STOCK EXCHANGE PRACTICES

HEARINGS

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
UNITED STATES SENATE

SEVENTY-THIRD CONGRESS

FIRST SESSION

ON

S. Res. 84

(72d CONGRESS)

A RESOLUTION TO INVESTIGATE PRACTICES OF STOCK EXCHANGES WITH RESPECT TO THE BUYING AND SELLING AND THE BORROWING AND LENDING OF LISTED SECURITIES

AND

S. Res. 56 and S. Res. 97

(73d CONGRESS)

RESOLUTIONS TO INVESTIGATE THE MATTER OF BANKING OPERATIONS AND PRACTICES, TRANSACTIONS RELATING TO ANY SALE, EXCHANGE, PURCHASE, ACQUISITION, BORROWING, LENDING, FINANCING, ISSUING, DISTRIBUTING, OR OTHER DISPOSITION OF, OR DEALING IN, SECURITIES OR CREDIT BY ANY PERSON OR FIRM, PARTNERSHIP, COMPANY, ASSOCIATION, CORPORATION, OR OTHER ENTITY, WITH A VIEW TO RECOMMENDING NECESSARY LEGISLATION, UNDER THE TAXING POWER OR OTHER FEDERAL POWERS

PART 3

Kuhn, Loeb; Pennroad Corporation

JUNE 27, 28, 29, 30, and JULY 5, 1933

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STOCK EXCHANGE PRACTICES

TUESDAY, JUNE 27, 1933

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

The subcommittee met, pursuant to call of the chairman, as a resumption of hearings recessed on Friday, June 9, 1933, at 10 o'clock a.m. in the Caucus Room of the Senate Office Building, Senator Duncan U. Fletcher presiding.

Present: Senators Fletcher (chairman), Barkley, Costigan, Goldsborough, Townsend, and Steiwer.

Present also: Senator Adams.

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; Carl A. de Gersdorff, Robert T. Swaine, and M. T. Moore, counsel for Kuhn, Loeb & Co.

The CHAIRMAN. The subcommittee will please come to order. We will proceed with the hearings. Mr. Pecora, who is your first witness?

Mr. PECORA. Mr. Otto H. Kahn.

The CHAIRMAN. Mr. Kahn will come forward to the committee table, hold up his right hand, and be sworn. 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. KAHN. I do.

TESTIMONY OF OTTO H. KAHN, A PARTNER OF KUHN, LOEB & CO., NEW YORK CITY

Mr. PECORA. Mr. Kahn, will you be good enough to give the committee reporter your full name and address, both residence and business?

Mr. KAHN. Otto H. Kahn; business address, 52 William Street, and residence address, 1100 Fifth Avenue, New York City.

Mr. PECORA. What is your business?

Mr. KAHN. I am a banker.

Mr. PECORA. Are you a member of any banking firm in the conduct of your business?

Mr. KAHN. I am a member of the banking firm of Kuhn, Loeb & Co.

Mr. PECORA. How long have you been connected with that firm?

Mr. KAHN. Since 1897.

Mr. PECORA. As a partner?

Mr. KAHN. Yes; as a partner.

Mr. PECORA. What is the personnel in that firm as at present constituted, Mr. Kahn?

Mr. KAHN. Shall I read the names, or give you the paper?

Mr. PECORA. If you will just give us the names.

Mr. KAHN. Felix M. Warburg, Otto H. Kahn, George W. Bovenizer, Lewis L. Strauss, Sir William Wiseman, John M. Schiff, Gilbert W. Kahn, Frederick M. Warburg, Benjamin J. Buttenwieser, Hugh Knowlton, Elisha Walker.

Mr. PECORA. How long has the firm of Kuhn, Loeb & Co. been in existence?

Mr. KAHN. About 65 years.

Mr. PECORA. And has its principal office during that time always been in the city of New York?

Mr. KAHN. Yes, sir.

Mr. PECORA. And does it maintain offices in any other city, Mr. Kahn, at the present time?

Mr. KAHN. It maintains offices in no other city.

Mr. PECORA. Has it at any time within the past 6 years maintained an office in any other city?

Mr. KAHN (after conferring with an assistant). I am sorry to have paused for a moment to ask a question or two, but I wanted to be precise. For a couple of years, during 1927 to 1929, I believe, or 1930, Mr. Leith, of London, was a partner in our firm, and he resided in London. We paid the office expenses. But it would be going rather beyond the spirit of our arrangements if I should say that we had an office in London. We had no offices, so to speak, but one of our partners for 2 or 3 years resided in London.

Mr. PECORA. Since 1927, and inclusive of that year, has the firm had any contract affiliation with any other bank or banking firm or banking house?

Mr. KAHN. None, sir.

Mr. PECORA. How would you describe the nature of the business conducted by the firm of Kuhn, Loeb & Co.?

Mr. KAHN. The firm of Kuhn, Loeb & Co. buys and sells securities from and to its clients. It accepts deposits from its clients but not from the general public, and it is not in the business of soliciting deposits. It buys and sells securities on the stock exchange, again for its regular clients, but not for the general public, and does not maintain any kind of special department for the service of clients that may wish to buy securities on the stock exchange through its offices.

Senator TOWNSEND. Do you maintain a stock-exchange membership?

Mr. KAHN. We maintain a stock-exchange membership in that one of our partners is a member of the stock exchange. But may I finish my answer, Senator, if you please?

Senator TOWNSEND. Yes.

Mr. KAHN. The part of our business which I was going to complete was: That it is our function to advise our clients, or those who wish to become our clients, upon financial affairs in general. And may I emphasize the word "financial", because our business is

a financial business and is not to run anybody else's business, only to run our own business as best we can in a financial way.

Mr. PECORA. Does that complete your answer, now?

Mr. KAHN. Yes, sir.

Mr. PECORA. You have referred to clients. Does the clientele of your firm consist of any particular kind of persons—that is, persons engaged in any particular kind of business?

Mr. KAHN. The clientele of our firm, Mr. Pecora, is primarily corporations engaged in different lines of business. We have few private clients. We have some inherited European clients, some of the leading European banks maintain relations with us and have maintained them for a great many years. But not of any significance, rather minor accounts. Generally speaking, it would be correct to say that our relationship is mainly with corporations.

Mr. PECORA. With what kind of corporations?

Mr. KAHN. Railroad corporations, and some industrial corporations. We have no public utility affiliations, and never have had any unless you consider the Western Union a public utility, or the American Telephone & Telegraph Co. in the financing of which we have for a number of years had an interest together with others.

Mr. PECORA. Would you say that railroad corporations constitute your principal corporation clients?

Mr. KAHN. I should say they would constitute the majority of our clients, yes.

Mr. PECORA. And has that generally been so in the past 10 years or 20 years?

Mr. KAHN. Mr. Pecora, it has been so long that I should say almost since the beginning of the firm we have specialized in the business of marketing railroad securities.

Mr. PECORA. That is, of railroad financing.

Mr. KAHN. Railroad financing; yes. That is, we have specialized in that line, perhaps unduly, and perhaps to the exclusion of a good many other opportunities which might have been more tempting. We have some industrial clients, but you are right in saying that the majority of our clientele is railroads.

Mr. PECORA. What is the general method, or what has been the general method by which your firm has financed railroad operations?

Mr. KAHN. May I ask, in order that I may correctly understand your question before I answer: Do you mean the general method in detail of buying railroad securities, or the general method in approaching railroads?

Mr. PECORA. Well, take the latter part of your inquiry, for instance, the general method of approaching railroads.

Mr. KAHN. Well, I should say precisely the same method by which a lawyer approaches clients. [Laughter.]

Mr. PECORA. Well, lawyers are not supposed to approach clients.

Mr. KAHN. I was coming to that, Mr. Pecora. Or the method by which a doctor approaches a patient who is sick. He does not go after him. Ethically and as a standard of the legal profession you are not permitted to go after him. And I do not suppose that a doctor would be permitted to go after a patient under the ethical standards of the medical profession. For instance, he could not go

if someone told him that "Mr. Smith in the next block is very sick with pneumonia, you better run in and try to find out if you can get him." That would not be the way to do it. He gets his clients by reason of his reputation for ability and for successful cures and for sound advice given. And so it is with the lawyer. So it is with the architect. And so in our case it has long been our policy and our effort to get our clients, not by chasing after them, not by praising our own wares, but by an attempt to establish a reputation which would make clients feel that if they have a problem of a financial nature, Dr. Kuhn, Loeb & Co. is a pretty good doctor to go to.

Mr. PECORA. Well, the contact having been established between doctor and patient, or in your case between banker and railroad, what is the next step in the operation of financing the railroad?

Mr. KAHN. A railroad, or some particular officer of a railroad—who, by the way, might be personally unknown to us before he was appointed to that particular position—would come to us and would say: "We have such and such a problem to solve, being a problem of a financial nature. We would like to get your advice as to the best kind of security to issue for that purpose—and, by the best kind of security I mean a security which on the one hand gives to the railroad the most useful instrument, not only for immediate purposes but for long-time purposes, and gives to the public the greatest possible protection without tying up the railroad unduly and beyond what is safe for it." So, he says: "Will you tell us what is the best kind of instrument to use for that purpose? Should it be a mortgage bond? Should it be a debenture? Should it be a convertible bond? Should it be preferred stock? Should it be an equity? We would like you to look into it and tell us. Here are our facts and figures. Go through them."

Then we would say: "It is of very great importance to know what kind of securities you want." And I might say that we have sometimes been stuck by not knowing what kind of securities would be most advantageous from all standpoints to issue. There is a great deal of importance in knowing when the market is receptive for a security. We would know that in a short while from now other large security issues are likely to come upon the market. It is our business to know that as far ahead as we can. We would know what is the general disposition of the security market. Is it favorable or is it unfavorable. Is there an investment demand or isn't there an investment demand. And that situation varies. Sometimes we can sell nothing but equities. Sometimes equities are thrown into the discard and people want safety. Again, that is our job, to know.

They would say: "Tell us your best judgment as to the time when we ought to have our bond, or whatever you advise us to use. ready for disposal. We should like your opinion as to that. We should like your opinion as to what is a fair price, both to the public and the railroad, or both to the public and the seller corporation."

I think it is essential that it should be a fair price equally to both, because if it is not you are liable to lose good-will of either of the two, and our business can only persist so long as we have the confidence and good-will of both our corporate clients and the public.

For instance, we haven't got a show window as you have in Fifth Avenue, where goods are attractively displayed and one can look in

and be enticed by quality and good taste on the part of the displayer. We have no show window. Our only attractiveness is our good name and our reputation for sound advice and integrity. If that is gone our business is gone however attractive our show window might be. We hold our position, and every leading banker holds his position, solely by reason of the confidence of the community in his skill, in his sponsorship, in his integrity, in his desire to be thorough and to advise correctly.

And, I might say, we hold our position subject to recall. It can be recalled by the public at any time they choose. It can be recalled by a corporation at any time they choose; if they think we are no longer the people they thought we were they are entirely at liberty to go elsewhere. And the public is entirely at liberty to go elsewhere, and both the public and corporations have done that in the past more than once. It would be ungracious for me to mention names, but there have been ups and downs in banking prestige, and there has been a rise and fall of banking firms. I hope you will not ask me to mention any names, but the history of finance is fairly full of them.

Mr. PECORA. Now, Mr. Kahn, isn't there the fairly well recognized principle, or canon of ethics we will say, that has been developed in the banking business, in pursuance of which a private banking firm which once undertakes the financing of a corporation continues to do its financing practically to the exclusion of any others, unless it voluntarily chooses to give up the client?

Mr. KAHN. Mr. Pecora, may I use the same simile again? If I am known to be a pretty good doctor I am liable to keep my patients. If I am not, and if for any reason it is possible to think somebody is coming up who is better, the patient will quit me, he will quit me cold. And so will the financial community, and so will corporations. If we do not live up to what they believe is our capacity, and to what they believe is the value of our sponsorship, of our trade mark, they will quit us. And we have no means to prevent them. We are not tied to them and they are not tied to us through any legal instrument or any fiscal agency agreement.

Senator BARKLEY. Is that cold-quitting process to which you refer reciprocal? I mean, is there any habit by which banking institutions, like yours, quit a patient cold if there is any good reason for it?

Mr. KAHN. If they find that the patient does not obey their competent advice in the one field where they ought to be competent. namely, the field of sound financing; if they find that the patient goes his own, in their opinion, dangerous, hazardous way, it is their duty to quit that patient.

The CHAIRMAN. And the next step, Mr. Kahn, after you establish that relationship and are prepared to give your advice, is the question of your compensation for services, isn't it?

Mr. KAHN. Yes, Senator Fletcher.

The CHAIRMAN. Is that based upon any general rule or is that the result of negotiation with each individual client?

Mr. KAHN. It is the result of negotiation—which, however, by this time is pretty well stabilized and normalized. As far as railroad securities are concerned the Interstate Commerce Commission fixes the price. We do not get any commission from the railroads, no fixed compensation. We buy the bonds that we buy at a price

arranged between the railroads and ourselves, and which in our judgment is fair to the railroads and to the public. And I cannot emphasize too much that the element of reciprocal fairness is of the essence of any banker's business. And if it is violated the banker will pay the price. But we agree with the railroad upon a price which we, reciprocally, consider a fair price, to the railroad and to the public, under the prevailing condition of the investment market.

For instance, a railroad will go to the Interstate Commerce Commission and say: "We wish to issue such and such bonds. We have been offered such and such a price by Kuhn, Loeb & Co." The Interstate Commerce Commission, as you well know, investigates the matter and gives its decision. Nothing is said in the contract as to the price at which those bonds which we have bought, we will say at 95, shall be issued to the public. But it is very well understood by practice and by usage at what price the securities will be offered to the public, what spread shall be allowed between the price at which we bought them and the price at which the public shall get them. And that spread is, I can say more than generally, and somewhat uniformly, known to the Interstate Commerce Commission. If we buy bonds at 95 the Interstate Commerce Commission would say: "Now, how much spread do they count on making as between the price at which they buy them from you and the price at which they sell them to the public?" Of course, that would be disclosed. If that spread should be unreasonable we get a pretty strong hint that it is unreasonable, and we better had obey that hint.

Senator TOWNSEND. On what basis is the spread fixed?

Mr. KAHN. The spread is fixed upon, first, reasonable compensation for the originators. Second, reasonable compensation for those who are called distributors, or who may be called underwriters, for their risk, for their effort, and for their responsibility. Again, that has become pretty well stabilized and normalized by usage. In the case of railroads almost unifom. In the case of coporations other than railroads it is a matter of negotiation depending upon the risk involved, the responsibility involved and the greater or lesser difficulty of placing the securities.

The CHAIRMAN. Say you pay 95; what would be a reasonable spread between that and the price the public pays?

Mr. KAHN. A reasonable spread, Senator, dependent upon the kind of issue, dependent upon the size of the issue, dependent upon the prevailing conditions in the market, would be between 2¼ and 2½ percent gross, out of which would come all expenses, out of which would come the compensation to the distributors, and out of which would come, Senator, not merely the originator's compensation for his work and his effort, but would come the compensation for the fact, which is not very generally known, that the originator, however many syndicates he may form, remains responsible with his entire fortune and good name to the railroad company for the contract which he has made, for the money which he has undertaken to pay, until that money is paid. He cannot say to the railroad, "I have divided that up amongst five or six hundred people; you will get your money from Tom, Brown, Smith, and Jack." They would say, "We do not know them. You are responsible to us for every one of your 600 subparticipants, distributors, or underwriters. We

look to you, and to you only. And if any of them fail, if any of them are not solvent, you are responsible, and you only."

Our responsibility frequently extends to 5 or 6 weeks in having the syndicate stand in the breach, and during that time the originators are responsible for every single participant in that syndicate, for his solvency and for his making good.

Senator COSTIGAN. Does the percentage vary with the amount involved?

Mr. KAHN. No; I should not think, Senator, it would vary materially with the amount involved. It would vary with the amount involved only to the extent of the increasing difficulty and risk if the amount is unduly large. It would not vary if the amount was unduly small. And we would not charge a man more because he sent us a small issue. We might charge him more if he sends us a large issue, an issue of unusual size, because it involves unusual effort, unusual responsibility, unusual risk.

Senator COSTIGAN. In your judgment is the responsibility measured by the size of the investment?

Mr. KAHN. I beg your pardon, Senator?

Senator COSTIGAN. Read the question, please.

(Thereupon the last question was read by the reporter, as above recorded.)

Mr. KAHN. The responsibility is measured to a certain extent naturally by the size of the investment, because if we take an issue of $50,000,000 it means that we take a risk of $50,000,000, and we take the responsibility of it ourselves, however many groups may be involved in its final distribution.

Senator COSTIGAN. You regard the risk as 50 times as great as in the case of a $1,000,000 issue?

Mr. KAHN. Mathematically so; yes. Mathematically; yes. Actually we do not regard it. Actually we have by long experience gained complete confidence in that list of distributors with whom we generally do business. It happened that we stood in the breach for syndicates at the time that the *Lusitania* went down, which was a very unpleasant experience and gave us some sleepless nights—but no worse than we had yesterday with the first touch of the heat, unfortunately.

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

But with few exceptions, even in the face of these unforseen calamities, our list of tested and well selected distributors and friends all made good. And, generally speaking, we have complete confidence in them. Therefore I do not consider the risk of a $50,000,000 issue 50 times as large as that of a $1,000,000 issue. I do consider the work greater, I do consider the effort greater, I do consider the responsibility greater.

Senator GOLDSBOROUGH. May I ask a question, Mr. Chairman?

The CHAIRMAN. Yes.

Senator GOLDSBOROUGH. Mr. Kahn, does not the nature of the security back of the issue have a tendency to increase or lessen the percentage of spread?

Mr. KAHN. I should say that the percentage of spread, as I said to Senator Costigan, before, by this time has become so stabilized

that it is a matter of a relatively trifling difference. There is some difference. The nature of the security has something to do with it. For instance, Senator, if we bring out an issue which we know is the kind of security that our savings banks and the insurance companies will be glad to buy because it is the kind of thing they like to buy——

Senator GOLDSBOROUGH. What you would call a triple-A security?

Mr. KAHN. Yes. If we bring that out, it is naturally easier to sell than if we bring out a security that has got to be explained, where we know the insurance companies will not under the law be permitted to buy them, savings banks probably will not buy them either, the extra prudent, old-fashioned investor probably will not buy them either, and we have got to go out and make a special effort to find people who are inclined to buy that kind of security. Now, that would have an influence upon the nature of the spread.

Mr. PECORA. Mr. Kahn, to go back to the relationship between the banker and his railroad corporation client, as an example. You have said, of course, that the client has the right at any time to transfer his financing to another banker. There is no obligation, contractual or otherwise, which binds the client to the banker. I recognize that. But has there not developed a rule or custom among bankers to keep hands off the client when they know that client has had its financing done by another banker?

Mr. KAHN. I should think, Mr. Pecora, that rule is very much in the spirit of the kind of code which the legislature has now adopted, or is about to adopt, to regulate the business activities of all branches of business in the country. In other words, instead of cutthroat competition, which is not to the interest of the public; instead of the kind of competition which we had between 1926 and 1928, when, to my own knowledge 15 American bankers sat in Belgrade, Yugoslavia, making bids, and a dozen American bankers sat in a half a dozen South and Central American States, or in Balkan States—instead of that kind of competition, cutthroat competition, one outbidding the other foolishly, recklessly, to the detriment of the public, compelling him to force bonds upon the public at a price which is not determined by the value of that security so much as by his eagerness to get it—that kind of competition I hope is ended.

As far as we are concerned we have always endeavored to observe the rules of fair competition. And I think some other bankers have. I hope most other bankers have. But it is exactly the same, again, as if an architect had built a house for me; no other decent architect would come to me and say, "I can build a better house for you." The architect relies upon his reputation. He will show by what he has done that he has built a better house. I have seen it, no doubt; I pass it every day on my way to my office.

The competition which exists is in my opinion a competition of service and of performance. The competition of attracting clients. Not by chasing after business. Not by trying to get another fellow out of business who is doing business legitimately and well, but by proving to the client that he would do better by coming to me. That has happened.

Senator COSTIGAN. Mr. Kahn, will you describe in greater detail the competition of bankers in Europe to which you made reference a few moments ago?

Mr. KAHN. I am not certain what reference I did make.

Mr. PECORA. You spoke of a dozen or more bankers competing with one another in Belgrade in some ruinous fashion.

Mr. KAHN. Oh, Senator, I beg your pardon. I referred to the competition by American bankers for European and foreign issues in general through the two mad years of 1926 and 1928 when, just as in 1929, nothing counted but pieces of paper, equities; so in the two or three preceding years before that the public had a mania for buying high-interest-bearing bonds.

Senator COSTIGAN. Where were these bankers assembled?

Mr. KAHN. Oh, in all the capitals of the various nations.

Senator COSTIGAN. Were they the leading bankers of the United States?

Mr. KAHN. It is a little ungracious of me to graduate them, Senator. They were bankers engaged in the business of buying securities. And I hope you will not ask me whether they were leading bankers or less leading bankers.

Senator COSTIGAN. Well, among them were there some leading bankers of this country?

Mr. KAHN. I hesitate—I hate to seem evasive to you, and I know I could not if I tried, but would it not be embarrassing and ungracious if I answered that question?

Senator COSTIGAN. Perhaps you will specify who the bankers were.

Mr. KAHN. Personally I do not know all of those bankers. Six years have gone by. I have grown 6 years older. My memory is not as keen as it used to be.

Senator COSTIGAN. Was your firm represented in this competition?

Mr. KAHN. Never, Senator. Not once.

Senator COSTIGAN. You added a statement to the effect that some compulsion was brought by those bankers on others to market the securities, if I understood you. Is that an accurate observation?

Mr. KAHN. I did not mean to imply that, Senator Costigan. I meant to say that the compulsion was rather upon the banker himself. He had the bear by the tail. He had to get rid of him somehow. I will give him credit for believing that he had a bear that was well worth disposing of. But the fact that he had him—the compulsion of getting rid of the bear was upon him.

Senator ADAMS. That would be true of most any bear, would it not, if you had him by the tail?

Mr. KAHN. Yes.

Senator BARKLEY. As a matter of fact he had a bull by the tail when he thought he had a bear.

Mr. KAHN. That has happened many times, as we all know to our cost. But the fact of the compulsion, and, as I have tried to bring out, by an unduly competitive system, by a cutthroat competitive system, by endeavoring to break in at whatever cost the public is damaged because the public pays an unduly high price. And the banker who has been triumphant in getting that issue will very soon find himself regretful that he did get it. And in any event he will be under the compulsion for his own solvency, to try and get rid of it. Therefore I say that kind of competition is harmful both to the corporations and to the public and to the government involved, because those governments by this very method have seen their credit spoiled, and have also seen money given to them which it would have been very much better if they had never had.

Mr. PECORA. Now, Mr. Kahn, in answering the question that I put to you a few moments ago I tried to follow your answer, which was illuminating, and I am still uncertain as to whether you intended to inform this committee in your answer that a custom had developed among bankers in pursuance of which a banker will not seek to gain a client whom he recognized already to be a client of some other banker. Has such a custom developed in the banking profession, Mr. Kahn?

Mr. KAHN. I should not say, Mr. Pecora, in the banking profession peculiarly. I should say it has developed more or less in all professions by a process of enlightenment.

Mr. PECORA. Well, we are confining ourselves now to the banking profession. I simply want the committee to know whether or not that custom has developed and exists in the banking profession?

Mr. KAHN. The custom which has developed and which is in the banking profession, and which has long existed among bankers, and not only the top-notch bankers, but among reputable bankers, is that of competing with one another on the basis of their services and their performance. Precisely as the railroads, now that the rates are regulated, can only attract clients by their service and their performance.

The corporations concerned are the ones who determine what bankers they want to deal with. It is not the banker who determines what corporation he wants to deal with. He might like to very much. But it is for the corporation to say, "Well, I am very happy where I am; I have picked that banking house and I will stick to it until they make a mistake. After they make a mistake I will quit it and go to another."

If a railroad corporation or any other corporation comes to us and says "We have determined to terminate our existing financial sponsorship and advice and we would like to get yours", I do not believe we would hesitate to act upon that, in decency, fairly, and with proper regard for our neighbors, whether they be bankers or whatever they may be. But that is our whole method of competition, and has been our whole method of competition always, and it is not merely between us and any one particular banker. It is between us and all bankers. I can give you a few instances—that I would rather not give—but I can give you a few instances where business heretofore done by us has gone to other bankers, and where business heretofore done by other bankers has gone to us. I would rather not mention names, but it has occurred. But our effort, and I hope the effort of all bankers, is that this thing shall be done decently, fairly, with a mutual respect for one another, and not a cutthroat competition, and not an undignified scramble for business.

Mr. PECORA. Then there is not that spirit or kind of competition among bankers which would cause a banker to seek to do the financing for a railroad corporation, for example, when he knows that that railroad corporation in the past has had its financing or banking done by some other banker?

Mr. KAHN. I do not believe, Mr. Pecora, that that is the element which would enter into the conclusion.

Mr. PECORA. Well, whether or not it is the element, is it the fact that bankers do not engage in that competitive kind of business one with another?

Mr. KAHN. I cannot answer yes or no without amplifying my answer by saying there is distinct and keen competition between bankers, but that competition is based not upon one banker trying to undercut the other banker's bid by an eighth or a quarter, but it is based upon services, upon accomplishments, and upon the choice of the corporation in question.

We do not go, and I do not believe any banker usually does go, to corporations of our own initiative. We would say, "These people, we hope, know that we have a good reputation. We hope that if there is business they will come to us." Our minds and our activities are wide open to do business with anybody who comes to us. But we will not chase after business. And I can only speak for ourselves. I cannot speak for other bankers, but I can say for ourselves, we will not chase after business. We will not engage in competition which we consider unfair and from which we consider neither the corporations nor the public benefit. But we welcome eagerly any new opportunity to do business. And it has happened to us that business which we heretofore have done with certain railroads has been done by others henceforth, and it has happened that certain issues heretofore done by large concerns that I could mention, but I prefer not to, have been done by us, because the business came legitimately and fairly.

Mr. PECORA. Well, those instances are relatively few and far between, are they not?

Mr. KAHN. They are relatively few and far between; yes.

Mr. PECORA. And do you know of a case where a prominent banking firm which had done the financing, we will say, for a railroad corporation, loses that client where the banking firm has indicated its willingness to continue financing for that road?

Mr. KAHN. Yes; Mr. Pecora, I do.

Mr. PECORA. Are those instances also relatively very few?

Mr. KAHN. They are relatively few; yes.

Mr. PECORA. Now, to be specific, let us assume that A. B. & Co., a private banking firm of standing and recognized prestige, has done the financing for the X. Y. Z. Railroad, you would not as a banker if you learned that the X. Y. Z. Railroad wanted to borrow, we will say, $50,000,000, offer your banking services without the consent of A. B. & Co., or unless the X. Y. Z. Railroad originally come to you?

Mr. KAHN. It does not depend upon anybody's consent, Mr. Pecora. It depends——

Mr. PECORA. No; but what has been the custom?

Mr. KAHN. It depends upon our own sense of what is fit and proper and decent to do.

Mr. PECORA. Well, you would not consider such a thing fit and proper and decent to do, would you?

Mr. KAHN. I would not; no.

Mr. PECORA. And that rule is observed generally by bankers, is it not?

Mr. KAHN. I can only speak as to my own firm.

Mr. PECORA. Well, can you not speak also from your knowledge of the banking business generally as to what the rule and custom is?

Mr. KAHN. I can say that I believe generally amongst houses of standing the ethics of the business is not to indulge in cutthroat competition and steal things away the one from the other, unless

there is a situation where the corporation concerned of its own volition or by the good offices of somebody comes and says, "We have determined to change our relations. We have come to you. Are you willing to do it?" "Gladly."

Mr. PECORA. For instance, if you learned that a railroad corporation wanted to borrow $50,000,000 and you knew that that railroad corporation had had its financing previously done by another banking firm, you would not think of going to that railroad corporation on your own initiative and offering to handle the financing operation, would you?

Mr. KAHN. I think, Mr. Pecora—I hate to take your time and the committee's time any longer than necessary, but I thought I had explained pretty clearly what our attitude in such a case would be.

Mr. PECORA. Well, in order to make sure that the answer is clearly in the record will you answer the question that I put to you, the present question? If you can answer it categorically, I think that will dispose of the question.

(The pending question was thereupon read by the reporter, as above recorded.)

Mr. KAHN. Well, if you want a categorical answer, Mr Pecora, I can only say it is always the other way around; has been with us for 50 years perhaps, or certainly for the last 30 or 40 years. It is not we that go to the corporations and ask them to do business with us. We hope that we have established a reputation which is our show window, which attracts customers. We hope that our trade mark, our sponsorship is recognized of some value to the corporation. We do not go after them. That may be conceited, but we do not. We would rather do less business. We do not go after them. But if a railroad comes to us, or if any corporation comes to us and says: "We want to place a $50,000,000 issue through you", and we know they have been doing business with somebody else, we ask them fairly and openly the question, "We know that you have been doing business with so and so; are you not doing business any longer with them?" "No, we have severed our connection". Then we consider ourselves entirely free to do their business.

Senator BARKLEY. But, if you knew that in the preliminary stages of the floating of the $50,000,000 loan they had been under negotiations with some other bank you would not step in voluntarily and seek to take that client away from the other bank?

Mr. KAHN. I would not seek to take any client away from anybody. I am seeking to develop in our own business and my associates are seeking to develop in our own business.

Senator BARKLEY. Is there not a very well developed code of ethics among bankers that one banker will not try to take business away from another banker?

Mr. KAHN. I think it is a well-recognized code of ethics, and it is getting better through the country.

Senator BARKLEY. That is undoubtedly a fact, though, is it not? It seems to me that a very simple proposition which a simple answer would clear up.

Mr. KAHN. I am not prepared to say that it is a fact, Senator. No; I am not.

Senator BARKLEY. Well then, the conditions are not as ethical as you might hope that they could be?

Mr. KAHN. I believe I have already shown that in 1926 to 1928 the conditions were such as I am far from approving. But I believe that especially under the new Recovery Act it will be more and more recognized that that kind of competition is detrimental, and is perhaps slightly unethical. I can speak for ourselves. We do not go after other people's business. We do not go after business at all. We have our shop window, as I call it. If somebody comes to us and says, "I would like to do business with you. I have heretofore done business with John Smith. I would like to do business with you." We would say, "Do you mean to say you have definitely broken with them?" "Yes." "And you tell us you are free, without infringing upon our conscientious scruples, to do business with us?" "Yes." I would not then hesitate to do business.

Senator BARKLEY. Do you know instances where other bankers have gone after your business?

Mr. KAHN. I have some, Senator. I hope you will not press me.

Senator BARKLEY. I am not going to press you, but it has occurred?

Mr. KAHN. Yes.

Senator BARKLEY. Are they reputable bankers—without giving their names?

Mr. KAHN. Yes.

Mr. PECORA. Has it succeeded? Has the effort succeeded in those instances?

Mr. KAHN. In some instances, yes. We are poorer for that effort.

Senator BARKLEY. Do you still regard them as reputable bankers?

Mr. KAHN. I regard them as reputable bankers. I would not have done what they did, but who am I to sit in judgment upon others? "Let him who is without sin first cast the stone." I guess I am guilty of other sins, too. But this particular thing I do not believe in.

Mr. PECORA. Would you say fairly, Mr. Kahn, that in the banking profession a system or code of ethics exists among the well-recognized bankers, bankers of reputation, in pursuance of which there is no competition among them for the business of a corporation which has had financing previously done for it by some banker?

Mr. KAHN. As far as we are concerned, that is correct. As far as our firm is concerned, that is correct.

Mr. PECORA. Opinions will differ among individuals honestly and fairly, will they not, as to the measure of risk involved in a piece of financing?

Mr. KAHN. Yes.

Mr. PECORA. And the measure of risk is an element that enters into the determination of the profit or spread to the banker?

Mr. KAHN. Yes.

Mr. PECORA. Now, in view of the fact that there is that normal and natural difference of opinion among bankers as to the element of risk involved in a financial operation, and hence as to what should be a fair and reasonable profit or spread to the banker in assuming the risk, would not the corporation seeking financing be likely to obtain better terms if there were more competition among bankers for these financial operations?

Mr. KAHN. You may think I am speaking pro bono in the answer I am going to give. I am too old to have axes to grind. I am trying

to answer according to my best judgment and through long experience, and if the answers I give can be of any service to your committee I shall be only too happy and too satisfied to have been able to be of that little service. And so I hope you will believe me that I am going to answer the question you have asked me, because it is a slight embarrassment, because it affects my pocket for the next few years that I still have, but not for very, very long. I hope that you will be convinced that I am answering without considering my personal or my firm's interest.

I do not believe, Mr. Pecora, that competition of that nature, either public or confined to a few banking houses, would be to the benefit of the corporations.

Perhaps I may be permitted to submit for the record a pamphlet which I wrote on that subject about 10 years ago—and I wrote it myself—and another pamphlet which a distributing house in New York wrote in 1928, quite unknown to me, as I only heard about it a few days ago, that it existed, on the question of competitive bidding. I do not know whether you want to clutter your record with it, but here they are, in case you should wish them.

But to sum up, I think if you have bidding for public issues on the part of the public you are leaning on a broken reed. The public does not bid. The public has proved again and again that you cannot entice it to go into competitive bidding.

Mr. PECORA. But, Mr. Kahn, my question did not involve the element of competitive bidding on the part of the public; it involved the element of competition among bankers for a financing operation.

Mr. KAHN. Well, I was coming to that particular phase of it. If you have competition amongst bankers for a certain issue you create what to my mind is one of the most undesirable conditions which you could create in the investment community, namely, bidding at the expense of the public.

If I make a bid, if any reputable house makes a bid, he knows he must consider for his own reputation both the interest of the corporation, to whom it must make a fair bid—if it does not make a fair bid it will lose the business—and the interest of the public to whom it must make a fair offer or it will lose the public clientele.

But if you stimulate me by saying, "Now, there are a dozen bidders bidding for that thing", you screw yourself up, screw yourself up a quarter percent, half percent, 1 percent, you will get rid of it to the public. I am gambling with the back of the public. I am damaging the public for my benefit. In order to enable me to retain that business I am bidding a price which is an unduly high price. That unduly high price does not do the community any good, because ultimately the price will find its own level. It does not do the corporation any good, because the price will go down and the corporation will lose a part of its public good will.

I do not see in what way that kind of competition has more good than harm in it.

Mr. PECORA. Has it been tried out so that that effect has been observed?

Mr. KAHN. I beg your pardon?

Mr. PECORA. Has that kind of competition been indulged in or tried out?

Mr. KAHN. Yes.

Mr. PECORA. So that you can point to that effect that you are now referring to?

Mr. KAHN. That effect is set forth in those two pamphlets at some length, but I do not want to impose them upon you by reading them.

Senator BARKLEY. I think it would be valuable to have those pamphlets printed in the record, and I ask that they be printed as a part of the hearing.

The CHAIRMAN. Without objection, they will be admitted and filed and carried in the record, both of them, and marked as exhibits.

(Pamphlet presented by Mr. Kahn entitled "The Marketing of American Railroad Securities, Memorandum for the Interstate Commerce Commission submitted by Kuhn, Loeb & Co.", dated October 25, 1922, was thereupon marked "Committee Exhibit 1, June 27, 1933." See p. 1034.

(Pamphlet presented by Mr. Kahn, entitled "Competitive Bidding for Equipment Trusts, A Discussion", written by Ernest L. Nye, Freeman & Co., New York, in 1928, was thereupon marked "Committee Exhibit 2, June 27, 1933." See p. 1052.

Mr. PECORA. We will read those pamphlets, but they are rather voluminous documents, I am afraid. Can you give us your own judgment with regard to the matters that I am questioning you about and not refer us at this time to these two pamphlets?

Mr. KAHN. Gladly. Gladly, Mr. Pecora. I am sorry I interrupted my answer.

I say as far as the public is concerned that kind of competition is, and has proved, especially during 1926 and 1928, exceedingly costly to the public, because it is more than human nature to expect that under the stimulus of having a price hung up someone, in order to get that price, is not going to pay a price which is not justified by the circumstances.

Mr. PECORA. Do you think a banker would pay a price not justified by the circumstances?

Mr. KAHN. Frequently.

Mr. PECORA. And he has remained in the banking business after frequently making those mistakes?

Mr. KAHN. He has remained in the banking business not as prosperous as he was before, but the public had paid the price in the meantime. The public had bought those bonds.

Moreover, Mr. Pecora, I want to say there is a constant check. The corporations are not dependent upon them for telling them "Your bonds are worth so much." The corporations, and especially the finanical officers of the corporations, have a very definite duty to go around and inform themselves what is a fair price. The railroad corporations have not only a very definite duty, but a legal duty, because the Interstate Commerce Commission has to approve what is a fair price and what price they are willing to sanction. It is not because I impress my views on corporations. We have constant competition, the potential competition of every other banking house, and if the particular official in question should lunch with Mr. Brown and say, "Here, we have your bond to sell. What do you think it is worth?" Mr. Brown says, "I think it is worth 95", and I have told him I think it is worth 92, I do not think it is likely to come back to me very frequently. There is a constant competition.

Mr. PECORA. Your judgment might be the better of the two?

Mr. KAHN. Yes; but unfortunately he might not take it, and it might be bad for him not to take it, because I do not believe that it is in the best interest of a corporation always to squeeze out the last dollar at a particular moment that the securities can be sold for, because whom do they squeeze it out of? They do not squeeze it out of the banker. I get exactly the same commission whether I sell a bond at 95 or sell a bond at 92½. But the public is paying an unfair price. My capacity to serve industry—and that is really the whole test of a private banker's usefulness——

Senator ADAMS (interposing). Mr. Kahn, that result only comes about in the event that you are able to definitely force the public to pay the added price to cover the commission, does it not? That is, that assumes that you can fix the price so as to cover the commission?

Mr. KAHN. I cannot fix the price to cover the commission, but as a matter of fact, in order to enable me to go ahead and do my business I have got to have a certain spread, which is not a commission; but I have to have a certain spread in order to compensate my distributors.

Senator ADAMS. Can you fix the spread or fix the price to the public so that you will secure that spread, or are you held back by the occasional unwillingness of the public to take the offer?

Mr. KAHN. Sometimes it is held back by an occasional unwillingness of the public, but generally speaking it is a recognized fact that the public will buy bonds that are offered to it by recognized distributors and recognized banking houses at a fair rate and a rate which is attractive to the public.

Senator ADAMS. That is, the public as a practice will accept the price which is fixed by the banking house?

Mr. KAHN. Under responsible sponsorship, yes, because that is where your securities bill comes in now, that henceforth the public will know about those facts.

Senator ADAMS. May I ask you: This pamphlet which you offer, Mr. Kahn, was written in 1922, I notice.

Mr. KAHN. Yes.

Senator ADAMS. Is there anything in the experiences of the years since then to change the conclusions which you have expressed in that pamphlet?

Mr. KAHN. If I had to write it again I would write it exactly the same way. I would change a few words.

Senator ADAMS. You were a fortunate man, that you did not have to learn anything like the rest of us.

Mr. KAHN. But as to this particular thing, I think my convictions are so deep-seated and so long, and my observation is an observation of 40 years, not only here but in Europe, in various countries in Europe, that I do not believe I am open to reconsideration, even though I may seem obstinate about it.

I really do believe I know that subject. I have seen it work in England, in France, in Germany, and I have seen that they have always come back in those countries to the same system; that if I want a plumber's job done I go to the plumber that I think is the best fellow, and as long as he does his job well I stick to him. If he

overcharges me I go to somebody else. If he tries any crooked business on me I go to somebody else.

But generally speaking, I do not gain much by having people compete with one another on what at best can only be a trifling difference.

And that is so in England; it is so in France; it is so in Germany; it is so in Holland and Belgium, that the corporations pick out the men of the firm that they want to do business with, and as long as they are satisfied and the service is good to them and they do not believe, and the experience has been—as far as I have had experience, that is over 40 years—has proven, that they have nothing to gain by inviting competition other than based on performances and services, they will continue with that firm.

Mr. PECORA. Mr. Kahn, who fixes the price to the public of these issues that are underwritten by bankers for railroad corporations?

Mr. KAHN. That price is fixed between the corporation and the banking house to which they go, and it is fixed by comparison of views, and sometimes those views are very wide apart. Ultimately a conclusion is reached as to what is fair to the corporation, what is fair to the public, and at what price can the issue be sold successfully. It certainly would not be to the corporation's interest to force the issue to be sold at a price where it would be a failure, because then it would be soiled goods and would not be salable any more.

Mr. PECORA. Well, let us see: First the banker negotiates with the railroad corporations for an issue, doesn't he?

Mr. KAHN. Yes.

Mr. PECORA. And the price to the banker is fixed as a result of such negotiations?

Mr. KAHN. Yes.

Mr. PECORA. And that is the price that the railroad corporation receives for its securities?

Mr. KAHN. Yes.

Mr. PECORA. Thereafter the price at which that security is sold to the public is primarily of concern to the banker, isn't it?

Mr. KAHN. Yes.

Mr. PECORA. So that, if there is a conflict or difference of opinion between the banker and the railroad company as to the price at which the security shall be offered to the public, the banker's judgment would usually control, would it not?

Mr. KAHN. It would usually control, except in the case of railroad securities, where the Interstate Commerce Commission's judgment absolutely controls. The Interstate Commerce Commission absolutely says: "If you are putting on a spread more than so-and-so we will disapprove it." In the case of railroad securities that element simply does not exist. It is definitely fixed by the Interstate Commerce Commission.

Mr. PECORA. If the Interstate Commerce Commission then fixes the price of the security to the public——

Mr. KAHN. Yes.

Mr. PECORA. And I understand that is what you mean to tell us——

Mr. KAHN. Yes.

Mr. PECORA. Then why could not there be a free competition among bankers for the financial operation for the railroad company in fashion calculated to produce a narrowing of the spread and a consequent benefit to the railroad company?

Mr. KAHN. For the reasons, Mr. Pecora, which I have endeavored to indicate, that somebody would depress that spread to a point where it would be, instead of being beneficial, damaging, because it would be a cut rate, it would be a cut price, it would drive reputable, responsible concerns more and more out of the business, and the result would be a diminished protection for the public.

Mr. PECORA. How does the public interest become diminished by those means, if the price to the public is fixed by the Interstate Commerce Commission?

Mr. KAHN. The public interest is diminished—and I assume that is why the Interstate Commerce Commission is interested in that spread—the moment that its service rendered to it is not rendered in the best possible way. The moment that the railroad concerned has not got the best advice as to the kind of security which it should issue, as to the mortgage which should be drawn, as to the instruments which should be prepared for the future, as to its clientele, as to its selling, if it could not get that service, and the people who render that service—and it is a year-round service—if it could not get the service of me and my associates, and we did not get a fee, after having given hours and days of time and thought to this matter, another concern would take the business away from us. The service which the investment banker now gives the railroads would be absolutely cut off, if, after having given the service, we haven't got a fair percent to do business from the railroad to which we have rendered great services and have advised.

Now, you may say that service is worth nothing. My experience and my belief is that service is a very valuable service.

Mr. PECORA. There has been no indication by anybody around this table that the service of the investment banker is worth nothing. But under this method that you have been testifying about, that is, with this absence of competition among investment bankers——

Mr. KAHN. Yes.

Mr. PECORA. Is not the spread to the banker placed largely within the control of the banker, because of that absence of competition?

Mr. KAHN. No; it is placed within the control of the Interstate Commerce Commission.

Mr. PECORA. Do you know of a single case where the Interstate Commerce Commission has disapproved a price of a security to the public because the spread to the banker was too small?

Mr. KAHN. I do not recall at this moment. I have very good—[After conferring with associates.] No.

