominated by Vaness. In this way they formed a whole series of holding companies: the Special Investment Corporation, the Virginia Transportation Company, the Pere Marquette Corporation, the Special Securities Corporation, and others. In particular, they formed the Chesapeake

Corporation, chiefly for the purpose of dominating the Chesapeake and Ohio Railroad, which had now become the key road in the proposed system. Most of these companies were duly dissolved when they had served their purpose. The money to acquire these purchases were derived in the main by loans from the House of Morgan, and by the sale of securities either of holding companies or of the railroads themselves.

These security issues through which the public's money was invested in the Morgan-Van Sweringen scheme, were very large, some of them aggregating $25,000,000 and even $48,000,000 in a single issue. But no matter how much public money was obtained, it was always carefully arranged that control should remain safely undisturbed in the hands of the Van Sweringens. Despite the action of the Interstate Commerce Commission, which had pointed out that "the Nickel Plate is the only railroad of importance in the country in which the preferred stockholders do not have the right to vote," Mr. O. P. Van Sweringen stoutly defended the practice. In his own words: "We figured that the investor wanted to be let alone and would be willing to let us alone." Willing or not, this was the only course which the Van Sweringens left for the investors to follow.

The stock of these various railroads was thus pretty well scattered among the holding companies dominated by the Van Sweringens, and among the component railroads themselves. In order to bring together

this vast system, in 1929 the Van Sweringens formed the superparent holding company, the Alleghany Corporation, of Morgan and Company preferred list fame.

The securities which the Van Sweringen brothers turned over to the Alleghany Corporation had a total market value of approximately $52,000,000. In return, they received either in cash or securities of the Alleghany Corporation, or other consideration, a total of more than $84,000,000, representing a gross profit of $32,000,000. Moreover, if the Alleghany stock received by them was valued not at its $20 book value, but at the much higher average market price actually obtained by some of the Van Sweringen holding companies in the succeeding months, their potential profit would have been not $32,000,000 but $93,000,000—not a bad return on their original $1,000,000 investment.

The Alleghany Corporation, like its predecessor, continued industriously to add to and rearrange the Van Sweringen railroad holdings, its principal new acquisition being the securities of the Missouri Pacific. With this purchase, "We have reached the place where Alleghany in a general way had acquired the properties it was seeking to obtain."

The collapse of 1929 and the ensuing depression, which was particularly severe in the railroad industry, put a quietus on the Van Sweringens' grandiose schemes. Eventually, as everyone now knows, they lost control of the mighty structure they had erected

so laboriously. But at the time of the investigation they were still at the helm. Looking back upon their seventeen years of activity, during which they had formed many, many corporations, mostly holding companies, in furtherance of their aims, Mr. O. P. Van Sweringen saw no evil in what they had done. If there was anything to criticize, he thought, it was not the holding-company structure, but its investigation by the Senate Committee.

MR. VAN SWERINGEN: . . . What we need is encouragement to business instead, if I can be frank, of frightening people. I do not want to get too personal, but these investigations are terrifically destructive.

Mr. Van Sweringen was surely right. Senatorial investigations are, sometimes, "terrifically destructive." But the question is, to whom? To the public which, in this instance, had been induced for seventeen years to pour money into the Van Sweringen coffers—or to the wizards who run $1,000,000 up to $100,000,000, without risk to themeslves? As the proverbial small boy says: "It was the medicine that made me sick."

* * *

The Van Sweringen empire was complicated enough, but even more so was that of Mr. Samuel Insull. It is said that only twelve men were qualified to understand the Einstein theory of relativity; but the Insull structure was so complex that no one could

fully grasp it, not even, probably, Mr. Insull himself.

Mr. Owen D. Young, Chairman of the Board of the General Electric Company, and certainly no novice in matters of this kind, testified very candidly that for his part it was beyond him.

MR. PECORA: You referred in the course of your testimony here to the structure of the Insull companies being a very complicated one.

MR. YOUNG: Yes.

MR. PECORA: As Chairman of the Board of the General Electric Company, you have found it necessary and advisable through the years to observe and study conditions in the public utility field, have you not?

MR. YOUNG: I have.

MR. PECORA: When you refer to the structure of the Insull Companies as being a very complicated one, will you tell the Committee just what you mean by that?

MR. YOUNG: Well, I confess to a feeling of helplessness as I began to examine in February, 1932, the complicated structure of that organization.

MR. PECORA: Did you find that it embraced a large number of companies of various kinds?

MR. YOUNG: Great numbers of operating utilities, with holding companies superimposed on the utilities, and holding companies superimposed on those holding companies, investment companies and affiliates, which made it, as I thought then and think now, impossible for any man, however able, really to grasp the real situation.

SENATOR BROOKHART: And all overcapitalized?

MR. YOUNG: I express no opinion on that, because I

do not know. But I say it is impossible for any man to grasp the situation of that vast structure. And if I may add: I should like to say here that I believe Mr. Samuel Insull was very largely the victim of that complicated structure, which got even beyond his power, competent as he was, to understand it.

SENATOR BROOKHART: Although he created it himself?

MR. YOUNG: I think all the people in administrative and executive positions in those different units, looking at their particular problem, did the thing which they thought was wise. But if one company needed money and another company had it, and they had control of both companies, they naturally transferred funds from the company which had it to the company which did not have it; and all the way along in this vast structure.

At the peak of their power, the Insulls were suzerain over a tremendous and far-flung system of power and light. Theirs was the third largest group of utility companies in the country, exceeded only in size by the Electric Bond and Share and the United Corporation. The main elements of the system consisted of five holding companies in each of which the Insulls owned a minority interest. These five holding companies in turn owned controlling interests in numerous subsidiaries which were directly engaged in the business of marketing gas and electricity.

The largest of these holding companies was the Middle West Utilities Company which had assets of over $1,200,000,000 and no less than one hundred and eleven subsidiaries. The Commonwealth Edison

Company, which was the second largest, had assets in excess of $450,000,000 and six subidiary companies. The Midland United Company, the third in point of size, had assets of approximately $352,000,000 and thirty subsidiaries. The fourth company was the People's Gas, Light and Coke Company, whose assets exceeded $211,000,000, and which controlled eight subsidiaries. And finally there was the Public Service Company of Northern Illinois, with assets of $210,000,000, and but one subsidiary.

It will be seen that the combined assets of these five holding company groups aggregated well over $2,500,000,000. In 1930, at the height of its prosperity, this system was furnishing gas or electricity or both to more than 4,500,000 customers. It produced more than one eighth of the total electric power of the country.

Theoretically, a corporation belongs to the individuals who own its stock, and the law says that the owners of fifty-one per cent of this stock control the corporation. But the law must be considered an optimist in this regard. Not fifty-one per cent, but twenty per cent and often less, is sufficient to ensure effective working control. The great bulk of the stock of a huge modern corporation is held by so many thousands of relatively small stockholders scattered all over the country, who do not know each other and have no means of organizing, that the owners of a substantial corporate minority generally have no difficulty in running things to suit themselves.

This control by minority groups is much facilitated through the instrumentality of the holding company. One holding company adequately supplied with the public's funds, and itself controlled by a small group of minority stockholders, may in its turn control any number of operating companies by similar minority stock ownership. Other holding companies may be superimposed on the first holding company, as additional vehicles for borrowing or for the public sale of securities. In the end a vast and complicated structure is thus erected over which, with a comparatively small investment, large sums of public money are controlled. Mr. Owen D. Young criticized this system.

> Mr. Pecora: Mr. Young, would you say that the system of superimposition of company upon company in a structure of that kind would easily lend itself to overcapitalization of the various companies?
>
> Mr. Young: It would lend itself, I think, to overcapitalization, but it is not that aspect, or that so much which disturbs me. It is this: if I am right in thinking that Mr. Insull himself was not able ultimately to understand that structure, how can the ordinary investor, buying shares or buying obligations, especially of the last companies, on the top, how can they be expected to know, or even to inform themselves, conscientious and able as they might be, really as to the value of those securities?

The control which the Insulls exercised over this system did not, however, seem to them to be very secure. The stocks of all these companies were listed on the Exchanges, hence anyone so disposed could purchase them; and so the Insulls might suddenly find an opposition group in control of what they regarded as their own holding companies. In fact, near the close of 1928, Mr. Samuel Insull was so concerned about the activities of some groups who were engaged in buying the stocks of his companies, that he conferred with Mr. Owen D. Young and solicited his aid. Mr. Young told the Committee of this visit which Mr. Insull paid to him in December of 1928 and went on to explain that:

> Mr. Insull said that that threat was having a very bad effect upon the morale of his operating organization. They were fearful that those outside groups, who then could buy the shares of those operating companies and sell shares of investment trusts against them even at higher prices than the aggregate value of the market shares they held, would be able in that way to accumulate such a block of shares that they might threaten the existing management. And that the men in important positions in his operating companies were very nervous about it, particularly in view of the fact that he, Mr. Samuel Insull, was getting along in years, and that his natural span of life, in the natural course, would be short; and because his son was not then old enough to come along and take his place.

This was the problem, but its solution presented

some obstacles. It was necessary to acquire additional shares of these holding companies, enough to prevent the rival groups from getting a foothold therein. To do this, however, required money. And the Insulls, acting in accordance with the *mores* of the times, exemplified as we have seen by many distinguished men of that era, naturally determined to obtain this money from the great reservoir of wealth—the public. The thing to do was to organize a holding company—or, if you will, a superholding company—for the purpose of obtaining control of the five existing holding companies.

The new company was quickly formed and was called Insull Utility Investments (Incorporated). The total amount of securities issued by this company was approximately $150,000,000. Of this amount, the Insulls themselves contributed between $8,000,000 and $9,000,000 by transferring the stock owned by them in the other holding companies to this new corporation. The new corporation employed its funds, of course, in purchasing additional stock in the five holding companies which the Insulls dominated. The Insulls were thus, with the aid of the money contributed by the public, enabled to establish themselves more firmly in control of their utility empire.

Apparently, however, the danger which brought about the organization of Insull Utility Investments (Incorporated) still continued, for again the stock of the new company was listed on the Exchange and, as the Insulls owned only a minority of it, there was

a real danger that competing groups might gain control of the whole pyramid by the simple process of acquiring a large block of the stock of the superholding company in the open market.

In order to forestall this unpleasant contingency, the Insulls again went to the public for a further contribution. This was in 1929, when they formed the Corporation Securities Company of Chicago. Again the Insulls acquired a minority interest in this new corporation by the exchange of securities and a comparatively small cash contribution. The new company also invested heavily in the securities of the Insull Utility Investments (Incorporated). The latter had in its portfolio securities of an aggregate market value of $285,000,000, and the Corporation Securities Company of Chicago had about $150,700,000 of similar securities.

The control by the Insulls and their associates of this vast system seemed now complete, although they did not own a majority of the stock of either of these top holding companies. Thus they owned only 46.9 per cent of the stock of the Corporation Securities Company of Chicago, and only 19.2 per cent of the stock of Insull Utility Investments (Incorporated). By causing the former corporation to acquire 25.7 per cent of the stock of the latter, and by causing the latter corporation to acquire 11.5 per cent of the stock of the former, the Insulls were able effectively to control both corporations, and through them, the entire pyramidic structure.

