STOCK EXCHANGE PRACTICES

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE COMMITTEE ON BANKING AND CURRENCY UNITED STATES SENATE

SEVENTY-SECOND CONGRESS

SECOND SESSION

ON

S. Res. 84 and S. Res. 239

RESOLUTIONS TO THOROUGHLY INVESTIGATE PRACTICES OF STOCK EXCHANGES WITH RESPECT TO THE BUYING AND SELLING AND THE BORROWING AND LENDING OF LISTED SECURITIES THE VALUES OF SUCH SECURITIES AND THE EFFECTS OF SUCH PRACTICES

PART 6

(NATIONAL CITY; CONTINUATION OF RICHARD WHITNEY TESTIMONY)

FEBRUARY 21, 22, 23, 24, 27, 28, AND MARCH 1 AND 2, 1933

Printed for the use of the Committee on Banking and Currency



UNITED STATES
GOVERNMENT PRINTING OFFICE
119852 WASHINGTON : 1933

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

STOCK EXCHANGE PRACTICES

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE
COMMITTEE ON BANKING AND CURRENCY
UNITED STATES SENATE

SEVENTY-SECOND CONGRESS

SECOND SESSION

ON

S. Res. 84 and S. Res. 239

RESOLUTIONS TO THOROUGHLY INVESTIGATE PRACTICES OF STOCK EXCHANGES WITH RESPECT TO THE BUYING AND SELLING AND THE BORROWING AND LENDING OF LISTED SECURITIES THE VALUES OF SUCH SECURITIES AND THE EFFECTS OF SUCH PRACTICES

PART 6

(NATIONAL CITY; CONTINUATION OF RICHARD WHITNEY TESTIMONY)

FEBRUARY 21, 22, 23, 24, 27, 28, AND MARCH 1 AND 2, 1933

Printed for the use of the Committee on Banking and Currency



UNITED STATES
GOVERNMENT PRINTING OFFICE
119852 WASHINGTON : 1933

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

COMMITTEE ON BANKING AND CURRENCY

PETER NORBECK, South Dakota, *Chairman*

SMITH W. BROOKHART, Iowa.	DUNCAN U. FLETCHER, Florida.
PHILLIPS LEE GOLDSBOROUGH, Maryland.	CARTER GLASS, Virginia.
JOHN G. TOWNSEND, JR., Delaware.	ROBERT F. WAGNER, New York.
FREDERIC C. WALCOTT, Connecticut.	ALBEN W. BARKLEY, Kentucky.
JOHN J. BLAINE, Wisconsin.	ROBERT J. BULKLEY, Ohio.
ROBERT D. CAREY, Wyoming.	THOMAS P. GORE, Oklahoma.
JAMES E. WATSON, Indiana.	EDWARD P. COSTIGAN, Colorado.
JAMES COUZENS, Michigan.	CORDELL HULL, Tennessee.
FREDERICK STEIWER, Oregon.	ROBERT R. REYNOLDS, North Carolina.

JULIAN W. BLOUNT, *Clerk*

SUBCOMMITTEE ON SENATE RESOLUTIONS 84 AND 239

PETER NORBECK, South Dakota, *Chairman*

JOHN G. TOWNSEND, JR., Delaware.	DUNCAN U. FLETCHER, Florida.
JOHN J. BLAINE, Wisconsin.	CARTER GLASS, Virginia.
JAMES COUZENS, Michigan.	EDWARD P. COSTIGAN, Colorado.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