Mr. PECORA. Do you know of instances where the I.C.C. has disapproved the price to the public because the spread to the banker was too large?

Mr. KAHN. Yes, informally.

Mr. PECORA. Do you recognize the fact that the presence of a free competition among investment bankers for the financing of a railroad company operation would have a tendency to reduce the spread to the banker?

Mr. KAHN. For a while, but only for a while. I think there is no guaranty whatsoever that what has now become a recognized norm amongst reputable bankers and what the Interstate Commerce Commission constantly watches, would remain permanently unused. I do not for a moment believe it would. Perhaps I can give an instance which one of my associates has just put before me to show the futility of that kind of competition.

On July 14, 1928, the Southern Pacific Co. sent invitations to 60 banks and bankers inviting bids on an issue of $4,815,000 of its equipment trust certificates. Kuhn, Loeb & Co. were also invited, but in accordance with our usual practice, along with others who were unwilling to make those bids for the certificates, we also wrote that if the company did not receive from others satisfactory service we should be prepared nevertheless to continue to serve the needs of the company.

Only three bids were received, the highest of which was 97¼ percent, which meant an annual percent of cost to the company of about 4.94 percent.

Those bids being unsatisfactory, they were rejected. On July 24, when advised by the Southern Pacific Co. as to the result of these bids, we offered to purchase the certificates at 98¼ instead of 97¼, which was the best bid that they received by competition between 60 firms. We offered to pay 98¼, and we promptly sold the certificates.

Mr. PECORA. Is that an exceptional case, Mr. Kahn?

Mr. KAHN. My partner just tells me that happened in other cases. For instance, in the Cincinnati Union Station Co. issue. We are speaking about something as to which naturally I can only put my experience and judgment against the questions which you are asking.

My experience and judgment and my absolute conviction is that if you control the spread your corporations in the long run would not gain anything. You would drive out the most responsible and reputable bankers. We would not bid—I beg your pardon for including ourselves among responsible and reputable bankers—but I know we would not bid. We do not do business on those lines. It is not the kind of business which we believe is compatible with dignity, and with the hard work done and with the services performed all the year round by a banker, and those services cannot be performed from one day to the next; they must be learned. They required the accumulated experience of three generations in our case. We pay for them by steady application to our job. We pay for them by not letting ourselves be distracted from our job. We pay for them by not going into things which would distract us from our job.

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

Now, my definite conviction is that by limiting the spread the corporation gains nothing. The reputable bankers are eliminated. The services which are now freely at the disposal of corporations

without their paying anything for it except an occasional business, but otherwise no fee is charged to them; any of our connections can come to our office and can sit there for days and days and come again and again and they will get our best advice for the corporation and they will pay us nothing for it whatsoever—no fee, no retainer. We rely upon doing business once in a while. If that is taken away from us we would not do it.

Mr. PECORA. Now, Mr. Kahn, is it your judgment and experience that competition among bankers for the financing, we will say, of a railroad corporation would have a tendency to reduce the spread to the banker?

Mr. KAHN. I do not.

Mr. PECORA. Is it your judgment and experience that that competition would have a tendency to increase the spread to the banker?

Mr. KAHN. I do not believe it would have any material effect.

Mr. PECORA. It would not have any effect on the spread of any material consequence one way or the other?

Mr. KAHN. It might in a few cases. It would not generally, and I believe the price which you would pay for that advantage, if it is an advantage, is much too high. I think the corporations and the public would suffer from it.

Mr. PECORA. How would they suffer, Mr. Kahn?

Mr. KAHN. They would suffer from it by losing—I beg your pardon. [After conferring with associates.] Mr. Pecora, I think it is conceivable that in a few cases, at the beginning particularly, but in a few cases the spread between what the corporation gets and what the public gets might be diminished. I do not dispute the possibility of that existing. I do not believe it would exist for long, but I believe there is a possibility of its existing. I do not believe that the spread in city bonds, for instance, has been materially modified by public competition or by competition between bidders.

Mr. PECORA. Have you any figures which would determine that one way or the other, or any instances?

What illustrations of any kind have you that would support the belief you have just expressed, that in the case of competitive biddings on municipal issues the price to the municipality has not been materially affected?

Mr. KAHN. I do not say so much as to the price to the municipality, because some one may have paid a very foolish price. I say, the spread to the public. If you get, by a lucky chance, a municipal issue at various prices you are going to offer it to the public, not on the basis of the price you paid; you are going to offer it to the public on the basis of the price which you believe it is worth, and therefore this does not determine it in any way.

Mr. PECORA. Would it not in such a case cause a person to make a higher bid for the issue if he thought he could dispose of it at an attractive profit to the public because it was worth that price?

Mr. KAHN. The reverse of that holds good equally. If I have no responsibility, if I am one of a number of bidders, I will try to buy as cheaply as I can, naturally. I have no responsibility; it is not my job to see that the railroads get the best possible price or that clients get the best possible price, as long as they are not my clients, as long as they are outsiders and I am an outsider. I will give you a case in point, Mr. Pecora.

Not so very long ago some of our clients wanted to sell bonds, wanted to sell them to us at 89. They were 4½-percent bonds or maybe 5-percent bonds—5-percent bonds, at 89. We told them we did not believe they would be wise in doing that, that "I think if you wait a little while you should get a much better price for them. The bond market just at present is not receptive. Take our tip and wait." They waited, and within a relatively short time those bonds which they wanted to sell to us at 89 they received 97 for. If there had been competition I would have been delighted to buy them at 89. I knew they were too cheap.

Senator ADAMS. Mr. Kahn, in this pamphlet, not the one lying by you, but the other pamphlet you handed in, there is contained quite a large number of letters on the subject of competitive bidding. I notice the letters are from dealers in securities, and they are all, or practically all, saying that they are opposed to competitive bidding because it results in over-buying securities or in lessening the margin to the dealers so that they cannot afford to deal in them, and thereby, they say, it is going to lessen the market.

Mr. KAHN. That is the very thing I was trying to bring out, that unless you pay the laborer what his hire is worth, if you compel people to go the limit in bidding at prices that they can just barely get away with, I do not believe you are serving anybody. The corporations, in the long run, will not be benefited. I am sure they will not be. I know that the most responsible bankers will not enter that kind of business, and I know that the railroads will be deprived of the service of the advice of their bankers, which advice is based upon generations of special study, and that they will be deprived of the advise of people whom they can rely upon in telling them what is the best time to sell bonds, for instance, telling them, "In a month or two a lot of other bonds are coming out. Hurry up and sell these bonds." You cannot get all these services unless the people who give you such services have a reasonable assurance that if the railroad has any business it will come to them.

Mr. PECORA. In the course of an answer that you made a few moments back you said, among other things, that you tried to get a security or an issue at as low a price as possible. That is quite natural, but——

Mr. KAHN. My partner suggests that I did not say I tried, but I said I would be delighted if I had an opportunity of getting a bond away below its value unless I have the responsibility for it. But if I have the responsibility for it, I will not let the corporation sell the bonds, if I have the power to prevent it, below their value. I tell them that such and such is my opinion.

Mr. PECORA. Let us go back to the answer you made. I think you said that in the course of an answer you were making to the question immediately prior to the question that Senator Adams asked you.

Mr. Reporter, will you go back to the answer immediately before Senator Adams' question, and read what the witness said?

(The reporter read as follows:)

Mr. KAHN. The reverse of that holds good equally. If I have no responsibility, if I am one of a number of bidders, I will try to buy as cheaply as I can, naturally.

Mr. PECORA. In saying that, were you referring to the attitude of the banker in case of competitive bidding for an issue?

Mr. KAHN. Yes, sir.

Mr. PECORA. Is it also the attitude of the banker where it concerns an issue without competition?

Mr. KAHN. No; it is not. It may seem quixotic, but it is good business that it should not be. A banker can only persist before the public and the corporations if they believe they can get a fair deal from it. I am not speaking as an altruist, but I think I know my business sufficiently to know that it rests entirely upon confidence. Since I have nothing else to offer but confidence, if I betray that confidence or, even without betraying it, if I make a mistake once or twice, they will say, "We will stop doing business with you; we will go elsewhere."

Mr. PECORA. The judgment, then, which controls as to the matter of giving a fair deal to the public is the judgment of the banker where there is no competition?

Mr. KAHN. No, Mr. Pecora. It is the banker's judgment. But the corporation is under a very definite duty to see that the judgment is right, and if it is not right, to decline to accept it. Moreover, the corporation is under a definite duty to submit such judgment to the Interstate Commerce Commission. There are three checks.

Mr. PECORA. Mr. Kahn, I understand that you were requested to produce here a copy of the articles of copartnership which bind together the members of your firm. Are you prepared to do that?

Mr. KAHN. Yes, sir.

Mr. PECORA. Will you kindly produce a copy of those articles?

Mr. DE GERSDORFF. Mr. Chairman, I have here the original copartnership agreement. I do not want to take up the time of the committee in making any motion. We have already communicated with Mr. Pecora's office. We hope that this original agreement will be considered by the committee in executive session, and that when it comes to be spread on the record certain things as to the contribution of capital, the division of profit, and other minor matters which we have submitted in another part of the records which I will also hand up, may be omitted from the record.

Mr. PECORA. Mr. de Gersdorff's firm has taken that up with us, Mr. Chairman, and I have expressed the opinion, feeling that I represented also the attitude of the committee, that for the public record we need only take a copy of the articles of copartnership which have deleted the respective rights and interests of the copartners and their respective contributions to the capital of the firm.

Mr. DE GERSDORFF. There are certain other minor provisions which we hope will be deleted, which do not concern anybody or anything except the relations between the parties. I would be very glad to take that up with you or with the chairman. I have the original in full.

The CHAIRMAN. You do not have a copy of the one with the deleted portions?

Mr. DE GERSDORFF. Yes; I have both of them here.

The CHAIRMAN. Are you willing that that should go into the record?

Mr. DE GERSDORFF. Yes, sir.

The CHAIRMAN. The other copy you will leave with the committee to consider in executive session?

Mr. DE GERSDORFF. Yes, sir.

Mr. PECORA. I suggest that that course be taken.

Mr. DE GERSDORFF. Do you want the original or just a copy?

The CHAIRMAN. We do not care about the original copy.

Mr. PECORA. A complete copy of the original will suffice for the purposes of the committee in executive session, and a copy with the deletions which you have referred to will suffice for the public record, I assume.

Mr. DE GERSDORFF. The copies that I have here have not the signatures. I suppose you want them?

Mr. PECORA. For the executive session?

Mr. DE GERSDORFF. I can write them in now and will hand them to you.

The CHAIRMAN. Let the copy be admitted for the record.

Mr. DE GERSDORFF. Do you want the original before you?

Mr. PECORA. I am not going to use it in the examination for the moment.

Senator BARKLEY. You may present it later.

Mr. DE GERSDORFF. We will give it to you at the recess.

The CHAIRMAN. It will be admitted later.

Mr. DE GERSDORFF. I am perfectly willing to give a deleted copy to the press.

Mr. PECORA. I am going to offer it in evidence now and ask that it be spread on the record.

The CHAIRMAN. That may be done.

(A copy of articles of copartnership dated Dec. 31, 1932, by and between Felix M. Warburg, Otto H. Kahn, George W. Bovenizer, Lewis L. Strauss, William Wiseman, Frederick M. Warburg, Gilbert W. Kahn, John M. Schiff, Benjamin J. Buttenwieser, Hugh Knowlton, and Elisha Walker, was received in evidence, marked "Committee Exhibit No. 3, June 27, 1933. See p. 1080.

Mr. PECORA. Mr. Kahn, you have already testified that your firm, while it does not solicit deposits, nevertheless does accept them from its clients?

Mr. KAHN. Yes, sir.

Mr. PECORA. Let me ask you now what has been the highest amount of deposit accounts that your firm has carried for its clients?

Mr. KAHN. I have the figures here, and I will get them from my partners.

Mr. DE GERSDORFF. That only goes back to 1927.

Mr. KAHN. Mr. Pecora, I find from the papers which I have here and which I will be glad to submit in detail in reply to your question, that the highest total deposits which we held on December 31 of any one year was $88,549,566.

Mr. PECORA. That was for the fiscal year 1929?

Mr. KAHN. Yes, sir.

Mr. PECORA. Have you furnished me upon my request with balance sheets of your firm showing its financial condition as of the end of each fiscal year from the period between 1927 and 1931, both of those years inclusive?

Mr. KAHN. I so understand, Mr. Pecora.

Mr. PECORA. I show this document to you, consisting of a number of typewritten sheets, and ask you if that is a correct copy of those balance sheets for those years.

Mr. KAHN. We are sure they are right.

Mr. PECORA. I offer that in evidence, Mr. Chairman, and ask that it be spread on the record.

The CHAIRMAN. It will be admitted.

(Copies of balance sheets of Kuhn, Loeb & Co. for the period between 1927 and 1931, both inclusive, were received in evidence, marked "Committee Exhibit No. 4, June 27, 1933." See p. 1085.

The CHAIRMAN. Have you any affiliates?

Mr. KAHN. No, sir; we have not and never had.

Mr. PECORA. Do you know a concern called the European Merchants Banking Co., Ltd., of London?

Mr. KAHN. Yes, sir.

Mr. PECORA. Is the firm of Kuhn, Loeb & Co. in any way directly or indirectly connected with that concern?

Mr. KAHN. Perhaps one of my partners could go into that matter of detail more accurately than I could. May I ask Mr. Buttenweiser to answer that particular question?—because it is more in the line of his knowledge than of mine.

The CHAIRMAN. That will be agreeable.

Mr. PECORA. All right, if you will answer that question, Mr. Buttenwieser.

The CHAIRMAN. Please stand and be sworn.

TESTIMONY OF BENJAMIN J. BUTTENWIESER, A MEMBER OF THE FIRM OF KUHN, LOEB & CO.

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

Mr. BUTTENWIESER. I do.

Mr. PECORA. Will you give your name and address to the reporter, please?

Mr. BUTTENWIESER. Benjamin J. Buttenwieser.

Mr. PECORA. Are you a member of the firm of Kuhn, Loeb & Co.?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. One of the copartners thereof?

Mr. BUTTENWIESER. Yes, sir.

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

Mr. BUTTENWIESER. Since January 1, 1932.

Mr. PECORA. Prior to that time had you been connected with the firm in any other capacity than as a partner?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. For what period of time?

Mr. BUTTENWIESER. Since September 1918.

Mr. PECORA. In what capacity?

Mr. BUTTENWIESER. In varying capacities, starting pretty far down the line.

Mr. PECORA. Will you just briefly enumerate them?

Mr. BUTTENWIESER. I think, like Mr. Kahn once said, pretty close to the line of licking postage stamps, through varying capacities; but at the time of your inquiry, head of the foreign department.

Mr. PECORA. Do you know a concern called the European Merchants Banking Co., Ltd.?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. Is the firm of Kuhn, Loeb & Co. connected with that concern in any way, shape, or form?

Mr. KAHN. The answer is, No. We are in no way connected with that firm. Excuse me for interrupting. We are in no way connected with that firm and have not been since 1930. We were connected with that firm for 3 years. Mr. Buttenwieser will give you the details.

Mr. PECORA. That is what I wanted.

Mr. BUTTENWIESER. That was a stock corporation of which we owned the shares. It was in existence from March 31, 1927, to December 31, 1930, during which period we owned the shares of that company; the ordinary shares.

Mr. PECORA. What was the business of that company?

Mr. BUTTENWIESER. I believe that was called "merchant bankers."

Mr. PECORA. What was its business?

Mr. BUTTENWEISER. That is the current name in England for such bankers, merchant bankers.

Mr. PECORA. Was it a private banking concern?

Mr. BUTTENWIESER. Yes.

Mr. PECORA. Accepting deposits from clients or customers and making loans?

Mr. BUTTENWIESER. Relatively small.

The CHAIRMAN. You owned all the shares?

Mr. BUTTENWIESER. We owned all the ordinary shares. There were some few other shares, I believe, which, under the laws of England, had to be owned over there.

Mr. PECORA. Qualifying shares?

Mr. BUTTENWIESER. I believe that was it. I understand there were 5,000 manager shares which had to be owned in England, by Mr. Godron Leith, who was our resident partner.

Mr. PECORA. Has the company been liquidated?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. When?

Mr. BUTTENWIESER. December 31, 1930.

Mr. PECORA. In the questionnaire which I caused to be submitted to your firm in behalf of the committee I asked for a copy of the balance sheet of that company, and I was furnished with this document [indicating]. Will you kindly look at it, Mr. Buttenwieser, and tell me if you can identify it as being a true copy of balance sheets of the European Merchants Banking Co.?

Mr. BUTTENWEISER. I have no doubt it is correct.

Mr. PECORA. I offer this in evidence.

The CHAIRMAN. Let it be admitted and entered on the minutes.

(A copy of balance sheets of European Merchants Banking Co., Ltd., was received in evidence marked "Committee Exhibit No. 5, June 27, 1933." See p. 1086.

Mr. PECORA. I will now resume the examination of Mr. Kahn on another subject.

Senator GORE. Were you going to go to another subject now, Mr. Pecora?

Mr. PECORA. Yes, Senator Gore.

Senator GORE. I wanted to ask this, Mr. Chairman, with your permission. I want it developed in the record somewhere, if not in

this connection in some other connection, the fact of Mr. Paul Warburg's activities in organizing the International Acceptance Bank. I think it was granted by Congress rediscount privileges with the Federal Reserve bank. It then formed a connection with some other bank in New York, the name of which has slipped my mind. What was it, Mr. Kahn?

Mr. KAHN. I suppose, Senator, what you are referring to is that later on it was absorbed by the Bank of Manhattan Co.

Senator GORE. Yes; that is it. I thought it was the Bank of Manhattan, but I was not sure enough to say so. I think this International Acceptance Bank has gone out of existence now, perhaps. I have had some information about it which seems like an interesting chapter, and I wish, Mr. Pecora, you would develop that sooner or later.

One other question, Mr. Chairman. I notice in this morning's paper a portion of Mr. Wilkins' testimony out in Detroit. I believe it was last night. It was in regard to the withdrawal of deposits and the clearing of certain checks after the holiday was declared. I want to ask now if that comes within the purview of your plans to develop that sooner or later.

Mr. PECORA. Senator Gore, may I ask you to repeat that? I was conferring with one of my associates.

Senator GORE. I noticed in the paper last night some reference to the clearing of checks in Detroit after the holiday had gone into effect. It was in the testimony of Mr. Wilkins. I do not know upon what foundation he bases his testimony. It seems to me that it would be worth looking into, because he alleges—upon what ground I do not know— that certain interests in New York deliberately closed those banks and brought about the crash, in order to embarrass Mr. Ford. I do not know whether that is true or not. It grew out of the investigation or the testimony of Mr. Wilkins before the grand jury. If there is any foundation to it, it ought to be developed, and if there is not, it ought to be developed—in either case, because it creates a terribly bad impression if it is untrue, and if it is true it is a matter of the highest importance.

The CHAIRMAN. I do not know whether Mr. Kahn knows anything about that or not.

Senator GORE. I am not on this committee, but I just dropped in, and I hope the chairman will pardon me for the interruption.

The CHAIRMAN. If Mr. Kahn has any information on that subject, the committee would be glad to hear it.

Mr. KAHN. I am afraid that I have no information on the subject. The International Acceptance Bank was formed by Mr. Paul Warburg as his personal venture and the venture of some of his friends, many years after he ceased to be a partner in my firm. That was after he left his official position in Washington. I could not possibly of my own knowledge testify to that.

Senator GORE. I knew you could not, Mr. Kahn, but I thought you might put into the record suggestions that would enable Mr. Pecora to develop the history of it.

Mr. KAHN. I am afraid that of my own knowledge I know of no way in which I could be helpful in that connection. I would be only too glad to be, if I could.

The CHAIRMAN. Have you any information regarding the Detroit matter that Senator Gore inquires about?

Mr. KAHN. No information of that or of any similar character came to my knowledge.

TESTIMONY OF OTTO H. KAHN, A MEMBER OF THE FIRM OF KUHN, LOEB & CO., NEW YORK CITY—Resumed

Mr. PECORA. Mr. Kahn, are there any meetings of the partners of your firm that are held at regular intervals for the transaction of the business of the firm?

Mr. KAHN. No, sir; we have no regular meeting of that kind. It varies. Once in a while we meet fairly regularly, twice a week or three times a week, when business happens to be active. Much more frequently we have no such meetings. I should say that the proportion between the years when we have such meetings and when we have no such meetings regularly, would be about one to five. I think, five times when we have no such meetings to one time when we have such a meeting.

Mr. PECORA. Are any written records or memoranda maintained of the proceedings at those meetings or conferences of the partners, Mr. Kahn?

Mr. KAHN. No, sir.

Mr. PECORA. Have they ever been?

Mr. KAHN. Never.

Mr. PECORA. Mr. Kahn, has there been any reason, any special reason, for not recording those proceedings by way of any written record?

Mr. KAHN. None whatever. The mere fact that they were held so irregularly proves that they were nothing but exchanges of opinion, that there were no new resolutions of any kind passed. For instance, if one partner had something in mind which he wanted all of the partners to know he would ask that a meeting be held. But there is no significance to the meetings. They are thoroughly informal and merely informative.

Mr. PECORA. Well, because they are informative wouldn't certain advantages be served by keeping a written record of those proceedings?

Mr. KAHN. I do not believe so, Mr. Pecora. That has not been our experience. We are a family affair. A number of us sit close together all day long, and we know pretty well what goes on. But once in a while, and sometimes more than once in a while, sometimes regularly for 2 or 3 or 4 weeks, there is a tacit understanding that we will have meetings. Then we find out, after having observed those meetings for 3 or 4 weeks, that we are wasting our time, and that too much is said, too much talk is indulged in, that everyone wants to " shoot off his face ", so to speak.

Senator BARKLEY. Sometimes what you might say is like the Senate?

Mr. KAHN. Well, Senator Barkley, I would not dare say that.

Mr. PECORA. But the Senate's proceedings are duly recorded.

Mr. KAHN. And then we drop them again. We find that no useful purpose is served by making any formal record of such meetings, and we have never done so.

Mr. PECORA. Mr. Kahn, is your firm subjected to examination with respect to its banking business by any public officer or authority either of the State of New York where its office is located or of the United States?

Mr. KAHN. No, sir. I know that you are familiar, much more familiar than I, with the laws of the State of New York in respect to private bankers' accepting deposits, and under the definition of that law we have accepted no such deposits and therefore are subject to no such examination.

Mr. PECORA. That is, you have conformed to those provisions of the banking laws of the State of New York which do not subject your firm to examination or inspection at the hands of the State superintendent of banks of New York?

Mr. KAHN. Yes.

Mr. PECORA. Do you know whether or not counsel for your firm had any part in the drafting of those provisions of the banking law of the State of New York?

Mr. KAHN. Not to my knowledge; but it might well be so. I know that one of my partners was consulted about it, and it is quite the reasonable thing that he consulted one of counsel. But I do not really know, of my own knowledge. I do not know, because I was not consulted.

Mr. PECORA. Don't you know, or have you heard, rather, that counsel for your firm appeared with or collaborated with counsel for other private banking firms in the city of New York and helped to draft the legislation which is now on the statute books of the State of New York with regard to private bankers?

Mr. KAHN. Not to my knowledge, Mr. Pecora, but it may well be so.

Mr. PECORA. Do you recognize any disadvantages that would attach to your firm in the conduct of its business if it were subjected to examination by the State superintendent of banks of New York in the same fashion that commercial banks, State banks in New York are subjected to examination by the State superintendent of banks?

Mr. KAHN. Isn't that water over the dam, Mr. Pecora, under the new laws that have been enacted?

Mr. PECORA. Well, I am not so sure that it is, but at any rate I should like to have your answer.

Mr. KAHN. Well, my answer is that as far as examination is concerned, I personally—and I haven't conferred with my partners about it—but I personally see no reason why we should not be examined.

Mr. PECORA. Has that always been your attitude or state of mind on that subject?

Mr. KAHN. I do not really know when I last gave it consideration, but I should think, knowing my slant of mind, that it probably has always been my attitude.

Mr. PECORA. Well, whether or not that was always your attitude, the fact is that the actual conduct of your banking business has been such as to avoid examination by the State superintendent of banks in New York, hasn't it?

Mr. KAHN. May I respectfully object to the use of the word "avoid"?

Mr. PECORA. Or it has been such as not to subject yourselves legally to such examination, if I may put it that way.

Mr. KAHN. Well, there was certainly no conscious avoidance of it.

Mr. PECORA. I am willing to let you use your own terminology in describing the fact.

Mr. KAHN. The fact is that there was no conscious avoidance. It simply happens that our business, which is not to solicit deposits, and not to take small deposits, and not having deposits subject to check, did not fall within the province of the law which would have implied an examination by the State superintendent of banks.

Mr. PECORA. Wasn't that provision put in the law for the benefit of a few private banking firms, to your knowledge?

Mr. KAHN. To my knowledge; no. Moreover, it would not appear to be to their benefit in my humble opinion. I see no benefit in not being examined.

Mr. PECORA. You could still have placed a limitation, a minimum amount on deposits that you would receive, and be subject to examination if it were not for that provision of the law; isn't that so?

Mr. KAHN. If it had not been for that provision of the law; yes.

The CHAIRMAN. Are your deposits time deposits or demand deposits, or what?

Mr. KAHN. Our deposits (conferring with associates) my partners tell me, and this is a little bit beyond my own activities in the firm; but they tell me that they change, sometimes being time deposits and sometimes being demand deposits. There is no definite rule either the one way or the other.

Senator BARKLEY. You say they are not subject to check?

Mr. KAHN. Pardon me, Senator, but I did not hear your question.

Senator BARKLEY. Did you say a moment ago that your deposits are not subject to check?

Mr. KAHN. They are not subject to check in any ordinary understanding of that term; no.

Senator BARKLEY. How does a depositor get his money out of your institution?

Mr. KAHN. He asks for it.

Senator BARKLEY. Sir?

Mr. KAHN. He asks for it and we transfer it to him.

Senator BARKLEY. Well, there has to be some written order, I suppose, in order to get it?

Mr. KAHN. It is subject to his order, but it is not subject to check as that term is generally understood. That is, as far as anyone except individual partners and relatives of the firm are concerned, no one possesses Kuhn, Loeb & Co. check books. If they want their money they ask for it and they get it.

Mr. PECORA. At any time?

Mr. KAHN. At any time, unless it is a time deposit.

Senator BARKLEY. And in that case you issue a Kuhn, Loeb & Co. check to the depositor?

Mr. KAHN. Yes, sir.

Senator BARKLEY. And he cashes that check somewhere else?

Mr. KAHN. Yes, sir. But it would go, probably, through our bank in the ordinary course of events.

Mr. PECORA. Now, Mr. Kahn, are your depositors corporations?

Mr. KAHN. Yes; and some, quite a number of them, hold European connections, banks that leave certain amounts here on deposit, but no very great amount at any one time. And yet we have quite a number of European depositors with whom we have had business relations for many years. And we have small amounts with them, and they have small amounts with us.

The CHAIRMAN. You do not have any savings deposits?

Mr. KAHN. I beg your pardon, Senator Fletcher?

The CHAIRMAN. Have you any savings deposits, Mr. Kahn?

Mr. KAHN. No, sir.

Senator BARKLEY. Does every member of your firm make a financial contribution, or put in a certain amount of money as though he were buying stock in a corporation, when he becomes a partner?

Mr. KAHN. No, sir. The articles of incorporation make that perfectly plain—or, my attention has been called to a misuse of a term there. I should have said the articles of copartnership make that perfectly plain. But whether he does or does not make a deposit, his liability so far as the firm is concerned is unlimited.

Senator BARKLEY. I understand. But a man is taken into the firm for what he may be worth as an addition to it and not by reason of what he puts into it by way of money; is that it?

Mr. KAHN. Yes, sir.

Senator BARKLEY. Where he might put in money, or in case he does not, upon what basis does he share in the profits?

Mr. KAHN. Upon a basis which is determined by mutual agreement.

Senator BARKLEY. Is that basis set out in the articles of copartnership?

Mr. KAHN. Yes, sir.

Senator BARKLEY. And those articles are changed every time you take in a new partner or lose one?

Mr. KAHN. Yes, sir.

Mr. PECORA. Now, Mr. Kahn, in the questionnaire which I submitted to your firm in behalf of this committee some time ago, I asked for the number of corporations engaged in interstate commerce having bank deposits with your firm, and the total amount of such corporation deposits at the end of each calendar year during the 5-year period from 1927 to 1931, both inclusive.

Mr. KAHN. Yes, sir.

Mr. PECORA. I show you this typewritten document, and ask you if that constitutes the answer prepared by your firm and the correct answer to that question.

Mr. KAHN. Yes, sir.

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

The CHAIRMAN. It will be received and will be made a part of the record by the committee reporter.

COMMITTEE EXHIBIT No. 6

QUESTION NO. 21

Total amount of deposits of corporations engaged in interstate commerce at the end of each of the calendar years 1927–31, inclusive, and the number of such corporations

Year ending—	Number of corporations	Total deposits
1927	14	$24,151,503.54
1928	17	33,338,974.89
1929	18	59,703,040.79
1930	19	31,245,767.37
1931	15	12,891,901.47

Mr. PECORA. Now, Mr. Kahn, question no. 22 of the questionnaire which I submitted to your firm in behalf of this committee asked for the names of all corporations engaged in interstate commerce having banking deposits with you in excess of $50,000 during that same 5-year period. And I received this document, which I now show you, as an answer to that question. Will you kindly look at it and tell us if that constitutes a correct and complete answer to that question?

Mr. KAHN. Yes, sir.

Mr. PECORA. I offer that in evidence and ask that it be spread on the record of the committee's hearings.

The CHAIRMAN. Let it be admitted and be made a part of the record.

COMMITTEE EXHIBIT No. 7

QUESTION 22

Names of all corporations engaged in interstate commerce having banking deposits with us in excess of $50,0000 during period 1927–31, inclusive

Balaban & Katz Corporation.
Baltimore & Ohio Railroad Co.
Chesapeake & Ohio Railway Co.
Chicago, Milwaukee, St. Paul & Pacific Railroad Co.
Chicago & North Western Railway Co.
Delaware & Hudson Co.
Denver & Rio Grande Western Railroad Co.
Gulf, Mobile & Northern Railroad Co.
Hudson Coal Co.
Hudson-Manhattan Railroad Co.
Illinois Central Railroad Co.
Indiana & Illinois Coal Corporation.
Inland Steel Co.
International-Great Northern Railroad Co.
Kansas City Southern Railway Co.
Mid Continent Petroleum Corporation.
Missouri-Kansas & Texas Railroad Co.
Missouri Pacific Railroad Co.
National Malleable Steel Castings Co.
New Orleans, Texas & Mexico Railway Co.
Pacific Oil Co.
Paramount Famous Lasky Corporation.

Paramount Publix Corporation.
Pennroad Corporation.
Pennsylvania Co.
Pennsylvania Railroad Co.
Southern Pacific Co.
Texas & Pacific Railway Co.
Transportation Products Corporation.
Union Pacific Railroad Co.
Utah Fuel Co.
Wabash Railway Co.
Western Maryland Railway Co.
Western Union Telegraph Co., Inc.
Westinghouse Electric & Manufacturing Co.
Westinghouse Lamp Co.
Youngstown Sheet & Tube Co.

Mr. PECORA. Now, Mr. Kahn, in looking over committee's exhibit no. 7, June 27, 1933, which is an answer to my question no. 22 of the questionnaire submitted to your firm, I notice the names of many railroad companies among corporations engaged in interstate commerce which maintain deposit accounts in excess of $50,000 with your firm. Are these railroad corporations companies for which your firm has done the financing in the past?

Mr. KAHN. May I have a look at it, Mr. Pecora, to see what it is?

Mr. PECORA. Yes; certainly.

Mr. KAHN. I have a copy here, I am told. I am sorry.

Mr. PECORA. All right. Please look at it and answer the question.

Mr. KAHN. Generally speaking, the answer to your question is "Yes." There may be one or two minor ones where that is not so, but generally speaking the answer to your question is "Yes."

Mr. PECORA. Were these deposits maintained by those railroads with your firm time deposits or were they deposits payable on demand?

Mr. KAHN. Yes; I give the same answer as before, that it depends upon the arrangement and the convenience of our depositors. Sometimes they prefer to keep it on time, when they have no immediate use for the money; and sometimes they are call deposits. There is no definite rule.

Mr. PECORA. Do you allow interest to them where the deposits are time deposits?

Mr. KAHN. Do we allow interest?

Mr. PECORA. Yes.

Mr. KAHN. Yes.

Mr. PECORA. Do you allow interest where they are time deposits, was my question.

Mr. KAHN. Yes, sir.

Mr. PECORA. What controls the rate of interest that you allow on such deposits?

Mr. KAHN. The best that we can afford, the best that the condition of the market permits.

Senator TOWNSEND. About what is the rate of interest paid on deposits?

Mr. KAHN. It varies, Senator Townsend. At the present time I am sure it is not very much, but we adjust it to the conditions prevailing in the money market at the time.

Senator TOWNSEND. Do you know what the rate of interest is at the present time?

Mr. KAHN. I will have to confer with some of my associates.

Senator TOWNSEND. All right.

Mr. KAHN. At the present time they tell me—well, I am afraid I am dependent upon information as to that, and do you want me to answer what is given to me?

Senator TOWNSEND. That will be all right.

Mr. KAHN. At the present time they tell me the deposits with us are very small, and that the rate which we allow varies from one half of 1 percent for call deposits to 1 percent for time deposits.

Senator TOWNSEND. Those rates were very much higher, I take it, during the boom period of 1929?

Mr. KAHN. Oh, yes; much higher.

Senator TOWNSEND. What was the highest rate at that time? Do you recall?

Mr. KAHN. I am having it looked up.

Senator TOWNSEND. That will be all right, and you can answer when you receive the information. In the meantime, Mr. Pecora may go ahead.

Mr. PECORA. Now, Mr. Kahn, in the questionnaire that we submitted to your firm, question no. 4, we called for the names of all banks and trust companies in which your firm maintained deposits during the 5-year period, 1927 to 1931, both inclusive, and the amounts of those deposits at the present time in any such banks and trust companies; and we also called for the names of all other banks and trust companies in which deposits are now maintained. In answer thereto I received from your firm a typewritten document which I will ask you to kindly look at and tell us if you can identify it.

Mr. KAHN. Yes, sir.

Mr. PECORA. Is that a correct and complete statement in answer to the question submitted to you?

Mr. KAHN. It is.

Mr. PECORA. I now offer it in evidence and ask that it may be spread on the record of the hearings.

The CHAIRMAN. Let it be admitted and the committee reporter will make it a part of the record of the hearings.

COMMITTEE EXHIBIT No. 8

QUESTION 4

A. Names of banks and trust companies in which this firm maintained deposits during the years 1927 to 1931, inclusive

Mechanics & Metals National Bank, New York.
National City Bank, New York.
Chase National Bank, New York.
National Bank of Commerce, New York.
Chemical National Bank (title changed), New York.
Guaranty Trust Co. of New York.

B. Balances as of Mar. 31, 1933

Guaranty Trust Co. of New York	$748,624.61
National City Bank, New York	161,792.03
Chase National Bank, New York	60,498.36
Chemical Bank & Trust Co., (title changed) New York	300,392.84
Bank of The Manhattan Co., New York	57,293.26

C. Foreign banks and trust companies in which deposits were maintained during the period 1927–31; balance as of March 31, 1933 (dollar equivalent)

Bank of Montreal, London, debit	$10.99
National Provincial Bank, Ltd., London	Account closed
Swiss Bank Corporation, London	Do
Westminster Bank, Ltd., London	$35,188.23
Dresdner Bank (formerly Darmstaedter & National-Bank), Berlin	316.67
Deutsche Bank & Discounto-Gesellschaft, Berlin	251.70
Deutsche Effecten- & Wochsel-Bank, Frankfurt a/M	1,078.18
Deutsche Vereinsbank, Frankfurt a/M	Account closed
Direction der Disconto-Gesellschaft, Berlin	Do
Oesterrreichtische Creditanstalt, Vienna	$64.00
Banque de Paris at des Pays-Bas, Paris	2,011.35
Comptoir National d'Escompte de Paris, Paris	Account closed
Credit Lyonnais, Paris	$957.00
Chase Bank (formerly Equitable Trust Co.), Paris	504.49
Société Générale pour favoriser, etc., Paris	480.34
Banque Centrale Anversoise, Antwerp	93.00
Banque de Bruxelles, Brussels	90.35
Crédit Suisso, Zurich	255.71
Banque Fedérale, Zurich	202.00
Amsterdamsche Bank, Amsterdam	101,476.50
Nederlandsche Handel-Maatschappij, N.V., Amsterdam	460.00
Centralbanken for Norge, Oslo	14.63

The CHAIRMAN. Did your firm make many of what are known as "brokers' loans" prior to October of 1929?

Mr. KAHN. Did we?

The CHAIRMAN. Yes.

Mr. KAHN. Yes. It is a part of the way in which we employ our money.

The CHAIRMAN. Would you give us an idea of the extent of those transactions in a general way?

Mr. KAHN. I am informed that it shows on our balance sheet, of which you have an exhibit.

The CHAIRMAN. Do you remember the rate of interest that you received on those loans?

Mr. KAHN. It varied, Senator Fletcher. Yes; it varied.

Mr. PECORA. Are those brokers' loans that are referred to in your answer as call loans secured by stock-exchange collateral?

Mr. KAHN. Yes, sir.

Senator TOWNSEND. Mr. Kahn, have you secured that interest in 1929 that I asked about?

Mr. KAHN. Fourteen percent, I am informed, was the highest rate.

Mr. PECORA. That is, prior to November of 1929?

Senator TOWNSEND. That is, on your deposits?

Mr. KAHN. Yes, sir.

Senator ADAMS. Inasmuch as two questions came in there at about the same time, I am wondering whether Mr. Kahn answered the one or the other.

The CHAIRMAN. Fourteen percent was your highest rate on those loans?

Mr. KAHN. That was on deposits, and I am trying to look it up. You realize that the renewal rate of the stock exchange is not fixed by the banker but by the stock exchange. It is a part of a ruling made every day, as to what shall be the rate which stock-exchange brokers are permitted to pay for renewal loans, and we are advised about that. I am trying to find out how high that rate was as a maximum, but we have not received it as yet.

The CHAIRMAN. Did you say you paid as high as 14 percent on deposits, or did you mean to say that those were the rates you received on call loans?

Senator TOWNSEND. I am wondering if we are not confused a little about the questions. My question of a few minutes ago was as to the highest rate you were paid for call loans during 1929.

Mr. KAHN. I am informed that in one or two cases we took deposits on the understanding that we would allow whatever the rate was that we might succeed in obtaining, less 1 percent for our services, that in one or two cases, or at least in a few cases, we received as high as 14 percent.

Mr. PECORA. What you mean to say is this——

Mr. KAHN (continuing). And I find I made a mistake in that last answer. My associates tell me that it was one half and one quarter of 1 percent.

Mr. PECORA. Do you mean by that answer that in those one or two instances your firm made call loans of moneys of clients, depositors, or customers, whatever you may choose to call them, and agreed to pay to those clients, depositors, or customers, the same rate of interest you got in the call money market for those loans, after deducting 1 percent for your commission?

Mr. KAHN. I am informed, Mr. Pecora, that I was wrong about deducting 1 percent, that it was less, and that I did ourselves an injustice, that we did it much cheaper. Now, what was it?

Mr. LANGENBACH. It was one quarter of 1 percent on time, and it was not in just a few instances but in many instances.

Mr. KAHN. Mr. Langenbach answered that.

Mr. PECORA. Is he a partner?

Mr. KAHN. No; he is our chief bookkeeper.

Mr. PECORA. Who handled those call loans for your firm in 1929; what members of the firm?

Mr. KAHN. The head of our loan department, whoever he happened to be at that time. I do not really know now who he was at that time.

Mr. PECORA. Were they partnership decisions, those decisions that were made with regard to moneys that would be loaned on call, or was that left to an employee?

Mr. KAHN. There were no partnership decisions made. But I presume one of the partners had general supervision over the department business. I know that I did not.

Mr. PECORA. Who did have? Which one of the partners did have that general supervision over the matter of loans?

Mr. KAHN. That would be my greatly esteemed former partner, Mr. Jerome J. Hanauer, who is here and in whose province that particular supervision lay.

Mr. PECORA. But he is no longer a partner?

Mr. KAHN. No.

Mr. PECORA. How did the interest rates that were allowed by your firm to these various corporations who maintained deposit accounts, balances in excess of $50,000 enumerated on committee exhibit no. 7 of this date, compare with the interest rates allowed by commercial banks at that time?

Mr. KAHN. I am sorry to have to consult about that. It is not within my knowledge.

Mr. PECORA. Well, give us the benefit of your consultation.

Mr. KAHN. Would you like to have Mr. Hanauer answer that question or shall I tell you what he says to me?

Mr. PECORA. I have no objection to his giving you the information and you can communicate it to us as having been obtained from him.

Mr. KAHN (after consulting). Mr. Pecora, I am sorry to have delayed you but it is not within my personal knowledge. But my former partner tells me that he depended upon the arrangements that were being made in each case with the corporations or their financial officers concerned. It depended on our own determination to a certain extent, about what they could tell us informally, how soon they were likely to use that money. There was no definite assurance given, but they would tell my partner something like this: We are not likely to need the money for 10 days or a fortnight, or possibly 3 weeks, as the case might be. And on the strength of that information, and on the strength of personal negotiations, the rate was fixed. Usually it was for the same rate as commercial banks were allowing or a trifle better. It was to the best of my knowledge never less than that, never less than they could get elsewhere and sometimes a trifle better.

Mr. PECORA. Did the rates vary with depositors?

Mr. KAHN. Yes; the rates varied.

Mr. PECORA. What was the range at any one time?

Mr. KAHN. Oh, I did not understand your question. Did you ask if the rates varied?

Mr. PECORA. Yes.

Mr. KAHN. I thought you asked as of the time. The rates did not vary as to depositors. They were as nearly alike as possible considering the circumstances of the case in each instance, as nearly as they could be considered.

Mr. PECORA. Where you regarded a deposit as a time deposit did you allow the same rate of interest to all depositors who maintained time deposits with you?

Mr. KAHN. For the same length of time?

Mr. PECORA. Yes, sir.

Mr. KAHN (after consulting with associates). Yes. They tell me, Mr. Pecora, if he deposited at the same time, for the same period, under the same circumstances, yes. We treat them all alike. But if times were different, if the circumstances were different, if the length for which they left it with us were different, the rate is different. But the answer to your question is generally yes.

Mr. PECORA. And your firm, I presume, made a use of these deposit funds profitable to it?

Mr. KAHN. Slightly to us. Not very. We allowed the closest rate that we could afford.

Mr. PECORA. You employed those funds in the making of loans generally speaking, did you not, for the most part?

Mr. KAHN. In the making of loans immediately available; yes.

Mr. PECORA. Now, were those deposit funds used in connection with the securities or the securities business handled by your firm?

Mr. KAHN. Perhaps I can answer that best by saying—and you will correct me if I am not right (addressing his associates) that our

first purpose and our first policy was always to have ample funds at hand to pay off our deposits. That was the first policy. Beyond that we did not distinguish, discriminate formally between deposits and between our capital, except that we always reserved against our deposits sufficient funds to pay them off at once.

Senator TOWSEND. Do you mean in cash?

Mr. KAHN. Yes.

Senator TOWNSEND. In cash?

Mr. KAHN. I mean to pay them off in cash immediately. For instance, if you would make what we call immediately available assets that would mean that we could sell or dispose of them, liquidate them, within 24 hours, and such assets we always had against our deposits to a more than ample extent.

Senator TOWNSEND. You mean you were liquid to the point of where you carried a great quantity of Government securities and cash?

