STOCK EXCHANGE PRACTICES

WEDNESDAY, OCTOBER 11, 1933

UNITED STATES SENATE,
SUBCOMMITTEE OF THE
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The subcommittee met, pursuant to adjournment on yesterday, at 10 a.m. in the caucus room of the Senate Office Building, Senator Duncan U. Fletcher presiding.

Present: Senators Fletcher (chairman), Adams (substitute for Barkley and proxy for Costigan), Norbeck, Townsend, and Couzens.

Present also: Ferdinand Pecora, counsel to the committee; Julius Silver and David Saperstein, associate counsel to the committee; and Frank J. Meehan, chief statistician to the committee; George S. Franklin, Wallace P. Zachry, Warren Leslie, Walter G. Dunnington, Clifton Murphy, John T. Cahill, and Bernhard Knollenberg, counsel for Dillon, Read & Co.; Root, Clark, Buckner & Ballantine, George H. Murphy of counsel, counsel for United States & Foreign Securities Corporation and United States & International Corporation.

The CHAIRMAN. The subcommittee will come to order. Mr. Dillon, Mr. Pecora desires to ask you some questions.

TESTIMONY OF CLARENCE DILLON, OF DILLON, READ & CO.—Resumed

Mr. PECORA. Mr. Dillon——

Mr. DILLON (interposing). Mr. Pecora, may I, before you start your examination, say that you asked on yesterday for us to prepare a list of some companies in the portfolio, which Mr. Tracy could not give offhand. You asked us to prepare a list of corporations whose securities were held on December 31, 1932 in the portfolio of United States & Foreign Securities Corporation and on whose boards there were no representatives from either the directors, officers, or employees of United States & Foreign Securities Corporation, United States & International Securities Corporation, the Keswick Corporation, or Dillon, Read & Co.; and, furthermore, where Dillon, Read & Co. had not acted as bankers. Mr. Tracy replied that he could not name these companies offhand, without checking. You asked us to prepare such a list. We did it last night hurriedly and we find in the portfolio of United States & Foreign Securities Corporation some 51 companies on whose boards there are no such representatives and no such banking connection. These companies are American Can Co., American Chicle Co., American Home Products Corporation, American Radiator & Standard

Sanitary Corporation, American Smelting & Refining Co., American Sugar Refining Co., American Telephone & Telegraph Co., American Tobacco Co., Axton-Fisher Tobacco Co., Inc., Baltimore & Ohio Railroad, Beatrice Creamery Co., Best & Co., Inc., Central Aguirre Associates, Chesapeake & Ohio Railway, Citizens & Southern National Bank, Savannah—but do you care for me to read off this entire list?

Mr. PECORA. No. We will put the whole list in evidence, Mr. Dillon.

Mr. DILLON. All right.

Mr. PECORA. I now offer in evidence the document produced by the witness, purporting to give the names of companies whose securities were purchased from time to time for the portfolio of United States & Foreign Securities Corporation——

Mr. DILLON (interposing). May I correct that——

Mr. PECORA (continuing). And in connection with which companies no director of the investment trust nor any member of the firm of Dillon, Read & Co., nor any agent or representative of such firm, had any affiliation as officer, director, or otherwise.

Mr. DILLON. And for which we were not bankers.

Mr. PECORA. Yes.

Mr. DILLON. And that was not as to purchases from time to time. We thought your statement was that we should furnish——

Mr. PECORA (interposing). Securities in the portfolio.

Mr. DILLON. Yes, on December 31, 1932.

Mr. PECORA. Well, I offer this statement in evidence and ask that it may be spread on the record of the hearings of the subcommittee.

The CHAIRMAN. Let it be so received and made a part of the hearings.

(The statement referred to was marked "Committee Exhibit No. 21, October 11, 1933", see p. 1937.)

Mr. PECORA. Mr. Dillon, would you say that a majority, or the greater part in amount, of the funds of United States & International Securities Corporation which were used in the purchase of securities for its portfolio, were used in the purchase of securities issued by corporations other than those in which any director of United States & International or any member of Dillon, Read & Co. had any affiliation as officer, director, banker, or otherwise?

Mr. DILLON. You are speaking now of United States & International Securities Corporation?

Mr. PECORA. Yes.

Mr. DILLON. You asked on yesterday for United States & Foreign Securities Corporation?

Mr. PECORA. Yes.

Mr. DILLON. I should say, without having those figures before me that the greater part were not that, but I haven't checked those figures.

Mr. PECORA. That is, you believe that the greater part of the funds invested by the United States & International Securities Corporation were invested in the purchase of securities issued by corporations with which some one or more of directors or officers of United States & International Securities Corporation, or one or more members of Dillon, Read & Co. had some affiliation?

Mr. DILLON. Well, that was true in the case of the United States & Foreign Securities Corporation figures. In the case of United States & International Securities Corporation figures it may not be true on account of the fact of Mr. Hayden being on the board of the Rock Island Railroad, and Mr. Ecker being on the board of the Frisco [consulting an associate]. They say here that I haven't your question correctly.

Mr. PECORA. I think you did twist it around.

Mr. DILLON. May I have it read to me?

Mr. PECORA. I will put it in another way: Referring now only to investments made by the United States & International Securities Corporation for its portfolio, is it your opinion or belief, based upon your best recollection of the facts, that the greater part of those investments were made in securities issued by corporations with which an officer or director of the United States & International Securities Corporation, or a member of the firm of Dillon, Read & Co., had some corporate connection?

Mr. DILLON. It would be very difficult for me to answer that question without checking, because that fact would never have entered into consideration when buying the security. So it is not impressed on my mind.

Mr. PECORA. I so understand, but I wondered if you could give the subcommittee your best recollection or belief about that. Of course, I take into account the fact that you have made no research for the purpose of ascertaining the specific fact.

Mr. DILLON. When purchases were made that specific fact was never brought up, because it was not of particular interest or concern to anyone. So it would be the wildest kind of guess if I should make it now. We have no figures prepared like that. My guess would be that it would be in about the same proportion in the case of the two securities companies.

Mr. PECORA. Would you make a similar answer to a similar question as applied to investments on behalf of United States & Foreign Securities Corporation?

Mr. DILLON. I would have to make the same answer, certainly.

Mr. PECORA. Now, you heard the testimony of Mr. Tracy during the time when he was on the stand, last Friday, and again on yesterday, didn't you, Mr. Dillon?

Mr. DILLON. I heard most of it. Some of it I could not get.

Mr. PECORA. Do you recall the testimony he gave with respect to the joint railroad stock trading account that was entered into in July of 1929 by the United States & International Securities Corporation with Dillon, Read & Co.?

Mr. DILLON. I think I heard most of it.

Mr. PECORA. Are you familiar with that joint trading account, Mr. Dillon?

Mr. DILLON. In a general way, yes.

Mr. PECORA. Will you tell the subcommittee in a general way and without traversing any ground that Mr. Tracy went over, the circumstances that surrounded the creation and formation of this joint trading account?

Mr. DILLON. I am afraid——

Mr. PECORA (continuing). As I understand it, and possibly to shorten your answer, the joint trading account was entered into on

July 13, 1929, the terms and provisions under which the account was to be operated being set forth in written form in the shape of a letter which has been received in evidence here, and those terms and provisions, in effect, were that there was to be equal participation by Dillon, Read & Co. on the one hand and United States & International Securities Corporation on the other hand. That confirms your recollection, does it not?

Mr. DILLON. Yes, sir.

Mr. PECORA. Now, who proposed originally that such joint trading account be created?

Mr. DILLON. I cannot say because I would not know. That matter was discussed over a period of a good many weeks—that is, the matter of buying railroad securities. It was discussed probably for a longer time, in meetings of the Board, and by Dillon, Read & Co. We also discussed the matter of railroad securities, and they looked attractive to us at the time. But just how they should be purchased, and how to the trading account was to be set up and so on, and who discussed it, I don't know.

Mr. PECORA. Mr. Tracy said that, among other things, the purpose of the account or its operation was simply to acquire railroad company stocks, not to trade in them as that term is ordinarily understood. Does that conform to your recollection?

Mr. DILLON. My recollection was that we bought. But I do not recall that that meant to enter into trading, buying, and selling from day to day. I think it was simply accumulating stocks.

Mr. PECORA. That was Mr. Tracy's testimony. But the account itself is headed, and the references to it in the minute book of United States & International Securities Corporation describe it as a joint railroad stock trading account. And the letter indicating the terms under which the account was created and was to be operated, gave authority to the managers of the account not only to buy but to sell and resell and to sell short. You recall that, don't you?

Mr. DILLON. May I look at the letter?

Mr. PECORA. Yes.

Mr. DILLON. The letter does not call it a trading account. It says "Joint Account."

Mr. PECORA. I said references in the minute book to the account stated——

Mr. DILLON (interposing). Oh.

Mr. PECORA (continuing). Are to the term "Joint Railroad Stock Trading Account."

Mr. DILLON. And in this letter I do not see anything about selling short.

Mr. PECORA. Perhaps I can point it out to you.

Mr. DILLON. All right. It might very well be put that way as it might use the ordinary phrase, but I do not see it in that letter. That letter does not say it, but it might probably have been overlooked.

Mr. PECORA. Well, I call attention to the first paragraph of this letter of July 13, 1929, which reads as follows, it being addressed by the United States & International Securities Corporation to Dillon, Read & Co.:

"DEAR SIRS: Referring to the above account which is being formed to buy and/or sell and/or trade in the common and/or preferred stocks and/or bonds of various railroads, subject to the condition that the account shall never be committed at any one time in a net amount exceeding $30,000,000, long or short, we beg to confirm the participation of the $15,000,000 allotted you in this account."

Mr. DILLON. That is simply ordinary phraseology. It means nothing because we did not trade and we did not sell short, and did not sell any stocks, and never intended to.

Mr. PECORA. Regardless of what was actually done in connection with this account, the fact is that the letter agreement gave the managers of the account the right to sell short. Now, you want to emphasize the fact, I presume, that while the managers had that power yet they did not exercise it in the operation of this account. Is that right?

Mr. DILLON. Yes. And why that phraseology is used I do not know, other than it is just the general way of writing a letter of that kind, to cover every possible thing, simply to protect the managers of the account in anything that they might do.

Mr. PECORA. The operations in this account, or the transactions that were had for the benefit of this account, were principally, so far as the amounts involved were concerned, in the stocks of two railroad companies, namely, the Chicago, Rock Island & Pacific and the St. Louis & San Francisco, weren't they?

Mr. DILLON. I think that is not correct. I think they bought a series of stocks.

Mr. PECORA. I know that they bought other railroad stocks, but the principal trades or the principal acquisitions in amount of money involved was in the stock of those two companies.

Mr. DILLON. In the Rock Island it was, in round numbers, $2,700,000, and in the Pennsylvania Railroad about one million dollars, and in the Frisco Railroad about four million dollars, and in the Southern Pacific about one and one-half million dollars, and in the Southern Railway about two million dollars or perhaps two and one-half million dollars, and in the Seaboard Air Line about one million dollars. That is, roughly, the account, but the principal items were those two.

Mr. PECORA. So that the largest individual amounts invested were in the stocks of the two railroad companies that I mentioned?

Mr. DILLON. That is correct.

Mr. PECORA. At that time and during the operation of this trading account, or this joint account rather—the reason I use the term "trading account"——

Mr. DILLON (interposing). I have no objection to "trading account."

Mr. PECORA (continuing). Is because it is styled even in that letter, if you see the caption of it, as a "joint trading account", isn't it?

Mr. DILLON (handing document to Mr. Pecora). No, it is not so styled; but I am perfectly willing to call it a trading account. I have no objection to it.

Mr. PECORA. No; it is "railroad securities joint account." I beg your pardon.

Mr. DILLON. Yes.

Mr. PECORA. I got the term "trading" from the minute book. During the time of the existence and operation of this joint account there were certain gentlemen who were directors of the United States & International Securities Corporation who were connected with those two railroad companies in some capacity or other, were they not?

Mr. DILLON. That is correct.

Mr. PECORA. And who were those men?

Mr. DILLON. I must correct my statement. There was no one on the board of United States & International that was connected with the Frisco. Mr. Hayden is on the board of United States & International and he is chairman, or was chairman, of the Rock Island Railroad. I think what has confused you, Mr. Ecker, who is on the United States & Foreign board, was a director of the Frisco, but he was not on the United States & International.

Mr. PECORA. Mr. Ecker as a director of the United States & Foreign Securities Corporation was in a position where his judgment was available to the board of the United States & International, was he not?

Mr. DILLON. Well, he was available to Mr. Tracy as president of the Foreign, who was also president of International.

Mr. PECORA. And also available to Mr. Tracy and members of the board of United States & International, because the United States & Foreign, on the board of which Mr. Ecker sat, had control through ownership of common stock of the United States & International?

Mr. DILLON. That is correct.

Mr. PECORA. Do you recall, Mr. Dillon, whether the advice, judgment, or opinion of Mr. Hayden and Mr. Ecker, or either of them, was specifically sought before this joint account invested so much money in the common stock of those two railroad companies?

Mr. DILLON. Well, I heard Mr. Tracy's testimony where he said he telephoned to all the directors that were available. I can remember myself, in the meetings preceding this, the general discussion of buying railroad stocks and the formation of an account to buy them. Whether those two men were specifically consulted I do not remember myself.

Mr. PECORA. Well, apparently Mr. Tracy did not remember either, because he was unable to testify specifically, as I remember his testimony here, as to whether or not he had any conversations with any particular director or directors. He merely told us of his general custom in telephoning people and conferring with them by that means.

Mr. DILLON. I think we filed with you the other day a list of all the meetings of the board and the men that attended in both companies. If just preceding these 6 weeks or so immediately preceding the account those men were present as directors, I should feel sure that it was discussed with them, because the matter was discussed at that time.

Mr. PECORA. Did you have anything to do with the investments that were made for this joint account?

Mr. DILLON. In what way do you mean?

Mr. PECORA. Advising or counseling the kind of investments to be made or the market operations by which the investments were made.

Mr. DILLON. Undoubtedly I discussed the different stocks we were buying, railroad stocks, whether we were going to buy Rock Island or Frisco or some other stock, Southern Pacific or Southern Railway. Undoubtedly I discussed that, in the board and with Mr. Tracy.

Mr. PECORA. The agreement dated July 13, 1929, which created this railroad securities joint account provided specifically that the account was to terminate on October 13, 1929, unless sooner dissolved by mutual agreement, and that it may be extended by mutual consent. Was it, as a matter of fact, terminated on October 13, 1929?

Mr. DILLON. It was terminated on November 9.

Mr. PECORA. Apparently then the life of this account was extended by mutual consent?

Mr. DILLON. That is correct.

Mr. PECORA. Up to and including November 9; is that right?

Mr. DILLON. I have a letter to that effect.

Mr. PECORA. I was just going to ask you if there was any written evidence of such extension.

Mr. DILLON. Yes; there is a letter here of October 14, extending it.

Mr. PECORA. I offer in evidence the document produced by the witness, purporting to be a copy of a letter addressed by the United States & International Securities Corporation to Dillon, Read & Co., dated October 14, 1929. I will read it into the record—it is very short—and I will give it to the reporter to mark.

The CHAIRMAN. The letter may go in the record.

(Letter and confirmation dated October 14, 1929, from United States & International Securities Corporation to Dillon, Read & Co. was thereupon designated "Committee Exhibit 22, October 11, 1933.")

Mr. PECORA (reading):

DILLON, READ & CO.,
Nassau and Cedar Streets, New York, N.Y.

$30,000,000 RAILROAD SECURITIES JOINT ACCOUNT

GENTLEMEN: Referring to our letter to you of July 13, 1929, with reference to the above account, this will confirm our understanding that the account is to be extended to December 15, 1929, unless sooner dissolved by mutual consent, and that it may be further extended by mutual consent. Kindly acknowledge receipt of this letter by signing the attached copy and returning to us.

Very truly yours,

UNITED STATES & INTERNATIONAL SECURITIES CORPORATION.

Accepted: Dillon, Read & Co.
October 14, 1929.

Mr. DILLON. Mr. Pecora, a moment ago you asked the companies whose securities were held in the portfolio of International and with which no representation on the board and for which we were not bankers. I didn't know we had it. We have it if you care for it. There are some 29. [Handing document to Mr. Pecora.]

Mr. PECORA. Now, after the extension of the life of this account from October 15 to December 15, were market operations continued for the account in the acquisition of railroad company stocks?

Mr. DILLON. As well as I can remember, we stopped buying stocks about the end of August, I should think it was, or the 1st of September. The security company, United States & Foreign, as I remember, was selling stocks from that point on, and from the 1st of September until about the 1st of November they had sold some 13

million dollars worth of securities other than railroads. They were keeping their railroad securities because they were a most attractive investment, in our judgment, but other things looked high and they were being liquidated in the hope of investing later on when the market should come down, if it did come down.

So that when we came to the 1st of November the United States & Foreign had some 13 million dollars odd in cash ready to invest on breaks in the market if they should come after that.

During that period the account was not buying stock. When I say "not", maybe a few odd shares, but it was not active. I will find that out for sure. That is just my memory.

Mr. PECORA. Surely.

Mr. DILLON (after conferring). I think that is substantially correct.

Mr. PECORA. What was deemed to be the necessity for extending the life of this joint account from October 15 to December 15?

Mr. DILLON. Why, I think we were just marking time to decide whether we wanted to buy more stock or not.

The CHAIRMAN. Did you invest the entire 30 million in railroad certificates?

Mr. DILLON. No, Senator; I think we only invested about 14 million in that account.

Mr. PECORA. Between 14 and 15 million. Mr. Tracy gave the specific figure. It was nearer 15 million than 14 million.

Mr. DILLON. I think I saw it here.

Mr. PECORA. Fourteen million seven hundred thousand?

Mr. DILLON. Fourteen million two hundred sixty-one thousand and odd.

Mr. PECORA. About fourteen and a quarter?

Mr. DILLON. Yes.

Mr. PECORA. Now, the account was actually terminated on November 9, at which time the stocks had been acquired and distributed in equal proportions between the two participants in the joint account, namely, Dillon, Read & Co. and the United States & International?

Mr. DILLON. That is correct.

Mr. PECORA. And at that time it became necessary for Dillon, Read & Co. to pay to the United States & International for one half of the securities that had been acquired for the benefit of this joint account and which had been distributed and turned over to Dillon, Read & Co. upon termination of the account?

Mr. DILLON. That is correct.

Mr. PECORA. Now, how was that payment made, if you can tell us?

Mr. DILLON. I heard yesterday that it was just credited on the books.

Mr. PECORA. Mr. Tracy gave some information about that, but I wondered if you could give us more definite information.

Mr. DILLON (after conferring with associates). I am informed that Dillon, Read & Co. made that payment of seven million one hundred and thirty-one thousand and odd dollars by crediting United States & International's accounts on Dillon, Read & Co.'s books with that amount. On the same day on order from United States & International Securities Corporation Dillon, Read & Co. paid to the Chase

National Bank for the credit of the United States & International $3,300,000 and paid to the Central Hanover Bank & Trust Co. for the account of the United States & Foreign $3,350,000.

Mr. PECORA. Why should payment have been made to the Central Hanover Bank for the account of the United States & Foreign by way of liquidating the indebtedness which Dillon, Read & Co. owed to the United States & International on account of this railroad stock joint account?

Mr. DILLON. Dillon, Read & Co. credited the whole $7,000,000 to United States & International and then paid it out on order of United States & International. United States & International instructed Dillon, Read & Co. to pay $3,300,000 to the Chase bank and to pay $3,350,000 to Central Hanover for the credit of the United States & Foreign. We simply followed the instructions of the depositor.

Mr. PECORA. You were director of both of these investment trusts, weren't you?

Mr. DILLON. Yes; and active in both.

Mr. PECORA. Yes. Can you tell us, Mr. Dillon, what was the nature of the account then existing between the Chase National Bank and the United States & International?

Mr. DILLON. May I inquire? [After conferring with associates.] I think, as I am informed here, that the United States & International simply transferred that to their account in the Chase, where they had an active bank deposit.

Mr. PECORA. It was credited to their deposit account—is that what you mean to tell us?

Mr. DILLON. We are not sure, but we assume that.

Mr. PECORA. And do you know the nature of the account then existing between the United States & Foreign Securities Corporation and the Central Hanover Bank?

Mr. DILLON. United States & Foreign?

Mr. PECORA. Yes.

Mr. DILLON. They kept their active checking account, their active banking account, with the Central Hanover Bank & Trust Co.

Mr. PECORA. What obligation at that time did the United States & International owe to the United States & Foreign which it liquidated either in whole or in part by means of the payment made by your firm?

Mr. DILLON. I should think it would either be for the purchase of securities or the payment of a loan or the making of a loan. I can find out which. [After conferring.] United States & International owed United States & Foreign money which they had borrowed.

Mr. PECORA. When this joint account was terminated on November 9, 1929——

Mr. DILLON (interposing). That borrowing, Mr. Pecora, was in anticipation of the subscriptions for the stock of United States & International, I am informed. That was paid in in installments, and they invested in anticipation of those installments and borrowed against it, sometimes from the bank. At this time United States & Foreign had money to loan, and they loaned it to International.

Mr. PECORA. When this joint railroad securities account was terminated on November 9 your firm received its half of the railroad stocks that had been accumulated through the account and paid in

the manner that you have just indicated for those securities an aggregate sum of something like $7,100,000, and then the stock was delivered to your firm?

Mr. DILLON. Well, I assume it was delivered. Yes; that is correct.

Mr. PECORA. Two days later, according to the testimony of Mr. Tracy, those shares of railroad company stock which your firm received upon the termination of this joint account, which consisted of the shares of the Chicago, Rock Island & Pacific Railway and of the St. Louis & San Francisco Railway, were sold by your firm to the investment trust?

Mr. DILLON. The investment trust bought those shares from us.

Mr. PECORA. At the then market?

Mr. DILLON. Yes; that was the United States & Foreign Securities Corporation bought them.

Mr. PECORA. Yes.

Mr. DILLON. At the then market?

Mr. PECORA. At the then market. Up to that time did you think that the acquisition of railroad stock was a good thing for the portfolio of either of these investment trusts?

Mr. DILLON. I did.

Mr. PECORA. Did you still think so on November 11, 1929?

Mr. DILLON. I did, decidedly.

Mr. PECORA. If they were a good investment for the investment trusts' portfolios, weren't they equally as good an investment for Dillon, Read & Co.?

Mr. DILLON. Had Dillon, Read & Co. been desirous of making investments at that time; yes.

Mr. PECORA. Well, your judgment that the acquisition of railroad stocks for the portfolio of either or both of these investment trusts was a good thing, was your judgment as a director of the investment trusts?

Mr. DILLON. That is correct.

Mr. PECORA. And it was actually your opinion and judgment at the time, irrespective of any relationship you bore to anybody?

Mr. DILLON. Exactly.

Mr. PECORA. And hence it was your opinion as a member of the firm of Dillon, Read & Co., wasn't it? I mean, whatever opinion you have is your individual opinion?

Mr. DILLON. That is correct.

Mr. PECORA. You may express it and you may render it and you may act upon it in any other capacity than for your own individual benefit, but it still remains your opinion—that is a constant thing?

Mr. DILLON. That is correct.

Mr. PECORA. Yes.

Mr. DILLON. And if I had money, for example, that I was not using, I would say to buy Rock Island at that time was a good thing to do. I would advise some other person differently if it meant something different to him, I would say, "Don't you buy."

Mr. PECORA. Dillon, Read & Co. had entered into this joint account with the United States & International to buy railroad stocks, and acquired an equal interest in the joint account with the investment trust, because they thought that such investments were sound and valuable at that time.

Mr. DILLON. That is correct.

Mr. PECORA. That being the case, what persuaded Dillon, Read & Co., on November 11, 1929, to sell at the then market to the United States & Foreign Securities Corporation the shares of these two railroad companies that I have already mentioned, and which had been acquired through the medium of this joint account?

Mr. DILLON. Dillon, Read & Co. went into this joint account to accumulate this stock in the expectation and in the belief that the stocks being so cheap and so attractive, would rise in price, and could later be sold at a profit. Dillon, Read & Co. are interested only in short-term investments. They do not make long-term investments. When it came to the termination of this account, it looked as though to hold them profitably would mean a long-term investment, which is not of interest to Dillon, Read & Co. Security companies, on the other hand, are interested in long-term investments.

Mr. PECORA. As well as short term?

Mr. DILLON. As well as short term. Those stocks were attractive, and Dillon, Read & Co. made a poor sale when they sold them to the security companies, because, had they held them a little longer, they could have obtained better prices for them.

Mr. PECORA. Had they held them for a period of about 2 months. The market went up somewhat from the price at which Dillon, Read & Co. sold to the United States & Foreign, as I recall.

Mr. DILLON. The sale to the United States & Foreign was made on November 11, 1929. The price paid by United States & Foreign for Frisco stock was 111¾; for Rock Island 114¼.

In every week thereafter to and including April 18, 1930—a period of 5 months—Rock Island sold on the New York Stock Exchange for a price higher than that paid by United States & Foreign, and only at times during 5 weeks of this 5 months' period did it sell for as low a price as that paid by United States & Foreign. During the 5 months' period it sold up to 125, and in 13 weeks of the 5 months' period it sold for a price of 120 or better.

In the case of the Frisco stock, this stock sold on the New York Stock Exchange in each of 15 weeks of the 5 months' period following the purchase by United States & Foreign at a price in excess of that paid by United States & Foreign, reaching a high during the 5 months' period of 119. In only 7 weeks during the 5 months' period did it fail to sell for as high a price as that paid by United States & Foreign, and even during this 6 weeks' period the low price at which it sold was less than 6 points below the price paid by United States & Foreign.

Mr. PECORA. I recall, on that point, the testimony of Mr. Tracy to the effect that between November 11, 1929, and December 31, 1929, the market value of these railroad securities in question had depreciated to a point where, on December 31, 1929, the United States & Foreign found it to its advantage to transfer the stocks to the United States & International at the lower prices in order to offset the consequent loss against their taxable profits for the year 1929. You recall that testimony of Mr. Tracy?

Mr. DILLON. Yes; I do. It might have been, on that particular day, of that particular week, they were selling below the November 11, 1929, price, but that in no way contradicts the statements I have just made.

Mr. PECORA. While we are on that particular point, Mr. Dillon, could you tell this committee, out of the fullness of your experience and knowledge of these things, whether or not a custom has developed in past years under which numerous transfers of securities are made at about the end of the tax year in order to reduce taxable profits made during the year, for income-tax purposes?

Mr. DILLON. My general knowledge and impression is that that is the case, that at the end of the year companies and people do sell stocks in which they have losses, in order to ascertain their net profit on which they should pay the income tax. I think that is a general practice.

Mr. PECORA. Does not that kind of a selling movement have the natural effect of temporarily depreciating the market value of securities, Mr. Dillon?

Mr. DILLON. I should think, if it were general at that time, it would.

Mr. PECORA. And you believe that it has been quite general, do you not?

Mr. DILLON. I think the practice has been general.

Mr. PECORA. So that the values established in the market for securities by means of these sales made for the purposes that you have indicated are really artificial to a certain extent?

Mr. DILLON. They might be very well, but that would mean that the volume would have to far exceed the normal trading on the Exchange. If it were a big market, it would affect it, naturally, very much less. If it were a dull market, it might affect it very much more.

Mr. PECORA. Mr. Dillon, the Seaboard Air Line Railway Co. is a company that your firm became bankers for some years ago?

Mr. DILLON. That is correct; jointly with Ladenburg, Thalman & Co.

Mr. PECORA. When did your firm and the banking firm of Ladenburg, Thalman & Co. undertake those banking relations to that railroad?

Mr. DILLON. 1924, they tell me.

Mr. PECORA. And sometime thereafter the bankers undertook a financial readjustment or reorganization of the railroad company, did they not?

Mr. DILLON. That is correct.

Mr. PECORA. When did they do that?

Mr. DILLON (after conferring with an associate). That was at the beginning of 1929.

Mr. PECORA. At the beginning, you say, of 1929?

Mr. DILLON. That is what I am told.

The CHAIRMAN. Was Mr. Warfield alive then?

Mr. DILLON. No; Mr. Warfield was not alive at that time.

The CHAIRMAN. I thought it was a reorganization begun during his lifetime.

Mr. DILLON. Mr. Warfield was the president of the railroad when it first came into our office, and he was very much interested in the development and extension of it through the South, particularly in Florida. Mr. Warfield had great confidence in Florida and the development of the State and the future traffic to come out of the

State, and we did finance the Seaboard for building those extensions in Florida, but Mr. Warfield had died before this time. He died in 1927.