CONTENTS

	Page
Testimony of—	
Baker, Hugh B., president National City Co., New York City	1889
Baker, Hugh B., president National City Co., New York City (resumed)	1911, 1926, 1965, 2006, 2047, 2060, 2080
Baldwin, Samuel W., treasurer National City Co	2141
Barrett, Edward F., a vice president, National City Co	2196
Brown, Edgar D., Pottsville, Pa	2170
Byrnes, Ronald M., late a vice president of National City Co	2119
Byrnes, Ronald M., late a vice president of National City Co. (resumed)	2298
Calvin, C. W., memorandum on the financing of the Peruvian Government	2103
Covington, J. H., Washington, D.C., counsel for National City Bank, statement of	2043
Davison, George W., Greenwich, Conn., officer of Central Honover Bank & Trust Co., New York	1759
Law, Harry S., secretary, National City Co	1900
Law, Harry S., secretary, National City Co. (resumed)	2147
Lehmann, Frederick W., Solicitor General of the United States, opinion of	2030
Meehan, M. J., stock broker, New York City	2343
Mitchell, Charles E.. chairman of the board, National City Bank of New York and National City Co	1762
Mitchell, Charles E., chairman of the board, National City Bank of New York and National City Co. (resumed)	1780, 1827, 1887, 1982, 2026, 2044, 2265
Mitchell, William D., Attorney General of the United States, letter of	2044
Rentschler, Gordon S., president National City Bank, New York City	1867
Ripley, Joseph P., a vice president of the National City Co	2324
Roberts, Grace Van B., Highland, Ulster County, N. Y., additional statement of	1821
Robinson, Edwin S., Brooklyn, N.Y., formerly an employee of J. R. Schmeltzer & Co., brokers	1998
Russell, Stanley A., a vice president of the National City Co	2269
Schoepperle, Victor, vice president, National City Co	2059
Schoepperle, Victor, vice president, National City Co. (resumed)	2088
Sylvester, Horace C., a vice president of the National City Co	2183
Train, George F., foreign department, National City Co	2139
Train, George F., foreign department, National City Co. (resumed)	2151
Whitney, Richard, president New York Stock Exchange	2202
Whitney, Richard, president New York Stock Exchange (resumed)	2227

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

STOCK EXCHANGE PRACTICES

TUESDAY, FEBRUARY 21, 1933

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

The subcommittee met, pursuant to adjournment on Friday, February 17, 1933, at 10 a. m., in room 301, Senate Office Building, Senator Peter Norbeck presiding.

Present: Senators Norbeck (chairman), Couzens, Townsend, Glass, and Costigan.

Present also: Senators Brookhart, Goldsborough, Walcott, Watson, Barkley, Bulkley, and Reynolds.

Further present: Ferdinand Pecora, special counsel to the committee; Julius Silver and David Saperstein, associate counsel to the committee.

The CHAIRMAN. The subcommittee will come to order. Mr. Pecora, call your first witness.

Mr. PECORA. We will ask Mr. George W. Davison to come forward. Mr. Chairman, he is called as a witness in connection with the Insull matter and is anxious to get away.

The CHAIRMAN. Please stand, hold up your right hand, and be sworn: You solemnly swear that you will tell the truth, the whole truth, and nothing but the truth regarding the matter now under investigation by this committee, so help you God.

Mr. DAVISON. I do.

TESTIMONY OF GEORGE W. DAVISON, GREENWICH, CONN., AN OFFICER OF THE CENTRAL HANOVER BANK & TRUST CO., OF NEW YORK CITY

Mr. PECORA. Mr. Davison, will you kindly give your full name, address, and business?

Mr. DAVISON. My name is George W. Davison. My residence is Greenwich, Conn. I am interested in banking and am an officer of the Central Hanover Bank & Trust Co.

Senator COUZENS. How long have you been in the banking business?

Mr. DAVISON. Not quite 21 years. It will be 21 years in April.

Senator COUZENS. Are you also a lawyer as well as a banker?

Mr. DAVISON. Yes, I was.

Senator COUZENS. You were?

Mr. DAVISON. I am.

Mr. PECORA. What office do you hold in the Central Hanover Bank & Trust Co.?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. DAVISON. Chairman of the board.

Mr. PECORA. How long have you been identified with that bank in an official capacity?

Mr. DAVISON. Twenty-one years on April 2.

Mr. PECORA. Did your bank have a number of loans outstanding in favor of Insull Utility Investments, Inc., Corporation Securities Co. of Chicago, and other companies identified with the so-called Insull group of public-utility companies?

Mr. DAVISON. We had a loan to Insull Utilities and a loan to Corporation Securities Co., and one to National Public Service.