Mr. KAHN. Government securities, cash, and other liquid assets. For instance, we would call stock-exchange loans against collateral approved by us liquid funds, because it has never happened that they were not paid off the next day when called for.

Senator BARKLEY. Was there any increase in your deposits about the time the call money rate went up to 15 percent or 20 percent in 1929?

Mr. KAHN. I believe there was. (After conferring with his associates.) We did get a material increase in deposits in 1929. Yes, Senator. In 1929 our deposits reached their climax. They varied with the times. And our climax was in 1929.

Senator TOWNSEND. Did you stipulate any amount that railroads for which you did the financing should leave with you on deposit?

Mr. KAHN. We stipulated no amount; no.

Senator TOWNSEND. That was left to their own discretion?

Mr. KAHN. And to our acceptance. We would not have accepted a trifling amount. We would have said in such case, "Go to your banks. That is not our business."

The CHAIRMAN. Do you have any regular period for settling with the partners? An adjustment time, a date at the end of the year, or what time?

Mr. KAHN. Settling with the partners?

The CHAIRMAN. Settling with the partners; yes.

Mr. PECORA. That is, distribution of profits among the partners; was there any fixed time for that?

Mr. KAHN. Yes. The 31st of December, every year.

Mr. PECORA. I believe I understood you to say in answer to a question put to you by one of the Senators a little while ago that not every partner in the firm is required to make a contribution to the capital of the firm upon his being accepted as a partner.

Mr. KAHN. That is right.

Mr. PECORA. Or admitted as a partner?

Mr. KAHN. That is right, Mr. Pecora.

Senator GOLDSBOROUGH. May I ask just a question. Mr. Kahn, when you made collateral loans did you require the borrower to maintain a certain percentage of balance with you?

Mr. KAHN. The borrower?

Senator GOLDSBOROUGH. Yes.

Mr. KAHN (after consulting with his associates). No; we did not.

Senator ADAMS. Your call borrowers are not necessarily depositors? You make those call loans through the stock exchange, do you not?

Mr. KAHN. Yes.

Senator ADAMS. And you do not know, oftentimes, the individual to whom they go? In most cases you do not know that?

Mr. KAHN. Yes; that is true.

Mr. PECORA. You make them on the responsibility of the broker?

Mr. KAHN. Yes.

Mr. PECORA. As well as on the security of the collateral?

Mr. KAHN. Mainly on the security of the collateral.

Mr. PECORA. Yes.

Mr. KAHN. And we pick good brokers. We do not make——

Mr. PECORA. You mean good brokers pick you.

Mr. KAHN. Thank you. Thank you.

Senator BARKLEY. There are a lot of people who were neither bankers nor brokers who got picked in 1929.

Senator GOLDSBOROUGH. Mr. Kahn, more fully explaining my recent question: If you had certain depositors with your corporation or firm and they wanted to make a collateral loan would you require them to maintain a certain balance against that collateral loan? I am not speaking about the ordinary brokerage loan.

Mr. KAHN. No.

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

Mr. KAHN. Senator, may I correct, or rather make plain one thing as to which my partner said I did not express myself very clearly? When I suggested that I would like to put in the statement by Freeman & Co., I said I did not know about that statement before. My partner understood me to say that I did not know about that firm before. They want me to say that that is incorrect, because it is an old, established and well-known firm. So, I did not wish to say that the firm was unknown to me. I wish to say that the statement was unknown to me until a few days ago.

The CHAIRMAN. You did not give the name of your partner who was a member of the stock exchange.

Mr. KAHN. John M. Schiff.

Senator BARKLEY. Shaefer?

Mr. KAHN. Schiff.

The CHAIRMAN. We will meet then at 2 o'clock.

(Thereupon, at 12.35 p.m. a recess was taken until 2 o'clock p.m. the same day, Tuesday, June 27, 1933.)

AFTER RECESS

The subcommittee reconvened at 2 p.m., Tuesday, June 27, 1933, at the expiration of the noon recess.

The CHAIRMAN. The subcommittee will come to order. You may resume the stand, Mr. Kahn.

TESTIMONY OF OTTO H. KAHN, A PARTNER OF KUHN, LOEB & CO., NEW YORK CITY—Resumed

Mr. PECORA. Mr. Kahn, in the course of your testimony at the forenoon session you read into the record from some typewritten statement that I observed was handed to you by someone in connection with the Southern Pacific Railway Co. financing.

Mr. KAHN. Yes, sir.

Mr. PECORA. Do you know who prepared that statement?

Mr. KAHN. I presume Mr. Percy Stewart, who is sitting by me, prepared it.

Mr. STEWART. I prepared it.

Mr. PECORA. Was it prepared before you came to this hearing?

Mr. KAHN. Oh, yes.

Mr. PECORA. What was the purpose of preparing that statement with regard to that episode?

Mr. KAHN. Perhaps the purpose was to pat ourselves gently on our backs.

Mr. PECORA. I beg pardon?

Mr. KAHN. Perhaps the purpose was to pat ourselves gently on our backs, and show that we of our own volition paid a great deal more than the company was able to obtain by competition.

Mr. PECORA. Was that such an outstanding event in the history of financing by your firm that you considered it important enough to prepare the statement in advance for use at this hearing?

Mr. KAHN. It was an outstanding event to that extent, that, generally speaking, as I mentioned this morning, we do not participate in competitive bidding, and this was a conspicuous instance where the company did much better by dealing with us than they could have done by competitive bidding.

Mr. PECORA. Would you say that because of that conspicuous incident, as you have characterized it, it proves the contention you were subscribing to, that competitive bidding is calculated to bring less beneficial results to the corporation seeking to do public financing?

Mr. KAHN. I am convinced of that; yes.

Mr. PECORA. Just from that one incident?

Mr. KAHN. Not from that one incident. From general experience and observation both in this country and many other countries.

Mr. PECORA. Does your experience include any other incidents than this conspicuous one that you have referred to?

Mr. KAHN. I cannot at this moment search my memory sufficiently to give you an answer under oath, but——

Mr. PECORA. Well, as a matter of fact, you had forgotten this conspicuous incident in the course of your testimony this morning until one of your associates gave you that typewritten statement to which reference was made, had you not?

Mr. KAHN. I do not say that I had forgotten it, but I did not have it in my memory.

Mr. PECORA. Now your firm, as I understood your testimony this morning, specialized—if I may use that term—in railroad financing?

Mr. KAHN. Largely, yes.

Mr. PECORA. Largely. In connection therewith, do you keep abreast or do you seek to keep abreast of the reports and decisions of the Interstate Commerce Commission?

Mr. KAHN. We seek to keep abreast; yes.

Mr. PECORA. You have no difficulty in obtaining them, do you?

Mr. KAHN. No.

Mr. PECORA. The reports and decisions of the Commission are public property and readily available to those who seek them?

Mr. KAHN. Yes.

Mr. PECORA. Do you know what has been the history as reflected in the reports of the Interstate Commerce Commission in the past few years of competitive bidding for the equipment obligations of railroads? Equipment Trust certificates?

Mr. KAHN. I believe that history is pretty definitely set forth in the pamphlet which I presented this morning, by Freeman & Co.

Mr. PECORA. Well, I have not seen that pamphlet yet, and I have not the advantage of examining the authors of that pamphlet here, because they are not here, but I want to ask you as a banker who largely specializes in railroad financing if you know what the history has been as that history has been recorded and reported in the public documents of the Interstate Commerce Commission with regard to Equipment Trust obligations or certificates?

Mr. KAHN. My own judgment is that it has narrowed and made more difficult the market for equipment trusts.

Mr. PECORA. When you say that it has narrowed and made more difficult the market for equipment trusts, what do you mean by that, so that there may be no misunderstanding of your statement?

Mr. KAHN. I mean by that that the distributors, who are a valuable portion of the investment business, have to a considerable extent shown a reluctance to go into the purchase or into the distribution of equipment-trust certificates unless they are sponsored by responsible bankers, and unless an adequate margin was secured to make it worth their while to go to the effort and the responsibility of going out and distributing such equipment trusts.

Mr. PECORA. Who has shown that reluctance?

Mr. KAHN. The distributors.

Mr. PECORA. The distributors?

Mr. KAHN. Yes.

Mr. PECORA. That is, the jobbing agencies?

Mr. KAHN. Yes.

Mr. PECORA. That are relied upon by the underwriting bankers; the issuing bankers? Is that right?

Mr. KAHN. Yes.

Mr. PECORA. And the reason for that reluctance is because of the narrowness of the spread or profit to themselves, is it not?

Mr. KAHN. Only in part, Mr. Pecora. I think the distributors, and I venture to say the public, do attach considerable importance to have securities that are offered to them under the sponsorship and bearing the trade mark of responsible bankers, which bankers over a course of many years have shown that they are thorough, that they are experienced, and that they are men of integrity. That is a fact.

Mr. PECORA. Are we to understand from that, Mr. Kahn, that the distributors rely in selling an issue to their customers or to the investing public upon the sponsorship of the underwriting banker or the issuing banker?

Mr. KAHN. Reliance is perhaps too strong a word, but it is undoubtedly an element which affects their judgment.

Mr. PECORA. Is it the most decisive single influence?

Mr. KAHN. That asks me to answer for every distributor, which I cannot do.

Mr. PECORA. I merely want your general observation.

Mr. KAHN. But my general observation is in this and in other instances that the trade mark and the sponsorship of a responsible banker, which means the examination he has made, the advice he has given, the thoroughness which he has devoted to a thing, the record of integrity which he has made, is an important element in influencing not only the distributors but also influencing the public.

Mr. PECORA. The investing public who buy from the distributors?

Mr. KAHN. Yes.

Mr. PECORA. Well, I repeat the question: Would you refer to that element as the most important single element which influences the distributor and the retail buyer, so to speak?

Mr. KAHN. It is difficult to say what is the most important single element.

Mr. PECORA. Well, do you know any single element more important than that?

Mr. KAHN. There ought be no single element more important than the assurance of the investor and of the distributor that he is buying something which has the best kind of sponsorship in the way of reliability and thoroughness. I do not know whether that is always so or not.

Mr. PECORA. And that is the sponsorship of the underwriting or issuing banker?

Mr. KAHN. Providing that underwriting and original banking has a reputation for thoroughness and integrity; yes.

Mr. PECORA. Yes. Issues such as equipment-trust certificates are now made as the result of competitive bidding, are they not?

Mr. KAHN. Yes, sir.

Mr. PECORA. And do you know what the effect has been of that competitive bidding for those securities, upon the spread?

Mr. KAHN. I could not answer that offhand.

Mr. PECORA. Well, let me read to you from the report of the Interstate Commerce Commission which I have before me, the Forty-fourth Annual Report, dated December 1, 1930, page 11:

> The amounts of equipment-trust obligations in respect of which carriers have been authorized by us to assume obligation and liability are shown above. All the equipment obligations, except those issued directly to the builders, were sold at competitive biddings. The table given on page 12 of our Annual Report for 1928 shows certain data with respect to the sale of equipment obligations and bonds in amounts of $100,000 and over to bankers, and resales by them to the public, in cases where complete sales information is available. The table is here reproduced with additional data for the last 6 months of 1928, the calendar year 1929, and the first 6 months of 1930 included.

Then in the table which follows, Mr. Kahn, it appears that for 7 months in 1920 the spread in the price to bankers and to the public per $100 unit was $1.91; that in 1921 it was $2.29½; in 1922, $2.33; in 1923, $2.33; in 1924, $1.86; in 1925, $1.80; in 1926, $1.47; in 1927, $0.66; in 1928, $0.64; in 1929, $0.89; and for the first 6 months of 1930, $0.72.

And reading from the forty-fifth annual report of the Interstate Commerce Commission dated December 1, 1931, and at page 10 thereof, we find a corresponding table for the first 6 months of 1931, which shows the spread in the sale of equipment obligations of 0.43.

And that the average spread for the entire year 1930 in the price to bankers in the sale of equipment obligations was 0.78.

Now you would accept these figures as authentic, would you not?

Mr. KAHN. Undoubtedly.

Mr. PECORA. Embodied as they are in the report of the Interstate Commerce Commission?

Mr. KAHN. Undoubtedly.

Mr. PECORA. Were you aware of that general trend downward of the spread in securities of this kind before I read it to you from these reports?

Mr. KAHN. I cannot say now that I was aware of it. As I said before, this pamphlet only came to my attention a few days ago. I brought it along because I thought it seemed to me a very eloquent statement corroborative of what I said to you gentlemen before. I have not compared it with this book and with these records.

The CHAIRMAN. What would happen, Mr. Kahn, in case there were no competitive bidding? Would the whole business be confined to one or two distributors?

Mr. KAHN. If there were no competitive bidding?

The CHAIRMAN. Yes.

Mr. KAHN. I think if there is no competitive bidding, Senator, the result will be that the railroads and other corporations are free to choose whom they want to do business with, and no one can say them nay. There is no one to control them. It has happened in our case more than once that a new financial vice president came into office; we did not know him before; we did not know who he was. We had no possible influence in bringing him in there. We had no possible influence in keeping him in there. But he would gradually acquaint himself with the facts as to the records of our dealings with that particular railroad, and the result was that he went on doing business with us. But it was entirely his doing. He can go to anybody else he chooses. And it is no more competitive or no less competitive than a doctor is competitive or an architect is competitive.

Mr. PECORA. Mr. Kahn, you recognize that there is a very sharp difference in principle between the analogy that you have drawn in the relations between a doctor and a patient, and the banker and the common carrier, do you not? There is a public interest in the latter classification that is not present in the relationship between a doctor and a patient, is there not?

Mr. KAHN. As far as the patient is concerned that does not enter. As far as the community is concerned of course it does.

Mr. PECORA. Yes. And that public interest and the service of that public interest is something that should be kept in mind.

Mr. KAHN. By all means.

Mr. PECORA. Yes.

Now in the case of the issuance and the sale of equipment trust obligations or certificates by common carriers, I believe it was in 1925 the Interstate Commerce Commission required those to be issued as the result of competitive bidding?

Mr. KAHN. Yes.

Mr. PECORA. And you have seen that the result has been a very appreciable narrowing of the spread to the banker?

Mr. KAHN. Yes.

Mr. PECORA. Now do you consider that has been harmful to the interests of the carrier or to the public?

Mr. KAHN. It may have been very harmful to the interests both of the carrier and of the public.

Mr. PECORA. Do you know of any instance that would establish that?

Mr. KAHN. I believe that the pamphlet I submitted does prove that it has been harmful; yes.

Mr. PECORA. You are referring now to the pamphlet of Freeman & Co.?

Mr. KAHN. Yes.

Mr. PECORA. Well I say again, I have not read that pamphlet and I have not the advantage of examining the authors of the pamphlet to see what their foundation for their conclusions was. But do you know of any instance within your personal knowledge where this rule of the Interstate Commerce Commission requiring competitive bidding in the issuance and sale of equipment trust certificates has worked to the detriment either of the carrier or of the public?

Mr. KAHN. I have given you one, Mr. Pecora, which I read to you this morning. I am not prepared without going into the thing more fully and examining the matter, to say whether there have been other instances. It is very difficult from a statement such as the Interstate Commerce Commission has made to know in what cases the offerings of equipment-trust certificates have been wholly unsuccessful. I have given you one instance in which they were wholly unsuccessful. There may be plenty of others. I do not know.

Senator ADAMS. Mr. Kahn, are you able to give us an approximate figure as to the prices at which equipment-trust certificates have been marketed during this period? Has there been a decline or an increase in the price of equipment-trust certificates?

Mr. KAHN. I see from Mr. Pecora's statement that there has been a decline. But I——

Senator ADAMS. No; his figures were a decline in the spread.

Mr. PECORA. A decline in the spread?

Senator ADAMS. Yes. I am talking about the price, which might be an entirely different thing.

Mr. KAHN. It might be an entirely different thing, as you rightly say, Senator, and I am not prepared now to say whether there has or has not been, because I do not know.

Senator ADAMS. The equipment-trust certificate has been regarded as a rather high-grade type of security, has it not?

Mr. KAHN. Yes; very high grade. And the question is, Mr. Pecora—and that was my whole point this morning—that there enter the interests of the public and the interests of the corporation in the first instance. The whole test of whether the investment banker is of any use or not depends on whether his services are of value to the industrial community, including the railroads, in enabling them to meet their long term requirements. If not, then the

investment banker might just as well go out of business. I am convinced, and the history of the other countries has shown, that these services are of real importance and of real usefulness. I cannot offhand tell you what elements in the particular passages you have read to me sustain your point and what elements sustain my point.

Mr. PECORA. I am not seeking to make any point. I am seeking to find out your view.

Mr. KAHN. Well, my point is that I am quite sure that you can bring some cases to my attention which seem to show that the noncompetitive bidding costs more than competitive bidding. But I am prepared to bring to you a whole raft of cases showing that competitive bidding has been most detrimental to the public, has compelled the public to pay unnecessarily high prices. Has in some cases destroyed the credit of corporations and of governments. And that if you weigh the one against the other, the thing to do, in my humble opinion, is to go to the people who have the greatest experience, who are most thorough, who have a good reputation, enlist their services and pay them what is a fair compensation—or not pay them any compensation at all, which is the usual case, but simply tell them, "We are willing to sell you that at such and such a price, and now you go out and resell them to the public at a fair increase"; and in selling them to the public at a fair increase we are perfectly willing to bear in mind that the investment banking business requires the services of a great many specialists. It requires the maintenance of a very large overhead. It involves a very great responsibility. It involves, if you want to maintain your reputation, your capacity to say no to a hundred tempting opportunities in order to maintain your reputation.

Mr. PECORA. That is true of business generally, isn't it?

Mr. KAHN. Not of all businesses as much as it is of the investment business, which is built upon one thing only, and that is——

Mr. PECORA. The difference is one of degree rather than of principle, is it not?

Mr. KAHN. I think it is to a considerable extent one of principle, because, as I tried to express this morning, we haven't got a show window. We do not advertise. We have no salesmen. We send nobody out to tout our goods. The only thing which keeps us alive is the confidence of the people, and that confidence is subject to being recalled. If we haven't got it any more we can just as well go out of business. And to maintain that confidence requires not only character and judgment, it requires also the capacity to say no to a hundred tempting opportunities.

Senator ADAMS. Mr. Kahn, if I might interrupt. Perhaps Mr. Pecora has grasped your explanation, but it has escaped me. I gather that your view is that it had been detrimental to the public as well as to the carrier to have competitive bidding on these equipment trust certificates. I find from these statistics that there is a smaller spread, so far as that is concerned; and apparently from the pamphlet, which I think has been identified as the Freeman & Co. pamphlet, the investment bankers or brokers say in that rather one after the other that it has resulted in a higher price of these equipment securities. Now I am not quite clear as to the point you make, as to why under those conditions it is detrimental to the public

and to the carrier, the carrier getting more money for his certificates, and, of course, rates and things of that kind are based upon the actual amount of money that comes in. It is more for the benefit of the public, I should think, if they get a dollar for a dollar obligation than if they get 97 for a dollar obligation. So I am really asking for information.

Mr. KAHN. Well, Senator, I am not—beg your pardon. [After conferring with associates.] Senator, I am getting valuable advice from the rear.

Senator ADAMS. You are fortunate in having it available. Most of us have to travel here without reserves or recruits back of us.

Mr. KAHN. What the rear tells me and what I fully approve is this: The statement which you have read me does not show whether on the whole the railroad obtained a better price or not in consequence of elimination of those sources of capital which they used to deal. It does show a lesser commission was paid. But if I am willing to pay, as I was willing to pay to the Southern Pacific, 98¼, and others were willing to pay only 97¼, I do not see in what way the fact that, if they could have sold them they might have sold them at 97¾, which would have been a half a cent spread to the officials of the railroad—I hate to argue with the master of the law——

Mr. PECORA (interposing). Please do not embarrass me.

Mr. KAHN. And to put my very poor knowledge or my very poor argument against yours. But how did I know that was beneficial to the railroad, or how do I know in your instance what the railroads would have obtained and what they would have obtained if they had come to us? How could anyone prove that? I know we would have to pay the top price that was possible to pay. How do I know that was the result, that either the bondholders or railroad was benefitted? I have given you one case showing where the railroad benefitted through the fact that they came to us instead of going to competitive bidding.

Mr. PECORA. Now, Mr. Kahn, perhaps this would be of some information or enlightenment to you on that very proposition. You were pleased to refer to the conspicuous instance of the Southern Pacific Railroad Co. this morning. You have made reference to it again this afternoon as illustrating the advantage to the carrier in that particular case of disposing of their bonds on your bid of 98¼ instead of accepting the best bid of 97 and a fraction which it received through competitive bidding.

Mr. KAHN. Yes.

Mr. PECORA. At what price did you sell those bonds to the public?

Mr. KAHN. 98½.

Mr. PECORA. 98½. That is, your profit was only one quarter of 1 percent?

Mr. KAHN. Yes.

Mr. PECORA. Wasn't that unusually small as compared to the profit in railroad bonds generally?

Mr. KAHN. That was an unusually small profit. The circumstances were unusual.

Mr. PECORA. Then if that was an unusual circumstance, why do you rely upon it to prove a generalization?

Mr. KAHN. It is merely one of the incidents which I happened to have at hand. I might be able to find others, or probably could

find others, which were eloquent of what I tried to prove this morning. That is not the only one. I told Mr. Pecora that the Cincinnati Union Station came to us and wanted to sell bonds to us at 89, and we said, no, don't sell them at that price. You can do much better. And shortly afterwards, a few months afterwards, it obtained 97 for them.

I can give you plenty of similar examples where, if bonds had been offered to competitive bidding at the time that the railroads wanted to offer them, they would have done infinitely worse than by waiting for the matured advice of their bankers who could afford to be disinterested—I do not pose as an altruist in business, but who could afford to be disinterested—because they knew that if they gave good service it would be appreciated and the business would come to them. No one would have given them that advice on competitive bidding. The railroads made up their minds they would sell at 89.

The CHAIRMAN. Mr. Kahn, since the Interstate Commerce Commission not only recommends but insists upon competitive bidding, would you recommend any legislation on that subject?

Mr. KAHN. Senator, the Interstate Commerce Commission, in my opinion, very wisely only insists on competitive bidding in the case of equipment trusts, and they are basing that upon certain premises, with some of which I agree, some of which I am a little doubtful about; but I haven't the slightest, not the slightest, fault with that going on as is.

My argument is in response to Senator—pardon me, Mr. Pecora's question. As Mr. Lamont says, perhaps I anticipate. My argument was——

Senator BARKLEY (interposing). Are there any vacancies in the diplomatic service? [Laughter.]

Mr. KAHN. A much broader one, Senator. I say it is a question for a decent investment banker to bear in mind the advantage of the corporation and of the public, and that the present method comes as near as is possible with our imperfect human nature, and has been found so everywhere in the world. But I don't say that this particular rule should be repealed.

The CHAIRMAN. Of course, it was this equipment trust matter that they were talking about, where they insist on the competitive bidding.

Mr. KAHN. Equipment trusts are a somewhat different class of securities from a bond. They are interested in other securities to a very large extent. The element of experienced banking advice as to what is the best kind of securities to offer——

The CHAIRMAN (interposing). Well, of course, they do not insist on competitive bidding as to stocks and bonds?

Mr. KAHN. Oh, no; they do not. Only as to equipment trusts.

Mr. PECORA. Now, the Southern Pacific Co. instance you cited related to bonds, not to equipment trust certificates?

Mr. KAHN. No; it related to equipment trusts, equipment trust certificates.

Mr. PECORA. In 1927 you recall that an application was made by the Southern Pacific Co. to the Interstate Commerce Commission for leave to issue $5,786,000 of equipment trust certificates. Do you recall that?

Mr. KAHN. I do not recall it, but I say the instance which I have given to you relates to equipment trust certificates, and I am not arguing, not attempting to argue now, with the wisdom of competitive bidding, for equipment trust certificates. I doubt very much whether either the railroad or the public gains anything by it, but I am not arguing about it.

Mr. PECORA. What was the date of that issue that you speak of?

Mr. STEWART. July 14, 1928.

Mr. PECORA. Are you familiar with the application that was made to the Interstate Commerce Commission in behalf of the Southern Pacific Co. on July 14, 1927, for leave to issue $5,786,000 of equipment trust certificates?

Mr. KAHN. I am not.

Mr. PECORA. Well, I am reading now from the report or decision of the Interstate Commerce Commission on that application, entitled "Finance Docket No. 6389, Southern Pacific Equipment Trust, Series J, submitted July 14, 1927, decided July 18, 1927." I merely want to read the following paragraph from it:

> Bids for the proposed issue of equipment trust certificates were solicited from 34 banks and bankers, and 8 bids were received, representing 16 banks and bankers. Subject to our approval the certificates have been sold to the Mellon National Bank, Pittsburgh, Pa., and Salomon Bros. & Hutzler, New York City, the highest bidders, at 99.52 percent of par and accrued dividends from July 1, 1927.

I see that in that instance, a year before this conspicuous example that you put into the record here, 5¾ million equipment trust certificates were sold to the highest bidder at 99.52.

Mr. KAHN. Yes.

Mr. PECORA. Which is even better than the 98¼ that you regard as a conspicuous example.

Mr. KAHN. Well, Mr. Pecora, times were different.

Mr. PECORA. Did you submit any bid on the occasion of this 1927 application?

Mr. KAHN. We did not.

Mr. PECORA. The year 1927 was, generally speaking, a good year for business, wasn't it?

Mr. KAHN. The year 1927?

Mr. PECORA. It was one of the so-called "boom" years?

Mr. KAHN. A very good year for business; yes.

The CHAIRMAN. Did you have anything to do with the Baltimore & Ohio issue of stocks and bonds?

Mr. KAHN. Very likely, Senator. We act as their bankers usually.

The CHAIRMAN. I have a statement showing that the stock of the Baltimore & Ohio Railroad selling for 150 on the market and they issued $150,000,000 more.

Mr. KAHN. Yes.

The CHAIRMAN. Giving to their stockholders the right to purchase at par, $100.

Mr. KAHN. Yes.

The CHAIRMAN. The privilege practically ate up the whole issue.

Mr. KAHN. Yes.

The CHAIRMAN. Do you remember that?

Mr. KAHN. I do not recall it, but I haven't any doubt that if such an issue was made it was underwritten by us and our associates.

The CHAIRMAN. It is said that the participants in the financing, or rather the bankers who did not participate in the financing probably paid $7,500,000 for them, just as though they had underwritten the issue but they did not.

Mr. KAHN. I do not have the instance in my memory, but I am quite sure that no railroad could expose itself to the risk of having that amount of stock offered to the public without being protected by some kind of underwriter. In fact, I have the issue here.

(At the close of the session Mr. Kahn submitted the following testimony for the record, bearing on this issue: Mr. Kahn. One of my associates informs me there was to his recollection no such issue of $150,000,000 of stock of the Baltimore & Ohio Railroad Company and suggests that perhaps the chairman has in mind an issue of 632,425 shares of that company's common stock which was offered by the company to its stockholders at 107½ on June 9, 1927, the issue being underwritten by my firm. The stock ranged in the market during the month of June 1927 between 114 and 125.)

The CHAIRMAN. If you are familiar with that subject matter, and I presume you are, Mr. Kahn, I am reminded that the total capital debt issued up to the time of the war of the railroads in this country was only 11 billion dollars.

Mr. KAHN. Yes.

The CHAIRMAN. And after that there was issued 12 billion more?

Mr. KAHN. Yes.

The CHAIRMAN. Making the total capital debt today something like 23 billion dollars?

Mr. KAHN. Yes.

Senator GOLDSBOROUGH. Billion?

The CHAIRMAN. Doesn't that look like an enormous increase in the capital debt of a railroad, 23 billion dollars issued up to now?

Mr. KAHN. It looks like an enormous effort on the part of the railroads to render that additional service to the public which had become probably necessary through the run-down condition that was a necessary matter permitted to exist during the war.

When the railroads were returned to private hands after the war they found that their expenditures had to be very large, because during the war other things were more important than maintaining the excellency of the railroads. The railroads made a very great effort to put themselves back on the map and to fight for their existence and to give the best possible service. In fact, they may have gone too far. Nearly every other industry went much too far in increasing its plant capacity and in raising money for the purpose of improving its service. It would have been very much better for the country if there had been generally more moderation and less eagerness for expansion and for perfection of service. But they all did it.

I do not know: I have not the figure in mind. I accept it, of course. But whatever the railroads did they did for what was not only the interest of the country, a laudable purpose, but what in their best judgment was the necessary purpose in order to maintain their position as a great branch of the national industry. It gave work to many people. It increased the general activity of the coun-

try. I haven't any doubt, in the light of hindsight, that it would have been much better if a little more moderation and restraint had been observed.

The CHAIRMAN. Does not such a large capitalization result in an increase of rates and repairs and freights and all that sort of thing, and put more burden on the people?

Mr. KAHN. But these expenditures since the resulting increases, if any, in rates, were subject to the approval of the Interstate Commerce Commission.

The CHAIRMAN. Yes.

Mr. KAHN. They must have approved it or the expenditures could not have been made.

Senator BARKLEY. Do you think that this 12 billion dollars increase in the bonded indebtedness of railroads since the war was reflected in the purchase of equipment or in physical benefits?

Mr. KAHN. Not all of it, I am afraid, Senator.

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

Mr. KAHN. I am afraid I cannot contradict you.

Senator BARKLEY. What were they doing with the rest of the money?

Mr. KAHN. You see, there happened from 1926 to 1929, and particularly in 1929, a perfect mania of everybody trying to buy everybody else's property, and the railroads were not excluded from that. New organizations sprung up. Money was so easy to get. The public was so eager to buy equities and pieces of paper that money was—just as it was pressed upon foreign governments, so it was pressed upon domestic corporations.

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

In consequence of that I believe that a good many of the expenditures that were made in those years were made for the purpose either of buying strategically located railroads or for the purpose of railroads defending themselves against the apprehended aggression on the part of other railroads or other corporations.

Senator BARKLEY. What sort of defense was necessary on the part of the railroads to keep one from selling itself out to some other road that would require the expenditure of billions of dollars for the issue of bonds? They did not have to sell. What sort of aggression was it that they had to defend themselves from?

Mr. KAHN. May I give you a case in point in answer to that?

Senator BARKLEY. Yes.

Mr. KAHN. In 1929 the Pennsylvania Railroad, representing as it did no one large holding or no combined large holding of stock but representing hundreds of thousands of small stockholders, became apprehensive that its legitimate territory, the legitimate assets of its hundreds of thousands of stockholders, most of them small stockholders, was being imperiled by the other railroads coming into that

territory and buying up strategically important pieces of railroading in their territory. They considered very carefully, to our own knowledge, what they ought to do to defend themselves, and they finally reached the conclusion that the only way in which they could defend themselves was to unite their own stockholders in a defensive organization, which had the name of Pennroad Corporation and which would be strong enough financially and which would be elastic enough constitutionally to go and buy strategically important pieces of railroad before somebody else snatched it away from them.

It was not a question of these newcomers wanting to buy the Pennsylvania Railroad; it was a question of these newcomers purchasing properties that were of strategic value to the Pennsylvania Railroad, which they were perfectly willing to leave independent but if somebody else was going to get them, it would be very damaging to their own property; and their own property represented not the holdings of a few rich men or of a small body of compact holdings but a percentage of holdings of much more than a hundred thousand of small investors. They felt called upon, and in my opinion they felt rightly called upon, even though it was costly, to do what they could to defend the assets entrusted to their care.

That is how this particular case arose, and I have mentioned it to you as an answer to your question.

Senator BARKLEY. Just one other question. Did that operation necessitate the enormous increase, or an enormous increase, in the bonded indebtedness of the Pennsylvania Railroad or of any of these companies which it was seeking to control through the formation of the holding company known as the "Pennroad Co."?

Mr. KAHN. In this particular case it did not, and if I may continue to indulge in a practice which I have started of saying pleasant things about ourselves, we most urgently warned the Pennsylvania Railroad that nothing should be done which would involve any increase in fixed charges and that the things should be handled in such a way that it would involve nothing but equity, which it was perfectly proper, within the choice of the Pennsylvania stockholders, to put up for their defense or not put up as they thought best. But there was not a dollar of fixed charge incurred. There was not even a dollar of preferred stock incurred. And I do claim a little of a credit of having most urgently advised that there should be no increase in the fixed charge and there should be no preferred stock.

Mr. PECORA. Mr. Kahn, you have already stated that the year 1927 generally speaking was a good business year.

Mr. KAHN. Yes.

Mr. PECORA. Was 1928 a better year for business generally?

Mr. KAHN. I cannot say exactly it was better, but it was a good year, too.

Mr. PECORA. Well, insofar as prices of securities were concerned, did securities, generally speaking, bring higher prices in 1928 than they did in 1927?

Mr. KAHN. I don't really recall.

Mr. PECORA. In 1927, which we have seen from the record that I have read and reports of the Interstate Commerce Commission decision on the application of the Southern Pacific Railway for leave to issue five million and odd hundred thousand dollars of

Equipment Trust dividends—we have seen that as a result of competitive bidding——

Mr. KAHN. Yes.

Mr. PECORA. The roads sold those to the Mellon Bank and to Salomon Bros. & Hutzler for 99.52.

Mr. KAHN. Yes.

Mr. PECORA. You said that the following year, the year 1928, this conspicuous example arose where your firm obtained an issue of Equipment Trust certificates from the same road at 98¼.

Mr. KAHN. Yes.

Mr. PECORA. Why didn't they bring as high in 1928 as they did in 1927?

Mr. KAHN. That depends upon circumstances.

Mr. PECORA. Do you know what the circumstances were?

Mr. KAHN. I do not, except——

Mr. PECORA (interposing). Can you tell us at this time?

Mr. KAHN. Except unwillingness on the part of the many people who were invited to submit a bid.

Senator TOWNSEND. Was the rate of interest the same?

Mr. KAHN. The rate of interest in that case was—the basis at which they were sold was 4.7785, and I believe they were 4½ percent bonds, 4½ percent equipment trusts. I could not possibly tell you what were the motives which induced the many people who were invited to bid to refuse to do so. But they must have been motives of self-interest. They must have believed they could not sell them.

Mr. PECORA. Now, you said something about what you described as a "perfect mania" on the part of everybody to buy everybody else's property in 1928 and 1929.

Mr. KAHN. Yes; particularly 1929.

Mr. PECORA. Particularly 1929 prior to October?

Mr. KAHN. Yes.

Mr. PECORA. Referring to 1929, you found quite a change after October 24 for the balance of that year?

Mr. KAHN. Yes.

Mr. PECORA. The Senator wants to know why I bring that up. Perhaps it is because of painful memories.

Now, like most manias, you found that mania an unhealthy one, didn't you, for the common good—it proved to be so?

Mr. KAHN. It proved to be so, and some of us were in before the event too early, and some of us were in after the event——

Mr. PECORA. But too late?

Mr. KAHN. But too late. And some of us reached the conclusion, let us say March, to give you an arbitrary date, that things could not go on, and then we were persuaded by the course of events that the thing could go on and did go on, and then we were in a position of the twelfth juryman, who said, "I have never seen 11 such obstinate men", and we thought, well, probably—at least some of us thought—probably we are wrong. Everybody else says, "This thing is going on for a few years longer anyhow. There is no sign of a reaction, and probably we are wrong. We do not want to assume that our judgment is right as against everybody else's."

We did do one thing, we did not join in the general scramble to create affiliates and to create securities corporations. Not one of them

bears our trade mark. Not one of them was set up by us. But we were not—at least I was not—determined enough when I found that my judgment was in defiance of the almost unanimous sentiment of the community. I for one was not willing to say, "Well, I am right and everybody else is wrong."

Mr. PECORA. Now, Mr. Kahn, when did you first realize that this was a mania?

Mr. KAHN. That this was——

Mr. PECORA. A mania, what you have called a "perfect mania"?

Mr. KAHN. Well, I realized off and on that it was a mania. I believed in 1928 already that it had reached the proportions of a mania, and then it went on and the public seemed determined——

Mr. PECORA (interposing). The mania became more furious and intense, did it?

Mr. KAHN. It was not the bankers, Mr. Pecora, that did that. Just as the bankers are not making the violent bull market in New York now. That is not the banking business. No banker can do that. No one individual or group of individuals can do that.

Mr. PECORA. If the bankers do not do it, can you tell us what group of persons can do it and do do it?

Mr. KAHN. There is nothing as strong as the determination of vast numbers of public opinion to be in the making of—no, that is not the right word—to be in when a great movement is going on. They want to be in. They do not want to sit outside and have their neighbors guess right and they guess wrong. So they go along, and the combined power of millions of people in doing that is infinitely stronger than anything that a combination of bankers can do, and no combination of bankers can make a market such as exists today in New York. No combination of bankers can make a market such as existed in 1929 in New York. They can participate in it, and some of them did to their cost, but they cannot make it.

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

Mr. KAHN. They should be.

Mr. PECORA. You have been a banker practically all of your adult life?

Mr. KAHN. Yes.

Mr. PECORA. I want to ask you, in the light of your experience over many years in the banking field, what corrective influence, if any, bankers are in position to apply to such a situation?

Mr. KAHN. Perhaps I can answer that by saying that in England, where they are very old in experience and very wise, because they have to be wise in order to live—it is a poor country and they can only live if they are wise; nature has not given them very much else—in England the governor of the Bank of England, who has no extraordinary executive power outside of the Bank of England, surrounds himself with a number of wise heads whom he selects, and if they reach the conclusion that something ought to go down the line in the way of advice to the community at large, especially the financial community, it does go down the line, and it goes down the line in such a way that it is heeded and obeyed.

We have no similar thing in this country. It is true that in 1929 the Federal Reserve Board—late in 1929—tried to stem the tide. It

is equally true that they did not do anything of the kind earlier; and the time to prevent something serious happening to the financial community is earlier, and not later. But I know of no one who can exercise that influence in this country except the Federal Reserve Board, or perhaps the Treasury. It is very difficult for the Treasury to do it, because if it gives wrong advice the Secretary of the Treasury is accused. If he gives wrong advice everybody will say, "You prevented me from doing the right thing." It is still more difficult for the President to say anything. I know of no agency in this country that is fitted to exercise that function except the Federal Reserve Board.

Mr. PECORA. Did not the Federal Reserve Board attempt to apply corrective influences early in 1929? You say it did not do it until late in 1929.

Mr. KAHN. It was too late, in my opinion.

Mr. PECORA. Did it not attempt to do it early in 1929, and even in 1928?

Mr. KAHN. It did not do it in 1928, to the best of my recollection, and the damage was done—again, to the best of my recollection—in 1927 when money was made far too easy, when we tried to help Europe to get back to the gold standard and when, for this purpose and for the purpose of facilitating the transactions of our Treasury, money was made far too easy, at a time when the handwriting on the wall——

Mr. PECORA. You say money was made far too easy. By what agency?

Mr. KAHN. By the Federal Reserve Board.

Mr. PECORA. Not by bankers generally?

Mr. KAHN. Bankers generally had to follow, because the Federal Reserve Board set the pace. The Bank of Chicago, early in 1929, if I remember rightly, tried to raise its discount rate as a warning, but the Federal Reserve Board forbade it. They would not have it; and they could not do it without the Federal Reserve Board.

Mr. PECORA. I recall that in February of this year at hearings held by a corresponding committee to this committee, of the Seventy-second Congress, officers of the National City Co. and the National City Bank were examined here and testimony was adduced to the effect that in March 1929 the Federal Reserve Board sought to apply the brakes to this speculative mania, and its action was nullified by the action of a certain bank or its officers in sending $25,000,000 to the New York Stock Exchange. Do you recall the incident?

Mr. KAHN. I recall the incident.

Mr. PECORA. Is it not a fact that one of the strongest tell-tale signs of the development and existence of a speculative mania is the loans made to brokers?

Mr. KAHN. That is one of them; yes.

Mr. PECORA. One of the signs; one of the almost incontrovertible signs, is it not?

Mr. KAHN. It never happened before. This was the first instance where it happened. We have nothing to judge it by.

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

Mr. KAHN. To put it mildly, Mr. Pecora——

Mr. PECORA. I want to be conservative.

Mr. KAHN. To put it mildly, they certainly did not do sufficient to prevent it or stop it. And would it have been human nature that they should prevent it or stop it, in view of the fact——

Mr. PECORA. If we cannot look to bankers to guide us, to what group can we look in periods of that sort, if they are not qualified to do it?

Mr. KAHN. I do not say they are not qualified to do it; but it is an exceedingly difficult thing in the face of an utter, complete, and unprecedented determination by the public to take the bit in its teeth. It is an extraordinarily difficult thing. If it were a possible thing for the private banking community or the banking community to stop it, they would be brushed aside and people would not pay any attention to them. I know that one of my partners, Mr. Warburg, made a speech warning against what was coming, and they paid not the slightest attention; and even as late as, I believe, in September 1929 Lehman Bros. made an issue of a securities corporation called the Lehman Corporation. There was nothing that they had to offer except their certificates. Not a single transaction had been consummated; not a single business was planned.

The public took that stock which was offered at par and bought it at 135. How could they defend themselves against a public mania like that? They did not put it to 135; they offered it to the public at par. The public went in and bought it at 135 simply because they were determined to speculate. They were determined that every piece of paper would be worth tomorrow twice what it was today. I do not believe the whole banking community together could have prevented it. While far from excusing some of the things they have done—I greatly deplore some of the things that were done, including the one that you mention—I doubt whether anything but a catastrophe could have stopped that violence unless it had been stopped earlier by the Federal Reserve Board.

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

Mr. PECORA. Could it not have been stopped or checked or retarded appreciably if the banking profession generally had declined to make these brokers' loans in the amounts in which they did?

Mr. KAHN. Mr. Pecora, you referred to loans for others. That is the very thing which happened. When the bankers tried to pull in their horns, some of them, outsiders came and said, "Oh, there is a chance to loan money at 15 percent. If the banks will not loan enough, we are going to loan, ourselves." And every industrial corporation, or most of them, came in and competed with the bankers for loans for the stock market.

Mr. PECORA. Did not many of those corporations invest their surplus funds through private banks in that very market?

Mr. KAHN. Not very many, I should think. Most of them, I should think, if my memory serves me rightly, did it through the regular banks.

My mentors want me to correct something which perhaps might give rise to international complications. I said England was a poor

country. I did not mean "poor" in that sense. I meant England is a country which by nature is not endowed with riches comparable to what we have here.

Mr. PECORA. It is poor in natural resources?

Mr. KAHN. Yes; poor in natural resources as compared with what we have. But I wish to make it plain that I did not mean to refer to England as a poor country.

The CHAIRMAN. England has an advantage over our system, has it not, in that the Bank of England is, as you express it, able to "go down the line", very largely because they have £175,000,000 equalization fund?

Mr. KAHN. Well, Senator Fletcher, before that fund ever existed England was able to do it. It is a tradition. It is a moral influence, more than anything else; and what I am praying for is that some similar moral influence may come to prevail in this country. I doubt whether it can be done through any legislation. I think it can be done through the force of one or two or three men who gradually acquire a moral force such as the Governor of the Bank of England has, because there is also with the Governor of the Bank of England the power over the purse. He can discount or refuse to discount bills. But his main influence is a moral one, and that is a matter of tradition. I hope very much that we in this country will develop a tradition which will place somewhere that power to control and restrain, and be listened to and heeded, utterly impartially and disinterestedly except for the good of the country. But I do not see how it can be done except through moral influence.

Mr. PECORA. I want to ask you about an issue of $20,000,000 of guaranteed sinking fund 6½ percent gold bonds, which was made by your firm in conjunction with the Guaranty Co., on about June 25, 1925, on behalf of the Mortgage Bank of Chile. Are you familiar with the transaction?

Mr. KAHN. You have touched a sore point.

Mr. PECORA. I did not know how sore it was.