Mr. PECORA. At the time of the undertaking of this reorganization did your firm or your associates, Ladenburg, Thalman & Co., make or cause to be made, a survey of the railroad company with a view of ascertaining its value as a property and a going concern?

Mr. DILLON. At the time these discussions were going on the Seaboard Railroad itself had that report made, which was completed, I am informed, in 1928.

Mr. PECORA. Who made that report for the railroad company?

Mr. DILLON. Coverdale & Colpitts.

Mr. PECORA. Had you, at any time since you became identified, or your firm became identified with the Seaboard Air Line Railway Co. as its bankers, made a study of that railroad company's history, properties, and so forth?

Mr. DILLON. May I just hear the opening part of your question?

(The reporter read the pending question.)

Mr. DILLON. Shortly after Mr. Warfield came in, in 1924, to discuss the Seaboard situation with us, a Mr. Hooper, who was a railroad expert in our office, went down and went over the property, and made his report, and thereafter we relied on Coverdale & Colpitts for our information.

Mr. PECORA. When did Hooper make his report?

Mr. DILLON (after conferring with an associate). I am told probably in 1925.

Mr. PECORA. Was there much difference in general conclusions regarding the value of the company's property, between Hooper in his report and Coverdale & Colpitts in their report?

Mr. DILLON. I am told that Mr. Hooper thought it was a fine property with great prospects, if put in good financial condition.

Senator COUZENS. Have you conveniently Mr. Hooper's report, and Coverdale & Colpitts' report.

Mr. DILLON. We do not have them here.

Mr. PECORA. Did you personally read or analyze those two reports?

Mr. DILLON. No.

Mr. PECORA. Were you aware of the fact that the Interstate Commerce Commission had caused a very complete survey and analysis to be made of the Seaboard Air Line Railway Co., and had made its findings public?

Mr. DILLON. Was I personally aware of that? No; I do not think I was [after conferring with an associate]. I am told that we did know that the United States Treasury loaned the Seaboard Railroad $17,000,000 with the approval of the Interstate Commerce Commission.

Mr. PECORA. That was during the war, or after the war?

Mr. DILLON. No; it was afterwards, when the Government turned the properties back.

Mr. PECORA. When was that loan made, Mr. Dillon?

Mr. DILLON. 1920 or 1921, some such time.

Mr. PECORA. That was shortly after the Government returned the management and operation of the railroads of this country, which the Government had taken over during the World War, was it not?

Mr. DILLON. I think that is correct.

Mr. PECORA. By the way, was that loan of $17,000,000 ever repaid to the Government?

Mr. DILLON. No. They tell me it was repaid in part.

Mr. PECORA. Do you know to what extent it was repaid?

Mr. DILLON. No. We have not those figures.

Mr. PECORA. The proportion of repayment was very small, was it not?

Mr. DILLON. I do not know, but I think that is a fair assumption.

Senator ADAMS. Loans which the Government itself makes are not often repaid.

Mr. PECORA. Did you know that the Interstate Commerce Commission, in its survey and analysis of the road, had reported publicly that as of the end of 1918 the road had outstanding a total par value of $190,938,527.20 in stocks and long-term obligations, of which $37,019,400 represented common stock, $23,931,400 preferred stock, $129,884,166.60 funded debt unmatured, and $103,560.54 non-negotiable debt to an affiliated company; and that as of the same time the cost of reproduction new of the railroad company as a physical property was $125,468,154, and that its cost of reproduction at that time, less depreciation, was $99,214,147, or something like $100,000,000 less than the securities it had outstanding?

Mr. DILLON. I do not recall knowledge of that report. I may have known it at the time. I do not recall the report at all.

Mr. PECORA. I am assuming that the figures of the Interstate Commerce Commission are quite accurate.

Mr. DILLON. What is the date of the report, Mr. Pecora?

Mr. PECORA. 1931. That is, the data that I have read are contained in a report or pamphlet issued by the Interstate Commerce Commission in 1931, but this report and its findings had been furnished to the railroad company at the time they were made, and as they were being made, which was long prior to 1931.

Mr. DILLON. I misunderstood you in the beginning. I thought that was some old report back in those years.

Mr. PECORA. The data embodied in this report were in the files of the railroad company, which had received them from the Interstate Commerce Commission long prior to 1931. Now, if it be——

The CHAIRMAN. Was not that along about 1918?

Mr. PECORA. The date as of which these figures are ascertained was sometime in 1918.

Senator COUZENS. Have you any information as to when the railroad got that report?

Mr. PECORA. I understand it is the practice and custom for the Interstate Commerce Commission to furnish railroad companies with its reports and findings as they are made. This pamphlet of 1931, which I now have before me, Senator, and from which I have read the figures which I have embodied in the question to the witness, was not published until 1931, but it is merely a compilation made in 1931 and embodied in this pamphlet of facts and figures which had been ascertained long before, and copies of which it had given to the railroad company.

Senator COUZENS. I was interested to know when the copies were given to the railroad. I do not presume you have that information.

Mr. PECORA. No. I can get that by inquiry at the Interstate Commerce Commission office. We will try to get that this afternoon.

As a matter of fact, as I understand it, these figures were arrived at from data furnished by the railroad company.

Mr. DILLON. Are those pre-war cost figures?

Mr. PECORA. These are the actual figures representing cost.

Mr. DILLON. At the time the road was built?

Mr. PECORA. Less depreciation.

Mr. DILLON. That is probably pre-war, that is, when the road was built. But that printed report was not available until after 1931, as I understand it.

Mr. PECORA. But the information embodied in this report was available long before that. Much of this information was taken out of the records of the railroad company itself, furnished to the Interstate Commerce Commission.

Have you any report in your possession, or did you ever have a report made, which indicated at any time, up to the time that you became bankers for the road, or up to the time subsequently when you undertook, as bankers, a reorganization of the finances of the road, the outstanding obligations of the company, and also showed the physical valuation of the company?

Mr. DILLON. We have a very complete report along those lines made by Coverdale & Colpitts.

Mr. PECORA. Do you recall whether that very complete report of Coverdale & Colpitts included the data embodied in this pamphlet taken from the records of the railroad company as furnished to the Interstate Commerce Commission?

Mr. DILLON. Those figures were prepared as of 1928 or 1927, and probably they would not be the same as in 1918, although they may have similar data. We go further than just the physical property in determining the value of a railroad. We take its earning power into consideration and its future prospects. In the case of the Seaboard we had great hopes and faith in its future earnings, because we had faith in the territory that it was opening up.

In speaking of this report of the Interstate Commerce Commission, of course you are aware that the Interstate Commerce Commission approved and passed on all the financing that we did for the Seaboard Air Line Railway. It was all done with their approval.

Mr. PECORA. I know that. I was just wondering what persuaded your judgment as a banker to have something like $2,000,000 in funds in either one or both of these two investment trusts to put into securities, both stock and bonds, of this railroad company subsequent to 1928 and 1929.

Mr. DILLON. As I said, we had faith in the future prospects of that railroad. We had great faith in the territory that was opening up. Mr. Warfield had a vision of developing the Southland, particularly the State of Florida.

He built these lines, which we financed, into the State, and we had great hope of traffic from there; and I still think that that railroad will be a valuable property and a prosperous railroad, because we still have faith in that territory which it taps.

Mr. PECORA. Do you know how many other banking firms had studied this railroad and its prospects besides yourselves? Do you know that other banking firms had?

Mr. DILLON. Ladenburg, Thalman & Co. did, because they went into it with us——

Mr. PECORA. Besides yourselves?

Mr. DILLON. I am informed that Ladenburg, Thalman & Co. had been bankers for this road for many years before we came in.

Mr. PECORA. When you undertook the reorganization of the road in 1929—or was it 1928?

Mr. DILLON. 1929.

Mr. PECORA (continuing). There was not much equity value in the stock, was there?

Mr. DILLON. In the common stock?

Mr. PECORA. Yes.

Mr. DILLON. The common stock, at the time that the plan was made effective—I think that is a correct statement—was selling around $16 a share; and the main part of that plan at that time was to put more into the common stock and make the senior securities better, and we agreed to furnish $20,000,000 for common stock. Common stock was offered to the stockholders and we underwrote the offer.

Mr. PECORA. How much of that $20,000,000 was subscribed for by these stockholders, as a matter of fact?

Mr. DILLON. I do not know whether any was. [After conferring with associates:] Yes; some was, about 300,000 shares out of about 2,000,000 shares. We underwrote that offer.

Mr. PECORA. That is about one seventh?

Mr. DILLON. I am surprised it is that much. Under the rules of the Interstate Commerce Commission we had to wait—I think it was 30 days or so—for their approval, and then beyond that there was another 30 days for the stockholders to come in and say what they would take. During that 60 days market conditions changed very much, and we were very disappointed in the results, and we as underwriters had to take it up. When, as a matter of fact, when we underwrote it for a small commission. It totaled $1 a share. We assumed it would be taken by the stockholders and that it would be a profitable underwriting.

Mr. PECORA. You encountered a very severe disappointment in the reaction by the stockholders to this reorganization insofar——

Mr. DILLON. No.

Mr. PECORA. Wait a minute—insofar as that was evidenced by their failure to subscribe for more than one seventh of the new issue?

Mr. DILLON. No; that is not a correct statement.

Mr. PECORA. Did you not expect the stockholders would take up a much larger proportion?

Mr. DILLON. Oh, we thought they would take it all; and they would have done so if general conditions in the stock market had not changed. That is why they did not take it.

Mr. PECORA. And when they took only about one seventh, you were disappointed?

Mr. DILLON. We were disappointed in the stock market and the general financial condition of the country that developed in those 60 days.

Mr. PECORA. But your firm, meanwhile, anticipating perhaps some disappointment at the results that would be obtained in offering

this stock to the stockholders, had organized a syndicate to take over on some underwriting basis those shares of new issues which were not subscribed for by the existing stockholders?

Mr. DILLON. No. When we agreed to underwrite the stock offering we offered interests in the underwriting to friends. We thought it would be profitable and that we were doing them a favor. We kept a substantial portion of it for ourselves.

Mr. PECORA. But you did organize such an underwriting syndicate?

Mr. DILLON. That is correct.

Mr. PECORA. And the Pennroad Corporation was one of the participants in that syndicate, was it not?

Mr. DILLON (after conferring with associates). Well, in effect it was. I am told that its participation in that syndicate was in the nature of a commitment to buy 25 percent of the stock that was not subscribed for by the stockholders. So the Pennroad Corporation was in the syndicate in that way.

Mr. PECORA. The United States & International Securities Corporation was also a member of that syndicate, was it not?

Mr. DILLON. I think it was. Yes; that is correct.

Mr. PECORA. That reorganization at that time of this railroad company was largely in the nature of a business gamble, was it not?

Mr. DILLON. I do not know what you mean by "business gamble", unless everything is that.

Mr. PECORA. Here was a road that up to that time had a very weak history——

Mr. DILLON. That is correct; but those roads, as a rule——

Mr. PECORA (continuing). And it was your object as bankers for the road to undertake a reorganization which was designed, to use the vernacular, to "put it on its feet"?

Mr. DILLON. Those have always been, in the history of this country, I think, the most profitable investments in railroads.

Mr. PECORA. That is, where they turn out successfully?

Mr. DILLON. Yes.

Mr. PECORA. And they have been the most expensive and costly where they have turned out unsuccessfully?

Mr. DILLON. No; I should not say so.

Mr. PECORA. They have been pretty expensive, have they not, where they turned out unsuccessfully?

Mr. DILLON. I was thinking of an investment we have just been discussing, where we bought a very prosperous railroad stock.

Mr. PECORA. I am talking about the Seaboard Air Line Railway investment. Is it doing violence to the situation to characterize the reorganization that you attempted back in 1929 as involving more or less of a business gamble?

Mr. DILLON. You might so characterize it. I would call it just an ordinary business transaction—the underwriting of stock.

Mr. PECORA. But the road was in poor shape. Its earnings did not justify according any substantial equity value to the stock. It needed, in your opinion, some 20,000,000 dollars' worth of new capital to help you to rehabilitate it; and to the extent that that $20,000,000 might not serve the purpose that you intended for it to serve, it was a gamble, was it not?

Mr. DILLON. No. We thought this road had a great future.

Mr. PECORA. That is why I call it a gamble. You thought it had a great future. There was nothing in the past up to that time which gave any certainty to the reorganization. It was more or less of a gamble, was it not?

Mr. DILLON. We thought it was an attractive investment to put money into the junior position of that railroad, because we thought that the future development of that railroad would make the investment exceedingly profitable; and the buying of that stock, Mr. Pecora, was not an investment. We were underwriting it and offering it to stockholders, and if we had not had the disturbance in the general security market, the stockholders would have taken that stock, and we would have been paid a commission as underwriters. The reason we took the stock up was that general conditions were such that the stockholders did not take the stock.

Senator COUZENS. Was the Interstate Commerce Commission's decision unanimous on this refinancing plan?

Mr. DILLON. May I find that out? I always assume Government bodies to be unanimous.

Senator COUZENS. Oh, no.

Mr. DILLON (after conferring with associates). We have no information or knowledge that that decision was other than unanimous.

Mr. PECORA. I will get that information from the Interstate Commerce Commission's office.

Senator COUZENS. I wish you would, because if it is unanimous we ought to investigate the Interstate Commerce Commission.

Mr. DILLON. In regard to that report of 1931 which you have just read, Mr. Pecora, I think the valuations you will find there were for rate-making purposes, and that they were based on the 1914 costs less depreciation.

Senator COUZENS. Plus additions, and so on?

Mr. DILLON. Yes, sir.

Mr. PECORA. They were based on the 1918 estimates of cost of reproduction.

Mr. DILLON. I think if you will read it you will probably find something like this, that the Interstate Commerce Commission's valuations were made for the purpose of determining comparative rates. The figures given out by the Interstate Commerce Commission were not actual costs, but costs of reproduction new, using for all roads the same price basis; that is, pre-war, 1914 prices.

Mr. PECORA. In the statement that was put into the record at the very end of the hearing yesterday afternoon, and which, I take it, was prepared by you or at your request——

Mr. DILLON. Yes.

Mr. PECORA (continuing). And a copy of which I have before me, you set forth that the United States & Foreign Securities Corporation was the first investment company of substantial size organized in the United States. Now, Mr. Dillon, was it your belief that investment trusts were intended to furnish capital to new enterprises or reorganizations of old enterprises, or was it your belief that investment trusts were primarily designed to find investments or to make investments of its funds in securities of established value and with an established income-producing power?

Mr. DILLON. My own conception of that is that they were organized for the profitable investments of the funds that had been entrusted to the securities company to invest. I should not feel that these companies were compelled to stay out of any profitable field. I personally would have advocated going into any field that seemed profitable. The prospectus stated the purpose, that it has been formed to buy, sell, underwrite, offer, and generally deal in corporation, government, and other securities, both American and foreign, and when desirable to take part in the organization and operation of corporations. So the purposes of the corporation were very broad.

Mr. PECORA. I know the prospectus sets that forth, but I was merely seeking to get your judgment or opinion as to whether or not investment trusts were organized for the purpose of investing the public's money in new enterprises or in reorganization or rehabilitation of old enterprises, rather than in the making of investments in securities that had an established value and an established income-producing power.

Mr. DILLON. My own judgment would be—which, I suppose, is what you want—to go into any field that is profitable, and I would diversify investments in all those fields. I would do all the things you have talked about. I would buy some seasoned securities, and I think the record of those companies is that they have been in the different fields. The United States & Foreign Securities Corporation made a profit by participation in syndicates, after taking losses, of over three and a half million dollars. So that is a profitable field. The corporation is not limited simply to the investments in interest-bearing securities. My feeling, Mr. Pecora, on that is that the corporation should go into any field that seems profitable, for a group of experienced men should try to handle the investment of those funds in the interest of the stockholders, to the best of their judgment, without being restricted. We have laws restricting investments of trust funds and other things.

Mr. PECORA. But those laws do not apply to the investment of moneys belonging to an investment trust.

Mr. DILLON. This is not a trust at all; it is a corporation. You call it an investment trust, but it is simply a corporation, a business corporation. The law governing the investment of trust funds, I was just going to say, does specify established earnings, and so forth. Those securities, I think you will find over the past decade, have suffered probably worse than any form of investment.

The CHAIRMAN. What proportion of the money going into these investment trusts came from the public?

Mr. DILLON. In the case of the United States & Foreign Securities Corporation—by the public you mean, I suppose, the stock offered to the public?

The CHAIRMAN. Yes.

Mr. DILLON. The first preferred stock?

The CHAIRMAN. Yes.

Mr. DILLON. There was originally 25 millions. There are now, I think, 21 millions and odd outstanding. And that stock is what you mean, Senator Fletcher?

The CHAIRMAN. Yes.

Mr. DILLON. That, of course, would mean the public. Some of us, ourselves, are the largest stockholders.

The CHAIRMAN. That is what I was trying to separate; what proportion came from the public and what proportion was put in by those who organized it.

Mr. DILLON. Those who organized it put in $5,100,000 for the second preferred and a part of the common. The first preferred was $25,000,000.

Mr. PECORA. That is what the public subscribed?

Mr. DILLON. If you call me the public, I own 25,000 shares of that for my family as an investment.

Mr. PECORA. You bought that——

Mr. DILLON. In the open market.

Mr. PECORA. I am talking about the original flotation of issues of the $25,000,000 worth of first preferred stock. That was offered and sold to the public?

Mr. DILLON. That is correct, Mr. Pecora.

Senator ADAMS. Mr. Dillon——

The CHAIRMAN. Let us go on with the other.

Senator ADAMS. May I just follow with one more question?

The CHAIRMAN. Yes.

Senator ADAMS. You made the statement a moment ago, which interested me, to the effect that the conservative investor had suffered more heavily than the investor in the less conservative lines.

Mr. DILLON. When I say "more heavily", maybe that is not exactly right; but he suffered very heavily. I do think it is more heavily, but I would want to check that.

Senator ADAMS. Would you deduce from that that the investor should avoid conservative investments?

Mr. DILLON. No. I think that investing to conserve money is a most difficult thing. I know of nothing that is so difficult or uncertain as investments. I am not sure that the phrase "security" is not a misnomer.

Senator ADAMS. Some of them might be called "insecurities"?

Mr. DILLON. Well, you should call them investments, because if you take the investments which we all considered to be the highest grade—and I do not want to particularize—but take such investments as you would have bought for trust funds, unfortunately you would have suffered more if you had bought them than if you had bought certain common stocks. It is very difficult to take over a period of years any specific class of security and just tie to that blindly. I think you have got to keep changing and rearranging your portfolio constantly and almost from day to day. It is very difficult to look into the future with respect to investments.

Senator ADAMS. It would not be very difficult now, with the information which you now have, to reach back and make safe investments in 1928?

Mr. DILLON. Yes. Looking backward we should have done a lot of things that we did not do.

Mr. PECORA. Mr. Dillon, another virtue claimed for investment trusts—and by that I mean investment corporations like the United States & Foreign and the United States & International—was that the investor in the stock of such companies was enabled to obtain a diversification?

Mr. DILLON. That is correct. I think that is one of the essences of it.

Mr. PECORA. That is one of the important virtues claimed for these so-called "investment companies"?

Mr. DILLON. That is correct.

Mr. PECORA. Yes. When the United States & Foreign Securities Corporation on November 11, 1929, took over large blocks of the shares of the railroad stocks which had been accumulated through the medium of the joint account that we have already spoken about, what proportion did the moneys that the United States & Foreign Securities Corporation paid for those railroad stocks bear to the then available cash resources of the United States & Foreign?

Mr. DILLON. Well, the then available cash resources—all were available resources really of a company like the United States & Foreign Securities Corporation.

Mr. PECORA. To the total resources.

Mr. DILLON. Yes; to the total resources. Just a second; if I can get the portfolio at that time. [After consulting same:] Less than 7 percent. About 6 percent plus.

Mr. PECORA. But subsequently that investment company had put in over 11 million dollars, had it not, in the stock of the Chicago, Rock Island & Pacific and of the St. Louis & San Francisco roads?

Mr. DILLON. Mr. Pecora, I think you are confusing the two security companies. The one that bought the stock from Dillon, Read & Co. was the United States & Foreign. The one that was in the joint account was the United States & International.

Mr. PECORA. It has appeared from the evidence heretofore submitted that one of these two investment trusts had in its portfolio stock of these two railroad companies that represented a total investment by the securities company of over 11 million dollars in the stock of those two railroad companies. I have that definitely in mind.

Mr. DILLON. I think that was in the International Corporation.

Mr. PECORA. All right.

Mr. DILLON. You are now speaking of the International?

Mr. PECORA. Yes; the International.

Mr. DILLON. I think that is correct.

Mr. PECORA. Was that not a very large investment to make in the stock of two railroad companies if diversification was one of the things sought for?

Mr. DILLON. That is about 9 percent, roughly, is it not, of the assets in each? Supposing that investment was equally divided between the two roads; say 5½ million in each; that would be roughly about 9 percent of the assets, assuming that the corporation had 60 million dollars, which, as I remember, is what it had.

Mr. PECORA. Eleven million dollars compared with a total of 60 million dollars is more than 9 percent.

Mr. DILLON. No; I say supposing that investment was equally divided between each of the two roads. Assuming that 11 million dollars is divided equally between the Rock Island and the Frisco.

Mr. PECORA. It would be 9 percent in each?

Mr. DILLON. That is right.

Mr. PECORA. Approximately 18 percent in both of them?

Mr. DILLON. Yes. I see no reason to couple those any more than any other investments in railroad securities.

Mr. PECORA. Except that they were acquired as a part of the same transaction and apparently were jointly considered.

Mr. DILLON. But I go further. I think 9 percent in one thing is a large proportion.

Mr. PECORA. Too large a proportion for safety, is it not?

Mr. DILLON. No; I would not say that, because it would depend on the circumstances. In this case it was an unfortunate investment. It was a mistake that we did not sell it. There is a difference. I think that these were good stocks when they were bought. In fact the record that I have just introduced shows they were good purchases. The mistake that was made was that they were not sold subsequently, say in the spring of the following year, when they could have been sold.

Senator ADAMS. Probably the bonds of Carthage had a time when they were very good.

Mr. DILLON. I did not know that Carthage had any bonds, Senator.

Mr. PECORA. According to our analysis of the portfolio statements issued annually by the United States & International Securities Corporation, the first time that it appears in the portfolio reports that any substantial investment had been made in the stock of the Seaboard Air Line Railway was during the year 1930, because it appears in the portfolio report as of December 31, 1930, that 131,908 shares of the stock of the Seaboard Air Line was on that date in the portfolio of the United States & International Securities Corporation, and those shares represented a cost of $1,478,675. Do you know when those one hundred and thirty-one thousand and odd shares were acquired during the year 1930?

Mr. DILLON. I am told in January 1930.

Mr. PECORA. That was in connection with the participation of the United States & International in the syndicate agreement managed by Dillon, Read & Co. in connection with the refinancing and reorganization of the road that was commenced in 1929?

Mr. DILLON. Most of them were.

Mr. PECORA. Yes. When did the Seaboard Air Line Railway go into receivership?

Mr. DILLON. In December 1930, I am told.

Mr. PECORA. That is 11 months after?

Mr. DILLON. Eleven months after.

Mr. PECORA. Your firm was one of the two bankers for the road?

Mr. DILLON. Yes.

Mr. PECORA. And had been since 1924?

Mr. DILLON. Or thereabouts.

Mr. PECORA. Or thereabouts. And that gave your firm exceptional opportunities to follow the course of the road, its values, and so forth?

Mr. DILLON. Yes.

Mr. PECORA. And its business prospects, as well as the actual earnings of the company?

Mr. DILLON. I should think that was correct.

Mr. PECORA. Were you not cognizant of conditions in January 1930 which made it seem extremely probable that the reorganization plan which you had undertaken would fail, and that a receivership might be imminent?

Mr. DILLON. Obviously not, because we would not have underwritten that common stock at $20,000,000 if we had any such feeling. Our feeling was that this would go through and that would be all that would be needed, and that the road would prosper.

Mr. PECORA. Railroad receiverships are not projected overnight, are they?

Mr. DILLON. Occasionally; yes.

Mr. PECORA. As a matter of fact the conditions that culminate in a receivership for a railroad company are conditions that accumulate over quite a long period of time before the receivership?

Mr. DILLON. Oh, yes. You mean that the road simply grows worse and worse?

Mr. PECORA. Yes.

Mr. DILLON. Yes; I should think that is generally a true statement.

Mr. PECORA. When for the first time were you able to observe as one of the bankers for the road that conditions were getting so bad that a receivership might be imminent within a year's time or thereabout?

Mr. DILLON. Oh, I do not think we foresaw it for a year, Mr. Pecora. We would not have underwritten that $20,000,000 of stock if we had.

Mr. PECORA. When did you first begin to feel that a receivership or other serious embarrassment was imminent?

Mr. DILLON. Right up to the time of the receivership we were hoping that it would not be necessary, so they inform me.

Mr. PECORA. Would you then say that this was one of those receiverships that developed overnight?

Mr. DILLON. They say that in 1930, just refreshing my mind, the business in the country disappeared very quickly, and from the middle of 1930 on the railroad traffic was disappearing very fast, and this receivership came on very quickly.

Mr. PECORA. And you saw the clouds gathering in the financial skies along about the middle of 1930?

Mr. DILLON. I do not think it was financial skies. I think they were talking about actual traffic on the railroad disappearing.

Mr. PECORA. Well, those conditions are reflected in the financial skies, are they not?

Mr. DILLON. Yes; I should think they would be.

Mr. PECORA. Yes. Was anything done by the investment trust or the people who operated it, so far as you know, to lessen the possible loss to this investment trust through its holdings of the Seaboard Air Line Co. stock by disposing of them before the crash came—the crash signalized by the receivership in December 1930?

Mr. DILLON. No; because we felt that to hold them was the best thing to do. That we would get more money by keeping them rather than by selling them. That was a mistake. Our judgment is not infallible, Mr. Pecora. I wish it were.

Mr. PECORA. And in the light of those conditions you still think that funds of investment corporations, so-called "investment trusts", should be used as a matter of brains or as a matter of sound business judgment in operations of this sort?

Mr. DILLON. Yes, I think that they should be so used, and I think probably we would do the same thing again. Possibly——

Mr. PECORA. You would still take a gamble on the improvement of a railroad company with funds of the public that had been put into an investment trust on the claimed virtues of diversification and the making of sound investments by experts of trained minds?

Mr. DILLON. But, Mr. Pecora, your assumption is not one in which I concur.

Mr. PECORA. Do you mean by that that you do not concur in my assumption that investments of investment trusts are made by persons of sound minds and trained judgment, expert judgment?

Mr. DILLON. I think if you will look at the record as a whole we may be excused pardonable pride when we think our minds were sound. But if you take some specific things such as we are talking about now—in those we may have made mistakes. But I think taking our record as a whole I doubt if there are any banks in the country—certainly not many—which can show a record in the balance sheet like these security companies show today.

Senator COUZENS. As a matter of fact if you had sold them the person who would have bought them would have been of unsound mind, would he not?

Mr. DILLON. Possibly. We sold some. We were not right in everything.

Mr. PECORA. I understand that the liquidating value of the first preferred stock of the United States & International is around $60 a share at the present time, according to its assets?

Mr. DILLON. I am told it is around $90 a share.

Mr. PECORA. Of the United States & International Securities Corporation?

Mr. DILLON. Yes.

Senator COUZENS. That is what was testified to yesterday.

Mr. PECORA. As of what date?

Mr. DILLON. September 30.

Mr. PECORA. Of this year?

Mr. DILLON. Yes. Just now.

Mr. PECORA. We were basing our estimates upon an analysis of the annual report as of December 31, 1932.

Mr. DILLON. There has been a decided appreciation since then.

Mr. PECORA. Because of the increase in value of the securities?

Mr. DILLON. Yes.

Mr. PECORA. On December 31, 1932, the liquidating or asset value of the first preferred stock was around $60 a share, was it not?

Mr. DILLON. That I do not know. It is $90 now. Do you want me to look back and see what it was?

Mr. PECORA. Yes.

Mr. DILLON. We do not have that.

Mr. PECORA. Is it not a fact that prior to December 31, 1932, United States & International Securities Corporation retired about 200,000 shares of the first preferred stock?

Mr. DILLON. I am not sure of the amount. They bought in the market a considerable amount.

Mr. PECORA. They bought in the market a large amount?

Mr. DILLON. Yes.

Mr. PECORA. Which I understand is about 200,000 shares?

