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PART 2

STUDY OF  
RECONSTRUCTION FINANCE CORPORATION

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INTERIM REPORT  
OF THE  
COMMITTEE ON BANKING AND CURRENCY  
PURSUANT TO  
S. Res. 219  
(81st Cong.)

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LUSTRON CORP.—TRANSPORTATION CONTRACT



AUGUST 11 (legislative day, JULY 20), 1950.—Ordered to be printed

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STUDY OF RECONSTRUCTION FINANCE CORPORATION  
LUSTRON CORP.—TRANSPORTATION CONTRACT

AUGUST 11 (legislative day, JULY 20), 1950.—Ordered to be printed

Mr. FULBRIGHT, from the Committee on Banking and Currency,  
submitted the following

INTERIM REPORT

[Pursuant to S. Res. 219]

INTRODUCTION

The Subcommittee on Reconstruction Finance Corporation of the Senate Banking and Currency Committee on April 19, 1950, received a preliminary report of the Investigation Division of the Reconstruction Finance Corporation on the transportation dealings between the Lustron Corp. and the Commercial Home Equipment Corp. That report charged that Commercial Home Equipment Corp. had fraudulently overbilled Lustron Corp. for transportation services in an amount in excess of \$500,000 and that the Lustron Corp. had paid such overcharges. This report was also presented to the Department of Justice and to Mr. Clyde M. Foraker, the receiver of the Lustron Corp. at Columbus, Ohio.

This subcommittee issued subpenas duces tecum for the appearance of witnesses and the production of documents relating to transportation transactions between the Lustron Corp. and the Commercial Home Equipment Corp. The staff of the subcommittee conducted a preliminary exploration of the facts.

Friday, June 16, Monday, June 19, and Tuesday, June 20, 1950, the subcommittee held hearings in executive session. During the entire week commencing June 26, 1950, the subcommittee conducted open hearings and received testimony and documentary evidence for the purpose of developing all of the pertinent facts. Those testifying included officials and employees of the Commercial Home Equipment Corp., the Lustron Corp., and the Reconstruction Finance Corporation.

The subcommittee has confined its study to arrangements for the transportation of completed houses. It has given special attention to the performance by the Reconstruction Finance Corporation of the

servicing and supervision of the Lustron loan in this respect. No attempt has been made to consider the advisability of the initial loan to Lustron Corp. or the question of the general administration and servicing of the loan.

#### FACTS

The Lustron Corp. was formed for the purpose of engaging in the manufacture of prefabricated enameled steel houses. It had a paid-in capital in cash and tangible and intangible property of \$1,700,000 and received a series of loans from the Reconstruction Finance Corporation totaling \$37,500,000. Thus, for every dollar risked by Lustron stockholders, the taxpayers risked 22. The first Reconstruction Finance Corporation loan was approved June 30, 1947. The first disbursement under that loan was made October 30, 1947. Subsequent amounts were loaned from time to time, the last of which was disbursed September 13, 1949.

Lustron officials considered various methods for the transportation of the completed Lustron houses from factory to home site. Eventually they decided to employ specially built trailers with shelves and compartments suitably arranged for direct loading of the various panels, parts, accessories, and equipment on the trailer as a part of the assembly line at the factory. The loaded trailer was then to be hauled by tractor directly to the location where the house was to be erected. Because of the special design these trailers are not adaptable to other uses. Except for the hauling of Lustron houses, therefore, the trailers have only a salvage value representing a very small fraction of their original cost.

A number of trucking concerns, both common carriers and contract carriers, negotiated with the officials of the Lustron Corp. for the performance of this transportation service. Among these negotiators was James Gottlieb, of Chicago, Ill. James Gottlieb had previously been engaged in the trucking business, being the sole owner of the Western Transportation Co., an incorporated common carrier, and the principal partner in the Central Leasing Co., a contract carrier engaged in the transportation of parts and equipment for the Fruehauf Trailer Co.

James Gottlieb testified that Lustron's transportation needs had been called to his attention by L. C. Schneider, vice president of the Fruehauf Trailer Co., and that his brother, John Gottlieb, who had been associated with James Gottlieb in the trucking enterprises and other business transactions, contacted a friend of 25 years' standing, Mr. Paul O. Buckley, a director of the Lustron Corp. Paul Buckley testified that he helped the Gottliebs organize and finance the Commercial Home Equipment Corp. He also assisted in the negotiation of the transportation agreement with Lustron, of which he was a director.

Negotiations with officials of the Lustron Corp. culminated in a tentative agreement that a corporation to be formed and to be known as Commercial Home Equipment Corp. would acquire the necessary tractors and specially built trailers and lease them to the Lustron Corp. at rental prices to be agreed upon and would thus provide approximately one-half of the total transportation service estimated to be required by the Lustron Corp. It was understood that Commercial Home Equipment Corp. would have a capital of \$200,000 contributed either in cash or in tangible property.

August 31, 1948, Commercial Home Equipment Corp. was incorporated in the State of Delaware, the incorporators being members of a firm of Washington attorneys. The records disclose that these incorporators did not resign their positions until November 19, 1948. Meanwhile, James Gottlieb, John Gottlieb, and Paul Buckley agreed to become the sole stockholders of Commercial Home Equipment Corp. Paul O. Buckley and John Gottlieb each owned 25 percent of the stock and James Gottlieb owned the remaining 50 percent as of March 31, 1950. James Gottlieb paid into the corporation the sum of \$2,000 for which 1,000 shares were issued to him. James Gottlieb, in turn, transferred stock to Paul O. Buckley and John Gottlieb. Neither John Gottlieb nor Paul Buckley gave any cash consideration for the interest in the corporation which each acquired. No other cash or tangible property was contributed to the capital of the Commercial Home Equipment Corp.

On September 21, 1948, four individuals loaned to the Commercial Home Equipment Corp. a total of \$125,000 for which they received the note of the Commercial Home Equipment Corp. and certain shares of stock. The amounts loaned by each of said individuals and the shares of stock received by them are as follows:

Name	Amount loaned	Percent of stock
Norman Gerstenzang.....	\$50,000	4
Max Kaplan.....	25,000	2
Solbert Greenberger.....	25,000	2
David Eisen.....	25,000	2
Total.....	125,000	10

November 1949 the above individuals commenced suit against Commercial Home Equipment Corp. and recovered judgment in the sum of \$132,007.72 representing the principal of the note of \$125,000 and \$7,007.72 interest and costs. November 4, 1949, this judgment was paid by the Commercial Home Equipment Corp. and simultaneously the stock previously held by the judgment creditors was returned to James Gottlieb.

The minutes of the Commercial Home Equipment Corp. are incomplete and do not reflect the election of officers; however, testimony of James Gottlieb and Paul Buckley was to the effect that the directors of the corporation were James Gottlieb, John Gottlieb, and Paul Buckley; that James Gottlieb was president and treasurer, Ben Spector was vice president, and Robert Koller was secretary of the Commercial Home Equipment Corp.

A contract dated September 1, 1948, was entered into between the Lustron Corp. and the Commercial Home Equipment Corp., being executed on September 17, 1948. This contract was signed on behalf of Commercial Home Equipment Corp. by James Gottlieb, president, and Robert Koller, secretary, and on behalf of the Lustron Corp. by Russell G. Davis, vice president, and D. W. Boylan, secretary. The corporate seals of both corporations were affixed. There was no certification that the execution of the contract had been approved by the board of directors of either corporation nor do the minutes of either of the corporations record approval of this contract by the boards of directors or authorization of the corporation officials to execute the same.

The significant provisions of this contract were as follows:

1. Commercial was to furnish tractors and specially built trailers as ordered by Lustron, provided that Commercial could not be required to furnish more than three trailers for each tractor.