Mr. KAHN. It is the only issue which my firm has made since the war, the only foreign issue which is in default. We made it after what we believed to be a very careful and thorough examination. We had before us the record of a country which for over 70 years had never been in default. We had before us the record of a country whose constitutional history was almost free from revolutions and which for many, many years had had a favorable balance of trade, and had a favorable balance of trade then. We had before us the history of a concern whose business was the making of first mortgages, which was guaranteed by the Government of Chile and which was vouched for by the Department of Commerce in records that we found. The record was not furnished to use, but we found it in the records, which said that they knew of no bank better managed, more carefully managed, than the Mortgage Bank of Chile. Everything that we could find out seemed to prove that this was a bond that we were justified in sponsoring.

Mr. PECORA. Prior to this $20,000,000 issue of June 1925 the external financing of Chile had been done in Europe, principally by French banks, had it not?

Mr. KAHN. Most of it; yes.

Mr. PECORA. Who brought this particular proposition relating to this proposed issue of 1925 to the notice of your firm?

Mr. KAHN. It was brought to the notice of my firm first by our old friends, a very conservative old banking house which had been the agents of the Mortgage Bank of Chile for many years—Dreyfus & Co.——

Mr. PECORA. Of Paris?

Mr. KAHN. Yes; of Paris. That is how it started. We insisted, after having looked into it, that although the business seemed tempting we would not do it unless the Government of Chile guaranteed it. We would not take merely the first mortgages. We insisted that the Government of Chile guarantee it. The Government of Chile refused to do so; at least, as far as Dreyfus & Co. could handle it, it was not possible, and therefore we declined to do the business.

About 6 months later our friends, Lehman Bros., came over and said, "There is some one here from the Mortgage Bank of Chile who wants us to do that business. It is out of our line. Does it interest you?" We examined into it and we said to them, "If you can get us the guarantee of the Chilean Government it will interest us in principle."

Then a little later, about June, we learned that the Guaranty Trust Co. was also trying to do that business; and from this point on I think my associate had better take up the story, because he is much better posted than I am. The business was done primarily from that spot on by my late partner, Mortimer Schiff, who died in 1931, and he was closely associated as to all details with Mr. Buttenwieser and Mr. Stewart; and they can tell you the details much better than I can tell them. If it meets with your approval, I would suggest that he tell the story from that point on——

Mr. PECORA. I will examine them in detail about that. I want to ask you a few questions about it before I examine those two gentlemen.

When did you learn that the Guaranty Co. of New York was interested in this financing?

Mr. KAHN. I believe in June.

Mr. PECORA. Of 1925?

Mr. KAHN. Yes.

Mr. PECORA. That was some 6 months after the proposal had been brought to your notice by the French firm of Louis Dreyfus & Co., was it not?

Mr. KAHN. Yes.

Mr. PECORA. Eventually your firm, after it learned of the interest of the Guaranty Co., which is the affiliate of the Guaranty Trust Co. in this proposed financing, instead of competing with them, joined forces with them in the financing?

Mr. KAHN. Yes. There was no reason why American investors should pay the competitive price and should pay the Chilean Government more money than it was entitled to.

Mr. PECORA. And was any fee paid Louis Dreyfus & Co. for finding the business for you?

Mr. KAHN. Yes.

Mr. PECORA. That is termed "finding." "Finding" is a term that is a familiar one in your business, is it not?

Mr. KAHN. It is; yes.

Mr. PECORA. One who finds a financial operation for a bank is rewarded by the payment of a commission?

Mr. KAHN. Of a reasonable commission.

Mr. PECORA. And Louis Dreyfus & Co. received such a commission in connection with this Chilean financing?

Mr. KAHN. It did.

Mr. PECORA. Did anyone else receive any commission or compensation as a finder or a promoter of the negotiation?

Mr. KAHN. From us?

Mr. PECORA. You or the Guaranty Co.

Mr. KAHN. From us; nobody else. From the Guaranty Co.; yes.

Mr. PECORA. Who?

Mr. KAHN. Mr. Norman Davis.

Mr. PECORA. How much did he receive?

Mr. KAHN. He received, for the first business which we did in the intermediaries' and negotiators' commission, $25,000.

Mr. PECORA. Did not your firm contribute $15,000 to that?

Mr. KAHN. My firm contributed nothing. The syndicate contributed, as part of the syndicate expenses, $15,000; and the Guaranty Co. contributed $10,000. Afterwards the second business was done and Mr. Davis received another fee of $10,000; so that his total fees received were $35,000.

Senator BARKLEY. What was the nature of that service?

Mr. KAHN. Here [exhibiting a paper] we have the memorandum for which we asked, from the Guaranty Co. of New York. Inasmuch as they were the originators of the relationship with Mr. Norman Davis, with your permission I will read it; it is very short [reading]:

The Guaranty Trust Co. of New York and the Guaranty Co. of New York from time to time had discussions with Mr. Davis regarding certain loan transactions with Latin-American countries because of his knowledge of Spanish-American affairs and financial questions in general. At such times and at the time of the Chile Mortgage Bank loan Mr. Davis was a private citizen. In 1925 Mr. Davis informed us that the representative of the Chile Mortgage Bank had consulted with him with regard to the placing of a loan in New York and wished to know if we would be interested in considering it, to which we replied in the affirmative. He accordingly presented to us Mr. Berisso, who had been sent to this country to negotiate a loan for the bank. As the Chile Mortgage Bank then had a long record of uninterrupted payments on its obligations, and the loan which it proposed to negotiate was guaranteed by the Chilean Government which had a similar financial record, the business proposed seemed sound. Accordingly, Mr. Davis was instrumental in putting us in touch with the Mortgage Bank of Chile business and in helping to conclude the negotiations.

Perhaps I might add here, Mr. Pecora, that to the best of my recollection Mr. Davis was present at one or two of the subsequent negotiations after the Guaranty Co. and we had agreed to join issue, and he assisted in the negotiations.

The Guaranty Co.'s memorandum goes on [continuing reading]:

There was no agreement with Mr. Davis as to the amount he was to receive for his services, though it was understood that he was to be compensated. Upon conclusion of the deal the bankers without previous consultation with Mr. Davis decided that the fee for his work in connection with the successful conclusion of the negotiations should be fixed at $15,000, to be paid by the banking group—

Which means the syndicate—

and an additional $10,000 was paid by the Guaranty Co. of New York with which Mr. Davis had originally discussed the matter. The representative of the Mortgage Bank of Chile and the Chilean Ambassador were informed of the bankers' intention to compensate Mr. Davis and were in accord therewith. Subsequently, a second loan was made and in this connection a further fee of $10,000 was paid by the banking group to Mr. Davis. No payment was made to him on any succeeding issues.

Mr. PECORA. What is the date of that memorandum?

Mr. KAHN. June 2, 1933.

Mr. PECORA. By whom was that memorandum prepared?

Mr. KAHN. It is initialed "J. R. S. (initialed)."

Mr. PECORA. Do you know to whom those initials refer?

Mr. KAHN. J. R. Swan, president of the Guaranty Co.

Mr. PECORA. And was this memorandum addressed to Kuhn, Loeb & Co.?

Mr. KAHN. Yes.

Mr. PECORA. Under date of June 2 of this year?

Mr. KAHN. Yes.

Mr. PECORA. And had your firm requested this memorandum for its information?

Mr. KAHN. We understood, Mr. Pecora, that you wished to be informed of the facts, and therefore we asked for the facts, and this is the result.

Mr. PECORA. This memoradum was sent you in compliance with your request for such information?

Mr. KAHN. Yes.

The CHAIRMAN. You say Mr. Davis was at that time a private citizen?

Mr. KAHN. He was at that time a private citizen; yes.

Senator BARKLEY. Was he practicing law in New York?

Mr. KAHN. I do not know whether he was practicing law or whether he was engaged in general business. I could not tell you that, Senator.

Senator BARKLEY. He is a lawyer, I believe, is he not?

Mr. KAHN. When I first met him he was a banker in Cuba; he was the president of a bank in Cuba, many years ago.

Senator BARKLEY. He has had considerable experience in Latin-American and European diplomatic and financial matters?

Mr. KAHN. So I understand.

Senator BARKLEY. Was he acting in the capacity of an adviser as to this particular loan; or in what capacity was he compensated?

Mr. KAHN. He brought this particular loan to the attention of his friends, the Guaranty Co., and he brought also to their office a representative of the Mortgage Bank of Chile, and that was his first, and I assume, his controlling service. To the best of my recollection he assisted in one or two of the subsequent negotiations, when the details of the business were being determined; but his controlling service was as here reported.

Senator BARKLEY. The parties in interest, then, as I understand it, felt that his services in bringing the business to them should be compensated for, and they fixed this amount as a reasonable sum? Is that correct?

Mr. KAHN. Yes.

Mr. PECORA. When did your firm decide to join forces with the Guaranty Co. in the flotation of this twenty-million dollar issue of Mortgage Bank of Chile?

Mr. KAHN. Mr. Pecora, I learn, but do not know it from my own knowledge, that it was probably early in June of that year.

Mr. PECORA. Are you familiar with the correspondence that passed between Mr. Davis and the Guaranty Co. of New York——

Mr. KAHN (interposing). I am not——

Mr. PECORA (continuing). In connection with this flotation?

Mr. KAHN. I am not at all familiar with it.

Mr. PECORA. Was there any competition at all between your firm and the Guaranty Co. with regard to this issue, Mr. Kahn, before the two institutions joined forces?

Mr. KAHN. Mr. Pecora, from the time that I stopped I have no longer any detailed knowledge, because I went away; I believe I went to Europe, and the matter was taken up by my partner, Mr. Mortimer Schiff. But I think Mr. Buttenwieser can tell you all the facts. I could only tell you by asking him, and will be glad to do it if you prefer it done in that way.

Mr. PECORA. Who is Mr. Laval? Is he a gentleman connected with Louis Dreyfus & Co.?

Mr. KAHN. Yes, sir. I know that he was the New York representative of Louis Dreyfus & Co. of Paris.

Mr. PECORA. Had Louis Dreyfus & Co. been interested previously in any Chilean financing?

Mr. KAHN. They were and had been for a long time the European representatives of the Chilean Mortgage Bank. Whether they did any business with the Government of Chile I do not know.

Mr. PECORA. Did you or any member of your firm have any conferences with the Chilean Ambassador in connection with this proposed loan?

Mr. KAHN (after conferring). No. We had no direct conference with the Chilean Ambassador in relation to this loan. But after the contract had been concluded he came there and signed the bonds and affixed to them, by authority of the Chilean Government, the guarantee of the Chilean Government. And to the best of my recollection and knowledge that was all the relation we had with him. He signed the contract.

Mr. PECORA. At the time of this issue of $20,000,000 for the Mortgage Bank of Chile, what kind of government existed in Chile?

Mr. KAHN. At that particular time—and I am now speaking subject to correction, but at that particular time they had what in Chile they called an election—no; they had what here we call an election; they had a new deal, and a new government came in. They did not come in by the peaceful means which characterizes the situation in this country; they came in with a moderate degree of violence.

Senator BARKLEY. It might have been called a raw deal.

Mr. PECORA. It was cold steel.

Mr. KAHN. But we were advised by counsel that the acts of that Government were absolutely valid in law and in every other way.

Mr. PECORA. Do you know what the present market quotations are for those bonds?

Mr. KAHN. Unfortunately I do know; yes.

Mr. PECORA. Well, will you impart your knowledge to us?

Mr. KAHN. They are quoted at about 13, now, between 13 and 14.

Mr. PECORA. Now, Mr. Kahn, how much, all told, of those mortgage bonds issued by the Mortgage Bank of Chile were underwritten by your firm and the Guaranty Co. of New York and thereafter sold to the American investing public?

Mr. KAHN. I believe $90,000,000.

Mr. PECORA. Over what period of time?

Mr. KAHN. From 1925 to 1929. And after that——

Mr. PECORA (interposing). There were five different issues, weren't there?

Mr. KAHN. Yes.

Mr. PECORA. And four of them were for $20,000,000 each and one for $10,000,000.

Mr. KAHN. Yes. And after that, Mr. Pecora, we were foolish enough, or right enough, or loyal enough, whatever might be the proper term, to put our own money into an additional loan of $8,000,000, which we did not offer to the public but which was our own money and the money of some of our associates, and which money is still there. We did not offer that issue to the public.

Mr. PECORA. That was a short-time advance that you made, wasn't it?

Senator GOLDSBOROUGH. It has turned out to be pretty long term.

Mr. KAHN. It did not turn out that way, Mr. Pecora.

Mr. PECORA. But it was intended as a short-term advance, wasn't it?

Mr. KAHN. It was hoped that in the course of time—and our confidence really had not diminished at that time—and as I say, it was hoped that within a year or so it would be possible to float another issue out of which that loan would be liquidated. But that was never possible, and therefore that money is still there.

The CHAIRMAN. Was that loan made after the other issues were floated?

Mr. KAHN. Yes, sir.

The CHAIRMAN. And all guaranteed by the Government of Chile?

Mr. KAHN. Yes; except this last loan, Senator Fletcher, where we were foolish enough even not to insist upon the guarantee of the Government.

Mr. PECORA. This eight-million-dollar short-term loan, which has proven to be not a short-term loan, you say was made by Kuhn, Loeb & Co.

Mr. KAHN. By Kuhn, Loeb & Co. and a small group of friends of theirs.

Mr. PECORA. How much of the funds of Kuhn, Loeb & Co. actually went into that eight-million-dollar advance?

Mr. KAHN. Originally, we took, as I take it, the whole responsibility.

Mr. PECORA. Together with the other participants?

Mr. KAHN. Together with the Guaranty Co. Then we succeeded in getting some other participants, with the result that our ultimate investment is—(turning to Mr. Buttenwieser)—How much is it? (After conferring.) Our original responsibility was $3,600,000, and then other people were not only willing but eager, strange as it may seem in the light of hindsight, to get a part of that loan, which car-

ried a very good rate of interest. They felt, and we felt, it was merely a temporary loan at a time when a good rate of interest for short-term loans was very desirable. But ultimately we found that $3,000,000 of our $3,600,000 were snapped up by others. We urged nobody to go in, but they liked it.

Mr. PECORA. How much of the actual funds of Kuhn, Loeb & Co. went into this eight-million-dollar loan eventually?

Mr. KAHN. Originally it was $3,600,000.

Mr. PECORA. Eventually, yes; but you passed a part of that to other participants.

Mr. KAHN. Now it is $600,000.

Mr. PECORA. Then $600,000 is the extent of your participation in that eight-million-dollar advance?

Mr. KAHN. Yes, sir.

The CHAIRMAN. What was the rate of interest?

Mr. KAHN. Originally the rate was 5½ percent. Since then it has vanished into thin air, since no longer is there any rate of interest.

Mr. PECORA. Now, Mr. Kahn, you said with reference to this Mortgage Bank of Chile issue that you insisted on a guaranty by the Chilean Government before you would underwrite that issue.

Mr. KAHN. Yes, sir.

Mr. PECORA. And you got that guaranty?

Mr. KAHN. Yes, sir.

Mr. PECORA. And the Government from which you got that guaranty was a government that had instituted itself in power by what you call a moderate show of force or violence.

Mr. KAHN. Yes.

Mr. PECORA. Did you consider that that was a safe guaranty on which to pass on $90,000,000 of securities to the American investing public?

Mr. KAHN (after conferring). What about these, Mr. de Gersdorff?

Mr. DE GERSDORFF. Let me see them.

The CHAIRMAN. While Mr. de Gersdorff is looking at those papers, Mr. Kahn, let me ask you: Was it the same government that guaranteed all those issues?

Mr. KAHN. Yes. It remained in power for quite a while.

Mr. PECORA. Are you sure of that?

Mr. KAHN. Well, I haven't answered your question, I am afraid.

Mr. PECORA. You stated before that you preferred to have Mr. Buttenwieser and Mr. Stewart examined with regard to this Mortgage Bank of Chile issue or issues, so I will adopt your suggestion.

Mr. KAHN. I think it would save your time, because, as you see, I have to turn to the right and to the left to get information.

Mr. PECORA. Well; I will do that. I think with advantage to yourself it should be done.

The CHAIRMAN. Where is that bank located, at Santiago?

Mr. KAHN. Yes; Senator Fletcher.

Mr. PECORA. I will examine Mr. Buttenwieser, if I may suspend with Mr. Kahn at this point, with the understanding that he is not excused from further attendance.

The CHAIRMAN. That will be all right.

Mr. DE GORSDORFF. Mr. Pecora, let me show you these letters. Have you any objection to their going on the record?

Mr. PECORA. This is the first time these documents have been shown to us.

Mr. DE GERSDORFF. It is the first time I have seen them.

Mr. PECORA. I will see what they are.

Mr. DE GERSDORFF. You can hold them over if you so desire. The second one of them I think is the most important.

Mr. PECORA. I will read the whole series in chronological order. (After scanning over the letters.) Just leave these letters with us for the present.

Mr. DE GERSDORFF. All right.

Mr. PECORA. Mr. Buttenwieser, I suggest that you now take the chair that has been vacated by Mr. Kahn.

TESTIMONY OF BENJAMIN J. BUTTENWIESER, A PARTNER OF KUHN, LOEB & CO.—Resumed

Mr. PECORA. Now, Mr. Buttenwieser, your name has been suggested by your associate, Mr. Kahn, as the gentleman in the firm of Kuhn, Loeb & Co. most familiar with the issuance of these bonds by the Mortgage Bank of Chile, floated by your firm in conjunction with the Guaranty Co. of New York, in the period between 1925 and 1929. So I am going to examine you with respect to those issues.

Now, take the first one in point of time, the one of June 25, 1925, and that consisted of an issue of $20,000,000 of guaranteed sinking fund 6½ percent gold bonds due June 30, 1957, did it not?

Mr. BUTTENWIESER. That is correct.

Mr. PECORA. Now, at the risk of traversing some of the ground that Mr. Kahn has covered but in view of the fact that I am going to examine you in detail about those issues, will you tell us how this proposal was first brought to the notice of your firm?

Mr. BUTTENWIESER. In a general way Mr. Kahn outlined it to you. That is, that late in 1924 our old friends, Messrs. Louis Dreyfus & Co., of Paris, were in communication with us as to whether or not we would be interested in a Mortgage Bank of Chile issue, with which bank they had had relations before the war and whose securities they had offered before the war. And, as Mr. Kahn told you, after some study of the facts they submitted to us we told them we would be interested only if we could obtain a guaranty of the bonds by the Republic of Chile.

Mr. PECORA. Now, which particular gentleman in your firm handled the proposition at its inception?

Mr. BUTTENWIESER. Mr. Mortimer Schiff.

Mr. PECORA. Did you assist him?

Mr. BUTTENWIESER. Yes.

Mr. PECORA. All right. Had you up to that time, or had your firm up to that time done any Chilean financing?

Mr. BUTTENWIESER. As I recall, we had made one issue of Chilean securities in conjunction with others, which issue has been repaid since then.

Mr. PECORA. Were you at that time familiar with political conditions in the Republic of Chile?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. What were they?

Mr. BUTTENWIESER. Well, at the particular time of which you speak, which was December of 1924, I believe the regular government was in effect. I think the provisional government to which you referred subsequently, only came into being in the spring of 1925.

Mr. PECORA. When this proposal was first brought to the notice of your firm by Louis Dreyfus & Co. in December of 1924, you indicated your willingness to underwrite the issue provided the Chilean Government guaranteed its payment?

Mr. BUTTENWIESER. That is correct.

Mr. PECORA. Was that guarantee to extend to the payment of interest as well as to the payment of the principal at maturity?

Mr. BUTTENWIESER. A full guarantee, of interest, sinking fund, and principal, by endorsement.

The CHAIRMAN. Have you got that guarantee here, or a copy of it?

Mr. BUTTENWIESER. Yes, sir. It is embodied in the loan agreement, which in turn contains a facsimile, or not a facsimile but the text of the bond and the guarantee endorsement.

Mr. PECORA. Tell us what kind of bonds they were, these so-called "bonds" of the Mortgage Bank of Chile.

Mr. BUTTENWIESER. Do you mean that you want me to outline what is the type of bond of the Mortgage Bank of Chile?

Mr. PECORA. Yes.

Mr. BUTTENWIESER. It is a bank which makes first-mortgage loans against any bonds which it issues.

The CHAIRMAN. You mean that it makes first-mortgage loans and issues bonds against those loans, do you not?

Mr. BUTTENWIESER. Yes, sir.

The CHAIRMAN. You had it the other way around.

Mr. BUTTENWIESER. Pardon me.

Mr. PECORA. Go ahead with your answer.

Mr. BUTTENWIESER. Perhaps I could do better by reading this circular.

The CHAIRMAN. Do they make first-mortgage loans on real estate?

Mr. BUTTENWIESER. Perhaps I could serve the purpose better by submitting to you a copy of the prospectus descriptive of the bank and the issue of bonds in question.

Mr. PECORA. All right. If you have a set of prospectuses please produce them.

Mr. BUTTENWIESER. This is the first issue. I believe you already have a copy of it.

The CHAIRMAN. What did you sell those bonds at?

Mr. BUTTENWIESER. At 97⅜ percent.

The CHAIRMAN. For the whole $90,000,000?

Mr. BUTTENWIESER. No. We are speaking now of the first issue of $20,000,000.

The CHAIRMAN. What was the next?

Mr. BUTTENWIESER. The next issue was another issue of $20,000,000, of which we bought only $18,330,000.

The CHAIRMAN. At what were they sold?

Mr. BUTTENWIESER. At 99¼.

The CHAIRMAN. What about the next $10,000,000?

Mr. BUTTENWIESER. That second issue, Senator Fletcher, was a 6¾-percent issue.

The CHAIRMAN. Go ahead with your answer.

Mr. BUTTENWIESER. The next $10,000,000 were 6-percent notes due in 5 years, which we sold at 98¾.

Mr. PECORA. And the fourth issue was one of $20,000,000?

Mr. BUTTENWIESER. Yes; 6-percent bonds, for a longer term, which we sold at 95¾. And the last issue was an issue of 6-percent bonds, made in 1929 and sold at 92.

Mr. PECORA. That was a $20,000,000 issue; that last issue?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. And do you mean you sold them at 92?

Mr. BUTTENWIESER. Yes, sir.

The CHAIRMAN. And those are now worth 13 or 14?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. Now, hadn't you better give me for the record a printed copy of the prospectus issued in connection with the first loan that does not contain lead-pencil notations?

Mr. BUTTENWIESER. I believe you have a copy of that prospectus already, Mr. Pecora. This is the only copy we have here, but we can furnish it.

Mr. PECORA. I offer this for the record, that is, the printed portions of it, and ask that it may be spread on the record.

The CHAIRMAN. It will be admitted and the committee report will make it a part of the record.

COMMITTEE EXHIBIT No. 9

TWENTY MILLION DOLLAR MORTGAGE BANK OF CHILE (CAJA DE CREDITO HIPOTECARIO) GUARANTEED SINKING FUND 6½ PERCENT GOLD BONDS DUE JUNE 30, 1957, UNCONDITIONALLY GUARANTEED, AS STATED BELOW, AS TO PRINCIPAL, INTEREST, AND SINKING FUND BY ENDORSEMENT BY THE REPUBLIC OF CHILE

Coupon-bearer bonds in denominations of $1,000 and $500 each. Principal and interest to be payable at the option of the holders in the New York City office of Kuhn, Loeb & Co. or of Guaranty Trust Co. of New York, in United States gold coin of or equal to the standard of weight and fineness existing June 30, 1925, or in Santiago, Chile, at the office of the Caja by sight draft on New York City without deduction for any taxes, imposts, levies, or duties of any nature now or at any time hereafter imposed by the Republic of Chile or by any State, Province, municipality, or other taxing authority thereof or therein, and to be payable in time of war as well as in time of peace, and whether be a citizen or a resident of a friendly or a hostile State.

INTEREST PAYABLE JUNE 30 AND DECEMBER 31

For further information regarding this issue of bonds reference is made to the accompanying letter received from His Excellency the Honorable Beltran Mathieu, Ambassador Extraordinary and Plenipotentiary of the Republic of Chile, and from which the following is summarized:

The bonds are unconditionally guaranted as to principal, interest, and sinking fund, by endorsement, by the Republic of Chile, pursuant to decree law of the Governing Council, dated March 9, 1925, and an Executive decree, dated June 15, 1925 (supplementing said decree law), issued under the authority of President Alessandri and his Cabinet, who are functioning as the Government of Chile, Congress having been dissolved in September 1924 pending the adoption of a new Constitution which is now being drafted. The guaranty thus authorized is valid and binding upon the Republic of Chile.

Beginning December 31, 1925, the bonds will be redeemable through a cumulative sinking fund calculated to retire the whole issue by June 30, 1957, to be

applied on each semiannual interest date to the redemption by lot of bonds at par. The Caja will have the right to increase the amount of any sinking-fund payment for the redemption of additional bonds on any interest date, and in any such case appropriate reductions will be made in subsequent sinking-fund payments. This right is reserved because repayments on the mortgage loans can be made by the borrowers either in cash or in bonds of the Caja in excess of the fixed premium amortization payments and the Caja is not permitted by law to have its bonds outstanding in excess of the mortgage loans against which they are issued.

THE UNDERSIGNED WILL RECEIVE SUBSCRIPTIONS FOR THE ABOVE BONDS SUBJECT TO ALLOTMENT, AT 97⅜ PERCENT AND ACCRUED INTEREST TO DATE OF DELIVERY, TO YIELD 6.70 PERCENT TO MATURITY

The undersigned reserve the right to close the subscription at any time without notice, to reject any application, to allot a smaller amount than applied for, and to make allotments in their uncontrolled discretion.

The bonds and the guaranty are, in the opinion of American and Chilean counsel, valid obligations respectively of the Caja de Credito Hipotecario and the Republic of Chile.

The above bonds are offered, if, when, and as issued and received by the undersigned, and subject to the approval of counsel. In the first instance, interim certificates of Guaranty Trust Co. of New York will be delivered against payment in New York funds for bonds allotted, which interim certificates will be exchangeable for definitive bonds when prepared.

Application will be made in due course to list these bonds on the New York Stock Exchange.

KUHN, LOEB & CO.
GUARANTY CO. OF NEW YORK.

NEW YORK, *June 25, 1925.*

WASHINGTON, D.C., *June 25, 1925.*

MESSRS. KUHN, LOEB & CO. and GUARANTY CO. of NEW YORK, N.Y.:

DEAR SIRS: Referring to the issue of $20,000,000 guaranteed sinking fund 6½-percent gold bonds due June 30, 1957, of the Mortgage Bank of Chile (Caja de Credito Hipotecario, Chile), I beg to give you the following information:

The bonds are unconditionally guaranteed as to principal, interest, and sinking fund, by endorsement, by the Republic of Chile, pursuant to decree law of the governing council, dated March 9, 1925, and an executive decree, dated June 15, 1925 (supplementing said decree law), issued under the authority of President Alessandri and his Cabinet, who are functioning as the Government of Chile, Congress having been dissolved in September 1924, pending the adoption of a new constitution which is now being drafted. The guaranty thus authorized is valid and binding upon the Republic of Chile.

The Caja de Credito Hipotecario was created by law of August 29, 1855, for the purpose of making available credit facilities on reasonable terms for the development and improvement of real property in Chile. The board of directors is selected by both legislative chambers of Chile, and the chairman of the board, the chief counsel, the cashier, the controller, and the secretary are appointed by the President of the Republic.

During its entire existence of 70 years, the Caja has operated successfully and has never failed to meet its obligations. The record of its loan collections is very satisfactory. The losses incurred by the Caja on property foreclosed under its mortgages have not exceeded $40,000 in the aggregate for the last 10 years. In his report, published February 1, 1924, to the Department of Commerce of the United States, Mr. Charles A. McQueen, special agent of the Bureau of Foreign and Domestic Commerce of the Department, states that in the course of its long existence the Caja has conducted its affairs with uniform safety and success.

The Caja has no capital stock and is not operated for profit. It has power to charge a commission to provide for its expenses and for a reserve fund, as additional security for its bonds, but having accumulated a sufficient reserve, the Caja has now discontinued charging such commission.

The Caja issues its bonds only against mortgages registered in its name. It makes only first-mortgage loans. The loans are made on a conservative basis and the risk is greatly diversified. On December 31, 1924, the Caja had out-

standing various issues of bonds aggregating $84,995,700, at approximate rates of exchange, against which it had made more than 9,800 mortgage loans, being an average of not more than $9,000 per loan. The aggregate appraised improved value of the properties mortgaged as security for these loans amounted to more than four times the amount of the loans. As further security for its bonds, the Caja has accumulated a reserve fund of approximately $5,118,000, at approximate present rates of exchange.

The law of September 10, 1892, authorizes the Caja to issue bonds and to make mortgage loans payable in foreign currencies. It is the practice of the Caja to make its mortgage loans, against which bonds payable in a foreign currency are issued, also payable in the same currency, except in cases where it has obtained a guaranty of the Republic of Chile for any loss resulting from exchange fluctuations. This was done in 1912 when Fcs. 58,823,500 gold bonds were issued (of which there are still Fcs. 28,444,500 gold now outstanding), and is also being done in the case of the present issue against $15,000,000 of which mortgage loans in Chilean currency will be outstanding. The mortgage loans against the balance of $5,000,000 of this issue will be made at the request of the Republic of Chile, for special purposes at lower interest rates than the Caja is paying on the bonds, and the Republic has agreed to pay the difference and to guarantee these mortgage loans. The entire present issue of bonds will also be guaranteed by endorsement by the Republic of Chile. No other issue of bonds of the Caja is endorsed with the guaranty of the Republic.

The bonds of the Caja are legal investments for savings banks and trust funds in Chile.

Prior to the war, in 1911 and 1912, three issues of 5 percent bonds of the Caja, not endorsed with the guaranty of the Government, were made in Europe, at prices from 96¼ to 99¼ percent.

The present debt of the Republic of Chile, including the present and all other obligations guaranteed by it, aggregates about $250,000,000, at approximately present rates of exchange. The proceeds of the Government loans have been largely used for the construction or improvement of railways, harbors, and other public works. The Government owns 3,624 miles of railroads, telegraph lines, and other property, of an estimated value of approximately $650,000,000, at approximate present rates of exchange, which is well in excess of the entire amount of the debt. In addition, the Government owns large and very valuable tracts of nitrate lands.

Chile is a mining and agricultural country. Its mineral products are largely raw materials for essential industries. Exports consist chiefly of nitrates and byproducts of the nitrate industry, copper, borax, wool, and a limited amount of agricultural products. The nitrate deposits are the only large natural deposits so far discovered in the world. The copper industry has been extensively developed, largely by American capital.

The trade balance of Chile is favorable. The total foreign trade for 1923 (the last year for which official figures are available) aggregated $318,000,000 at the approximate present rate of exchange, and the balance of exports over imports amounted to $78,000,000. The unofficial estimates for 1924, both for the total trade and for the favorable balance, exceed the results for 1923. Since 1915 imports have exceeded exports in only 1 year.

The present currency circulation of Chile at the present rate of exchange of about 11½ cents per peso, is equivalent to $35,855,645. Part of this currency is covered by gold reserves, part by commodities, and part by mortgage loans and other obligations. The total gold reserve amounts to approximately $41,800,000, which is in excess of the dollar equivalent, as stated above, of the present currency circulation.

The $20,000,000 guaranteed sinking fund 6½ percent gold bonds of the Caja, constituting the loan designated "Emprestito oro Caja Hipotecaria", 1925, which you have agreed to purchase, will be in coupon-bearer form, in denominations of $1,000 and $500, will be dated June 30, 1925, will mature June 30, 1957, and will bear interest at the rate of 6½ percent per annum from June 30, 1925, payable semiannually on June 30 and December 31 of each year. Principal and interest will be payable, at the option of the holders, in the borough of Manhattan, in the city of New York, at the office of Kuhn, Loeb & Co., or at the principal office of Guaranty Trust Co., of New York, in gold coin of the United States of America of or equal to the standard of weight and fineness existing June 30, 1925, or in Santiago, Chile, at the office of the Caja, by sight draft on New York City, without deduction for any taxes, imposts, levies, or duties of any nature now or at any time hereafter imposed by the Republic

of Chile, or by any State, Province, municipality, or other taxing authority thereof or therein, and will be paid in time of war as well as in time of peace, and whether the holder be a citizen or a resident of a friendly or a hostile state.

Beginning December 31, 1925, the bonds will be redeemable through a cumulative sinking fund calculated to retire the whole issue by June 30, 1957, to be applied on each semiannual interest date to the redemption by lot of bonds at par. Notice of redemption is to be given by advertisement, the first advertisement to appear at least 30 days before each redemption date. The Caja will have the right to increase the amount of any sinking fund payment for the redemption of additional bonds on any interest date, and in any such case appropriate reductions will be made in subsequent sinking-fund payments. This right is reserved because payments on the mortgage loans can be made by the borrowers either in cash or in bonds of the Caja in excess of the fixed minimum amortization payments, and the Caja is not permitted by law to have its bonds outstanding in excess of the mortgage loans against which they are issued.

Application will be made to list the bonds on the New York Stock Exchange.

Very truly yours,

BELTRAN MATHIEU,
Ambassador Extraordinary and Plenipotentiary of the Republic of Chile to the United States.

The CHAIRMAN. Are all these issues in default, Mr. Buttenwieser?

Mr. BUTTENWIESER. Yes, sir.

The CHAIRMAN. And have been in default for some time?

Mr. BUTTENWIESER. And have been since July of 1931.

Mr. PECORA. Now, Mr. Buttenwieser, your firm would never have underwritten this issue, and I am referring to the first issue, of June of 1925, without a governmental guarantee made by the Chilean Government, would it?

Mr. BUTTENWIESER. I cannot answer as to that. I know that we wanted the guarantee.

Mr. PECORA. You so notified Louis Dreyfus & Co. when they called the proposal to your attention, didn't you?

Mr. BUTTENWIESER. Yes, sir; in 1924.

Mr. PECORA. And that was because you did not consider the security of the issuing bank, that is, the Mortgage Bank of Chile, sufficient in and of itself to justify your underwriting the issue and offering it to the American public?

Mr. BUTTENWIESER. That was partly it, Mr. Pecora; and because the American public might not have appreciated how good or how bad the Mortgage Bank of Chile was. The guarantee of the Government of Chile was what we wanted to rely on; yes, sir.

Mr. PECORA. You wanted that as a selling argument?

Mr. BUTTENWIESER. No; as the security.

Mr. PECORA. You wanted it because you needed it as security for the payment of both principal and interest?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. I see. It is a fair inference, then, that you did not consider the security of the Mortgage Bank of Chile, or the responsibility of the Mortgage Bank of Chile itself sufficient.

Mr. BUTTENWIESER. That is a fair inference; yes, sir.

Mr. PECORA. Well, now, you said that at the time when this proposal was first brought to your notice, in December of 1924, you requested a governmental guaranty. But that Government changed in the spring of 1925, did it not?

Mr. BUTTENWIESER. I find from a memorandum which has just been furnished to me by Mr. McEldowney, that the Government had changed in September of 1924.

Mr. PECORA. Oh, it was in September of 1924?

Mr. BUTTENWIESER. Yes; and my memory about it was wrong.

Mr. PECORA. The Government had come into power in September of 1924, which was a Government that obtained its power through a show of force. It was a revolutionary Government, wasn't it?

Mr. BUTTENWIESER. I believe so.

Mr. PECORA. That established itself by means of revolution?

Mr. BUTTENWIESER. I think it was what you would call a de facto government.

Mr. PECORA. It wasn't a constitutional government, was it?

Mr. BUTTENWIESER. That is a legal question, Mr. Pecora.

Mr. PECORA. Well, it is considered by your firm, isn't it? Legal questions are considered by your firm, are they not, in making up its decision on the underwriting of issues of foreign governments or of foreign institutions?

Mr. BUTTENWIESER. On a problem like that, of course, we would consult our counsel.

Mr. PECORA. And you had advice with regard to the nature of this government risk?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. And your advices were to the effect that the government was established by a revolutionary force?

Mr. BUTTENWIESER. Our advice was that it was a government whose acts would have to be recognized.

Mr. PECORA. By whom? By all succeeding governments?

Mr. BUTTENWIESER. I think that was the information.

Mr. DE GERSDORFF. I think that was written advice, and if we have it here he could give it to you, Mr. Pecora.

Mr. PECORA. This is the gentleman who has been suggested as the one connected with Kuhn, Loeb & Co. who should be examined with regard to these loans.

The CHAIRMAN. Did you issue any prospectus with reference to this loan?

Mr. BUTTENWIESER. That was the prospectus, the one that I just submitted.

The CHAIRMAN. I thought that was the Chilean bank.

Mr. PECORA. It was the prospectus of Kuhn, Loeb & Co. and the Guaranty Co. of New York.

Mr. BUTTENWIESER. It embodied what was represented by the bank, and the government by the Chilean Ambassador.

The CHAIRMAN. Did you represent anything in that prospectus as to the attitude of this Government, as to this loan?

Mr. BUTTENWIESER. Do you mean the United States Government?

The CHAIRMAN. Yes.

Mr. BUTTENWIESER. No. We are not permitted to do that, as that letter quite clearly states.

The CHAIRMAN. You made no reference in your prospectus as to the attitude of the Government?

Mr. BUTTENWIESER. As to the attitude of our Government we are not permitted, as that letter clearly sets forth.

The CHAIRMAN. But I am not aware whether you observed what the State Department required or not. I do not know.

Mr. BUTTENWIESER. We always observe what the State Department asks us to do.

The CHAIRMAN. The public seemed to have got the impression, is the reason I mention that, that this Government was behind this issue of bonds by the Chilean Government in some way.

Mr. BUTTENWIESER. I do not think there is any ground for it in any circular that we issued.

Senator BARKLEY. Are you one of a syndicate that floated the Colombian bond issues?

Mr. BUTTENWIESER. No, sir.

Senator BARKLEY. So you were not subject to pressure there from the State Department in another direction?

Mr. BUTTENWIESER. We had nothing whatever to do with any of the Colombian issues.

Mr. PECORA. Now, have you produced here a copy of a written communication sent by your firm to Louis Dreyfus & Co. under date of January 9, 1925?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. Will you let me have it, please?

Mr. BUTTENWIESER. Here it is. It is the only copy I have.

Mr. PECORA. I want to offer this in evidence and ask that it may be spread on the record.

The CHAIRMAN. That may be done.

(The letter dated January 9, 1925, from Kuhn, Loeb & Co. to Louis Dreyfus & Co. is as follows:)

Mr. PECORA (reading):

JANUARY 9, 1925.

Confidential.

Messrs. LOUIS DREYFUS & Co.,
Paris.

Caja de Credito Hypothecario—

I suppose that is the Chilean title of this bank?

Mr. BUTTENWIESER. Mortgage bank; yes.

Mr. PECORA. Which we called and continue to call for the purpose of convenience the Mortgage Bank of Chile.

Mr. BUTTENWIESER. Yes.

Mr. PECORA (continuing reading):

DEAR SIRS: We beg to acknowledge receipt of your favor of December 27 which we have perused with much interest. In leaving out of consideration that part of the institution's balance sheet which is in francs and sterling, and the meaning of which is not entirely clear to us, we gather from the balance sheet submitted to us that the reserve fund of the institution amounts to just about 5 percent of its circulation of mortgage bonds, and that, inasmuch as the institution has no capital, thus constitutes the sole equity behind the mortgage bonds. This in itself would make it impossible for us to consider offering these bonds for public subscription without the bonds being additionally secured by a guaranty of the Government endorsed on the bonds. We also notice from the profit and loss account that the total profit of the year was less than one quarter of 1 percent of the circulation of the mortgage bonds.

We cabled you to inform you of our decision. If it should be possible for you to arrange that the Government give its guaranty for an issue of bonds, of the institution in the United States, we would, of course, be prepared to consider this matter further. In this connection, may we not call to your attention that the very fact that the mortgages are expressed and collectible in Chilean money, which is now quoted roughly at about one third of its official gold parity, and which is subject to wide fluctuations, would make it impossible for the institution to assume a debt expressed in gold dollars, without obtaining for its own protection some guaranty on the part of the Government to make good any loss incurred through differences in exchange. If the Government of Chile should deem it desirable that the institution raise a loan in

the United States, and if our impression is correct that on account of the exchange situation a certain guaranty would be necessary in any event, it might be possible to convince the Government that it should go one step farther and guarantee the bonds and the interest and sinking-fund payments thereon entirely.

If the matter could be reopened again on the basis of a government guaranty we should for our own guidance like to receive from you some additional information with regard to the nature of the repurchase of the bonds of the French loans of 1911 and 1912 at a sum exceeding their par value in francs. Was this done on account of some question having come up as to the right of holders to collect in some other currency than French francs, and was the repurchase of the bonds at a premium the outcome of a compromise on such question?

Believe us, dear sirs,

Very truly yours.

Mr. DE GERSDORFF. Who is it signed by?

Mr. PECORA. I do not know.

Mr. BUTTENWIESER. I would have to see the initials to say.

Mr. PECORA. The letters are L. K.

Mr. BUTTENWIESER. That is Leonard Keesing.

Mr. DE GERSDORFF. Well, in their office. What I was getting at is whose letter was it? Kuhn, Loeb & Co.'s letter?

Mr. PECORA. Kuhn, Loeb & Co. letter; yes, sir. This is a letter sent by your firm to Louis Dreyfus & Co. after they had called to your attention this Chilean financing proposal?

Mr. BUTTENWIESER. That is correct.

Mr. PECORA. Now, some stress is laid in this letter, or rather, mention is made of the lack of capital of the Mortgage Bank of Chile. And reference in this letter is made to that circumstance as one which would preclude you from taking over this issue and offering it to the public here without a government guaranty.

Mr. BUTTENWIESEN. That is correct.

Mr. PECORA. What information did you get from Louis Dreyfus & Co. or from any other source in reply to the request you made in this letter for information respecting the nature of the repurchase of the bonds of the French loans of 1911 and 1912 at a sum exceeding their par value in francs?

Mr. BUTTENWIESER. We have a reply which is in French.

Mr. PECORA. Well, what is the contents of it? The substance of it?

Mr. BUTTENWIESER. You will have to pardon the substance of my translation of it. It says—do you want it read in French or do you want me to try to give a translation of it?

Mr. PECORA. No; just give us a free translation of it.

Mr. BUTTENWIESER. It says:

As concerns the question which you have raised on the subject of the repurchase of the obligations issued in France in 1911 and 1912, it concerns in effect an equitable arrangement arrived at between the mortgage bank and the French holders who wished to cash their coupons in sterling, an arrangement which was concluded at the time under the auspices of the National Association of Holders of Securities in France.

A better scholar of French has told me that instead of saying "it concerns," I should said "it constitutes."

Mr. DE GERSDORFF. "It constitutes in effect."

The CHAIRMAN. They do not make any reference to the smaller amount of profits that they made? The smaller amount of reserve?

Mr. BUTTENWIESER. To clarify that point I might state that I haven't that 6½ percent prospectus before me because it has just

been submitted for the record, but my recollection is clear that we pursued the same line in that prospectus as we did in this prospectus, which says:

The Caja has no capital stock and is not operated for profit. It has power to charge a commission to provide for its expenses and for a reserve fund, as additional security for its bonds, but having accumulated a sufficient reserve, the Caja has now discontinued charging such commission.

Mr. PECORA. What information or advice did your firm have with respect to the value of, the soundness of, the security behind the mortgage loans made by the Chilean Bank? Did you have any advices or information on that at all?

Mr. BUTTENWIESER. We had an unbroken record of 70 years during which the largest loss in the aggregate of 10 years was $40,000. And, of course, we could have no information as to the mortgages themselves. We only had this long record of the Mortgage Bank whose securities in Chile sold as well or better than the Chilean Government's own securities. And in addition to that we insisted on having the guaranty, the unqualified guaranty, endorsed on the bonds of the Republic of Chile itself.