Mr. DILLON. That I do not know, but I am willing to assume that it was a substantial amount.

Mr. PECORA. I also understand—and you can affirm or correct it, if you wish—that the United States & International Securities Corporation retired that stock by buying it in the open market at a cost of about one half what that stock had originally been sold for to the public.

Mr. DILLON. I do not know if that was the average price, but I assume it was. But of course we cannot assume we were buying it from the original purchasers. We do not know from whom we were buying it.

Mr. PECORA. The company was able to improve or enhance the liquidating value of the stock to the extent of about $10,000,000 by buying in and retiring these 200,000 shares—that is an approximation—of the first preferred stock, at a cost of about $10,000,000 less than the sum which the company received from the original subscribers for that stock?

Mr. DILLON. I am not sure that is a correct statement. The correct statement, I think, would be—and they may coincide—that you increase your liquidating value by the difference in your cost and your asset value, not the par value.

Mr. PECORA. I understand that that represented an improvement in the company's asset position or liquidating value of the stock of about 10 million dollars?

Mr. DILLON. If your assumption—and I am taking your assumption—is correct that the liquidating value was only $60, and your assumption is correct that our purchase price was $50, then we only improved the asset price by $10 a share; not by $50.

Mr. PECORA. I said by $10 a share.

Mr. DILLON. Yes; that is right.

Mr. PECORA. In other words, you improved the liquidating value from $50 a share to $60 a share, representing an improvement of about 10 million dollars?

Mr. DILLON. That would only be true if you bought 50 percent of the stock.

Mr. PECORA. Yes; at about half the price which the company received from the public upon its original issuance.

Mr. DILLON. Take our present asset value of stock, say, of $90. Suppose we buy stock at $80. We are adding $10 to asset value. If your asset value in 1932—and I am accepting your figure at that time—was $60, and you bought it at $50 a share, you are adding $10 to your asset value on each share that you buy; not on the shares that are left.

Mr. PECORA. You reduced the outstanding shares held by the public by means of the retirement of the shares we have referred to through the purchase in the open market by the company, did you not?

Mr. DILLON. That is true. But you took $50 a share out of your assets in order to do that. So you have only improved your asset value by $10 a share.

Mr. PECORA. One or two more questions, Mr. Dillon, and I will be through with you.

The CHAIRMAN. One moment, Mr. Pecora.

Mr. PECORA. Certainly, Mr. Chairman.

The CHAIRMAN. What I am most concerned about, or am more particularly concerned about, is how the investor came out. He is

the chap I am interested in. How about the man who put his money into these investment trusts? How did he come out by reason of this transaction?

Mr. DILLON. We will take the first trust first, Mr. Chairman—and I take it you do not want my experience, because it has not been a very good one. My investment has not paid as well as those who bought the senior securities. You want the preferred stock, do you?

Mr. PECORA. The first preferred.

Mr. DILLON. The man who bought that received one share of first preferred and one share of common and paid $100. With the money that was paid in for the second preferred stock the corporation showed a value back of his preferred stock of about $116 a share. Now, he has gone through this period of depression, and he has received in dividends $6 a year. The company has paid the total sum of about $13,000,000 through dividends.

The CHAIRMAN. Six percent?

Mr. DILLON. Yes. And the investor has an asset value back of his first preferred stock. Today the asset value back of his preferred stock—and when I say today I mean at the time of our last calculation—is about $138 a share. Or, in other words, the asset value of the stock is considerably more than when he started. In the meantime he has received 6 percent per annum dividends. Does that answer your question? I am assuming he did nothing with his common stock but held it. He fared one way or the other according to what he did. But I am assuming that he did not sell it, and that——

The CHAIRMAN (interposing). Then notwithstanding the losses suffered by the investment trust, the investor really has not lost anything yet?

Mr. DILLON. Oh, no. You are talking about losses in particular terms. If you are looking at our operations as a whole they are not losses but profits. We are here just going into some unfortunate things that we did, where our judgment was not so good as in others. But if you take our operations as a whole over the period of time, they have been profitable. Does that answer your question, Senator Fletcher?

The CHAIRMAN. Yes.

Mr. PECORA. Mr. Dillon, is it fair to say that the most of the losses that were incurred by the investment trusts were by reason of investments made in securities of corporations with which members of the board have been affiliated in some capacity or other, or associates of Dillon, Read & Co. had likewise been so associated?

Mr. DILLON. I think when you put the question in that way I must answer yes. But in making such answer I should like to qualify it.

Mr. PECORA. Go ahead.

Mr. DILLON. The fact that we bought Rock Island or Frisco stock or Seaboard stock, or other things where we have had losses, wasn't because Mr. Hayden and Mr. Ecker, or someone else, happened to be on those boards, but simply because we thought those were good investments.

Mr. PECORA. When you say "we" you mean directors who included Mr. Hayden and Mr. Ecker?

Mr. DILLON. That is true.

Mr. PECORA. That brings me to a point I want to question you about briefly. You heard me read into the record on yesterday, didn't you, the text of paragraph 8 of the charter of United States & Foreign Securities Corporation?

Mr. DILLON. Yes. May I look at that? [After looking at the paper.] Yes; I did.

Mr. PECORA. You know the contents of it, or the general substance of it, do you not?

Mr. DILLON. I know the general substance of it.

Mr. PECORA. What was the reason for including or inserting that provision in this charter?

Mr. DILLON. I assume that that was done by the lawyers as a general practice. Provisions similar to that are, I think, not unusual. It is done in order to give protection to directors against, well, we will say, unfair claims that might be made against them. It is to protect them against that.

Mr. PECORA. It also goes further than that, and gives those directors protection against claims that might be fair because based upon the exercise of judgment by directors where that judgment was not exercised by them in good faith.

Mr. DILLON. If that were true, I think a clause like that should not be placed in any certificate of incorporation, because I think a director should be fully responsible, fully liable for the exercise of good faith in all things.

Senator ADAMS. Then I gather if there is any fault any place it is to be put upon the lawyers; that if anybody is to be made the scapegoat it is the lawyers.

Mr. DILLON. If that is put in, or any other provision is put in a charter, which would excuse a director for the exercise of bad faith, then I certainly think it is their fault. I do not think any company should do that.

Senator ADAMS. Don't most lawyers do what their clients ask them to do? I am simply trying to present the lawyer's standpoint a little bit. [Laughter.]

Mr. DILLON. I haven't found that to be so, because we do not ask lawyers to do things. We ask them to tell us how things should be done or shouldn't be done, and they draw the documents. But we do not ask them——

Mr. PECORA (interposing). Did you ask the lawyers in this instance to tell you how directors could be rendered immune for liability for acts committed in bad faith and which might prove a loss to stockholders?

Mr. DILLON. No. This was simply put in by the lawyers themselves when they drew whatever this is.

Mr. PECORA. The charter?

Mr. DILLON. Yes; the charter.

The CHAIRMAN. That is, the amendment to the charter?

Mr. PECORA. That was amended on March 12, 1930. But I was talking about the original charter for the time being.

Mr. DILLON. It is the certificate of incorporation.

Mr. PECORA. Which is another term for charter.

Mr. DILLON. Yes; but as I read it, it does not excuse directors for bad faith or anything like that.

Mr. PECORA. Well now, let me read it to you. Let us read the original provision prior to its amendment on July 12, 1930:

In case the corporation enters into contracts or transacts business with one or more of its directors, or with any firm of which one or more of its directors are members, or with any other corporation or association of which one or more of its directors are stockholders, directors, or officers, such contract or transaction shall not be invalidated or in any wise affected by the fact that such director or directors doing it may have interests therein which are or might be adverse to the interests of this corporation, even though the vote of the director or directors having such adverse interest shall have been necessary to obligate the corporation upon such contract or transaction. No such director or directors shall be liable to the corporation, or to any stockholder or creditor thereof, or to any other person, for any loss incurred by it under or by reason of such contract or transaction, nor shall such director or directors be accountable for any gain or profits realized thereon.

Mr. DILLON. Yes; but that does not excuse them for bad faith. I think this clause is too broad, myself.

Mr. PECORA. So do I; and that is why I think the text of it excuses them, the import of it is designed to exclude such director from any liability.

Mr. DILLON. But not for fraud.

Mr. PECORA. Well, I think our courts of equity might intervene there and not enforce this provision, but the presence or inclusion of this clause in the charter, if it was calculated to serve any purpose at all, was calculated to protect the directors even from the exercise of bad faith. Whether the courts would give effect to that purpose is another thing.

Mr. DILLON. No; I shouldn't think that at all, because that was simply put in by the lawyers in the drafting of the charter. It was nothing that we had any interest in or were consulted about, because the charter of the United States & International Securities Corporation hasn't that clause in it at all.

Mr. PECORA. I know that.

Mr. DILLON. And this has been amended since. But I think directors of any company should always be liable and responsible for the exercise of good faith.

Senator ADAMS. Do lawyers get the share of profits commensurate with the responsibility which they seem to bear? [Laughter.]

Senator COUZENS. Might I ask what brought about this amendment you refer to?

Mr. DILLON. I do not know. I suppose the lawyers suggested the amendment, that they brought it in and then the directors adopted it.

Senator COUZENS. So the lawyers corrected their previous act?

Mr. DILLON. I think that is probably true.

Mr. PECORA. Mr. Dillon, would you today approve in principle the inclusion of any such provision in the charter of a company whose securities are to be sold to the public?

Mr. DILLON. We have a real problem there and it is difficult to know how to handle it; not in this company, but I mean in general. I think directors should be responsible for their acts, for the exercise of care and diligence. They should be liable for any malfeasance or bad faith, of course. On the other hand, directors receive as compensation from $200 to probably $600 a year. You give some sort of protection to a man of character and standing if you want

him to do a public service by serving on a public company, where he gets nothing out of it except the satisfaction of acting in the interests of the stockholders.

Senator ADAMS. Well, now, a director is supposed to be a man who is interested in the company. That is, he is there serving his own interest. He does not go on a board because of his little director's fee.

Mr. DILLON. He goes on the board to represent the stockholders.

Senator ADAMS. The law requires in some cases that he must be a stockholder himself.

Mr. DILLON. But that can be fulfilled by owning 1 share or 10 shares.

Senator ADAMS. I know, but you do not hire directors like you hire a manager.

Mr. DILLON. No; you try to get men to serve as directors who are not for hire.

Senator ADAMS. Yes; but don't you do that because of the knowledge and understanding that the members of boards of directors are really the principal owners of the business, and you hold out the board of directors as representing—well, take a list of bank directors and you draw the conclusion that they are the men who not only control but own the concern generally, don't you?

Mr. DILLON. In our companies that is the fact.

Senator ADAMS. And it ought to be the fact, ought it not?

Mr. DILLON. The directors here are largely the people that own the securities, that own the company so to speak. They own first preferred and second preferred and common stock. But I am speaking now on a broader plane.

Senator ADAMS. But you ought not to window dress a company with people as directors who are not substantially interested?

Mr. DILLON. No. You ought not to window dress anything.

Mr. PECORA. But that is frequently done, isn't it?

Mr. DILLON. I think it has been done.

Mr. PECORA. And it has been quite a common practice to your knowledge, has it not?

Mr. DILLON. Well, I have seen boards of directors that looked as though the directors were just there lending their names; yes.

Mr. PECORA. You know of many instances where persons serving on many corporations the securities of which are sold to the public, and where those corporations represent a great diversity or variety of business interests, so many in fact that the director has no adequate opportunity for really fulfilling the functions of a director as those functions should be fulfilled.

Mr. DILLON. I think that may be true; but there are men that serve on a great many boards, and you wouldn't think they would have the time to do anything about their own companies. As a matter of fact, some of those men are the most helpful directors. I personally do not serve on any boards at all except these security companies, and that takes all of my time. Other people probably have greater capacity than I have and can serve on more boards. But I think a director should take a real responsibility for the company and should be familiar with its management and operation.

Mr. PECORA. Take a personality like one of the directors of United States & Foreign Securities Corporation, Mr. Ecker.

Mr. DILLON. Yes, sir.

Mr. PECORA. He is the president of a great life insurance company, with billions of dollars of resources. Now, as the president of that company, looking after the safety and the interests of policyholders and the resources of the company, running into the billions of dollars, isn't it fair to assume that all of his working time would be consumed by attention exclusively to the interests of his life insurance company?

Mr. DILLON. Well, he is one of our most valuable directors, because of his familiarity with his own investments, which run into very large figures. His advice and guidance are of great value to us. We appreciate that he does give us the time that he gives us.

Mr. PECORA. Do you know on how many boards Mr. Ecker has served?

Mr. DILLON. No.

Mr. PECORA. The largest number at any one time, I mean; can you give us that?

Mr. DILLON. No. But I should like to finish my statement in connection with your previous question. His service is more than just a help to us. His company as shown by the last statement of the Metropolitan Life Insurance Co., owns 10,000 shares of the first preferred stock of the United States & Foreign Securities Corporation, which is a very substantial investment, and probably Mr. Ecker serving on that board is following the investment of his own company, because his company is a large stockholder, being the owner of first preferred stock.

Mr. PECORA. Don't you think the interests and activities of his insurance company are so vast as to require and absorb all of his time without his sitting on the board of directors of perhaps a dozen other corporations?

Mr. DILLON. Well, Mr. Pecora, I do not like to discuss the capacity of a particular individual. But I know Mr. Ecker very well, and he is a man of very high character, and I am sure he would not take time away from his own company that is needed in the operation of his company. I agree in general with your observation that a man with varied outside interests probably does not have as much time for his particular job as he could give it if he did not have these other duties. But I do not think that applies to Mr. Ecker.

Mr. PECORA. You think, then, he is an exception to the rule?

Mr. DILLON. Yes. I think Mr. Ecker is a man of very unusual ability, and that he would not take a job outside if it took too much of his time away from his own company.

The CHAIRMAN. That brings us to this thought: Whether or not some supervision or regulation of these corporations, particularly corporations engaged in interstate commerce, in the use of the postal facilities, isn't the proper thing for Congress to look at. Some of these corporations are growing very enormously and are becoming very powerful. They are run by a handful of men without regard to the stockholders. That is, the stockholders do not get a look in on the operations, and they are getting to be very immense in their power and strength.

Proper regulation of corporations and the practices and operations of such corporations, and securing the rights of stockholders and all that sort of thing, might reach all the way along the line of our inquiry here even to the extent of the stock exchanges; whether or not Congress should undertake something like that in connection with the legislation which we expect to bring out, some control or regulation of these corporations, to correct some of the evils that we have found to exist. What would be your thought about that?

Mr. DILLON. I think you will correct many of them by requiring detailed and frequent publicity statements regarding their operations.

Mr. PECORA. How frequently do you think they should be required?

Mr. DILLON. I think as frequently as practicable, quarterly, and maybe even monthly if the data would be made available. I think the more details that are given to the investor and the stockholder, to the man who owns a company, the better it is, because it helps him to form a better judgment of the value of his investment. And I think it would go a long way toward satisfying the investing public if they could have and did have regular information in great detail. I mean in such detail as would be sufficient for them to form a real judgment of the operations and the value of their company.

Senator ADAMS. Congress, largely through the activity of this committee, passed what is known as the Securities Act recently, in which they require detailed information when a new security is put out. Would you, Mr. Dillon, following your own statement made just now, feel that it would be appropriate to go beyond that, and not merely require publicity and information when securities are put out, but require such information to be given out periodically by companies now doing business, so as to make it available to security holders and to security purchasers?

Mr. DILLON. Senator Adams, not only do I feel it would be appropriate, but I think it would be highly desirable. I think the Securities Act does not go far enough on the question of information. But there are things in that act, registration of certificates, for instance, that you will want to change. There are some things that are not so valuable.

Senator ADAMS. Even a committee of the Congress, it follows, makes mistakes, just like investment houses, sometimes.

Mr. DILLON. But I hope they do not make as many. [Laughter.] I think that requirement should go farther and should require continuing information. If a man buys a security, no matter how much information he may have when he buys it, if a year or 2 years thereafter he only gets his information once a year, he can go through many uncertain months without knowing what is going on in his company. And I think it would be entirely proper and helpful if you should require more regular giving of information. Does that answer your question, Senator?

Senator ADAMS. Yes, sir.

The CHAIRMAN. I think that is a good idea myself.

Mr. PECORA. Mr. Dillon, would you favor, in the light of your experience as a financier and an investor too, the enactment of a law by Congress, assuming that Congress has jurisdiction, requiring

that all corporations whose securities are listed on any public exchange file, say monthly, if it be feasible and practical, a kind of statement of financial condition that you have just been discussing, in order that the investing public might be kept currently posted through the medium of such monthly reports of the general course of a corporation's business, and thereby enable the investing public to acquire reliable information and data that would be useful to the investing public in determining the value of the securities that are listed on the public exchanges?

Mr. DILLON. I think anything like that would be helpful. Maybe monthly is too often to have the thing in complete detail, but I should think certainly we should have quarterly, semiannually, and then monthly what it is practical to give. Because I think one of the things that an investor feels—most certainly we do, with our investments—is the desire for current information, and when we have to wait for an annual report and sometimes we have to wait 6 and 8 months, it leaves you in a position where he really cannot judge as intelligently as he should be able to regarding the value of your particular investment.

Mr. PECORA. Have you on occasions in the past endeavored to obtain for the benefit of these two investment trusts information from corporations whose securities the investment trusts have purchased concerning those corporations, and if so, what has been the result of those efforts, as a rule?

Mr. DILLON. My impression is that there have been instances where the men from the security companies or from Keswick have gone to the offices of companies in which the security companies are substantial stockholders to get certain information, particularly concerning the details of their sales, gross sales, and things of that nature. The companies have not been willing in all cases to give us the information that we would have liked to have.

The CHAIRMAN. That is so as to stockholders as well?

Mr. DILLON. We are stockholders. I am not speaking as a banker. My remarks were, Mr. Pecora, from the standpoint of a stockholder. I think the situation is improving all the time. I think companies are giving more and more information. But there are exceptions. It is not every company that does it, and I think every company whose stock is publicly held should do so.

Mr. PECORA. Should be required to?

Mr. DILLON. Yes.

Mr. PECORA. Are there any other views or opinions with respect to the very broad subject matters of this investigation that you would like to express to this committee while you are on the stand, Mr. Dillon? If so, I am sure the committee would be glad to hear them from you.

Mr. DILLON. I am glad to discuss anything that anyone wants to ask me; but as to volunteering anything, the only thought I have at the moment goes back to our discussion of responsibility of directors and officers of corporations. The Securities Act puts a rather definite responsibility on directors and officers of companies for matters beyond their own knowledge or own ability to know. I think a director or an officer should be responsible for what he can properly know. I think an accountant should be responsible for what

he can properly know; an engineer likewise, and so forth. But making directors responsible for an error of an accountant, I am afraid, is going to make it very difficult to keep as directors the men you would like to keep on boards of directors. It is impossible for a director to know whether an accountant, for example, has made an error somewhere in his statements. I think that probably could be clarified. Put full responsibility on everybody but for their own acts and for what is properly within the range of their own knowledge, but do not make it quite as all-embracing.

Senator ADAMS. What responsibility would you put upon some of those who bear more or less distinguished names who sort of market those names by going on boards of directors—and there are such in New York that you know—who accumulate a rather large list of directorships and some of them draw rather large salaries? What kind of responsibility would you put on them?

Mr. DILLON. I should think the same responsibility as on any other director, and that is responsibility for carrying out his proper functions in a proper fashion.

Senator ADAMS. Here is a purchaser of stock who relies upon a published statement that goes through official channels under the Securities Act. There is a very serious error in that. Either the investor must lose because of that error or somebody else must make good. Now where should the loss be put? The investor is not in anywise responsible for that.

Mr. DILLON. No.

Senator ADAMS. The director has put his name up there as a managing officer. Is it an unfair thing to say to the director that he must bear the responsibility? While he did not know about it, at least his name was there and he had a chance, as against the investor who had no chance and who relied upon the information.

Mr. DILLON. I think there are two sides to that. I think that is all right from the investor's point of view, but who is going to be a director? You are not going to have people fighting to be on boards. You are going to have people getting off boards, because a man cannot take the responsibility.

Now, take a banker, for example. I don't want to avoid any responsibility that properly comes to the banker. But we could not go before the public representing that we know by our own knowledge that all the statements of an accountant are correct, all the statements of an engineer are correct, because we cannot possibly know that. We can go before the public saying that we have chosen reliable accountants and we have made them comply with the requirements of the Securities Act that such and such things must be examined and reported on. We have accepted their reports. That is as far as we can go. We should be responsible for giving to the public everything that we know from those reports.

Senator ADAMS. But it is the question as to a loss that is to fall on a man who is wholly innocent or upon the other man who had a chance to correct it.

Mr. DILLON. But has a director a chance to go back, say over a period of 10 years, and correct the figures that an accountant makes up? He cannot possibly do it.

Senator ADAMS. But should the investor stand the loss?

Mr. DILLON. The thing is——

Senator ADAMS (interposing). In all of these cases where there is a loss between two more or less innocent parties you always have that problem, both an ethical and a legal problem.

Mr. DILLON. Yes; and you have the problem of protecting the investor and making it possible for a man to serve as a director.

Senator ADAMS. And from the standpoint now of a man dealing in investments, would not in the long run the investment houses be better off if the investor had that assurance that he could rely absolutely upon the responsibility of responsible people for those statements?

Mr. DILLON. I think he ought to have that right, but that ought to be divided. I don't think you can have an accountant responsible for an engineer's mistake, for example.

The CHAIRMAN. On the other hand, Mr. Dillon, you must recognize that these issuing corporations select their own accountants, select their own engineers. They are agents of the corporation issuing the securities. Ought not that corporation be responsible for the acts of its agents?

Mr. DILLON. I think the corporation itself should be. I think that is all right, sir.

Mr. PECORA. Mr. Dillon, yesterday I asked Mr. Tracy to prepare a list of the corporations other than those in which a director or officer of either of these two investment trusts or of which a member of the firm of Dillon, Read & Co. was a director or officer whose securities were purchased for the portfolio of the United States & International Corporation. You have given me this list?

Mr. DILLON. Yes.

Mr. PECORA. Is that list in answer to that request that I made of Mr. Tracy?

Mr. DILLON. Yes.

Mr. PECORA. I offer it in evidence.

The CHAIRMAN. Let it be received and entered in the record.

(The list of corporations referred to was thereupon designated "Committee Exhibit 23, Oct. 11, 1933," and is as follows:)

COMMITTEE EXHIBIT NO. 23, OCTOBER 11, 1933

UNITED STATES & INTERNATIONAL SECURITIES CORPORATION

Companies in the fortfolio of United States & International Securities Corporation on whose boards there are no representatives from either the directors, officers, or employees of United States & International Securities Corporation, United States & Foreign Securities Corporation, Keswick Corporation, or Dillon, Read & Co.; furthermore, Dillon, Read & Co. has not acted as banker for any of these companies:

American Radiator & Standard Sanitary Corporation.
American Smelting & Refining Co.
American Tobacco Co.
Atchison, Topeka & Sante Fe Railway Co.
Banque de Paris et des Pays-Bas.
Chesapeake & Ohio Railway Co.
Chrysler Corporation.
Deutsche Bank und Disconto-Gesellschaft.
Drug Incorporated.
General Baking Co.

Gillette Safety Razor Co.
Guardian Casualty Co.
Liggett & Myers Tobacco Co.
Lorillard, P., Co.
May Department Stores Co.
Mead, Johnson & Co.
Missouri Pacific Railroad Co.
National Sugar Refining Co. of New Jersey.
Pacific Gas & Electric Co.
Pacific Western Oil Co.
Pennsylvania Co. for Insurance on Lives and Granting Annuities.
Pennsylvania Railroad Co.
Public Service Corporation of New Jersey.
Reynolds, R. J., Tobacco Co.
Southern Pacific Co.
Southern Railway Co.
Standard Oil Co. of California.
Title Guarantee & Trust Co.
United States Steel Corporation.

Mr. PECORA. I am through with this witness unless there is something more. The next witness will be Mr. Hayward.

TESTIMONY OF ROBERT OTIS HAYWARD, A MEMBER OF THE FIRM OF DILLON, READ & CO., NEW YORK CITY

The CHAIRMAN. Mr. Hayward, do you solemnly swear that you will tell the truth, the whole truth, and nothing but the truth, regarding the matters now under investigation by the committee, so help you God?

Mr. HAYWARD. I do.

Mr. PECORA. Mr. Hayward, will you give your full name and address to the reporter for the record?

Mr. HAYWARD. Robert Otis Hayward. My post-office address is Bronxville, N.Y. My residence is physically situated in the city of Yonkers.

Mr. PECORA. And what is your business address?

Mr. HAYWARD. 28 Nassau Street.

Mr. PECORA. Are you a member of the firm known as Dillon, Read & Co.?

Mr. HAYWARD. Yes; I am.

Mr. PECORA. How long have you been a member of that firm?

Mr. HAYWARD. I became vice president in 1927—January.

Mr. PECORA. Was that your first connection with the firm in any capacity whatsoever?

Mr. HAYWARD. No. My first connection with the firm dates back to 1916. I have been continually associated with them since that time, with the exception of the period while the United States was in the war. I then received leave of absence and represented the State Department and the War Trade Board in Europe.

Mr. PECORA. The firm of Dillon, Read & Co., which is a joint-stock corporation, was organized some time in 1921?

Mr. HAYWARD. Yes.

Mr. PECORA. And were you connected with it from that time to the present time?

Mr. HAYWARD. Yes.

Mr. PECORA. You are now one of the vice presidents of it?

Mr. HAYWARD. Yes.

Mr. PECORA. And have been since 1927?

Mr. HAYWARD. That is correct. 1922, I am told, the joint-stock corporation was organized.

Mr. PECORA. Now, Mr. Hayward, since you have been connected with the legal entity known as Dillon, Read & Co. have you had any special branch of activities or business of that company committed to your charge, or are your activities of a general character?

Mr. HAYWARD. We are not strictly departmentalized, but during all the time since 1916 I have devoted most of my time to our foreign interests. Of course, I could not always be personally familiar with all of those transactions, but so far as our organization exists today I am more familiar with those transactions than anyone else, and I am quite ready to assume full responsibility for all of them.

Mr. PECORA. Mr. Hayward, are you familiar with an issue of 8 percent sinking fund gold bonds made by the city of Rio de Janeiro in the Republic of Brazil, dated October 1, 1921, and maturing October 1, 1946?

Mr. HAYWARD. Yes, I am.

Mr. PECORA. Did Dillon, Read & Co. underwrite that issue?

Mr. HAYWARD. With associates, yes.

Mr. PECORA. With associates. Did you have anything to do personally with the transaction that led to the underwriting of these bonds by Dillon, Read & Co. and its associates?

Mr. HAYWARD. To answer that adequately I will have to ask you to look into that distant scene you so aptly referred to last week for a moment.

I was in Brazil in the summer of 1921. During my visit I became acquainted with the mayor of the city of Rio, who at that time was Dr. Carlos Sanpaio. Dr. Carlos Sanpaio had been for some time extremely anxious to carry on a program of municipal improvements, and I discussed the matter with them on a great many occasions. I met his subordinates in the Treasury Department. I looked over some of the improvements that he wanted to carry out, and as a result of some protracted negotiations I accepted on behalf of the firm an option from Dr. Carlos Sanpaio for this loan.

Mr. PECORA. What was the amount of it?

Mr. HAYWARD. The amount of the loan was $12,000,000. There was one complication, however, which had to be removed before we could proceed to a public offering. The reason was that the city of Rio de Janeiro had previously borrowed in the United States. In 1919 through the firm of Imbrie they had issued $10,000,000 of bonds maturing serially, the first maturity occurring I think in March 1922. In connection with that loan the city had given to Imbrie & Co. an irrevocable option on all future financing.

Unfortunately, by the time of my visit, the firm of Imbrie & Co. had fallen into difficult times, and I think a receiver had been appointed in the Federal courts in New York. That left the mayor of Rio de Janeiro, Dr. Sanpaio, in an extremely embarrassing position, because obviously he could not finance through any other banking house unless this option were removed. Therefore he appealed to me to help him out of this situation, and I put the option in my pocket and came back to New York. Senator McAdoo, a member of this committee, was our counsel at that time, and with his collaboration

we took the matter up with the Federal court, and as the result of some discussions a sum was fixed which the court would be willing to allow the receivers to accept in cancelation of this tie.

Mr. PECORA. May I interrupt you just a moment there, Mr. Hayward? When you say Senator McAdoo was your counsel at the time, you mean that he was at that time a member of the law firm of McAdoo, Cotton & Franklin, and that law firm was general counsel for Dillon, Read & Co. at that time?