Mr. PECORA. What was the aggregate amount of those loans in December 1931?

Mr. DAVISON. They were $12,500,000.

Mr. PECORA. Were any of those loans reduced in that month?

Mr. DAVISON. They were.

Mr. PECORA. By what amount or amounts, and when?

Mr. DAVISON. The Insull Utilities loan was reduced $500,000, I think on the 24th of December, and the Corporation Securities loan was reduced $1,000,000, I think, on the 28th of December.

Mr. PECORA. What was the aggregate amount of those loans?

Mr. DAVISON. Each was for $5,000,000.

Mr. PECORA. And at times subsequent to the making of the loans did your bank call upon the borrowers for additional collateral to secure the loans?

Mr. DAVISON. We did.

Mr. PECORA. And received such collateral?

Mr. DAVISON. They did.

Mr. PECORA. And the collateral consisted for the most part of securities issued by one or more of the Insull Cos.?

Mr. DAVISON. The collateral were securities of operating companies, Commonwealth Edison, People's Gas, Public Service of Northern Illinois, and some Mid-West utilities.

Mr. PECORA. You know, do you not, that all those companies are in the so-called Insull group?

Mr. DAVISON. Yes.

Mr. PECORA. Between June and December of 1931 were you familiar with certain debenture obligations which were then outstanding against Insull Utility Investments, Inc., and Corporation Securities Co. of Chicago?

Mr. DAVISON. I was not.

Mr. PECORA. At no time during that period were you familiar with those debenture obligations?

Mr. DAVISON. At no time during that time.

Mr. PECORA. Did you have any conversations with Mr. Owen D. Young with regard to those loans at any time prior to the 1st of January 1932?

Mr. DAVISON. No.

Mr. PECORA. Did you have any communication with him on the subject?

Mr. DAVISON. No.

Mr. PECORA. Do you know whether any other officer of your bank had such conversation or communication?

Mr. DAVISON. I am rather certain not, but am not positive.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Did you have any such conversation or communication between the 1st of January and the 16th of April, 1932?

Mr. DAVISON. Yes.

Mr. PECORA. With whom?

Mr. DAVISON. Mr. Young.

Mr. PECORA. What was the general substance of the conversations?

Mr. DAVISON. Some time in February Mr. Young came in and talked about the Insull situation, and I think he asked our cooperation. An agreement had been made in December about not calling for additional collateral, but it had not been signed, I think, by anybody.

Mr. PECORA. That is the so-called "standstill agreement"?

Mr. DAVISON. It has been referred to in that way. We were claiming that we had the right to go ahead, and I think that was the subject of Mr. Young's conversation, that we should not do it, and that the Insull situation probably was not hopeless.

Mr. PECORA. Well, as a result of that conversation did your bank stand still?

Mr. DAVISON. We did.

Mr. PECORA. And when did you first learn of those debenture obligations that I have referred to?

Mr. DAVISON. I think it was the end of February, 1932.

Mr. PECORA. But that was not your first knowledge of these loans which your bank had made?

Mr. DAVISON. Oh, no.

Mr. PECORA. Did you consult the files of your bank with regard to those loans at any time prior to February, 1932?

Mr. DAVISON. I did not; no.

Mr. PECORA. Did you at any time consult the files of your bank with regard to those loans?

Mr. DAVISON. No.

Mr. PECORA. Do you know now that among the files of your bank with regard to the loans there was a memorandum relating to those debenture obligations?

Mr. DAVISON. I do not.

Mr. PECORA. Did you, at the outset, take any part in the conferences that led to the making of the loans to those Insull companies originally?

Mr. DAVISON. Yes.

Mr. PECORA. Did you take part in any subsequent conferences which led to the making of payments on account of those loans?

Mr. DAVISON. Yes.

Mr. PECORA. And which also led to the making of demand for additional collateral to secure the loans?

Mr. DAVISON. No; I did not have anything to do with that.

Mr. PECORA. And at no time prior to February, 1932, did you learn of these debenture obligations?

Mr. DAVISON. That is correct.

Mr. PECORA. That is all.

The CHAIRMAN. Mr. Davison, you will be excused.