The CHAIRMAN. It seems to have been a kind of public corporation that was not operating for profit?

Mr. BUTTENWIESER. It was. The closest analogy I can think of is our Federal land banks, operated very much along the same line, although, of course, there is the technical difference that they had stock and this bank had no stock. It is the usual form of credit foncier.

The CHAIRMAN. The Federal land banks all had capital, you know. The Government subscribed to the capital, but they had capital.

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. Now, at the time your firm, with the Guaranty Co., underwrote this $20,000,000 issue, had not the Chilean Congress been dissolved?

Mr. BUTTENWIESER. I think it had, and if I had that circular here, I could read you exactly.

Mr. PECORA. Haven't you the circular before you?

Mr. BUTTENWIESER. No. You see the circular of the 6½ percent issue went to the stenographer for the record, and that handicaps me.

Mr. PECORA. Is not the stenographer that has it here?

Mr. BUTTENWIESER. I think Mr. McEldowney has another copy.

Mr. PECORA. Let me read from the copy of that circular which I have before me the following statement:

The bonds are unconditionally guaranteed as to principal, interest, and sinking fund, by endorsement, by the Republic of Chile, pursuant to decree law of the governing council, dated March 9, 1925, and an executive decree, dated June 15, 1925 (supplementing said decree law), issued under the authority of President Alessandri and his cabinet, who are functioning as the Government of Chile, Congress having been dissolved in September 1924, pending the adoption of a new constitution which is now being drafted. The guaranty thus authorized is valid and binding upon the Republic of Chile.

Did your banking firm think, Mr. Buttenwieser, that a guaranty by a government that was in existence under the circumstances indicated by this prospectus was a proper and sound guaranty?

Mr. BUTTENWIESER. Our counsel, the Guaranty Co. counsel, and most eminent counsel in Chile, all agreed that it was a valid and

binding guaranty of the Republic of Chile, and it has never been questioned by the Government of Chile, the validity of that guaranty, or any of the proceedings surrounding the guaranty of the issuance of the bonds.

Mr. PECORA. Well, did you not recognize that unstable and unsettled political conditions in Chile would affect the value of that guaranty from a practical standpoint, if not from a legal standpoint?

Mr. BUTTENWIESER. The Chilean Government, over a long period of time, had been stable. Chilean politics, as I recall, had been stable for many years. Chile had——

Mr. PECORA. But a change took place in 1924.

Mr. BUTTENWIESER. That is right.

Mr. PECORA. And this stable Chilean Government that I presume functioned under a constitution adopted by the Chilean people, was replaced in September 1924, by a government which obtained power by the use of power and force?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. And dissolved the congress and was about to adopt a new constitution?

Mr. BUTTENWIESER. Yes.

Mr. PECORA. That was the situation presented in the spring of 1925 when these bonds were offered and sold to the American investing public, was it not?

Mr. BUTTENWIESER. Well, I think that question resolves itself into two parts. It is the legal aspect of it and the intrinsic merit of the guaranty. Now as to the legal aspect, we had competent legal advice.

Mr. PECORA. I am passing on to the intransic merit, as you call it, and which I call the practical merit of the guaranty.

Mr. BUTTENWIESER. The practical merit of the guaranty, as far as I can see, is not affected by the Government, or the form of government that happens to be in power at the moment.

Mr. PECORA. If the government is an unstable government would you accept the guaranty of such a government as readily as you would that of a stable government?

Mr. BUTTENWIESER. If I were advised——

Mr. PECORA. Away from the legal aspects now, on the practical consideration of the question?

Mr. BUTTENWIESER. Well, it was the only government that existed, and we were advised that its acts were binding upon the Republic of Chile.

Mr. PECORA. Well, even though it were the only government that existed there, it was nevertheless a government of the nature that has been referred to. Now, would you consider a guaranty of such a government, functioning by decree, under a decree rather than under a constitution, invested in office through the exercise of force and violence, a good practical guaranty upon which to pass on $90,000,000 of securities?

Mr. BUTTENWIESER. I do not want to quibble on this, but it seems to me either the guaranty is binding or it is not binding. The best legal advice that we could get was that it was binding. And the proof of it is that it was always considered a valid and binding thing.

Mr. PECORA. Now you are discussing the legal effect of the guaranty rather than its intrinsic value. Now, address yourself to what you call the intrinsic value of the mortgage, and what would you say?

Mr. BUTTENWIESER. I say if it were binding that would not affect its intrinsic value.

The CHAIRMAN. How about the securities on which these bonds were based? Did the value of property go down, or what became of the value of the mortgages? Did that continue under this new government?

Mr. BUTTENWIESER. The value did continue, as far as I know, under the new government; yes.

The CHAIRMAN. There must have been depreciation in the value of their securities or their bonds would not have dropped so.

Mr. BUTTENWIESER. I did not catch that question, Senator.

The CHAIRMAN. I say there must have been a depreciation in the value of the securities held by the bank or their bonds would not have dropped so.

Mr. BUTTENWIESER. Well, I think it is more than just the value of the securities back of these bonds that affects the market price of these securities. There are many other problems involved.

Mr. PECORA. We all understand that legally one endorsement is as good as another, but practically they are not alike, are they? They depend on the financial responsibility of the endorser, do they not?

Mr. BUTTENWIESER. That is correct.

Mr. PECORA. Now, would you not say the same principle would apply to governments?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. Well, then, did you consider that the endorsement of a revolutionary government in Chile was a sound and safe endorsement or guarantee?

Mr. BUTTENWIESER. Well, first, again, Mr. Pecora, I must say that if it were a valid, binding obligation of that Government the form of that government, as far as I can see, makes no particular difference.

Mr. PECORA. Suppose a revolutionary government cannot continue in power, and chaos and disorder prevails, that is reflected in the ability of the government to make good on its guarantee, is it not?

Mr. BUTTENWIESER. It does not follow that the form of government has any bearing on the ability of the government to make good under its guaranty.

Mr. PECORA. Have you not heard as a banker of governments repudiating the acts of prior governments?

Mr. BUTTENWIESER. Yes, and we had competent advice, I repeat, to state that the Republic of Chile could not repudiate the acts of this Government, and have not.

Mr. PECORA. Well, here you were given this guaranty at the time when this Government of Chile was functioning without a constitution and without a congress, which had been previously dissolved by the usurping government.

Mr. BUTTENWIESER. Mr. Pecora, I can only rely on the previous statement that I have made, that all the counsel that we consulted, two eminent firms in New York, leading counsel in Chile, said that as it was the only apparent government there its acts could not be repudiated under international law. And the fact is its acts were not repudiated. The validity of this guaranty has never been questioned.

Mr. PECORA. Did that control your judgment as to the intrinsic value of the guaranty?

Mr. BUTTENWIESER. The intrinsic value is predicated on other considerations than the legal question.

Mr. PECORA. I agree with you, but did the fact that this guaranty was obtained from a government that existed under the circumstances that then prevailed in Chile have any bearing in your mind upon the sufficiency, from a practical standpoint, of this guaranty?

Mr. BUTTENWIESER. No. I do not see that it has any bearing.

Mr. PECORA. And it was in pursuance of such judgment that you accepted the guaranty and underwrote this issue and passed it on to the public here? Is that right?

Mr. BUTTENWIESER. Guided, once again, by competent legal advice that this guaranty would be valid and legally binding. And if I may consult counsel as to whether or not I may read into the record a copy of the telegram which we had from the State Department on the subject? But I do not know whether we are permitted to make that public.

The CHAIRMAN. From our State Department?

Mr. BUTTENWIESER. Yes. Supplementing that letter that you saw, Senator Fletcher.

The CHAIRMAN. Well, they simply say that there has been no change in their recognition of the Government there. No objection to reading that in, I do not think. You might read that into the record. Just read the telegram. Have you got it with you?

Mr. PECORA. I have here a copy of a cable addressed to Manuel Foster, Esq., Santiago, Chile. Under date of June 22, 1925. Have you got a copy of that cable before you?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. Who sent that cable?

Mr. BUTTENWIESER. Did you say June 22, to Manuel Foster?

Mr. PECORA. June 22, 1925. File no. 1123–6.

Mr. BUTTENWIESER. I have one of June 21 to Manuel Foster.

Mr. STEWART. How does it start, Mr. Pecora?

Mr. BUTTENWIESER. What is the first of it?

Mr. PECORA. It starts:

N.Y., June 22, '25.

Copy of cable to Manuel Foster, Esq., Santiago, Chile: Answering questions your cable 19th instant.

Mr. BUTTENWIESER. Well, that is "from."

Mr. STEWART. That is received from.

Mr. BUTTENWIESER. That is why I could not place it.

Mr. PECORA. I have here "Copy of cable to Manuel Foster."

Mr. BUTTENWIESER. It is "from." I think you will find it reads that way.

Mr. PECORA. Well, the copy we have says "to."

Mr. STEWART. Here is the original.

Mr. BUTTENWIESER. Is that the one that says: "Answering questions your cable 19th instant"?

Mr. PECORA. Yes. "Your cable 19th instant." Well, the copy you furnished us reads: "Copy of cable to." Undoubtedly a typographical error.

Mr. BUTTENWIESER. I am sorry. I just wanted to make clear.

Mr. PECORA. Well, that was a cable, then, from Manuel Foster?

Mr. BUTTENWIESER. Yes; that is right.

Mr. PECORA. Now, Manuel Foster represented your firm, did he?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. In Chile?

Mr. BUTTENWIESER. He was our counsel in this transaction in Chile.

Mr. PECORA. Yes. He said as follows in this cable:

Answering questions your cable 19th instant: First president was duly elected under constitution, but present cabinet was appointed by former military council and practically confirmed by the president. Constitutionally they have no authority to recognize debts unless by law enacted by Congress. But in this case their decrees as proceeding from a de facto government recognized by the country and respected by all the citizens are valid and binding upon the Republic.

Second. As I have stated in the preceding point your assumption is right.

Third. It depends on decree law 308 dated March 9 up to 50,000,000 pesos Chilean currency but said decree law was complemented by executive decree dated June 15 extending authorization up to $20,000,000 United States currency in order to authorize the negotiation of one single loan. This last decree, although not shaped in the form of the so-called "decree laws", enforced the same binding upon the Republic.

Fourth. The simple fact of using the word "guaranty" conveys the idea of a collateral obligation and indicates the existence of a principal debtor which in this case is the Caja but decree 8 of June authorizes endorsement of direct guaranty to bondholders on temporary and definitive bonds.

Fifth. Both decrees have been signed by President and by minister of finance as it is observed in the promulgation of laws passed by Congress.

Sixth. I insist in my opinion that insofar as the legal aspects of this negotiation is concerned there is no danger in the operation.

The Caja Hipotecario is a state institution or organism created by the state and administered by a director and a board appointed by government and its bonds are signed by a high government official. Therefore, in my opinion the government is ultimately responsible for its operations. In this very sense it was considered by France and Germany when gold bonds were issued in 1911 and 1912. Therefore even without any declaration from the government its guaranty or final responsibility is absolutely clear, as arising from acts of its own organism. I must also add that as you are acting bona fide with the only apparent government of this country you shall be placed under the protection not only of the Chilean but also of even the international law.

Now, your firm sent a reply to that cable to Mr. Manuel Foster, did it not, under date of June 23, 1925?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. And in that cable did you say as follows:

Is it not correct to refer to council as governing council which we prefer instead of military council?

Mr. BUTTENWIESER. Yes, sir.

Mr. PECORA. Now, your legal adviser resident in Chile said that this Government whose guaranty you were seeking, or rather the President of the Government whose guaranty you were seeking, was appointed by a former military council, or rather the Cabinet was appointed by a former military council. You did not like that term "military council" and suggested a modification or change to "governing council", is that correct?

Mr. BUTTENWIESER. If he felt they were synonymous.

Mr. PECORA. Yes. And that is the term that you used in your prospectus to the American public, was it not, "governing council" instead of "military council"?

Mr. BUTTENWIESER. Which it was.

Mr. PECORA. Why did you prefer the term "governing council" to "military council" for the purpose of your prospectus?

Mr. BUTTENWIESER. Well, I think "governing council" is a more accurate statement of what a government is than "military council", which might be misinterpreted.

Mr. PECORA. Were you overruling the advice conveyed to you by your counsel resident in Chile when you referred to it as a "military council" and you suggested you preferred the term of "governing council"?

Mr. BUTTENWIESER. We were not overruling it, Mr. Pecora. We merely wanted to get the most accurate statement in English of what that council was.

Mr. PECORA. Well, hadn't he given you a very definite designation or characterization of it when he said it was a military council?

Mr. BUTTENWIESER. It was doubtless a governing council or else he would not have agreed to the word "governing."

Mr. PECORA. Had not Mr. Foster accurately designated or described this council as a military council when he cabled your firm under date of June 22, 1925?

Mr. BUTTENWIESER. In English he had suggested that it was a military council.

Mr. PECORA. He did not suggest it. He stated it.

Mr. BUTTENWIESER. He stated it was a military council.

Mr. PECORA. Yes. He stated it "By former military council", and then you cable the following day and say: "Is it not correct to refer to council as governing council which we prefer instead of military council." Now the reason you had that preference was because you thought that it would sound better in the prospectus to the investing public here to say that this Government or the Cabinet of the President had been confirmed by a governing council rather than a military council? Is not that plainly the reason?

Mr. BUTTENWIESER. I would say that "governing council" is less susceptible to misinterpretation than "military council", because, as you see, it takes a long legal explanation to show that military council is that—the guaranty of this Government under this military council was a valid, binding obligation of the Republic of Chile under Chilean law and under international law.

Mr. PECORA. Do you know the personnel of that council that you preferred to call a "governing council"?

Mr. BUTTENWIESER. No; I do not know.

Mr. PECORA. Was it not all composed of military and naval officers?

Mr. BUTTENWIESER. I do not know that.

The CHAIRMAN. Did you ever approach the Government of Chile with the idea of making good their guaranty?

Mr. BUTTENWIESER. Yes, sir. We protested to the Chilean Government with reference to making good their guaranty on all these $90,000,000 of bonds, and we sent a very comprehensive protest first to the State Department asking them to forward it, and I have it here, if you desire it, the reply of the State Department wherein they stated why they could not forward it, and subsequently we forwarded it ourselves to the Republic of Chile and to the Mortgage Bank, both.

Mr. PECORA. By the way, had the American Government recognized this de facto government at that time?

Mr. BUTTENWIESER. The State Department advised us in that telegram, of which you have a copy, that they had recognized no change in the Government. I believe that is the exact wording of it.

Mr. PECORA. Well, did you interpret that as meaning that our Government had recognized formally this de facto government? Or does it mean that it had not extended such recognition to it?

Mr. BUTTENWIESER. I cannot answer that.

Mr. PECORA. Well, who can answer it for your firm?

Mr. BUTTENWIESER. I believe the fact that it had recognized no change, that they considered the Government of Chile existed under the same circumstances as it had existed. In other words, they recognized that no change had taken place.

Mr. PECORA. In other words, they recognized that the de facto Government was merely a de facto government, did they not? Is that not what that means?

Mr. BUTTENWIESER. That is a legal point again on which I am really not qualified to pass. But I believe these legal opinions amply cover that point.

Mr. PECORA. Well, I do not know, Mr. Buttenwieser. Your legal adviser in Chile refers to this council as a military council. You asked him to correct it and refer to it as a governing council because you preferred that to a military council. Now whose opinions control your judgment, your own or the advices of your lawyers with regard to these questions?

Mr. BUTTENWIESER. On legal subjects of course the advice of our counsel.

The CHAIRMAN. What response did the Chilean Government make to your protest?

Mr. BUTTENWIESER. They wrote us a letter stating why it was impossible for them to live up to the payments under their guaranties. The whole subject was covered in the text of the Chilean moratorium law of July 1931.

The CHAIRMAN. The effect of their reply was that while they did not deny the guaranty they were unable to perform the contract?

Mr. BUTTENWIESER. That is it exactly. They have never denied in any way the validity of their contract.

The CHAIRMAN. Did they give any reason why they could not live up to the guaranty?

Mr. BUTTENWIESER. Yes. They furnished many statements—they published some statements as to why it was impossible for them to service their foreign obligations. Their own obligations and their guaranteed obligations.

The CHAIRMAN. Did they make any promise to do it in the future?

Mr. BUTTENWIESER. Yes. They said they hoped to be able to do it.

The CHAIRMAN. I think we had better take a recess. We will now recess until 10 o'clock tomorrow.

(Thereupon, at 4:30 o'clock p.m. Tuesday, June 27, 1933, an adjournment was taken until 10 o'clock a.m. the next day, Wednesday, June 28, 1933.)

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COMMITTEE EXHIBIT 1

(In the matter of terms and conditions to be prescribed by the Commission in connection with the issuance of securities under section 20*a* of the Interstate Commerce Act, as amended)

THE MARKETING OF AMERICAN RAILROAD SECURITIES

INTRODUCTION

THE PROBLEM

No more important problem today challenges the skill and wisdom of American railroad managements—and the public authorities charged with the function of regulation—than that of how to obtain the capital necessary to provide the facilities required to transport the commerce of our growing country.

It has been estimated by several high authorities that in order to meet with any degree of adequacy the requirements for new construction, for additional main tracks, sidings, and yards, for equipment and terminal facilities, for elimination of grade crossings, especially in the larger cities, for block signaling and other safety appliances, and the requisite general strengthening and improvement of existing properties, expenditures are called for, aggregating as much as $1,000,000,000 a year for a series of years to come.

There is never-ceasing demand in the United States for more and better railway services. Unless this demand is to remain unsatisfied the railway management must find some way to attract to the railway industry an uninterrupted and steadily augmenting flow of new capital.

The problem is no less vital to the public whose prosperity and convenience so largely depend upon the adequacy of its transportation service. At the same time the public, which pays the rates providing the return earned upon capital invested in railroads, has a clear interest in having the railroads sell their securities—and obtain their new capital—upon terms which involve no burden upon rates beyond that actually necessary to attract the required capital.

Capital already invested in railroad facilities is irrevocably committed, but any and all new capital must be attracted from the investing public upon terms and under conditions which appeal to that public.

It is thus of essential importance that the following purposes be accomplished:

1. Obtain the capital.
2. Attract it upon fair and reasonable terms.
3. Have a broad and stable market for railroad securities and a favorable disposition on the part of investors toward such securities.

Generally speaking, the existing method of disposing of railroad securities is by three processes:

1. Offering stocks pro rata to existing shareholders, the issue usually being underwritten by bankers;
2. Selling bonds at a fixed price to bankers, who through the medium of a syndicate and with the cooperation of distributing houses throughout the country, market them to the public; and
3. Selling an issue through a banker to the public, with a commission to the banker for his services. (This method is very rarely employed.)

The question is now raised whether it would be well that the existing practice be changed and that railroad securities hereafter be sold by one of the following methods, viz, (1) unrestricted public bidding, or (2) competition among bankers.

Such a change would, of course, involve the abandonment of the heretofore prevailing method, under which a railroad company usually selects a banking house of high standing and, so long as the services of that banker are satisfactory, makes its issues of securities customarily through or with the aid of that house.

The suggested change contemplates that the relationship between the railroad and the investment market shall be similar to that between American municipalities and the investment market, wherein issues of securities are usually sold by competitive bidding.

In considering this problem, the paramount question is, How can it be made certain that the vast amounts of new capital required by the railroads, year in and year out, shall be forthcoming upon the most advantageous terms?

I. The Existing Practice of Dealing Through Bankers

A. WITH AMERICAN RAILROADS

As a rule, railroad companies of the United States, like those of other countries, market their bonds by selling them either to or through bankers. In cases where securities are offered for pro rata subscription to stockholders it is customary for the corporation to protect itself by arranging with bankers to underwrite, or to form a group to underwrite, their sale, that is, to agree to purchase such of the securities as are not taken by the stockholders.

Most of the important railroad companies, as well as industrial corporations, make a practice of dealing with a particular banking house or a particular group of bankers in marketing securities. This relationship rarely rests on formal contract. As a rule, the relationship is informal and tacit and its duration, as will be developed in detail further on, depends wholly upon the satisfaction of the railroad with the services rendered. A railroad company gradually comes to recognize a particular banking house as its banker.

The existence of such a relationship means that the railroad has at its disposal continuously the services, skill, standing, experience, advice, and financial influence and capacity of the banker.

Among the banker's functions are to keep track of the financial situation and requirements of the railroad, to assist in the preparation, in advance of the need, of a proper and serviceable system for financing such requirements; to advise as to the class, kind, and denomination of securities to be issued and as to the best time for selling them, so that his clients may not miss an opportune moment for meeting their requirements; to indicate from his survey of the markets of the world his judgment as to the amount of securities which could be absorbed in one or the other market; to scrutinize the mortgages and deeds of trust under which securities are to be issued, with a view to their provisions being, on the one hand, carefully protective of the investor, and, on the other hand, sufficiently broad and elastic not to hamper and restrict the corporation unduly in respect of its future requirements.

The terms of a negotiation are by no means imposed by the banker, for it is easily within the means, and is recognized as an important and responsible duty, of those conducting negotiations on behalf of the railroad company, to acquaint themselves with the reasonable market value of the securities which it desires to sell and to insist upon obtaining a fully adequate price.

The railroads for whom bankers act nowadays can have no inducement to continue that affiliation except satisfaction with the services rendered.

A railroad company generally is, and always ought to be, free to terminate its relationship with its bankers at any time and entirely within its own discretion.

That changes in the relationships between railroads and bankers do occur is indicated by the variations which take place in the course of time, in the connections, and the relative influence and position of the prominent banking firms which deal in railroad securities.

The relationship between the railroad and its bankers is one which, whilst not limiting the railroad's freedom of action according to its own judgment of its best interest, does involve upon the part of the bankers certain definite and continuous duties and obligations, more fully referred to later on.

B. WITH INDUSTRIAL CORPORATIONS

Industrial corporations, unlike railway companies subject to public regulation, are entirely free to sell their securities in whatever way they deem most advantageous. Their managers, or presidents, are very frequently among the larger stockholders, and indeed, in numerous cases, are the principal stockholders, of the respective concerns, and therefore have a more direct and important pecuniary stake in their enterprises than can be the case with the chief executives of our large railroad corporations, the ownership of which is scattered in the hands of several hundred thousand shareholders.

Yet there are hardly any industrial concerns either here or in Europe which dispose of their securities by competitive bidding among bankers or by direct offering to the public. Practically all such corporations pursue the course of negotiating with one particular bank or group of bankers and entrusting the

handling of their security issues to such banker or group of bankers so long as their services prove satisfactory. Their action is conclusive evidence that the system of competitive bidding is found unsuitable and disserviceable by the consensus of opinion of those in charge of industrial affairs, here and in Europe.

II. How Railroad Securities Are Placed With the Public

The great complexity involved in the sale of securities will readily be seen from a brief outline of the method usually adopted in marketing a large issue of bonds. The railroad, in the first instance, sells the issue to a strong banking firm at a price mutually agreed upon through negotiation. That firm then associates with itself a syndicate consisting of many (usually hundreds) of other banking, brokerage, investment, and distributing houses throughout the country, each having its clientele of investment customers.

Bankers, of course, do not buy securities for permanent investment by themselves. If bankers or syndicates permanently kept the securities which they bought from the railroads their capacity to undertake such transactions would be exhausted very soon.

If securities are to be placed, they must ultimately find lodgment with investors, and, while the amounts of securities taken by large investors, such as the life insurance companies, savings banks, and capitalists, appear large, their aggregate, especially since the advent of the high surtaxes, is small compared with the investments of the rank and file of small investors.

Pending the formation of a syndicate, the firm which has contracted with the railroad stands in the breach, and is responsible to the railroad whether or not it succeeds in forming the syndicate. Even after the formation of the syndicate, the practice is that the responsibility of the contracting firm continues and it remains liable to the railroad for the due fulfillment by each syndicate member of the obligation undertaken by him.

Then begins the laborious process of selling securities to ultimate investors, through advertising, letters and circulars, and personal presentation, and in this labor are engaged large numbers of dealers in securities, each with his own clientele. In time, if the issue is a success, the securities are absorbed.

If the issue is not a success the participant in the syndicate must either sell the securities at a loss or carry them along until the advent of propitious times enables them to dispose of them.

The selling of securities to the public has in recent years undergone a radical change. Formerly, the principal buyers of railroad bonds were wealthy individuals and large corporations, especially insurance companies and savings banks. The former, owing to the surtaxes, have practically been eliminated as absorbers of railroad bonds and confine their investments very largely to tax-exempt securities, while the insurance corporations and savings banks do not invest as largely as before the war in railroad securities.

It has therefore been found necessary to discover new channels for the absorption of railroad bonds. This has been accomplished within the past few years by a most intensive campaign of education and distribution among the rank and file of investors.

The result has been exceedingly gratifying in that a vast army of small investors has been developed. The achievement is of great public consequence from the social and economic point of view.

III. The Proposal To Market Railroad Securities by Competitive Bidding

It is now urged in certain quarters that railroad companies would do better if they should discontinue dealing habitually with particular banking houses, and, whenever they have securities to sell, would offer them for sale by competitive bidding among bankers, regardless of past affiliations.

Some even go so far as to advocate that bankers, as such should not be used at all, not even upon a competitive basis, but that the railroad companies should sell their securities directly to their own stockholders or to the public at large, preferably offering them for public tender and accepting the proposals of the highest bidders.

If railroads offered bonds direct for public subscription in limited amounts, the result might be fairly satisfactory in good or normal times, although even then, deprived of the facilities, the skill, and the sponsorship of responsible bankers, the prices obtained would probably be lower than those which would have been realized by dealing with a banker, and that consideration takes no

account of the uncertainty in which the railroad would necessarily find itself as to what portion of the funds it required would be in fact realized as the result of the public offering.

Moreover, the public demand would naturally concentrate itself upon the issues of the best known and most prosperous railroads, making it very difficult for railroads not enjoying high credit to obtain necessary funds—all the more difficult, as the system of competitive bidding would offer no inducement to bankers to take upon themselves the risk and responsibility of acquiring such issues.

Under that plan there would likewise be less assurance of the pursuance by railroads of a sound and consistent financial policy such as a prudent and conservative banker requires as a basis for commending securities to the confidence of the investing public which looks to the banker for advice and leadership.

In unfavorable times, of course, the public's response to an offering of securities is small, at times exceedingly small. It occurs frequently that bankers or syndicates have to carry issues of bonds, which they have purchased, for many months or even years, until investment demand revives. If an issue of bonds offered by a railroad for competitive bids on direct public subscription resulted in nonsuccess, the issue, if saleable at all, could only be disposed of at a very heavy sacrifice.

The failure of a public offering and the consequent public knowledge that the railroad had been unable to obtain the funds it requires, would cause grave damage to a railroad's credit, if it did not for the time entirely destroy it, would cause alarm amongst investors, and in not a few cases might cause bankruptcy.

That is the vital and fundamental difference between the risk incurred by municipalities and that incurred by railroads in the disposal of their bonds by public bidding. If a municipality fails to dispose of its bonds, the situation thereby created, though embarrassing, does not ordinarily involve grave harm, and can be dealt with. If a railroad fails, however, the damage done is exceedingly grave at best—and may be irremediable.

THE PUBLIC DOES NOT BID

As a matter of fact, unrestricted public competition does not in practice mean what the term implies, because all experience has shown that the public does not care for such bidding and actually refrains from participating therein to any appreciable extent. Even in the case of municipal securities, it is amply demonstrated that the offerings are not taken by the public in the process of competitive bidding, except in a very limited measure. The successful bidders both as to quantity and price are almost invariably bankers or banking syndicates who buy for resale to the investor.

The public wisely requires, even in the case of municipal securities, the advice and moral responsibility of bankers. They want to be sure that all legal matters have been properly looked into by somebody, not the seller, and that the soundness and validity of the security is vouched for by a competent and reliable firm.

If, as experience has shown, the public cannot be depended on to cover the offering even of municipal bonds by competitive bidding, this would be so in a still more pronounced degree in the case of railroad securities. It follows that public competition would really mean not offering securities to the public, but offering them to the bankers.

The banker, if he were—as he would be in this case—entirely free to bid or not to bid, to pick and choose, to take the best and leave the less good alone, would actually leave the less good alone, with the result that many railroads would find themselves faced with the grave consequences of the failure of public offerings.

Municipal and State securities possess the immense advantage of being tax free. Yet it has happened, in the past quite often, and even not unfrequently of more recent dates, that such issues were not covered when offered for public bidding, the failure, entire or partial, being due usually to their being unsuited to the market or because of some doubt as to their legality. Can it be doubted that the same result would occur much more frequently in the case of railroad securities if offered for public bidding?

THE EXPERIENCE OF CITIES

It is true that Government and municipal securities in this country are usually offered for competitive bidding, but Government, State, and municipal financing is not comparable with corporation financing. In the former case the securities based upon the taxing authority are in the simplest form—generally little more than a plain promise to pay—and in recent years, since the advent of high surtaxes, a ready market is usually assured by the tax-exemption feature.

Nevertheless, public officials usually deem it wise to consult bankers before determining their financial policies and particularly before issuing large loans, and at times have sought and obtained in advance informal guarantees from bankers that offerings will be covered. They can, of course, rely upon bankers rendering assistance as a matter of civic duty. In the case of railroads, with the element of habitual clientage between railroad and banker eliminated, it would naturally be impossible to count upon any such uncompensated advice and assistance.

As illustrating the point that the financing of State and even the highest grade municipal bonds has not always been successful in spite of the tax-exemption feature, it may be mentioned that in June and August 1907, the city of New York offered two issues of bonds of $29,000,000 and $15,000,000, respectively, for which bids of only $2,100,000 and $2,700,000, respectively, were received. The issues were sold by private sale to bankers a few months later.

About the same time a small offering of bonds by the State of New York met with a similar result.

In 1914, shortly after the outbreak of the war, the city of New York, finding itself in immediate need of $100,000,000 of gold to pay notes maturing in England and France, turned to J. P. Morgan & Co. and Kuhn, Loeb & Co., who, without compensation, as a matter of public duty, undertook to organize, and in the midst of conditions of unprecedented difficulty, did organize a syndicate to provide the necessary funds.

In more than one instance in the years preceding that occurrence, the city was compelled, in order to avoid failure of an issue offered for public tender for the purpose of meeting pressing requirements, to have recourse to one or the other of the leading banking houses. In numerous cases it was only large subscriptions by such banking houses—made often without any expectation of profit and resulting none too rarely in losses—which avoided the, at least partial, failure of public offerings of the bonds of the city of New York.

There is no reason to believe that the cities have been better off under the practice of selling bonds at public offering to the highest bidders than they would have been had they been permitted to deal privately with the bankers as do the railroads. But, even if it were otherwise, it is manifest that railroad companies could not possibly expect to fare as well as do the municipalities if they had to depend upon the uncertain and fluctuating public demand when they attempt to sell their securities at public offering to the highest bidder.

Especially does this hold true in the case of the less strong railroads, where a careful analysis and study of the condition of the company and sometimes even an auditor's or an expert's report is required before a conservative banker will stand sponsor for the company's securities. The investing public will neither take the trouble, nor does it possess the qualifications, to analyze for itself the position of the securities of the less well-known properties and to form a reasoned estimate as to their degree of safety, based, as such estimate must be, upon the compilation and study of statistical and other data, which it is among the functions of the banker to gather and to make available to his investment clients in convenient and easily understood form.

In this connection it is significant that the Farm Loan Bureau of the United States Treasury has found it advantageous to issue the bonds of the farm-loan banks not by competitve bidding but through a group of bankers selected by the Bureau whom it may at all times feel free to consult and who watch the markets in the interest of the Bureau.

EUROPEAN PRACTICE

In not a single European country does the system prevail of competitive sale, either general or limited, of securities on the part of corporations. Moreover, many even of the governments and municipalities, in placing their loans,

have recourse not to competitive bidding but to regularly established and continuous connections with a banking house or a group of banking houses. Not one of the foreign governments, belligerent or neutral, which during the European war have found access to the American investment market for the securities of their respective countries, had recourse to competitive bidding amongst bankers or otherwise. In each instance the government concerned has dealt with some one particular banker or group of bankers whom it selected as efficient and worthy of confidence.

A cabled inquiry addressed within a week to eight different countries in Europe, and also to Japan, to find out whether, since the war, the practice has been modified in those countries of dealing with selected bankers for the sale of public service and other corporate securities and even, in numerous cases, governmental or municipal bonds, elicits the information that no reason has been found to change that practice and that it continues to prevail.

IV. The Present Method of Underwriting the Sale of Stocks to Shareholders

Under the laws of most States and the charters of most corporations, it is necessary that new issues of stock, or of bonds carrying the privilege of conversion into stock, must first be offered for pro rata subscription to the corporations' stockholders. In such cases the banker's knowledge of markets is valuable to advise the corporation of the character of securities which its shareholders are likely to accept or for which the subscription rights would command a market value.

When an offering of new stock is made to shareholders of a corporation it creates a technically weak market position, inasmuch as both the existing stockholder and the speculator know that there is a mass of new stock about to issue, and the market must absorb it. Consequently the speculator is apt to incline toward rushing into the market, arguing to himself, "I will sell that stock. I will get it back cheaper. The market must absorb such and such a number of millions of new stock, and it cannot do that without going down. I am quite safe in selling some."

Experience has shown that in many cases the stockholder to whom the so-called right to subscribe for new stock is offered, does not exercise that right. He is not always prepared to put up additional cash. He frequently sells his "rights" for whatever may be their market value.

Consequently, by the very issue of additional stock, offered to existing stockholders, there is created an unfavorable and somewhat hazardous market condition. Naturally, the tendency invariably is for the offering of stock to depress the existing level of the stock. That may go so far as to remove any inducements to the stockholder to subscribe for the new stock, and to render "rights" valueless. An unprotected offering, i. e., an offering not protected by underwriters, is a target for selling.

Moreover, not to mention the damage to its credit in case of the failure of such an offering, the railroad is uncertain pending the time in which the securities are under offer to the stockholders (usually not less than from 45 to 60 days) whether or not, or to what extent, the stockholders will subscribe, and is, consequently, in doubt whether, at the end of the subscription period, it will come into possession of the funds it requires.

All of this is obviated by the formation of an underwriting syndicate inasmuch as it guarantees to take and pay for any part of the offering which the stockholders may not want to take. The existence of such a syndicate and the resulting guarantee of the success of the offering has a strong moral effect upon the stockholders in encouraging them to subscribe, and an equally strong effect in discouraging speculators from "short selling" while an unprotected offering invites such selling.

It follows that a railroad can safely afford to offer securities at a much higher price when underwritten than they would risk fixing when not secured and protected by an underwriting.

A characteristic illustration of the foregoing is furnished by the experience of the Pennsylvania Railroad Co., than which there is no stronger railroad corporation in the country, when, in 1903, it, without underwriting, offered $75,000,000 of its stock for subscription by its stockholders at 120 percent. The market price of the stock at the time was, and for some time had been, around 145 percent. Owing to the large difference between the market price and the price of the offering, the officers and directors of the railroad deemed it unnecessary to insure success by an underwriting.

As a result of changes in market conditions, sales of rights by stockholders, and selling by speculators, it being known that there was no underwriting syndicate, the market value of the stock rapidly declined. When the price in its descent had reached 125½ and the failure of the offering appeared imminent, the railroad finally called upon its bankers to form a syndicate to underwrite the issue, which was promptly done. The reassuring effect of the mere public announcement that a syndicate had guaranteed to take and pay for any part of the offering which was not subscribed for by the stockholders was such as to arrest immediately the selling on the part of alarmed stockholders as well as by speculators. The decline in the market stopped, and a threatened failure, which might have involved serious consequences and affected railroad credit generally, was turned into a complete success.

Even after taking into consideration the expense of an underwriting syndicate, a railroad will usually obtain materially higher net proceeds from an underwritten offering than from one not underwritten, in addition to the advantage of being certain of securing the required funds.

Manifestly, it is more advantageous to a railroad's financial position and the maintenance of the price level of its securities to offer a security, even to its stockholders, at, say, 110, and pay a reasonable underwriting commission, rather than to offer it at par without an underwriting.

The cases in which railroad companies or other corporations have successfully sold their securities direct to the investor are exceedingly rare, and even then usually at prices below what could have been obtained from bankers.

To quote only one example of nonsuccess in the case of direct dealing with the public, the Vermont Valley Railroad in 1914 offered for competition by sealed tenders an issue of $2,300,000 of its 6 percent 1-year notes. Although the Vermont Valley Railroad was a very prosperous concern, having a record at that time of having paid dividends at the rate of 10 percent per annum for 9 years, and the notes had the additional security of being guaranteed by the Connecticut River Railroad Co., the offering resulted in complete failure, practically no bids having been received.

On the other hand, the case of the case of the American Telephone & Telegraph Co. which recently sold a large issue of stock at par directly to its stockholders, without the intermediation of bankers, has been cited as significant and indicative of the possibilities of effective results without the cooperation of bankers. The real significance in that case, however, lies in the patent fact that had that issue been underwritten by bankers a considerably higher price for the company could have been obtained. The security sold by the American Telephone & Telegraph Co. was seasoned stock paying 9 percent dividends. It was offered at par. Bankers, in consideration of a reasonable commission, would gladly have underwritten the offering at a considerably higher price. It should be understood that this does not imply any suggestion of criticism as to the course pursued by the company. There were valid considerations of broad policy which guided the decision of those in responsible charge, to give to the vast body of its stockholders the benefit of a stock offering at a particularly attractive price.

V. Effective Competition Prevails Under Present Methods

There are ever present elements of actual or potential competition which assure favorable terms to a railroad company dealing habitually with the same bankers.

The price and the margin of profit or commission at which a banker concludes a negotiation with a railroad company for its securities is necessarily in competition with the terms upon which other bankers negotiate with other railroad companies for their securities.

The prices at which railroads sell their securities are now matters of public record. Moreover, the terms of a contract between the railroad and the bankers are subject to the approval of the Interstate Commerce Commission. No banker expecting to maintain his regular connection with a railroad company can do otherwise than pay full and fair value for the securities which it has to sell. It is a matter of necessity and self-interest for him to do so.

Railroad companies, through various means, are well able to place an accurate estimate upon the market value of securities which they have for sale, and no board of directors could afford to incur the approbrium and responsibility of selling securities to their regular banking connections otherwise than on the basis of what they are reasonably and fairly worth, considering the time and the conditions.

The prevailing market prices of existing issues fix very closely the prices at which new securities can be sold to investors. The banker who would make a practice of marketing the securities of his clients at prices materially below the prevailing prices for issues of similar character and quality would soon lose his clients.

In isolated instances, for the purpose of obtaining advertisement or position, or even, in certain instances, for reasons of a less legitimate kind, others than the regular banking connections of particular railroads may conceivably be willing to pay a somewhat higher price for an issue of securities than such regular connections; but there is no reason whatever to think that such "occasional" bidders would be able or willing to do better for the railroads, year in and year out, than the bankers usually acting for those railroads. On the contrary, there is every reason to expect the reverse.

Whether through a system either of unrestricted public bidding or of competitive bidding limited to bankers, the railroads year in and year out would obtain higher prices for their securities than have been and are being realized under the existing time-tested system, is a matter of opinion and cannot be anything else. Whether that opinion is pro or con, there can be no question that as against gaining a wholly problematical and uncertain benefit the railroads stand to lose the certain, well-established, and weighty advantages which now accrue to them through the responsibility and moral and practical obligations toward them of the bankers with whom they habitually deal.

To market railroad securities on a large scale requires a combination of skill, experience, capital, reputation, and connections that, from the nature of the case, can be possessed by only a limited number of concerns at any one time, because only the test of time will produce most of these necessary qualities.

That skill, experience, and reputation it is the business of the banker to make available to his clients, together with his financial potency and relationships.

A banker of long experience with a record of success, conservatism, and integrity develops a power to place securities that is of great value to his clients, cumulatively so the longer the relationship is maintained.

RESULTS MUST BE JUDGED OVER PERIOD COVERING BOTH RISING AND DECLINING MARKETS

The question of the best and most serviceable method of selling railroad securities must be determined not from the wholly exceptional and fortuitous circumstances which have prevailed during the last year, but in the light of the experience of the longer past and the needs of the future.

In the marketing of securities, as in other businesses, there are occasional periods of excessive activity, usually of comparatively short duration, occasional periods of acute depression, and longer periods of normal activity.

It happens that this year has been a period of unparalleled activity in the marketing of securities of domestic issues, simultaneously with and partly caused by growing reluctance to invest in issues of European countries. There has been a vast and almost insatiable demand for new domestic securities, particularly bonds, an almost uninterrupted decrease in interest rates and a corresponding increase in the market value of securities.

The result has been that bankers and syndicates have been much more than usually successful in marketing the domestic security issues which they have purchased and that as a rule new security issues have advanced in the market and reached prices in excess of the issue price. The upward trend of security values is illustrated by the fact that in the last 10 months the average market price of 10 standard railroad bond issues taken at random has increased about 13 points.

It has been a time when it was possible to indulge in improvident bidding or "spite-bidding", without being deterred by the swift penalty of nonsuccess in marketing, which follows such practices under normal circumstances.

Under these conditions, it is easy for critics who consider only recent experience, and whose knowledge does not carry them back to the pre-war years (which, after all, furnish the best standards for judging the future), to jump at the conclusion that the railroads have not been receiving the best possible prices for the securities they have marketed and that higher prices would have been realized if the sale of railroad securities had been opened up for competition.

Criticism has been especially easy and abundant on the part of those who have little or no background of experience in the marketing of railroad

securities to guide them, who have not had to bear the responsibility of financing the requirements of great railroad properties in normal times and during periods of depression and who do not realize the necessity of looking ahead to the future periods of depression or of more normal demand for securities when the railroads of the country will have the same need for new capital as now.

VI. Present Procedure Has Proved of Advantage to the Railroads

To deal through bankers in accordance with present practice, has actually proved itself a source of distinct financial advantage to railroads—even the most prosperous and soundly financed companies.

A few conspicuous cases may be cited here to illustrate the point:[1]

1. In March 1905 the Pennsylvania Railroad arranged with its bankers to form a syndicate to underwrite the offer to its shareholders at par of $100,000,000 Pennsylvania Railroad 3½ percent convertible bonds (convertible into stock at 150 percent). The stockholders subscribed for less than 10 percent of the offering and, consequently, the underwriting syndicate had to take and pay for about $90,000,000 of the bonds. The bonds within the year declined to 97½ percent and never again reached par, the price at which they were first offered.

If it had not been for the underwriting syndicate, the situation, resulting from the failure of the stockholders to subscribe and thus provide the money needed by the railroad, would have been very embarrassing to the railroad and very serious in its effect upon the general financial and investment situation of the country.

2. In 1908 a situation had arisen which had brought the market for railroad bonds in this country to a complete standstill. Railroads for many months were unable to obtain funds except, to a limited extent, by means of the costly and dangerous expedient of selling short-term notes. The effect was cumulative and far-reaching and threatened to bring about serious consequences. As this juncture the bankers of the Pennsylvania Railroad succeeded in inducing the two foremost banking houses in England, Messrs. N. M. Rothschild & Sons, and Messrs. Baring Bros. & Co., Ltd. (the former of whom had not issued an American security for many years), to purchase and bring out jointly with them at 96 percent an issue of $40,000,000 Pennsylvania Railroad 4 percent consolidated bonds.

Largely in consequence of the prestige and placing power and investment following of the issuing houses, the public offering was a complete success and its effect, as recognized by many published comments here and abroad, was to break the deadlock which had existed, and to cause capital to flow again freely into the investment market.