Mr. HAYWARD. That firm were counsel for us in all these early Brazilian issues.

Mr. PECORA. In your reference to Senator McAdoo, did you mean to imply that he personally rendered legal services that were rendered by counsel to your firm in connection with this particular issue?

Mr. HAYWARD. Oh, yes; in connection with this transaction, because he personally worked on that with me until the matter was cleared up. The matter of drawing the contract was in the hands of his firm. I believe the actual drafting of it was largely in the hands of Mr. Joseph P. Cotton.

Where was I? Will you please read the last part of my statement?

(The reporter read as requested.)

Senator COUZENS. What was that amount?

Mr. HAYWARD. $120,000 was the total sum to be paid to the bankrupt estate.

Senator COUZENS. For the waiving of the option?

Mr. HAYWARD. Yes.

Mr. PECORA. That $120,000 happened to be exactly 1 percent of the face amount of the loan.

Mr. HAYWARD. Yes; exactly.

Mr. PECORA. Was it fixed at that percentage rate advisedly?

Mr. HAYWARD. The Senator and I discussed it with the judge. I do not remember now just how that sum was arrived at, but it was felt by all concerned, including the receivers for the bankrupt estate, that that was a reasonable figure.

Mr. PECORA. You would not have sought to acquire the rights of Imbrie & Co. under their contract or agreement or understanding with the city of Rio de Janeiro unless you thought it was a profitable thing for your company to succeed to the position of Imbrie & Co. as the external financiers for the city?

Mr. HAYWARD. No; certainly not. That would have been charity.

Mr. PECORA. In other words, you paid this $120,000 for the privilege of doing business with the city of Rio de Janeiro with respect to the underwriting of its loans.

Mr. HAYWARD. That is correct. That $120,000 was to be paid if the public issue was made, as it was.

Senator ADAMS. Did you take over the same rights as this other firm had?

Mr. HAYWARD. No. We made a present of that to the mayor. I felt it was very unreasonable to tie the city up.

Senator ADAMS. You did not become the eternal and perpetual guides, as this other firm was?

Mr. HAYWARD. No. As a matter of fact, it may interest you to know that we brought out the loan of $12,000,000 for the city in 1921.

The following year the city made a public offering in this country through another banking house, of $13,000,000 of bonds with which we were not associated. In 1927 or 1928 two more issues were made through still another banking house. In other words, this transaction we are now discussing was the only one in which we acted as issuers for the city.

Senator ADAMS. Is this type of arrangement which this bankrupt firm had a common transaction for a city or foreign government to make, an irrevocable and perpetual contract to give an exclusive right to handle financial adjustments?

Mr. HAYWARD. It is my opinion that that went a great deal further than the normal practice. It is occasionally done in the form of a limited option, perhaps an option for a period of a year or 6 months. Very frequently we ask a city to agree that they will not issue any other bonds for 6 or 12 months after our issue, the idea being to use it as somewhat of a brake on their future financing and protect the people who have bought these bonds, but an option in this form was quite unusual. I do not recall ever having seen one as drastic, and that was the reason which led us to make the mayor a present of it and tear it up.

Senator COUZENS. Are any of these bonds, either in principal or interest, in default?

Mr. HAYWARD. All the outstanding ones are in default, Senator. The issue has been reduced since 1921 from $12,000,000 to approximately $8,000,000 by the operation of the semiannual sinking fund. They failed to pay in 1931. They have been in default since then.

Senator COUZENS. Are all those other bonds which have been floated by the other houses also in default?

Mr. HAYWARD. That is correct. All the Brazilian municipalities and States are at the present time in suspense as to payments, with one or two exceptions, such as the coffee loan of Sao Paulo.

Mr. PECORA. By "suspension" you mean in default?

Mr. HAYWARD. Yes.

Senator ADAMS. It is the bondholder that is in suspense?

Mr. HAYWARD. They are all in suspense.

The CHAIRMAN. Your contract did not provide for limiting their issue in any way?

Mr. HAYWARD. No, Senator.

Mr. PECORA. By the way, do you know about the present market value of the bonds represented by this particular $12,000,000 issue that you are going to testify about?

Mr. HAYWARD. $160 per thousand dollar bond.

Mr. PECORA. Will you resume your narrative of the circumstances under which Dillon, Read & Co. underwrote this issue back in 1921?

Mr. HAYWARD. This obstacle then having been removed, the city was free to proceed with the issue, and a public offering was eventually made on the basis of that option, which was common with all these early issues. The contract was subsequently drawn up and signed, and the bonds were delivered to the purchasers.

Mr. PECORA. Did you personally handle the negotiations that led to the underwriting of this issue for the city by your firm?

Mr. HAYWARD. With the mayor?

Mr. PECORA. Yes.

Mr. HAYWARD. Yes, sir.

Mr. PECORA. What was to be the purpose for which the loan was to be made? In other words, what uses were to be made of the proceeds of the loan by the municipality?

Mr. HAYWARD. The principal purpose was designated as municipal improvements. The outstanding purpose was an extremely interesting operation which the city of Rio de Janeiro had had in mind for a number of years. I think if I show the committee this map it will make it a little clearer to you [exhibiting a map]. This [indicating] is the business section of the city of Rio de Janeiro. Rio de Janeiro clusters around high mountains, extremely sharp ones in some cases, so that in one instance, particularly, you will find only one street between the ocean and the mountain range. The principal business street of the city runs across from here to here [indicating] and at this point [indicating] was a large hill, called the Morro do Castello.

Mr. PECORA. A free translation of that name into English would be "Castle Hill"; isn't that right?

Mr. HAYWARD. That is right.

Mr. PECORA. You may refer to it as "Castle Hill."

Mr. HAYWARD. Very well. I will try to use as few Portuguese names as possible.

The CHAIRMAN. The high mountains you speak of are only about 2,000 feet.

Mr. HAYWARD. That is pretty high for an Easterner.

Senator ADAMS. It is pretty high for a fellow from Florida.

The CHAIRMAN. But not very high for a fellow from Colorado. [Laughter.]

Mr. HAYWARD. There are approximately 5,000 people living on the top of this hill, and it was the slums of that section of the city. On the other hand, the property all around it was the most valuable business property that the city has, and for a good many years the succeeding mayors of Rio had had in mind to make it their monument to tear down this hill. It is a very common thing in the case of Latin American officials to select some item of public works which they can tackle during their term of office, and leave to posterity something with which their name can be attached.

Mr. PECORA. Is that weakness exclusive to Latin American countries?

Mr. HAYWARD. I have heard of it in our own municipalities. I understand now, however, we are discussing only foreign countries. So that they have been extremely anxious to demolish this hill. When I arrived in Rio that summer, the mayor took me over the location, and I found that a local contractor had been at work on it for some time. I do not recall exactly how long, but they were doing it in such a manner that it would have taken certainly the next 20 years to remove the hill. In other words, it was a pick-and-shovel job.

There were small donkey carts, and they would draw up in a row and the dirt would be put into the cart and they would go down the street. As they went down the street a red flag was placed in the driver's seat and he would be checked off and the contractor would be credited with removing so much dirt. Being of a somewhat curious temperament, I walked around the block one day and observed that it was quite the common practice for the drivers to

conceal the red flag after they had gone by the checking station, and thus they got credit twice for the amount of dirt they had removed.

Mr. PECORA. Is that practice peculiar only to South America? [Laughter.]

Mr. HAYWARD. It displays an ingenuity which perhaps is general.

Mr. PECORA. What Senator Steiwer might call an old Spanish custom? [Laughter.]

Mr. HAYWARD. The mayor appreciated that this was wasting money, and he also felt that there was no chance of the mountain being demolished during the term of his office, and therefore he would not get much credit for it. He was anxious for us to suggest some competent American engineers who would do the job quickly and in an efficient manner and use the latest approved methods. That was really the basis for this loan.

Mr. PECORA. In other words, the proceeds of the loan were to be used principally for the removal of this Castle Hill?

Mr. HAYWARD. That is correct.

Mr. PECORA. Was it also designed, in connection with this public improvement, for the municipality to sell the leveled land that would remain, the area, rather after the hill had been removed.

Mr. HAYWARD. That is correct.

Mr. PECORA. In other words, they were going to reclaim what was a hill into level land, and sell the lots.

Mr. HAYWARD. What they did was this. They asked us to suggest some one to them who was an expert in sluicing, the idea being to put flumes across this roadway and, in effect, wash the mountain into the bay. So that if you go down there today you will find this land entirely flat, and out here [indicating] there is a sea wall which takes about that space [indicating], and this mountain has been filled into the bay, thus producing about twice as much in area as there was before. That land, as you have seen by the prospectus, was the most valuable land in the city of Rio de Janeiro, and as part of the security for this loan, it was agreed that as and when the municipality could dispose of those lots, they would remit the proceeds of such sales to us in New York to be used in retiring the bonds of this issue. They did reserve, as I recall it, the right to use part of the land for municipal purposes if they so desired, or for the purposes of the federal government, but that was the spirit of the agreement. It was at that time, I believe, estimated that the land in that neighborhood was worth approximately $11 per square foot. If such a price could have been realized it would, of course, have been enough to pay off almost all the funded debt of the city.

Mr. PECORA. Which was what, at that time?

Mr. HAYWARD. That would be in the circular. I do not recall. [After consulting an associate:] $49,000,000.

Mr. PECORA. Of which about one half was external?

Mr. HAYWARD. Yes.

Mr. PECORA. All right. Proceed.

The CHAIRMAN. What was accomplished? The land was leveled, you say, and that area reclaimed?

Mr. HAYWARD. The hill was, in effect, washed into the bay.

The CHAIRMAN. Did they sell the lots?

Mr. HAYWARD. The sale of the lots is another story.

Mr. PECORA. I was coming to that.

Mr. HAYWARD. I suspected so.

Mr. PECORA. I was going to come there step by step, and not take in the distant scene at one glance.

Mr. HAYWARD. I was sorry to see a Washington paper quote you as looking at the "distant sea." He evidently is not a good Episcopalian.

Mr. PECORA. I do not know where that came from. I do not recall having given out any such interview.

Mr. HAYWARD. You were talking about the distant scene last week. The reporter said you spoke of the "distant sea."

Mr. PECORA. He might have had reference to the Atlantic, which I crossed a great many years ago.

Mr. HAYWARD. Senator, the history of the sale of lots is this. This work was begun in 1922, under the supervision of the American contracting firm which was designated.

Senator COUZENS. What was the name of that firm?

Mr. HAYWARD. Kennedy & Co. It proved to be a long job. The hill was not finally removed and the land was not finally made available for sale until sometime in the middle of 1929. If you could go down there and see this property, you would appreciate that the sale of any lots would be quite impossible until the whole improvement had been completed. In other words, a person would not buy a piece of property and settle on it or build a house with a steam shovel working in his back yard, and although that area looks quite large, it is only a matter of a few city blocks. After that was completed, the land had to be leveled, sewers had to be laid, it had to be paved, and all those processes took a considerable amount of time, so that I believe it was not until about the middle of 1929 that sales would be possible.

Mr. PECORA. In the course of your conversations with the mayor of Rio de Janeiro with respect to the proceeds of this loan, was anything said about the time when the improvement you were referring to, the leveling off of this hill, and so forth, would be completed?

Mr. HAYWARD. He foresaw that it would take a period of years.

Mr. PECORA. Did he so tell you?

Mr. HAYWARD. I do not think he needed to tell me. That would be obvious.

Mr. PECORA. You foresaw that yourself?

Mr. HAYWARD. Certainly. That would be obvious. It was impossible for anyone to estimate exactly the length of time that would be required. As I recall it, when the core of the hill was reached, it was found that a good deal of it consisted of hard rock that had to be blasted and removed in freight cars, and it took the city some time to find a place where they could put that material. One reason or another made it a long job.

The CHAIRMAN. Did that go into the bay?

Mr. HAYWARD. They filled to a certain extent, and after that there was surplus material, and that had to be taken off in another part of the city.

The CHAIRMAN. They built the wall.

Mr. HAYWARD. Yes; they built the wall. Rio de Janeiro has five or six bays like this, with the city around each one.

The CHAIRMAN. Where is the Monroe Monument?

Mr. HAYWARD. Right here at the end of the street, Senator. That has been used until recently as the meeting place of the Brazilian legislature.

We are now in the middle of 1929. By that time the conditions for the sale of real estate were not particularly favorable. They have become progressively less favorable since.

The city started, in early 1930, to boom the sale of lots, and they advertised auctions and put up pieces of property for sale just to test out the market. The response, however, was quite limited, and, to make a long story short, at the present time a very small number of lots have been disposed of.

Mr. PECORA. To an aggregate value of how much?

Mr. HAYWARD. Well, they have on deposit in Brazil at the present time the equivalent of a quarter of a million dollars at the present rates of exchange, representing the part of the proceeds of sales which has been paid in. In order to effect these sales they had to arrange for payment on the installment plan, and so the payments for lots sold have not all come in, but at the present time they have approximately a quarter of a million dollars, I am advised, awaiting shipment to New York when exchange makes it possible. That, of course, is a very small product for such a length of time, but the security is still there. I think it is good security. I cannot think of anything better.

Mr. PECORA. Are you referring to the land value?

Mr. HAYWARD. The land. After all, your security cannot be removed short of an earthquake or the drastic retrogression of the shore line.

Senator COUZENS. You say this land is security for these bonds?

Mr. HAYWARD. That is correct. The proceeds from the sale of land which is not used by the Federal Government or the city government.

Senator COUZENS. Is it an obligation of the whole community?

Mr. HAYWARD. Yes, indeed.

Senator COUZENS. It is not an obligation of this contractor?

Mr. HAYWARD. No; it is an obligation of the city.

The CHAIRMAN. Are they selling the reclaimed lots?

Mr. HAYWARD. The city can retain some of the property if it wishes.

The CHAIRMAN. I mean the reclaimed land.

Mr. HAYWARD. It is all part of one piece.

The CHAIRMAN. They are dividing that into lots?

Mr. HAYWARD. Yes. I would rather have this as security for a bond than I would, for instance, the bonds of a neighboring government which are secured by the droppings of birds on a desert island. I would be rather afraid that my security might be dropped in the wrong country which did not recognize the right of recapture.

Mr. PECORA. The general result of your conversations with the mayor was that they wanted to borrow $12,000,000 through the sale of bonds, and that the proceeds of that issue were to be used primarily for the leveling of this Castle Hill, the reclamation of the superficial area occupied by the hill, and the sale of lots in that superficial area to the public?

Mr. HAYWARD. That is correct.

Mr. PECORA. Was there not another purpose also discussed between you and the mayor to which the proceeds of the loan were to be applied?

Mr. HAYWARD. Yes. I have mentioned simply the most striking purpose. Another purpose was the construction of a municipal slaughterhouse.

Mr. PECORA. Were those improvements regarded as revenue-producing improvements?

Mr. HAYWARD. No; I should say not.

Mr. PECORA. The reason I asked you that is because in the circular that was issued by your firm and its associates in the underwriting of these bonds the following statement is made concerning the uses to which the proceeds of this loan would be applied:

> The proceeds of this loan are to be chiefly employed for permanent and revenue-producing municipal improvements, including the removal of Castle Hill and the construction of a municipal slaughterhouse.

Mr. HAYWARD. That is correct, Mr. Pecora. I was speaking simply in the case of the hill——

Mr. PECORA. The removal of the hill was to absorb by far the major portion of the proceeds of this loan?

Mr. HAYWARD. That is right. This is a capital asset.

Mr. PECORA. Not a revenue-producing one, but a capital asset?

Mr. HAYWARD. If you sold lots, in a sense that is revenue, but not an annual revenue, not a recurring, regular sum.

Mr. PECORA. After paying this $120,000 for the rights, your firm entered into a loan agreement or contract with the municipality with respect to this loan, did it not?

Mr. HAYWARD. Yes, sir.

Mr. PECORA. Have you a copy of it here?

Mr. HAYWARD. I think your assistants have one.

Mr. PECORA. Mr. Hayward, will you kindly look at the printed documents that I will now hand you and tell us if they constitute a true and correct copy of the contract or loan agreement entered into by Dillon, Read & Co. with the city of Rio de Janeiro dated as of October 1, 1921, with respect to this loan, and also of a supplemental agreement between the same parties dated as of October 1, 1921, covering the same loan?

Mr. HAYWARD. Yes. That seems to be identical with ours.

Mr. PECORA. I offer it in evidence.

(The contract referred to, dated as of Oct. 1, 1921, was marked "Committee Exhibit No. 24", see p. 1938.)

I observe that the contract just offered in evidence, with respect to the date thereof, reads as follows:

"Contract dated as of October 1, 1921, made by" so-and-so and so-and-so. Does that language mean that the contract itself was not signed or executed on October 1, 1921?

Mr. HAYWARD. That is what I take it to mean.

Mr. PECORA. When was it actually executed in this instance?

Mr. HAYWARD (after consulting with associates). I am told it was actually executed about October 31.

Mr. PECORA. And when was the supplementary contract which is annexed to this main contract, as offered in evidence, actually executed?

Mr. HAYWARD. At the same time.

Mr. PECORA. And that also is dated as of October 1, 1921?

Mr. HAYWARD. That is correct.

Mr. PECORA. I suggest, Mr. Chairman, that we take a recess at this time.

The CHAIRMAN. We will have that contract admitted in evidence and placed on the record.

Mr. PECORA. It has already been offered in evidence.

Mr. HAYWARD. You will find that in all these early contracts, Mr. Pecora, they are all dated " as of " some date.

Mr. PECORA. I am coming to that this afternoon.

The CHAIRMAN. The committee will take a recess until 2 o'clock.

(Whereupon, at 1 p.m., a recess was taken until 2 p.m.)

AFTERNOON SESSION

The hearing was resumed at 2 p.m., Wednesday, October 11, 1933, at the expiration of the noon recess.

The CHAIRMAN. The committee will come to order. You may proceed, Mr. Pecora.

TESTIMONY OF ROBERT OTIS HAYWARD, A MEMBER OF THE FIRM OF DILLON, READ & CO., NEW YORK CITY—Resumed

Mr. PECORA. Mr. Hayward, you testified this forenoon that the loan contract into which your firm entered with the city of Rio de Janeiro, and which has been marked in evidence as " Committee's Exhibit No. 24 " of this date, although dated textually as of October 1, 1921, was not actually executed until the 31st of October 1921.

Mr. HAYWARD. That is my best recollection.

Mr. PECORA. And you testified also that the same is true of the supplementary contract?

Mr. HAYWARD. That is correct.

Mr. PECORA. When did your firm actually issue and offer to the American investing public the bonds representing this loan? When did you make a public offering of this issue of bonds?

Mr. HAYWARD. October 7.

Mr. PECORA. 1921?

Mr. HAYWARD. 1921.

Mr. PECORA. Why was the offering made to the American public before the terms of the loan contract had been actually embodied in an agreement?

Mr. HAYWARD. The terms of the loan contract were contained in the option which I received from the mayor at a previous date. The definitive contract simply embodied those terms in the usual legal phraseology.

Mr. PECORA. Have you a copy of that option with you?

Mr. HAYWARD. Yes. I think you have it too, Mr. Pecora.

The CHAIRMAN. Do you remember the date of the option, Mr. Hayward?

Mr. HAYWARD. The option was dated September the 3d.

Mr. PECORA. May I look at your copy of the option agreement?

Mr. HAYWARD. Certainly. [Handing same to Mr. Pecora.]

Senator COUZENS. While you are looking that up let me ask this question: What price did you pay for the loan?

Mr. HAYWARD. Ninety-one.

Senator COUZENS. You paid 91?

Mr. HAYWARD. Eighty-nine and interest.

Senator COUZENS. Eighty-nine and interest. And what did you offer it at?

Mr. HAYWARD. Ninety-seven and three fourths.

Senator COUZENS. What maturities were they?

Mr. HAYWARD. Twenty-five years.

Senator COUZENS. And what did that net the investor?

Mr. PECORA. Supposed to net about 8⅕ percent.

Mr. HAYWARD. 8.20.

Senator COUZENS. Did you market them through your own selling agency, and if so, what portion of them?

Mr. HAYWARD. Well, Senator, at that time our retail interests would take some small percentage of the issue. The greater part, however, would be sold to other dealers. What you might call the wholesale part was far more important than the retail was.

Senator COUZENS. How many points between the wholesale and retail prices?

Mr. HAYWARD. What you might call the originating profit was from 89 to 91. There was then a banking group which brought it from 91 to 93¾. The syndicate received four points. That is the difference between 93¾ and 97¾.

Senator COUZENS. Was that not a rather unusual spread?

Mr. HAYWARD. Oh I do not think so, Senator, for this type of business. No.

Senator COUZENS. I remember the Senate Finance Committee held extensive hearings on Senator Johnson's resolution in respect to selling of foreign securities, and it seemed to me that there were hardly any spreads that great.

Mr. HAYWARD. Well, they may not have been gone into in detail. Of course, at that time we filed a complete table of all of our foreign issues giving the various steps. And looking back to 1921 I should say that this was quite normal. And, of course, out of our part of the originating profit we had to contribute toward this amount we spoke of this morning that we paid to Imbrie & Co. We paid part of that and part of that was paid by the banking group, and part I believe by the syndicate. It was divided among three groups.

Mr. PECORA. Mr. Hayward, I have hurriedly read the text of the so-called "option" which you have shown me, and unless I have overlooked something in it I fail to find any commitment in this option as to the purposes for which the proceeds of this loan were to be used. That is an important detail, is it not?

Mr. HAYWARD. Well now, Mr. Pecora, I think that is a question.

Mr. PECORA. What do you think about it?

Mr. HAYWARD. I should regard it myself as perhaps the least important of the details.

Mr. PECORA. Is it one of the least important details for an underwriter who proposes to sell to the investing public an issue of bonds to

know what use is going to be made of the proceeds of those bonds by the borrower?

Mr. HAYWARD. Well, certainly an underwriter would as part of his examination of the issue—that is before he reaches the point where he has decided to buy the issue—want to know in connection with his study of the borrower's general characteristics and his financial position, about what the money was to be used for.

Mr. PECORA. You do not call such a negotiation one of the minor details, do you?

Mr. HAYWARD. When I said minor details I was getting a step further than that, that is, when it comes to the public offering. My impression is that in the offering of governmental and municipal bonds the purpose of issue is of comparatively minor importance. So much so that in our municipal financing in this country it is frequently the case that issues are offered for sale without any reference whatever to the purpose for which the money is to be devoted.

Senator COUZENS. Will you give us some example of that. My observations are in disagreement with that conclusion.

Mr. HAYWARD. Well, I can look some up. I happened to see the other day an advertisement, Senator, of the city of New Haven, Conn., offering an issue of municipal bonds where there was nothing in the advertisement except a description of the bond itself. There was not even a reference to the financial condition of the municipality.

Senator COUZENS. Is it not a fact with most of these municipal bonds that it is usually stated that they are issued for school purposes, or for refunding, or for city hall, or for sewers, or for water works, or for something of that sort?

Mr. HAYWARD. Well, it is and it is not. I do not know that you can lay down a strict rule about that.

Mr. PECORA. Well, is that not the general rule? It may not be followed in every case, but is not that the prevailing rule, in your experience?

Senator COUZENS. It is my experience.

Mr. HAYWARD. Certainly it would be true in the legal authorizations for the loan. But I know that certainly there are a good many instances when that is not stated in the prospectus.

Mr. PECORA. Where, for instance, a municipality is seeking to obtain a loan for public-improvement purposes and it indicates that the public improvements that are to be constructed with the proceeds of the loan are not of a revenue-producing character, a self-liquidating character, is not that an important circumstance that is considered by a prospective lender or underwriter?

Mr. HAYWARD. More by the underwriter than by the ultimate purchaser, I should think.

Mr. PECORA. Well, the ultimate purchaser buys usually without any detailed knowledge of the loan agreement, does he not?

Mr. HAYWARD. Yes.

Mr. PECORA. So that the underwriter who proposes to pass on the bonds that he underwrites to the investing public virtually assumes and accepts there a responsibility to the investing public, does he not?

Mr. HAYWARD. Well, I think that is a legal question.

Mr. PECORA. That is inherent in the situation, is it not?

Mr. HAYWARD. That is a legal question.

Mr. PECORA. No; I am not talking about it as a legal question but as a moral question.

Mr. HAYWARD. No; I should think not.

Mr. PECORA. As a matter of fact, Mr. Hayward, when you negotiated this loan with the city of Rio de Janeiro on behalf of your firm you knew, did you not, that it was the purpose and intention of your firm to sell these bonds in the American market?

Mr. HAYWARD. Yes.

Mr. PECORA. And to sell them at a price that would reap a satisfactory profit to your firm?

Mr. HAYWARD. Yes, sir.

Mr. PECORA. Your firm undertook it partly as a business proposition?

Mr. HAYWARD. Yes, sir.

Mr. PECORA. In view of the fact that your firm through its representative right on the ground, consisting of yourself, was in a position to inform itself fully of all the purposes for which the proceeds of the loan were to be applied, and in view of the fact that you knew at the time that your firm intended to pass these bonds on to the American investing public, and that the American investing public would not have any opportunity comparable to yours to inquire into the credit of the municipality that was negotiating this loan with you, did you not think it was up to you to exercise all the caution, judgment and care and circumspection you possibly could to make sure that these bonds would be a sound investment for the American public?

Mr. HAYWARD. I did, certainly.

Mr. PECORA. You did?

Mr. HAYWARD. We were discussing just before, I thought, a general theoretical point.

Mr. PECORA. In determining the soundness of such an investment do you not pay more than mere passing attention to the question of what is to be done with the proceeds of the loan by the municipality?

Mr. HAYWARD. Well, it would be very important first of all in making up your own mind as to whether the borrower was what you might call a profligate spender or was careful in placing loans and spending money. The point I had in mind was this, that it is my impression when the public buys a bond that bond is purchased for the sake of the particular features of maturity, interest, and sinking fund rather than what is going to be done with the money after the borrower takes it down.

Mr. PECORA. And do you think that the ultimate buyer, which is the investing public, does not take into account at all the factors that go to determine the credit of the borrower and the ability and capacity of the borrower to meet his obligations under the bond?

Mr. HAYWARD. Well, we are talking now of bonds of sovereign governments. I think that the average member of the public in buying the security would rely chiefly on his belief in the integrity and goodwill of that sovereign. Not so much on what it was going to do with the money.

Mr. PECORA. Well, do you not think that the buyer in the American market as a matter of fact relies a good deal upon the standing,

prestige, and integrity of the issuing house, of the underwriting house?

Mr. HAYWARD. Certainly; to quite an extent.

Mr. PECORA. Yes. And because of that fact do you not think that the underwriter bears a relationship of a fiduciary character to the investor who buys in reliance upon the prestige and standing and judgment of the underwriter?

Mr. HAYWARD. Well, I do not know about the fiduciary character. That is a pretty broad term.

Mr. PECORA. I am using it in the broad sense.

Mr. HAYWARD. Yes.

Mr. PECORA. Not in the narrow, legal sense.

Mr. HAYWARD. Certainly they rely on the issuing house doing its utmost to know all about what it is offering.

Mr. PECORA. Where a municipality, particularly in a foreign land, borrows money and issues its bonds as evidence of the loan, and those bonds are underwritten by an American banking house with a view to ultimately selling it to the American investing public, would not knowledge of the purposes for which the proceeds of the loan are to be applied be of value to the underwriter in determining the soundness of the security or the soundness of the loan?

Mr. HAYWARD. Oh, I think it might, and it might not. I think it depends entirely on the individual circumstances.

Mr. PECORA. Would it not always contribute materially to the judgment of the underwriter as to the soundness of the loan?

Mr. HAYWARD. I think it might and it might not. I do not want to waste time in bandying words with you, but I think it depends on the individual circumstances, it seems to me.

Mr. PECORA. In the study that you made of various loan negotiations with foreign jurisdictions in behalf of Dillon, Read & Co. did you approach the question of determining the soundness of the loan in the manner that you have indicated?

Mr. HAYWARD. We always tried to; yes, sir.

Mr. PECORA. I mean the matter of the disposing of the proceeds by the borrowing municipality or country was of slight consequence to you in aiding you to form a judgment as to the soundness of the loan?

Mr. HAYWARD. It certainly was of some consequence.

Mr. PECORA. Well, was it of material consequence, or slight, or minor consequence?

Mr. HAYWARD. I should say of minor consequence. What we rely on is the integrity of the borrower in the case of a foreign governmental body, and that is all you can rely on, it seems to me.