Mr. DAVISON. Thank you.

(Thereupon the witness was excused.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Mr. Chairman, I now ask that Mr. Charles E. Mitchell be called.

The CHAIRMAN. You will stand, hold up your right hand and be sworn, Mr. Mitchell.

Mr. PECORA. Mr. Chairman, Mr. Mitchell is simply recalled for further examination. He has already been sworn in these hearings.

The CHAIRMAN. Very well.

TESTIMONY RESUMED OF CHARLES E. MITCHELL, CHAIRMAN OF THE BOARD, NATIONAL CITY BANK OF NEW YORK AND NATIONAL CITY CO.

(The witness was sworn on his prior appearance before the committee.)

Mr. PECORA. Mr. Mitchell, I believe you have heretofore been sworn as a witness before this committee.

Mr. MITCHELL. I have.

Mr. PECORA. And you are now being recalled for further examination.

Mr. MITCHELL. All right.

Mr. PECORA. In your prior testimony you gave some testimony with respect to the organization of the National City Co. I believe you said it was organized in 1911.

Mr. MITCHELL. I think that is correct.

Mr. PECORA. Under the laws of which State was it incorporated?

Mr. MITCHELL. Of New York State.

Mr. PECORA. When did you first become connected with the National City Co.?

Mr. MITCHELL. In 1916.

Mr. PECORA. When did you first become connected with the National City Bank?

Mr. MITCHELL. In 1921.

Mr. PECORA. That bank was organized in the year 1812, was it not?

Mr. MITCHELL. It was.

Mr. PECORA. And the National City Co. is regarded as the investment affiliate of the National City Bank of New York?

Mr. MITCHELL. It is.

Senator COUZENS. In fact, the National City Bank owns all of the stock of the National City Co., or their stockholders do; isn't that true?

Mr. MITCHELL. I think I explained that in my previous testimony, Senator Couzens.

Senator COUZENS. I think you did.

Mr. MITCHELL. The stock of the National City Co. is trusteed with three trustees for the benefit of the shareholders of the National City Bank; and a record of that beneficial interest, through the trustees, appears on the reverse side of the stock certificates of the National City Bank.

Senator COUZENS. That was my understanding.

Mr. PECORA. When was that trust agreement prepared and when did it become effective?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. I assume that it did at the time of the organization, Mr. Pecora. I can not conceive it as being otherwise, but I would have to look it up.

Mr. PECORA. You mean at the time of the organization of the National City Co. in 1911?

Mr. MITCHELL. Quite so.

Mr. PECORA. Who were the original trustees under that trust agreement for the benefit of the shareholders of the National City Bank?

Mr. MITCHELL. I have not refreshed my memory on that, and I would rather leave it to the record.

Mr. PECORA. How many trustees are there under this agreement?

Mr. MITCHELL. Three, I think.

Mr. PECORA. Do you know who the three trustees are today?

Mr. MITCHELL. I think the trustees today are Mr. Beekman Winthrop, Mr. Percy A. Rockefeller, and Mr. James A. Stillman. That is my recollection. That, again, I would prefer to leave to the record.

Mr. PECORA. How were those trustees designated or chosen?

Mr. MITCHELL. That I cannot say. I have not refreshed my memory on that particular phase of the situation, Mr. Pecora.

Mr. PECORA. By the exercise of whose power are they subject to removal?

Mr. MITCHELL. Again I should have to give the same answer there. It is a matter of record, and if I were to be asked to state from memory I should say the board of directors of the National City Bank. But of that I am not wholly certain.

Mr. PECORA. May I suggest, Mr. Mitchell, that a memorandum be made of these various matters with respect to which you want to inform yourself from the records?

Mr. MITCHELL. Certainly.

Mr. PECORA. So that you may have an opportunity later of informing the committee of those items.

Mr. MITCHELL. Certainly. I will give you a memorandum for the use of the committee with respect to them.

Mr. PECORA. All right. Now, Mr. Mitchell, do you know whether the trustees at any time since their designation in 1911 have held any stated meetings?

Mr. MITCHELL. They have met from time to time, but what their procedure has been I do not know.