In all, by January 31, 1932, the Insulls had formed more than ninety-five holding companies and two hundred and fifty-five operating companies. The investment which the Insulls had made to secure the direction of this pyramid was something less than one million dollars. If we consider the market value of their holdings in March, 1930, it amounted to more than $100,000,000. This $100,000,000, in turn, now controlled $2,500,000,000. For every dollar that the Insulls originally invested, they now controlled $2,500 of the public's money.

The Insulls were not absentee owners. They were engaged in the actual management and supervision of the affairs of their dynasty. Mr. Samuel Insull himself was chairman of the board of all five of the original holding companies, and Mr. Samuel Insull, Jr., his son, was the vice-chairman of four of the copmanies and the president of the fifth. Martin J. Insull, a brother of Samuel, was the President of Middle West Utilities Company and a member of the board of directors of each of the other four companies. When the two superholding companies were formed, Samuel Insull became the chairman of the board of both and Samuel Insull, Jr., the president of both, and Martin J. Insull served on the board of both.

Naturally, the participation by the public in these large corporations engineered by the Insulls could hardly be effected without the efficient aid of distinguished members of the securities-selling fraternity. To this end, the Insulls associated with them-

selves the banking firm of Halsey, Stuart and Company. Through its efforts hundreds of millions of dollars of Insull stocks and bonds were distributed to the public. Their task was not a simple one and they had to employ all of the strategy known to their profession. Indeed, it must be admitted that they spared no expense and left no device untried.

In addition to the garden variety methods so common in Wall Street—and some of which we have heretofore described—they initiated an interesting radio program, presided over by a professor of the University of Chicago, who came in the course of time to be known to the public as "The Old Counselor." He delivered very stirring and persuasive speeches, all of which were prepared for him by employees of the firm of Halsey, Stuart and Company. His task was to inspire the public with his mellow voice and winning personality, and to make them feel the real advantages to be derived from purchasing securities sponsored by Halsey, Stuart and Company, among which, of course, the Insull securities loomed large.

The rest of the story of Insull's empire—its collapse despite every effort to preserve it, Mr. Insull's self-imposed exile and enforced return to this country to stand criminal trial, and his dramatic and pathetic death in a Paris subway—are all too fresh in the public memory to need repetition here. No financier in our time had a more dazzling rise or suffered a more tragic fall. The greater pity, however, is that tens of thousands of innocent investors went down too.

II

"IT'S UP TO THE GOVERNMENT"

MOST of the banks and investment houses investigated by the Senate Committee were "Wall Street" concerns, either situated in that geographically tiny but financially mighty center of finance, or dominated by it. We come now to some banks which operated far from New York City, and under different auspices entirely. These were the famous "group banks" of the city of Detroit, whose collapse, in February, 1933, led directly to the national bank holiday the following month.

There were two such "group banks" in Detroit. Each was a holding company, owning all of the capital stock of the various unit banks affiliated with it. One was called the Guardian Detroit Union Group, Incorporated. The other was called the Detroit Bankers Company. They were, prior to their collapse at

least, very imposing institutions. The Guardian Group, organized in December, 1929, had the blessing of the magic name of Henry Ford himself, for no less a person than Henry Ford's own son, Edsel Ford, sat on the board of directors, and Mr. Ernest Kanzler, Edsel Ford's brother-in-law, served for a time as its Chairman.

Many other famous and nationally known figures of the automobile industry likewise served as directors, including Roy Chapin, of the Hudson Motor Car Company; William Fisher, of the Fisher Body Corporation; Alvin Macauley, of the Packard Motor Car Company; and Ransom Olds, Chairman of the Reo Motor Car Company. Mr. Charles S. Mott and Mr. Fred J. Fisher, Vice-Presidents of the General Motors orporation, were also identified with the original formation of "the Guardian group." Indeed, there were so many noted figures from the automobile world, that the Guardian Group became known throughout the country as an "automobile" bank. At its peak, this group controlled twenty banks in sixteen Michigan communities, and thirteen other corporations as well, with resources of over half a billion dollars.

The other "group bank," the Detroit Bankers Company, organized in January, 1930, had to get along without the prestige of a member of the Ford family on its board, but it was even larger than the Guardian Group. At its inception, it had combined resources of $725,000,000, and capital, surplus and

undivided profits of $90,000,000. One of its units, the First National Bank in Detroit, itself had 194 branches and seventy-six directors, and was the third largest separate bank outside New York City. The banks which formed the units of this group served approximately 900,000 depositors.

These "group banks" were supposed to be sounder than ordinary banks, yet they were the first great metropolitan institutions to go under in the crisis of 1933. To understand this paradox, and to follow clearly what happened to the banks in Detroit, it is necessary to know just what is meant by a "group bank," and what the problems are which it is supposed to solve.

Everyone will agree that the first desideratum of a bank, or a system of banking, is that it should be safe. Nothing is of more basic importance to the economic life of the country. Yet even before the national bank holiday of March 5, 1933, bank failures by the hundred were a commonplace occurrence in the world's wealthiest country. Between January 1, 1921, and March 15, 1933, over 11,000 banks, with deposits of over five billion dollars, closed their doors. Even during the "new era" years of fabulous plenty from 1921 to 1929, over 5,700 banks were suspended, with deposits of over a billion and a half. Such great losses, demoralizing to business and bringing cruel hardship to millions of depositors, large and small, are by no means inherent in the nature of banking institutions. During the same periods, for example,

in Great Britain, the home of banking, not a single bank failed; and in Canada, only a handful.

The historic banking holiday of 1933, when every bank in the United States closed its doors, was merely the culmination of decades of an archaic banking structure, which finally crumpled up under the hammer blows of the depression. Even today, six years after that dramatic demonstration of fundamental unsoundness, the problem is essentially unsolved.

From time to time, many panaceas have been suggested to cure these admitted evils. According to some, the fault lies in having a multitude of small institutions, instead of a few big ones. The development of branch banking, although bringing with it all the dangers of greater and greater concentration of control over the nation's credit by a few private individuals or corporations, has been defended vigorously by this school of thought, as the logical and necessary way to strengthen our banks.

On the other hand, branch banking has been very unpopular in certain quarters, not merely because its trend is in the direction of a "money trust," but also because it means the domination of smaller communities by strangers, who may care and know little of local needs and prejudices. Just as the small town may prefer its own familiar grocer, to an impersonal branch of some nation-wide chain, so it may prefer its own bank, operated by well-known local figures, to the representative of some far away, inaccessible big-city banker.

Now, the so-called system of "group banks," of which the Detroit companies were leading examples, purports to be a compromise between the advocates of branch banking and its opponents. Under this system, a holding company is organized, which acquires the stock of a number of individual banks. These individual banks are left to operate, under their own names, with their personnel undisturbed, and with a high degree of independence in their management. At the same time, the common ownership enables the various banks in a group to co-operate with one another in case of need. The system is supposed to unite the strength of a great institution with the benefits of local autonomy, combining the best features of both.

Such was the theory. But the practice was very different. The Senate Committee investigated thoroughly the rise and collapse of the two great "group banks" of Detroit; and its conclusions, to put it mildly, do not inspire confidence in the new system.

To begin with, it was found that through the device of the holding company, which was the central idea of the scheme, a handful of ambitious promoters, with no stake of their own, could—and in the case of one of the groups did—seize control of the whole setup at its very inception. The Detroit Bankers Company, as we have said, had resources of almost three quarters of a billion dollars. Yet, incredibly enough, control of this vast sum, representing the major part of the banking resources of the fourth

largest city in the country, was obtained by a dozen men who advanced only $1,200, all told, out of their own pockets!

How this remarkable result was accomplished is not a secret to lawyers trained in the intricate art of separating the management and control of a corporation from its titular ownership, and perpetuating power over other people's money. Mr. Julius H. Haass was the guiding spirit. Together with eleven other gentlemen, some of them already directors of other banks, he organized the new corporation, the Detroit Bankers Company. The stock of this new corporation was of two kinds: first, there were 2,500,000 shares of common stock at $20 a share; and, second, there were one hundred and twenty so-called "trustee shares," costing $10 each. These one hundred and twenty "trustee shares" had all the voting rights, and they were promptly distributed among the twelve organizers, who thereby, for $1,200, acquired complete control of the company without responsibility to anyone.

The next step was to get control of five important Detroit banks and unite them into one group. These were the People's Wayne County Bank, the First National Bank in Detroit, the Detroit and Security Trust Company, the Bank of Michigan, and the Peninsular State Bank. To each of the stockholders of each of these banks, a letter was sent, inviting the stockholder to exchange the stock he then owned in

his bank for a certain number of shares of the common stock of the new corporation.

This letter was very skilfully drafted; it was a masterpiece of sonorous financial conservatism, shrewdly conceived to draw the most wary stockholder into the project. It was signed jointly by the officers of all five banks, and stated that it was sent with the unanimous approval of the boards of directors of each of the banks. It was pointed out that the banks and trust companies which would thus come into one family would form a mighty whole, having a combined capital, surplus and undivided profits of $90,000,000 and total resources of $725,000,000. Above all, the letter held out the lure of high dividends: "It is proposed that dividends be paid upon the common stock of the new company, in the aggregate amount of 17 per cent per annum, payable quarterly." No stockholder could afford to ignore so golden an opportunity, particularly when it came to him over the signature of the officers of his own bank and other leading bankers of the community.

When the new structure was finished, the former stockholders of the five banks held stock in the new holding corporation instead: the new corporation—the Detroit Bankers Company—held all the capital stock of the five banks; and the twelve trustees, owning $1,200 worth of shares, controlled the whole organization.

The other group bank—the Guardian Detroit Union Group, Incorporated—was formed by the merger of two earlier holding companies. There were no "trustee shares" in this organization, but the spirit of bold speculation was pervasively present. The leading organizer here, and the pioneer in introducing group banking to the State of Michigan, was Mr. Robert O. Lord. Mr. Lord had spent many years in a Chicago bank before coming to Detroit in 1927, but he was nevertheless characterized by Alfred Leyburn, the dispassionate National Bank Examiner for the Detroit district, as follows:

> It is very apparent that Mr. Lord of the Guardian Group is not a banker and he never has been and never will be one. He is more of a glad-hand promotion type, and he always chooses the path of least resistance, which has now [June, 1932] created the present problem with the group.

From the very beginning, as was to be expected, the stocks of the new group banks were the subject of furious speculation. They were at once listed on the Detroit Stock Exchange. In 1929, Guardian Group stock sold in quantities at around 250 to 300. Some shares reached as high as 350. Within a year the price had dropped to 75 or 80. Such "nose dives" in the market price of the stock of the holding company naturally caused profound apprehension and uneasiness among the depositors of the various unit banks forming the group. Large withdrawals of deposits followed. Instead of the weak units being buoyed up by the strength of the group, as they were supposed to be

in theory, it generally worked the other way around. Like the rotten apple in the fable, a sick member tended to contaminate its healthier fellows, and caused suspicion of the whole group. Failure of confidence in the group as a whole, in its turn, dragged down the individual units as well.