Mr. PECORA. Well, where the proceeds of a loan are to be used for the construction of revenue-producing and self-liquidating improvements, isn't there, in that circumstance of a loan, a greater security back of the bonds?

Mr. HAYWARD. May I have that question read?

Mr. PECORA. Yes; the committee reporter will repeat it for you. [Which was done.]

Mr. HAYWARD. Well, there might and there might not be. The breakdown at the present time in Latin America is due, of course, to circumstances which at that time no one could foresee. Chiefly

there is a breakdown in the exchange relationship between those countries and other countries. Now, in all of these loans which your assistants have been examining you have a concrete illustration of where you have a security which under almost any circumstances would be valuable but which under the present emergencies of today cannot be realized upon.

Mr. PECORA. What was said in the option to which you have referred concerning the purpose or purposes to which the proceeds of this loan were to be applied?

Mr. HAYWARD. The letter of September 3 of itself doesn't go into the details of the use of the proceeds. You will find, Mr. Pecora, that that is covered in the letter of October 4, or the cable of October 4, which——

Mr. PECORA (interposing). You will recall that a few minutes ago when I asked you to explain to the subcommittee the reason for your firm on October 7, 1921, offering these bonds to the American investing public in advance of the actual execution of the loan agreement, which execution was had on October 31, 1921, you replied, in substance, that because you had this option of September 3, 1921, you knew what the loan agreement was to be.

Mr. HAYWARD. Yes, sir.

Mr. PECORA. Now, I looked at that option agreement, and like yourself, I was unable to find anything there that committed the municipality to the application of the proceeds of this loan to any definite thing or usage.

Mr. HAYWARD. Their general expression of intent as to how they would use the proceeds.

Mr. PECORA. And what was it as to date?

Mr. HAYWARD. It was contained in this cable.

Mr. PECORA. Well, now, the cable is something that came more than a month after that option, isn't it?

Mr. HAYWARD. Oh, no.

Mr. PECORA. Well, what is the date of the cable?

Mr. HAYWARD. It is 1 month afterwards.

Mr. PECORA. What is the date of the cable?

Mr. HAYWARD. October 4.

Mr. PECORA. And the date of the option is September 3?

Mr. HAYWARD. Yes, sir. That was previous to the date of the public offering, though.

Mr. PECORA. What is there contained in the cable concerning the application to be made of the proceeds of the loan by the municipality?

Mr. HAYWARD. Let me see. [Looking at paper.]

Senator COUZENS. Who is the cable from and to?

Mr. HAYWARD. The cable is from our representative in Brazil, Sir Alexander MacKenzie, to us in New York, and is based on a signed statement he had received the previous day from the mayor of the city.

Senator COUZENS. What does the cable say?

Mr. HAYWARD. It says:

We accept loan of 12 million dollars on conditions your proposal September 3, with the following changes and additions——

Shall I read the whole thing?

Mr. PECORA. No. Just read that portion that indicates the purpose to which the proceeds of the loan were to be applied.

Mr. HAYWARD. It says:

First. $1,500,000 will remain on deposit to be applied in purchase of municipal bonds which we will indicate.

Mr. PECORA. In other words 1½ million dollars were to be first applied toward the retirement or redemption of some floating indebtedness?

Mr. HAYWARD. Some municipal bonds.

Mr. PECORA. All right. Go ahead.

Mr. HAYWARD. And it says:

Second. Minimum (?) required for slaughter house is $1,500,000.

Third. $5,000,000 to be deposited in bank here to be approved by us, for Morro and connected works, as mentioned by Alexander MacKenzie's telegram to you, No. 20——

Mr. PECORA (interposing). That refers to the leveling of Castle Hill?

Mr. HAYWARD. Yes. It goes on:

No. 20, October 2, including some mention Clause no. 2 of said telegram.

I think that is all that covers this point.

Mr. PECORA. How much was to be applied to Castle Hill?

Mr. HAYWARD. Five million dollars, to be put in bank.

Mr. PECORA. Does it appear from any cable you had, or any communication you had at that time from any other source, how much this Castle Hill improvement was to cost?

Mr. HAYWARD. Of course, I discussed that at great length with the mayor when there.

Mr. PECORA. And what was that cost?

Mr. HAYWARD. He felt, having 5 million dollars in this fund, that any contractor coming down there to do that specific part of the work should be amply covered.

Mr. PECORA. Did he have any estimates from any reliable engineers on the cost of that work at that time?

Mr. HAYWARD. I do not know whether they did or not. It is very hard to determine how much that kind of work would cost, depending on the time it would take to take the hill down and the composition of the hill itself.

Mr. PECORA. Well, an engineering contractor could determine that fairly accurately in an approximate way, couldn't he?

Mr. HAYWARD. Not necessarily.

Mr. PECORA. Isn't that always done in the letting of contracts for public improvements? Those contracts are let upon proposals made by the contractor and which are subsequently embodied in the contract?

Mr. HAYWARD. It is very frequently done in that way. But I mean in this particular case the situation——

Mr. PECORA (interposing). There is no inherent difficulty about a contractor estimating within a fair approximation the cost of an improvement, is there?

Mr. HAYWARD. It depends upon the kind of improvement.

Mr. PECORA. Well, any kind of improvement.

Mr. HAYWARD. The composition of this bill was such that it was rather difficult at the start to estimate exactly how much it would cost. In fact, it ended up by costing considerably more than they thought it would.

Senator COUZENS. Who selected the contractors—Kennedy & Co.?

Mr. HAYWARD. The mayor asked us to nominate somebody, an American firm, whom we would rely on and who could, in our opinion, do the job satisfactorily, and at some time, after a number of discussions, this firm was mentioned and their name was put in the contract.

Senator COUZENS. Kennedy & Co.?

Mr. HAYWARD. Yes, sir.

Senator COUZENS. Who owns Kennedy & Co.?

Mr. HAYWARD. Well, I could not answer that question, Senator Couzens. I don't know.

Senator COUZENS. Have your associates sitting there got any information as to who owned Kennedy & Co.?

Mr. HAYWARD. I do not believe we have. [After consulting an associate.] No; I haven't got that information.

Mr. PECORA. Now, did you know at any time that any member of your firm had any substantial interest in Kennedy & Co.? Did you ever know that?

Mr. HAYWARD. No.

Mr. PECORA. Did you ever know that any member of your firm ever had any substantial interest in Kennedy & Co.?

Mr. HAYWARD. No, sir.

Senator COUZENS. Were Kennedy & Co. an incorporated concern?

Mr. HAYWARD. I believe it is incorporated. It is an American company. Yes, sir.

Senator COUZENS. Did they bid on this work or just take it without bidding?

Mr. HAYWARD. They got the contract because we insisted that someone in whom we had confidence should be designated to do it. And the mayor of the city insisted that it should be done in that way. It was not done through public tenders.

Senator COUZENS. It was not done through public bidding?

Mr. HAYWARD. No, sir.

Senator COUZENS. Was any figure set by Kennedy & Co. to do the job?

Mr. HAYWARD. It was a cost-plus contract.

Senator COUZENS. Those are quite famous contracts.

Mr. HAYWARD. That was the only way they felt it could be done.

Mr. PECORA. Who recommended Kennedy & Co. as contractors for this Castle Hill removal?

Mr. HAYWARD. I did.

Mr. PECORA. What did you know about them at that time?

Mr. HAYWARD. Well, Mr. Pecora, I had been brought up with Mr. Kennedy. We were classmates at college. I had known him since 1905. I had known about his organization. I knew that he had the available men who had done this kind of work in Seattle; that he had other men who were dirt movers in connection with iron operations out in the Mesaba Range. There were at that time very few American contracting firms operating in South America, so

the choice was limited. I felt he was the best person I knew of to carry out the job in the way it was intended.

Senator COUZENS. And you didn't know who his partners were when you arrived at that conclusion?

Mr. HAYWARD. I knew who some of them were; yes, sir.

Senator COUZENS. Who did you know his partners to be?

Mr. HAYWARD. The most valuable asset he had in addition to his own capacity at that time was the organization of Mr. Schlesinger, who was president of the Steel & Tube Co. of America, and he had a large number of men who could be drawn on for this work, and that is what actually happened. Men were selected from that organization and sent down there.

Senator COUZENS. But I was particularly interested in knowing who his financial associates were.

Mr. HAYWARD. I am not familiar with that.

Senator COUZENS. Do you know any of his financial associates?

Mr. HAYWARD. His financial associates?

Senator COUZENS. Yes, who was interested in either holding stock of the company or the profits of the concern?

Mr. HAYWARD. Well, Mr. Schlesinger had an interest. Mr. E. G. Wilmer had an interest. Through a family corporation of some of Mr. Dillon's family, they had an interest. I do not know of any others.

Mr. PECORA. How big was the interest of Mr. Dillon's family?

Mr. HAYWARD. I do not know. I could not say.

Mr. PECORA. It was 45 percent, wasn't it?

Mr. HAYWARD. Well——

Mr. PECORA (interposing). Did I have to remind you of that before you could think of it?

Mr. HAYWARD. Well, I am testifying under oath and want to be sure I am saying what I know.

Mr. PECORA. Did you actually need a reminder from me to enable you to recall that that was the extent of that interest?

Mr. HAYWARD. No.

Mr. PECORA. Why didn't you tell that in answer to Senator Couzens' question?

Mr. HAYWARD. Well, I have no way of knowing from my own knowledge, without having seen the books of the company.

Senator COUZENS. How was this 5 million dollars put in, and I suppose it was put in escrow?

Mr. HAYWARD. It was deposited in the Bank of Brazil at Rio, and the arrangement was that as the contractor progressed vouchers would be drawn on that fund by the local authorities and countersigned, and signed by the contractors, and they would go to the bank and get their money.

Senator COUZENS. How much in excess of the 5 million dollars was needed before the job was completed?

Mr. HAYWARD. Well, it is difficult for me to say that definitely. I know that in 1927 Mr. Kennedy's organization completed the part of the work that they were to undertake and withdrew. At that time there was still a small end of the mountain which had not been taken down, and the work of paving and laying sewers and all that sort of thing had not been completed. And the city subsequently borrowed in New York an additional sum to finish it.

Senator COUZENS. In other words, the $5,000,000 was used up and then how much more of the $12,000,000 was used for that purpose?

Mr. HAYWARD. I could not say exactly.

Mr. PECORA. How much information, if any, did you have at the time this loan contract was entered into, concerning the general credit of the municipality known as the city of Rio de Janeiro?

Mr. HAYWARD. Well, we had all the information that was available to the public.

Mr. PECORA. What was the substance of it?

Mr. HAYWARD. As I recall it the substance was that the credit of the city was good, that they had met their obligations, that they were not in default at the time. They had gone through the European war and had continued to pay the interest on their bonds when even the Federal Government of Brazil had suspended payment. I should say that generally it had very good credit.

Mr. PECORA. Did you know, for instance, what its then indebtedness was that was outstanding?

Mr. HAYWARD. Yes, sir.

Mr. PECORA. Did you know what its revenues were annually?

Mr. HAYWARD. All of that information was supplied to us by the city.

Mr. PECORA. Did you have it at that time?

Mr. HAYWARD. Yes, sir.

Mr. PECORA. Did you also have information as to the expenditures of the municipality?

Mr. HAYWARD. I presume so.

Mr. PECORA. Did they show consistently a history of the revenues exceeding the expenditures?

Mr. HAYWARD. No; probably not.

Mr. PECORA. Did you have any specific data, consisting of statistical information, that was given to you or which was gathered by you while you were down in the city of Rio de Janeiro?

Mr. HAYWARD. Yes.

Mr. PECORA. And is that in your files today?

Mr. HAYWARD. We gave that to your assistants.

Mr. PECORA. Did you give us all the material that you had on that?

Mr. HAYWARD. I think I showed your assistants all that we had.

Mr. PECORA. I think you did, too.

Mr. HAYWARD. A lot of it was in the form of books and papers in Portuguese.

Mr. PECORA. Will you consult your own files on that and see what you find therein concerning the possession by you at that time of this kind of information we have been alluding to, and see what your own files show on that?

Mr. HAYWARD. Mr. Pecora, I could not have brought all the library that we have. What we have here are simply copies of what Mr. Ross took. That shows, I think, among other things, an official memorandum from the city covering the years 1918, 1919, and 1920.

Senator COUZENS. Have you any information there as to the relation of the municipality's debt to its assessed valuation?

Mr. HAYWARD. Well, they don't figure those things as we do, Senator Couzens, in foreign countries. I don't think that would have any value.

Senator COUZENS. Do you mean that the size of the debt as it may have related to the assessed valuation of a community would be of no interest?

Mr. HAYWARD. Oh, no. I mean that they do not figure it exactly on the same basis as we do in this country. They have some taxes that are different. Their tax systems vary, so that I could not give you any figure that you could compare with, for instance, Detroit or any other American city.

Senator COUZENS. Have you any information as to the total debt of the municipality?

Mr. HAYWARD. Surely.

Senator COUZENS. What was its total debt?

Mr. HAYWARD. That was set out on the circular.

Mr. PECORA. The total debt on December 31, 1921, was $49,423,300, of which $24,332,700 was external.

Mr. HAYWARD. That is right. And that was a city as of that time of 1,200,000 people.

Mr. PECORA. Who prepared the circular that accompanied the offer of these bonds by your firm and associates to the public?

Mr. HAYWARD. What individual?

Mr. PECORA. Yes.

Mr. HAYWARD. I am afraid I could not tell you that. That was 12½ years ago and I don't remember.

Mr. PECORA. Did you have anything to do with the preparation of it?

Mr. HAYWARD. I do not write circulars myself.

Mr. PECORA. Did you supply the information from which this circular was prepared?

Mr. HAYWARD. No; the Government supplied it. I collected some and brought it back with me, and it was obtained from governmental sources.

Mr. PECORA. Was the contract actually let for the Castle Hill improvement by the municipality to Kennedy & Co. after this loan was made?

Mr. HAYWARD. Yes.

Mr. PECORA. And under the terms of the contract when was the improvement to be completed?

Mr. HAYWARD. That I could not tell you. I do not know that I ever saw the contract.

Mr. PECORA. Did you ever have any information as to what the contract provisions were for the completion of the Castle Hill improvement?

Mr. HAYWARD. Well, the date?

Mr. PECORA. Yes.

Mr. HAYWARD. No; I don't believe any date was specified.

Mr. PECORA. The loan agreement that has been put in evidence here, among other things, provides, as you probably know, that the land to be reclaimed by the municipality by means of the leveling of Castle Hill and its collateral work was to be sold by the municipality to anyone that wished to buy, and that the proceeds from the

sale of those lots was to be set aside in trust for the retirement of these bonds.

Mr. HAYWARD. That is correct.

Mr. PECORA. That is correct, isn't it?

Mr. HAYWARD. Yes, sir.

Mr. PECORA. Was it of no consequence to you in determining the soundness of this loan and the soundness of the bonds as an investment for the American public, to know about when the public improvement to be constructed out of the proceeds of this loan was to be completed, so that you might also know what funds would be available or might be available for the redemption of the bonds?

Mr. HAYWARD. Well, we knew that whenever the hill was completed we could expect or hope then that the sales of lots would be begun. But I mean as to any specific date when it was all to be done, I have never heard that any date was ever set. As I testified this morning, it was actually the middle of 1929 before they were ready to dispose of lots.

Mr. PECORA. By the way, Mr. Hayward, from your own recollection as well as any records of your office, can you tell this subcommittee whether or not Dillon, Read & Co., or any of its agents or representatives, sought to keep currently posted as to the progress of this public improvement that was to be paid for out of the proceeds of this loan?

Mr. HAYWARD. Yes; decidedly so.

Mr. PECORA. What efforts did you make, and what results did you get?

Mr. HAYWARD. This loan was discussed in the summer of 1921, as I testified this morning. The bonds were issued in October. I went back to Brazil within a few months after that offering date; and I was there during the time when the contractors were beginning their preliminary preparations to start the job. That was the beginning of 1922. I was in Rio again in the middle of 1922. I went down to Rio in 1923. I was there again in 1924. And I was there in 1927. Now, on each of those occasions I observed the work of Mr. Kennedy's organization. I naturally was very much interested in the work. It was a picturesque and interesting job. I spent a great deal of time going over the thing physically and seeing how the work was progressing. I discussed it with the municipal officials, and occasionally was able to help in smoothing over minor difficulties. In fact, there was nothing going on in Brazil that interested me personally more than to see how this hill was coming down. So that I have always maintained the closest contact. And during my absence our representatives maintained the closest contact with the contractors on that work.

Mr. PECORA. Originally, when you undertook the negotiations for this loan in Rio, in 1921, it was expected by you that these improvements, particularly the Castle Hill improvement, would be completed in about 5 years, wasn't it?

Mr. HAYWARD. I should say yes; about that.

Mr. PECORA. After 5 years had elapsed, in fact before 5 years had elapsed, you had opportunities by reason of your visits to the city of Rio de Janeiro on the various occasions that you have just told

us about, to observe the course of the progress of the improvements down there, didn't you?

Mr. HAYWARD. Yes.

Mr. PECORA. Well, you were surprised to see that the progress was not nearly so rapid as was expected in 1921, weren't you?

Mr. HAYWARD. Well, no; I cannot say that I was, Mr. Pecora. You have got to realize that you are in a semitropical climate. The conditions are difficult, and things do not move as rapidly as they do here in our country.

Mr. PECORA. How much of the proceeds of this loan actually was put into public improvements by the municipality?

Mr. HAYWARD. I could not tell you that exactly.

Mr. PECORA. Did you ever know?

Mr. HAYWARD. No.

Mr. PECORA. Wasn't that something that you considered it your duty to inform yourself about?

Mr. HAYWARD. Oh, we were dealing with the Goverment here, Mr. Pecora.

Mr. PECORA. You were also dealing with the investment public here in America to which you sold these bonds.

Mr. HAYWARD. That is quite true.

Mr. PECORA. Dealing with an investment public which was relying upon your standing, prestige, and judgment.

Mr. HAYWARD. That is quite correct, but as to how they spent each dollar of the loan, or how any government spends each dollar of any loan, I wasn't in a position to determine.

Mr. PECORA. Did you ever know how much of the moneys were actually put into public improvements?

Mr. HAYWARD. No, sir.

Mr. PECORA. Did you ever take the trouble to find out?

Mr. HAYWARD. In a general way, yes.

Mr. PECORA. And what did you find out even in a general way?

Mr. HAYWARD. My impression was that they were chiefly employed in public works.

Mr. PECORA. How much of this $12,000,000 went into public works?

Mr. HAYWARD. Well, if you take out the banker's discount, the permanent deposit fund that was left with us, and the provision for sums to purchase bonds, so far as I know in a general way the balance was expended for municipal improvements. But I could not testify to that from my own knowledge, because I never have examined the books of the city of Rio.

Mr. PECORA. Well, without examining the books can you testify to that from any information you made it your business to obtain from the municipality or from any other source, about that?

Mr. HAYWARD. Merely by deduction.

Mr. PECORA. Does that mean that you made no inquiries?

Mr. HAYWARD. I made no request for an accounting, if that is what you mean.

Mr. PECORA. Does that mean that you made no inquiries?

Mr. HAYWARD. Not necessarily.

Mr. PECORA. I said nothing about an accounting.

Mr. HAYWARD. Oh, I made inquiries. I discussed the question with the mayor in office at the time and his successors.

Mr. PECORA. As a result of your inquiries how much did you learn had actually been put out of the proceeds of this loan into public improvements by the municipality?

Mr. HAYWARD. I have knowledge of their having expended on other than public improvements nothing save the points just mentioned.

The CHAIRMAN. Did they pay Kennedy & Co.?

Mr. HAYWARD. I assume so.

The CHAIRMAN. You do not know how much?

Mr. HAYWARD. No.

Mr. PECORA. Now, in the circular that was issued when these bonds were offered to the public here in 1921, I find the following statement, referring to the Castle Hill improvement:

> The removal of this hill, which is already under way, will make available approximately 4,840,000 square feet of land. All of this land, other than that required for governmental purposes, will be offered for sale by the city, and all the proceeds from said sale, up to an amount sufficient to retire by purchase or call this entire issue, will be deposited in trust for that purpose.

Do you find that statement in your copy of the circular?

Mr. HAYWARD. That is correct.

Mr. PECORA. Now, what, if anything, did you or anyone connected with your organization do after this loan was floated to inform yourselves as to whether or not the municipality was doing the things that this circular, or that portion thereof which I have just read to you, said it was going to do?

Mr. HAYWARD. Well, we have watched ourselves and through our local representatives the progress of the attempts made to sell this land. As I explained this morning, the public offering of these lots began early in 1930. They had during the year a series of auction sales, which were advertised in the press, and they tried, naturally, to create as much interest as possible so as to get a good price. They were not very successful because of the drop in values in Rio at that time. They did, however, dispose of a number of lots, and they have reported to us the manner in which those sales lots were sold and the proceeds received. A good many of those are on a partial-payment basis, and the money is not all in yet. During the year——

Mr. PECORA (interposing). Do you know whether those moneys have been set aside in trust for the purpose of the purchase or retirement of these bonds?

Mr. HAYWARD. We are advised by the city that that money is in a bank at Rio.

Mr. PECORA. When did you get those advices?

Mr. HAYWARD. Last week.

Mr. PECORA. When did you first begin to make inquiries about that?

Mr. HAYWARD. We have made inquiries constantly. We showed your representatives a report on the sales covering the year 1930.

Mr. PECORA. Which you received when, in 1930?

Mr. HAYWARD. Early in 1931. In 1931 and in 1932 there were no sales. In 1933, I am recently informed, there have been two sales only. My feeling about this land, Mr. Pecora, is this: It is an extremely valuable asset. There is no question about that. Now,

under the circumstances of the depression in Brazil, as everywhere else, with the drop in real estate values, certainly the city is using the better part of judgment in not sacrificing that land. They have a funded debt which was, of course, larger than this loan, and certainly they are entitled to sell the land at the best available prices at the best times. I do not feel that we have any right to insist that they throw it away. It would not be in the interest of the bondholders. The bondholders have purchased a 25-year bond, and they have a long time yet to run. I have complete confidence that sooner or later these $8,000,000 of bonds will be paid off in this way, but they cannot do it immediately. You have got also to appreciate that once they sold the lots they get local currency. Now, the local currency has got to be converted into dollars, and with milreis selling at a low point they would sacrifice a great part of the price received for the lots in buying dollars to remit to us.

Senator COUZENS. How much have you got deposited over there now on this contract?

Mr. HAYWARD. They have in Brazil approximately a quarter of a million dollars, representing the amount already paid in on those lots. That is in Brazilian currency. Under the exchange situation at the moment they will only be able to remit that to us under a special arrangement with the Brazilian Government, and I am hopeful that they will eventually arrange to transfer that to New York.

Mr. PECORA. Have these funds been set up in trust for the purchase or redemption of these bonds?

Mr. HAYWARD. We are advised they are in the special account for that purpose. Now you will appreciate that under Latin American law their trust provisions are not exactly the same as ours are, so I cannot say just what form that deposit takes, but it is a special deposit, we are informed.

The CHAIRMAN. You sold the bonds to the public for 97¾ and they are now worth 16?

Mr. HAYWARD. That is right, sir. That is what they are selling at. I should say they are worth a great deal more intrinsically.

The CHAIRMAN. That is the market price?

Mr. HAYWARD. That is the market price; yes.

Mr. PECORA. Now your circular further states as follows:

> The receipts from the vehicles tax, the sanitary tax, and the Imposto de Laudemios (a realty tax), and the equity in the licenses tax, cattle tax, and property transmission tax will be allocated to the service of this loan.

The municipality obligated itself in the loan agreement to your firm to do these things, didn't it?

Mr. HAYWARD. That is correct.

Mr. PECORA. Has it lived up to those obligations?

Mr. HAYWARD. So far as I know.

Mr. PECORA. Have you taken steps to inform yourself as to whether or not the municipality has currently, since the making of this loan, lived up to these obligations?

Mr. HAYWARD. Mr. Pecora, for 10 years after these bonds were issued the municipality paid the service on the loans. Therefore the question of allocation of revenues did not come up.

Mr. PECORA. Wasn't the question of allocation of revenues always present, in view of the obligation in the loan contract that the municipality make this allocation of these loans?

Mr. HAYWARD. If you distinguish "allocation" from "segregation", I should say yes. There was never any requirement that they be put in a special place for the service of these bonds during the time they were paying the interest. But they always have been earmarked for the service.

Mr. PECORA. What did you mean when you informed the investing public here in this circular offering the bonds to them that these receipts from these various taxes will be "allocated to the service of this loan"? What did you intend to convey to the investing public here by that statement?

Mr. HAYWARD. The Government intended to convey that it would allocate these revenues to the specific service of this particular loan.

Mr. PECORA. Well, do you consider it a part of your duty as the underwriter or banker which underwrote the issue and then sold it to the American public to find out and to keep currently informed as to the fulfillment by the municipality of its obligations under this loan?

Mr. HAYWARD. Yes, indeed. We have done everything we can to that end.

Mr. PECORA. What efforts did you make if any to ascertain since 1921 and up to the time of the default on these bonds whether or not these revenues were being allocated for the service of these bonds?

Mr. HAYWARD. Well, the contract provides they are allocated, so they must have been.

Mr. PECORA. You say "they must have been." You are merely assuming now that the other party to the contract lived up to all its obligations, are you not?

Mr. HAYWARD. I have no reason to think they did not.

Mr. PECORA. Did you consider it any part of your duty to see to it currently that the other party to the contract, in this case the municipality, lived up to all of its obligations?

Mr. HAYWARD. Why, whether we had a duty or not, we have done it.

Mr. PECORA. Do you know up to the present minute whether or not the revenues from these special taxes enumerated in your circular have been allocated to the service of these bonds?

Mr. HAYWARD. It is perfectly evident that certainly some of them have been, because in later years the city issued other loans secured by other revenues and having in some cases a subordinate charge on the same revenues, and in each case they recognized the prior position of these bonds.

Mr. PECORA. Well, they may have recognized the existence of the obligation by so doing, but what I am seeking to find out from you is what efforts if any you or your firm made currently to ascertain whether or not the municipality was living up to its current obligations under the loan agreement?

Mr. HAYWARD. Yes; we made every effort.

Mr. PECORA. And what did you learn concerning the allocation of these taxes to the retirement or service of these bonds? What specifically have you learned about that, Mr. Hayward?

Mr. HAYWARD. The situation is just this, Mr. Pecora: Until 1931 they paid the interest and paid the sinking fund. At that time they went into default. Shortly thereafter the mayor started making

monthly deposits in the bank in Brazil of funds which would be applicable toward the service of this loan. Those deposits went on for some months, and then they ceased. We made representations to find out why they had stopped. The reasons given by the city were this, that——

Mr. PECORA (interposing). Mr. Hayward, this is all interesting, but I first want to get an answer to my question. You are talking about what was learned, apparently, after the default occurred in 1931.

Mr. HAYWARD. Yes.

Mr. PECORA. My question calls for a statement from you as to what efforts, if any, you or your firm made from the time of the making of the loan in October 1921, up to the present time to see to it that the municipality currently lived up to all of its obligations under the loan agreement, especially with regard to the allocation of these revenues to the service of these bonds.

Mr. HAYWARD. Well, we were continually in touch with the situation. Now they were not required to segregate those revenues.

Mr. PECORA. Oh, they were. I beg your pardon. Look at your loan contract, page 4. I haven't got the page in mind now probably, but in that loan contract you will find certain provisions to the effect that the receipts from certain taxes would be allocated in the service of this loan. You know that those provisions are in the contract, don't you?

Mr. HAYWARD. I would like to read that section if I may. This is on page 4, section 4, of the main contract:

Without intending to limit or lessen the obligations assumed by the obligor under the bonds or elsewhere under this contract, the obligor covenants and agrees that its obligations hereunder and under the bonds shall at all times be and constitute a special and first charge on the revenues received by the obligor from the vehicles tax—

I will leave out the Portuguese words—

the sanitary tax, and the Imposto de Laudemios, as now existing or as in the future the same may exist, levied by the obligor or with its authority, and convenants and agrees that all the proceeds of said vehicles tax, sanitary tax, and Imposto de Laudemios, and all taxes and exactions levied in substitution for said taxes or any of them or amendment thereof, shall, so long as the obligor shall not have fulfilled all his obligations then due hereunder and under the bonds, be specifically set apart——

Mr. PECORA. "Specially set apart."

Mr. HAYWARD (continuing):

Specially set apart, and used for the fulfillment of the obligations of the obligor hereunder and under the bonds (pro rata and without discrimination as to any of the bonds issued hereunder), and shall not be used for or devoted to any other purpose.