3. In August 1913 bankers formed a syndicate to underwrite the offer to Union Pacific stockholders of $88,000,000 Southern Pacific stock trust certificates at 92 percent. The effectuation of that sale was of very great importance as, failing it by a certain very near date, the Southern Pacific stock in question would have been placed, under a court decree, in the hands of a receiver, the sentimental and actual effect of which course would have been grave.

In the face of many predictions that a syndicate to guarantee the sale of so vast an amount of stock could not be formed under the then prevailing generally disturbed and unfavorable conditions, the bankers, with the aid of their connections throughout America and Europe, succeeded in the undertaking, the syndicate as finally made up consisting of nearly a thousand participants. It is entirely safe and well within bounds to say that if that mass of stock had been offered without guaranty and protection of an underwriting syndicate, it would not have been sold—if at all, within the time limit set by the court—at a price averaging better than 80 percent.

4. In connection with the first plan for the dissolution of the Union Pacific-Southern Pacific combination approved by Attorney General Wickersham (which failed of adoption because of the refusal of the California Railroad Commission to approve certain of its features), he imposed the condition that the sale of the Union Pacific Co.'s holdings of Southern Pacific stock (which would be offered for pro rata purchase to the stockholders in the Southern Pacific Co.) should be underwritten by a syndicate.

[1] A number of additional instances of a similar value to the railroads will be found on pages 33 to 37.

He imposed that condition for the manifest reason that the sale of the stock, however attractive the price to the stockholders might be, could be insured only in case definite arrangements were made for a sale of the stock that might not be taken by the stockholders upon the offering.

None of the aforementioned transactions, under the circumstances of the cases and the times, could have been effected equally well, if at all, by any method of competitive negotiating or bidding.

VII. THE PAYMENT TO THE BANKER IS FOR ASSUMING A SUBSTANTIAL RISK AND PERFORMING A VALUABLE SERVICE

The risk taken by the banker and the syndicates he may organize is always a real and at times a very great one. There is widespread misapprehension as to the profits made by bankers and syndicates upon the underwriting and purchase of securities of railroad companies.

There is also a frequently encountered misconception to the effect that the railroads are in the habit of paying a commission to the banker when selling securities to him.

When the banker forms a syndicate to underwrite an offer of securities to shareholders a fixed commission is naturally stipulated, commensurate with the advantage secured by the railroad company in obtaining through the underwriting the certainty of the success of its offering, and with the risk incurred by the banker and the syndicate affiliated with him.

On the other hand, in the case of the sale of railroad securities to or through bankers without an offering to stockholders, it is very unusual for the sale to be on a commission basis. As a rule, the procedure is that the banker makes a firm bid to the railroad for such securities at a fixed price, said price with the addition of a reasonable standardized percentage for his own compensation being the figure at which he expects to be able to form a syndicate. That compensation is in return for his preparatory work, his moral and actual responsibility and risk and his services in managing the syndicate. It is a charge made by the banker to the syndicate.

The compensation of the banker and the anticipated profit of the syndicate are practically a fixed percentage. The banker's method is not to buy low and sell high. In fixing the selling price to the public, he merely adds to the purchase price a certain percentage to cover his own and his syndicate's compensation and expenses, and that percentage does not vary materially irrespective of whether the purchase price was say 90 or 95 or 100 percent.

His aim and inducement are to buy at a price which will enable the securities to be sold to the public after adding to that price the customary compensation. He has no inducement whatever to buy at a lesser price because his compensation would not be increased thereby, but on the other hand the good will and approval of the railroad concerned would be jeopardized.

When a syndicate is formed the banker's financial risk is by no means ended, as, in practically all cases, he is himself a large participant in the syndicate—is, in fact, expected to be. Moreover, generally he remains financially responsible to the railroad for the commitment of each individual syndicate participant. The railroad looks to him for the due performance of the contract, and not to the hundreds of syndicate members.

Again his moral risk and responsibility toward the syndicate is great, inasmuch as he is relied upon by its members to have examined carefully into the soundness of the security, to have scrutinized the mortgage, to have taken competent legal advice, to have correctly gauged the moment and estimated the price at which the securities can be advantageously placed with the public, to do the principal work in marketing them, and to guide the work done by others.

If the banker is found wanting in any of these respects, or his judgment proves to be faulty, he loses the confidence of those who habitually participate in syndicates and with it his capacity to engage in financial transactions on a large scale, as it is only with the cooperation, financial or otherwise, of syndicates that large transactions can be carried through.

The spread on which the syndicate figures as between the purchase price and the price of resale to the public is not more than sufficient to cover the expense of "overhead", the outlay for advertising, circularizing and counsel fees, and reasonable compensation divided over hundreds of syndicate participants and distributing houses for their risk and their work in placing the securities with the public. In view of the change which has taken place, as previously referred to, in the clientele for railroad bonds (owing to the pref-

erence of large investors for tax-exempt bonds) the selling of railroad securities has become both a more laborious and intensive and a more costly process than formerly. In addition to a highly trained and expensive office staff, bond houses nowadays must employ an army of traveling salesmen.

In order to get issues of railroad securities well placed among, and absorbed by, bona fide investors, it is necessary, under the conditions created by the advent of high surtaxes, to employ retail distributing houses throughout the country to a far greater extent than used to be the case. The margin upon which the calculations of the syndicate and its managers are based must therefore be sufficient to enable reasonable compensation to be afforded to such retail distributing houses so as to give them a fairly adequate inducement to put forth their efforts in placing the securities.

If, through an excessive narrowing of the margin, whether due to vagaries of competitive bidding or to other causes, such adequate inducement cannot be given to that Nation-wide force of distributing houses in the case of railroad securities, the inevitable result would be that these houses would more and more relinquish that field and devote their principal attention to pushing the distribution of industrial and other securities, of which a constantly growing supply is available.

Under the methods now prevailing it is wholly impossible that the originating banker, the syndicate participants and the distributing houses can make an undue profit as between the railroads and the public. The expected compensation for their respective services is expressed in practically standardized percentages, varying somewhat in accordance with the quality of the security and the risk and difficulty of the business. There can be no profit to bankers, syndicates or distributors over and above these percentages, but of course there can be a loss if the banker's judgment as to the price which a given security is worth or as to the general condition of the investment market is at fault, or if a sudden change occurs in that market owing to unforeseen events. The limit of possible profit is fixed, the limit of possible loss is indeterminate.

It is worth mentioning in this connection that the banker in England does not render the same measure of service to the corporations whose securities he sells to the public, as does the American banker. It is the practice of the London banker, immediately after the public issue has taken place, to dissolve his syndicate, distribute amongst the syndicate participants any bonds remaining unsold and leave it to them to sell at the best price they can get. He does not usually consider himself responsible to endeavor to protect the stability of the issue price.

The practice of the American banker, on the contrary, in cases where a public issue has not resulted in placing with the public the entire amount offered, is to keep his syndicate together for a certain length of time (sometimes for a great length of time), to retain charge of the disposal of the unsold balance and to continue his efforts to place the same with the investing public at the original issue price—a practice fairer and more serviceable both to the railroads and to the public. Even in the case of wholly successful issues, it is the usual practice here to keep the syndicate together for from 2 to 3 months, so as to be ready to "protect" the market, as more fully explained later.

SOME INSTANCES OF SYNDICATE RISKS TURNED INTO LOSSES

The following actual cases, which are by no means exhaustive, indicate the risks incurred by banking syndicates, and illustrate the losses and vicissitude to which they are subject:

1. In September 1905 the Erie Railroad arranged with its bankers to form a syndicate to underwrite the offer to its shareholders at 100 percent of $12,000,000 convertible 4 percent bonds, series "B" (convertible into common stock at $60 per share). The result of the offering was that the stockholders subscribed for only 18 percent and, consequently, the syndicate had to take and pay for $9,840,000 of the bonds. The syndicate was dissolved in December 1906, none of the bonds taken by it having been disposed of. The bonds were listed on the stock exchange in February, 1907, when they sold at 85 percent.

2. In January 1906 the Missouri, Kansas & Texas Railway arranged with its bankers to form a syndicate to underwrite the offer to its shareholders at 87½ percent of $10,000,000 general mortgage 4½ percent bonds. The stockholders subscribed for only 50 percent of the offering and the syndicate had to take $5,000,000 of the bonds. The syndicate was dissolved in December 1907, only a few of the bonds taken by it having been disposed of.

3. In May 1907 the Union Pacific arranged with its bankers to form a syndicate to underwrite the offer to its stockholders at 90 percent of $75,000,000 4 percent convertible bonds (convertible into stock at 175 percent). The stockholders subscribed for barely 5 percent of the offering and, consequently, the syndicate had to take and pay for about $70,000,000 of the bonds. The bonds in the course of the following 6 months declined to 78¼ percent.

4. In January 1913 the Baltimore & Ohio Railroad Co. arranged with its bankers to form a syndicate to underwrite the offer to its stockholders at 95½ percent of $63,000,000 4½ percent convertible bonds (convertible at 110 percent). The stockholders subscribed for barely 30 percent of the offering and, consequently, the syndicate had to take and pay for about $44,000,000 of the bonds. In the course of a few months the bonds declined to 88½ percent.

5. In April 1906 the Wisconsin Central Railway arranged with bankers to form a syndicate to underwrite the offer to its shareholders at 89 percent and interest, of $7,000,000 Superior & Duluth Division & Terminal first mortgage 4 percent bonds. The stockholders subscribed for only 1 percent of the offering and the syndicate had to take $6,930,000 of the bonds. The syndicate expired by limitation July 1, 1908, none of the bonds taken by it having been disposed of in the interval.

6. In March 1910 the Atchison, Topeka & Santa Fe Railway Co. arranged with its bankers to form a syndicate to underwrite the offer to its shareholders at 102½ percent of $43,686,000 convertible 4 percent bonds due 1960. The stockholders subscribed for only about 12½ percent of the offering, leaving about $38,000,000 of the bonds to be taken by the syndicate.

7. In February 1906 the Southern Railway sold to its bankers $20,000,000 development and general mortgage 4 percent bonds at 89 percent less commission. The syndicate formed by the bankers to handle this transaction remained in existence for nearly 2½ years, i. e., till July 1, 1908, at which time the syndicate members had to take up 68 percent of their participations. The market price of the bonds at that date was 74 percent.

8. In January 1909 the Western Maryland Railroad sold to bankers $6,500,000 first mortgage 4 percent bonds. On January 18, 1909, about 90 percent of the bonds had to be taken up by syndicate participants. No bonds were disposed of by the syndicate until September 1910, and from then on, at various dates up to February 28, 1911; thus the syndicate lasted more than 2 years.

9. In June 1909 the Seaboard Air Line arranged with bankers for the formation of a syndicate to guarantee the sale of $18,000,000 adjustment bonds at 70 percent. November 1, 1909, syndicate members took up about 90 percent of the bonds, which were disposed of in small lots between February 1910 and November 30, 1910, the syndicate thus lasting about 1½ years.

10. In January, 1910, bankers purchased $22,000,000 Chicago City & Connecting Railways collateral trust 5 percent bonds, and formed a syndicate at 91 percent. The syndicate expired in February 1912, leaving syndicate members with almost 90 percent of the total amount unsold in their hands.

It will be observed that all the above examples, the list of which could be considerably prolonged, relate to the period preceding the war. The selection has been so made purposely, because ever since the beginning of the war the conditions of the investment market have not been normal. During the greater part of that period they were abnormally adverse, while since the beginning of the present year they have been abnormally favorable. Therefore, the war and post-war periods offer no basis upon which to found permanent conclusions. However, a few examples from these periods, which might be greatly multiplied, may be inserted here:

11. In March 1916, bankers formed a syndicate to underwrite the offer to stockholders of $40,180,000 Chesapeake & Ohio Railway Co. 30-year 5 percent secured convertible gold bonds at 97½ percent and accrued interest. The stockholders subscribed for but slightly over 5 percent of the offering and the syndicate had to take and pay for $38,047,500 of the bonds, equal to 94¾ percent of the issue. At the time when the syndicate was called upon to make good its obligation, the bonds were selling in market at 94⅞ percent.

12. In January 1917, the Chicago, Milwaukee & St. Paul Railway sold to its bankers at 93½ percent $25,000,000 general and refunding mortgage 4½ percent bonds, series "A", due January 2014. On April 24, the syndicate was dissolved, the members having to take up 43 percent of their participations. The bonds at that time were selling in the market at 88½ percent.

13. In June 1919, the Baltimore & Ohio Railroad Co. sold to its bankers at 93½ percent $35,000,000 of 10-year 6 percent secured gold bonds. The syndicate

remained in force until January 30, 1920, when the members had to take up 23 percent of their participations. The bonds were then selling in the market at 83⅝ percent.

14. In July 1919, the Cleveland, Cincinnati, Chicago & St. Louis Railroad Co. sold to its bankers at 95½ percent $15,000,000 6 percent bonds. On December 1, 1919, the syndicate was dissolved, the members having to take up 11 percent of their participations. The bonds were then selling in the market at about 86 percent.

VIII. The Nature and Value of an Established Banking Relationship

The considerations which make a system under which railroads would offer their securities direct for public bidding precarious, hazardous, and futile are so patent and so conclusive that it may well be assumed that no reasonably informed person will contend seriously that it would be either advantageous or safe for railroad companies to pursue the course of attempting to market their securities without the trained cooperation of bankers.

The question remains to be discussed whether it is in the public interest that a railroad company should habitually deal with a particular banker and give that banker the preference when it has securities to be sold or underwritten as long as—and only so long as—it is satisfied with his services. The following considerations are offered in support of this, the existing practice:

1. The present plan enables a railroad to be certain of its ability to secure the necessary funds for its commitments.

It is of the greatest importance for a railroad, when making commitments for expenditures for improvements, new construction, equipment, etc., to be certain that it will be able to sell the requisite securities when such commitments come due and must be met. That is a fundamental principle of sound railroad financing.

In dealing regularly with a banking house of ample financial strength and wide connections, the railroad company is assured that it will be able to obtain the requisite funds, even in unfavorable times, because the banking house, in order to insure the continuity of the connection and the solvency of the railroad, cannot do otherwise than use to the utmost the resources and the facilities of connections and credits at its disposal to provide for the requirements of the railroad.

If, on the other hand, the railroad had been in the habit of selling its securities on a competitive basis, it would have no such friend in need, and the various bond and banking houses would naturally buy its securities only as it suited their own purposes. The strongest railroads have found themselves in the situation where large sums of money have been imperatively needed in most unfavorable times and where only their claims upon their regular bankers have enabled them to obtain the necessary funds.

It has of late years been a matter of not infrequent occurrence that during the pendency of applications for the approval by a public service commission of proposed bond issues, railroads have found themselves in need of temporary financial accommodation. For such accommodation, if not readily or opportunely obtainable from the railroad's banks and trust company connections, the railroad would turn to its banker.

Furthermore, in the case of bonds, the application for the issue of which is pending before a public service commission, it is not unusual for the banker. at the railroad's request, to obligate himself to purchase such bonds, subject to the approval of their issue by such commission, so that the railroad is protected against an unfavorable change in the investment markets while its application is being considered and is certain of obtaining the needed funds as soon as the application is granted.

The temporary financial accommodation previously referred to, and the definite sale of bonds in advance of, and subject to action by public-service commissions, have at times been of great service and value to railroads. It is doubtful whether either expedient would be at the service of a railroad if securities were sold by competitive bidding among bankers.

There have also been numerous instances when railroads which found themselves confronted with grave financial problems or in need of large sums for refunding purposes have applied to bankers to evolve plans and inaugurate measures for dealing with these problems comprehensively, for strengthening their credit, or for their financial rehabilitation without the expense and detriment of a receivership. The accomplishment of this task on the part of

the banker involves much time, thought, and study as well as a degree of financial risk and the assumption of great moral responsibility toward investors who, following the banker's advice, may aid in furnishing the requisite funds and who look to the banker to safeguard such investments.

Last April, for example, the New York, New Haven & Hartford Railroad Co. was faced with the maturity of $28,000,000 of debentures of which one half were held in France and one half in this country. The company's credit was not sufficient to make a new issue of securities possible. Failure to meet or extend the debentures at maturity would have meant bankruptcy.

With the active aid of banking houses through whom the debentures had been placed originally and with whom the company had been in consultation many months in advance, a voluntary extension of the debentures was secured. The negotiations involved a great deal of time, thought, skill, and effort, and, it is fair to say, could not have been successfully concluded, except through the influence, prestige, skill, and activity of the banking houses concerned.

It is a significant fact that most of the railroads which have gone into receivers' hands in recent years had followed the practice of selling their securities to different bankers at different times, and for the financing and support of, and advice to, such railroads, and the preservation of their solvency, accordingly, no single banking house felt itself responsible.[1]

2. A railroad's financial requirements must be foreseen and assured long in advance of the actual need, and the present practice makes that possible.

In July 1921, when investment conditions had not yet become propitious, an issue of the combined bonds of the Northern Pacific and Great Northern Co.s aggregating $200,000,000 fell due. The refunding of this vast amount of bonds was successfully accomplished with the aid of the bankers who had been concerned in their issue originally. The preparations for this refunding operation had been in progress for the best part of a year and were necessarily of the most elaborate character.

Manifestly, this immense operation could have been successfully carried through on an acceptable basis only by experienced bankers of high standing and Nation-wide connections, who were familiar with the history of the transaction and the manner in which the securities to be refunded were held, and who had adequate inducement to give to this complex and difficult negotiation the time and thought and the painstaking effort which its preparation required.

In June 1906, when the investment market in this country was practically at a standstill, American bankers placed an issue of 250,000,000 francs Pennsylvania Co. 3¾ percent bonds in France; in February 1907 an issue of 145,000,000 francs New York, New Haven & Hartford Railroad Co. 4 percent bonds in France and Germany; in March 1910 an issue of 150,000,000 francs Chicago, Milwaukee & St. Paul 4 percent bonds in France and England; and in February 1911 an issue of 250,000,000 francs Central Pacific Railway Co. 4 percent bonds in France and England.

All of these loans were negotiated at times when it was of great advantage to the railroads as well as to the general financial situation to obtain money abroad. They took many weeks of preliminary negotiation and complex arrangements and could not possibly have been negotiated on a competitive basis.

One railroad company alone must provide for $130,000,000 of maturities in 1925 and another for $50,000,000 the same year. It will inevitably be necessary for these companies to consult with bankers a long time before the maturity date, and devise plans for refunding, and obtain competent advice as to the best moment and method for carrying out these large transactions.

No banker could reasonably be expected to undertake the task and assume the responsibility of building up a railroad's credit, of studying and advising upon financial policies and methods, and putting his skill and placing power and sponsorship at its disposal if he had to expect that after having devoted his time, effort, and reputation to the work, the security-issues of the railroad would be thrown open to competitive bidding, whether general or confined to bankers, regardless of whether or not his own services were faithful and efficient and satisfactory to the board of directors and management.

3. The technical advice and the assistance growing out of the practical experience of the banker are of great value to the railroad.

[1] EXAMPLES: Wabash, Western Maryland, Wheeling & Lake Erie, Kansas City, Mexico & Orient, St. Louis & San Francisco, Norfolk & Southern, Chicago Great Western, Chicago, Rock Island & Pacific, etc.

A. Importance of Advice as to the Best Time to Issue Securities

In dealing regularly with one banking house, a railroad obtains the benefit of expert advice (and that from someone thoroughly familiar with, and interested in, its affairs) as to financial policy, as to the best and most opportune time for selling securities, and for providing for its financial requirements, as to the class and kind of securities best suited to conditions prevailing and to be anticipated, and as to the best method of offering them to the public.

The element of the selection of time is of much importance in itself, for it happens not infrequently that the lapse of a single week or less measures the difference between reasonably favorable and unfavorable or even totally forbidding conditions.

The ebb and flow of the currents in the investment markets depend on many and complex conditions and considerations, and it is one of the functions of the competent banker to keep himself posted as to affairs, aspects, and prospects in America, Europe, and elsewhere, and to anticipate in his judgment and advice their results and their effects upon the money and investment markets.

The advice and cooperation of the banker are especially important to railroad companies during periods of declining security values, with which the Interstate Commerce Commission has not yet had occasion to deal, inasmuch as during the more recent past there has been an almost continuous upward trend of prices. In times of declining markets for securities quick action and sound advice are particularly essential. Premature publication of a company's intention to issue new securities must be guarded against. Apart from other considerations, holders of its securities already outstanding might hasten to sell their holdings without waiting for full information. Such premature selling might so affect the market as to make the new transaction more costly or perhaps impossible.

Furthermore, public knowledge that one or more issues of railroad securities are contemplated might cause industrial concerns or foreign govenments or municipalities to hasten offerings of their own securities, as indeed has occurred in the past, so as to anticipate the railroads' offerings and get prior access to the investment market. The supply of available investment capital has, of course, its limitations, and in normal times the rule "first come, first served" does apply to a certain degree.

If a sale by public tender or by competitive negotiating or bidding among bankers were required, no one would be interested in supporting the market for a company's outstanding securities; in fact, prospective bidders would be benefited by a decline. On the other hand, with bankers having a continued interest in its welfare and a publicly recognized moral responsibility for its securities, the situation is quite different.

In this connection the question may be pertinent as to the relative desirability of the practice of selling securities before (or simultaneously with) the application to the Interstate Commerce Commission for approval, the transaction being made subject to the Commission's subsequent approval, or of delaying the offering until the Commission's approval has actually been obtained. On the whole, the first method, although not free from objection, would seem to be the safer and more desirable from the point of view of the railroads. It is quite impossible for any banker to definitely advise a corporation, with any degree of positiveness, as to the price its securities will command several weeks later. Too many elements of uncertainty are involved. The publication, weeks in advance of the actual consummation of the transaction, of the intention of railroad companies to make issues of securities might prove seriously detrimental as indicated in the preceding paragraph.

Everything considered, it would seem best that the companies should be accorded discretion to exercise their own best judgment in each instance whether they should sell subject to subsequent approval by the Commission, or should first obtain the Commission's leave for selling, at a price not below a stated minimum.

B. Importance of Advice as to Technical Details Surrounding Issuance of Securities

It is of great importance that care should be taken that new issues of bonds should comply with the statutory requirements of various States respecting legal investments of insurance companies, savings banks, and other fiduciary

institutions. Whether or not a given issue of bonds meets these requirements will often make a difference of several points in their value.

Investors attach considerable importance to knowing that the mortgages, trust deeds, etc., and all legal steps relating to the issue of securities which they are asked to buy have been carefully examined by bankers of repute and experience and their counsel, with a view to safeguarding the interest of the holders of the bonds as distinguished from those of the railroads, the makers of the bonds.

The mortgages and trust deeds under which the securities are to be issued, before being put in final shape, are carefully gone over by the banker, and his advice is given with the view to creating the best and most salable instrument satisfactory both to the public and to the railroad company, and having due regard both for the protection of the investor and for the future financial requirements of the railroad. Such advice is frequently, especially in the case of large refunding mortgages which are meant to be the principal means of raising money for the railroads for years to come, of very great utility. It is likewise greatly valued by the investor who has come to rely upon the tried and tested thoroughness and competence of experienced and highly reputed bankers to protect the interests of the investing public in respect of not only the intrinsic goodness of a security for which they become sponsors, but also in respect of the provision of the mortgage or trust deed appertaining to such security.

4. The bankers' dual obligation to the investing public, on the one hand, and, on the other, to the corporation whom he serves constitutes a protection to both.

The leading bankers could not maintain their position as such if they did not have the confidence of the investing public and a large following amongst investors, large and small, both here and abroad.

Careful analysis, continuous and watchful scrutiny, in respect of securities issued by him and of the companies concerned, are essential functions of the banker. In buying securities and offering them for sale, he gives public notice, so to speak, that he has examined into and satisfied himself as to their safety and merit.

The banker does not safeguard merely the technical and, to the best of his ability, the intrinsic soundness of the securities he issues; it is alike his duty and to his own self-interest to protect and stand behind the securities for which he is recognized as sponsor, just as it is his duty and to his own self-interest to satisfy himself by careful investigation as to the soundness of such securities, because the banker whose clients suffer loss through following his advice will very soon lose his reputation and the confidence and patronage of his clients.

The banker knows well that such reputation and confidence are the mainstays of the prosperity and success of his own business and, once forfeited, are exceedingly difficult to regain.

"PROTECTING" THE MARKET

The function of the banker in "protecting" the market for services issued through his house is of peculiar importance.

Reference has been made to the altered character of the investment market, in which a great army of small investors has come into existence to take the place of the larger investors who because of preference for tax-exempt securities can no longer be counted upon to be a considerable factor in absorbing railroad securities.

If that army, so important and desirable from the social and economic viewpoint, and created at such great cost and effort, is not to disintegrate again, it is absolutely indispensable that the market for the securities which they have bought be "protected" at least for a reasonable length of time after the offering (barring exceptional economic or financial changes)—which protection is one of the useful and legitimate functions of leading issuing houses and has no relationship whatever to what is usually termed manipulating or "rigging" the market.

It must be made somebody's business to see to it that if the investor wishes to sell within a reasonable time after having bought, he can, under normal conditions, find a market at or near the price at which he bought.

To provide such a market by being able and willing to a reasonable extent to repurchase bonds sold by him is part of the business of the banker who made the public offering—provided that he has a definite and acknowledged relationship toward the company whose bonds he has offered. If he has no such relationship, if the public offering is simply the result of competitive

bidding, either general or limited, the banker may be expected to be apt to feel that his functions are completed when he has marketed the securities.

The result would be that the immensely valuable work which had been done lately of popularizing railroad bonds might be largely undone, the vast clientele which had been created for railroad bonds might be materially curtailed, and the resulting diminished demand for railroad bonds could not fail to be reflected in the price level which they would command.

The continuing responsibility of the banker for bonds which he has offered and sold under the existing system of dealing between bankers and railroads is an exceedingly valuable element from the point of view of the small investor and a strongly steadying factor in the market for railroad securities. That responsibility would be jeopardized by competitive bidding, whether general or limited.

It is interesting to note in this connection that even so eminently successful a public offering as that of the recently issued United States Government 4¼ percent bonds, was followed by a substantial decline in the market price of those bonds below the price of issue. There being no one responsible for the "protection" of the market for those bonds, the price declined quickly from the issuing price of 100 to 98.90 percent, which in the case of the world's premier government security has considerably greater significance than a like decline would have in the case of a corporate issue.

It is to the interest of a railroad company that its securities should be absorbed by the investing public and that their market value should be maintained, under normal conditions. It is more important to the railroad industry at large that a favorable reputation, the good will of the investing public, and a broad, steady demand for its securities should be preserved than that in every instance the very top-notch price should be obtained to which, through taking advantage of fortuitous circumstances, the purchasing banker may be driven. To disappoint and disgruntle the investor by selling him securities at unduly high prices, which will not stand the test of the workings of ordinary supply and demand, is in its ultimate consequences to be "pennywise and pound-foolish", especially since railroad securities are more and more coming into competition for public favor with industrial securities.

The end the railroad company should always have in mind is to maintain a broad and stable market for its securities, and to that end wise discretion in the interest of railroad credit generally and of the particular borrower may even make it desirable in given instances, under all the surrounding circumstaces of the case, to accept an offer which would enable resale to the public under tested and responsible auspices at a fair and reasonable price, rather than an offer of an extreme price with the resulting consequence of the resale to the public being attempted necessarily at an unduly high level.

It may safely be said that such railroad issues as are known to be under the habitual sponsorship and consequent moral responsibility of well known and strong bankers have a wider and steadier market and command better prices among investors than those which are not under such auspices and responsibility.

If the sale of securities were thrown open to competitive negotiating or bidding, either general or limited, the possession of large capital would tend to become prime requisite for dealing in securities, and the financier or combination of financiers controlling the largest amount of capital would have a much more potent advantage over others than under now existing conditions.

The exercise of care, skill, industry, scrutiny, and the sense of moral responsibility toward clients, which now are and always have been the prerequisite for acquiring the reputation and the public confidence upon which an investment banker's position depends, and without which it cannot be maintained for any length of time, would no longer be essential.

IX. Summary and Conclusion

A. The vital necessity is to obtain for the railroads the assurance of adequate capital upon favorable terms.

B. The existing practice of selecting, and dealing with, a particular banking house as long as its services give satisfaction, is an outgrowth of actual experience in the effective marketing of securities.

C. In dealing with so delicate a matter as security markets it is of primary consequence that any plan adopted for the sale of securities shall command the utmost confidence on the part of investors.

D. The existing practice has proven itself, in numerous instances, of the greatest utility to railroad corporations, and actual experience demonstrates that the remuneration to bankers and syndicates is but a fair equivalent for very real services actually performed and risks assumed, and that the average of such remuneration, over a term of years, has afforded no more than a reasonable return upon the capital involved, and due compensation for the work rendered.

E. The existing practice has been found effective by industrial corporations not subject to public regulation, and it is the method employed by many foreign governments and municipalities in the issuing of securities.

F. Some of the advantageous characteristics of the present practice are:

1. The relationship between railroad and banker is wholly informal and continues only as long as it is deemed advantageous to the railroad by its officers and directors.

2. The relationship, while in no way limiting the railroad's freedom of action, does impose upon the banker definite and continuous duties and obligations.

3. The bankers have no power to determine the decision of railroads in such matters.

4. The banker is not only the distributor of and propagandist for railroad securities, but he fulfills, at his own risk and cost, the important and valuable function of steadying and protecting the market for such securities.

5. The railroad receives continuously the knowledge, services, skill, standing, financial advice, and financial potency of the banker in both good and evil times.

6. The banker advises as to the financial situation and policy of the railroad, prepares plans for meeting requirements, recommends the kind and character of the security to be created, scrutinizes mortgages and trust deeds, and indicates the best moment at which to sell.

7. The bonds of the corporation represent a promise to pay. The value of that promise depends not merely upon the tangible security offered, but also upon excellence and fidelity of management. While strictly refraining from any attempt to influence the operating and tariff policies of the railroad, it is the banker's duty and self-interest, to the best of his ability, to promote wise and sound management and safe financial policies on the part of the corporation, the securities of which he has issued and for which he has consequently assumed moral sponsorship before the investing public.

8. Even where affiliations between particular bankers and railroads avoid nominal competition, there is a potential competition which operates powerfully in the following particulars:

(*a*) The fact that complete publicity is by law enforced as to the terms upon which security issues are obtained by bankers naturally causes both the banker and the railroad to seek to give, on the one hand, and to obtain on the other, the best terms which conditions and circumstances warrant.

(*b*) The fact that the terms involved in a contract between the railroad and the banker must be approved by public authority is a moral guaranty that such terms will be proposed as will stand well-informed scrutiny.

(*c*) If railroads find that other companies are securing better terms through other bankers, it is inevitable that other bankers will ultimately obtain the business.

(*d*) If railroads cannot obtain what they consider satisfactory terms from their regular bankers, they are entirely free to terminate the negotiations and do business with others.

(*g*) There is no reason to think that, year in and year out, railroads would obtain higher prices for their securities under any form of competitive negotiating or bidding than under the present practice. There is every reason to think that the stability and broad receptiveness of the market for railroad securities would be lessened and the interests of the investors less carefully and responsibly safeguarded.

(*h*) Many, if not all, of the effective values of the advantages (both to the railroads and to the investing public) inherent in the present practice, would be eliminated by competitive negotiating or bidding, whether unrestricted or confined to bankers. No banker could be expected to give his time, effort, reputation and responsibility, material and moral, to the financial affairs of a corporation if he is wholly uncertain whether he will reap any return for his services, as must necessarily be the case in the event of competitive negotiating or bidding.

I. To change the prevailing practice would mean to give up definite and tested benefits, alike to the railroads and to the public, for the sake of one wholly problematical advantage.

J. Practical experience shows that the operation of the present method under public supervision and with full publicity attending it, assures more success than any other plan yet proposed or practiced in obtaining the necessary capital for the railroads upon favorable terms.

K. To the extent that the terms upon which securities are sold have a bearing upon the rates paid by the public for railroad service, the present method secures to the public, insofar as that item is concerned, the lowest burden upon the rates and the greatest assurance of the railroads being able to obtain the capital to provide necessary facilities.

CONCLUSION

To compel railroads to have recourse for the sale of their securities to competitive negotiating with or bidding on the part of bankers and brokers, or to direct offerings to the public, would be to run counter to the practice and experience of every country in the world.

It would confuse and trouble the investing public and destroy elements and features of evident and proved value for public protection.

It would tend to make the possession of capital the sole requisite for dealing in securities, irrespective of skill, care, reputation, and the confidence of investors.

It would limit, hamper, and restrain the flow of capital into American railroad securities and cause delay, uncertainty, risk, and damage to railroad corporations.

Railroads and other corporations should be left free, under the responsibility of their board of directors, and subject to such authority over the issue of their securities as is now exercised by the Interstate Commerce Commission, to deal with whatever banking houses they deem it in their best interest to employ.

They should neither be bound by contract or control to deal with any one banking house exclusively, nor forced by statute or regulation to take the chances involved in competitive negotiating or bidding among bankers or of direct dealing with the public.

Respectfully submitted.

KUHN, LOEB & Co.

OCTOBER 25, 1922.

COMMITTEE EXHIBIT (No. 2)

COMPETITIVE BIDDING FOR EQUIPMENT TRUSTS

FOREWORD

An article on the subject of competitive bidding for equipment trusts appeared at some length in the New York Times of January 30, 1928, and therein tne writer of this booklet was quoted as follows:

"Due to extraordinarily easy conditions in the money market, banking firms have been basing bids in competition for equipment trust securities on a narrow margin of profit not at all commensurate with the services performed or the banking risk entailed through a possible reaction in bond prices.

"As a result, equipment trusts have been offered at prices which many of the former large buyers of car trusts, such as insurance companies, have not hesitated to call excessive and out of line with the market. The small investor and less experienced buyer has been invited to pay prices for equipment trusts which the larger and better versed buyers consider to be above the market and in fact the larger buyer, by avoiding the original offering, has been able to wait out a situation and make a 'close-out' bid at a lower price for an unsold balance, which more than once has remained on the shelves.

"The actual sufferer, therefore, is the small investor, or the very individual the protection of whose interests has appealed most strongly to the governmental authorities. If the protection of the investor has not been accomplished during a rising and very favorable bond market, there is much less likelihood that he will benefit during a period of declining prices, for at such times not only is the larger institutional buyer unwilling to purchase offerings unless they are priced exactly on the current market conditions, but his experience

even then causes him to hold back because of his expectation of lower prices for all investment securities."

Shortly after this quotation appeared a distinct tightening of conditions in the money market became evident, and with it a drop in the price for equipment trusts which was not only severe but also more drastic than it should have been, owing to the artificial price level created through competitive bidding. Railroads which contemplated the placing of equipment trusts quickly found that houses which enthusiastically pursued every opportunity to bid for such offerings under easy-money conditions were reluctant to bid at all in the face of tightening money. Equipment trusts as money continued to tighten became an unpopular security with bankers who had been "stung" at top prices, and when at a later date one of the leading railroads of the country came into the market to dispose of a substantial issue of car-trust certificates it found that instead of 30 or 40 bidders being anxious to submit bids for its car-trust obligations only a few laggard bidders were in evidence, these being actuated, perhaps, by a desire for publicity, and whose bids were then found to be even lower than conditions warranted. Finally, with the approval of the Commission, this road, the Southern Pacific, was allowed to dispose of its car-trust certificates to its own bankers.

In selling this issue to its bankers the carrier received a better price than the highest bid offered in competition, and the issue was sold in a prompt manner calculated to strengthen the entire equipment-trust market. As this news became public it was rumored that the Interstate Commerce Commission, because of the recent criticism leveled at competitive bidding, was willing to give the original order of doing business a new trial. Unfortunately, such rumors may have been regarded as a reflection on the judgment of those responsible in the first place for the inauguration of competitive bidding.

There are officials in Washington who at one time sincerely believed that all railroad securities should be sold under terms of competitive bidding. In some channels the 1926 ruling on equipment trusts was reported to be an entering wedge which would lead to competitive bidding for all forms of railroad securities. It has been shown that such a system would have been a great detriment to the credit of the carriers.

Competitive bidding for equipment trusts was an experiment and as such developed unfavorable factors which were not originally apparent. However, the Commission still firmly maintains its position and in its approval of the Chicago, St. Paul, Minneapolis & Omaha issue dated August 31, 1928, restates its attitude as follows:

"During the early part of the current year equipment obligations sold in some instances on such bases that the cost to the carriers was as low as 4.23 percent. Certain developments in the financial situation during the past few months have narrowed the investment market, with a resulting increase in rates on long-term securities, including equipment obligations. We feel, however, that this condition does not warrant a change in our policy with respect to the disposition of equipment obligations. Moreover, we are of the opinion that we should do nothing that would tend to discredit the method of disposing of equipment obligations that has been employed with success for the last 2 years or that would result in the withdrawal of the support of the investment houses that have participated in the sale of such securities. We can hardly expect bankers to continue to submit tenders for equipment obligations on invitation from carriers if the carriers may reject all bids and after thus testing the investment market place the obligations privately. We are of the opinion that if the offers received for the equipment obligations are not satisfactory the carriers should again call for tenders and accept the most favorable bid or should reject all bids and resort to temporary financing until there is such an improvement in the investment market as will enable a sale to be made on satisfactory terms. In accordance with these views, authority to assume obligation and liability in respect of the certificates under consideration will be granted upon condition that the certificates again be offered for sale at competitive bidding and sold to the highest bidder."

The recommendation which forms the basis of this most recent report, namely, that equipment trusts under conditions where acceptable bids are not forthcoming should be readvertised or that the equipment should be temporarily financed is make-shift advice, in the opinion of the writer. The obligation of a recognized municipality may be so handled but it is on an entirely different basis. Whether a municipal obligation is sold to one investment house or to another is of little consequence, and if an issue is not disposed of under

terms of the original sale, it can be readvertised at a later date and sold with no adverse consequence to the obligor.

The issuance of equipment trusts is predicated upon orders placed with car and locomotive builders for the purchase of new equipment to be delivered at a very definite time, and which must be paid for as this equipment is delivered. Under the time-honored practice of doing business with its own bankers, the officials of a railroad, even in an unfavorable market, felt in position to arrange if necessary for a temporary loan with such bankers, rather than be forced to offer its equipment trust certificates under unfavorable market conditions.

Generally speaking, it is impossible for a carrier to provide for temporary financing of equipment purchases without the assistance of bankers closely associated with the carrier. The validity and security of equipment trusts is based entirely on the theory of a conditional sale, that is, a purchase of the equipment by the carrier from the trustee on such terms that title to the equipment is retained by the trustee as security for the payment of the equipment obligations. Obviously, when a carrier has once acquired title to equipment by the use of treasury funds or as a result of temporary financing, a conditional sale of such equipment to the carrier can no longer be made and the whole basis for the equipment trust is destroyed. Moreover, most carriers have outstanding mortgages which contain either a general clause subjecting after-acquired property to the mortgage. or, even in the absence of a general after-acquired property clause, a clause providing that any equipment or interests therein which the carrier acquires after the date of the mortgage shall become subject to the mortgage. Whenever there is such a mortgage, the carrier's interest in any equipment acquired through temporary financing would become subject to the mortgage, and it would not thereafter be possible to place an equipment trust on such equipment except subject to the lien of the mortgage.

If, however, the carrier proposes to sell equipment trust certificates to bankers closely associated with it, it may procure the use of the necessary equipment when it is needed and still await a favorable market for the issue of its equipment obligations by having its bankers arrange to purchase the equipment and to lease it to the carrier. Thus no title to the equipment vests in the carrier and, when the equipment trust is to be issued, the bankers can transfer title to the equipment to the trustee, free from incumbrances. However, such an arrangement necessarily involves close contact between them and the carrier, since bankers would not be interested in acquiring equipment for a carrier except as part of the service rendered by them to their regular clients in anticipation of permanent financing.

Competitive bidding, however, has impaired the relationship between the railroad and its bankers, and has actually relieved the bankers of responsibility for arranging any emergency accommodations.

Moreover, the readvertisement of an issue unless the market itself has given strong evidence of a more favorable trend will not result in any improvement of the bids received by the carrier and if a readvertisement produces a lower bid this is a decidedly unfavorable reflection on the credit of the carrier—or will the Commission recommend a third, fourth, or fifth readvertisement?

The opinion is therefore widespread that the relationship between the carrier and its accepted bankers is not only a valuable one but one to be protected and encouraged, as evidenced through quotations which are attached at the end of this discussion, and which were received from investment dealers through the country in answer to a brief inquiry sent out by Freeman & Co. in January 1928.

COMPETITIVE BIDDING FOR EQUIPMENT TRUSTS

It is undoubtedly very hard for the members of any governmental regulatory body to accept facts which cannot actually be substantiated with tabulations of figures. The writer feels that it is fair, however, for the Interstate Commerce Commission to admit as evidence hundreds of adverse opinions received from investment dealers throughout the country in connection with the question of competitive bidding for equipment trusts.

A serious impairment of the popularity of equipment trusts with the public has occurred. This situation, unless corrected, may eventually deny to the carriers the cheapest and soundest method of financing the purchase of rolling stock.

The regulation of the issuance of railroad securities, as is well known, was vested originally in the Interstate Commerce Commission under the Esch-

Cummins bill. A portion of this bill, namely, section 20a, outlines the powers of the Commission in relation to the approval of securities issued and gives the processes through which railroad securities are to be sold.

It is set forth that the Commission not only may supervise the price received for an issue of securities but that it may also, to a certain extent, supervise the disposition of the cash received for such securities. This, in effect, gives to the Commission a privilege formerly entirely controlled by the board of directors of a railroad. It is claimed that the original intent of section 20a of the Transportation Act of 1920 was only to regulate the issuance of securities in the public interest, and that when the Commission arbitrarily takes upon itself what at times amounts to the function of management, it acts in excess of its authorized powers. This contention has been prominently brought to the foreground through the recommendation issued in 1926 to the effect that issues of equipment trust certificates should thereafter be sold under terms of competitive bidding.

It is perhaps in order at this point to outline most briefly the usual method employed by the Commission in supervising the financial arrangements of the carriers. Division 4 of the Interstate Commerce Commission has been entrusted with this work and under section 20a of the Transportation Act of 1920 any railroad wishing to sell its obligation must make application through this division for authority to issue such obligation according to the rules and regulations as embodied in the act.

Division 4 is under the supervision of a director of finance, who is in close touch with security market conditions from day to day, and while the judgment exercised is tremendous, in order that an unbiased survey of the situation be presented, it is proper to state that the viewpoint taken by the director of finance usually has been a broad and reasonable one. It is not with the personnel of division 4 nor with that of the Commission that the writer has predicated his argument. During 1922 a public hearing was held on the subject of competitive bidding and it was evident then that the trend of the opinion of certain Government officials was toward competitive bidding, not only for equipment trust certificates but also for all forms of railroad securities. It was not until 1926 that a definite recommendation was issued to the effect that competitive bidding must be employed by the carriers in disposing of equipment trust certificates.

At the time of the issuance of the 1926 recommendation covering competitive bidding the Commission stated its opinion more or less as follows: In the first place it took the position that equipment trust certificates were so standardized and were of such similarity, both as to the legal procedure governing the issuance of such securities and as to the collateral underlying the same, that their issuance became more or less a matter of form. It also set forth that it believed that such substantial savings could be made in discounts through competitive bidding that the public interest would be greatly served through the natural broadening of the market for equipment trust securities. A paragraph from the opinion issued by the Commission dealing with the issuance of equipment trusts during 1926 follows:

"It is our opinion, however, that the sale of equipment trust certificates by public competitive bidding will be effective in so widening the market for these securities as to assist in the effective and economical financing of railroads by means of other securities, such as may from time to time become necessary."

In other words, the Commission at that time felt that a broadening of the market for equipment trusts would come about as a result of competitive bidding and that, therefore, his broadening would tend to improve the entire credit structures of the various carriers.