2. Lustron was to have the right to cancel orders for equipment upon payment of appropriate cancellation charges.

3. Lustron was to pay Commercial rental based upon the number of tractors assigned to Lustron at the rate of 28 cents per mile with a guaranteed minimum of 4,000 miles per month per tractor. Payments on the guaranteed minimum mileage basis in excess of the payments due Commercial for miles actually traveled were to be accumulated to the credit of Lustron as prepaid rental.

4. Lustron was to deposit \$400 to secure the payment of rent upon the delivery of each trailer with a credit of one one-hundredth of each such deposit to be applied each week against weekly rental statements. This provision was expressly stated to be subject to the approval of the Reconstruction Finance Corporation.

5. The contract recites that Commercial was a duly organized corporation with capital, as of September 30, 1948, of "not less than \$200,000, fully paid in cash or its equivalent in tangible property."

After the execution of the contract dated September 1, 1948, negotiations were entered into between representatives of Commercial Home Equipment Corp. and representatives of Lustron for a revised contract. The precise date of the execution of this revised contract which was dated October 1, 1948, does not appear. However, James Conger, Lustron attorney, testified that on March 3, 1949, the October 1 contract was signed on behalf of the Lustron Corp. by Russell G. Davis, vice president, D. W. Boylan, secretary, and was signed by James Gottlieb, president of the Commercial Home Equipment Corp., at the offices of the Lustron Corp. at Columbus, Ohio. Both original copies of the October 1 contract were taken to Chicago by James Gottlieb for the purpose of obtaining the signature of Robert Koller, secretary of Commercial, and to affix the seal of the Commercial Home Equipment Corp. Like the contract dated September 1, 1948, the contract dated October 1, 1948, does not contain a certificate that its execution was authorized by the boards of directors of either of the two corporations, nor do the minutes show such authorization. The files of the Lustron Corp. do not contain an original executed copy of this contract nor was a copy of this contract furnished to the Reconstruction Finance Corporation, although this contract, like the one dated September 1, 1948, made the \$400 deposit per trailer subject to Reconstruction Finance Corporation's approval. A photostatic copy of this contract was furnished to this subcommittee by representatives of the Commercial Home Equipment Corp. during the subcommittee's executive hearings.

No satisfactory explanation of the whereabouts of the other original of the October 1, 1948, contract has been provided, nor has the failure of the Lustron files to contain an original copy of the October 1 contract been explained. What purports to be a conformed copy of the October 1 contract was found in the Lustron files, but this draft contains a significant variation from the original produced by the Commercial Home Equipment Corp. officials in that the copy in the

Lustron files contains a clause requiring Commercial Home Equipment Corp. to provide paid-in capital of \$200,000 as of September 30, 1948, whereas that provision is omitted in the purported original contract produced by Commercial Home Equipment Corp. representatives. It should be pointed out that the receiver appointed March 6, 1950, by the United States district court in Columbus, Ohio, acted in reliance on the September 1, 1948, contract and the Lustron copy of the October 1, 1948, contract to work out temporary hauling arrangements with Ben Spector and Commercial Home Equipment Corp. The October 1, 1948, contract considered by the court appointed officials contained the provision for \$200,000 capital. Mr. Conger, attorney for Lustron, however, testified that Lustron agreed to the deletion of the \$200,000 deposit requirement in the revised contract, because there was already sufficient equipment on hand to assure performance.

Under the transportation contracts the Lustron Corp. had ordered on January 13, 1949, a total of 800 trailers and 267 tractors, calling for complete delivery by March 7, 1949. Subsequently on February 16, 1949, this order was increased by 70 additional special trailers and 23 tractors, making a total of 870 trailers and 290 tractors.

Around the 1st of March 1949 it became apparent that Lustron would not need the trailers and tractors in the quantities and at the times ordered. Accordingly, conferences were held between Lustron and Commercial Home Equipment Corp. officials in which Lustron sought to reduce the number of tractors to be delivered and to delay delivery of some trailers for several months. The negotiations on behalf of the Lustron Corp. were conducted principally by Russell G. Davis, vice president.

Meanwhile, deliveries of tractors and trailers had been made so that by March 2, 1949, it was reported that 160 tractors and 312 trailers had been furnished by Commercial Home Equipment Corp. to Lustron Corp.

It is unquestionably true that the difficulties in the transportation arrangements were in large part due to the abrupt turnabout of Lustron's officials as to their needs. From their prior heavy pressure for more trailers and tractors in January and February 1949, they suddenly found they had ordered too many and sought to cut back the number furnished by Commercial in early March 1949.

Since the manner in which the receipt of equipment was recorded and evidenced is material to the alleged overcharges by Commercial Home Equipment Corp., it is necessary to describe these procedures in detail. As to the trailers, it was the practice of Commercial Home Equipment Corp. to furnish a written statement of the delivery of the trailers, including a serial number, and to obtain from a representative of the Lustron Corp. a signed receipt for delivery of such trailers.

With respect to tractors, however, this practice was not followed but a representative of Lustron was orally notified, either by telephone or in person, that tractors were available for Lustron's use. This oral notification was made on behalf of Commercial Home Equipment Corp. by Ben Spector, vice president of Commercial Home Equipment Corp. and its resident manager in Columbus, or by Mr. Spector's subordinates, one of whom was Sidney Katz. The oral notification was received on behalf of Lustron Corp. by Mr. Brian O'Rourke, truck dispatcher for Lustron. It should be noted that both contracts September 1, 1948, and October 1, 1948, provided that Commercial

Home Equipment Corp. should furnish Lustron with a specific description of each piece of equipment.

Mr. O'Rourke had previously been employed by Mr. Sidney Katz, a nephew of the Gottliebs engaged in the trucking business in Nashville, Tenn. In October 1948, while Katz was employed by Commercial Home Equipment Corp., Mr. O'Rourke was hired by Lustron as truck dispatcher. O'Rourke was recommended to Mr. Russell G. Davis, Lustron's vice president, by Mr. Ben Spector, vice president of Commercial Home Equipment Corp. Mr. O'Rourke's salary was fixed at \$125 a week, \$25 per week in excess of the salary of his superior, Mr. W. H. Welch, supervisor, motor transport division of Lustron.

The testimony shows that Mr. O'Rourke prepared daily tractor and trailer receiving reports which were signed by Mr. Welch. Copies thereof were distributed to various officials in the Lustron Corp. and to representatives of the Reconstruction Finance Corporation. It was on the basis of these reports that the accounting division of Lustron Corp. approved and paid bills submitted by Commercial Home Equipment Corp. for the rental of equipment.

Mr. O'Rourke, under oath, admitted that he knew that the receipt of a tractor available for Lustron's use created a liability on the part of Lustron in favor of Commercial Home Equipment Corp. at the rate of \$1,120 per tractor per month. He also admitted that he knew that the reports which he prepared were the basis upon which Lustron approved and paid billings by Commercial Home Equipment Corp. Mr. O'Rourke further admitted that he was the only one on behalf of the Lustron Corp. responsible for certifying to the receipt of tractors.

Prior to March 2, 1949, Lustron had received from Commercial Home Equipment Corp. 160 tractors. The serial numbers of these tractors were obtained by O'Rourke and recorded in Lustron's records. Between March 2, 1949, and March 14, 1949, Mr. Ben Spector on behalf of Commercial Home Equipment Corp. reported to Mr. O'Rourke that a total of 40 additional tractors had been received and were available for Lustron's use. In the usual course of business, Mr. O'Rourke recorded the receipt of these tractors on the daily tractor and trailer receiving reports prepared by him for Mr. Welch's signature. The serial numbers on these 40 tractors were never supplied by Commercial Home Equipment Corp. to Lustron. Neither Mr. O'Rourke nor any other official or employee of Lustron checked the accuracy of the representations made by Mr. Spector. Nevertheless, during and subsequent to March 1949 payments were made to Commercial Home Equipment Corp. by Lustron under the minimum guaranteed mileage clause based upon the receipt of a total of 200 tractors.