I think that is enough.

Mr. PECORA. Suppose you continue.

Mr. HAYWARD. All right.

The obligor further covenants and agrees that in like manner the obligations hereunder and under the bonds issued hereunder shall be especially a charge on the license tax, cattle tax, and property transmission tax, as now existing or as in the future the same may exist, levied by the obligor or with its authority (though subject and subsidiary to all the charges now existing), and that the proceeds thereof shall in like manner be specially set apart and used for the

fulfillment of the obligations of the obligor then due hereunder and under the bonds (pro rata and without discrimination as to any of the bonds issued hereunder), and shall not be devoted or used for any other purposes.

Mr. PECORA. Yes.

Mr. HAYWARD. As I understand it, Mr. Pecora, the requirement for segregation only comes into effect when the obligor is failing to meet his obligations.

Mr. PECORA. That is after default?

Mr. HAYWARD. That is right.

Mr. PECORA. Have you seen to it that the obligor, in this case the municipality, has set apart these revenues for the purposes of this loan?

Mr. HAYWARD. That is what I was starting to answer before.

Mr. PECORA. Well, go ahead.

Mr. HAYWARD. After default the municipality began a monthly deposit of an equivalent amount of funds in a local bank, the reason being that they could not obtain exchange to convert it into dollars to meet their obligations.

After a certain number of months those deposits stopped. When we found that they had stopped we took the question up and insisted that they should continue. We discussed the matter with the other bankers who had issued such large loans for the city of Rio and who were in the same position relatively that we were. We made joint representations to the city. We were advised by the mayor that he was working out a plan which he wished to submit to the bankers calling for some temporary suspension of debt service with an ultimate resumption.

After some months had passed the mayor advised us that he was sending a representative to New York to discuss that question with the bankers. That representative eventually arrived, and we all had a number of discussions in general regarding the financial difficulties of the city and as to what kind of a plan could be worked out, and the representative then had to leave for the London Economic Conference. He has just recently arrived back in Brazil.

I may say this, that I understand at the present time the Brazilian Government has in mind and is actually working on a plan calling for the partial, at least, resumption of payments of debt service on all state and municipal loans some time next year. That plan has not yet sufficiently developed so that it can be publicly announced in detail.

Now, the net result of all this is that technically today the municipality is obviously not making these deposits, but it is working on a scheme which will I think provide for at least partial resumption of service in the near future. When you realize that we are dealing with a sovereign government, which we cannot coerce, our greatest service to the bondholders is, it seems to me, first of all to know the situation to the bottom, to keep a friendly contact with these officials—they are honest people; they want to meet their obligations—and if possible to find out helpful means whereby they can be returned to a position of solvency. In my mind that is much more valuable in the interest of bondholders than the sending of an occasional cable or letter of protest.

Mr. PECORA. You just said that when you deal with a sovereign power you cannot coerce them or force them into fulfillment of obligation, the obligations they assume when they obtain a loan. Did you take that into account in determining in the first instance whether bonds issued by a foreign sovereignty are a good and sound investment for the investing public here?

Mr. HAYWARD. Yes; I think that is an important element. There are unfortunately——

Mr. PECORA (interposing). Well, you know that a foreign sovereignty cannot be coerced into a fulfillment of its obligations?

Mr. HAYWARD. You have to depend entirely on their good faith and credit.

Mr. PECORA. That does not make the investment a sounder one because of that circumstance, does it?

Mr. HAYWARD. Oh, obviously not.

Mr. PECORA. It rather militates against the security and soundness?

Mr. HAYWARD. It certainly might.

Mr. PECORA. So the most careful circumspection should have been used by the American bankers in financing these foreign loans and selling the bonds here? Don't you think so?

Mr. HAYWARD. Oh, yes; certainly. There are, of course, today unfortunately governments in the world who are not fortunate enough to preserve this good faith and credit, and therefore could borrow nothing. I myself made a long trip through Russia and Siberia and China 3 years just studying the situation. There is a corner of the world which contains upwards of a third of the world's population, all good people in their way.

Mr. PECORA. One third of the world's population?

Mr. HAYWARD. Yes.

Mr. PECORA. In Russia?

Mr. HAYWARD. No; Russia, China, Siberia, all that section. Unfortunately, they have no credit of their own today which would enable them to float bond issues. If they obtain credit, it has to be governmental credit; and I understand both of those Governments have recently received advances from our Government. That is very helpful. It is not a basis, however, on which banking houses could issue securities.

Mr. PECORA. Now, you told us that from the sales of lots made available through this Castle Hill improvement during the year 1930 and the year 1931 the sum of approximately two hundred and thirty odd thousand dollars was realized. The terms of the loan contract provide that the proceeds of such sales of lots should be put in an account for the payment, and redemption, of these bonds. Is that right?

Mr. HAYWARD. That is right.

Mr. PECORA. Has that condition been fulfilled?

Mr. HAYWARD. To the best of my knowledge.

Mr. PECORA. With respect to that two hundred and thirty odd thousand dollars?

Mr. HAYWARD. To the best of my knowledge. In other words——

Mr. PECORA (interposing). As a matter of fact, Mr. Hayward, haven't the proceeds from the sale of these lots today, amounting to an aggregate of around $230,000, taken the form of municipal bonds and not of cash?

Mr. HAYWARD. No; this is cash I am speaking of.

Mr. PECORA. Are you sure of that, Mr. Hayward?

Mr. HAYWARD. Well, I am just giving you the information received from the city.

Mr. PECORA. Received when?

Mr. HAYWARD. Last week, as I told you.

Mr. PECORA. We have not received that.

Mr. HAYWARD. Mr. Ross saw a report as of 1931 which showed at that time a substantial amount of city municipal bonds and a very small amount of cash. I think it was three or four thousand dollars at that time.

Mr. PECORA. $300, wasn't it?

Mr. HAYWARD. $300, was it?

Mr. PECORA. $300.

Mr. HAYWARD. Cash. Since that time they have made some conversions into cash, and the city now shows that they have deposited in the bank 3,000,000 milreis.

Mr. PECORA. Which is equivalent to how much in America?

Mr. HAYWARD. That is about $240,000. That will be in due course, I anticipate, sent up to us.

Mr. PECORA. When you said in your circular that the revenues will be allocated to the service of this loan—and I am using the precise words employed in the circular—what did you mean by the term "allocated?"

Mr. HAYWARD. It means allocated, and to put it in a different way, I should think it is a marshaling of debts.

Mr. PECORA. A marshaling, a setting aside or setting apart of these funds?

Mr. HAYWARD. No; it is just simply a mark of identification in case of future difficulties.

Senator COUZENS. Is there any obligation on the city not to repeal those taxes in any manner?

Mr. HAYWARD. If they repeal them, Senator, they have to substitute something else of equal value.

Senator COUZENS. I read something about that.

Mr. HAYWARD. Perhaps I was too quick. That is a frequent provision.

Senator COUZENS. So, in effect, the city could have repealed those taxes any time and you would not have had any money that you could allocate?

Mr. HAYWARD (after conferring). Any substituted tax would likewise be allocated.

Senator COUZENS. No obligation though to substitute any tax, as I read it.

Mr. HAYWARD. Well, it certainly implies that. We would have to see to it that they did.

Senator COUZENS. You would have a fine time compelling a municipality to apply a tax.

Mr. PECORA. They might move across the river. [Laughter.]

Now you spoke before of the application of about $1,500,000 out of the proceeds of this loan for the construction of municipal slaughterhouses. Was that ever done?

Mr. HAYWARD. After the loan had been arranged the mayor found that he could make a more advantageous arrangement for the city by making a contract with other people for the improvement and development of the slaughterhouse, and he suggested that he would prefer to do that and to add the amount of the slaughterhouse money to Castle Hill money, and that eventually was done.

Mr. PECORA. Did you agree to that departure from the specific terms of the loan contract?

Mr. HAYWARD. We were not called upon to agree, but we were advised of the fact. We submitted it to our counsel. We received an opinion from Mr. Joseph P. Cotton that we had no right to object to that, and it was done. The result so far as the bondholder is concerned certainly is an advantage, because, for whatever it may be worth, he has pledged for his loan the receipts from the slaughterhouse, and the mountain was just so much more demolished.

Senator COUZENS. So this million and a half went to Kennedy & Co. instead of going to the slaughterhouse?

Mr. HAYWARD. No, Senator; it was added to the Castle Hill fund.

Senator COUZENS. I thought they were the ones engaged in moving the hill.

Mr. HAYWARD. Well, Senator, the work that Kennedy & Co. did was only part of the general program. How much was covered I don't exactly know, but a large amount of money was spent, for instance, in ex-appropriating the land. The city had to buy it before they could move the people out and tear the mountain down.

Mr. PECORA. You also told us that another sum of a million dollars and a half approximately was to be used from the proceeds of this loan, toward the redemption or retiring of existing indebtedness of the municipality to that amount.

Mr. HAYWARD. The supplemental contract provides for the leaving of a million and a half dollars on deposit with us to be used in purchasing bonds of the city which the mayor might designate.

Mr. PECORA. Was that million and a half used for such a purpose?

Mr. HAYWARD. No; it was not. Only a small part of it.

Mr. PECORA. What was done with that money, that million and a half that was left in your hands as a deposit out of the proceeds of this loan?

Mr. HAYWARD. The mayor finally instructed us to keep a million dollars instead of a million and a half. He thereupon designated as the bonds he wished us to purchase the series of the 1919 Imbrie loan, which matured in 1922. That would be $1,000,000. We attempted to buy all that we could of that issue. We found, however, that by reason of the fact that it was then a short-time obligation having only a few months to run, that it was held in large blocks by a few individuals who did not wish to sell. We were finally able to buy only, I think, $20,000 par value of those bonds.

The mayor thereupon, and shortly before this maturity, instructed us to turn over those bonds and the balance of the million dollars to the Equitable Trust Co., who were the trustee under the Imbrie loan. That was done, and I understand that that money was used to pay that maturity when it came due.

Mr. PECORA. Was there anything said in the circular that accompanied the offering of these bonds to the investing public to the effect

that any part of the proceeds of this loan was to be used for the retirement, payment, or redemption of existing bonds of the city?

Mr. HAYWARD. No, Mr. Pecora, it is not mentioned.

Mr. PECORA. Is there any reason why no mention was made of that in the circular?

Mr. HAYWARD. Yes.

Mr. PECORA. What was the reason?

Mr. HAYWARD. You will notice that this provision was in the supplemental indenture, which contains the purely administrative part of the agreement. When I discussed this loan with the mayor in Rio we first of all went into the subject of municipal improvements. That was his chief purpose and his greatest interest. During the course of our discussions he developed the thought that he might like to keep back part of the proceeds in New York and use it to reduce the debt of the city. He thought he might be able to pick up bonds at advantageous prices. I did not like that particularly. We were interested in a loan for municipal improvements and not a refunding operation. However, he want to use part of the money for that purpose, and there was no reason why we should object.

Mr. PECORA. Well, if you did not like to have the proceeds of the loan itself used for the retirement of other indebtedness, why shouldn't you have objected?

Mr. HAYWARD. We might have objected, but he was making the loan and he wanted to use part of it to retire his debt. That certainly would be an advantage to the holders of these bonds, because it would reduce the debt of the city, and it was the mayor's desire to do so. He was making the loan.

Mr. PECORA. But when you subscribed to this loan or underwrote it, it was with the knowledge on your part or the belief on your part that a million and a half proceeds of the loan were to be used for the redemption of this other indebtedness?

Mr. HAYWARD. We did not care one way or the other. The less he used for that purpose the better satisfied I was. Now for that reason——

Mr. PECORA (interposing). But at the time you underwrote this loan it was your knowledge and belief that a million and a half proceeds were to be used for the retirement of this other indebtedness?

Mr. HAYWARD. He expressed in the supplemental agreement a general intention to do that, but it all hinged on his designating bonds to be purchased.

Mr. PECORA. When did you learn or when were you told that approximately a million and a half was to be used for the redemption of existing indebtedness? You first were told that in either the option of September 3, 1921, or the cable of October 4, 1921, weren't you?

Mr. HAYWARD. Yes; in that he expressed his general purpose as to how he was going to use it.

Mr. PECORA. Exactly. And you knew then that a million and a half was to be used for the retirement of existing indebtedness?

Mr. HAYWARD. If he elected so to do, and he designated bonds and we were able to purchase them.

Mr. PECORA. Yes. That being your knowledge, on October 4, 1921, why didn't you impart that to the investing public here in your circular?

Mr. HAYWARD. It did not seem to be a material part of the business. The loan was chiefly for municipal improvements.

Mr. PECORA. Where the loan is to be used for improvements, that is a circumstance that might make the bonds a more desirable investment than if they were to be used as a refunding or liquidation of existing indebtedness, isn't that true?

Mr. HAYWARD. It would depend on the way the man looked at it.

Mr. PECORA. Generally speaking, isn't that so?

Mr. HAYWARD. I think a refunding operation is quite a laudable one.

Mr. PECORA. The credit position of one who borrows from A in order to pay off an existing indebtedness to B is not improved by borrowing from A.

Mr. HAYWARD. He might get better terms than he had from his first creditor.

Mr. PECORA. His asset position is not improved, is it?

Mr. HAYWARD. Not necessarily; no.

Senator COUZENS. I do not understand about this $1,500,000. I do not understand what became of it all. I understand you bought $20,000?

Mr. HAYWARD. That is right. We had eventually $1,000,000 left with us.

Senator COUZENS. What became of the half million out of the $1,500,000?

Mr. HAYWARD. That was drawn down by the city, and went to Brazil.

Senator COUZENS. What became of the half million he drew down?

Mr. HAYWARD. It went into the city's general funds.

Senator COUZENS. You do not know how it was spent.

Mr. HAYWARD. I could not say.

Senator COUZENS. So that, after having made this loan, you did not follow it to find out how the money was spent.

Mr. HAYWARD. Not every dollar. You cannot do that with a city.

Senator COUZENS. The $1,500,000 was for refunding purposes, apparently, and he drew down half a million dollars for some purpose you knew nothing about?

Mr. HAYWARD. He elected to leave $1,500,000 to be used in buying bonds which he would designate.

Senator COUZENS. But he changed his mind and withdrew $500,000, and did not designate any bonds.

Mr. HAYWARD. I am reading from the circular [reading]:

> The proceeds of this loan are to be chiefly employed for permanent and revenue-producing municipal improvements.

Mr. PECORA. But there was no information given to the investing public here in your circular that any part of the proceeds of this loan was to be used for the retirement or refunding of any existing indebtedness.

Mr. HAYWARD. It was never considered to be a part of the security for the loan.

Mr. PECORA. Is that the reason it was not mentioned in your circular to the public?

Mr. HAYWARD. I do not recall, 12½ years ago, what the reason was.

Mr. PECORA. Don't you purport to give to the public in general all the information you have concerning the uses to which the proceeds of a loan are to be applied, when you sell to the public the bonds that are the evidence of the indebtedness?

Mr. HAYWARD. I should say that that has been the general practice heretofore. Under the new securities bill it is provided that certain things should be stated in regard to the proceeds but a Government circular can be little more than a picture of the situation.

Mr. PECORA. Your circular is not a Government circular.

Mr. HAYWARD. It is a governmental body. This is an obligation of the Federal District of Brazil, which is the capital, and the mayor of the city is appointed by the President of Brazil.

Mr. PECORA. Mr. Hayward, you seem to draw a distinction of some kind based upon the fact that these bonds are bonds issued by a foreign municipality and not bonds issued by Dillon, Read & Co., and that the obligation is that of a foreign municipality. As a matter of fact, it was not the municipality which sold these bonds to the American public. It was your house and those associated with it in the underwriting; isn't that true?

Mr. HAYWARD. The investment banker is an intermediary between the person who is seeking credit and the public which has money to lend.

Mr. PECORA. As a matter of fact, the investment bankers in this case were the purchasers directly of these bonds from the municipality, were they not?

Mr. HAYWARD. Yes. We purchased them.

Mr. PECORA. Dillon, Read & Co. and whatever other banking houses were associated with it in this underwriting directly bought these bonds from the municipality, did they not?

Mr. HAYWARD. That is correct; yes.

Mr. PECORA. And, in turn, sold them to the investing public here?

Mr. HAYWARD. That is correct.

Mr. PECORA. So that the sale to the investing public here was not a sale by the municipality of its bonds but a sale by Dillon, Read & Co. and its associates of the municipality's bonds, which had been purchased by the bankers and were the property of the bankers; isn't that so?

Mr. HAYWARD. That is perfectly correct.

Mr. PECORA. So that it was the duty of the bankers, when they attempted to sell these bonds to the investing public, to inform the public generally and comprehensively concerning the bonds, the security back of them, and so forth?

Mr. HAYWARD. Certainly; and we have always attempted to do that.

Mr. PECORA. Let us assume that the purpose of this entire issue had been to refund existing indebtedness, and you had so stated to the public in a prospectus in which the bonds were offered for sale to the public. Do you think the public would have subscribed for those bonds as freely and readily as it would if the bonds were stated to be used, or if the proceeds of the loan represented by the bonds were stated to be used for public improvement and revenue-producing or self-liquidating purposes?

Mr. HAYWARD. Oh, yes, sir.

Mr. PECORA. You do?

Mr. HAYWARD. We have sold millions of dollars of foreign government bonds which were specifically for the purpose of refunding.

Senator COUZENS. Who were your associates in the marketing of these securities?

Mr. HAYWARD. Of course there was the usual large list all over the country.

Mr. PECORA. The originating group?

Mr. HAYWARD. The originating group who appeared on the circular were ourselves, Lee Higginson & Co., and the Continental Commercial Trust & Savings Bank of Chicago.

Senator COUZENS. Those others relied upon your investigation and your representations in their participation?

Mr. HAYWARD. That is the usual practice.

Mr. PECORA. Mr. Hayward, I show you what purports to be a photostatic reproduction of the prospectus or circular issued by Dillon, Read & Co., Lee Higginson & Co., and the Continental Commercial Trust & Savings Bank in connection with the offering of these $12,000,000 par value of the city of Rio de Janeiro bonds. Will you please look at it and tell us if that is a true and correct copy of such circular or prospectus so issued [handing a paper to the witness]?

Mr. HAYWARD. Yes; with the exception of the pencil marks, of course.

Mr. PECORA. I offer that circular in evidence.

The CHAIRMAN. Let it be received and entered in the record.

(The document referred to, prospectus of Dillion, Read & Co., et al., in re $12,000,000 Rio de Janeiro bonds, was received in evidence, marked "Committee's Exhibit No. 25", see p. 1937.)

Mr. PECORA. Mr. Hayward, on or about May 23 last a witness by the name of J. P. Morgan testified before this committee and, among other things, stated this as his opinion of the duties of bankers who underwrite issues and then sell them to the investing public:

> If he [meaning the banker] makes a public sale and puts his own name at the foot of the prospectus, he has a continuing obligation of the strongest kind to see, so far as he can, that nothing is done which will interfere with the full carrying out by the obligor of the contract with the holder of the security.

Do you subscribe to that principle or declaration of Mr. Morgan's?

Mr. HAYWARD. It sounds very sensible to me.

Mr. PECORA. You subscribe to it?

Mr. HAYWARD. I think that is quite correct. I think it is the principle we have always tried to follow.

Mr. PECORA. Was that principle followed in the instance of this particular $12,000,000 issue, with respect to what was done with the $1,500,000 which the contract provided should remain in the hands of the bankers?

Mr. HAYWARD. Yes; certainly.

Mr. PECORA. What was done in that connection?

Mr. HAYWARD. The money did not belong to us, Mr. Pecora. We had to follow the instructions of the mayor. That whole provision hinges on the mayor eventually designating certain of the munici-

pality's bonds to be purchased by us. If he did not designate such bonds we had no right to withhold the sum from him. He designated bonds that could not be purchased, except for $20,000 of them, and when that became evident, and he instructed us to pay the balance of the money to the trustee for his 1919 loan, I conceive that we had no choice whatever but to do that. It was not a part of the security for the loan.

Senator COUZENS. Do I understand that the mayor had the same right to use any of the other funds for any other purpose he chose?

Mr. HAYWARD. He generally stated that he was going to use the other funds chiefly for municipal improvements, and he went to the extent of saying, I believe, that——

Senator COUZENS. Yes; I remember that. But what I am trying to get at is this: Suppose the mayor changed his mind and wanted to use the $5,000,000 to increase salaries, and asked that it be drawn for that purpose. Would you be obligated to give it to him?

Mr. HAYWARD. I do not think we could have refused to draw down the money if he had instructed us to pay it.

Senator COUZENS. So, as a matter of fact, there is nothing binding in that circular about the purpose for which the money was to be used.

Mr. HAYWARD. Would you read that question again?

(The reporter read the pending question.)

Mr. HAYWARD. I see here, Senator, on page 3 of the agreement, section 7, it says:

> The obligor agrees that the bankers shall deposit $5,000,000 out of such proceeds with a bank in Rio de Janeiro to be mutually agreed upon by the bankers and the obligor, and such deposit shall be a trust fund to be disbursed only on requisition signed by the proper officers of the obligor and by a representative of Kennedy & Co. duly authorized for such purpose, and disbursed on order of the Perfecto (that is, the mayor).

It would seem to me that that was certainly a definite obligation, and he carried that out.

Senator COUZENS. But assuming the mayor changed his mind, and he could have got Kennedy & Co. to have joined with him. They could have used the money for any purpose.

Mr. HAYWARD. I should not think so, not with as definite language as that. That language differs entirely from the language in the supplemental agreement covering the $1,500,000.

Senator COUZENS. What language of the supplemental agreement?

Mr. PECORA. The language of the supplemental agreement is contained in section 5, page 2 of the supplemental agreement:

> The obligor agrees that the bankers shall retain $1,500,000 out of the payment to be made by them under article 3, section 2, of the main agreement, such amount to be used by them in the purchase of such foreign obligations of the obligor (other than bonds issued hereunder) as may be designted by the Perfecto of the obligor.

Mr. HAYWARD. That is very different from the other.

Mr. PECORA. Under the terms of section 5 of the supplemental loan agreement, $1,500,000 out of the proceeds from the sale of these bonds was to be retained by the bankers—in this case Dillon, Read & Co.—and that was to be used by the bankers in the purchase of other obligations of an external character, of the municipality.

Mr. HAYWARD. If the mayor designated them.

Mr. PECORA. It does not say "if the mayor designated them." It says, "as may be designated by the prefect"; that is, the kind of obligations to be retired or redeemed out of this fund of $1,500,000, was to be designated by the mayor. That is, as I read this contract.

Senator COUZENS. That is the way I understood it, and therefore you surrendered this money in violation of the agreement.

Mr. HAYWARD. No; not at all, Senator. There was no requirement on us to keep that money here except for the purpose of buying bonds which the mayor might designate. Suppose he had not designated any bonds.

Senator COUZENS. I do not admit that you had any right to surrender it, because that $1,500,000 would reduce the liabilities of the municipality, as you stated awhile ago, and therefore improve the credit on these bonds, so that if he elected to use this $1,500,000 for any other purpose than retiring the obligations of the municipality he was not doing what he agreed with you to do.

Mr. HAYWARD. He did actually reduce them by $1,000,000 that was paid to the trustee on these other bonds and they were redeemed?

Mr. PECORA. But you were to retain, as collateral, or as further security for the indebtedness represented by this loan, any bonds so purchased out of this fund of $1,500,000, were you not? Does not the contract so provide? Let me refer you specifically on that to section 6 of the main contract, page 5 thereof, which reads as follows:

> The obligor covenants and agrees that such bonds or other evidences of indebtedness issued by the obligor (but not including the bonds issued hereunder), as are purchased or acquired by the use of any part of the proceeds of this loan, shall be delivered to and deposited with the bankers, to be held by the bankers as security for the fulfillment by the obligor of its obligations hereunder, and under the bonds issued hereunder.

Mr. HAYWARD. Suppose, for the sake of argument, the mayor designated some London issue. As a matter of fact, that is what he had in mind, earlier sterling bonds of the city, which matured after our loan. There might have been some use, perhaps, in our holding those in the box until these bonds matured. But he did not do that. He designated an issue which matured in May 1922. We purchased only $20,000 of those notes. They matured in May 1922.

We would then have had, if we had presented them at the office of the Equitable Trust Co., $20,000. I see no authorization or right on our part to retain that $20,000 for 25 years. Certainly it would have done the bondholders no good to have $20,000 of matured obligations of the city of Rio de Janeiro as collateral security for this loan.

Mr. PECORA. Now, let us see. What did you understand to be the duty imposed upon the municipality by the provisions of section 6 of the main contract, the main loan agreement?

Mr. HAYWARD. That if bonds were purchased, they should be retained by us.

Senator COUZENS. Is the word "if" there?

Mr. HAYWARD. "As are purchased." That means "if."

Mr. PECORA. A fund of $1,500,000 out of the proceeds of this loan was set apart to be retained by the bankers, namely, Dillon, Read & Co. What was that fund of $1,500,000 to be used for, as you understood the contract?

Mr. HAYWARD. According to the supplemental agreement it was to be used to purchase such external obligations of the city as the mayor might designate.

Mr. PECORA. And if such moneys were used for that purpose, didn't you understand, under the provisions of the loan contract, both the main and the supplemental agreements, that you, or the bankers, were to retain as additional security those bonds so purchased?

Mr. HAYWARD. If he designated an issue which we were able to purchase, yes.

Mr. PECORA. And if he did not designate any issue to be purchased, and if no issue was purchased——

Mr. HAYWARD. Then the money would go back to him.

Mr. PECORA. Where do you find that?

Mr. HAYWARD. There is no provision for anything else. There is no right on our part to keep that money.

Mr. PECORA. When were you to return it?

Mr. HAYWARD. Whenever he asked us to. Suppose, Mr. Pecora, I went to you and said, "I would like to have you lend me $100 but you keep the $100. I don't want it. I will just pay you interest at 8 percent on that for 25 years, and at the end of the 25 years you transfer the money from one pocket to the other."

Mr. PECORA. I would think you were crazy for borrowing $100 from me in that fashion.

Mr. HAYWARD. Yes. I think you would apply for a commission to examine my sanity.

Mr. PECORA. I would not know why you would want to make such a loan.

Mr. HAYWARD. Here you have the same situation. Why would the mayor of Rio de Janeiro borrow $1,500,000 in New York for 25 years at 8 percent and leave the money on deposit with us until the maturity of the bonds?

Mr. PECORA. I am trying to find out the reason, in the first instance, for the inclusion of these provisions in the loan agreement.

Mr. HAYWARD. I thought I made that clear. He thought he could profit by buying some of the bonds of the city abroad or in this country, and thus reduce the city's debt, at some discount. We found, after working on the situation, that it was not possible.

Mr. PECORA. My impressions as to the reason for that are more or less reinforced by the testimony you have given, that at the very outset, before the execution on October 31, 1921, of the loan agreement, you were informed, and advised by the municipality that $1,500,000 out of the proceeds of this loan of $12,000,000 was to be used for the retirement of existing indebtedness.

Mr. HAYWARD. Provided——

Mr. PECORA. Apparently that was your understanding from the very beginning.

Mr. HAYWARD. Provided the mayor designated bonds and we were able to purchase them, which we were not.

Mr. PECORA. There is no such provision, either in the cable advices of October 4, 1921, to your firm, or in the loan agreements. If you can enlighten me on that I would be glad to have you do so.

Mr. HAYWARD. I do not see how it can mean anything else. It says issues which the mayor designates.

Senator COUZENS. Was there any time limit on it?

Mr. HAYWARD. None at all.

Mr. PECORA. Why did you return the $1,500,000, then, if there was no time limit for the use of that portion of the proceeds of this loan for the retirement of other indebtedness?

Mr. HAYWARD. Mr. Pecora, if we had had any thought at the time that this was a part of the security for the loan, we would have done two things. We would have put it in our circular, and we would have insisted ourselves on selecting what bonds should be purchased. We would not have left that to the choice of the mayor. This man was out of office in a year. We had no reason to think that they might not create another issue of bonds in the future in which we might not have much confidence, and we would have been obligated to spend $1,500,000 out of the proceeds of the loan for some bonds we did not believe in. That did not happen, but it might have happened.

Mr. PECORA. That very thing could have happened under the terms of the loan agreement.

Mr. HAYWARD. Yes.

Mr. PECORA. And you agreed to those terms.

Mr. HAYWARD. It was left in this way. He had the choice of designating bonds, and if we could buy them, those bonds would be bought.

Senator COUZENS. But he had no alternative of withdrawing the cash.