Mr. Lord testified that "the decline in the quoted price of group shares was adversely affecting the institution's standing with an already hysterical public." Mr. Kanzler testified that the market price of the stock was "inherently and unfortunately" bound up in the public's mind with the caliber of the institutions represented by the stock. Dr. Fred Murphy, Chairman of the Board of the Guardian National Bank of Commerce, one of the units of the group, wrote: "There can be no question but that brokers, as a class, are interested solely in the buying or selling of a stock in order that they may collect a commission. Undoubtedly their constant telephoning to stockholders has been very unsettling." In the opinion of various other officers, the stock was being "batted around from pillar to post like a football," and "a large percentage of the decrease in group deposits can be traced directly to market quotations on its stock."

These are the statements of officers of the Guardian Group, or of its units themselves. Yet, despite urgent suggestions, those in control refused to take the stock off the Exchange. That would be "too unsettling"; it would be construed as an admission of weakness. Instead, the dominant spirits preferred to

put on as bold a face as possible, to keep up appearances at all costs. A $27,000,000 pool was formed for the purpose of trying to sustain the market price of the stock. High dividends were declared, just as though all were really well, to reassure the public. Glowing statements of the banks' condition were sent out to stockholders, drawn to mask or conceal the profound weaknesses that actually existed. As one memorandum somewhat naïvely put it, it was decided that the consolidated financial statement should be in the "standard form" rather than the "understandable form," which was felt not suited to the times.

Often resort was had to barefaced juggling and shifting about of funds from bank to bank, on the eve of an expected examination, so that banks really heavily in debt could make a fictitious showing of being wholly out of debt. We will spare the reader the intricate details, which would lead us into a bewildering maze of evasive technicalities and accounting magic. So fair a picture was painted, indeed, that even colleagues in the banking fraternity throughout the country were misled into congratulation. The National City Bank of New York wrote, "You have made a good showing." The Chase National Bank assured them, "You have every reason to be proud." The Irving Trust Company felt, "If all the banks of the country pursued a similar policy [with regard to debt], there would be a far greater stability in banking." To the Bank of America, New York, the showing of the

Guardian Group seemed "little short of miraculous." Dozens of other banks sent similar messages.

As late as January 24, 1933, the stockholders of the Guardian Group were told that "while bettering their liquid position, our banks have at all times continued to render constructive, helpful service. . . . Consolidated net earnings of the Group Company, banks, trust companies, and all other affiliated companies amounted to $1,316,952. . . . Nothwithstanding the exceptionally trying times . . . our unit banks are entering the new year prepared to furnish better and more efficient banking service to the communities which they serve."

But even before such a gratifying and reassuring report could be properly printed and distributed, these highly efficient and liquid institutions collapsed!

Behind the scenes, of course, the Guardian Group had long been in bad straits. The group had commenced operations after the beginning of the depression in 1929; but the latter's unparalleled extent, especially the paralysis of the automobile industry upon which almost all values ultimately rested in Detroit, shook Detroit banks to their foundation. The situation, at its best, was grave in the extreme, and called for the most prudent and conservative banking policy.

This was just what the Guardian Group did not pursue. The group was a boomtime project, conceived in a boomtime mood, and it was managed

with boomtime nonchalance. The vaunted "autonomy" of the individual banks which formed the units of the group covered a shocking laxity in the supervision of their activities by the central institution. These units had been permitted to become enmeshed in bad loans of huge amounts which were not charged off as losses, and in many "slow and doubtful" assets. Tens of millions of dollars had been loaned on the security of real estate, which could not possibly be liquidated under depression conditions.

Further millions were loaned on the security of shares of the Guardian Detroit Union Group, Incorporated, itself. It is, of course, illegal, for a bank to loan money on the security of its own stock. But the holding company was technically different from the banks whose stock it owned; and this technical distinction, thin as it was, sufficed to satisfy the easy standards that prevailed. These loans were not only illegal in all but the technical sense—if not that, too—they were also highly improper from the point of view of sound banking. For the banks could not sell out such collateral without depressing still further the market price of group stock, and thus causing more withdrawals of deposits and more loss of confidence. In effect, such security was no security at all.

National bank examiners protested and warned repeatedly against what one of them termed the "outrageous concentration" of collateral in group stock; but to no avail. Many of the loans, indeed, were made to officers and directors of the various banks in

the group itself, to enable them to buy group stock. Toward these officers and directors the utmost leniency was exercised. Such loans on group collateral were practically never called. At least partly on this sort of worthless security, the Guardian National Bank of Commerce, one of the banks of the Guardian Detroit Union Group, loaned to its directors over $4,400,000 in direct loans and over $3,300,000 in indirect loans. Similar loans by other banks in the group were on the same scale. As for the Detroit Bankers Company, the figures here were even larger: the banks in this group loaned to their directors, in direct loans and affiliated borrowings, no less than $42,000,000.

The banks in the Guardian Group were still further weakened by losses which sprang from nonbanking corporations owned by the group. There was absolutely nothing to prevent the group corporation from entangling itself in any kind of dangerous business it pleased. Not being itself a bank, but a holding company, it was in no way subject to the supervision or control of the banking authorities, or to the legal restrictions that governed the operations of a bank, any more than "security affiliates" like the National City Company or the Chase Securities Corporation were. There was therefore nothing to prevent the Guardian Group from buying control of Keane, Higbie and Company, a Michigan investment and brokerage house; and when this company got into severe difficulties, it was the group that had to come to the

rescue. The strain which this put upon the group's resources was, indeed, listed by National Bank Examiner Leyburn as one of the principal reasons for its eventual downfall.

Altogether, it became clear that the group corporation was a liability, rather than an asset, to the banks it controlled—at least to such as had any degree of soundness. The holding company desperately needed money, not only to sustain morale and confidence by paying dividends to its own stockholders, but to meet about $850,000 annual expenses, covering operating expenses and interest charges on over $14,000,000 it had been forced to borrow. It had no source of substantial income other than dividends paid to it by the banks whose stock it owned; and in the eyes of the officials of the holding company, the chief function of these banks was the production of such dividends. The unit banks were ruthlessly "milked," against every dictate of banking prudence and caution. So flagrantly improvident were these dividend declarations, in view of the shrunken state of the bank's assets, that in the opinion of Bank Examiner Leyburn they were "absolutely unwarranted" not only from a business, but from a legal, standpoint as well.

Nevertheless, from 1929 to 1932, the Guardian Detroit Union Group, Incorporated, squeezed more than $9,700,000 in dividends out of its unit banks, and paid over to its stockholders approximately $9,300,000. Time after time, banks whose capital was actually impaired, according to the impartial audit

of the bank examiners, were forced to deplete still further their already alarmingly inadequate means. Thus, in May, 1932, the bank examiner reported that the Guardian National Bank of Commerce had taken a loss of $1,200,000, but that this sum was merely "nominal" in comparison with the actual loss, which was so great in amount that the authorities did not dare make it public; that the bank derived no strength from the group, which was a constant drain upon it, and that "the situation is a serious one." Yet this bank had paid out a dividend of $200,000 for the first quarter of 1932.

In November, 1932, another bank examiner reported that the "doubtful" loans of this same bank then exceeded the entire capital funds of the bank; yet a dividend of $150,000 was declared by it, for the final quarter of 1932. Whatever scruples or hesitation the officers of individual banks might manifest were suavely over-ridden by imperative and very specific "suggestions" from the parent body. It was at all times the Group Corporation, the supposed reservoir of strength and safety, which exercised this disintegrating pressure.

The Detroit Bankers Company—the other group—was equally reckless in its dividend policy. It had, as the reader will remember, promised its stockholders dividends of seventeen per cent, in the palmy days of 1929, and, depression or no depression, this was one promise the directors kept. The full seventeen per cent was paid throughout 1930 and 1931, despite

the increasing gravity of the banking situation. In the first quarter of 1932, a reduction was finally made—to sixteen per cent!

In order to maintain these dividends, the stronger banks in the group were subjected to a terrific strain. As business conditions went down, dividends from these banks went up. The important First National Bank in Detroit, for example, had paid average dividends, from 1925 to 1929, of about $975,000 annually. In 1930, after joining the group, it raised its dividend to $1,137,000; and in 1931, the bank found it possible to pay dividends of $4,650,000—four times as much as in 1930, and almost five times as much as in the prosperous years before it had joined the group! Even in 1932, in the very depths of the depression, this bank paid out over $2,800,000 in dividends—almost three times as much as in 1929.

Mr. John Ballantyne, the President of the Detroit Bankers Company in 1931 and 1932, was completely unprepared to defend this dissipation of the bank's reserves:

Mr. Pecora: . . . Do you recall any facts and circumstances which warranted the payment, having in mind business and banking conditions as they were in 1931, of that dividend of over $4,600,000 by the First National Bank?

Mr. Ballantyne: I could not have any idea on that subject. . . . I was giving all my time to the question of

credits in the bank. . . . I do not have any personal knowledge of what the dividends were. . . .

MR. PECORA: Had this dividend of over four and a half million dollars been earned?

MR. BALLANTYNE: I am not prepared to say. . . .

MR. PECORA: What can you tell us about the declaration of these dividends of over four million, six hundred thousand, in the year 1931?

MR. BALLANTYNE: *I cannot tell you a thing.*

How little warrant there was for such dividends was clearly shown in the reports of a number of bank examiners. In July, 1932, the losses had been found so great, that the examiners feared to tell *even the directors of the bank* their full extent, lest utter demoralization result. In November, 1932, the examiner reported:

> The enormous amount listed as doubtful cannot but help reveal the extent of losses this bank will be called upon to absorb. . . . Loan after loan in sizable amounts was made to persons who had no license whatever to borrow money and who are so badly involved that it is useless to even consider that they can ever attempt to pay.

Examiner Leyburn testified before the Senate Committee that the First National Bank had become a veritable "monkey house."

> MR. LEYBURN: In the first place, let us get this straight. You have heard a story about rotten loans and rotten

> banks. The First National Bank of Detroit was not rotten—it was putrid. . . . The failure of this bank, as in the case of the Guardian Detroit Group, is due to the involved condition of the holding company, the Detroit Bankers Group . . . the taking over of the American State Bank and the banks at Redford. . . . Also the high percentage of loans secured by real-estate collateral. Speculative loans did not have proper attention, and the most incompetent management that the examiner has ever contacted in a large bank was met with.

The beautiful annual financial statements which had aroused so much enthusiasm and congratulation among their banking colleagues did not arrest the debacle in either group. The public was apparently harder to fool than the bankers. They kept drawing their money out by the millions. Guardian Group stock, which had sold in the 300's, dropped to 5½, and was actually not freely disposable in quantity even at that price. Detroit Bankers Company stock dropped to $80 by the end of 1930, to $30 by the end of 1931, to $10-15 by the end of 1932, and, a few months later, to nothing.

By February, 1933, the long-deferred day of reckoning was at hand. It was in the Union Guardian Trust Company, one of the unit banks in the Guardian Group, that the most acute distress broke out. The group authorities made desperate efforts and exhausted every means of help. The important automobile magnates who were directors and big stockholders had already, at various times, advanced a total of

$27,000,000 of their own money, by way of loans, to help keep the structure intact. The Ford interests alone had advanced $16,000,000, in one form or another, in the preceding three years. In this emergency, the group turned to the Reconstruction Finance Corporation, organized under President Hoover in 1932. This body had already loaned the Guardian Group banks over $16,000,000 (part of which had been canceled). Now they were asked to make a loan of an additional forty-nine millions and a half or, at the very minimum, forty-three millions and a half.