As a matter of fact, the White Motor Co. during the month of March 1949 completed 50 tractors for the order of Commercial Home Equipment Corp. These tractors as completed by White Motor Co. were not ready and available for service for Lustron because certain equipment had to be added by Commercial Home Equipment Corp. to prepare the tractors for service on the road; namely, a fifth wheel and tires, sanders, extra gasoline tanks, spot-lights, and other miscellaneous equipment costing in the neighborhood of \$500 per tractor. These 50 tractors were never so equipped by Commercial Home Equipment Corp. There is evidence that the

White Motor Co. sought to induce the Commercial Home Equipment Corp. to accept delivery of these 50 tractors. However, delivery was never at any time accepted by Commercial Home Equipment Corp. nor did Commercial Home Equipment Corp. at any time have title to the 50 tractors in question. Being unsuccessful in persuading Commercial Home Equipment Corp. to accept the 50 tractors, the White Motor Co. disposed of them, at no loss, through its dealer organization. Forty-six of the tractors in question were shipped during the month of July 1949 and the four remaining tractors were shipped in the early part of August 1949.

Negotiations for further revision of the transportation contract continued and various proposals were considered and drafts prepared. The testimony indicates that in November 1949 one such draft was agreed to, in principle, by officials of Commercial Home Equipment Corp. and officials of the Lustron Corp. However, this draft was never executed. By its terms the draft of November 1949 was dated back to July 1, 1949, and recited that 200 tractors had been furnished to Lustron by Commercial Home Equipment Corp. The basis of payments of rentals was changed in the November 1949 draft to provide for a minimum flat payment of \$235,000 per month. Although never executed and therefore presumably never a valid and binding contract, Commercial Home Equipment Corp. billed and Lustron paid on the basis of the provisions of this November 1949 draft, making the \$235,000 monthly payments retroactive to July 1, 1949. On December 6, 1949, a difference owing Commercial Home Equipment Corp. between the \$235,000 rate and the payments actually made by Lustron prior to that time was computed and was paid by Lustron to Commercial Home Equipment Corp.

Representatives of Commercial Home Equipment Corp. seek to explain the representation that 200 tractors had been delivered, whereas only 160 had ever been in fact owned by Commercial Home Equipment Corp. and supplied to Lustron, by the following arguments:

1. Commercial Home Equipment Corp. points out that the contracts of September 1, 1948, and October 1, 1948, provided for a demurrage charge on trailers left on lot location in excess of 96 hours. Commercial Home Equipment Corp. claimed \$121,120 accrued demurrage as of March 31, 1950, for which Lustron officials disputed liability on the ground that it was agreed between Commercial Home Equipment Corp. and Lustron that in the stages preceding full production and delivery of Lustron houses, the demurrage charge was unrealistic and should be waived. There are memoranda in the Lustron files evidencing this waiver of demurrage by officials of Commercial. This waiver is further substantiated by the fact that the books of Commercial do not record any charge for demurrage prior to September 1949. The fact that Commercial's books record \$121,120 as demurrage should also be viewed in the light of the contract, said to be agreed to in principle in November 1949 but dated back to July 1, 1949. This draft, which was never completed or executed, provided that Commercial's "claims for demurrage, yard haulage, and all other items existing as of the date hereof which aggregate \$-----" were to be credited against the prepaid accumulated mileage credit owing to Lustron.

2. Commercial Home Equipment Corp. representatives point out that under the contracts of September 1, 1948, and October 1, 1948,

they could not be required to furnish trailers in a ratio in excess of three trailers for each tractor and that in fact, they did furnish 810 trailers, which would have permitted Commercial Home Equipment Corp. to furnish and charge for 270 tractors. However, the fact remains that only 160 tractors were furnished and no interpretation of the contract would justify charging for tractors not supplied. Furthermore, Lustron files disclose that arrangements for the payment for 200 of the trailers were to be made outside the basic contract.

3. The Commercial Home Equipment Corp. also points out that at the request of Lustron officials 200 trailers were furnished Lustron over and above those furnished under the contract on the ratio of 3 trailers to 1 tractor and that these 200 extra trailers were to be paid for by Lustron outside the basic contract. There are memoranda, dated July 13 and July 27, 1949, in the files of the Lustron Corp. supporting this arrangement for the extra 200 trailers. The memorandum of July 27, 1949, indicates that the exact figure was still to be negotiated and it is clearly established that the extra trailers were, in fact, furnished to Lustron and that extra compensation in some amount for their use was entirely proper. Testimony of Commercial representatives indicates that the figure for the rental of these extra 200 trailers was agreed upon at \$249.55. Commercial's books show a claim against Lustron for excess trailer rental totaling \$323,651.24. With respect to this claim, the following should be noted:

(a) The contract of October 1, 1948, does not provide that Commercial would automatically be entitled to additional rental in case it furnished trailers in excess of the ratio of 3 trailers to 1 tractor, but rather that Commercial "shall not be required to furnish more than three trailers for each tractor requested." Neither did the contract provide, on the other hand, that the extra trailers should be furnished without charge.

(b) Claim for excess trailer rental commenced in September 1949.

(c) The unexecuted draft of supplemental agreement said to be agreed to in principle in November 1949, but dated back to July 1, 1949, provides that "claims for demurrage, yard haulage, and all other items existing on the date hereof which aggregate \$-----" are to be charged against the accumulated prepaid mileage credit due Lustron. This unexecuted draft also requires Commercial to furnish 810 trailers and such tractors as are necessary to haul them as needed by Lustron in accordance with a formula set forth and eliminates all charges for demurrage except in the State of Ohio. This draft also provides for a flat payment of \$235,000 per month based upon operations totaling 600,000 tractor-miles per month or less with greater flat sums provided in the event of the use of more than 600,000 tractor miles per month. No specific charge is mentioned for excess trailers. Since the flat payments of \$235,000 per month were made retroactive to July 1, 1949, and were accepted by Commercial, the accumulation of \$121,120 for demurrage, all subsequent to September 1949 and the accumulation of \$323,651.24 excess trailer rental, all subsequent to September, 1949, on the books of the Commercial Home Equipment Corp. are difficult to explain.

(d) The daily trailer and tractor receiving reports of Lustron Corp. show that as of June 17, 1949, only 463 trailers had been received, whereas those reports, since March 15, 1949, had shown the receipt of 200 tractors. On March 15, 1949, only 394 trailers

had been received. Accordingly, for the period of approximately 3 months between the two dates mentioned, there was a deficiency in the number of trailers according to the ratio of 3 to 1 which Lustron was entitled to require under the contract, or the difference between a maximum of 463 trailers and 600 trailers, namely 137 trailers. Taking the same valuation per trailer per month as Commercial applied to the excess trailers, namely \$249.55 per trailer per month, Lustron would be entitled to a credit on account of the deficiency in trailers provided by the ratio of 3 to 1 in the contract in an amount in excess of \$100,000.

(e) The claim with respect to excess trailers arose in August of 1949 at the time at which the 200 excess trailers were delivered to Lustron. The overbillings alleged to be fraudulent by the Investigation Division of the Reconstruction Finance Corporation totaling over one half million dollars, arising out of the representation that 40 tractors were furnished under the contract which had not been furnished, began in March 1949. Even granting the fairness of some claim for the rental of the 200 excess trailers furnished beginning in August 1949 in the subcommittee's judgment, this would hardly make the billings for the 40 excess tractors not furnished beginning in March 1949 either a normal, businesslike, or proper procedure.