Mr. PECORA. Do they have stated meetings or do they meet on rare occasions and in an informal fashion?

Mr. MITCHELL. I do not know how informal their meetings are, but they meet on occasion.

Mr. PECORA. Do you know whether minutes or other records of the business transacted by them at their meetings are kept?

Mr. MITCHELL. I do not know.

Mr. PECORA. Will you find out by reference to the records of the bank?

Mr. MITCHELL. I will.

Mr. PECORA. Do you know what powers are exercised by those trustees for the shareholders of the bank?

Mr. MITCHELL. They have all the powers incident to shareholder ownership.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Do you mean that they vote the stock for the shareholders at all meetings of the banks' shareholders?

Mr. MITCHELL. They vote as trustees all the National City Co. stock.

Mr. PECORA. Well, they represent all shareholders of the bank, don't they?

Mr. MITCHELL. They are acting as trustees of this stock for the benefit of the shareholders of the bank.

Mr. PECORA. Well, do they vote the stock either of the bank or of the National City Co. at meetings of the shareholders of those organizations?

Mr. MITCHELL. They vote all the stock of the National City Co.

Mr. PECORA. Now, sometime subsequent to 1911 did the National City Bank enter into an arrangement or agreement with the banking institution known as the Farmers Loan & Trust Co.?

Mr. MITCHELL. Might I have a repetition of your question?

Mr. PECORA. I will ask the committee reporter to read it to you [which was done].

Mr. MICHELL. It entered into an agreement for the merging of the interests of those institutions, and the Farmers Loan & Trust Co. was merged with the National City Bank.

Mr. PECORA. When did that happen, Mr. Mitchell?

Mr. MITCHELL. It happened in the spring of 1929.

Mr. PECORA. At that time was the capital stock of the National City Bank increased in order to effect that merger?

Mr. MITCHELL. It was.

Mr. PECORA. By what amount?

Mr. MITCHELL. Of course, that is a matter of record, Mr. Pecora. I would have to again refresh my memory. I will give you a statement of that if that is all right.

Mr. PECORA. All right. Now, Mr. Mitchell, can you give the committee, in a general way, the terms upon which that merger was effected in 1929?

Mr. MITCHELL. I cannot recall the exact ratio, but it was on a basis of so many shares of National City Bank stock for so many shares of Farmers Loan & Trust Co. stock.

Mr. PECORA. Will you procure the details of that for subsequent testimony?

Mr. MITCHELL. I will give you that later.

Mr. PECORA. The Farmers Loan & Trust Co. was a banking corporation at that time, existing under the laws of the State of New York?

Mr. MITCHELL. That is so.

Mr. PECORA. And it had a large trust business?

Mr. MITCHELL. That is so.

Mr. PECORA. Its trust business was one of the attractive features of that institution which induced your bank to effect this merger?

Mr. MITCHELL. The particular advantage, over and above the volume of trust business which they had, which was large, was the fact that it was the oldest trust organization in the State of New York, and the men connected with it had had unusual and long experience in trust work.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. As a result of that merger the National City Bank took over all the commercial banking business of the Farmers Loan & Trust Co., did it not?

Mr. MITCHELL. It did.

Mr. PECORA. And the Trust Co. took over all the trust business of the National City Bank?

Mr. MITCHELL. It was unable to take it over in total, en bloc, but it supervised all the trust business.

Mr. PECORA. In substance it took over all the trust business, but the title in some cases had to remain in the National City Bank of New York because of legal questions?

Mr. MITCHELL. Quite so.

Mr. PECORA. The purpose of the incorporation of the National City Co. was to give the National City Bank an investment affiliate in connection with its business, was it not?

Mr. MITCHELL. I assume so. It ultimately developed so, at any rate.

Mr. PECORA. Do you know that there is a provision in the charter of the National City Co. specifically providing, in substance, that transactions in which the National City Co. engages, even with officers of the company, are not to be invalidated for that reason? You are familiar with such a provision, aren't you, Mr. Mitchell?

Mr. MITCHELL. In the charter?