The Reconstruction Finance Corporation, however, felt that the assets which the Guardian Group could offer as collateral were, at their most liberal valuation, insufficient to cover this proposed loan. Mr. Ford, who was asked to help by subordinating $7,500,000 Ford deposits, declined, feeling that he had already done enough. The Reconstruction Finance Corporation concluded that its offer was the maximum it could legally make. The difference between at least temporary safety and a crash was very narrow—not more than ten or thirteen million dollars.

Mr. Kanzler, in fact, testified:

> The board of the Reconstruction Finance Corporation was willing to lend thirty-seven and a half million dollars, but forty-three and a half million dollars was necessary.

Six million dollars would have kept these institutions from closing.

Six million dollars—and the Guardian Group had disbursed over *nine* million dollars in unwarranted dividends!

Chief Examiner Leyburn gave a vivid picture of the negotiations:

> MR. LEYBURN: . . . The Reconstruction Finance Corporation talked to us about the loan. They figured there was not enough security there. And they asked all the time, "Well, what will Mr. Ford do?" . . . At that meeting was Ogden Mills, the Secretary of the Treasury then, Undersecretary Ballantyne, Jesse Jones, Mr. McCarthy, who was a member from Utah, and . . . Pomerene, I guess it is. . . .
>
> Their idea was all the way through, or their thought was—and they did not hesitate to say so, and I don't recall whether they stated that openly, I was in the meeting of course by myself; I don't recall whether they stated it openly or just at the meeting I was present at—but it was, "Why should we bail out Mr. Ford?" They figured that he should come to the rescue up there.
>
> Just about the conclusion of that meeting they said, "Why we want you to get Senator Couzens to recommend this loan to us." And they didn't care much about that.
>
> MR. PECORA: Who didn't care much about what?
>
> MR. LEYBURN: About asking the Senator. Mr. Longley and Mr. Kanzler [group bank officials] did not want to do that.

So they came up and saw the Senator, and he told them that if the loan was made, I think, he would "shriek from the housetops," or something like that, if the loan was made to the group on the basis of that collateral.

MR. PECORA: Because the collateral was not sufficient?

MR. LEYBURN: Inadequate, that is right, was inadequate.

So then we came back to the Reconstruction Finance Corporation, maybe it was the next day, and talked to Mr. Miller, who was President of the Reconstruction Finance Corporation at that time . . . and he made the suggestion that possibly if he could talk to Mr. Ford and tell him what the situation was, that it may mean a collapse of the whole banking structure in Michigan and every other place probably, that maybe he would convince him to put some money in there so the loan could be made.

It was suggested—Mr. Miller suggested possibly Mr. Hoover could invite Mr. Ford to the White House, and then he would come over there and see him, and that suggestion was put up to Mr. Ford by Mr. Longley. . . . Then Mr. Longley came back and he said Mr. Ford's answer was that no matter who called him down to Washington the answer would be no.

Faced with Mr. Ford's definite refusal, the authorities decided to close the Union Guardian Trust Company. Nothing was said, however, about closing up the First National Bank in Detroit, the leading bank of the other group. This did not please Mr. Ford, who was closely affiliated with the Guardian Group.

The Ford interests had about $18,000,000 of deposits in the First National Bank, and Mr. Ford threatened to withdraw this great sum immediately if the bank of his group was closed, and the other group's bank allowed to remain open. Such a withdrawal would, of course, have made it impossible for the First National to continue.

Mr. Edsel Ford, his son, testified that Mr. Henry Ford thought the two banks "should both be treated alike in every instance. . . . He was quite incensed over the way the thing turned out at the end; I mean this suggestion about a great amount of additional help after what we thought was a lot of help that had been given" in the past. Mr. Mills, the Chairman of the Board of the First National Bank from which Mr. Ford threatened to withdraw his deposits, attempted, without success, to dissuade him.

MR. PECORA: . . . Now, did it ever occur to you to ask anyone connected with the Ford Motor Company what reason they had for announcing that they would withdraw their deposit of approximately twenty millions from your bank if the Guardian bank closed?

MR. MILLS: Yes, it did.

MR. PECORA: . . . Whom did you ask about it?

MR. MILLS: I talked to Mr. Henry Ford.

MR. PECORA: Did he give you his reason for that attitude? . . .

MR. MILLS: Ford stated to me—this was on . . . Monday evening of the Michigan holiday . . . the thirteenth day of February—that unless the Guardian were permit-

ted to open the following day he would come down and take his money, every cent of his funds, from us and from any other Detroit bank that was open.

THE CHAIRMAN: And what?

MR. PECORA: Did he give you his reason for so doing?

MR. MILLS: I said, "Why is this, Mr. Ford?" He said, "I think it is up to the Government to save these institutions by making them loans. They saved the Dawes bank."

It was "up to the Government" then—in 1933. But today, Mr. Ford, like many of his fellow leaders of industry, feels that Government should not "interfere" with business.

Between Mr. Ford's "It's up to the Government" stand, and the Reconstruction Finance Corporation's "Why should we bail out Mr. Ford?," the deadlock was complete. The result was that all the banks in Michigan were closed, the panic spread to other States, and the rest is painful history.

* * *

Despite the Detroit experience, there are still many group banks in the United States. Indeed, at the end of 1936, fourteen per cent of all the bank deposits of the country—almost seven billions—were still in banks belonging to such groups. The Senate Committee's investigation does not suggest that this widespread growth is a wise and healthy one. On the contrary, it is a most dangerous development. To be sure, the troubles of the Detroit banks were due to

other causes as well. The banks forming the groups inherited, as one witness put it, "a legacy of grief," and they had to cope with appalling business conditions. But none the less, the Detroit experience constituted a disastrous demonstration of inherent dangers in this form of banking organization that it would be folly to ignore.

In the Banking Acts of 1933 and 1935, Congress has to a certain extent moved to regulate these companies. Under the law as it now stands, the stock of a bank which is a member of the Federal Reserve system may not be voted by the holding company without the permission of the system's board of governors, and this will not be granted unless the holding company gets rid of "security affiliates," and fulfills certain other salutary conditions. But many feel that these measures do not go to the root. President Roosevelt, in particular, in his message to Congress of April 29, 1938, recommended that the growth of holding-company control of banks be immediately halted, before it became entrenched and unmanageable, and that provision be made for the gradual separation of existing ties.

It is all very well to have billion-dollar institutions. But mere banking bigness, hybrid in character, ill organized and irresponsible, is not the answer to our banking problems.

12

"GOD-GIVEN MARKETS"

THROUGHOUT the course of the investigation, as the reader must have observed, no matter what the immediate subject of inquiry—private bank, investment trust, holding company, or a great commercial bank—the Stock Exchange was never very far away. Manipulation of the markets was not merely the source of immediate stock-market profit, but the indispensable means to innumerable tortuous schemes and devices. Whether it was an Insull or a Van Sweringen engaged in building up his empire, or a Wiggin exploiting his inside position at the head of a great bank, or J. P. Morgan and Company launching a vast new enterprise, we invariably find the Stock Exchange utilized as an important instrument to facilitate their purposes. Like a scarlet thread, it winds through the entire Senate investigation.

Yet this great institution, whose slightest mood is reflected manyfold in the business life of the country, was wholly outside the sphere of governmental control. It was operated as a strictly private gentlemen's club, and an extremely select one, at that. Its membership was specifically limited to 1,375, and in order to join it was necessary not only to purchase the right from an existing member, but also to gain the approval of the governing board.

There was, it is true, an elaborate system of committees, rules, and regulations by which the Exchange was supposed to exercise "self-discipline," but no outside power could set foot within its walls.

The official Stock Exchange point of view, as expressed by Mr. Richard E. Whitney, its President, held that it was a "perfect institution": its members were high-minded; its officers vigilant; its rules were adequate. The pools that flourished were not necessarily evils; short selling was a justifiable and even indispensable practice. The Exchange bore no responsibility, and ought to have none, for the truth of statements in prospectuses and other information relative to the securities which were listed upon its board. Its sole function was to act as a market place for the sale and exchange of stocks and bonds, a place where the laws of supply and demand might play themselves out free of all extraneous interference.

The Exchange authorities not only defended their practices, but did so on the highest moral grounds. Said Mr. Richard Whitney: "The policies of the

New York Stock Exchange have resulted from a century-old experience. . . . The New York Stock Exchange has been fully aware of its serious responsibilities." The Exchange's refusal to pay heed to popular demand for reform was, he declared, simply a manifestation of "courage to do those things which are right, regardless of how unpopular they may be for the time being."

In his opinion, which was the official opinion, it did not and never had considered itself as having any rights to evaluate the securities traded on its floor. If Radio common went to 400 without ever having paid a dividend, it was strictly up to the public to decide whether or not it wanted to buy. The Exchange, as such, could take no action.

> The Exchange is a market place. . . . If a market place for securities is to fulfill its function in the economic order of things, it must fairly and honestly permit the forces of supply and demand to determine prices. The Exchange, as an institution, must be impartial.

It was admitted, of course, that there were some abuses, and these were condemned in principle, but it was not admitted that they obtained widely in practice. The officers indeed had heard rumors of wrongdoing, but only seldom had they actually discovered it.

In fact, the leaders of finance, as a group, were strangely ignorant of all detailed knowledge, even in

theory, of manipulative practices. Mr. Mitchell, you will remember, informed the Committee: "I am not familiar with these pools." Arthur W. Cutten, one of the most famous speculative names in American financial history, was asked what the term "wash sale" meant to him. He replied: "I do not know." Mr. Buttenwieser, of Kuhn, Loeb and Company, understood the meaning of the term "pegging" only from hearsay. Mr. Harry F. Sinclair, whose tremendous gains from manipulation of stock we have described in a previous chapter, declared: "I am a very poor market operator." Mr. Wiggin had "not the slightest familiarity with the way they [pools and trading accounts] are operated." Mr. Wiggin, in fact, totally disclaimed human intervention of any kind as a major cause in the great stock-market advances of 1928-1929, amounting, as in the case of the Chase National Bank stock, to hundreds of points. It was not pools; it was not rumors; it was not expert artificial stimulation which caused these frantic markets. Instead, Mr. Wiggin, somewhat blasphemously, described them as a gift from heaven: they were God-given.

> Mr. Pecora: Well, according to your answer to Senator Adams, the transactions that were consummated by these two accounts which had the same syndicate members, involved buying and selling at virtually the same time. That is so, is it not, Mr. Wiggin?
>
> Mr. Wiggin: Some days, undoubtedly.

Mr. Pecora: Is that not a scheme for "churning the market" and producing an activity that would stimulate prices?

Mr. Wiggin: I think the market was a "God-given" market.

Mr. Pecora: What is that?

Mr. Wiggin: I think it was a "God-given" market.

Senator Adams: Are you sure as to the source?

Mr. Wiggin: No, sir.

Mr. Pecora: "God-given" market, did you say?

Senator Couzens: That is a new one.

Mr. Pecora: Was it "God-given" because the price of the stock went up nearly 400 or more points during the life of these two accounts?

Mr. Wiggin: The market in bank stocks was just like the market in other stocks. As you know, in 1928-1929 there developed a great demand for stocks, a great demand for securities. That applied to bank stocks just the same as everything else.