4. James Gottlieb and Ben Spector of Commercial testified before the subcommittee in executive session that Russell G. Davis, vice president of Lustron, in the week of March 20, 1949, agreed, in effect, that 40 tractors completed by the White Motor Co. for Commercial Home Equipment Corp. could be left at the White factory at Cleveland and not delivered to Lustron at Columbus, Ohio, but that Commercial nevertheless could charge the minimum mileage rental on such 40 tractors as if they had been delivered at Columbus. These officials of Commercial relied heavily on this alleged oral agreement by Mr. Davis to justify Commercial's billing for 200 tractors.

With respect to this claim the following should be noted:

(a) In his testimony in public hearings James Gottlieb fixed the date of the conference at which Mr. Davis' agreement was alleged to have been made as March 24, 1949.

(b) Ten days prior to March 24, 1949, namely on March 14, 1949, Spector had already reported to O'Rourke, Lustron dispatcher, the receipt of 200 tractors (including the 40 tractors in question) in the usual course of reporting the receipt of tractors, and O'Rourke had prepared for Welch's signature the daily trailer and tractor receiving report recording the receipt of 200 tractors in the usual course of business.

(c) There is no evidence that Davis' authority was such that he could alter the terms of a written contract binding both Lustron and Commercial.

(d) There is considerable doubt whether Davis made or attempted to make any such agreement arising from the following circumstances:

(1) James Gottlieb and Ben Spector testified that L. G. Schneider, vice president of Fruehauf Trailer Co., was present at the time of the conversation in question. Subsequent to the hearings, representatives of Commercial Home Equipment Corp. furnished to the subcommittee an affidavit bearing the date June 13, 1950, signed by L. G. Schneider, in reference to this conversation. In the affidavit

Mr. Schneider stated that Mr. Davis knew that the 50 extra tractors were being held at the White factory in Cleveland and had not been delivered to Lustron. The affidavit lends support to the testimony of the Commercial officials by stating:

Mr. Gottlieb and I returned to the meeting and Mr. Gottlieb stated that if the 50 tractors could be left at the White Motor Co. without taking title to them so that payments on such tractors would not have to be made, that Commercial Home Equipment Corp. would be willing to bill on the basis of 200 tractors and 600 trailers for a period of 3 months or a total monthly billing of \$224,000 per month; that of the monthly payments of \$224,000 Commercial Home Equipment Corp. would allow Lustron to hold back \$24,000 per month for 3 months (April, May, and June 1949) which retained moneys were to be paid back to Commercial Home Equipment Corp. when Lustron's cash position warranted such payment; that on the basis of \$200,000 per month for 3 months Commercial Home Equipment could meet its commitments provided that it did not have to meet monthly payments on the 50 tractors held by White.

Mr. Davis left the room for discussion of this question with other Lustron officials and later came back and stated that it was satisfactory and thanked me and Mr. Gottlieb and Mr. Spector for our aid and assistance in working out this new arrangement.

June 26, 1950, Mr. Schneider testified on this point in the public hearings of this subcommittee, as follows:

Mr. SCHNEIDER. There was discussion on the 50 tractors that were at the White Co.

Mr. MEADER. What was the discussion about those?

Mr. SCHNEIDER. That they did not need them and what would they do with the problem of storing them, that they did not need them immediately.

Mr. MEADER. Who discussed that?

Mr. SCHNEIDER. Mr. Davis brought up the point and Mr. Gottlieb brought up the point with me.

Mr. MEADER. Did Mr. Davis say to Mr. Gottlieb in your presence that it was all right to leave those 50 tractors at Cleveland but to charge Lustron for them anyway?

Mr. SCHNEIDER. He never put it in those words. He did say that it was all right to leave them at Cleveland, because they asked if I would store them in my yard.

Mr. MEADER. We had an interview Saturday afternoon, Mr. Schneider.

Mr. SCHNEIDER. Yes, sir.

Mr. MEADER. You had two of your counsel there.

Mr. SCHNEIDER. Yes, sir.

Mr. MEADER. I asked you whether you heard Mr. Davis or Mr. Strandlund or any other official of Lustron say to any representative of Commercial Home Equipment that it was satisfactory to the Lustron Corp. for Commercial Home Equipment Corp. to charge the minimum mileage on 200 tractors, although only 160 tractors had been delivered to Lustron, and that the remaining 40 tractors be held at the White Motor Co. in Cleveland, Ohio; did I not ask you that?

Mr. SCHNEIDER. And I answered you "No."

Mr. MEADER. You never heard any such conversation?

Mr. SCHNEIDER. Yes; and I say "No" again.

\* \* \* \* \*

Mr. MEADER. At any rate, you heard no statement by any official of Lustron Corp., that it was satisfactory to the Lustron Corp., to be charged for 40 tractors that were not physically delivered to Lustron?

Mr. SCHNEIDER. No, sir.

(2) Mr. Robert Black, of the White Motor Co., in his letter of July 8, 1949, to his regional manager M. H. Anderson in Cleveland, gives further support to the claim of Commercial by stating:

We have delivered 150 tractors to Lustron to date. These tractors are doing a magnificent job. We were scheduled to deliver 50 more in May and June and were being pushed hard for delivery, so we had these built up and ready to go. Lustron was not able to attain the manufacturing rate they had anticipated and have asked to hold these jobs until October or November. We can force them to

take this delivery, but it is not advisable to do so because we have customers' relations to consider and expect to ultimately deliver the total of 500 which are on order.

Representatives of Commercial Home Equipment Corp. have furnished to the subcommittee a telegram dated August 9, 1950, from Robert F. Black, president of the White Motor Co., which reads as follows:

Reference your inquiry re my letter July 8, 1949, to our field selling organization please be advised that request to White to hold 50 White tractors until October or November came from Lustron and my best recollection came from their executive vice president, a Mr. Davis.

ROBERT F. BLACK,  
*President, White Motor Co.*

(3) On April 2, 1950, Russell G. Davis was interviewed by investigators of the Reconstruction Finance Corporation and signed a written statement of his recollection of the conversation referred to in which he stated the following:

I wish to state at this time that Mr. Spector telephoned me from Chicago last week; that I was then in Ohio on business; that Spector said he wished to see me and we arranged a meeting for Friday March 31, 1950 at the Congress Hotel where Spector had a room; that Mr. Spector called Jake Gottlieb and he later joined us. Mr. Spector said that they had everything in apple pie order except the 50 tractors that had not been delivered to Columbus; that Mr. Welch, of the Lustron transportation section, had told them that I had purportedly told Welch that these 50 tractors were to remain up at Cleveland because we had no room at Columbus; that I told Spector and Jake Gottlieb that I could not recall ever having made that statement but that I felt that there was no particular reason why that statement should be so important because if there were any question I believed that the White Motor Co. records could easily establish when the 50 trailers were—

that is a typographical error, it should be "tractors"—

manufactured, completed and turned over to Commercial Home Equipment Corp. It was then for the first time that I heard that there was a revised contract; Spector and Gottlieb said that they had revised the Lustron contract in September, I believe, and dated it back to July 1949; that they gave me this explanation when I inquired as to whether White Motor Co. still had the tractors. Spector and Gottlieb stated that White had sold the tractors to others. However, I could not understand how White Motor Co. could have sold these 50 tractors, but they claimed that this was as a result of their revised contract with Lustron.