Mr. PECORA. In the charter or in the by-laws of the National City Co.

Mr. MITCHELL. Well, I should have to refresh my mind on that. Frankly, I do not recall the particular provision.

Mr. PECORA. Since 1911, the National City Co. has entered into business transactions to which some of its officers were parties in their individual capacities, has it not?

Mr. MITCHELL. Well, do you mean that it has sold securities and bought securities from officers? Yes.

Mr. PECORA. And it has done that rather frequently since 1911, hasn't it? That is, these incidents have not been rare occurrences.

Mr. MITCHELL. I assume not.

Mr. PECORA. Now, the National City Co. was organized, among other things, to conduct the business of buying and selling securities to the general public, was it not?

Mr. MITCHELL. Well, that has been a large part of its business.

Mr. PECORA. That has been by far the greatest part of its business, hasn't it?

Mr. MITCHELL. Yes.

Mr. PECORA. What is the governing board of the National City Co.—its board of directors?

Mr. MITCHELL. Its board of directors.

Mr. PECORA. How frequently does that board meet?

Mr. MITCHELL. Once each week.

Mr. PECORA. Is there any subdivision of the board of directors, such as an executive committee, or a finance committee, or an investment committee, which functions between meetings of the board of directors?

Mr. MITCHELL. Up to 4 or 5 years ago, or perhaps 3 or 4 years ago, we had an executive committee, who met each week prior to the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

board meeting. Latterly, and I should say for 2 or 3 years, the entire affairs of the company have been considered by the board itself acting as a whole, and I do not recall the functioning of the executive committee during this latter period.

Mr. PECORA. Well, when did this executive committee cease to function; in what year?

Mr. MITCHELL. As I say, I should say 3 or 4 years ago.

Mr. PECORA. Wasn't it prior to 1927?

Mr. MITCHELL. I would not think so.

Mr. PECORA. You can verify the fact, can't you?

Mr. MITCHELL. I can. And I am advised here that it was prior to 1927.

Mr. PECORA. How long prior to 1927?

Mr. MITCHELL. That I cannot give you. I will look that up for the record, if you choose.

Mr. PECORA. Now, since the beginning of the year 1925 the National City Co.'s transactions in the buying and selling of securities to the public increased tremendously in volume year by year, did they not? That is, up to the year 1931.

Mr. MITCHELL. Well, they were more or less stable for several years.

Mr. PECORA. Then they took a spurt in 1925.

Mr. MITCHELL. I think that was the large year.

Mr. PECORA. And another spurt in 1926.

Mr. MITCHELL. I should say, roughly, Mr. Pecora, from pure recollection, that the sales of securities by the National City Co. had averaged over a 10-year period a billion and a half dollars a year, and I think the high was about $2,000,000,000, and the low was just under a billion dollars.

Mr. PECORA. When was the high reached—what year?

Mr. MITCHELL. I should say from memory that it was 1927 or 1928, but I should want to check it. It is a matter of record.

Mr. PECORA. When was the low of that 10-year period?

Mr. MITCHELL. This past year, I think.

Mr. PECORA. Can you find out now from any of your associates sitting with you, Mr. Mitchell, in what year the executive committee of the board of directors of the National City Co. ceased to function?

Mr. MITCHELL. I asked for that.

Mr. PECORA. Is any one of the gentlemen back of you able to tell you?

Mr. MITCHELL. In 1926, I am told.

Mr. PECORA. Now, Mr. Mitchell, since 1926——

Senator COUZENS (interposing). Before you go into that, may I ask why they ceased to function?

Mr. MITCHELL. They ceased to function, Senator Couzens, because the executive committee constituted a large portion of the board, anyway, and it seemed best, instead of having two meetings, to bring all matters that were brought to the executive committee to the attention of the board as a whole. I think it meant the introduction of a comparatively small number of additional men, and it seemed best to hold one meeting instead of two.

Senator COUZENS (continuing). Had anything gone wrong to cause you to decide to dispense with executive committee meetings?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Nothing.

Senator COUZENS. Who is the executive officer of the National City Co. now?