Mr. Pecora: I believe that Napoleon said that "God is on the side that has the heaviest artillery." In this case apparently he was on the side of the Chase Bank and its affiliates?

But it was by no means so simple: the markets of 1928-1929 were not "God-given," but essentially man-made. It was of course true that many deep-seated and world-wide economic forces were involved. The Senate Committee's investigation, however, established beyond peradventure of a doubt that whatever evils were inherent in the situation were enor-

mously aggravated by the speculative and manipulative practices of Wall Street. It was not inevitable that securities should rise to astronomical heights, only to be thrown clear down to the bottom.

Far from being an impartial forum for the free play of supply and demand, as pictured by its authorities, the Exchange was in reality neither more nor less than a glorified gambling casino where the odds were heavily weighted against the eager outsiders. On this "free and unrestricted market" there were operating in 1929 pools, syndicates, joint accounts, or the like—however one terms them—in not less than 105 public stocks listed on the New York Stock Exchange. The public who bought these stocks at dizzily mounting prices did not do so merely because of impersonal economic forces; they were the victims of a determined, organized group of market-wise operators, armed with special information and special facilities, and backed generously with bankers' credits.

Senator Brookhart: Are pools against the rules of the Exchange?

Mr. Richard Whitney: No, sir. . . .

Mr. Pecora: Is it easily possible for a group operating through the medium of a pool to exercise temporarily, at least, or for the purposes of the operation, a control of the market prices?

Mr. Whitney: I will answer yes, sir; on the conditions——

Mr. Pecora: The market price of a given security?

MR. WHITNEY: As long as the stock and their money hold out, yes.

MR. PECORA: Yes. And to that extent, those persons are enabled to exercise a control, are they not?

MR. WHITNEY: By bidding and offering, yes.

MR. PECORA: By bidding and offering. Now, what steps, if any, does the Exchange take to prevent that kind of control?

MR. WHITNEY: I do not know of any, Mr. Pecora.

MR. PECORA: When such a pool is operating and effecting such control, it is restricting a free and open market where honest values can be obtained, is it not?

MR. WHITNEY: No, sir.

MR. PECORA: Is it not?

MR. WHITNEY: No, sir. . . .

The prohibition which the Exchange imposed upon its members was not against pools, as such, but only against what they considered improper methods of operation. Fraudulent statements and certain obviously misleading practices were supposed to be taboo. So lax was the "self-regulation" of the Exchange authorities, however, that even the formally condemned abuses were actually detected and punished only on the most infrequent occasions.

Two devices employed by pools which were officially prohibited even by the Exchange rules were so-called "wash sales" and "matched sales." Suppose, for example, you were a pool operator and the current quotation for the stock in which you were operating was $40, and you wished to raise the quoted

price without running any risk. If you were allowed to use the "wash sale" technique, it would simply be necessary to offer to sell a quantity of the stock at say, $41, and at the same time arrange either through the same or a different broker to buy the identical stock you were offering to sell. There would, of course, be no real change of ownership; it would simply be selling to yourself.

The public, however, would know nothing of this. All it would see would be a statement on the ticker: "100 shares blank stock sold at $41." There was nothing to apprise the observing public that the price had really not advanced $1 on the open market, but that the quotation of $41 was just so much camouflage. When this sort of transaction is repeated over and over again, day after day, in large amounts and at constantly advancing prices, the effects upon public buying can easily be imagined.

Only slightly different in technique was the so-called "matched sale." Here one operator would put in an offer to sell a stock at a given price, and simultaneously another operator with whom he was acting in concert would arrange to buy it at the offered price. On the next transaction, their respective roles might be reversed. The erstwhile seller might become a buyer, and the buyer a seller. Again there was the same appearance of activity and change in prices while actually all the trading was strictly "within the family."

Entirely similar in essence was an even simpler

technique which was extremely common and considered quite legitimate. The pool operator who wished to advance the price of his stock might merely put in a buying order in the morning, at an increased quotation, and sell out in the afternoon, and could keep on playing this game indefinitely, thus creating an entirely fictitious impression of tremendous activity and buoyancy.

SENATOR BROOKHART: Let me ask you about another transaction or two. Supposing a brokerage firm is selling securities for anybody, are they permitted to buy them for the same party, if at the same time, they are selling, the same day?

MR. WHITNEY: Do you mean if I sell securities to one individual for the account of a firm, may I buy securities for that same firm from another individual?

SENATOR BROOKHART: Yes, we will take that first.

MR. WHITNEY: The answer is yes.

SENATOR BROOKHART: They are permitted to take orders buying and selling for the same firm, on the same day, at the same time?

MR. WHITNEY: Certainly. So can I buy hogs the same day for the same individual, and sell for him. Absolutely, yes.

SENATOR BROOKHART: Yes, but we do not do the hog business that way until it gets in the Produce Exchange.

The controversial practise of "short selling" has already been described, notably in connection with Mr. Wiggin. We shall not, therefore, further burden

the reader with the interminable and involved defenses of this practice which the Stock Exchange authorities and others persistently advanced. Briefly, while they agreed that "bear raids" calculated to demoralize the market were evil, "short selling," as such, far from being an evil, was an indispensable pillar of the market.

Mr. Richard Whitney, on one occasion, went so far as to declare that if short selling were prohibited, the effect would be to close the Stock Exchange and precipitate a banking crisis. "In so far as the Exchange is concerned," added Mr. Whitney, "the defense of short selling is not a matter of opinion; it is a matter of principle."

The Senate Committee, however, after taking full testimony on both sides, rendered a contrary verdict. It found that the supposed advantages of short selling, such as that it provided a "cushion" for a falling market, were largely mythical. In good times Wall Street does not sell short. When calamity threatens and the bear comes out of his lair, he makes his profits by exploiting and completing public demoralization.

The public was always in the dark. It could not tell whether sales were merely due to the "free play of supply and demand," or whether they were the product of manipulated activities. Neither did it know whether a sale was of the ordinary variety or a short sale. It all looks alike on the ticker. Nor did the public have access to the inside information on which the

officers, the directors, and the dominant stockholders act.

Mr. Wiggin, for example, was in June, 1932, Chairman of the Finance Committee of the Brooklyn-Manhattan Transit, receiving a salary of $20,000 a year. He was also the head of the Chase National Bank. Mr. Wiggin's Shermar Corporation at that time owned 26,000 shares of the common stock of the Brooklyn-Manhattan Transit. A meeting of the board of directors of the Brooklyn-Manhattan Transit was scheduled for June 20, at which time a decision was to be made as to whether or not to pass a dividend on the corporate stock. In large part, if not entirely, this decision depended upon the policy of the Chase Bank with reference to certain projected Brooklyn-Manhattan Transit financing, and on this issue Mr. Wiggin's own decision was of course final. Mr. Wiggin decided on or about June 3 that in his judgment, at least, the board should pass the dividend.

Having once decided, Mr. Wiggin rushed to unload his personal holdings, and within the next three days all of his Brooklyn-Manhattan Transit common stock was sold at an average price of about $24 per share. Within two or three days thereafter the stock had dropped from 24 to 11. On June 20, the board of the Brooklyn-Manhattan Transit duly met and decided that the dividend should be passed. By taking prompt market action based on information derived from his position of trust, Mr. Wiggin

was able to sell his stock at twice the price of the ordinary uninformed stockholder. And such abuses of official position were of common occurrence.

These revelations of the Senate Committee specifically inspired the inclusion in the Securities Exchange Act of 1934, of the so-called "anti-Wiggin" provision. This requires an officer, director, or other "insider" of a corporation, who trades in its stock, to account to the corporation for profits made by him from this source, within a six months' period. Hereafter, it will be less profitable to be a "fiduciary."

The Exchange authorities, to be sure, tardily admitted that they might perhaps go farther than they had in meeting their responsibilities to the public. Mr. Richard Whitney readily conceded:

> We have a responsibility, a very real one, as to the securities that we list on the New York Stock Exchange. . . . And we are trying to progress. We do not say that our rules are perfect by any manner of means.

Such reforms, however, it was contended, might safely be left to the Exchange itself.

Similarly, Mr. Otto Kahn, while recognizing the public function of the Exchange, expressed his confidence in its powers of self-discipline.

> The only legitimate function of the Stock Exchange is to be a fair and free market. . . . I believe, so far, of

late, particularly, they have made a very great effort to control it; I think they are doing everything now that I could think of if I were a Mussolini of the Stock Exchange, to prevent these artificial, antisocial, illegitimate practices which thrive on the gullibility of the public.

Mr. Kahn gave this testimony on June 30, 1933. Yet at that very moment, as the investigation of the Senate Committee subsequenly revealed, the stock market was in the throes of precisely the same sort of reprehensible manipulation that flourished in 1929, and which Mr. Kahn himself deplored. In the midst of the Senate's investigation into stock-market practices during the Spring of 1933, and, as it were, in complete contempt of public opinion and impending Congressional action, Wall Street carried on its business in the good old way, and at its accustomed stand.

The particular pool inquired into by the Committee dealt in the stock of the American Commercial Alcohol Company. It will be recalled that the stock of this company was then traded on the New York Stock Exchange in large quantities, and that a spectacular rise in price attracted the public to this security. On May 2, 1933, it was selling around $20 per share. By July 18 it had risen almost 70 points, to nearly $90 per share. Within the next three days it dropped 60 points and was selling again at about $30, relatively as disastrous a performance as any that occurred in October, 1929.

Mr. Russell R. Brown, Chairman of the Board of the American Commercial Alcohol Company, was called to the witness stand to testify about it. According to his own account, he was a business man and not a stock speculator, and he did not understand about the stock market. He was, he testified, interested only in the furtherance and advancement of the interests of his company. These, as he and his associates conceived, required the raising of additional capital for the corporation. Instead of pursuing any of the more orthodox methods of raising this capital, however, Mr. Brown followed a very different course.

The American Commercial Alcohol Corporation, which had been organized in 1928 under the laws of Maryland, had only 194,748 shares of common stock. Under the laws of the State of Maryland, no new stock could be issued for cash unless the stockholders of record were first given an opportunity to buy. This did not suit Mr. Brown and his associates at all, even though they themselves held a large part of the stock. A loophole was found in the fact that the law of Maryland—while it required new stock to be first offered to existing stockholders if the stock was to be sold for cash—contained no such direction if the newly issued stock was merely to be exchanged for the stock of another corporation.

Mr. Brown accordingly invoked the aid of two of his close friends, the first a gentleman by the name of K. B. Phagan—a certified public accountant, the second, a gentleman by the name of C. C. Capde-

vielle, a molasses broker. These gentlemen kindly consented to act as dummies for Mr. Brown. Two corporations were formed, one called Maister Laboratories Incorporated, and the other called Noxon, Incorporated. To the former, Mr. Phagan gave his promissory note for $180,000, and to the latter Mr. Capdevielle gave his promissory note for $270,000. For each of these notes, the respective gentlemen received all of the shares of stock of the respective corporations, which they then exchanged with the American Commercial Alcohol Corporation for 25,000 newly issued shares of its common stock. In this way the law of Maryland was respected.

Mr. Brown, through his two dummies, now had control of 25,000 newly issued shares of the corporation, and better yet, had acquired these without spending a dollar. They had been obtained in return for the stock of the two dummy corporations, which, in their turn, had been acquired merely for the promissory notes of two gentlemen of doubtful ability to pay.