I was aroused by Spector's anxiety to see me and it was my impression that something was going on; that it seemed that they were trying to assist me to refresh my recollection as to what had happened.

It was always my impression that 200 tractors were manufactured by White and delivered and/or made available to us by Commercial Home Equipment Corp.; that I had no direct or indirect information that Commercial Home withdrew any tractors for its own benefit and it is my impression that we paid Commercial Home Equipment the contract minimum monthly guaranty of 4,000 miles per tractor computed on the basis of 28 cents per mile; commencing with about the middle of March 1949, when Mr. Welch reported 200 tractors. I assume that Lustron paid Commercial Home Equipment Corp. the monthly minimum guaranty on the basis of 200 tractors. I was therefore surprised to learn from Messrs. Gottlieb and Spector that 50 tractors had been sold by White and that the original transportation contract between Lustron and Commercial Home Equipment Corp. had been revised.

(4) Mr. Russell G. Davis died May 13, 1950.

(5) Although both Welch and O'Rourke testified before the subcommittee regarding statements to them by Davis tending to support the account of James Gottlieb and Ben Spector of the conversation in question, the signed statements of Welch and O'Rourke made to

investigators of the Reconstruction Finance Corporation on March 31, 1950, prior to Mr. Davis' death, contain no reference whatever to any such statements.

(6) Although urged to do so by the White Motor Co., Commercial never accepted title to the 40 tractors in question and all of them were disposed of otherwise in July 1949.

The subcommittee finds it difficult to decide what credence or legal effect to give to the alleged oral statement by Mr. Davis, whose mouth has been sealed by death, to the effect that Commercial could charge Lustron for 40 tractors although they were not furnished and available for Lustron's use at Columbus.

5. It should also be pointed out that there is an accumulated mileage credit in favor of Lustron in the approximate amount of 1½ million dollars and that in their testimony before the subcommittee, officials of Commercial have recognized the validity of this credit. Commercial claims that if Lustron were able to take full advantage of this credit, Lustron would recover the alleged half-million-dollar overpayment based on the undelivered tractors. However, it should be noted that this credit can be used only in miles traveled in the hauling of Lustron houses in excess of the guaranteed minimum monthly mileage provided. In view of the circumstances that Lustron's operations have ceased altogether at the present time and that its future is in litigation through receivership proceedings in Columbus, Ohio, and bankruptcy proceedings in Chicago, Ill., there is considerable doubt of the prospect of realization of this credit in the foreseeable future. It also should be pointed out that the financial stability of Commercial Home Equipment Corp. is dubious due to the fact that Commercial has a capital structure with an original equity of only \$2,000; that in excess of \$400,000 was withdrawn by the stockholders in salary, loans, expenses and for other purposes and accordingly there is little or no capacity in Commercial to provide the miles of transportation service to which Lustron is entitled. In spite of this fact, the corporation's stockholders insist on their ability to maintain solvency and carry out the corporation's contract.

6. Commercial's officials also cite the unexecuted revised contract of November 1949, dated July 1, 1949, as proof that the alleged over-billing for the tractors did not continue after July 1, 1949, in any case. It is conceded that Lustron made payments of \$235,000 a month, retroactive to the 1st of July, as called for in that contract. Commercial argues that this established a different, lump-sum basis for rental payments and supplanted the original contract provisions for payments based on the number of tractors delivered. This contract did specify that Commercial should furnish 810 trailers, but did not specify the ratio or number of tractors Commercial would be required to furnish. This unexecuted contract required Commercial to furnish "sufficient tractor equipment to meet lessee's requirements for hauling such trailers." They argue that the overbilling is at most for a period of 3 months, therefore, and did not approach the alleged figure of over \$500,000.

It must also be noted, however, that if this theory is adopted, it knocks out Commercial's counterclaims against Lustron for demurrage and excess trailer rentals carried on Commercial's books, both of which sets of charges would thereupon have been covered by the new lump-sum payments. And it will be recalled that even the November con-

tract was predicated upon recitals that 200 tractors had been furnished, although the White Co. had by then disposed of the extra tractors.

The total paid by Lustron for trucking equipment furnished and billed for by Commercial to March 6, 1950, was \$2,990.939.45. It is charged by the Investigation Division of Reconstruction Finance Corporation that of this total, fraudulent excessive billings were made by Commercial of \$501,466 between March 1, 1949, and March 6, 1950, and that payments of this amount were made by Lustron. In addition, the Investigation Division of Reconstruction Finance Corporation charges that Commercial fraudulently overcharged \$31,128.28 by representing that it had furnished tractors earlier than the actual date of delivery of the tractors to Commercial from the White Motor Co. and that payment of this amount was also made by Lustron. Thus the total alleged overcharges amounted to \$532,594.28. It is as an offset to this amount that Commercial claims the charges of \$121,120 for demurrage and \$323,651.24 for excess trailer rental should be considered.

The subcommittee does not seek to pass upon questions of legal liability. However, the neglect to observe legal formalities in the execution of the various contracts, the continual renegotiation of the terms of the transportation arrangement and frequent departures from the provisions of the executed contracts render it difficult to ascertain the true facts with respect to the legal status and rights and obligations of Lustron and Commercial Home Equipment Corp. with respect to their transportation dealings. It is this confusion and uncertainty and unbusinesslike recording of transactions and agreements between Lustron Corp. and Commercial Home Equipment Corp. which the subcommittee regards as being contrary to the public interest where the expenditure of public funds is involved.

Out of the funds paid by Lustron to Commercial Home Equipment Corp., the stockholders and directors of Commercial Home Equipment Corp. have made withdrawals in their own favor as follows:

	Salary	Loans	Expenses	Total
John Gottlieb.....	\$15,000	0	\$12,568.95	\$27,568.95
James Gottlieb.....	15,000	\$81,058.86	13,627.44	109,686.30
Paul Buckley.....	15,000	195,000.00	8,481.83	218,481.83
Total.....	45,000	276,058.86	34,678.22	355,737.08

In addition the books of Commercial Home Equipment Corp. show that a total of \$21,150 was withdrawn by R. J. Koller, secretary. This sum, together with the sum of \$55,772.50 of the amount charged to James Gottlieb, or a total of \$76,922.50, was used to purchase \$70,000 5 1/4 percent Missouri Pacific bonds for the account of James Gottlieb. Subsequent to the subcommittee's hearings, evidence has been furnished to the subcommittee showing the sale of these bonds and the deposit on May 10, 1950, of the entire proceeds, \$79,351, to the credit of Commercial Home Equipment Corp. A profit of \$2,428.50 was thus realized and credited to Commercial Home Equipment Corp. In addition, the sum of \$35,000 is shown on the books of Commercial Home Equipment Corp. as being withdrawn by Mr. Oscar Schaefer, accountant. This sum was used for the acquisition of certain oil interests for John and James Gottlieb. Accordingly, total

withdrawals in favor of the stockholders of Commercial Home Equipment Corp. were as follows:

Paul Buckley	-----	\$210, 000. 00
James Gottlieb	-----	134, 708. 86
John Gottlieb	-----	32, 500. 00
Total	-----	377, 208. 86
Total expenses	-----	34, 678. 22
Total	-----	411, 887. 08

It appears that no collateral was given for the loans to either John or James Gottlieb and that only \$158,000 of the loans to Buckley were evidenced by notes. \$123,000 of this amount was secured by the unsecured note of a corporation in which Buckley has a substantial stock interest. Actually, at the time the Reconstruction Finance Corporation investigators examined the books of the Commercial Home Equipment Corp. during the first week in May 1950 there was no note found securing Paul Buckley's loans or any part thereof.