Mr. MITCHELL. We are made up, Senator Couzens, by my being chairman, which is the chief executive office.

Senator COUZENS. Yes. But you do not operate in the National City Co.'s office all day, do you?

Mr. MITCHELL. Oh, no.

Senator COUZENS. Who is the executive officer who runs that office?

Mr. MITCHELL. The president of the National City Co. is H. B. Baker.

Senator COUZENS. How long has he been that?

Mr. MITCHELL. He was made president early in 1929.

Senator COUZENS. What was has occupation prior to that time?

Mr. MITCHELL. He was a vice president of the National City Co.

Senator COUZENS. Who was the chief executive officer before Mr. Baker was made president of the National City Co.?

Mr. MITCHELL. I was.

Senator COUZENS. And you went from there to the National City Bank?

Mr. MITCHELL. Yes. But I still held the presidency of the National City Co. for a considerable period after I had been made president of the National City Bank.

Senator COUZENS. Sometimes it is only theoretically that the president is the chief executive officer. I mean, who managed the business? I mean the everyday business without calling in the president or the chairman of the board.

Mr. MITCHELL. I attempted to attend the officers' meetings every day. The officers, the vice presidents, constituted the operating management of the company.

Senator COUZENS. Yes. But there was some one of them who was superior to the rest, was there not?

Mr. MITCHELL. I was the superior officer, Senator Couzens.

Senator COUZENS. In other words, all of the vice presidents were on the same basis. One had no more authority than another, do you mean?

Mr. MITCHELL. One had no more authority than another, although each had his particular part of the business to handle, and all questions of policy, for instance, the taking on of any new issue, was considered in detail by the officers' council, and you might say we maintained a practice similar to that of a general partnership—that no issue was taken on except by the unanimous approval of all the officers.

Senator COUZENS. Who decided the spread as between the price you paid and the price at which you sold a security?

Mr. MITCHELL. The necessities of a situation, of course, were constantly under discussion in each particular issue. The officer in charge of the negotiations was the man who ultimately negotiated the spread.

Senator COUZENS. And, then, I suppose you had different acquisitions of securities, where the spread was small in one case, and larger in another case, and intermediate in another case.

Mr. MITCHELL. Oh, quite so.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator COUZENS. Depending upon the gullibility of the public, or the ease with which the sale of the securities might be made, or the soundness of the securities, I suppose?

Mr. MITCHELL. I would not grant your expression, gullibility of the public.

Senator COUZENS. Well.

Mr. MITCHELL. I think you will grant very readily, Senator Couzens, that there is a great deal of difference between selling, for instance, a bond of the State of New York and selling a bond of the primest of our railroads. Sales requirements, methods of distribution, are very different, and different in their cost, and that is all represented in the spread.

Senator COUZENS. In other words, you would get a bigger spread on an Insull security than you would on a prime railroad security.

Mr. MITCHELL. Well, I recall in the so-called "Insull securities" that bonds of the Commonwealth Edison Co. were regarded over a long period of years as among the primest of all public utility or corporate bonds in the United States, and their spread was very, very small.

Senator COUZENS. I was not speaking of those underlying organizations, operating organizations, so much as I was those that had the name Insull attached to them.

Mr. MITCHELL. Well, I have very little knowledge of that, because we were not active in that business, Senator Couzens.

Senator COUZENS. That is all, Mr. Pecora. I did not want to interrupt your line of examination.

Mr. PECORA. That is all right. Now, Mr. Mitchell, was there any particular reason for dispensing with the services of the executive committee of the board of directors of the National City Co. in 1926?

Mr. MITCHELL. I thought I had answered that.

Senator COUZENS. Yes; he answered that to me.

Mr. PECORA. There was no other reason than that embodied in your answer to Senator Couzens' question?

Mr. MITCHELL. None, so far as I know.

Mr. PECORA. Did this board of executive officers of the company keep a record of its activities and proceedings?

Mr. MITCHELL. No.

Mr. PECORA. Had the executive committee during its existence kept such a record?