Mr. PECORA. There was no time limit for the exercise of the mayor's judgment with regard to the bonds that would be retired through the employment of this fund of $1,500,000.

Mr. HAYWARD. We went through the operation contemplated in the supplemental agreement, that is, an attempt to buy the bonds he designated, and we bought only $20,000 of them.

Mr. PECORA. And the balance of the money was used——

Mr. HAYWARD. To reduce the city's debt.

Mr. PECORA. It was turned over to the Equitable Trust Co.

Mr. HAYWARD. That is correct, and they paid off the maturity in May 1922. The city's debt was thereby reduced $1,000,000.

Mr. PECORA. If, instead of the moneys having been used for that purpose, the moneys had been used in the purchase of $1,000,000 of outstanding bonds other than those issued under this loan agreement, this agreement gave the bankers the right to retain those bonds as additional collateral or security for the payment of the bonds issued under this loan.

Mr. HAYWARD. I think that is what I said a moment ago. If, for instance, we had bought sterling bonds in London for the full amount, this agreement gave us the right to retain those bonds.

Mr. PECORA. When, instead of using the $1,000,000 or more to buy outstanding bonds, it was used to pay the Equitable Trust Co., which held other obligations of the municipality——

Mr. HAYWARD. No; they were just trustees of that loan.

Mr. PECORA. Trustees of another loan, a loan other than the one you made?

Mr. HAYWARD. The other loan was the Imbrie loan of 1919.

Mr. PECORA. Did you get the bonds or other evidences of indebtedness paid off by that $1,000,000 by the Equitable Trust Co.?

Mr. HAYWARD. No. They would have been valueless, just pieces of paper. They were canceled on the maturity date. It would have done our bondholders no good to hold $1,000,000 worth of matured obligations.

Mr. PECORA. Why would they have been worthless?

Mr. HAYWARD. They had matured. They have been paid off. You cannot reinforce one note of a debtor by taking a canceled note of that debtor.

Mr. PECORA. The Equitable Trust Co. was a trustee under the Imbrie loan, for the benefit of the holders of the bonds that had been issued under that loan, was it not?

Mr. HAYWARD. They were the paying agent.

Mr. PECORA. Trustee, or fiscal agent, or functioning in some such capacity?

Mr. HAYWARD. Yes.

Mr. PECORA. You turned over to them, upon the order of the prefect of the municipality, a sum of about $1,000,000 out of this fund of $1,500,000?

Mr. HAYWARD. Yes; $1,000,000 less this $20,000, or whatever those bonds cost us.

Mr. PECORA. That $1,000,000, less that $20,000, you had been authorized to retain out of the proceeds of your loan, to enable you to buy bonds, other outstanding bonds of the municipality; and you were also authorized to retain such other bonds as security for this loan, were you not?

Mr. HAYWARD. Now, Mr. Pecora. You have taken two hurdles there, and I am not over the first one. We were authorized to retain that money to buy bonds if the mayor designated an issue for us to purchase.

Mr. PECORA. And if you bought bonds, you were also authorized to retain those bonds.

Mr. HAYWARD. That is correct.

Mr. PECORA. Those are the provisions of the loan agreement.

Mr. HAYWARD. That is correct. We bought $20,000, and those bonds matured May 1, 1922. After that they were of no value to our bondholders.

Mr. PECORA. In addition to that, you turned over about $1,000,000 to the Equitable Trust.

Mr. HAYWARD. Yes.

Mr. PECORA. What did you get for this, if anything?

Mr. HAYWARD. We got a receipt, I presume.

Mr. PECORA. But this $1,000,000 was part of the fund of $1,500,000 that you were authorized to retain for the purchase of other outstanding obligations?

Mr. HAYWARD. If the mayor designated them.

Mr. PECORA. If the mayor designated them; and there was no period of time in the loan contract, was there, limiting the power of the mayor to designate such purchases?

Mr. HAYWARD. That transaction was completed when he designated that issue. He could have told us anytime to pay it back to him.

Senator COUZENS. What about the half million? You gave him that in cash?

Mr. HAYWARD. He drew that down with the rest of the proceeds of the issue.

Senator COUZENS. In cash? That did not go to liquidate any bonds?

Mr. HAYWARD. No.

Mr. PECORA. What did you consider were your rights as bankers under this provision, section 6 of the main contract?

The obligor covenants and agrees that such bonds or other evidences of indebtedness issued by the obligor (but not including the bonds issued hereunder), as are purchased or acquired by the use of any part of the proceeds of this loan, shall be delivered to and deposited with the bankers, to be held by the bankers as security for the fulfillment by the obligor of its obligations hereunder, and under the bonds issued hereunder.

Mr. HAYWARD. That gave us the right to retain the bonds we purchased.

Mr. PECORA. When you paid over this fund of $1,000,000, more or less, for the retirement of the Imbrie & Co. loan to that amount, did you receive anything other than a receipt for the money as security for the fulfillment by the municipality of its obligations under this loan agreement?

Mr. HAYWARD. Nothing other than the benefit the bondholders obtained by having the city's debt reduced by that amount.

Mr. PECORA. What were you supposed to get in the event that any part of that $1,500,000 was used to reduce outstanding indebtedness other than the indebtedness created by this loan?

Mr. HAYWARD. Nothing, as I see it.

The CHAIRMAN. The situation was that the mayor could designate to you what bonds he wanted you to purchase.

Mr. HAYWARD. That is right.

The CHAIRMAN. The mayor enters into an agreement to the effect that you are to hold as part of your security the bonds that you purchase. Now, if he had the right to require that you purchase bonds that had matured and when you purchased them they were paid, what good was the other provision that you were to hold them as security? That actually happened in the case of the Equitable Co. You might say that he told you to buy the bonds through the Equitable Co. and that that was carrying out that agreement. But that was paying off bonds. Consequently, you had no additional security anywhere. There is nothing there to protect these bonds.

Mr. HAYWARD. It was never considered as a part of the security, Senator. Otherwise it would have been made much more specific than it is.

Mr. PECORA. Apparently that clause in section 6 of the main contract means practically nothing.

Mr. HAYWARD. Oh, no. It is very important, Mr. Pecora, provided he had designated something we could buy.

Mr. PECORA. What was done with the other $500,000 of this fund of $1,500,000 that you were authorized to retain out of the proceeds of this loan?

Mr. HAYWARD. That was drawn down in the regular way as part of the proceeds of the issue.

Mr. PECORA. What was done with it? How was it withdrawn? How did it pass out of your possession?

Mr. HAYWARD. I will have to look that up, to see how they withdrew those funds. [After consulting an associate:] The city withdrew, on November 10, 1921, through a transfer by us to the Bank of Brazil, $8,930,000. There were other subsequent transfers. It is the usual form of taking down the proceeds, unless it is going to be left in New York.

Mr. PECORA. There is a provision in the loan contract, or the supplemental agreement, providing that the municipality would create and at all times maintain with the bankers a deposit of not less than $250,000. Do you find that in section 2?

Mr. HAYWARD. That is just the difference, Mr. Pecora, in the wording there. They would at all times create and maintain——

Mr. PECORA. The obligor covenants that it will create and at all times while any of the bonds issued under the said main agreement are outstanding, maintain with the bankers a deposit of not less than $250,000. Do you find that provision?

Mr. HAYWARD. Yes; section 2.

Mr. PECORA. Was such deposit account created and maintained at all times?

Mr. HAYWARD. That deposit account was created, and it was maintained until it was drawn on in March 1931. That was a general reserve or cushion. That cushion was used——

Mr. PECORA. To take care of current obligations under the bonds?

Mr. HAYWARD. Yes. That was used to make up a fund sufficient to complete a sinking-fund payment in 1931.

Mr. PECORA. That was done on March 31, 1931, was it?

Mr. HAYWARD. That is right.

Mr. PECORA. When was this deposit account created?

Mr. HAYWARD. When was it created?

Mr. PECORA. Yes; originally?

Mr. HAYWARD. I will get that for you in a second. So far as our records here show, that was constantly on deposit from the time of this transaction until it was drawn on in March 1931.

Since that time the city has made one addition to the fund some time during the summer.

Mr. PECORA. This sum of $250,000 provided for by section 2 of the supplemental agreement remained in your hands from the time of the issuance of the bonds, did it not?

Mr. HAYWARD. That is correct.

Mr. PECORA. And you held it under the terms of this agreement as expressed in section 2 of the supplemental agreement; is that correct?

Mr. HAYWARD. That is correct.

Mr. PECORA. When was it set up on the books of your firm as a deposit account maintained by the city of Rio de Janeiro?

Mr. HAYWARD. My understanding is that it was always in their general account as a general deposit.

Mr. PECORA. I am not speaking of a general account. When was it set up as a general deposit?

Senator ADAMS. Was that amount set up as a special deposit or as a general deposit?

Mr. HAYWARD. It apparently was in their general account, Senator, until April 2, 1924.

Mr. PECORA. Until what date?

Mr. HAYWARD. April 2, 1924, at which time it was set up in a special account.

Senator ADAMS. What were the provisions attached to the special account?

Mr. HAYWARD. Well, that would relate back to the contract. It was just a banking deposit, that is all.

Mr. PECORA. Was it set up as a permanent deposit for the service of these bonds?

Mr. HAYWARD. It is difficult for me to say from this designation that we have here on this piece of paper.

Mr. PECORA. No; not alone from the designation, but from the contractual provisions of the loan agreement?

Mr. HAYWARD. Well, the money was kept here for that period and it was kept available for the purpose we had in mind.

Mr. PECORA. Was it kept here for the service of these bonds, or was it intended to be kept as a general deposit to the credit of the municipality?

Mr. HAYWARD. The latter, is my understanding.

Mr. PECORA. What?

Mr. HAYWARD. General deposit, the agreement says.

Senator ADAMS. A general deposit is one that is open to check; a special deposit is a trust account subject to special conditions, not open to check.

Mr. HAYWARD. This was a special account. When we found that they were going to fail in the payment of the sinking fund we applied it for that purpose.

Mr. PECORA. Then it was not a general deposit in that sense?

Mr. HAYWARD. Yes; it was a general deposit, but it had to be kept here. It was not subject to withdrawal by check.

Mr. PECORA. Well, to be kept for what purpose?

Mr. HAYWARD. For a cushion.

Mr. PECORA. What purpose was to be served by it?

Mr. HAYWARD. It might have been used for any purpose in connection with the loan.

Mr. PECORA. For any purpose in connection with the servicing of these bonds?

Mr. HAYWARD. Yes. As I understand it, suppose they had failed to pay us our commissions as sinking-fund agents I think we would have been within our rights in taking some of that.

Mr. PECORA. Exactly. In view of those circumstances, and in view of those attributes of this deposit why was it kept as a general deposit instead of a special deposit fund in the servicing of these bonds?

Mr. HAYWARD. There was no provision that it was to be a special deposit.

Mr. PECORA. But you knew the reasons for this deposit account, did you not? You just stated for the servicing of these bonds?

Mr. HAYWARD. Yes, Mr. Pecora, but we did keep the money for that purpose, and it was so used.

Mr. PECORA. But you did not keep them apart from other funds for that purpose, did you?

Mr. HAYWARD. Well, I do not know whether they were separated from other funds by a piece of paper, or how you would separate them.

Mr. PECORA. How was this $250,000 account originally set up on the books of Dillon, Read & Co.?

Mr. HAYWARD. The deposit was just an ordinary banking deposit by the Government with Dillon, Read & Co., forming part of the regular business of Dillon, Read & Co., coupled, however, with the right on the part of Dillon, Read & Co. to apply the funds in such deposit for the benefit of the bondholders in case of any default. The opinion of counsel of Dillon, Read & Co. clearly supports this view. The whole question as to the nature of these funds is entirely immaterial, since the actuality of the situation is that the funds were in fact held by Dillon, Read & Co. and applied only from time to time for the benefit of the outstanding bonds. In other words, the funds are still there except to the extent that they have been paid out for the benefit of the bondholders.

Mr. PECORA. I notice you read that answer from some document. From what document did you read it?

Mr. HAYWARD. This is a memorandum, I suppose, from our bookkeeping department.

Mr. PECORA. It sounds more like the opinion of some counsel.

Mr. HAYWARD. I do not know whether counsel saw that or not, Mr. Pecora. It sounded like it.

Mr. PECORA. Where did you get it from?

Mr. HAYWARD. Our Mr. Shedden, who had charge of our accounts, gave it to me as his interpretation of how they were kept. We have, of course, discussed this with counsel frequently.

The CHAIRMAN. In other words, Rio had to keep on deposit with you $250,000?

Mr. HAYWARD. Until the bonds matured.

The CHAIRMAN. Until the bonds matured, for servicing?

Mr. HAYWARD. For servicing; to be used for any purpose in connection with the loan.

The CHAIRMAN. They had to keep a deposit of that amount?

Mr. HAYWARD. They had to keep a deposit of that amount, and we used a part of it in 1931 to make up the sinking-fund payment, and part of it was restored this summer by the municipality.

Mr. PECORA. Originally it was set up as a general account, was it not?

Mr. HAYWARD. Yes; it was in the general account.

Mr. PECORA. Now some time in April 1924, if I correctly understood your very recent testimony, it was set up in a different way?

Mr. HAYWARD. Yes.

Mr. PECORA. In what way was it set up in April 1924?

Mr. HAYWARD. That was set up in an account called permanent deposit account with the federal district.

Mr. PECORA. The federal district referred to being the municipality?

Mr. HAYWARD. Yes; that is a bookkeeping designation.

Mr. PECORA. Were any of the moneys to the credit of this account used for the servicing of these bonds at any time?

Mr. HAYWARD. Yes; that was the only time they have been drawn.

Mr. PECORA. When for the first time were they so used for any such purpose?

Mr. HAYWARD. April 1, 1931.

Mr. PECORA. And what were they used for then, and how much?

Mr. HAYWARD. We applied $33,558.98 to make up the sinking fund on the bonds.

Mr. PECORA. The contract provided for certain sinking-fund requirements annually or semiannually, and for the first time since these bonds were issued and sold in October 1921, in April 1931 you found it necessary to draw moneys from this special deposit of $250,000 to meet the sinking-fund requirements of the loan agreement?

Mr. HAYWARD. That is correct.

Mr. PECORA. Were the bondholders informed of that?

Mr. HAYWARD. Oh, I could not say. Probably not.

Senator COUZENS. Had all the previous sinking-fund arrangements been kept up to that time?

Mr. HAYWARD. Yes. They had paid in full for 10 years up to that time, sinking fund and interest. You see, the result of that is that the man who bought these bonds in 1921 at $975 had received by that time $700 in interest. He has a bond which he could today sell for $160. That is not so bad, considering that he still has the obligation of the city, which I believe is good and will be paid.

Mr. PECORA. Has he not been deprived of the use of his thousand dollars during that period of time, and could he not have gotten something for the use of that money in some other form of investment?

Mr. HAYWARD. Oh, I do not mean for a moment that he could not have done better. But he might have done a good deal worse.

Mr. PECORA. When you say he has received so much in interest and you say that he still could get in the open market so much for his bond and that he has not fared so poorly, it seems to me that you are distorting the functions of interest as applied to a principal obligation.

Mr. HAYWARD. No; I am just bringing out the fact that he certainly has not lost all of his investment.

Senator ADAMS. You see, Mr. Pecora, the fellow is lucky to get his money if he is paid back.

Mr. HAYWARD. Yes, certainly. A lot of us have not got that.

Mr. PECORA. When the municipality ordered you to draw down in April 1931 the sum of thirty and odd thousand dollars out of this deposit account of $250,000 to fulfill this sinking fund requirement under this loan agreement, that indicated to you as the bankers that the city was in some financial embarrassment, did it not?

Mr. HAYWARD. Well, I do not remember the exact date, but that was about the period of the general default.

Mr. PECORA. Yes; and that circumstance alone indicated some financial embarrassment by the city to you, did it not?

The CHAIRMAN. Did they ever replace that $33,000?

Mr. HAYWARD. They made a repayment this summer of some amount, but still it is not a very large amount. The difficulty, of course, is due to exchange. That is the only reason that I know of for any default. As I think I testified this morning, practically all

of the State and municipal loans of Brazil at the present time are in default, and arrangements are being made for—and we hope that there will be—a gradual resumption of payment next year. That is all the result of exchange; not because of lack of money in the cities. They have the money there, but cannot get it out of the country.

Senator ADAMS. I should say the price of $160 then was pretty low for a bond that has that prospect.

Mr. HAYWARD. I think it is very low. All of these bonds are selling for very low prices. In all of the business that we have done for these Latin-American governments in the last 10 years I believe there has not been a case where they have even in the slightest degree intimated that they intend to repudiate. They all, on the other hand, constantly express an intention of resuming payments at the earliest possible moment, and I think that this is a time when they are all trying to work out their own N.R.A. programs, and we certainly can benefit them by devising means whereby they can be restored to prosperity instead of criticizing their lapses.

Senator ADAMS. Why should the price be as low as that if the prospects are so good?

Mr. HAYWARD. Well, we have had an extraordinary lack of confidence on the part of our public, Senator. I could give you, if we had time, a great many instances where similar bonds issued by these obligors in London are selling at a great deal higher price than they are in our market. We are still more or less under a feeling of shock from the depression and a general lack of confidence, which has been contributed to by the speeches and articles attacking these issues. I think they are all selling at far too low prices.

The CHAIRMAN. What is the cause of that depreciation in their money and this rise in exchange?

Mr. HAYWARD. A fall in agricultural prices, Senator; the fact that their gold reserves were depleted; and the general lack of international trade at the present time. They are doing their utmost to meet this situation. They are very sensitive. They resent criticism. And I am very glad to see Mr. Pecora's sense of statesmanship is such that he has put the burden of this on me, and I am delighted to have you do that, and I am delighted to carry it. I think these friends of ours are honest, upright people. I have lived with them for 15 years. I have known all the administrations. I have traveled there constantly. I have not seen the slightest desire to repudiate on the part of any one of them. We have got to be patient.

The CHAIRMAN. What is the rate of exchange now?

Mr. HAYWARD. The milreis today is quoted at about 8¼ cents. The so-called "par" is just under 12 cents. It has been a good deal lower than that in the last few months.

Mr. PECORA. Mr. Hayward, there was an interest payment due on these bonds on October 1, 1931, was there not?

Mr. HAYWARD. Yes; that is correct. They made that payment.

Mr. PECORA. And in order to enable the municipality to meet that interest payment, did not your firm permit it to apply the sum of $239,518.34 out of this deposit account of $250,000 towards the payment of that interest?

Mr. HAYWARD. That is correct.

Mr. PECORA. Were the bondholders then advised of that circumstance?

Mr. HAYWARD. No; they were not. Not to my knowledge; no.

Mr. PECORA. Did that not virtually indicate a practical, if not a technical, default on these bonds?

Mr. HAYWARD. Oh, it was a default; certainly.

Mr. PECORA. Yes.

Mr. HAYWARD. But the point is——

Mr. PECORA. Do you not think the bondholders here were entitled to know the facts at that time so that they might do whatever they wanted to with their bonds, instead of being permitted to remain in ignorance of these circumstances and hence retaining their bonds?

Mr. HAYWARD. Might I before answering that, correct my previous statement? My attention is being called to the fact that this was not even technically a default, inasmuch as this was the city's money which could be used for that purpose.

So far as notifying the bondholder is concerned, I want to say this: During this period—during that year particularly—the Brazilian Government and all the municipal authorities were still trying hard to work themselves out of the situation. They were in the same frame of mind that we were in in this country, where we felt that the depression was going to be over always week after next.

Mr. PECORA. You mean "just around the corner."

Mr. HAYWARD. Yes. We could not make a public announcement of the fact that the city of Rio was going to default when we did not know whether it was going to default or not. This might have been simply a temporary period of difficulty. Fortunately we had this cushion here which had been provided for that purpose, and they were able with their own funds to make the payment. It would have been highly unjust, and I think we would have subjected ourselves to great criticism on the part of the borrower, if we had stated in the papers that it was our opinion that they were going to fall down on their obligation.

Mr. PECORA. This so-called "cushion" that you have alluded to practically disappeared with the payment of the interest that fell due on October 1, 1931, did it not?

Mr. HAYWARD. Yes; the cushion was then about removed.

Mr. PECORA. The cushion was flattened out completely?

Mr. HAYWARD. Decidedly.

Mr. PECORA. That is, with the exception of about $7,000?

Mr. HAYWARD. With the exception of about $7,000. And, as I said, this summer they made a deposit toward building it up.

Mr. PECORA. Has it ever been restored since October 1931 to its original principal amount of $250,000?

Mr. HAYWARD. Oh, no; not yet, due to exchange. They cannot get the money out. They have the money there, but they cannot get it out.

Mr. PECORA. As I understood your testimony a few minutes ago the present exchange is about two thirds of parity?

Mr. HAYWARD. Yes.

Mr. PECORA. Of par?

Mr. HAYWARD. If my arithmetic is right, yes. Eight and one quarter against twelve. Yes; that is right.

Mr. PECORA. Have they remitted funds to the amount of two thirds?

Mr. HAYWARD. Oh, that would not follow. The restrictions on Brazilian exchange are similar to restrictions in almost all countries at the present time, and that is that no purchaser is allowed to get dollars or sterling or francs without showing a special purpose and without special permission. The Government has in effect been obliged to prevent all of these borrowers from meeting their foreign payments because there is not enough money to go around. They obviously cannot prefer one over the other, and before you can reestablish general payments even on a partial scale you have got to do it on general agreement among all these people and rationing the exchange.

Mr. PECORA. To what extent has this cushion been restored at the present time?

Mr. HAYWARD. As I recall, they sent us $30,000 this summer. Yes; I think it is $30,000. That would be $37,000.

The CHAIRMAN. What would hinder a bondholder who had a thousand dollar bond from going down to Rio and turning it in and accepting milreis for it?

Mr. HAYWARD. Nothing at all, Senator. I hope you will go.

The CHAIRMAN. I think I would do that if I had one of the bonds.

Mr. HAYWARD. Not that I wish to dispense with your presence here now.

The CHAIRMAN. Unfortunately I have not got any of the bonds.

Mr. HAYWARD. We constantly receive inquiries from bondholders as to whether or not if they are traveling there they can get their money in local currency. I see no reason why they cannot do it. But that would not help many people.

The CHAIRMAN. It would give them about two thirds of their money.

Mr. HAYWARD. I mean there are very few that would go to Brazil and take advantage of that opportunity.

Senator COUZENS. They could not get it out of the country even then, could they?

Mr. HAYWARD. No.

Mr. PECORA. I think that is all with this particular issue.

The CHAIRMAN. The committee will stand adjourned until 10 o'clock tomorrow.

(Thereupon at 4:20 p.m., Wednesday, Oct. 11, 1933, an adjournment was taken until 10 a.m. the next day, Thursday, Oct. 12, 1933.)

COMMITTEE EXHIBIT NO. 21, OCTOBER 11, 1933

UNITED STATES & FOREIGN SECURITIES CORPORATION

December 31, 1932.—There are 51 companies in the portfolio of United States & Foreign Securities Corporation on whose boards there are no representatives from either the directors, officers, or employees of United States & Foreign Securities Corporation, United States & International Securities Corporation, Keswick Corporation or Dillon, Read & Co. Furthermore, Dillon, Read & Co., has not acted as banker for any of these companies:

American Can Co.
American Chicle Co.
American Home Products Corporation.

American Radiator & Standard Sanitary Corporation.
American Smelting & Refining Co.
American Sugar Refining Co.
American Telephone & Telegraph Co.
American Tobacco Co.
Axton-Fisher Tobacco Co., Inc.
Baltimore & Ohio Railroad.
Beatrice Creamery Co.
Best & Co., Inc.
Central Aguirre Associates.
Chesapeake & Ohio Railway.
Citizens & Southern National Bank, Savannah.
Coco-Cola Co.
Colgate Palmolive Peet Co.
Columbia Gas & Electric Corporation.
Commercial Solvents Corporation.
Commonwealth Edison Co.
Consolidated Gas & Electric Co. of Baltimore.
Detroit Edison Co.
Drug, Incorporated.
Federal Bake Shops, Inc.
First National Bank of Chicago.
General Foods Corporation.
Gilbert, A. C., Co.
Gillette Safety Razor Co.
Hydro-Nitro S.A.
International Business Machines Corporation.
Lorillard, P., Co.
M. & T. Trust Co., Buffalo.
Macy, R. H., & Co., Inc.
May Department Stores Co.
Mission Oil Co.
National Biscuit Co.
National Dairy Products Corporation.
New York Central Railroad.
Pacific Gas & Electric Co.
Pacific Lighting Corporation.
Pennsylvania Railroad Co.
Public Service Corporation of New Jersey.
Sears, Roebuck & Co.
Southern California Edison Co., Ltd.
Southern Pacific Co.
Southern Railway Co.
Standard Oil Co. of California.
Tobacco Products Corporation of New Jersey.
Trojan Oil & Gas Co.
Union Pacific Railroad Co.
William Wrigley, Jr., Co.

COMMITTEE EXHIBIT 24, OCTOBER 11, 1933

City of Rio de Janeiro (Federal District of the United States of Brazil) with Dillon, Read & Co.—Contract, dated as of October 1, 1921

Contract, dated as of October 1, 1921, made by Federal District of the United States of Brazil, hereinafter termed the "obligor", acting by the honorable the consul general of United States of Brazil in the city of New York, thereunto duly empowered, and Dillon, Read & Co., a copartnership of the city of New York, State of New York, United States of America, hereinafter sometimes termed the "bankers."

ARTICLE I

The obligor covenants with the bankers as follows:

SECTION 1. The obligor will issue its external gold loan bonds bearing interest at the rate of 8 percent per annum (hereinafter termed, collectively, the

"bonds"), for the aggregate principal amount of $12,000,000, all dated October 1, 1921, and payable on October 1, 1946, in which bonds the obligor will covenant to pay the principal and the interest on said principal sum and the sinking fund payments herein provided, in the city of New York, State of New York, United States of America, in gold coin of the United States of the standard existing October 1, 1921, without deduction for any tax or taxes now or at any time hereafter imposed by the United States of Brazil or by any taxing authority thereof or therein or by the obligor or by any taxing authority thereof. The bonds shall be substantially in the form set forth in schedule A hereto attached, and shall be signed in behalf of the obligor and be countersigned by Central Union Trust Co. of New York (or its successor designated for the purpose by the bankers) as in said schedule A indicated.

SEC. 2. The bonds shall bear interest at the rate aforesaid from the date thereof until the principal sum thereof shall have been paid, or until they shall be purchased by the sinking fund or redeemed as herein provided. Such interest shall be payable semiannually on the 1st day of April and the 1st day of October in each year. For the collection of such interest the bonds will have attached coupons substantially in the form set forth in said schedule A.

SEC. 3. The bonds shall be issuable in the denomiation of $1,000 and $500 and the text thereof shall be in the English language, and if so requested by the bankers, shall be printed from engraved plates in a manner conforming to the requirements of the New York Stock Exchange for quotation; but until such time as such bonds in definitive form shall have been prepared for delivery, one or more temporary or provisional bonds for the aggregate principal amount of $12,000,000 without coupons shall be issued. The obligor will deliver in the said city of New York definitive bonds in exchange for the temporary bonds, without charge or expense to the bankers or other persons entitled to receive the definitive bonds. The obligor hereby designates Central Union Trust Co. of New York, in the Borough of Manhattan, New York City, as registrar of the bonds; and so long as any of the bonds are outstanding the obligor will register, or cause to be registered by said registrar (or a successor duly appointed by the bankers for such purpose) as to principal, but as to principal only, any of the bonds upon presentation for such purpose, pursuant to such reasonable regulation as the bankers may prescribe. Such registration shall be noted on the bonds by the registrar so appointed, after which registration and notation thereof on the bonds, no transfer shall be valid unless made at the office of said registrar by the registered holder in person, or by his attorney, duly authorized, and similarly noted on the bonds; but the same may be discharged from registry by being in like manner transferred to bearer, after which it shall again be transferable by delivery. Successive registrations and transfers may be made from time to time as desired. Such registration shall not affect the negotiability of the coupons belonging to any bond, but every such coupon shall continue to pass by delivery and shall remain payable to bearer as therein provided. The bonds of the several denominations shall be interchangeable. Upon surrender by the holder at said registry office of bonds of one or more denominations, with all unmatured coupons thereto attached, with the request that there be issued in exchange therefor bonds of the same aggregate principal amount but of other denominations, the obligor will effect such exchange. In case of any exchange of bonds, the obligor may, with the approval of the bankers, make a reasonable charge for the bonds issued in exchange for outstanding bonds and for the expense of such service. No charge, however, shall be made for any exchange of temporary bonds for definitive bonds.