Concurrently with the negotiation and the execution of the first contract between Commercial Home Equipment Corp. and Lustron executed September 17, 1948, but dated September 1, 1948, Paul Buckley also received loans from James Gottlieb, as follows:

Aug. 23, 1948 (credit memorandum)	-----	\$213
Aug. 23, 1948	-----	1, 900
Aug. 31, 1948	-----	6, 000
Sept. 13, 1948	-----	10, 000
Nov. 15, 1948	-----	16, 887
Total	-----	35, 000

James Gottlieb denied that this extension of credit to Paul Buckley had any connection with Buckley's assistance as director of Lustron in the negotiations of the trucking contract. He explained the loans on the basis that Mr. Buckley needed the money and so he, James Gottlieb, let him have it. No security for these loans was asked for or provided. It should be noted that no notes were given by Buckley for any portion of this \$35,000 indebtedness.

Mr. Harvey Gunderson, Reconstruction Finance Corporation Director, testified (p. 187, hearings) as follows:

My present impression is that, if the houses had come off the line as was expected, and these trucks had been used as anticipated, that would have been a very favorable situation for everybody. The hauling rate might have been a little higher, something like that, but it would have worked out and it would have been favorable, and I still to this day think it was a very good thing to have them do, because it saved the RFC about \$8,000,000 that we would have had to put up to buy that motor equipment.

The subcommittee has not sought to analyze the transportation arrangement from the point of view of its desirability in comparison with other possible methods of transportation. The subcommittee has concerned itself rather with the manner in which the agreement with respect to transportation was embodied in formal contracts and the manner in which the contract was performed. The subcommittee sought to learn whether the transaction was handled in a regular and businesslike manner.

The evidence in the record before the subcommittee raises considerable doubt as to the accuracy of Director Gunderson's impression that the Commercial Home Equipment Corp. contract with Lustron

saved the Reconstruction Finance Corporation \$8,000,000 which otherwise would have had to be invested in motor equipment. Commercial Home Equipment Corp. did not invest \$8,000,000 but only \$2,000. The tractors purchased from the White Motor Co. were financed by banks and financing companies in the fashion usual in commercial trucking operations. Aside from the claim of the Commercial Home Equipment Corp. officials, there is no evidence to indicate that Lustron would have encountered any greater difficulty in financing these tractors than was the case with Commercial Home Equipment Corp.

With respect to the trailers which were specially built and not readily convertible to uses other than the hauling of Lustron panels and parts, the situation is somewhat different. However, the subcommittee has received assurance from the Fruehauf Trailer Co. that it would have been willing to deal directly with Lustron on substantially the same basis as that on which it did in fact deal with Commercial Home Equipment Corp. This position is stated in the following exchange of telegrams:

JULY 28, 1950.

**ROY FRUEHAUF,**  
*President, Fruehauf Trailer Co.,*  
*Detroit, Mich.:*

June 30, 1950, your counsel informed me that the Fruehauf Trailer Co. was willing in the fall of 1948 to sell specially built trailers direct to Lustron Corp. on terms equally as favorable as those on which such trailers were in fact sold to Commercial Home Equipment Corp. for lease to Lustron Corp. Repeated attempts have been made to obtain written confirmation of this statement of position. These attempts have been unsuccessful due to your unavailability for comment. Members of subcommittee are interested in the position of the Fruehauf Trailer Co. on this point and would therefore appreciate such information as you can furnish with respect thereto.

**GEORGE MEADER,**  
*Counsel, RFC Subcommittee,*  
*United States Committee on Banking and Currency.*

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DETROIT, MICH., July 28, 1950.  
**GEORGE MEADER,**  
*Counsel, Subcommittee on Reconstruction Finance Corporation (J. W. Fulbright, Chairman):*

Retel answer to your telegram is obvious as you remember I testified that we based on our sale on assurances from RFC officials that they were going to see Lustron through. Therefore we were depending on Lustron's standing RFC and not the credit of Commercial Home Equipment. We would have been happy to sell Lustron direct.

**ROY FRUEHAUF.**  
**FRUEHAUF TRAILER CO.**

#### COMMENTS

##### 1. *The alleged fraud*

The representatives of the Lustron Corp., when it becomes settled who they may be, will undoubtedly explore the possibilities of recovery in civil proceedings for any overpayments to Commercial Home Equipment Corp.

The evidence leaves no doubt that the Commercial Home Equipment Corp. representative, Mr. Ben Spector, represented to Mr. Brian O'Rourke, the Lustron truck dispatcher, that 40 tractors had been furnished in the same way that the availability of the first 160 tractors had been reported. The preponderance of the evidence is to

the effect that O'Rourke and all other employees and officials of Lustron with the exception of Davis, as to whose knowledge and acquiescence the record is in conflict, relied on the representation that a total of 200 tractors had been furnished to Lustron at Columbus, and that all subsequent billings and payments and all negotiations for compromises and substitute arrangements were based upon the continuous representation by agents of the Commercial Home Equipment Corp., and the belief in that representation by Lustron officials, that 200 tractors had in fact been furnished by Commercial to Lustron pursuant to the terms of the contract.

The subcommittee believes it is also clear that the representation that a total of 200 tractors had been furnished under the contract was not true. The 40 tractors in question at no time became the property of Commercial Home Equipment Corp. The evidence before the subcommittee indicates that the manufacturer, the White Motor Co., repeatedly sought to induce Commercial Home Equipment Corp. to accept title to the tractors in question but that Commercial Home Equipment Corp. refused to take the tractors, and in July and early August of 1949 all of the 40 tractors in question were sold to other customers. There is no evidence that Commercial Home Equipment Corp. at any time reported that the 40 tractors in question were no longer available to Lustron, even after they were sold to others. It is also indisputable that Commercial Home Equipment Corp. knew it did not have the tractors and knew that they were not available for service to Lustron subsequent to July and early August 1949. Nevertheless, the November 1949, draft of a substitute transportation agreement, which, although unexecuted, was said to be agreed to in principle, and on which payments were made by Lustron and accepted by Commercial, contained the following express recital:

Whereas pursuant to said agreement dated October 1, 1948, lessor has furnished to lessee 600 specially built trailers and 200 tractors, and \* \* \*.

Mr. Ben Spector contended that the 40 tractors in question were furnished to Lustron because their manufacture had been completed by the White Motor Co., and it only remained for a driver to go to Cleveland and bring the tractors to Columbus and for Commercial Home Equipment Corp. to execute the necessary documents to acquire title to the tractors. Mr. Spector argued before the subcommittee that the provision for payment of rental, identical in both the September 1, 1948, and October 1, 1948, contracts, based on tractors "assigned to and available for service" was satisfied by the completion of the tractors by the White Motor Co. at Cleveland although Commercial Home Equipment Corp. did not yet own them, had not added the equipment required to make them ready for service and had not brought them to Columbus.

Of course, the interpretation of legal phraseology is a matter for the courts. However, the subcommittee considers it clear that the purpose of obtaining the tractors was not served by the bare completion of manufacture at Cleveland and cannot conceive how it can reasonably be maintained that the 40 tractors were still available after they had been disposed of by White Motor Co. to others than Commercial Home Equipment Corp. Put in the light most favorable to Commercial Home Equipment Corp., it must be admitted that the reporting of 40 tractors as delivered to Lustron which had, in fact, not been delivered was an unusual, if not irregular, practice. On the

other hand, due weight should be given to the claims of Commercial Home Equipment Corp. for demurrage and excess trailer rental, and to the testimony of its officials that Mr. Davis, of Lustron, had orally agreed to the holding back of the trailers in Cleveland.