Having obtained control of the stock in this pleasing manner, the next step was to sell it at as high a price as possible. Here is where the pool comes in. The principal active figures were Mr. Thomas E. Bragg and Mr. Ben Smith, both noted personages in the trading fraternity. Of their share in the matter, however, only indirect evidence can be narrated in these pages. For at the time of this investigation they were far, far away. Mr. Bragg was in Honolulu on a

cruise, and Mr. Smith was somewhere down around Melbourne, Australia.

As was usual, formation of the pool was preceded by the grant of an option, which in this case was given by Mr. Brown and his associates to Mr. Bragg, and conferred upon the latter the right to buy 25,000 shares of American Commercial Alcohol at $18 per share. Such an option gives the pool a reliable source of supply for their operations. Should the venture fail, the holder of such an option does not have to buy the stock. If it succeeds in putting up the market, everything they realize above the option price is profit.

The pool as finally formed by Mr. Thomas E. Bragg consisted of eight gentlemen, of whom two were dummies for Mr. Brown and his associates, and for certain other directors of the American Commercial Alcohol Company. The actual management of the pool was placed in the able hands of Mr. Ben Smith. His job was to stimulate activity in the market and to bring the public in. The operations of the pool began on May 2, 1933, and Mr. Ben Smith promptly commenced vigorous activity in both buying and selling the stock. His accounts leave one quite dizzy. For example, on May 4 he sold 3,700 shares, but on May 5 he bought 600. On May 8 on the other hand, he bought 500 shares and sold 1,000 shares. On the next two days, the 9th and the 10th, he merely bought 900 shares and 200 shares respectively. On the 11th he bought 700 and sold 300 shares.

But on the 12th he bought nothing at all and sold 1,100 shares, and so on, until July 24, when his final transaction consisted in the sale of 500 shares. When the totals are added up, it was discovered that during the period from May 3 to July 24, Mr. Smith purchased 54,894 shares and sold about the same amount.

Now let us see what effect this activity had on the prices. On May 15 the price of the stock had risen to 24½, but by May 27 it had reached 35. By June 28 it had gone upward almost in a straight line to 43¾, and on July 18 it had reached an all time high of 89⅞.

The extent to which these operations attracted the public can best be seen from the fact that between May 15 and July 22, the total number of shares of this stock traded on the Exchange, was 1,145,100. It will be remembered that the total capitalization of the company was originally only 194,000 shares.

There were a number of other pools in American Commercial Alcohol, all originating with options issued by Mr. Brown and his associates. Mr. Ruloff E. Cutten, a member of the firm of E. F. Hutton and Company, had received an option back in 1932, but it did not turn out to be very profitable, although the firm of E. F. Hutton and Company did their utmost to boost the issue. Market letters were sent to their customers pointing out the advantageous position in which the company found itself. The bulletins of course did not mention the fact that Mr. Cutten, a

member of the firm of E. F. Hutton and Company, had an option on the stock, but they did point out, from time to time, such important items of interest to the investor, as this:

> A cold winter would result in substantial sales of anti-freeze mixtures by the alcohol companies, swelling final quarter net. It is estimated, in informed quarters, that American Commercial Alcohol earned upwards of 35 cents for third quarter, bringing 9 months net to $2.10 a share.

Mr. Cutten himself did not consider such recommendation by a brokerage house having a concealed interest "a good practice."

While Mr. Ben Smith was the first aide of the Bragg pool, its actual operations were entrusted to a broker on the floor of the Exchange, Mr. Charles Wright who proved to be one of the most candid witnesses called before the Committee. Mr. Wright was a member of the brokerage house of Wright and Sexton, and was the "specialist" for American Commercial Alcohol.

A "specialist" is a broker who confines himself to a particular stock or to a few particular stocks, and who buys and sells only these securities. Other brokers who have orders either to buy or sell his stock place them with the specialist, who fills them as occasion permits. The "specialist" is a very important figure in Wall Street trading, as his special knowledge of ex-

isting bids and offers before they are executed, gives him inside information of enormous advantage. If he trades for his own account—as he was freely permitted to do, or for the account of pools with which he was associated—he is in a position to make profit with a minimum of risk. The public buys blindly, ignorant of the underlying strength or weakness of the market. The insider, with access to the specialist's private information, is forewarned of future currents.

MR. PECORA: Have you ever participated in any pool-account trading in the stock of any listed security?

MR. WRIGHT: Yes, sir.

MR. PECORA: Now, what do you understand by the term of "pool" or "pool account"?

MR. WRIGHT: I do not understand those terms, Mr. Pecora. I have never been able to understand them.

MR. PECORA: Well, you stated that you had participated in pool accounts, and then you say you do not understand what a pool account is? How do you know you have been a participant in such an account?

MR. WRIGHT: Well, from the subscribing to the other members of the Exchange or firms or individuals where we have bought a block of stock and where we have redistributed that stock. Whether that comes under the reference to "a pool operation" I do not know.

But while Mr. Wright was not clear about the technical meaning of the word "pool," he was perfectly clear as to how a pool operates.

MR. PECORA: How do such pools operate? Will you tell the committee from your familiarity with the activities of such a pool account, how it is operated?

MR. WRIGHT: Some pool accounts operate on options, that is, some by way of direct purchase of stock and redistribute it, and others may be accumulation pools where they accumulate stocks that somebody desires. Each one is in a different group.

MR. PECORA: Well, let us take a pool account organized for the purpose of making a market in a stock.

MR. WRIGHT: All right.

MR. PECORA: In which an account is organized to trade in the stock.

MR. WRIGHT: All right.

MR. PECORA: How does such a pool actually operate in the market? How does it make a market?

MR. WRIGHT: By creating activity.

MR. PECORA: And how does it do that?

MR. WRIGHT: By trading in the stock.

MR. PECORA: That is, the pool buys and sells the stock?

MR. WRIGHT: Yes, sir.

MR. PECORA: For its own account?

MR. WRIGHT: Yes, sir.

MR. PECORA: And frequently, if not invariably, such a pool has an option covering the stock in which it trades.

MR. WRIGHT: That is right.

MR. PECORA: And it gets that option as a rule from what kind of persons?

MR. WRIGHT: Sometimes from individuals, and sometimes from officers of the company, and sometimes from large stockholders, and sometimes from the corporation

which might hold a good block of stock and which wanted to get rid of it.

MR. PECORA: And as a rule what is the object sought to be accomplished by those persons who organize a pool account in order to make a market in the stock? . . .

MR. WRIGHT: To redistribute the stock at a higher price if possible.

MR. PECORA: That is, to raise the price level of the stock as much as possible?

MR. WRIGHT: Yes, sir.

MR. PECORA: So that they may distribute whatever accumulation of stock they have at a higher price and at a profit.

MR. WRIGHT: But it does not often work out at a profit.

THE CHAIRMAN: In short, you are trying to make money? That is the idea, isn't it?

MR. WRIGHT: Trying to make money; yes.

SENATOR ADAMS: It is quite possible and not at all unknown to have a syndicate or pool account trying to run the price of the stock down some, isn't that true?

MR. WRIGHT: I never heard of that.

SENATOR COUZENS: Do you say you never heard of that?

MR. WRIGHT: I have never heard of a pool to depress stocks—no, sir.

SENATOR KEAN: Well, you have certainly heard of a pool trying to accumulate stocks in the market, I take it?

MR. WRIGHT: Yes, sir.

Mr. Wright had engaged in many pools. In less than two years, he had held more than fifteen options on different stocks. He was fully familiar with the

American Commercial Alcohol pool, for he handled the trades for the group. He remembered vividly the collapse in July. He was asked by the Chairman of the Committee:

You say the public were not buying or dealing in this stock at all in July?

MR. WRIGHT: Yes; they were buying it and selling. They damn near ruined me, I know. [Laughter.] That thing got to be a nightmare with me.

The nightmare, however, was not a particularly unpleasant one, as will appear from the fact that Mr. Wright netted approximately $138,000 as a result of it.

MR. PECORA: Did you trade actively for your own account or for your firm's account in American Commercial Alcohol during the months of May, June and July of last year?

MR. WRIGHT: Yes, sir.

MR. PECORA: And at the end of July did your trades show a net profit or a loss for the three months' period from May to July?

MR. WRIGHT: A profit.

MR. PECORA: It showed a profit, do you say?

MR. WRIGHT: Yes, sir. It showed a profit of $138,000.

MR. PECORA: So that when the nightmare was over it was not so bad after all?

MR. WRIGHT: Yes, sir; it was very bad.

MR. PECORA: Well, how much would you have to make in order to avoid a nightmare? [Laughter.]

The Chairman: Mr. Wright, you spoke about your losses a while ago. It seems that the ultimate result was fairly good for you, wasn't it?

Mr. Wright: It was fairly good, but I had some very severe days.

Senator Adams: Well, if we might speak of a fellow who was murdered, you were a pretty live corpse.

Mr. Wright: Well, that is my business.

Mr. Pecora: And it is fair to say that you know your business.

The pool as an entity did a little better than Mr. Wright. Not being on the firing line, as Mr. Wright was, it had fewer "severe days." It netted a profit of $210,000—which was distributed among its members. All this was outside of the profits that were made by members of the pool and their friends trading on their own accounts. The public, who had been promised huge profits with the repeal of the Prohibition Amendment, were left to hold the bag.

This story would not be complete without telling the reader how its facts were ascertained.

The "little bull market" of the spring of 1933 was led by the activities in the so-called "repeal stocks"—the stocks which had been boosted upon the prospects of the repeal of the Eighteenth Amendment which had been advocated by President Roosevelt in his 1932 campaign.

This repeal could become effective only after its ratification by three fourths of the states—thirty-six

of them. During the winter and spring of 1933, state after state ratified the repeal. By July 18, repeal at the following Congressional session had become a virtual certainty, and its influence as a market-boosting factor practically ceased. This was the signal for the pool to wind up its operations. Whereupon the market, bereft of pool support, precipitately sagged down to its natural levels. Hence, for instance, the slide of American Commercial Alcohol from 89⅞ on July 18 to about 30 by July 22.

Within a few days thereafter, the writer called upon Mr. Whitney and a few other officers and directors of the Stock Exchange, and urged them to use their own complete and autocratic powers over their own members, with a view to ascertaining what pool operations, if any, had contributed to the remarkable advance in the preceding three months, and to the frightful debacle in the final four days.

The writer was met with protestations that they knew of no evidences of any such pool operations. After much persuasion from the writer, they finally promised to make an investigation and to give him the results thereof. Weeks of waiting followed. Finally, the writer received a letter from Mr. Richard E. Whitney, as the Exchange's President, informing him that the investigation had brought no evidence of wrongdoing to light, and that "there were no material deliberate improprieties in connection with transactions in these securities."

This information left the writer incredulous. He

accordingly picked out, at random, the trading in American Commercial Alcohol—which had been especially active—and investigated for the Committee with his own limited facilities. It required only a few days to come upon written proofs of the pool operations above described, among the records of the brokerage firm of W. E. Hutton and Company, in which Mr. Ben Smith then had his office. The writer, incidentally, had been assured that W. E. Hutton and Company's office had previously been visited and was still being examined by the Exchange's investigators in its own sweeping search for the truth. The writer is still uncertain why those investigators had not succeeded in finding it.