The bonds and coupons and all payments thereon shall be exempt from any and all taxes, imposts, stamp dues, and assessments, now or at any time hereafter imposed or levied by the United States of Brazil or by any taxing authority thereof or therein or by the obligor or by any taxing authority thereof.

In case of loss or destruction of any bond or coupon, a duplicate will be issued upon proof of such loss or destruction and upon receipt by the obligor of proper indemnity.

SEC. 4. Without intending to limit or lessen the obligations assumed by the obligor under the bonds or elsewhere under this contract, the obligor covenants and agrees that its obligations hereunder and under the bonds shall at all times be and constitute a special and first charge on the revenues received by the obligor from the vehicles tax (imposto sobre vehiculos), the sanitary tax (taxa sanitaria), and the imposto de laudemios, as now existing or as in the future the same may exist, levied by the obligor or with its authority, and

covenants and agrees that all the proceeds of said vehicles tax, sanitary tax, and the imposto de laudemios and all taxes and exactions levied in substitution for said taxes or any of them or amendment thereof shall, so long as the obligor shall not have fulfilled all its obligations then due hereunder and under the bonds, be specially set apart and used for the fulfillment of the obligations of the obligor hereunder and under the bonds (pro rata and without discrimination as to any of the bonds issued hereunder) and shall not be used for or devoted to any other purpose. The obligor further covenants and agrees that in like manner the obligations hereunder and under the bonds issued hereunder shall be a special charge on the licenses tax, cattle tax, and property transmission tax, as now existing or as in the future the same may exist, levied by the obligor or with its authority (but subject and subsidiary to all the charges now existing) and that the proceeds thereof shall in like manner be especially set apart and used for the fulfillment of the obligations of the obligor then due hereunder and under the bonds (pro rata and without discrimination as to any of the bonds issued hereunder) and shall not be devoted or used for any other purposes.

SEC. 5. And as an additional guarantee the obligor covenants that its obligations hereunder and under the bonds shall at all times be and constitute a special and first charge on all receipts, income, and revenues accruing from the slaughterhouse to be constructed by or for the obligor (to pay for the construction of which it is proposed that a part of the proceeds of this loan is to be used) whether such receipts, income, and revenues shall accrue in the operation of the slaughterhouse by the obligor or by its rental or otherwise; and the obligor covenants that all such receipts, income, and revenues shall, so long as the obligor shall not have fulfilled all its obligations then due hereunder and under the bonds, be specially set apart and used for the fulfillment of the obligations of the obligor hereunder and under the bonds (pro rata and without discrimination as to any of the bonds issued hereunder) and shall not be used for or devoted to any other purpose.

SEC. 6. The obligor covenants and agrees that such bonds or other evidences of indebtedness issued by the obligor (but not including bonds issued hereunder) as are purchased or acquired by the use of any part of the proceeds of this loan shall be delivered to and deposited with the bankers, to be held by the bankers as security for the fulfillment by the obligor of its obligations hereunder and under the bonds issued hereunder. When all of such obligations hereunder, and under the bonds issued hereunder, shall have been completely performed such bonds and evidence of indebtedness as shall remain in the hands of the bankers shall be surrendered to the obligor for cancelation, but on default by the obligor under any of its obligations hereunder or under the bonds issued hereunder the bankers may, in such manner as they may deem wise enforce such bonds or evidences of indebtedness, or any of them, from time to time for the pro-rate benefit of the holders of bonds issued hereunder.

SEC. 7. The bankers shall have exclusive authority to issue the bonds through a syndicate which they have formed or may form for such purpose. The obligor hereby ratifies and approves the syndication and disposal thereof heretofore accomplished by the bankers. On such date not later than November 1, 1921, as the bankers shall designate, the obligor will deliver to the bankers in the city of New York temporary or provisional bonds in such denominations as the bankers shall request, dated October 1, 1921, and bearing interest from October 1, 1921, for the aggregate principal amount of $12,000,000, and thereupon the bankers will make payment therefor as provided in article III, section 2, of this contract.

SEC. 8. Pending the delivery of the definitive bonds, the bankers may deliver to subscribers for or purchasers of the bonds a receipt or other writing in their name, evidencing the right of the holder to receive an amount of such bonds specified in such receipt or writing.

SEC. 9. The obligor will deposit with the bankers at their office in the city of New York, at least 1 month in advance of the maturity, respectively, of the interest and sinking fund instalments payable on the bonds, funds sufficient to pay in United States gold coin the amount of such instalments.

ARTICLE II

The obligor further covenants with the bankers for the benefit of the holders, severally and respectively, of the bonds, as follows:

SECTION 1. The obligor at its option, on October 1, 1931, and on any interest date thereafter, may redeem all or any part of the bonds then outstanding at

the rate of 105 percent of the principal amount thereof and accrued interest to date of redemption. In case the obligor shall desire to exercise such right of redemption, it shall notify the bankers at least 6 months prior to the redemption date of the amount of bonds to be redeemed and at least 1 month prior to said redemption date will deposit with the bankers in the city of New York an amount in United States gold coin or its equivalent sufficient to redeem such amount of bonds which are to be called for redemption at such price. In case less than all of the bonds then outstanding are to be redeemed, the bonds so to be redeemed shall be selected by lot by the bankers in any usual manner as they may direct. Notice of such intention to redeem shall be given on behalf of the obligor by the bankers by publication not less than four times in two daily newspapers of general circulation published in the Borough of Manhattan, city of New York (the first publication to be at least 6 months prior to the date fixed for such redemption), setting forth that the bonds shall be redeemed at the place of payment specified in the bonds upon the redemption date at the price of 105 percent of the principal sum and accrued interest to said redemption date upon presentation and surrender of such bonds and of the coupons maturing on and after such redemption date. In case less than all of the bonds then outstanding are to be redeemed, such notice shall state the serial numbers of the bonds so to be redeemed. Upon publication of notice of redemption as above provided the bonds designated in such notice shall become payable at such redemption price on the redemption date in such notice set forth. And, after the redemption date so designated, provided the funds for redemption shall have been deposited as above provided, no interest shall accrue upon or in respect of any bonds called for redemption, nor shall any coupon for the payment of interest upon any bond called for redemption maturing subsequent to said date be of any force and effect. The amounts paid by the obligor to the bankers for the redemption of bonds under this article and not used on said redemption date shall be held by the bankers for account of the holders thereof as follows: Such funds (without interest) shall be from time to time paid to such holders on presentation and surrender of such bonds with all coupons maturing on or after such redemption date. In case any of such bonds so called for redemption shall not have been so presented within 1 year from such redemption date the bankers may repay such founds so held on account thereof to the obligor and at the end of 3 years shall so pay such funds. The bankers are authorized to hold such funds for redemption after such redemption date in any bank or trust company of good standing in the city of New York. All bonds redeemed as herein provided shall be canceled by the bankers and be delivered to the obligor and no bonds of this loan shall be issued in lieu thereof.

SEC. 2. So long as any of the bonds shall be outstanding, the obligor will pay to the bankers on or before the 1st day of April and the 1st day of October 1946, as a semiannual sinking fund on amount which shall be equal to 105 percent of one fiftieth of the aggregate principal amount of $12,000,000 (viz., 105% of $240,000), plus an amount equal to 4 percent of said one fiftieth. Each such payment shall constitute a sinking fund to be held and applied by the bankers as sinking-fund trustees in the purchase of bonds as in this article provided.

SEC. 3. All moneys received by the bankers by any such sinking-fund payment may be from time to time applied by the bankers to the purchase of bonds in the market at such price or prices, not exceeding 105% and accrued interest, by private or public purchase without inviting or advertising for tenders of bonds. It is intended that the times, manner, and price of such purchases shall be determined by the bankers in their absolute discretion as they may from time to time deem for the best interest of the obligor. All bonds so purchased for the sinking fund, together with all unmatured coupons annexed thereto at the time of purchase, shall be canceled by the bankers and delivered to the obligor and no bonds shall be issued in lieu thereof.

SEC. 4. If, 6 months from the date on which a sinking-fund payment is due under section 2 of this article (or if such payment is not made on or before the due date, then 6 months from the date it is made), such payment or any part thereof has not been applied to the purchase of the bonds, such payment or the unapplied part thereof shall revert to the obligor and be paid to the obligor. The bankers shall not, excepting on express instruction from the obligor, by the use of any single semiannual sinking-fund payment in their hands, acquire more than one fiftieth of the total face amount of bonds issued hereunder. In case they shall, out of any such sinking-fund payment, have

purchased such amount of bonds, to wit, one fiftieth, the unused balance of such sinking-fund payment in their hands shall immediately be paid to the obligor (even if such 6 months shall not have expired).

SEC. 5. It is agreed that a portion of the proceeds of this loan is to be used for the removal of the Morro de Castello and the improvement of the property thus made available and that after such removal, land thus made available (except such portions as shall be actually in use by the obligor and/or the United States of Brazil) will be offered for sale by the obligor, and the bankers will cooperate in such program of sale. The obligor covenants that all proceeds of such sale or sales or other disposal of such lands will, as soon as received, be paid by the obligor to the bankers in New York and will be applied by the bankers in the purchase of bonds hereunder in the manner and at the prices provided by section 3 of this article (and with the consent of the obligor at prices higher than provided in said section 3). Such payments by the obligor under this section 5 shall not however relieve the obligor of its obligation under sections 2 and 3 of this article. Any balance at any time in the hands of the bankers pursuant to this section 5 shall not be paid back to the obligor under section 4 hereof but on and after October 1, 1931, shall be from time to time applied by the bankers in the purchase of bonds as aforesaid or, if the bankers at any time deem it not feasible to acquire such bonds at such price, then in redemption of bonds for account of the obligor in accordance with the provisions hereof.

SEC. 6. In case the obligor shall fail to make any sinking fund payment or other payment as in this article provided, or any interest payment as provided in article I, when and as the same shall become payable under section 9 of article I, and such default shall continue for a period of 60 days, Dillon, Read & Co., as representative of the holders of the bonds, may declare to be forthwith due and payable by the obligor the principal sum of the bonds and the interest accrued to the date of such declaration, and thereupon such sums shall become and be forthwith due and payable by the obligor, and the obligor covenants to pay the same at the place for the payment of the bonds in the city of New York. Dillon, Read & Co. may thereupon immediately dispose of any and all securities held under section 6 of article I or otherwise hereunder and may liquidate and enforce any and all guarantees, charges, and deposits and apply the proceeds and all moneys in their hands received from or for account of the obligor, under any of the provisions hereof or otherwise, to the obligation of the bonds and coupons (pro rata and without discrimination as to any of the bonds issued hereunder), all as in their absolute discretion they may deem most advantageous to the holders of the bonds.

SEC. 7. Dillon, Read & Co. may act as the representative of the holders of the bonds in all matters arising under this contract. For this service they will receive no compensation from the obligor.

ARTICLE III

SECTION 1. The obligor agrees to sell to the bankers, and, subject to the conditions herein specified, the bankers agree to purchase from the obligor, the said $12,000,000 principal sum of bonds at the price of 89 percent of the principal sum thereof, plus accrued interest from the date of the bonds to the date of payment therefor.

SEC. 2. Upon delivery to the bankers as provided in article I of this contract of the temporary or provisional bonds for the aggregate sum of $12,000,000, the bankers will make payment therefor by crediting to the account of the obligor in New York City 89 percent of the principal amount, plus accrued interest from the date of the bonds to the date of such credit.

SEC. 3. The bankers have, with the authority of the obligor, offered the bonds for public subscription and sale and are hereby authorized to offer the bonds for public subscription at such times and in such amounts and at such prices as the bankers shall determine.

SEC. 4. The obligor represents to the bankers that the loan created under this contract is duly authorized by the laws of the obligor and of the United States of Brazil and that the faith and credit of the obligor is pledged for the performance of this contract and the payment of the bonds issuable hereunder in accordance with the terms thereof respectively. The obligor covenants that it will do and obtain such further authorization as may be deemed by the bankers from time to time necessary or expedient for the security of this loan.

ARTICLE IV

SECTION 1. The obligor hereby authorizes the bankers in behalf of the obligor to make arrangements for the payment of the principal and interest at the places where such sums are payable. Accounts between the obligor and the bankers concerning such payments, and concerning the administration of the sinking fund and all expenses, charges and other proceedings hereunder will be kept by the bankers in the city of New York in terms of United States money; and such accounts, of which transcripts will be sent to the obligor, may at any time be inspected by duly authorized representatives of the obligor. The obligor will pay the cost and expense of engraving, printing, and delivering the bonds, both temporary and definitive, and the transmission and execution of the contract, and of the bonds and of the issue thereof, including the reasonable charges for counter-signature of the bonds and the fees of legal counsel for the bankers in connection with this contract and the performance hereof and the issue and sale of bonds hereunder in the United States, and will reimburse the bankers for the cost of preparing and delivering any receipts deliverable by them to subscribers for the bonds pending the issue of definitive bonds. All expenses not herein specified as being payable by the obligor will be paid by the bankers. The obligor further covenants that it will reimburse the bankers for any and all expenses incurred by them in the course of their proceedings as fiscal agents (including their expenses in administration of the sinking fund and in the redemption of the bonds), and that it will pay them for their services as such a commission of 1 percent of the amount of all moneys disbursed by them for account of the obligor.

SEC. 2. The obligor also will indemnify and save harmless the bankers against and from any loss, cost, or expense which they may sustain by reason of any delay or default in the performance by the obligor of any of the agreements of the obligor herein set forth or which they may sustain by reason of their acting as agents or depositaries of the obligor in accordance with the terms of their agency or with instructions of the obligor.

SEC. 3. The bankers shall not be answerable for the default or misconduct of any agent or attorney appointed by them to carry out any of the provisions of this contract, if such agent or attorney shall have been selected with reasonable care and with the consent of the obligor. If the bankers shall be in doubt in any instance as to their rights or obligations or the rights of bondholders under this contract, they may advise with legal counsel selected by them, and anything done or suffered in good faith by the bankers in accordance with the opinion of such counsel shall be conclusive in their favor as against any claim or demand by the obligor in the premises.

SEC. 4. The obligor and the bankers may deem and treat the bearer of any bond which shall not at the time be registered as to principal as herein provided, and the bearer of any coupon for interest on any bond, whether or not such bond shall be so registered, as the absolute owner of such bond or coupon, as the case may be, for the purpose of receiving payment thereof, and for all other purposes, and neither the obligor nor the bankers shall be affected by any notice to the contrary. The obligor and the bankers may deem and treat the person in whose name any bond shall be registered as to principal as aforesaid as the absolute owner thereof for the purpose of receiving payment of or on account of the principal thereof, and for all other purposes except to receive payment of interest by outstanding coupons.

SEC. 5. The bankers may become the owners of any or all of the bonds, with the same rights as any other bondholders. All notices from the bankers to the obligor in connection with this contract, including the declaration under article II, section 6, may be given by written communication, or by cable, addressed to the Prefect of the Federal District of the United States of Brazil, Rio de Janeiro, Brazil. All notices from the obligor to the bankers may be similarly given, addressed to Dillon, Read & Co., city of New York, United States of America.

SEC. 6. The obligor will comply with the reasonable requests of the bankers for such information concerning the Federal district of the United States of Brazil, its laws, revenues, etc., as reasonably may be deemed useful both in aid of the issue and sale of the bonds in the United States, and so that the bankers may continue to be informed as to such matters and as to the security pledged hereby for the bonds; and the obligor authorizes and instructs its representatives to sign in its name appropriate circulars in connection with the issue of the bonds.

SEC. 7. Whenever in the bonds or in this contract the term "United States gold coin" is used, it is intended to mean gold coin of the United States of America of the standard of weight and fineness existing at the date of the bonds.

SEC. 8. This contract shall bind and shall enure to the benefit of the copartnership of Dillon, Read & Co., as now organized, or as hereafter organized, and also any successor of the firm. The English text of this agreement shall govern the interpretation of its terms.

For the Federal district of the United States of Brazil:

Witness:

J. C. MUNIZ.

HELIO LOBO,
Counsul General of the United States of Brazil in the City of New York.

For Dillon, Read & Co.:

Witness:

ROBERT O. HAYWARD.

DILLON, READ & CO.

SCHEDULE A—FORM OF DEFINITIVE BOND FOR $1,000

City of Rio de Janeiro, federal district of the United States of Brazil. Twenty-five year 8 per cent sinking fund gold bond

Federal district of the United States of Brazil, hereinafter termed the "obligor", for value received, promises to pay to bearer, or if this bond be registered as herein provided, to the registered holder hereof, on the 1st day of October 1946 the principal sum of $1,000 and to pay interest on such principal sum at the rate of 8 percent per annum semiannually on the 1st day of April and on the 1st day of October in each year, until such principal sum shall have been paid, but only upon presentation and surrender of the coupons for such interest hereto attached as they severally mature. Such principal sum and interest and the sinking-fund payments herein provided will be paid in the city of New York, State of New York, United States of America, at the office of Dillon, Reed & Co. in gold coin of the United States of America, of the standard weight and fineness existing on October 1, 1921, without deduction for any taxes now or at any time hereafter imposed by the United States of Brazil, or by any taxing authority thereof or therein or by the obligor or any taxing authority thereof.

In and by a contract dated as of October 1, 1921, made by the obligor with said Dillon, Read & Co. pursuant to which this bond is issued as one of a series of like bonds of an aggregate principal amount of $12,000,000, the obligor covenants to pay to said Dillon, Read & Co., on or before the 1st day of April, and on or before the 1st day of October in each year until and including the 1st day of October 1946 as a semiannual sinking fund an amount which shall be equal to 105 percent of one fiftieth of said aggregate principal amount of $12,000,000 (plus an amount equal to 4 percent of said one fiftieth). Each such payment shall constitute a sinking fund to be held and applied by said Dillon, Read & Co., as sinking fund trustees, in the purchase of bonds of said series at prices which shall not exceed 105 percent of the principal amount and accrued interest, in the manner and on the conditions and terms provided in said contract.

In the manner provided by said contract the obligor allocates to the services of said series of bonds issued under said contract to an aggregate face amount of $12,000,000, the proceeds of certain taxes, including the vehicles tax, the sanitary tax, and the Imposto de Laudemios, for the pro rata benefit of said series of bonds.

This bond is subject to redemption in the manner provided by said contract at the option of the obligor on October 1, 1931, and on any interest payment date thereafter prior to maturity, after publication in two daily newspapers of general circulation in the Borough of Manhattan, city of New York, not less than four times (the first publication to be at least 6 months prior to the date fixed for such redemption) of notice of such intention to redeem by payment of 105 percent of the principal amount hereof and the interest accrued hereon to and including the date fixed for such redemption.

Dillon, Read & Co. may act as the representative of the holder of this bond in all matters arising under the said contract. In case the obligor shall fail

to make any interest or sinking-fund payment when and as the same shall become payable, and such default shall continue for a period of 60 days, Dillon, Read & Co., as representative of the holders of the bonds, may declare to be forthwith due and payable the principal sum of the bonds and the interest accrued to the date of such declaration.

This bond shall pass by delivery, unless it is registered in the owner's name at the office of Central Union Trust Co. of New York or other registrar in the borough of Manhattan, city of New York, appointed by Dillon, Read & Co. for the purpose, and such registration is noted hereon by such registrar. After such registration no transfer shall be valid unless made by the registered owner in person or by attorney, and similarly noted hereon by such registrar; but this bond may be discharged from registry and its transferability by delivery be restored by like transfer to bearer noted hereon, after which it may again from time to time be registered or made transferable to bearer as before. Such registration, however, shall not affect the negotiability of the coupons which shall continue to be transferable by delivery.

This bond shall not be valid for any purpose until countersigned by Central Union Trust Co. of New York or its successor duly appointed by Dillon, Read & Co. for such purpose.

Dated, October 1, 1921.

FEDERAL DISTRICT OF THE UNITED STATES OF BRAZIL,
By ----------

Countersigned:

CENTRAL UNION TRUST CO. OF NEW YORK,
By ----------
Treasurer.

(Form of coupon)

No. —— $40.00

On the —— day of ———, 19—, unless the bond herein mentioned shall have been called for previous redemption, Federal district of the United States of Brazil promises to pay to bearer, in the city of New York, State of New York, United States of America, at the office of Dillon, Read & Co., $40 gold coin of the United States of America, without deduction for any taxes now or at any time hereafter imposed by United States of Brazil or by said Federal district of the United States of Brazil, or any taxing authority thereof, being 6 months interest then due on Federal district of the United States of Brazil 25-year 8 percent sinking-fund gold bond no. ——.

FEDERAL DISTRICT OF THE UNITED STATES OF BRAZIL,
By ——— ———.

Agreement, dated as of October 1, 1921, made by Federal District of the United States of Brazil, hereinafter termed "the obligor", acting by his excellency the consul general of the United States of Brazil in the city of New York, thereunto duly empowered, and Dillon, Read & Co., a copartnership of the city of New York, State of New York, United States of America, hereinafter termed "the bankers."

SECTION 1. This agreement is a part of a contract between the same parties bearing the same date hereinafter termed the "main agreement." The covenants and conditions contained in the main agreement are the consideration for the covenants herein contained; and this agreement is governed by the terms and conditions in such main agreement provided.

SEC. 2. The obligor covenants that it will create and, at all times while any of the bonds issued under the said main agreement are outstanding, maintain with the bankers a deposit of not less than $250,000.

SEC. 3. Without intending to limit or lessen any of the obligations assumed by the obligor, the obligor hereby irrevocably authorizes the bankers to retain and apply, out of the payment to be made by them under article III, section 2, of the main agreement, and out of any other moneys which may be from time to time on deposit with the bankers to the credit of the obligor an amount or amounts sufficient to fulfill any and all the obligations of the obligor with regard to the bonds and sinking fund and other payments thereon and, in general, with regard to commissions, expenses, and all other charges, which become payable by the obligor to the bankers, when and as such obligations mature.

S53. 4. Proceeds of the loan and moneys on deposit with Dillon, Read & Co., which the obligor is entitled to withdraw as herein provided, will be subject to drafts payable at sight. Such moneys shall from time to time bear interest at a rate which shall not be less than the average current rate then generally

allowed by responsible banks and trust companies in the city of New York on similar deposits.

SEC. 5. The obligor agrees that the bankers shall retain $1,500,000 out of the payment to be made by them under article III, section 2, of the main agreement, such amount to be used by them in the purchase of such foreign obligations of the obligor (other than bonds issued hereunder) as may be designated by the prefect of the obligor.

SEC. 6. The obligor agrees to cancel existing contract and that a new contract for the removal of the Morro de Castello mentioned in the main agreement will be made by the obligor with Kennedy & Co. of the city of New York on the basis of actual cost plus a commission for Kennedy & Co. of 12 percent of such actual cost. In the event that it be necessary for the obligor after the employment of Kennedy & Co. to indemnify the person to whom the contract for such removal has heretofore been awarded, the bankers will pay a portion of such indemnity but such portion shall not in any case exceed 300,000 milreis.

SEC. 7. The obligor covenants and agrees that it will use $1,500,000 of the proceeds of this loan in the construction of the municipal slaughterhouse referred to in section 5 of article I of the main agreement. The balance of the proceeds to the credit of the obligor from this loan, after the deduction of the deposits to be retained by Dillon, Read & Co. and the amounts to be used as above provided in the main agreement, are to be used for the removal of the Morro de Castello and connected works. The obligor agrees that the bankers shall deposit $500,000 out of such proceeds with a bank in Rio de Janeiro, to be mutually agreed upon by the bankers and the obligor, and such deposit shall be a trust fund to be disbursed only on requisition signed by the proper officers of the obligor and by a representative of Kennedy & Co. duly authorized for such purpose, and disbursed on order of the prefeito.

SEC. 8. The bankers agree that the aggregate cost to the obligor of the legal expenses of the bankers in connection with the execution of the main agreement and this agreement and the engraving, printing, and registration of the bonds shall not exceed $30,000.

The bankers agree to deliver to the obligor the assignment of the rights of Imbrie & Co. to participate in financing the obligor which the bankers have heretofore received from the receivers of Imbrie & Co.

SEC. 9. The obligor hereby appoints the bankers its purchasing agents in the United States for all purchases of material and supplies made by the obligor in the United States with the proceeds of this loan and covenants that it will pay to the bankers for their services as such a commission of 2 percent of the amount of such purchases and will reimburse them for any and all expenses incurred by them in the course of such agency. This appointment as purchasing agent is not revocable so long as any of the bonds are outstanding. The obligor hereby appoints the bankers its agent charged with the operations of the sinking fund, the payment of interest and the transfer of bonds, for the purposes of the main agreement during the life of the loan created thereby. This appointment is not revocable so long as any of the bonds are outstanding.

SEC. 10. The obligor hereby appoints the bankers its general fiscal agents in the United States, but such appointment is revocable by the obligor at any time on notice by cable or in writing.

FEDERAL DISTRICT OF THE
UNITED STATES OF BRAZIL,
By HELIO LOBO,
Consul General of United States of Brazil in the City of New York.

Witness:
J. C. MUNI.
ROBERT HAYWARD.

DILLON, READ & CO.

COMMITTEE EXHIBIT NO. 25, OCTOBER 11, 1933

$12,000,000

City of Rio De Janeiro (Federal District of the United States of Brazil)

Twenty-five year 8 percent sinking-fund gold bonds, dated October 1, 1921; interest payable April 1 and October 1; due October 1, 1946. Principal and interest payable in New York City in United States gold coin at the office of

Dillon, Read & Co., free of all present and future Brazilian taxes. Coupon bonds of $1,000 and $500 denominations, registerable as to principal.

The bonds are not callable until October 1, 1931, on which date, and any interest date thereafter, the issue may be called, in whole or in part, on 6 months' notice at 105 and interest. As a sinking fund the government of the Federal District agrees to provide a sum sufficient to buy $240,000 principal amount of bonds semiannually during the life of the loan, which payments will be applied by Dillon, Read & Co. to the purchase of bonds in the market if obtainable at or below 105 and accrued interest. Any balance unexpended at the end of 6 months reverts to the Federal District.

These bonds will be a direct obligation of the city of Rio de Janeiro (Federal District of the United States of Brazil) and their issue, as required by law, has been duly authorized by the Brazilian Government. The city of Rio de Janeiro is the capital of the United States of Brazil and is controlled by, and administered under the supervision of the Brazilian Government. It has a population of approximately 1,200,000 and is the second largest city in South America. The harbor of the city, which is one of the finest in the world, is equipped with modern docks and warehouses and handles over 40 percent of the total imports and exports of Brazil.

The total funded debt of the city outstanding on December 31, 1920, was $49,422,300, of which $24,332,700 was external. The city has always met the principal and interest of its funded debt in cash. Revenues of the city are chiefly derived from taxes on real property, licenses, vehicles, cattle, etc. The revenue of the city, at exchange rates then current, was approximately $11,000,000 in 1918 and $13,000,000 in 1920.

The proceeds of this loan are to be chiefly employed for permanent and revenue producing municipal improvements, including the removal of Castle Hill and the construction of a municipal slaughter house. Castle Hill is situated in the center of the principal business section of the city between the Avenida Rio Branco and the bay. We are informed that all property on this hill has been acquired by the city, and that property in the immediate vicinity has been sold at a price as high as $11 per square foot. The removal of this hill, which is already under way, will make available approximately 4,840,000 square feet of land. All of this land, other than that required for governmental purposes, will be offered for sale by the city, and all of the proceeds from such sale up to an amount sufficient to retire by purchase or call this entire issue will be deposited in trust for that purpose.

The receipts from the vehicles tax, the sanitary tax, and the imposto de laudemios (a realty tax), and the equity in the licenses tax, cattle tax, and property-transmission tax will be allocated to the service of this loan. The average annual return for the last two calendar years from these taxes amounted to $2,615,630 with prior charges of $909,247. The receipts from the operation or rental of the municipal slaughterhouse to be constructed with part of the proceeds of this issue will also be allocated to the service of this loan.

Computations of foreign money, except as otherwise indicated, are made at the rate of 12.5 cents per milreis and $3.75 to the pound sterling. Average value of the milreis in 1920 was over 20 cents.

We offer the above bonds for delivery when, as, and if issued and received by us, subject to approval of legal proceedings by counsel.

Price, 97¾ and interest; to net over 8.2 percent.

Dillon, Read & Co.

Lee, Higginson & Co.

Continental and Commercial Trust & Savings Bank

The information contained in this advertisement has been obtained from sources which we consider reliable. While not guaranteed, it is accepted by us as accurate.