The Commission then summed up its attitude more or less as follows:

"Equipment trust certificates are of a uniform character, and the relative financial strength of the issuing carriers is not a very important factor in determining the price at which these securities are to be sold. Equipment trust securities, which at one time were sold largely to purchasers such as insurance companies and large banks, have become popular with the smaller investors, and it seems to us that the sale under competitive bidding will tend to widen the market for these securities and produce capital for the railroads under cheaper terms."

The writer does not hesitate to state his belief that these two major contentions of the Commission have been proved to be wrong and that not only has the public interest been damaged through competitive bidding, but also that competitive bidding, far from broadening the market for equipment

trusts, has resulted in creating a feeling of distrust regarding the marketability of equipment trust securities which has narrowed the market for car trusts in all parts of the country. This contention is backed by letters on file received from dealers throughout the Nation whose contact with investors bears a relationship similar to that existing between lawyer and client and physician and patient.

The writer, therefore, is not at all concerned with the much-mooted question as to whether or not the Commission in prescribing competitive bidding for equipment trusts has usurped the functions of management of the carriers in what may be an unwarranted manner. He believes that the action of the Commission has not been a sound one and that a reversal of its recommendations should be forthcoming to correct a condition which in the long run will spell economic loss for the carriers.

He believes that the Commission's position that equipment trust securities are uniform as regards methods of issuance and types of collateral is not a correct one. In a very ample textbook on equipment obligations issued by Kenneth Duncan, Ph.D., after a study made at the University of Michigan, the reader may quickly find that history shows that the legal procedure attendant upon issues of equipment trust securities is most important and that a very critical attitude has been evidenced in past years by courts throughout the country in the adjudication of contentions arising through foreclosure under equipment trust liens.

Professor Duncan states that quite a number of years ago the confidence of investors was badly shaken through neglect by those creating equipment trust obligations to see that there were no irregularities and in very recent years the Investment Bankers Association found it necessary to recommend that laxity on the part of corporate trustees of equipment trusts be corrected before serious damage resulted to the holders of such notes, certificates, or bonds. Professor Duncan states that while the judicial status of railroad equipment obligations has been greatly strengthened during the past years by court decisions, there exist divergent attitudes under different jurisdictions throughout the United States, which have not been uniformly determined at common law. To understand that this may be true it is only necessary for the reader to realize that equipment trusts, for example, may be issued under various procedures, the three most important of which are absolute sale, conditional sale, or lease with option to purchase.

It is therefore evident that the issuance of equipment trust securities should be supervised by banking institutions and lawyers familiar with such matters. It is not fair to investors to permit the drawning of the governing indenture to be handled exclusively by the lawyers for the carriers. The correct marking of the units of equipment, for example, may be of the greatest importance in certain States of the Union which even prescribe the exact size of the letters which the name of the trustee-owner must take to effectively establish its position in foreclosure proceedings.

The Commission itself, through its regulation issued regarding equipment trusts secured on rebuilt equipment, entering into lengthy requirements concerning the question of the actual cash percent of the original equipment, the depreciated value of the same at the contemplated time of rebuilding, and other technical matters, admits that equipment trust certificates are by no means uniform in issuance.

To the mind of the equipment trust specialist, many conditions affecting the solidity of an equipment trust obligation exist which on the surface are not apparent to the small investor who may be the purchaser of the given equipment trust certificate. Fluctuations in the cost of units of equipment make it evident that an issue secured on equipment purchased under very favorable terms, even though the cash payment be smaller, may be preferred over one secured on equipment purchased at temporary peak prices of any one year though the actual down payment in cash be larger on the latter issue. Moreover, certain kinds of equipment, such as standard types of box cars, have a readier resale and are to be preferred as collateral over such types of equipment as gasoline motor cars, ditching machines, lifting cranes, and wrecking machinery, all of which types have been included in latter-day equipment trusts.

A very recent application filed by a well-known carrier with the Commission included second-hand dining cars in the equipment. The question of the inclusion of rebuilt equipment is also an important factor, as is the setting up of the maturities with regard to the actual ratio of depreciation on the collateral. In recent years it has become somewhat of a practice to defer the earlier

maturities under an equipment trust, which to the equipment specialist is simply a method of diluting the security and also of modifying the rather stringent procedure which heretofore surrounded the methods employed in setting up an equipment trust unless the original amount of cash equity has been commensurately increased. Because of such situations the position of the Commission that all equipment trusts are alike and that the question of the credit of the carrier is more or less a minor one, in the opinion of the writer, is not acceptable.

At the original hearing in 1922 regarding the proposition of competitive bidding, it was strongly argued that the marketing of such securities should be made not only through investment houses entirely familiar with equipment trust procedure but through the actual bankers for the railroads expecting to issue such securities. The writer heartily subscribes to this opinion and believes that no investment house is so well able to dispose of an equipment trust as is the banking house which through long association with the problems of the carrier is able to give it not only a fair price but expert advice in marketing its securities. He believes that the present unpopularity of the equipment trusts can be directly traced to the handling of such issues by houses who felt no responsibility whatsoever with regard to supporting the market for such securities after the original sale.

The writer feels whole-heartedly that the supervision of the Interstate Commerce Commission regulating the issuance of railroad securities has been of benefit. However, it seems that "a penny wise and a pound foolish" policy has developed with regard to equipment-trust securities.

It is certainly impossible to obtain the proper national distribution for equipment-trust securities without giving to the small investment broker throughout the country a fair commission for his services in placing equipment trusts with investors. There is no doubt but that equipment-trust certificates are easier to sell than are many other forms of securities, and it is not the contention of the writer that this commission should be a large one. He believes that enough leeway should be given to the purchasing house, which in his opinion should be the accepted banker for the carrier, to enable this banking house to redistribute a portion of its limited profit in order to obtain permanent distribution and to be in position to protect the secondary market of the securities so sold.

Certainly to the mind of a specialist in equipment-trust securities who has watched the marketing of this form of security for a good many years, the prices paid by inexperienced bidders under the recent money conditions prevailing were nothing short of amusing. This is an advertising age and an extreme premium has been placed in business channels upon publicity of every sort so that investment houses are now using every available method to keep their names before the public, even including the use of radio circuits.

It is therefore easy to see that a house which has not been successful in obtaining business through its regular channels may be persuaded to enter a bid for an equipment-trust issue, feeling that no profit or even a small loss will be a worth-while procedure from the standpoint of publicity. A house specializing in inactive or high yield industrial issues may decide that a conservative railroad equipment-trust offering helps, as the saying goes, to "dress up the list." Of course, in such an instance the sufferer is the general public, which may be invited to purchase such securities at too high levels. Thirty-five or forty houses bidding on practically no margin of profit for equipment-trust issues during 1 month and a few weeks later under tightening money conditions less than five very weak bids available for a better issue, is a situation for the Commission to ponder over at some length.

What has actually happened during 1928 was foretold in 1926 by a committee of the Investment Bankers Association when it was predicted then that while in good times high prices would be realized, in a tight money situation the railroads would not only fail to receive proper prices for their securities under competitive bidding but that they would lose the contact with their regular bankers, which despite many attacks on the part of radical politicians may be conceded as a most valuable connection for any corporation, whether it be railroad or industrial. It is certainly the feeling among investment houses throughout the country that securities brought out by the regular bankers for railroads are more fairly priced than those offered to the public by investment houses which have purchased such securities under terms of competitive bidding and as a matter of opportunity to do business.

It is therefore to be hoped that the members of the Interstate Commerce Commission will be ready to recognize that an actual error occurred in the inaugu-

ration of competitive bidding for equipment-trust securities. Proof is contained in the following comments received from all parts of the country. An overwhelming preponderance of opinion, not only to the effect that competitive bidding for equipment trusts has been a failure but that the market for these bonds has been greatly narrowed through the regulatory action on the part of the Commission, cannot be lightly dismissed.

EXTRACTS FROM LETTERS RECEIVED BY US, CONCERNING COMPETITIVE BIDDING FOR EQUIPMENT TRUSTS

POPULAR POSITION CAN BE LOST

To not practice competitive bidding in the selling of securities, appears on first thought, to be derogatory to economic law. Looking at the matter from all angles we can see lurking dangers in this method used by the railroads to sell their equipment trust securities. While it is undoubtedly true that the railroad companies will receive slightly higher prices for their securities now, the narrow margn of profit made by dealers in distributing these securities, and the high price the public is obliged to pay in buying them, will most certainly ultimately act to the disadvantage of the railroads. The popular position now occupied by this class of securities with the investing public can certainly be lost through a process of overpricing. Even the handling of the securities can lose favor with the investment dealers if the profits are not permitted to remain reasonable, and their customers be well served by a security which is not overpriced.

To save the popularity of equipment trust securities with the public and thereby help the railroads ultimately, we recommend the discontinuance of the practice of competitive bidding in the sale of equipment-trust securities by the railroads. This is an expression of our feelings as well as that of our constituency.

THE CITIZENS NATIONAL BANK OF EVANSVILLE,
Evansville, Ind.,
By CHARLES E. HOWARD, *Manager Bond Department.*

MORE HARM THAN GOOD

However it has been our thought that competitive bidding in the buying of securities has perhaps done more harm than good, and has resulted in unduly high prices to the public. Too often, therefore, after the closing of the syndicate, prices have not been maintained.

WM. CAVALIER & CO.,
San Francisco, Calif.

LIABLE TO OVERPRICE

In addition I do not believe that competitive bidding on equipment trusts will make the strongest issues still more prominent. The various types of houses who may become interested are liable to overprice some issues just because of their desire to get equipment trusts to sell—the answer is obvious, that the general regard for equipment trusts must suffer.

ROBERT GENNERT MACKS,
Denver, Colo.

CHARACTER OF PAST PERFORMANCES MATERIAL FACTORS

In the second paragraph of your letter you have brought out certain points which we believe to be correct, and which need not be recited. While the idea of awarding to the highest bidder on first blush appears to be the correct attitude, yet where a party has a piece of work to be done, and asks for competitive bids, and where it would seem that the lowest bidder for the performance of a certain job would be the one to select, yet we all know that other circumstances enter into the situation, the responsibility of the bidder, and the character of his past performances are very material factors, and frequently a higher bidder will get a certain job for such reasons. Coming back to the

question of competitive bidding for equipment issues, a certain firm of bankers with small distributive capacity, in a market such as we are having now, might overtop a bid made by another firm with good distributive capacity and the result would be that the equipment trust issues would lie on the first dealer's shelf a long time, thereby hurting the market for subsequent issues of bonds of the same railroad, when next in the market.

WURTS, DULLES & CO.,
Philadelphia, Pa.

SO HIGH PRICED

Among the principal reasons that we are not interested in equipment trusts today is the fact that they are so high priced and that the margin of profit is not sufficient to warrant our taking a chance on being able to distribute them successfully.

FREEMAN, SMITH & CAMP CO.,
Portland, Oreg.

FAVOR THE OLD METHOD

From the standpoint of the dealer, we are inclined to favor the old method of sale and this attitude, we feel, is not entirely selfish. As you say, over-pricing has resulted from competitive bidding, which together with the small margin of profit now available to the retail distributor, makes participation in the sale of equipment trust securities less desirable than it formerly was. This latter condition also tends to produce sales in large rather than small blocks which makes for a less satisfactory secondary market, besides, as you say, contributing to the possibility of "a situation which may prove costly when less favorable conditions govern the money markets."

The discussion, as we see it, really boils down to the question as to whether the public will benefit most by having the railroads receive a somewhat higher price for these securities temporarily, or whether more profit would accrue from having securities brought out on a strictly conservative basis, and with a satisfactory market after the original offering. The latter, we think, would be the more desirable of the two.

THE HUFFMAN CO., *Dayton, Ohio.*

DISTRIBUTORS ENTITLED TO REASONABLE PROFIT

It seems to me, with reference to equipment-trust issues, that a more sound and advantageous policy for all concerned would be for the Interstate Commerce Commission to allow customary bankers for railroads to buy equipments in the former way, the Commission reserving the right to order competitive bidding if the price was not, in its judgment, fair and satisfactory. The difference of ¼ or ½ percent in the amount received by the railroad would hardly justify its putting its securities in a position of disfavor and uncertainty with the public.

It is also to be considered that there are certain necessary costs of distribution and that distributors are entitled to this cost plus a reasonable profit.

With the Commission exercising the control and authority it has in the manner suggested above the interests of the public, railroads, distributor, and investor—all of whom have rights in the matter—could be properly protected.

WM. MARRIOTT CANBY,
Philadelphia, Pa.

PRICED TOO HIGH

Have always felt in offering an equipment-trust security was offering my clientele one of the safest type of investments. No doubt you have noticed that my business with you on this particular class of issues has not been as large as in days gone by, due to the fact that my clientele feel that this type

of security is priced too high, which have understood has been caused by competitive bidding by the brokers for this business.

WARREN C. M. BINCKLEY,
Reading, Pa.

DISTRUSTFUL OF PRACTICE

We have your letter of February 2 regarding sale of equipment-trust securities, and while our experience with these has been simply that of the small distributor and not at all from the angle of the original purchaser, we are distrustful of the practice of competitive bidding for railroad securities of all kinds.

In our opinion the point that you make as to the deviation of car trust indenture provisions under stress of competitive bidding from the standard safeguards which have given equipments their remarkable record for security is one of the strongest arguments against competitive bidding for this particular type of security.

WILLIAM O. KIMBALL & Co.,
Boston, Mass.

SECURITY NEGLECTED

While, of course, it is true that the railroads have been receiving more for these securities under this practice, it just seems to us that perhaps the restrictions surrounding their issuance are not quite as well regarded as they were before the sales were made to some one particular house. The competition by banks and bond houses for good loans has been so strong, that many times thes good old-time customs of seeing that plenty of security is obtained are being neglected to a great extent, and we notice it more and more every day. We are so far away from the source of the issuance of bonds and securities of the type mentioned, that we want to know we are doing business with a reliable house, and one that is going to take everything into consideration, before buying an issue. This might not be watched so closely if the securities are sold under terms of competitive bidding.

CEDAR RAPIDS SAVINGS & BANK TRUST CO.,
Cedar Rapids, Iowa,
By L. J. DERFLINGER, *Cashier.*

PROFIT MATERIALLY REDUCED

Since the profit has been materially reduced through competitive bidding methods we have been forced to discontinue what little effort we had put forth in the distribution of this type of security, on account of the small volume which we would be able to handle not offering us sufficient profit to bother with.

We can readily see that competitive methods might work out advantageously for the railroads themselves under existing conditions, but feel that in the long run the practice formerly followed would have a more beneficial effect from the standpoint of the investor, the distributor, and the railroads. It would be our opinion that we would welcome a return to the old practice.

M. E. TRAYLOR & Co., INC.,
Denver, Colo.,
By WALTER E. OLIN, *Vice President.*

REGRET SUCH CLOSE TRADING PHILOSOPHY

We regret that such intense, competitive, dollar-and-cents, close trading philosophy has crept into a business as personal as the retail distribution of investment securities. After all, if a house of retail distribution has any economic justification, it is that it renders a personal service to an individual

who has funds to invest and to a corporation which needs funds for the conduct of its business.

BANKS, HUNTLEY & Co.,
Los Angeles, Calif.

RETURNS TO CUSTOMER LOW

Reading the orders of the Interstate Commerce Commission, permitting the sale of these bonds as the same appear in the United States Daily, it has been obvious to me that the underwriting houses were not making enough money to continue in business if they were forced to handle this kind of securities alone, and I know from the offerings which we have received, including yours, that the selling commission you were able to pass along to the retail distributor has been so small that the handling of these securities has been unprofitable. Incidentally, the returns to the customer have been ordinarily so low that the customers to whom one is able to distribute the securities have been greatly reduced. Probably to date in a bull market the result has been at least temporarily advantageous for the borrower, but that this condition can continue indefinitely is at least doubtful.

CANTON O'DONNELL, *Vice President*,
THE UNITED STATES NATIONAL Co.,
Denver, Colo.

INVARIABLY TAKE A LOSS ON LIQUIDATION

Please be advised that within the last year we have refrained from taking on any equipment issues, only in such cases where an urgent demand compels us to do so, for the reason that our experience has been that the prices are so extremely high when the offering is made, that if any of our loyal clients wish to liquidate, invariably it means that they must take a loss.

ZIMMERMAN & Co., *Pittsburgh, Pa.*

DOUBT RAILROADS WOULD BENEFIT

It is our opinion that if money conditions get bad, the railroads would naturally receive a lower price for their equipment trust obligations, and in the long run it is doubtful to us if the railroads would benefit from competitive bidding.

COURTS & Co., *Atlanta, Ga.*

MARGIN OF PROFIT SO LIMITED

We have always specialized in equipment trust securities as you know, but the margin of profit has been so limited in the last few years that our business has fallen off 50 percent and it pays us to devote our efforts to other classes of securities. Even in very high class railroad bonds, we receive three fourths to a point profit for handling bonds of this character.

NEWBOLD & Co., INC.,
By THOMAS R. NEWBOLD, *President*,
Colorado Springs, Colo.

RAILROADS BETTER SERVED BY NONCOMPETITIVE SALE

Generally speaking, it is our feeling that the railroads in the long run will be better served by the noncompetitive sale of equipment trust securities. We feel that such a method gives to the railroad companies greater continuity of banking service, and therefore more interested and helpful financial advice. It is very distinctly our feeling that equipment trusts during the last few years have not received the excellent distribution that they formerly enjoyed.

Whether this is the fault of public competitive bidding or not is another question. We are inclined to think the competitive bidding is largely responsible.

It is our feeling that financial service and proper financial interest are of such paramount importance to our railroads that the mere question of cheapness should be accepted with a great deal of caution.

STANLEY & BISSELL, INC.,
Cleveland, Ohio,
By EDWARD S. LITTLE, *Vice President.*

COMPETITIVE BIDDING HAS CAUSED LOSS OF DISTRIBUTION

In answer to your letter of January 30, with reference to the present method of selling railroad equipment trust obligations, we feel that competitive bidding has caused the price of these obligations to become so high that the distribution in this section has been materially cut down.

It has been our intention in this department to place some railroad equipment obligations on our list, but in view of their present yield we do not think that it would be advisable for us to materialize this plan at this writing.

DALLAS TRUST & SAVINGS BANK,
Dallas, Tex.
By J. LEWELL LAFFERTY, *Manager Bond Department.*

NO BENEFIT IN OVER PRICED OFFERINGS

It is our experience that a company does not benefit by having an issue of securities over priced on original offering. The inevitable result is an unsatisfactory secondary market which affects unfavorably the opinion not only of the original purchaser, but also of prospective buyers. The net result is that any subsequent issue has to be priced so as to overcome unfavorable market conditions. This is, of course, likely to be intensified when the margin of profit to the distributors is too narrow to permit really good distribution.

CHARLES W. SCRANTON & CO.,
New Haven, Conn.

FORCES HIGHER PRICE THAN MARKET WARRANTS

Competitive bidding, however, frequently results in forcing the successful bidder, in order to realize a profit, to put a higher price on the securities than market conditions actually warrant, which in turn leads to an unsatisfactory secondary market for the securities and a consequent adverse effect on the credit of the issuing company.

This is an age of expert advice, and if a railroad executive feels that he can dispense with the advice and cooperation of some specialist in the banking field, he is at perfect liberty to make his own set-up and shop his bonds to the highest bidder; but in this case the margin of profit to the banker is apt to be so small and his grip on future business so insecure that it does not pay him to consider more than his own immediate problem of marketing the bonds, so as to quickly realize his profits or losses.

STONE & WEBSTER AND BLODGET, INC.,
New York City.,
By R. H. CARLETON, *Vice President.*

GREAT DEAL AGAINST PRESENT METHOD

We have your letter of February 2 in regard to our opinion on the present policy of competitive bidding for car-trust securities. While we do not claim to be at all expert in this line of financing, we are rather of the opinion that in the long run the present method of competitive bids will not prove as satisfactory as the former method of each road dealing with their own particular banking house. While the railroads are probably getting a slightly higher

price for their car-trust securities with the present bond and money situation, when this situation changes and the price of money goes up and the sale of securities is made more difficult, it is quite probable the railroads, not having any particular banking house under obligations to them, will not get as high a price for securities as they have in the past. There is certainly a great deal to be said against the present method.

WOOLFOLK, WATERS & Co.,
New Orleans, La.

RAILROADS AND INVESTING PUBLIC BETTER OFF

Our feeling has been that the bankers commonly associated with the railroads should be permitted to continue to finance the railroads with which they have been associated. This feeling is based on the belief that over a long period of time the railroads and the investing public are better off under such a policy. This is without reference to what might be considered fair play in allowing the banking houses to profit by years of association and building up of railway credit.

METROPOLITAN NATIONAL CO.,
Minneapolis, Minn.,
By CHARLES A. FULLER, Jr., *Manager Bond Department.*

FICTITIOUS MARKET CONDITIONS CREATED

Competitive bidding for bond issues has created a speculative state of mind within many underwriting circles, and fictitious market conditions have been created which have been detrimental to participating dealers and to their clients.

DAVIS, SKAGGS & Co.,
San Francisco, Calif.

FAVOR OWN BANKING CONNECTIONS

In reply to your letter of February 2, we are very much in favor of the policy of railroad companies selling their bonds and car-trust securities through their own banking connections rather than by competitive bidding. We believe that competitive bidding is likely to cause too many issues to be overpriced and as a result cause dissatisfaction among the ultimate consumers.

RUFUS E. LEE & Co.,
Omaha, Nebr.,
By F. W. PORTER, *Vice President.*

COMPETITIVE BIDDING UNSATISFACTORY

It has been our observation in municipal bond issues and also in the farm loan business that competitive bidding for business proves very unsatisfactory. The bond houses and trust companies who take part in such competition are usually led to take more chances in order to get the business which in a good many cases afterward proves unsatisfactory.

THE FIRST NATIONAL BANK,
Friend, Nebr.,
By H. J. SOUTHWICK, *President.*

WOULD PROVE COSTLY IN THE LONG RUN

In reply to your letter of January 31 in regard to the policy of the Interstate Commerce Commission asking for competitive bids on equipment trusts, we might say that we feel this system does lead to overpricing and in the long run would make the cost of financing high to railroads.

We feel that the investment bankers for this type of security can adequately price the issues, and in a great majority of cases they are priced more favorably than as a result of competitive bidding.

HUGH B. MCGUIRE & CO.,
Portland, Oreg.,
By HUGH B. MCGUIRE.

FEW INVESTORS INTERESTED

It would seem to us that this has resulted in paying the railroads a slightly higher price for equipment-trust certificates, but we feel it is a debatable point as to whether this is of real benefit to the roads themselves. As the result the interest basis on equipment-trust certificates has declined to a point where very few of our western investors are interested in this paper, and the margin of profit which can be offered to houses who retail equipment-trust certificates has declined so very much that we do not feel that we can afford to handle them. We presume that other houses in the West have had the same experience.

Some time ago we handled quite a number of equipment-trust certificates. During the past 12 months our volume in this class of paper has been negligible. Therefore it would seem that the market is being restricted, and in our opinion a greater proportion now than formerly is being absorbed by insurance companies and large financial institutions. In a period of tight money this may react on the roads to their disadvantage.

BOSWORTH, CHANUTE, LOUGHRIDGE & CO.,
Denver, Colo.
By ARTHUR H. BOSWORTH.

WILL REMOVE A TREMENDOUS DISTRIBUTION ORGANIZATION

As it is generally recognized, the volume of bond distribution in United States is done to a very large extent by the smaller dealer whose channels, if closed to equipment-trust certificates through lack of adequate profit in the business, will remove eventually a tremendous distributing organization from equipment-trust certificates.

C. T. WILLIAMS & CO., INC.,
Baltimore, Md.,
By JOHN ROBERTSON, *Vice President.*

SHOULD PICK BANKER WITH CARE

On the other hand, it has led to very high prices being paid by underwriting houses, and in some cases not enough profit left to pay for the trouble of marketing the securities in a comprehensive manner, thus making the market for the security narrow and in a very vulnerable position in the case of a declining market.

The writer feels strongly that large companies borrowing large amounts of money from time to time should pick their investment banker with care and then use him as their agent in all offerings of their securities. By doing this the company insures itself against poor treatment in bad financial times. This was certainly demonstrated by the railroads and public utilities during and immediately after the war.

NORTHERN TRUST CO.,
Duluth, Minn.,
STANLEY L. YONCE, *Vice President.*

MUST LOOK TO FUTURE REQUIREMENTS

Looking at the matter through the eyes of the railroad president, there is little doubt that the open and competitive bidding system brings somewhat higher prices for the securities. Or rather, such is the case just now, in this period of

widespread demand for investments. Yet railroads must look to their financial requirements for years to come, and if this country should once again run into the financial storms of 1920–21, most of the houses which are so active in their competitive bidding today would completely withdraw from the market. The inevitable result, of course, would probably be inadequate prices received by the railroads for their securities.

DUNN & CARR, *Houston, Tex.*

TENDENCY TO RESTRICT MARKET

Due to the low yields which new equipment offers have afforded, except in isolated cases, we have been compelled to be nonparticipants. Undoubtedly these prices are the results of competitive bidding, and it is my opinion that while the railroads have been receiving the benefits of higher prices received for their equipments, I think the effect on dealers has had a tendency to restrict the market, and should money conditions change it might be difficult to get the cooperation of the dealer in distribution.

Take, for instance, our own case; many channels in which we have placed equipment obligations we have since diverted into other more profitable securities, more profitable not only to ourselves but to our clients, and I think you can multiply this situation many times.

R. E. PROCHNOW & CO., INC.,
Chicago, Ill.,
By R. E. PROCHNOW, *President.*

SHOULD PROVIDE FOR EFFECTIVE DISTRIBUTION

If the distribution of equipment trusts among the general investment public is of interest, it is impossible to get such distribution with the margins now prevailing on that line of securities. For ourselves we sell a few but only when we have to. This business cannot be handled except at a loss on the present margins prevailing. If it is in the interests of the railroad corporation to get the most on a dollar for their securities, then competitive bidding in equipment trusts will probably accomplish that result. If, on the other hand, it is desirable for the railroad corporation itself to have a wider public interest in their securities, particularly in the territory in which they operate, and we believe it is, there should be a sufficient margin provided in the difference between the issue price and the price to the railroads to provide for effective distribution.

ANDERSON, PLOTZ & STEWART, INC.,
Chicago, Ill.,
By J. A. ANDERSON, *Vice President.*

WOULD SELL ONLY TO SPECIALISTS

If the writer had equipment-trust certificates to dispose of, he would see to it that they were sold to underwriting houses who were specialists in such distribution. On the other hand, he would not sell an issue of oil bonds to an equipment specialist. We have in mind one particular instance where a substantial issue of oil bonds were sold to a New York underwriter who had no particular ability to retail or wholesale them. The bonds are without question sound, but the offering was not favorably received because of the underwriter's unfitness to distribute it, and as a result the bonds declined 8 percent in price and are now out of line with equally desirable securities of the same class, and when this company again comes into the public market it will find it will have to pay for its failure to recognize the necessity of accepting not only a fair price for its bonds but moreover of selecting some distributor who has the ability to successfully accomplish this work.

COMMERCE TRUST CO.,
Kansas City, Mo.,
By GERALD PARKER, *Vice President.*

INSURANCE IN FINANCE IMPORTANT

We are told that a new era of finance has arrived and that precedents have no value, but from my point of view, if I were president of a railroad, I would think it an advantage to the railroad in the long run, and also to the public, that I should deal in the sale of new securities with some established house or houses with whom I had long associations, knowing that I would be fairly treated and that I could rely on them that the securities would be well placed. If I sold my securities at auction I might temporarily get a slightly better price but I would feel that in time of stress I would have very few friends, and I think that insurance in matters of finance is as important as insurance against fire or other casualties.

WALKER BROTHERS, *New York City,*
N. S. WALKER, *Esq.*

ARGUMENTS VERY SOUND

The arguments advanced by you are very sound and I believe most private corporations, where not subject to public supervision, adopt this method of selling their securities; however, in view of the fact that railroads are under the supervision of the Interstate Commerce Commission, doubt very much if they could be convinced of the wisdom of doing otherwise than by asking for public bids on these securities.

WHITNEY-CENTRAL TRUST & SAVINGS BANK,
New Orleans, La.,
C. G. RIVES, JR., *Vice President.*

POSITION OF INDEPENDENT DEALER UNSATISFACTORY

Formerly I have sold a good many equipment bonds to corporations and investors when there was a fair profit to the distributing house. Now, as an independent dealer, it is not profitable for me to handle any of this type of security. Furthermore, the low yield which equipment bonds now offer does not tempt me to offer them to my customers. If that is the general attitude, would the result not be that the railroads might lose any advanage they may gain through competitive bidding?

ALANSON G. FOX, *New York City.*

GREATEST SERVICE THROUGH STRONG BANKING HOUSES

As you know, we are not bidders for this special type of security. We are thus enabled to disclaim any direct concern in the matter. A long experience in the securities business, however, confirms us in the opinion that the greatest ultimate service is obtained both for the obligor corporation and the investing public, if strong banking houses are permanently allied in financing the recurring requirements of growing railroads. It thus becomes for them a matter of enlightened self-interest to render the best possible professional services.

F. S. SMITHERS & Co.,
New York City.

RESULTS IN FALSE VALUES

Competitive bidding for railroad car trust issues: These reasons impel us to register a "negative" on the present method in vogue through the interposition of the I.C.C. with reference to the sale of railroad-car trust issues:

(*a*) It deprives the railroad of a serious, tangible, dependable financial connection.

(*b*) It frequently involves hasty and ill-advised buying judgment on the part of too-eager executives of buying departments of security houses.

(*c*) It results in a false level of values, i.e., bottomed on temporary, fluid commercial credits, whereas due consideration should be accorded the long-term capital lock-up and the intervening economic (and other) possibilities.

(*d*) Finally, it robs the distributing dealer of any real incentive to effect a worthy lodgment of the securities, due to the prohibitively small profit involved, in a time of almost terrifying overhead expenses.

BOWMAN & CO., *St. Louis, Mo.*
By D. ARTHUR BOWMAN.

MANY FORMER BUYERS NO LONGER INTERESTED

Replying to your letter of the 30th instant, will say that it has been our experience that many who formerly bought equipment trusts no longer are interested in them because of the high prices at which they must be purchased. We have certain clientele that will buy them. but I think that the market could be greatly broadened if the price were more consistent with the character of the security.

PARTRIDGE-PATMYTHES CO., INC.,
Milwaukee, Wis.,
By JOHN C. PARTRIDGE, *President.*

INSTITUTIONS NOT INTERESTED

Your letter of February 1 was received several days ago, since which time the writer has given considerable thought to the matter contained therein. In the first place, we have not been particularly active in equipment trust obligations the past few years, due principally to the fact that the yield has, generally speaking, become so low that our institutions have not been interested.

Relative to your inquiry regarding competitive bidding, we are somewhat at a loss as to what to say. We do feel that this undoubtedly has been the cause of severe overpricing, not only in the case of equipment trust securities, but other issues as well. with the result that underwriting houses and those participating with them, have lost money and the credit of the issuing corporation has by no means been enhanced. On the whole it seems to us that competitive bidding might be eliminated to advantage. We feel that railroads and other corporations would receive practically as good prices, and that distributing houses and the public would probably fare better.

PUTNAM & CO., *Hartford, Conn.*

APT TO WORK A HARDSHIP

In other words, we believe that competitive bidding, particularly in the equipment trust business, is apt to work a hardship in the long run on the borrower. We also feel that any fair-minded borrower should take into consideration the assistance which has been given him in past years by a banking house, before breaking off relations for some slight concession in price made by another banking house. The writer has a very strong feeling on this point as he has seen competitive bidding in commercial paper transactions work very decidedly to the detriment of the borrower in the long run.

It goes without saying that any high grade, reputable banking house would certainly not take unfair advantage of a client in making him a price on his financing, simply because the banking house knew they were bidding without competition.

SIDLO, SIMONS, DAY & CO.,
Denver, Colo.,
By RICHARD M. DAY.

DISTRIBUTION BEING CURTAILED

We realize that the railroads are securing good prices at the present time but feel that distribution of the securities through a number of small dealers is being curtailed through lack of adequate profit. This curtailment may in time react to the disadvantage of the distribution of equipment trusts at a time when money is not so plentiful for investment.

MARSHALL & Co., *Pittsburgh, Pa.*,
By R. B. MARSHALL, *President.*

SUCH ISSUES LOSING FAVOR

We aline ourselves on the side of the critics of this method and agree that severe overpricing has been one of the results. This may have benefited the roads temporarily but is causing such issues to lose favor in the investment markets. We cannot see the advantage to the roads in dealing now with one group of bankers, again with another group, and so on ad infinitum and are thorough believers in the theory that a corporation's finances may be most successfully handled through the consistent and sustained cooperation of one banking house.

BANK OF NORTH AMERICA & TRUST CO.,
Philadelphia, Pa.
By J. H. MASON, JR., *Vice President.*

HIGH PRICES WOULD BE OFFSET

The increased demand for credit for commercial and industrial purposes from customers of the banks could very easily result in a congestion of equipment trust notes that would affect their market unfavorably and in the long run result in the railroad companies finding it necessary to sell such securities at such a disadvantage that the high prices obtained through competitive bidding during easy money times would be more than offset.

We feel that the firms of high standing who have specialized in certain classes of bonds over a long period are in better position to know the real value of such securities and handle them to better advantage both for the borrower and the investor than the firms interested only in the commission on a specific issue and not in the general and lasting good market for that class of bond.

THE NATIONAL STOCK YARDS NATIONAL BANK,
National Stock Yards, Ill.,
By OWEN J. SULLIVAN, *President.*

FAVOR RECIPROCITY

The writer's experiences as a director in the United Light & Railways Co. and the General Gas & Electric Co. showed him most impressively that it was most important and beneficial for those companies to have friends during the troublous times of the World War.

A corporation which merely puts out its securities on a competitive basis and does nothing to warrant receiving help in bad times in our opinion is not in such a strong position as if it took the opposite course of having friends and working under a reciprocity arrangement.

MOORS & CABOT, *Boston, Mass.*

FINAL RESULTS NOT BENEFICIAL

In reply to your letter of January 31, we beg to say that we believe the final results of the new practice in the sale of equipment trust securities will not be beneficial, with the two main thoughts in mind, that the distributor will not

receive a profit commensurate with his efforts and that the former wide distribution of these securities will be cut down with the higher prices, and the investor will probably put his funds in inferior securities as a substitute.

In other words, regarding the two main objects of the investment business being the welfare of the investor and a profit to ourselves (two points so closely related that it is hard to consider one over a period of time except in the light of the other), we feel that both the investor and the dealer are better served in the long run under the old system.

Also, as we see it, the credit of the railroads is not helped in the long run by the sale of securities, bearing their name to the public, which are over-priced as some have been under the new plan.

SMITH, STROUT & EDDY., INC.,
Seattle, Wash.
By E. A. STROUT, Jr., *Secretary and Treasurer.*

PUBLIC SHOULD BE ENCOURAGED TO BUY

In a favorable market such as this one it is true that competitive bidding may get slightly higher prices for the railroads. On the other hand, over a period of time we do not believe this balances the good to be derived from the old-fashioned relationships between corporation and banker. The railroad should make its money out of operating a railroad and not out of banking. Furthermore, the public should be encouraged to buy railroad securities, and the way to do this is not to see at how high a price they can be unloaded on the public.

BACON, WHIPPLE & CO., INC.,
Chicago, Ill.,
By W. T. BACON, *President.*

FANCY PRICES PAID

No doubt, in some instances, the originating house has paid a very fancy price for the issue with the idea that the advertisement of the origination by them would be advantageous to them otherwise and also with the idea that their dealer clientele would help them bear their loss, if any, in distributing the issues. This same originating house will, of course, be the unsuccessful bidder for the same road's issues when the bond market is in a bad way and naturally the banking house sponsoring the railroad will then have to buy them and take their chances, and my argument would be that they should be allowed to purchase equipments through good and bad times by negotiations only.

SECURITY TRUST CO., *Lexington, Ky.,*
By J. D. VAN HOOSER, *Vice President.*

ADVANTAGE OF WIDE DISTRIBUTION DEFEATED

We feel that the increase in price of Equipment Trust securities has made it almost impossible for the dealers in the smaller communities to distribute them. This has undoubtedly led to a greater concentration of securities in this class in the financial centers, and particularly New York. While there would seem to be an advantage to the railroads in selling their securities at a high price, we feel that it is quite possible that in the long run this advantage may be lost by the decrease in the railroad security holders. If there is an advantage in wide distribution of securities of any corporation, we feel that this advantage is defeated in the case of competitive bidding for investment trusts.

NORTHERN BOND & MORTGAGE CO.,
Green Bay, Wis.

OPPOSED TO PRESENT METHODS

We have your favor of February 1 regarding present methods of selling equipment trust securities by the railroads. From a purely selfish standpoint we are opposed to the present methods as we find that the margin of profits is

so small that we could only afford to handle them if we knew we had an immediate turnover. As it is, the price is usually so full that the offering is not attractive and the interest in the offering on the part of institutions is decidedly lessened. In other words, there is too much sales resistance on account of price and the profit to the dealer is so small that there is no incentive to overcome this. We agree with you that this will limit the distributoin of such securities and when we again get into a lender's rather than a borrower's market, considerable missionary work will have to be done to re-establish equipment trust securities with a broad list of investors.

HILL, JOINER & CO., INC., *Chicago, Ill.*,
By C. C. ADAMS, *Vice President.*

MARKET ACTION UNSATISFACTORY

We feel that your position on this subject, as outlined in your letter, is absolutely correct. So far as we are concerned, we have practically discontinued over the past year or so the handling of equipment trust securities because of the close margin of profit. Consequently we are gradually losing contact with any market for this class of obligation, and as we build up other lines of distribution, we doubt if our interest could be revived in equipment trust securities in a less favorable money market when there might be more profit in the distribution of equipments.

It has always been our experience that when securities are offered to us by originating houses who have been forced into competitive bidding to secure the business, the market action of the securities after the expiration of the syndicate has not been satisfactory as a general proposition. This is usually true because the securities are over priced.

On the other side of the picture we have always felt that any corporation, be it railroad, public utility or otherwise, is in a much more satisfactory position so far as its public financing is concerned during the period of stress, if it has had satisfactory and continued relations with a banking or originating house who feels under obligations to take care of its wants. Certainly such an obligation does not exist if, for every piece of financing that the corporation desires to put out, the bankers have to enter into competitive bidding.

We feel very strongly that your position as outlined is entirely correct.

ROBINSON-JENKINS-TAYLOR CO., *Minneapolis, Minn.*,
By H. R. TAYLOR, *Vice President.*

SHORT-SIGHTED VIEWPOINT

The writer's views on this subject are very much in accordance with your ideas as outlined in your letter. It has always been our opinion here that competitive bidding, although it unquestionably is very advantageous to the issuing company in a favorable market, has a tendency to undermine banking relationships of a character very necessary to the company whose securities are being sold. We have always felt that for a railroad, utility, or industrial company to form a powerful banking connection of a semipermanent nature might be of great benefit to the company in future years when the security markets might not be anywhere near as good as at this time. It is quite possible that the practice inaugurated by the Interstate Commerce Commission may be successful and may operate to the advantage of the issuing company in the next few years over the period of cheap money which can be expected for some time, but when the reaction sets in we believe the loss of permanent connections will operate to the disadvantage of these same companies.

Summing up the above, we take the position that the Interstate Commerce Commission is looking at the practice from a rather short-sighted viewpoint, and also that time alone will prove which theory is correct.

CHICAGO TRUST CO., *Chicago, Ill.*,
By J. W. MARSHALL, *Vice President.*

DO NOT FAVOR ORDER

We do not favor the order of the Interstate Commerce Commission that equipment trust certificates or other railroad securities should be sold as the result of competitive bidding. Our opinion is that over a period of years the interests of the weaker railroads, and in fact of practically nearly all of such corporations, except the very strongest, would be better served by having their securities marketed through bankers who would feel a responsibility for the properties.

WM. E. BUSH & CO., *Augusta, Ga.*

COMPETITIVE BUSINESS NOT FAVORED

It has always been our opinion that railroad business of all kinds, including both the majority finance and equipments, should be done by the banking houses sponsoring the railroads concerned, not by any system of competitive business by investment bankers. We are therefore very much in sympathy with this movement in regard to bringing this matter to the attention of the Interstate Commerce Commission, and I hope that your efforts will meet with success.

FOURTH & FIRST NATIONAL CO., *Nashville, Tenn.,*
By B. O. CURREY, *Sales Manager.*

WOULD NOT PURCHASE FROM INEXPERIENCED BANKERS

Replying to your favor of the 31st ultimo; we have been large buyers of equipment certificates during the last 20 years and have always regarded them prime investments. This type of investment security has increased in favor among certain classes of investors upon recommendation of investment houses. This has primarily been the reason for the success in financing this requirement of our railroad systems. The high standing of the investment house specializing in this type of security brings a corresponding investment standing and credit to the railroad which desires to sell such instruments of indebtedness. We would not purchase this form of investment if brought out and handled by inexperienced bankers or investment houses who have no particular interest in the security except to handle it at a profit. Convertibility, rating, and character of the investment banker bringing out the certificates all enter into the value. If competitive bidding is adopted or forced upon the railroads, car-trust securities will be changed from high grade ultra conservative investments to speculative investments and they would therefore be unacceptable to our clients.

AMBROSE R. CLARK CO., *New York City.*

SHOULD RECEIVE SERIOUS CONSIDERATION

Of course, we agree that the purchase of issues of the equipment trust by competitive syndicate houses has had a tendency to raise the price which the railroads have received for these securities, and reduced the return basis to the holding public. We believe that the equipment trust securities should be sold with the market as it is when the securities are brought out, and we do not feel that this should be influenced as it is by the competition of syndicate houses in the purchase of these securities. We feel as you do that this should receive very serious consideration.

WILKES-BARRE DEPOSIT & SAVINGS BANK,
Wilkes-Barre, Pa.,
By BENJAMIN F. WILLIAMS, *Cashier.*

COMPANY'S CREDIT WOULD SUFFER

If bonds are offered at a higher price than they are really worth and the secondary market is unable to hold the price, it would seem to us that the

credit of the company would suffer and that on future issues they might not obtain as good a price as would have been possible under the old system.

CORNING TRUST CO.,
Corning, N.Y.,
By G. A. HEERMANS, *Secretary.*

DEFINITE BANKING CONNECTIONS OUTWEIGH HIGHER PRICES

We have your letter of January 31, and it is our opinion that the benefits to the railroads of definite banking connections upon whom they can depend in bad times as well as good, considerably outweigh the possibly somewhat higher prices which they may obtain for their securities through competitive bidding under favorable market conditions.

HUNTINGTON JACKSON & CO.,
New York City.

PROFITED DURING EASY MONEY

In other words, the railroads no doubt have profited by selling their securities to the highest bidder during this time of very easy money, but if and when the conditions change materially we feel that they may regret not having tied up to dealers who can always take care of their requirements.

SECURITY SAVINGS & TRUST CO.,
Portland, Oreg.,
By EDW. H. GEARY, *Vice President.*

BETTER TO SELL TO OWN BANKER

In reply to your letter of February 2, 1928, in regard to railroads selling their equipment-trust securities by competitive bidding, we have always been of the opinion that over a term of years it is better for the railroad company to sell all their securities to their own banker.

It is true that under the present conditions the railroads are getting a better price for their equipment-trust securities by competitive bidding, but we are not so sure that this practice will prove profitable to them during the time of stringent money.

HOWZE, SPENCER & CO., *Duluth, Minn.*,
By GERALD HOWZE, *President.*

CARE OF THE AFTERMARKET

Generally speaking, we are not interested in participating in any syndicate if there is a possibility that no one is going to take care of the aftermarket. The danger to the small house from lack of a proper aftermarket is accentuated in the equipment-trust field due to the small amount of the various maturities outstanding.