13

AFTER THE INVESTIGATION

THE investigation was not completed until June, 1934. But long before that date the defects it had laid bare in our financial structure had already led to the institution of a sweeping program of reforms. The old regime of unlimited license may be said to have definitely come to an end. The testimony had brought to light a shocking corruption in our banking system, a widespread repudiation of old fashioned standards of honesty and fair dealing in the creation and sale of securities, and a merciless exploitation of the vicious possibilities of intricate corporate chicanery. The public had been deeply aroused by the spectacle of cynical disregard of fiduciary duty on the part of many of its most respected leaders; of directors, who conveniently subordinated their official obligations to an avid pursuit of personal gain; of great banks, which combined the functions of a

bank with those of a stock jobber; of supposedly impartial public markets for the sale of securities, actually operated as private clubs for the individual benefit of their members.

Many aspects of the New Deal of course bore no direct relation to the subject matter of the Senate Committee's inquiry. But four statutes in particular grew out of the effort to cope with the abuses it had revealed. These marked the beginning of a new era in the history af American finance.

First of all, the Banking Act of 1933, passed on June 16, among other very important provisions dealing with various phases of the crisis, decisively rescued commercial banking from its entanglement with the extraneous business of security flotation and market plunging. It provided that thereafter the commercial banks must divorce themselves from their security affiliates. Nor could any director or officer of such a bank serve as an officer of an investment house. On the other hand, the private bankers, such as J. P. Morgan and Company and Kuhn, Loeb and Company, were given a clear-cut alternative: either they must give up their deposit business or they must give up the business of floating new securities. After many years, the 1911 opinion of Solicitor General Lehmann, so long buried in the archives of the Attorney General, in opposition to security affiliates, was vindicated—but at a cost that is incalculable.

The changes effected by this bill were radical and fundamental in their nature, and went to the heart

of the excesses that had grown up under the old regime in the 1920's. It was to be expected that its provisions would arouse determined opposition. The great figures of the banking world, however, were themselves divided as to its wisdom. Mr. Aldrich, who had recently become head of the gigantic Chase National Bank, took the position, as we have already seen, that such a reform was vitally necessary. Indeed, he advocated more radical proposals than Congress itself adopted.

But the "Old Guard" stuck to their guns; their sentiments were characteristically expressed by Mr. W. C. Potter, head of the Guaranty Trust Company, who declared that the Aldrich proposals were "quite the most disastrous" he had "ever heard from a member of the financial community." As for the private bankers, Mr. J. P. Morgan gave it as his considered opinion that such a division of function as the bill effected would cripple the underwriting business. He said:

> The question has been raised whether a private banker should be permitted to accept deposits. . . . If we, for instance, should be deprived of the right to receive deposits which clients wish to leave with us, we should very probably have to disband a large part of our organization, and thus should be less able to render in the future that important service in the supply of capital for the development of the country which we have rendered in the past.

Nevertheless, the bill was passed. It was put into effect. The commercial bank security affiliates such as the National City Company and the Chase Security Corporation were divorced from their parent institutions. J. P. Morgan and Company gave up its investment business, preferring to retain its purely banking and deposit functions, and formed a new firm, Morgan, Stanley and Company, to carry on the investment business. And no disaster befell.

The other three statutes growing directly out of the investigation were the Securities Act of 1933—the so-called "Truth in Securities" bill, the Securities Exchange Act of 1934, and the Public Utility Holding Company Act of 1935.

The first of these dealt with the creation of new securities, and was intended to give the public the benefit of a full disclosure of all relevant facts. President Roosevelt, in advocating the measure, said: "The proposal adds to the ancient rule of *caveat emptor,* the further doctrine: 'Let the seller beware.' It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities, and thereby bring back public confidence." The essential provisions of this law were not new. They had been tried, with marked success, in England, but the practice was a departure from the smug laissez-faire economics of American business that found it difficult to realize that from now on you must take prospective security holders into your confidence and must tell them all the essential facts be-

fore you may solicit their savings for a private hazard.

The Act prohibited the use of the instrumentalities of interstate commerce or of the mails to anyone who seeks to sell securities unless a registration statement is first filed with a governmental agency. In this statement, a full and complete disclosure of the condition of the corporation issuing the securities, as well as the terms and provisions under which the securities are issued and a complete description of the legal relations resulting from the acquisition of the securities, must be made. If anyone is to make a profit on the sale of the securities, the amount thereof must be stated. And all the facts have to be published in the registration statement twenty days before the security can be sold to the public, so that there may be time for proper examination. Penalties, civil and criminal, are imposed upon the unauthorized sale of securities which were not properly registered, and these penalties are serious and not to be easily ignored.

The Securities Exchange Act of 1934 not only amended the Securities Act of the prior year, but broke new ground. For the first time it sought to regulate operations on the New York Stock Exchange and the other securities exchanges, and to protect the public from the multitude of sharp practices that flourished there. It created a new body, known as the Securities and Exchange Commission, consisting of five members, to whom were granted very effective and far-reaching powers. This was indeed necessary in

dealing with such an institution as the New York Stock Exchange. To have done otherwise, as a witness testified before the Committee, while the bill was pending, "would be like advising that one put a baby in a cage with a tiger to regulate the tiger."

The new law required all stock exchanges to register with the Commission. Restrictions were put on borrowing by brokers and other dealers. A direct prohibition against the manipulation of security prices and the conduct of pools was for the first time made a part of the law of the land. The members of the exchanges and the corporations whose securities are listed thereon may be required to make a full disclosure of their affairs to the Commission upon its demand, so that the light of day might reach where previously all had been dark. Severe penalties, both civil and criminal, were enacted for the violation of the law, and the Commission was given power to enforce its regulations by suitable orders. The board of governors of the Federal Reserve Bank was given authority to regulate margins and a fixed minimum percentage was written into the law itself.

The writer was privileged to be designated by President Roosevelt on July 1, 1934, as a member of the Securities and Exchange Commission as it was first organized; and for a short time, until his resignation to assume his present judicial office in January, 1935, he participated in its councils and in the organization of its various departments and the formulation and direction of its policies.

Among the most important matters dealt with in the administration of the securities statutes of 1933 and 1934, were the problems of short selling and "over the counter" trading. Very careful studies were made with respect to short selling, and while the practice was not entirely banned, it was greatly confined and restricted. No short sale may now take place on an exchange except at a price higher than the last preceding reported sale. It is therefore no longer possible by repeated short sales at prices constantly placed below the market, to drive a stock down and demoralize it. The short seller may still sell short, but his action can no longer be manipulated so as automatically to lower the quotation for the stock.

"Over the counter" trading is trading by means of brokers who do not deal on recognized exchanges and who do not confine their operations to stocks listed on the exchanges. Notwithstanding this fact, there are many such brokers who handle many important transactions totaling hundreds of millions of dollars. There was really no good reason why these transactions should be exempted from regulation, and in 1936 the Securities Exchange Act of 1934, which had already dealt with the subject, was amended to prohibit more stringently manipulation and deceptive practices by "over the counter" brokers. The Commission was directed to formulate rules in this respect, and subsequently did so.

According to the estimate of James M. Landis, former Chairman of the Commission, more than a

billion dollars of American money was kept from falling into the hands of scoundrels through the watchful activities of the Commission.

Despite this record, Wall Street opposition to the Commission was long unabated. The lack of new financing during the years 1933 and 1934 was blamed by many financial and industrial leaders on the Securities Act of 1933. *The Washington Post* collected more than one hundred responses to inquiries from men in high position, freely offering the opinion that the Securities Act of 1933 was the cause for the absence of a market in securities. All of these replies were couched in almost the same language as that of Silas H. Strawn, one time President of the American Bar Association and of the United States Chamber of Commerce, who wired:

> I believe there is an abundant market for securities, if the Securities Act did not prevent their issue and distribution.

It was undeniable that there was a dearth of new financing. But the attempt to shift responsibility for this state of affairs on to the "impracticability" of the new legislation compelling truth and honesty in the creation and sale of securities, disingenuously ignored many of the dominant realities of the situation. Defeated at the polls, big business and finance still have their own crushing economic weapons of pressure and retaliation. In Europe, one may observe the

process with the utmost clearness. The manner in which the Labor Government of Great Britain, for example, or the "Popular Front" administration in France was allegedly driven from office by the financial operation of the money powers of those countries, has attracted frequent comment. In the United States, fortunately, matters have not been carried to such an extreme.

In the following year, 1935, the Securities and Exchange Commission was entrusted with power in still another direction. The Public Utility Holding Company Act of that year was aimed at such structures as the Insull pyramid. It did not deal with holding companies, however, except in the public utility field—by which was meant, in the main, electric-light, power, and gas companies. It did not extend to banks or railroads. Under its provisions, public utility holding companies had first of all to register with the Securities and Exchange Commission. Unless they did so, they could not legally do business after December 1, 1935.

The Act conferred on the Commission general supervisory power over the affairs of these holding companies. The Commission was directed to study the corporate setup of these holding companies and their subsidiaries, and to determine whether or not they served any useful economic purpose. Wherever possible, complexities were to be simplified. The voting power was to be put in the hands of those to

whom it fairly belonged. The ultimate goal was to confine each holding company combination to properties which constituted an integrated economic system, and to eliminate the use of this dangerous device where it served only to further speculative control.

All this, it was contemplated, would require long study and in the meantime the registered holding companies were forbidden to alter the *status quo* by issuing new securities or changing the preferences and priorities and voting power of the securities already issued, except under regulations to be established by the Securities and Exchange Commission.

Collectively considered, these four measures opened the way for changes of the utmost importance to the economic welfare of the people of the United States. They cannot fail to be of marked significance in the reorganization of our social and economic life.

14

A WORD ABOUT THE FUTURE

IN EARLY 1933, the captains of Wall Street, still within the shadow of panic and depression, gave utterance to little outspoken criticism of the New Deal. Their cry then was that we were all victims of a common calamity, due not to bankers' guilt, but to human fallibility. All of us were equally willing to learn by experience and to correct whatever abuses were shown to have grown up. Said Mr. Mitchell:

> With respect to the future, and on market prices, and on the economics of the situation, there are so many factors over which the men in finance have no control, and really have comparatively little knowledge, that it is just as impossible for them to predict a definite future, as it is for anybody else. . . . I only hope that we can learn something from all this and be able to reach that period

when we can put into constructive effort the lessons that we have learned during this period.

Mr. Otto Kahn asserted roundly:

The test and the only justification which exists for the private banker is: what services can he render better than others to the industries of the country? . . . Impose upon him the strictest requirements of disclosure as to what he offers. Impose upon him the strictest requirements as to the profits he is to make. By that you will *ipso facto* limit those profits and prevent them from becoming exorbitant.

The more business recovered, however, and the stronger it felt, the more openly and bitterly did Wall Street oppose any sound program of reform. In place of the humble disclaimers of omniscience of March, 1933, the titans of finance developed once again an arrogant self-confidence and a dogmatic assurance that any attempt to restrain their own activities must inevitably mean the ruin of the country.