## *2. Conduct of Lustron and Reconstruction Finance Corporation officials*

Whatever may be the outcome of the charges of fraud, the subcommittee regards as its primary responsibility the appraisal of the conduct of Lustron and Reconstruction Finance Corporation officials rather than that of Commercial Home Equipment Corp. officials. It is to the Lustron Corp., which was provided with 22 public dollars for each dollar risked by its stockholders and to Reconstruction Finance Corporation officials charged with the duty of protecting tax dollars from waste, dissipation and careless and unintelligent management that the subcommittee believes its attention should be primarily directed.

The manner of making the transportation charges, whether fraudulent as alleged, or merely irregular, was not a complex and difficult matter to comprehend. It did not require the mind of a genius to find out whether the 40 tractors were present or not. It seems to the subcommittee that even a minimum standard of normal business practices and procedures would have detected or rather would have made impossible the factual misrepresentation that seems to have succeeded. The subcommittee believes that, where liability for payment is predicated upon receipt of a particular item, it is a rare thing for any businessman to fail to check the actual receipt of that item. It is an unusual business practice to accept blindly the accuracy of the representation of the one in whose favor the obligation arises, without verification, if only to prevent unintentional inaccuracies or errors. The subcommittee feels this is more than a matter of second-guessing and hindsight. It believes that such checking of invoices, bills of lading, and reports of delivery of an item creating a legal liability, are simply routine, normal functions performed as a matter of course by any well-run business. This was the responsibility of Lustron officials in the first instance. Reconstruction Finance Corporation officials supervising and servicing the Reconstruction Finance Corporation loan were under a duty to examine the practices and procedures employed by Lustron to make certain that sound businesslike practices were consistently being followed.

In general, the subcommittee concludes that the negotiation, execution and performance of the transportation contract were conducted in a most irregular and unbusinesslike manner. The contract, by its terms, was to run 4 years and upon the basis of the quantities of equipment to be provided as contemplated would have involved total rental payments of from \$10,000,000 to \$12,000,000.

It should have been perfectly apparent to everyone that until the Lustron Corp. could achieve operation on a profitable basis that the payments on the transportation contract would have to be made out of public funds provided by the Reconstruction Finance Corporation loans. Under these circumstances, in the view of the subcommittee, it was incumbent upon the officials of Lustron, Commercial, and the Reconstruction Finance Corporation to exercise scrupulous care in observing normal business procedures and legal requirements, as well as ordinary good business judgment, to prevent the dissipation and waste of funds in a careless and improvident manner.

The facts in the record of the subcommittee can lead to only one conclusion, namely that this obligation was wholly disregarded and that on the contrary, the transportation phase of Lustron's operations was handled carelessly, irregularly, and unintelligently. Legal formalities were wholly disregarded, resulting in such confusion that it is impossible even at this time and after a careful study of the facts and records to ascertain precisely the rights and obligations of the parties with respect to the transportation of completed Lustron houses. The subcommittee believes it a sound, general proposition that it is in such confusion and uncertainty that waste and losses are most likely to occur. The subcommittee cannot escape the feeling that if normal, sound business procedures had been observed the waste and losses which have been suffered in the transportation phase of Lustron's operation could not have occurred. The subcommittee believes that no private enterprise under an obligation to safeguard the investment and earnings of private stockholders would have been so inefficiently managed. The subcommittee cannot escape the feeling that simply because huge sums of public money were involved with no possibility of loss to those handling such funds that operations were conducted indifferently and in a careless fashion which would not have been tolerated with respect to stockholders' capital.

The officials of the Reconstruction Finance Corporation responsible for the servicing and supervision of the Lustron loan have sought in their testimony before the subcommittee to escape responsibility for the waste and loss which has been disclosed on the grounds that it is the firm policy of the Reconstruction Finance Corporation not to interfere with the management of the borrower.

It is the view of the subcommittee that the Reconstruction Finance Corporation owes to the public a duty to safeguard the public funds it loans. Its obligation in the Lustron loan was even more pronounced due to the extraordinary circumstances surrounding that loan from its inception. The investment of the stockholders of Lustron totaled \$1,700,000. The loans from Reconstruction Finance Corporation totaled \$37,500,000. For every dollar invested by Lustron's stockholders the United States taxpayer risked 22. It would seem reasonable to expect that Reconstruction Finance Corporation would follow and protect the taxpayers' investment in the Lustron enterprise closely and diligently. The public had the right to expect that the Reconstruction Finance Corporation would insist that sound, businesslike practices would be adopted and carried out.

The subcommittee's criticism is directed to the quality of the supervisory activity of Reconstruction Finance Corporation personnel rather than its quantity. The record discloses that a sufficient, if not an excessive, number of man-hours and other expenditures were devoted to the servicing of the Lustron loan. However, the record also shows conclusively that the only legitimate purpose of such Reconstruction Finance Corporation supervisory activity, namely, insuring that the public funds entrusted to Lustron be utilized efficiently in accomplishing the objective of the loan, was not served.

The subcommittee believes it is the responsibility of Reconstruction Finance Corporation to devise and execute proper programs for the servicing of loans. It is not the responsibility of the subcommittee. The subcommittee is convinced, however, that the results as shown in the Lustron-Commercial transportation dealings reveal serious

inadequacy and weakness in Reconstruction Finance Corporation's loan-servicing measures and procedures.

The Cleveland Loan Agency of Reconstruction Finance Corporation was assigned the primary task of servicing the Lustron loan. The manager of that agency was Mr. Jesse A. Fraser. Mr. Paul Boardman, Senior Examiner in the Cleveland agency, was assigned specifically to the Lustron case in March 1948 and has been the principal representative of Reconstruction Finance Corporation in handling the Lustron loan up to the present time. Mr. Roy Busch, a Reconstruction Finance Corporation examiner, and Mr. Edwin F. Mewhinney, a Reconstruction Finance Corporation engineer, were stationed at the Lustron plant for the purpose of observing Lustron operations during the entire life of the loan. Boardman, Busch, and Mewhinney all spent the major portion of their time on the Lustron loan.

Routine reports of the Lustron Corp. disclosing financial operations, including the daily tractor and trailer receiving reports, were regularly and continuously furnished these Reconstruction Finance Corporation representatives. There is not a shred of evidence that Lustron officials concealed any aspect of Lustron's operations from Reconstruction Finance Corporation representatives, that Lustron officials refused to supply any information or were uncooperative in any way. On the contrary, there are indications that Lustron officials were sensitive and receptive to suggestions made either by Boardman and his associates, or by other Reconstruction Finance Corporation officials, concerning Lustron's operations. There is evidence that Boardman sought information regarding Commercial Home Equipment Corp., particularly with respect to its financial stability, which information was refused by Commercial.

In his testimony before the subcommittee in executive session and in public hearing, Mr. Boardman expressed his surprise that what he now believes to be a half-million dollar fraud had been perpetrated. However, Mr. Boardman did not regard the disclosure of the fraud as any reflection on the quality and effectiveness of his supervisory activities. Moreover, Mr. Boardman was unable, in retrospect, to offer any suggestions for improving Reconstruction Finance Corporation's supervisory or servicing procedures which might prevent a recurrence of the Lustron-Commercial transportation episode with respect to future Reconstruction Finance Corporation loans. Mr. Boardman professed the view that no method could be devised to protect the dissipation of public funds loaned by Reconstruction Finance Corporation from dishonest or fraudulent inroads. Mr. Boardman professed an ignorance of some matters connected with the Lustron-Commercial transportation dealings, in which he was not corroborated by other witnesses. Mr. Boardman also professed a lack of authority with respect to day-to-day decisions in Lustron's operations which was at variance with the understanding of other witnesses. Mr. Boardman stated to the subcommittee that he scrupulously observed the firm policy of Reconstruction Finance Corporation against interference in the management of a Reconstruction Finance Corporation borrower. The record before the subcommittee fails to disclose any noticeable reticence on the part of Reconstruction Finance Corporation officials with respect to making suggestions on matters normally considered as prerogatives of management.