In the past we have seen many cases where a banking house has taken an issue and distributed it and supported it until the issues of the corporation in question had a market standing far superior to any previously experienced. We have seen such corporations sell succeeding issues of securities to other banking groups at higher prices, such higher prices being made possible in many cases because of the good work of their first banking connection. Such action is morally improper and we believe economically unsound.

The Interstate Commerce Commission has done great things for the American railroads, but not all its action has been sound. It can certainly reverse itself from time to time and thereby gain a greater respect from the general public.

S. C. PARKER & CO., INC., *Buffalo, N.Y.*,
By SELBY C. PARKER, *President.*

THOUGHT COMMISSION MAKING A MISTAKE

Replying to your letter of February 1, we have to say, at the time the I.C.C. insisted on competitive bidding for the sale of equipment-trust securities of some prominent railroad company, whose petition to sell the equipments was then under consideration, I thought the Commission was making quite a mistake, and I have found no reason since, in further considering the subject, to change my mind. I still believe the best results can be obtained by the railroads in negotiating direct with their bankers.

THE INDIANA TRUST CO., *Indianapolis, Ind.*
J. P. FRENZEL, *Chairman of the Board.*

SUCH A POLICY UNWISE

Responding to your request for an expression of my opinion as to the desirability of competitive bidding as a policy in the sale by railroads of their car-trust obligations, I think such a policy is unwise because its tendency is to create an artificial primary market for such securities, leaving the secondary market stale when owners desire to sell them, which must eventually be detrimental to car-trust obligations as a class.

HENRY T. KEELER.

NOT PRONE TO PUSH THIS CLASS OF SECURITY

We are in touch with quite a few buyers of equipment trust securities and when brought to their attention at the present prices, they are very loath to purchase. In addition, we are not as prone to push this class of security as we would if the margin of profit were greater, because at the present margin, after taking into consideration the expense of obtaining the business, handling, etc., we are actually handling equipment-trust securities at a loss and no house wishes to handle anything at a loss.

Summarizing our opinion, therefore, we are pleased to advise you that we feel that were the bankers given more consideration in the handling of equipment-trust securities as regards profit and in addition, by means of this profit, distribution, that while the railroads would probably not get as good prices as they have at the present time, their securities would actually be in better shape, marketwise and from a point of investment to the actual holder.

KUECHLE & CO.,
Milwaukee, Wis.,
By C. E. REDEKER, *Vice President.*

CEASE TO FEEL ANY OBLIGATION

It seems to us, while we are not particularly active in equipment trusts, we nevertheless participate in some of the syndicates and selling groups, that an occasional issue will sell entirely too high, others issues perhaps too low. We have experienced in the Iowa municipal market that when a dealer pays too much for an issue of bonds, in order to keep other dealers from purchasing a similar issue in the near future, he buys it for more than it is worth in order to keep the price up, thereby protecting his original purchase. This is of course a very vicious procedure, but I presume it could possibly happen with equipment trusts. I think the most unfortunate part of the competitive bidding is that certain dealers who have understood that they would be required to handle the equipment trusts of certain railroads will now cease to feel any sense of obligation and will buy the bonds as cheaply as possible; in other words, the roads will not have a sort of understood financial arrangement, which has worked out so satisfactorily in the past.

PRIESTER-QUAIL & CUNDY, INC.,
Davenport, Iowa,
By JOHN J. QUAIL, *Vice President.*

DISTRIBUTION WILL BE SERIOUSLY AFFECTED

Naturally, we have been forced to begin operations in this highly competitive market at small profit on large turnover. If the competitive bidding results in continued buying of new issues by larger banking houses at prices which show them practically no profit, we are convinced that our operations will be narrowed to such an extent that distribution will be seriously affected. As distribution narrows the popular criticism of poor market becomes true and outweighs the advantage of security.

HATHAWAY & Co.,
Chicago, Ill.,
By CHARLES D. MARSH, *Manager Bond Department.*

COMPETITIVE BIDDING RESPONSIBLE FOR NARROW DISTRIBUTION

Our experience has been that equipment trust securities have been so overpriced that it has been next to impossible for us to move any in our territory. During the summer season we have a very heavy demand for high-grade, short-term paper, and equipment trusts, if reasonably priced, would allow us to place a considerable block of these short-term securities. We feel that competitive bidding is responsible for the narrow distribution and overpricing of these securities and it would seem more satisfactory if the railroads would sell these securities as they previously did.

DAVIS & WEST,
Norfolk, Va.

EQUIPMENT ISSUES IN DANGER

In connection with the subject of equipment trust securities and the advisability of having competitive bidding therefor, we are strongly of the opinion that for the good of the purchasers of the bonds the first consideration is to have the financing handled by houses that are thoroughly acquainted, through experience, with the necessary legal requirements to guarantee protection to such issues. We believe that this is vital because in the long run the record of the equipment trust issues with respect to security and final payment has a very definite relation to the selling price.

In other words, if equipment trust issues are continued to be carried through a house such as your own—which has demonstrated its ability to see that issues are properly protected—there is little likelihood that the good record that these issues enjoy will be marred. On the other hand, if we get into wholesale competitive bidding without consideration to the requirements above enumerated, we are apt to have occasions arise that would mar not only the record of the specific road putting out the issue, but the equipment issues as a class.

MERCHANTS SECURITIES CORPORATION,
Worcester, Mass.
By HARRY R. MCINTOSH, *Treasurer.*

NOT INTERESTED IN NEW ISSUES

The very low yield on these securities of late has forced us to strike them even from considering their purchase, and until the yield becomes very much more attractive and we can be sure that there will be a constant substantial market for the certificates in the event a sale is necessary, we do not see how we can be interested in new issues. It seems to us that this grade of securities should be treated in a somewhat different manner than the sale of ordinary securities, and we should be pleased to see the equipment trust handled as of old.

COMMERCE TRUST CO.,
Lincoln, Nebr.
By M. L. SPRINGER, *Secretary-Treasurer.*

PUBLIC CARRYING THE BAG

Claims have been made by several of our customers that severe overpricing has been the result, which has caused an attitude of disfavor on the part of these purchasers. The customers, as well as ourselves, agree that the protection of public interests should be the first consideration. However, they seem to feel, because of this overpricing, that the public is carrying the bag and that the railroads are receiving all the benefit of this practice.

SULLIVAN & SMITH,
Wellsboro, Pa.,
By M. J. SULLIVAN.

COMPETITIVE BIDDING UNSOUND IN POOR MARKET

Competitive bidding brings into the market anyone who is able to pay for the securities, and of course those people are very numerous on a good market. However, on a poor market it is only those who have established clienteles and who have dealt with concerns regularly who will then, even at their own disadvantage, take care of borrowing corporations. As mentioned above, it is true in all kinds of negotiations.

WHELLOCK & CO.,
Des Moines, Iowa,
By L. F. WHEELOCK.

OLD SYSTEM THE BETTER

In reference to your letter in regard to competitive bidding for equipment trust securities, we feel that in the long run the old system of having one of several houses identified with the securities of each road is perhaps the better system, as their handling of the securities tends to stabilize the market, and they are more inclined to lend their support to the road when conditions are unfavorable. These facts, we think, offset the immediate advantage of somewhat better terms resulting from competitive bidding.

J. WM. MIDDENDORF & SONS,
Baltimore, Md.

BECOME INDIFFERENT TO THIS CLASS OF SECURITY

We think you are doing a good work in securing a cross-section of the opinions of houses which have in the past offered equipment trust certificates. Since the Interstate Commerce Commission has ruled that equipment trust securities offered by the railroads should be sold to the highest bidder, we have found it impractical and unwise to be actively interested in the distribution of them.

We have felt in nearly every case that the bonds were being offered at the very highest price at which they could hope to be sold.

Disregarding for the moment the selling price of such offerings, we have also become indifferent to this class of security, inasmuch as we felt we could not afford to purchase them, put them on our list, and offer them to the people to whom we used to sell them, due to the fact that there would be a great sales resistance in moving them off, and we might have them on our list for some little time with little or no profit to ourselves.

We feel, too, that our banking institutions, which at one time bought great amounts of equipment trusts, also believe that they are being brought out at the very highest price, and that once they are purchased it is difficult to secure a market at anywhere near the price which they paid for them, in case they found it necessary to resell them.

As we look at it, the only benefit derived from the distribution of the equipment trusts under the present arrangements is the publicity which certain originating houses feel they are receiving when they are the successful bidders.

After an investor or banking institution has been urged into the purchase of such securities under this plan and then has occasion to resell them and learns

of the unsatisfactory market, we think they too must become prejudiced; and a continuance of this policy is unquestionably going to spoil in time what has been a very fine market for this form of investment.

MERRILL, HAWLEY & Co.,
Cleveland, Ohio.

NOT WORKING IN PRACTICE

We believe that in theory this is all right, but in practice that it is not working out to the real advantage of the railroads or the investing public, not to mention the banker. Apparently in good bond markets such as the present one many houses will buy equipment at exceedingly high prices to be offered as "window dressing" and feel that they have done a good piece of advertising even though they only break even on the deal. In a declining bond market such houses would not be willing to bid and the railroads would have to go to their regular bankers and probably take a price lower than they would have received if these bankers had had all their business.

HILL BROS. & Co., *St. Louis, Mo.*

NOT IN THE PUBLIC INTEREST

During a period when bond prices have been steadily rising it is difficult to present convincing arguments against the sale by railroads or car trust securities by competitive bidding. Although during the period that it has been in operation this practice has undoubtedly resulted in the railroads securing higher prices, we believe that it is not in the public interest for the following reasons: It is a specialized business and great care should be exercised in drawing up the various indenture and trust provisions. Poor distribution results from overpricing and an insufficient margin of profit. There is no incentive for bankers to help out roads in times of stress.

In the past where a railroad's entire financing has been handled by one banker there may have been cases where this relationship has been abused. However, we feel that at the present time the possibility of such abuse is negligible in comparison with advantages to be gained, both by the railroads and the public through more intelligent handling and better distribution.

MAYNARD, OAKLEY & LAWRENCE,
New York City.

WILL RESULT IN OVERPRICING

It occurs to me, although I have no experience in original purchases along this line, that open competitive bidding for these securities will result in overpricing, which will ultimately result in a reluctance on the part of the individual distributing dealers to handle equipment certificates and will therefore have a tendency to concentrate holdings so that if any unforeseen break takes place in the market this type of security is apt to be offered in such volume that the market effect will be decidedly disturbing. I believe it to the interest of those who wish to borrow money in this form to keep the market position of securities in such shape as to inspire the public's confidence in that particular type of security.

W. E. HUTTON & Co.,
Cincinnati, Ohio,
By CAMPBELL S. JOHNSTON,
Manager Bond Department.

NECESSARY THAT DEALER MAKE PROFIT

Equipment trust securities are not at present, as a class, on an equal rank with Liberty bonds and municipal bonds. To a certain extent, a secondary market must be maintained. Therefore, we believe it is necessary that the dealer be given a certain amount of profit in order to make it worth his while

to handle such a market. Otherwise, it is possible that the securities might decline in price very shortly after the offering.

E. G. CHILDS & CO., INC.,
Syracuse, N. Y.

NOT FOR THE BETTER INTERESTS OF THE RAILROADS OR THE PUBLIC

It is therefore our opinion that the policy of competitive bidding is not for the better interest of the railroads or the public from the broader viewpoint. The railroads of the United States are directed by men of sufficient intelligence, well enough acquainted with economic conditions, not to be milked by any unscrupulous bond companies in underwriting their equipment trust issues.

Furthermore, a close, permanent connection with a reputable banking firm will result in greater economy in marketing equipment issues, due to the fact that such banking connection could adequately educate its clientele in the character of the roads, and in such fashion elminate much of the sales resistance that must be overcome by strange houses who competitively bid and secure car trust issues.

MORTGAGE & SECURITIES CO.,
New Orleans, La.
By FRED. N. OGDEN,
Manager Bond Department.

OFFERINGS DECLINED

Of course, we are small dealers in a far-away section, but if our experience is any indication of the general experience, we would certainly feel that the public interest is better protected by not enforcing competitive bidding. We know that several of our large bank customers constantly decline any offerings of equipment trust certificates since the inauguration of competitive bidding, on account of the feeling that under competitive methods there is naturally a tendency for investment bankers to pay too much for the issues offered.

GUARDIAN TRUST CO.,
Houston, Tex.
By L. B. DUQUETTE,
Vice President.

CANNOT FAIL TO DETRACT

From the prices asked for various issues of car trust securities recently offered to us, we are inclined to agree with your contention that competitive bidding frequently results in over-prices, with the attendant weakness in after-markets which cannot fail to detract somewhat from the favor in which this type of securities is normally held.

We agree also that less favorable conditions in the future may serve to emphasize still further the value of a permanent connection as above.

THE COMMERCIAL NATIONAL BANK,
Peoria, Ill.
By A. B. LLOYD,
Manager Bond Department.

CARE OF REQUIREMENTS IN BAD TIMES

In response to your letter of February 2, regarding the sale of equipment trust securities by the railroads at private or public sale, I do not see where the railroads or any other corporation particularly profit in this manner, as I am firmly convinced that the average corporation of that class has enough able-bodied men who know the value of securities and who are in close touch with the market in general, they can demand from their bankers the price they should receive for this class of securities, thereby favoring the bank and bond house who in turn will favor them in a depreciated period.

This may not be true, however, when it comes to the sale of municipal bonds, as the average small town citizenship is not made up of that class of director-

ship. I still favor, and always will, new business with the party who will be able to take care of the requirements in bad times as well as in good times.

HOME TRUST CO., *Kansas City, Mo.*,
JOSEPH DUNER, *Manager Bond Department.*

SLIGHT SAVING IN TIMES OF LARGE DEMAND

As long as the demand for equipment obligations is greatly in excess of the supply, and the credit of all railroads is improving, there is probably a slight saving to the roads through the method of competitive bidding, but we believe that in the long run it is more advantageous to have all the financing of a railroad, equipment and otherwise, handled by one house.

It is our belief that in recent years the great power held by the large financial interests in New York has been more wisely and more justly used than ever before, and that they can be safely trusted to deal justly with all borrowers.

LLOYD & PALMER, *Philadelphia, Pa.*

LESS DISTRIBUTION TO INVESTORS

Referring to your letter of February 1, relative to equipment trusts, it is our opinion that due to overpricing as a result of competitive bidding, the distribution of equipment trusts to investors has acted adversely.

We formerly could distribute many more equipment trusts than we can under the present competitive bidding arrangement.

YOUNG & BLAIR, INC., *Buffalo, N.Y.*,
By C. D. BLAIR.

BENEFITS NOT GREAT

The policy of competitive bidding has undoubtedly resulted in higher prices to the railroads for their securities, but we do not think that the benefits have been as great as at first seemed probable because of the uncertainty of the after-market and the discouragement that many investors felt in buying issues that were priced too high.

BAINBRIDGE & RYAN, *New York City.*

TREAT SAME AS MORTGAGE-BOND ISSUE, OR STOCK

We believe equipment issues should be part of the general financing program of a railroad and be handled by that road's bankers. We can see no reason why a railroad about to sell an equipment-trust issue should not consult its bankers as it would if it were about to sell a mortgage-bond issue, or stock.

MACCALL, FRASER & WHEELER,
Providence, R.I.

SOUND BASIS FOR CRITICISM

The situations are, in any event, not entirely analogous as there can be no control of the set-up of municipal issues nor often any vital need to borrow in an emergency, and these two elements provide, in my opinion, the soundest basis for the criticism of competitive bidding for other types of corporate financing.

DEAN WITTER & CO., *San Francisco, Calif.*,
DEAN WITTER, *President.*

DEALERS REQUIRE A FAIR MARGIN OF PROFIT

Usually we like equipment-trust securities. We have sold very few of them recently, because of the fact that the margin of profit has been so small, that it has not been worth the effort to go out and push them.

We believe something ought to be done to give dealers a fair margin of profit on which to work, and we also believe something should be done to stop the overpricing of these bonds.

If competitive bidding has caused this condition, it seems as if steps to change the situation should be taken.

Goss & Co., *South Bend, Ind.*,
By Harold K. Forsythe, *President.*

WOULD NOT BENEFIT RAILROADS OR PUBLIC

In regard to the question contained in your communication, we are of the opinion that competitive bidding for equipment trust certificates, as suggested by the Interstate Commerce Commission, would not to any degree benefit the railroads, and indirectly, of course, the general public. We are of the opinion that the business judgment and sound management and fiscal policies of the majority of railroads provide automatically the safeguard of realizing the actual worth of equipment-trust certificates sold to underwriters. It is our belief further that competitive bidding would make necessary the acceptance on the part of railroad management the proposals of institutions which were not properly qualified to set up, distribute originally, or maintain subsequent markets for the securities so awarded them. We feel that the possibility of obtaining slightly higher prices for their securities on the part of the railroads would only be temporary, and would be more than offset by the ultimate weakening off due to improper handling of distributions and markets.

Blankenhorn & Co., Inc., *Los Angeles, Calif.*,
By Edward V. Carter, *Vice President.*

COMPETITIVE BIDDING NOT TO BEST INTEREST OF PUBLIC

We have your letter of February 1 in relation to equipment-trust securities issued by the railroads under terms of competitive bidding. Due to the high standing of the banking houses who have specialized in equipment financing, we are firmly of the opinion that the public interest has been in the past, is now, and will be in the future, well served by the continuance of this general practice.

We have seen in the municipal bond business, situations arise whereby municipalities have received far less money for their bonds under competitive bidding than would have been the case had they been privileged to sell direct to some reputable banking house who were really interested in their financing.

Porter, Erswell & Co., *Portland, Me.*,
By W. H. Porter, *President.*

FAVOR RESPONSIBLE BANKERS

We feel that in most cases corporation borrowers can secure better service, greater protection, and, on the whole, as low rates and favorable terms by dealing privately with responsible bankers rather than asking for competitive bids on their special financing.

Ferris & Hardgrove, *Spokane, Wash.*,
By J. E. Ferris, *President.*

SHORTSIGHTED POLICY

It seems to us that railroads are following a rather shortsighted policy in severing valuable connections which have extended over a long period of years with banking houses which have represented them in the distribution of their securities. They are taking this action to avail themselves of more favorable bases of issuing securities, which we believe result purely from the competitive situation at the present time. In the future, if there should be another period of stringent money, as there may very well be, these corporations would probably receive a cold reception upon returning to the houses which have represented them so long, and they would scarcely be in a position to criticize the reception received in view of the action they are taking.

JAMES H. CAUSEY & Co.,
Denver, Colo.,
By JOHN C. ROBERTS, *Treasurer.*

FUTURE INTEREST OF INESTIMABLE VALUE

We have never felt that the public sale of this type of security, that is, railroad or utility securities, works to the ultimate interest of the company. The future interest that an underlying house has in the welfare of the companies whose securities it underwrites is of inestimable value. Wherever competitive bidding enters, this is destroyed.

MILLER, VOSBURG & Co.,
Los Angeles, Calif.,
By L. REVEL MILLER, *President.*

EXCESSIVE PRICES

While undoubtedly under present money market conditions the railroads have been receiving a somewhat higher price for this class of securities, we know that as far as our own actual working under the new plan, that we have distributed practically no equipment trust securities on the basis that it has been our own feeling that practically all new issues have been brought out at excessive prices and without any possible margin of profit to reimburse us for the cost of effecting distribution.

THE NATIONAL BANK OF COMMERCE,
Seattle, Wash.,
By DIETRICH SCHMITZ, *Vice President.*

COMMITTEE EXHIBIT 3

Articles of copartnership, dated December 31, 1932, by and between Felix M. Warburg, Otto H. Kahn, George W. Bovenizer, Lewis L. Strauss, William Wiseman, Frederick M. Warburg, Gilbert W. Kahn, John M. Schiff, Benjamin J. Buttenwieser, Hugh Knowlton, and Elisha Walker

A majority of the parties hereto are transacting business in the city of New York as partners, under the firm name of Kuhn, Loeb & Co. Said firm succeeded other partnerships transacting business under the same firm name, and it and its predecessors have transacted business in the city of New York under the same firm name for more than 60 years, during which time they have also had business relations in and with foreign countries. The parties hereto desire to continue such business from and after January 1, 1933, as a general partnership under the same partnership name.

The parties hereto accordingly agree as follows:

I. The parties hereto hereby continue in general partnership under and pursuant to the laws of the State of New York for the purpose of carrying on the business transacted by them, and such partnership shall be conducted under the firm name of Kuhn, Loeb & Co.

II. The partnership shall continue from year to year unless and until terminated in the manner provided in article IX hereof.

III. The capital of the partnership shall be ———, which shall be contributed by the partners as follows: ———

Each partner, as an expense of the business, shall be entitled to receive interest at the rate of ——— percent per annum from December 31, 1932, payable semiannually on June 30 and December 31 of each year, upon the capital contributed by him as aforesaid, and shall not be entitled to any profits of the business on account of the capital so contributed by him. No part of the capital so contributed by any partner shall be withdrawn without the consent of all the partners so long as he shall remain a member of the partnership.

John M. Schiff, as an expense of the business, shall be entitled to receive interest at the rate of ——— percent per annum from December 31, 1932, payable semiannually on June 30 and December 31 in each year, upon the value of his New York Stock Exchange seat, which value shall be taken at the last price paid for a New York Stock Exchange seat in the year preceding the year for which interest is computed. By contributing the use of his membership in the New York Stock Exchange, John M. Schiff agrees that insofar as it may be necessary for the protection of the creditors of the partnership said membership may be treated as an asset of the partnership.

IV. The partnership shall take over all the assets and assume all the liabilities and commitments of the predecessor firm as of the close of business December 31, 1932.

V. The net profits of the partnership shall be shared by and between the partners in the following proportions: ———

If, instead of net profits, there shall be a net loss in any year, such net loss shall be borne by the partners in the same proportion in which they are entitled to share in the net profits, except that neither ——— nor ———, shall be liable for any share of such net loss, and what would otherwise be their respective shares of such net loss, shall be borne by ——— and ———, who shall be jointly and severally liable therefor, but who as between themselves shall bear such net loss in the proportion that their respective interests in the net profits of the partnership for such year bear to their aggregate interest in such net profits: *And provided further*, That as between themselves, ——— and ——— shall be jointly and severally liable for the aggregate amount of such net loss which the two of them shall be obligated to bear as above, and ——— and ——— shall be obligated to bear as above, and ——— and ——— shall be jointly and severally liable for the aggregate amount of such net loss which the two of them shall be obligated to bear as above. The above-named partners who are liable for net losses further guarantee to each of the following-named partners that his interest in the net profits, as specified in this article V, shall be not less than the following-named amounts in each year, that is to say, ———, which amounts each of said partners shall be entitled to draw in equal monthly installments in each year. Such guaranty shall be joint and several, but as between the partners making the same shall be borne in the same proportion in which they shall bear net losses as hereinabove set forth.

VI. All questions concerning the course of business of the partnership and the transactions which it shall undertake shall be determined, if possible, by unanimous action of the partners, but in case of disagreement such questions shall be determined by a vote of a majority of ———, ———, and ———. No partner shall, without the written consent thereto of the other partners, directly or indirectly speculate or be interested in speculation in stocks or any other article whatsoever. No partner shall directly or indirectly make investments in any securities of which a majority of said ———, ———, and ——— shall disapprove, and in case of such disapproval, such investments shall be promptly disposed of by such partner. No partner shall, without the written consent thereto of the other partners, use the name of the partnership, except in the business of the partnership, or become surety, or, for the accommodation of another, incur any liability either in the name of the partnership or in his individual name. No partner shall borrow or take to his own use any securities or property of the partnership.

VII. In the event of the death or withdrawal or termination of the interest of any partner or partners, the partnership shall be continued by the remaining partners without further action on their part, unless and until terminated as in article IX hereof provided. The interest of any deceased partner shall remain until the December 31, next succeeding his death, up to which time his executors or administrators or other legal representatives (hereinafter referred

to as personal representatives) shall be entitled to the same share of profits, and shall bear the same share of losses, as would have been received or borne by him had he survived; *Provided*, That if such partner shall die on December 31 of any year his interest shall terminate on that date. Upon the termination of the interest of any partner, his interest in the profits and his responsibility, if any, for losses shall be allocated by the unanimous action, if possible, of the surviving or remaining partners, but in case of disagreement, such allocation shall be made by the vote of a majority of ———, ———, ———, and ———. The same procedure shall be followed in case any interest in profits or responsibility for losses arising from the reduction of the interest of any partner or otherwise, is to be allocated.

VIII. In the event of the death of any partner, the survivors shall value the assets of the partnership as of the December 31 next succeeding his death, or if he shall die on a December 31, as of such December 31, at the fair market value thereof at that time according to their judgment. Pursuant to the practice that has prevailed since the beginning of the business, no value shall be included for good will, nor for the right to use the name of the partnership. The parties have entire confidence that a valuation by the survivors, in case of the decease of a partner, will be fairly made, and for reasons which are satisfactory to the parties they regard it as to their interest that the survivors shall make such valuation. The survivors shall make such valuation notwithstanding their interest and notwithstanding that one or more of them may be executor or administrators of the deceased partner. On the basis of such valuation, the interest of the deceased partner shall be ascertained and settled. In case at the time of his death any partner shall be indebted to the firm, the amount of such indebtendness, with interest, shall be taken into account as a set-off and deducted in ascertaining and settling the interest of such deceased partner. In case of the death of a partner, the survivors shall furnish to his personal representatives a statement of the amount of the interest of his estate in the partnership on the basis of such valuation, and the same shall be accepted by the personal representatives of the deceased partner, and without examination of the books of account of the partnership except by such of the personal representatives of the deceased partner, if any, as may happen to be partners. The parties enjoin upon their personal representatives the observance of this provision, which is made for mutual benefit.

In case of the death of a partner the survivors shall (except as herein otherwise provided) have 6 months succeeding such December 31 in which to pay his interest in the capital and profits of the partnership as the same shall have been ascertained. The survivors may at their option pay the whole or any part of the amount due from time to time during such 6 months. Interest upon all unpaid amounts shall run at the rate of ——— percent per annum from such December 31. The survivors may at their option, to be exercised by 30 days' written notice given not later than such December 31, or if such partner shall have died between December 1 and December 31, inclusive, of any year, not later than 30 days after such death, turn over to the personal representatives of a deceased partner; and the personal representatives of a deceased partner may at their option, to be exercised by like notice, require delivery of (in each case at valuations to be fixed as hereinbefore provided) an amount of any or all securities or loans belonging to the partnership (certificates of interest therein in cases where suitable subdivision cannot be made), not, however, greater in the case of any security or loan than the proportion of his obligation for losses, if any, of the business, even though the same may exceed the amount due him on capital and profit accounts: *And provided further*, That so long as the firm or any successor which has assumed its obligations shall exist the surviving partners shall, and they hereby agree that they will, in disposing of such securities and loans as shall remain to them, make a similar disposition of those which shall come to the representatives of the deceased partner, if such personal representatives so desire; that is to say, they shall treat all alike.

If such securities and loans, either or both, shall be subject to any syndicate agreement or other agreement to which the partnership with other persons shall be a party, which affect such securities or loans, the proportion therein of such deceased partner so to be turned over to his personal representatives, shall remain subject to such agreement. The surviving partners shall have said period of 6 months, however, in which to turn over the securities and loans to be received by the personal representatives of a deceased partner and may turn over the same from time to time during that period. If the

amount of securities and loans which shall come to the personal representatives of the deceased partner as hereinbefore provided shall exceed the amount due him on partnership account, such personal representatives shall pay such surviving partners the amount of such excess, and they shall have 6 months from such December 31 within which to do so, and during that 6 months they may at any time and from time to time make payments on account. Interest on all unpaid amounts at the expiration of such 6 months shall run at the rate of ——— percent per annum. The right to deliver securities shall not apply to any partner not contributing capital to the firm, nor shall the right to require such delivery apply to any such partner unless there shall have been a net profit for the year. All of the foregoing provisions of this article VIII shall be applicable to a case of a partner whose interest in the partnership is terminated by withdrawal, dissolution, or in any other manner.

The term "survivors" as used herein shall mean surviving or remaining partners, as the case may be. It is expected that all action required on the part of the survivors hereunder will be taken by unanimous vote but in case of disagreement, such action shall be taken by the vote of a majority of ———, ———, ———, and ———, or the survivors of such four partners.

IX. The right to use the name Kuhn, Loeb & Co., and to use the books and records and the place of business of the partnership shall be confined to ———, ———, ———, ———, ———, and ———. Such right shall continue in said five partners so long as they are partners in the partnership, or in any partnership succeeding it, and shall cease as to any one of said five partners who shall for any reason cease to be a partner in the partnership or in any partnership succeeding it.

It is hoped and expected that any action involving the exercise of the rights and privileges reserved to the partners named in this article as having the right to use the name Kuhn, Loeb & Co., will be by unanimous agreement of said partners, but in case there should be disagreement, such action shall be determined by a majority vote of ———, ———, ———, as long as they are partners in the partnership. If in the case of death or of other incapacity of any of the partners named in this article, there shall not at any time any action is proposed to be taken under this article be a partner living who shall be entitled to cast the vote as stated above of such ——— the personal representatives of the partner who shall have last represented such ——— shall be entitled to designate any partner of the partnership to cast the vote to which ——— would otherwise be entitled under this article. Any action so taken by a majority vote shall for all purposes be deemed to be the unanimous action of said partners.

On December 31 of any year, having given, on or before November 1 of such year, notice in writing to the other partners, such of said partners named in this article as shall then have the right to use the name Kuhn, Loeb & Co., or a majority of them voting as hereinbefore provided, shall have the right to dissolve the partnership and after such dissolution, with the consent of such of said partners named in this article as shall then have the right to use the name Kuhn, Loeb & Co., or a majority of them voting as hereinbefore provided, one or more of the partners of the dissolved partnership shall have the right to form a new partnership, corporation, or association under the name Kuhn, Loeb & Co., with or without other partners or stockholders, subject, however, to the conditions hereinabove provided.

On December 31 in any year, having given, on or before November 30 of such year, notice in writing to the other partners, such of said partners named in this article as shall then have the right to use the name Kuhn, Loeb & Co., or a majority of them voting as hereinbefore provided, shall have the right to admit an additional partner or partners into the partnership and to determine the proportions in which the net profits of the partnership shall thereafter be shared and the net losses borne by and between the partners: *Provided*, That if any such notice is given, any partner not wishing to remain in the partnership may withdraw from the partnership on December 31 of such year by giving at least 2 weeks' notice in writing to all the other partners.

Notwithstanding any other provisions of this agreement, on December 31 of any year, the interest of any partner in the partnership may be terminated by notice in writing given to him on or before November 1 of such year by such of said partners named in this article as shall then have the right to use the name Kuhn, Loeb & Co., or a majority of them voting as hereinbefore provided.

X. On December 31 of any year, having given on or before October 1 of such year, notice in writing to the other partners (except in the particular case hereinabove in the fourth paragraph of article IX referred to providing for two weeks' notice of withdrawal), any partner may withdraw from the partnership.

XI. If any partner shall withdraw from the partnership, or if the interest of any partner is terminated, or if the partnership shall be dissolved, and after such dissolution and with the consent aforesaid, a new partnership, corporation, or association shall be formed as hereinbefore provided, each partner so withdrawing or whose interest is terminated, and each partner who shall not be a member of the new partnership or a stockholder of the corporation or association so to be formed, covenants and agrees that he will not, for a period of 3 years thereafter, conduct, or in any way become interested directly or indirectly (either individually, as a member of a partnership, or as an officer of, or through an active interest in, a corporation or association), in, or in the vicinity of, the city of New York, in a business similar to that which has been conducted, or similar to that which under these articles of copartnership shall be conducted, by the partnership of Kuhn, Loeb & Co.; but this provision may be waived in writing at any time, as to any partner, wholly or in part, by the partners named in article IX hereof who shall at the time of such waiver have the right to use the name Kuhn, Loeb & Co., or a majority of them voting as in said article IX provided. In case of the dissolution of the partnership and the continuation of the business thereof by a new partnership, corporation, or association in accordance with the provisions of this article XI, the liquidation of the interest of the partner or partners of the dissolved partnership who do not become members of the new partnership, or stockholders of the corporation or association so to be formed, shall be conducted by the remaining partners in accordance with the provisions of the article VIII hereof.

XII. In case the partnership is dissolved and its business is not continued by a new partnership, corporation, or association, the business shall be liquidated by such partner or partners as shall be selected by a majority of ———, ———, ———, and ———, any of whom may themselves be selected, and upon such terms and conditions not inconsistent with this agreement and for such compensation to said liquidating partner or partners as such majority may determine. Interest at the rate of — percent per annum shall continue upon capital and other moneys of partners until the same shall be actually paid. The distribution among the partners or the personal representatives of a deceased partner shall be in proportionate shares and in monthly installments as the business shall be liquidated.

In case any vote or other action on the part of ———, ———, ———, and ——— shall be required by the provisions of articles VI, VIII, or this article XII of this agreement, and ——— and/or ——— shall have died or for any reason be incapacitated from voting or acting, ——— may vote or act in the place of ——— and ——— may vote or act in the place of ——— and the then executors or personal representatives of ——— or ———, respectively, may designate any partner to so vote or act in his place.

XIII. Should differences arise among the partners or with a partner withdrawing from the partnership or with a partner whose interest is terminated or with the personal representatives of a deceased partner with respect to the dissolution of the partnership, or the payment of the interest of a deceased or withdrawing partner or of a partner whose interest is terminated or the delivery of securities or loans, or other matters growing out of the partnership, the same shall be settled by arbitration as follows: Either party to such differences may select an arbitrator, and in writing notify the other party of such selection. Within 5 days after receipt thereof, the other party may select an arbitrator and give written notice thereof to the first party. The determination of the arbitrator first chosen, unless another shall be so selected, and, in such case, the determination of the two thus chosen or, in the event of their disagreement, of two out of three consisting of such two and a third to be agreed upon in writing by them, shall be final and conclusive. If such two first chosen arbitrators cannot in such event of disagreement agree upon a third arbitrator within 10 days after such disagreement, the third arbitrator shall be appointed at the request of either of such two arbitrators by the senior judge of the United States Circuit Court of Appeals for the Second Circuit.

For the purposes of this agreement any notice to be given to any of the partners shall be sufficiently given if delivered to him personally in writing or

sent by registered mail addressed to him in care of Kuhn, Loeb & Co., 52 William Street, New York City.

XIV. Every position of trustee or director of a financial or business corporation or association or of membership in a reorganization committee, and every other position having relations to financial or other business enterprises, which may be held by any of the partners, shall be held by him, as between the partners, on behalf of the partnership. Each partner hereby severally agrees that he will relinquish any such position at any time upon a demand of a majority of ———, ———, ———, and ———.

COMMITTEE EXHIBIT No. 4

QUESTION NO. 14

Kuhn, Loeb & Co. balance sheet, Dec. 31, 1927

Cash on hand and in banks	$1,904,952.28
Call loans secured by stock-exchange collateral	60,825,000.00
Time loans secured by stock-exchange collateral	1,150,000.00
All other loans	6,478,136.67
Accounts receivable	16,457,667.76
State and municipal bonds	2,931,668.91
Other bonds and stocks	7,427,202.40
New York Stock Exchange membership	70,000.00
Total	97,244,628.02
Capital	20,000,000.00
Deposits	69,449,016.08
Accounts payable	7,795,611.94
Total	97,244,628.02

Kuhn, Loeb & Co. balance sheet Dec. 31, 1928

Cash on hand and in banks	$747,157.81
Call loans secured by stock-exchange collateral	46,180,000.00
All other loans	2,077,670.01
Accounts receivable	6,455,582.74
State and municipal bonds	15,859,779.25
Other bonds and stocks	15,043,781.10
Total	86,363,970.91
Capital	20,000,000.00
Deposits	58,821,113.02
Accounts payable	7,542,857.89
Total	86,363,970.91

Kuhn, Loeb & Co. balance sheet, Dec. 31, 1929

Cash on hand and in banks	$1,999,739.30
Call loans secured by stock-exchange collateral	39,350,000.00
Time loans secured by stock-exchange collateral	10,000,000.00
All other loans	8,634,640.82
Accounts receivable	10,796,770.75
State and municipal bonds	27,080,026.22
Other bonds and stocks	22,540,926.69
Total	120,402,103.78
Capital	25,000,000.00
Deposits	88,549,766.13
Accounts payable	6,852,337.65
Total	120,402,103.78

Kuhn, Loeb & Co. balance sheet, Dec. 31, 1930

Cash on hand and in banks	$3,435,565.80
Call loans secured by stock-exchange collateral	8,725,000.00
All other loans	9,339,298.61
Accounts receivable	9,012,002.35
U.S. Government certificates of indebtedness	9,146,956.00
State and municipal bonds	24,403,922.07
Other bonds and stocks	21,093,007.69
Total	85,155,752.52
Capital	25,000,000.00
Deposits	57,032,847.08
Accounts payable	3,122,905.44
Total	85,155,752.52

Kuhn, Loeb & Co. balance sheet, Dec. 31, 1931

Cash on hand and in banks	$16,295,242.63
Call loans secured by stock-exchange collateral	300,000.00
All other loans	8,378,314.21
Accounts receivable	777,409.31
U.S. Government Treasury bills and certificates	24,919,859.72
State and municipal bonds	9,953,051.25
Other bonds and stocks	6,350,968.34
Total	66,974,845.46
Capital	21,250,000.00
Deposits	29,118,918.20
Accounts payable	16,605,927.26
Total	66,974,845.46

COMMITTEE EXHIBIT 5

QUESTION 14

European Merchant Banking Co., Ltd., London, balance sheet as at December 31, 1927

ASSETS

	£	s.	d.
Cash in hand	89	14	5
Investments (quoted stocks at market prices ruling at Dec. 31, 1927. Unquoted stocks as valued by the managing directors)	111,826	8	6
Sundry debtors and debit balances:			
Foreign currency credit balances	316	12	7
Stockbrokers' accounts (in respect of securities sold for future settlement)	42,573	3	0
Loans, advances, and amounts due from clients	2,882	3	7
Syndicate participations at cost	61,917	19	8
Sundry debit balances	1,534	18	1
Total	109,224	16	11
Preliminary expenses	3,667	19	8
Profit and loss account (loss for the 9 months ended Dec. 31, 1927	7,501	10	11
Total	232,310	10	5

LIABILITIES

	£	s.	d.
Capital:			
Authorized:			
5,000 management shares of £1 each	5,000	0	0
300,000 ordinary shares of £1 each	300,000	0	0
Issued:			
5,000 management shares of £1 each, fully paid	5,000	0	0
300,000 ordinary shares of £1 each, 5 shillings paid	75,000	0	0
Total	80,000	0	0
Sundry creditors and credit balances:			
Westminister Bank, Ltd., overdraft	8,073	19	0
Stockbrokers' accounts (in respect of securities purchased for future settlement)	5,504	5	1
Sundry accounts	138,732	6	4
Total	152,310	10	5
Grand total	232,310	10	5

NOTE.—Contingent liabilities at December 31, 1927, in respect of: (1) Partly paid investments held, £437 10s. 0d., (2) Options outstanding, £16,500.

European Merchant Banking Co., Ltd., London, balance sheet as at Dec. 31, 1928

ASSETS

	£	s.	d.
Cash at bankers	8,088	7	9
Loans at call	125,000	0	0
Investments	77,680	6	1
Participations	6,418	8	3
Profit and loss account [1]	1,953	2	11
Debtors	4,470	2	9
Stockbrokers	16,808	13	1
Sundry suspense accounts, income tax, etc. (mostly recoverable)	1,501	7	7
Formation expense account	3,667	19	8
Office decoration account	5,041	3	10
Total	250,629	11	11

LIABILITIES

Capital account	80,000	0	0
Creditors	169,850	12	8
Sundry suspense accounts	778	19	3
Total	250,629	11	11

European Merchant Banking Co., Ltd., London, balance sheet as at December 31, 1929

ASSETS

	£	s.	d.
Cash at bankers	9,519	15	3
Loans at call	90,000	0	0
Investments	65,207	3	2
Participations	8,966	2	3
Stockbrokers' account	12,617	8	8
Debtors	6,992	18	3
Sundry suspense accounts, income tax, etc	413	17	11
Formation expense account	3,667	19	8

[1] After allowing for the loss of £7,501 10s. 11d. carried forward from 1927.

	£	s.	d.
Office decorations account	4,850	9	4
Profit and loss account	32,360	10	2
Total	234,596	4	8

LIABILITIES

Capital account	80,000	0	0
Creditors	152,364	4	11
Sundry suspense accounts	2,231	19	9
Total	234,596	4	8

European Merchant Banking Co., Ltd., London, balance sheet as at Dec. 31, 1930

ASSETS

	£	s.	d.
Cash at bank	7,477	15	11
Money on short notice	40,000	0	0
Sundry debtors and outstandings:			
Foreign currency balances	126	9	6
Stockbrokers' accounts in respect of securities sold for future settlement	2,562	16	6
Loans, advances and amounts due from clients	5,221	16	9
Sundry debtors and outstandings	1,232	7	11
Total	9,143	10	8
Office decorations, furniture, and fittings at cost, less depreciation			
Per last balance sheet	4,850	9	4
Less: Amount written off	4,850	9	4
Preliminary expenses at cost, less amount written off:			
Per last balance sheet	3,667	19	8
Less: Amount written off	3,667	19	8
Profit and loss account:			
Balance at debit, Dec. 31, 1929	32,360	10	2
Add:			
Loss for the year ended Dec. 31, 1929	24,159	19	5
Office decorations, furniture and fittings, amount written off	4,850	9	4
Preliminary expenses written off	3,667	19	8
Total	65,038	18	7
Grand total	121,660	5	2

LIABILITIES

Capital:			
Authorized:			
5,000 management shares of £1	5,000	0	0
300,000 ordinary shares of £1 each	300,000	0	0
Total	305,000	0	0
Issued:			
5,000 management shares of £1 each, fully paid	5,000	0	0
300,000 ordinary shares of £1 each, 7s. paid	105,000	0	0
Total	110,000	0	0

	£	s.	d.
Sundry creditors:			
Stockholders' accounts in respect of securities purchased for future settlement	207	1	1
Deposit and current accounts	9,941	13	5
Sundry creditors	1,511	10	8
Total	11,600	5	2
Total	121,660	5	2

NOTE.—The unpaid accrued cumulative preferential dividend on the management shares at December 31, 1930, amounted to £750.

European Merchant Banking Co., Ltd., London, liquidator's statement of account from Jan. 1 to Dec. 30, 1931

	£	s.	d.
To assets realized:			
Cash at bankers	7,477	15	11
Cash at call	40,000	0	0
Foreign currency balances	126	9	6
Stockbrokers' accounts	2,562	16	6
Loans, advances, and amounts due from clients	5,221	16	9
Sundry debtors	1,232	7	11
Total	56,621	6	7
To net amount realized, brought down	44,961	1	5
To directors' fees received	193	16	6
To interest received	197	18	2
To sundry receipts	9	15	1
To dividends and other amounts collected on behalf of clients	1,841	9	11
Total	47,204	1	1
By liabilities discharged:			
Stockbrokers	207	1	1
Deposit and current accounts	99,941	13	5
Sundry creditors	1,511	10	8
Sundry net amount realized carried down	44,961	1	5
Total	56,621	6	7
By legal charges	252	0	1
By postage, telephone calls, lighting and sundry expenses	33	13	5
By income tax	50	4	0
By liquidator's remuneration	525	0	0
By amounts paid to, or on behalf of, clients	1,841	9	11
By payments authorized by extraordinary general meeting on 2d April, 1931:			
Gordon Leith — 34,000			
Harold Wooding — 4,500			
	38,500		
By balance, available for distribution among members, carried down	6,001	13	8
Total	47,204	1	1