Even so mild a measure as the creation of the Federal Deposit Insurance Corporation became a target of vehement resentment. Mr. Francis H. Sisson, President of the American Bankers' Association, sent a telegram to all the member banks, urging them to oppose the banking bill of 1933, which contained this feature. He said in part:

The American Bankers' Association fights to the last

ditch against the guaranty provisions of the Glass-Steagall bill, as unsound, unscientific, unjust, and dangerous. Overwhelming opinions of experienced bankers are emphatically opposed to deposit guaranties which compel strong and well managed banks to pay the losses of the weak.

The "Truth in Securities" bill was condemned as a measure which would "hinder legitimate business without accomplishing any essential purpose." To the Merchants' Association of New York "it was almost self-evident" that practically no individual dealer or banking house would assume the personal liability provided for in the Act. Senator Ashurst described the opposition in these words:

Some inquiry was made as to what opposition there might be to the bill. I said, in reply: "There may be some opposition but it will be secret, silent, subterranean opposition that will never come to the surface. If you will explore the sources of opposition, you will probably find that the opposition came from organizations and promoters that have sold 'fake' securities throughout this country to the tune of billions, and have sunk their fangs into the pocket-books of innocent investors with greater rapacity than a school of sharks ever sunk teeth into human flesh."

The Senator could hardly be blamed for failing to realize in those days that in addition to the secret, silent, subterranean opposition, there would also ap-

pear definitely outspoken and public opposition to the measure. But the stakes were high! During the ten prior years, approximately twenty-five billion dollars' of worthless stocks had been sold to American investors.

As for the Public Utility Holding Company bill, the opposition here was commensurate with the magnitude of the interests affected. It is estimated that in 1930 ten public utility systems of the country controlled assets of about seventeen and one-half billion dollars. No wonder that President Roosevelt is reported to have said at a press conference that the lobby against this measure was the most dangerous created by any organization in the United States. Senator Wheeler dramatically described it as follows:

> The corridors have been filled and the Senators' offices have been filled with utility lobbyists every day since the bill was introduced. They have been sitting in the Senate gallery watching each Senator, calling him from the floor, giving him suggestions, calling him out of Committee rooms, and haunting him from day to day, getting their employees and their poor victims whom they have robbed and cheated to come down here and their widows and orphans to write down here and say, "Save us from the effects of this bill."

As soon as the bill was introduced the presidents of ten public-utility holding companies, representing about one half of the industry, organized into a body to oppose "wanton" destruction of holding companies by law and, of course, from the American Liberty

League came the usual and expected opposition based on economics, morals and the Constitution. Mr. Jouett Shouse, President of the American Liberty League, said in speaking of this bill:

> You have here a nation which has lain prostrate on its back for four years and you are attempting by this measure to force down its throat things that it cannot digest without destroying it.

An official statement by the American Liberty League assured the public:

> Like the Securities Act of 1933, which was so severe as to hold back the flow of capital necessary to the revival of industry, the pending bill would tend to nullify the effects of activities under other laws.

And Mr. Wendell Willkie, of the Commonwealth and Southern power system, predicted that the bill, if enacted, "would destroy every instrumentality by which the use of electricity has been made more dependable, economic and efficient, and more widespread in this country than in any other country in the world."

He went further and extravagantly promised that the defeat of the bill "would do more to lift the country out of the depression, take more men out of the bread lines and off the relief rolls than in any other industry . . . and do more than the Government itself can do with all its expenditures."

Even after the Public Holding Utility Company Act was adopted and approved by the President, the utility magnates did not feel that they were compelled to comply with its provisions. On the contrary, they immediately took the position that the law was wholly unconstitutional and that they were therefore not bound by any of its terms. It was vainly urged by the Commission that a statute of Congress must be regarded as valid until its invalidity is determined by a court of competent jurisdiction. The utilities decided this vexed question for themselves and declined to recognize the existence of the law.

They went further, and, with the professional aid of influential members of the American Bar, attempted to have the constitutionality of the act passed upon without giving the Commission or the government an opportunity to be heard. Their extraordinary effort took the following form: There happened to be a certain reorganization proceeding pending in the federal court at Baltimore. It was alleged therein that the operation of the Public Utility Holding Company Act of 1935 would render the proposed plans of reorganization inoperative. This gave the leaders of the opposition to the law just the opportunity that they wanted. A Baltimore dentist was found, by the name of Ferd Lautenbach, who was a creditor of the company to the extent of $2,500. An eminent attorney was retained to represent the obscure Doctor Lautenbach and in his behalf there was filed a petition asserting that the act was unconstitutional and asking the

court to approve the plan of reorganization without regard thereto.

The Securities and Exchange Commission and other Government representatives protested vigorously that the constitutionality of a statute of such vast importance should not be determined in a proceeding to which they were not a party. To provide a fair court test, the Government initiated its own proceeding in New York State against the Electric Bond and Share Company, to compel that company to register in accordance with the provisions of the law. For so uncompromising was the opposition to this statute, that the utility companies would not recognize its validity even to the extent of taking this first step of registration. The case was finally carried to the Supreme Court of the United States. The utility holding company lawyers argued that the registration provisions of the Act could not be separated from the remainder and that the intention of Congress was to control public utility holding companies "even to the point of their destruction."

The Supreme Court, however, speaking through Mr. Chief Justice Hughes and with only Mr. Justice McReynolds dissenting, held that the Act was quite valid, at least in so far as it was involved in this particular case. The Electric Bond and Share Company, which is the "top holding company" of a system operating in 32 states, had perforce to register. When last heard from, it had not suffered any ill effects.

The bitter contest in the courts with respect to

the constitutionality of this statute, following the fierce opposition to its enactment while the bill was before Congress, demonstrates how determined the utility magnates were to preserve their ancient privileges. This in spite of the fact that even among utility men there are those who acquiesce in the beneficient character of the law and who are keenly aware of the evils that flow from the complications resulting from existing holding company structures.

* * *

While opposition was strong against all of these measures, and while perhaps the most intense lobbying occurred in connection with the Public Utility Holding Company Act, the real center of warfare, so to speak, remained the New York Stock Exchange.

A century ago it was considered an intolerable intrusion on private rights if the Government attempted to tell a factory owner that he had to maintain the most rudimentary provisions for the health and safety of his employees. Since that time the public attitude has slowly changed. In one field after another, the necessity for some measure of public control, where private ownership failed to meet its social responsibilities, has been recognized. Public utilities —railroads—"business affected with a public interest"—banks—industry generally, all came to regard public supervision as normal and beneficial.

But there was one important outpost that resisted the tide of progress—the New York Stock Exchange, the last citadel of "rugged individualism." Since its

foundation in 1791, it exercised complete control over its own practices and jealously guarded its self bestowed privileges. Despite the fact that it was intimately intertwined at a thousand points with vital interests of the public, it knew no law but its own will.

The cumulative effect of the crash in 1929, the slow attrition of the depression years, President Roosevelt, the New Deal, and the Senate Committee's investigation were finally too much even for the New York Stock Exchange. The disclosures of the shocking practices and base uses to which the Exchange was customarily put, stripped it of its mystery and sanctity, and dissipated the awe with which it had been regarded. Fighting at every step, it finally went the way of all flesh. Like the humblest of us all, even the mighty Stock Exchange must now recognize the existence and authority of the United States Government.

No doubt these results would have been attained ultimately by the inexorable pressure of events and of public opinion, and by the steady insistence of the newly constituted Securities and Exchange Commission upon its statutory authority. But the process of reforming the Exchange was greatly accelerated by what amounted to an internal revolution as well. Under the old dispensation, the Exchange had resembled a corporation with many stockholders, but with all real power in the hands of an inner clique. Many of the members found the rule of the insiders

harsh and despotic, and chafed at the authority that was exercised over them, but few dared to rebel openly. For the sway of the Exchange over its members was "absolutely autocratic" and the governing bodies, moreover, were in close league with the really great powers of Wall Street.

Mr. Richard Whitney, for example, the President of the institution, was the brother of George Whitney, a partner of J. P. Morgan and Company. In the final event, it was Mr. Richard Whitney's spectacular collapse that hastened and decided the battle. As the reader must remember, Mr. Whitney was shown to have been speculating for years with his clients' money, even with that of the Stock Exchange itself, and was convicted on his own confession. Without seeking to make controversial capital of what was truly a tragic misfortune, it was and is obvious in the face of such evidence that when such things are possible in the very highest circles, no one can reasonably deny the necessity for new leadership. At the election of April, 1938, the Old Guard was completely routed and a younger progressive group, far more imbued, it is hoped, with the necessity of reform and co-operation, was installed in office.

"At long last," indeed, the financial community seems to have come to a realization that the reforms embodied in these new regulatory and banking laws are not vicious acts of reprisal, but sound and statesmanlike measures long urgently needed. Mr. B. C. Forbes, the well known financial commentator whose

opinions not infrequently reflect the prevailing view of conservative elements, declared that the New Deal legislation in the banking field, was, on the whole, better than in any other. The *New York Herald Tribune*, partisan opponent of the bulk of the New Deal program, more handsomely declared in an editorial: "By far the most useful labor that the Roosevelt Administration has performed has been its regulation of the New York Stock Exchange in aid of higher standards of integrity and public service. This reform was long overdue." While the editorial does not refrain from certain criticisms, it concedes that "broadly speaking, the means adopted were as sound as the end was desirable," and that "the general results have been almost wholly sound."

These are heartening portents, and it is certainly well that Wall Street now professes repentance. But it would be most unwise, nevertheless, to underestimate the strength of hostile elements. When open mass resistance fails, there is still the opportunity for traps, stratagems, intrigues, undermining—all the resources of guerilla warfare. These laws are no panacea; nor are they self-executing. More than ever, we must maintain our vigilance. If we do not, Wall Street may yet prove to be not unlike that land, of which it has been said that no country is easier to overrun, or harder to subdue.

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ABOUT THE AUTHOR

FERDINAND PECORA was born in Italy and was brought to the United States when he was five years old. He has lived in the City of New York ever since. After studying law in the New York Law School, he was admitted to the bar in 1911. When the late Theodore Roosevelt formed the National Progressive Party in 1912, he became one of its New York leaders, and in 1915-1916 was its vice-chairman in New York County. Upon the disintegration of the National Progressive Party in 1916, he became a Wilson Democrat, and has since been a member of the Democratic Party. From 1918 to 1930, he served on the staff of the District Attorney in New York County, first as an assistant, and then from 1922 on, as chief assistant.

From January, 1933, to June, 1934, he was counsel to the United States Senate Committee on Banking and Currency, during which time he conducted its famous investigation into banking and stock-market practices. This investigation resulted in the enactment of various regulatory measures by Congress, the most important of which was the one creating the Securities and Exchange Commission on July 1, 1934.

President Roosevelt appointed him a member of the original commission. He resigned therefrom in January, 1935, to accept appointment by Governor Lehman as a Justice of the Supreme Court of New York. In the fall of 1935, he was nominated for the full fourteen-year term as a Supreme Court Justice by both the Republican and Democratic parties—a distinction rarely conferred upon a judicial officer who had not previously served a full term. His election was virtually unanimous. He has frequently demonstrated his political independence—notably when he ran for District Attorney of New York County in 1933 as an anti-Tammany candidate on the Recovery Party ticket headed by Joseph V. McKee for Mayor. This movement undoubtedly led to the defeat of the Tammany regime that year.

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