The subcommittee is unable to form a clear understanding of the precise duties and responsibilities of Boardman, Busch, and Mewhinney with respect to Lustron's operations. The subcommittee, in the light of the history of the transportation dealings and based upon the testimony of the above witnesses, is not sure that it perceives clearly the exact purpose of stationing Boardman, Busch, and Mewhinney at the Lustron plant. On the record before it, the subcommittee suspects that Boardman, Busch, and Mewhinney share the subcommittee's uncertainty.

One possible explanation of this confusion with respect to function and responsibility is that there apparently were no written instructions to these Reconstruction Finance Corporation representatives.

In addition to the Reconstruction Finance Corporation field representatives, there were many special studies of the Lustron operation directed and controlled from the Washington office of the Reconstruction Finance Corporation. Some of these studies were undertaken by Reconstruction Finance Corporation personnel, such as auditors or examiners and even some of the directors. Others were conducted by outside accountants, engineering firms, or manufacturers and businessmen. Stone & Webster, an engineering consulting firm, made surveys in the early stages of the Lustron operation. Booz, Allen & Hamilton made a survey of Lustron in the fall of 1949.

Lustron employed Ernst & Ernst, certified public accountants, copies of whose reports were regularly furnished to Reconstruction Finance Corporation.

In September 1949 a special survey was conducted by two Detroit manufacturers, Mr. Rex C. Jacobs and Mr. E. J. Hunt. They reported to Reconstruction Finance Corporation on September 9, 1949, calling attention, among other things, to the high cost of transportation.

In addition, three of the directors of Reconstruction Finance Corporation made special trips to the Lustron plant. The record discloses frequent long-distance telephone conferences and many personal conferences in Washington between Reconstruction Finance Corporation officials and officials of the Lustron Corp. At the subcommittee's request a summary of the expenditures incurred in the servicing of the Lustron loan was prepared by Reconstruction Finance Corporation showing an estimated grand total of such expenses of \$162,139.03, exclusive of salaries and general overhead expenses at the Cleveland and Washington offices of Reconstruction Finance Corporation.

The subcommittee is at a loss to understand how the irregular business practices connected with the transportation dealings between Commercial Home Equipment Corp. and Lustron could have gone unnoticed in the light of the extensive activities by and on behalf of the Reconstruction Finance Corporation in servicing the Lustron loan as recounted above.

The testimony shows that in December 1949 Lustron officials learned of the unauthorized use of a Lustron tractor for some other hauling work of the Gottliebs. Thereupon Mr. Brian O'Rourke, Lustron truck dispatcher, made a physical count of tractors available to Lustron, checking those at the Lustron plant, those in service on the road and those in the Commercial Home Equipment Corp. garage at Columbus, for repairs and maintenance. He was able to account for only 157 tractors. Neither Lustron officials nor Reconstruction Finance Corporation officials have given the subcom-

mittee any satisfactory explanation of the failure to initiate a thorough investigation immediately as a result of this report made by Mr. O'Rourke.

James Gottlieb in his testimony aptly pointed out that even after this fact became known nothing was done except that Lustron continued to make the payments for an additional 2 months or more on precisely the same basis as payments had previously been made. It was not until the Investigation Division of the Reconstruction Finance Corporation was authorized to look into the matter in March 1950 that any effective action was taken on the part of anyone either in the Lustron Corp. or in the Reconstruction Finance Corporation to find out the true facts. The subcommittee can find no justification for this apparent laxity and indifference.

## CONCLUSIONS AND RECOMMENDATIONS

### CONCLUSIONS

1. The Reconstruction Finance Corporation was ineffectual in its supervision of the transportation phase of the Lustron operation, which involved a substantial portion of the 37½ million dollars of public funds loaned by Reconstruction Finance Corporation to Lustron to promote the manufacture of prefabricated housing.

2. Reconstruction Finance Corporation representatives charged with the duty of protecting the public funds loaned to Lustron exhibited inability to detect irregularities and an indifference to unbusinesslike procedures in dealings connected with the transportation from factory to homesite of the completed panels, parts, and equipment of prefabricated Lustron houses.

3. Lustron officials failed to adopt, with respect to transportation of completed houses, normal businesslike procedures and practices which would have prevented the dissipation of funds derived from and owing to the Government through the payment of overcharges made by the Commercial Home Equipment Corp.

4. Officials of Lustron and Reconstruction Finance Corporation were aware that a director of Lustron was also a stockholder and director of Commercial Home Equipment Corp. and that this director actively conducted negotiations on behalf of the Commercial Home Equipment Corp. with his associates and subordinates in the Lustron Corp. with respect to the transportation dealings between the two corporations. These Lustron and Reconstruction Finance Corporation officials were remiss in their duties through their tacit approval of such practices and through their failure to subject transactions and arrangements arising from such negotiations to the most rigorous scrutiny.

5. An exception to the inefficiency displayed by officials and employees of the Reconstruction Finance Corporation was the activity of the Investigation Division of the Reconstruction Finance Corporation. This Division, upon receiving authority to look into the transactions between the Lustron Corp. and the Commercial Home Equipment Corp., displayed diligence and effectiveness in its thorough exploration of these transactions and thereby uncovered what are claimed to be excessive and irregular payments of more than \$500,000 made to the Commercial Home Equipment Corp.

## RECOMMENDATIONS

1. The subcommittee does not undertake to pass upon the legal consequences of the evidence. That task is one for the Department of Justice. The Department of Justice should therefore promptly investigate the circumstances surrounding the transportation arrangement between Commercial Home Equipment Corp. and the Lustron Corp. for the purpose of ascertaining whether there is probable cause to believe that an offense has been committed against the laws of the United States.

2. The Reconstruction Finance Corporation should thoroughly re-examine its procedures and practices for the supervision and servicing of its loans with the objective of providing better protection for the funds derived from and owing to the Government at less cost in man-hours of personnel and other expenses. In such re-examination the Reconstruction Finance Corporation should give consideration to the following:

(a) A clearer definition of the duties and responsibilities of Reconstruction Finance Corporation personnel assigned to the servicing of loans.

(b) A well-defined policy with respect to the extent to which Reconstruction Finance Corporation should control the activities of the management of its borrowers where funds derived from and owing to the Government and their safety and proper use are at stake.

(c) A system for utilizing the information provided to Reconstruction Finance Corporation through the borrower's routine reports of its operations and through routine and special reports of Reconstruction Finance Corporation personnel.

(d) A system for instructing Reconstruction Finance Corporation personnel, charged with the duty of supervising and servicing such loans, regarding sound principles of business which will enable them to recognize and correct irregular practices when they occur.

(e) Special and extraordinary provisions for servicing and supervising loans, such as the loan to Lustron, where the Government risks a far greater amount of money than is risked by the Reconstruction Finance Corporation borrower.

3. The Reconstruction Finance Corporation should consider the advisability of expanding and strengthening its Investigation Division. It should provide adequate funds and authority to make possible the detection and, more important, the prevention of improper practices on the part of Reconstruction Finance Corporation personnel and Reconstruction Finance Corporation borrowers. In this connection the Reconstruction Finance Corporation should consider the advisability of the following:

(a) Providing the Investigation Division with authority to initiate investigations without prior instructions.

(b) Including in each loan agreement provisions for complete and continuous access by Reconstruction Finance Corporation to the books and records of borrowers for purposes of investigation or observation.