Mr. MITCHELL. The executive committee meetings of the National City Co. were quite informal. Occasionally you would find a formal action taken by the executive committee, and that would be recorded. But their meetings were largely informal meetings that were held at luncheon as a matter of fact to save the time of everybody, and the discussion was general and informal.

Mr. PECORA. Since 1926, decisions with respect to the nature and kind of securities that the company would buy for resale to the public were made in this informal fashion by the executive officers of the company?

Mr. MITCHELL. That is quite true.

Mr. PECORA. And the officers would meet daily, usually at luncheon, for that purpose?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. No. The officers met daily in the board room of the National City Co., but their findings on various issues were reported informally again to the executive committee when they met, so that the executive committee were quite familiar with the operations of the executive group, and with the new issues that were coming out or that were in contemplation from time to time.

Mr. PECORA. But since 1926 there has been no executive committee?

Mr. MITCHELL. Well, business has been considered by the board as a whole.

Mr. PECORA. Which officers composed the group that since 1926 has acted in the place of the executive committee; I mean which officers of the company?

Mr. MITCHELL. None have acted in place of the executive committee.

Mr. PECORA. Well, they functioned in the fashion that you have described. Who were they?

Mr. MITCHELL. All the vice presidents——

Mr. PECORA (interposing). How many were there, or are there?

Mr. MITCHELL. Oh, I should say seven or eight. It is a matter of record that I should be glad to produce.

Mr. PECORA. What other officers besides the vice presidents took part in those conferences that made those decisions?

Mr. MITCHELL. The president and myself.

Mr. PECORA. And the president at the present time is Mr. Baker.

Mr. MITCHELL. Yes.

Mr. PECORA. When did he become president?

Mr. MITCHELL. In the early part of 1929.

Mr. PECORA. Who preceded him in that office?

Mr. MITCHELL. I did.

Mr. PECORA. You became president in what year?

Mr. MITCHELL. 1916, I should say; it might have been 1917.

Mr. PECORA. And coincidentally you became president of the National City Bank?

Mr. MITCHELL. No. I became president of the National City Bank in May of 1921.

Mr. PECORA. Well, then, in 1929 you were made chairman both of the bank and the company?

Mr. MITCHELL. Chairman of the company, chairman of the bank, and chairman of the trust company.

Mr. PECORA. The trust company to which you refer is now known as the City Bank Farmers Trust Co., isn't it?

Mr. MITCHELL. Yes, it is.

Mr. PECORA. Now, in the year 1927 was a management fund created by action of the board of directors of the National City Co.?

Mr. MITCHELL. It was created many years before that.

Mr. PECORA. But in 1927 was there any modification made in the management fund plan?

Mr. MITCHELL. None that I can recall.

Mr. PECORA. What was that management fund plan designed for?

Mr. MITCHELL. You see, the National City Co. was an investment corporation, and it selected as its executives men who would normally be of the type to hold partnerships in private banking and investment companies. It was necessary to meet the competition of pri-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

vate partnerships, which partnerships were often extremely lucrative, by giving to the officers, who were the equivalent of partners in a private banking or investment firm, some share in the profits that they should make.

Mr. PECORA. Was that share beyond and in addition to their salaries?

Mr. MITCHELL. Yes. Their salaries in the case of the National City Co. were held at what was regarded as a low figure, and all vice presidents and the president received the same base salary.

Mr. PECORA. What was that in 1925?

Mr. MITCHELL. It was $25,000 each.

Mr. PECORA. How about the chairman?

Mr. MITCHELL. I was president at that time.

Mr. PECORA. Well, when you became chairman in 1929.

Mr. MITCHELL. Well, my recollection is that that was not changed, that all the so-called "executive officers" carried the same salary of $25,000. Then the plan of the management fund was this: The officers, looking at it as a group, and I think I can explain this so it will be understandable, and, say, this is the theory of it: They paid 8 per cent on the tools to start with, the tools being the capital and surplus and undivided profits as furnished by the shareholders. Those we can consider as the tools with which the officers were furnished to operate. In setting up the management fund there was, first, allowed 8 per cent per annum on the tools—

Senator BROOKHART (interposing). On what stock was that, the National City Co.?

Mr. MITCHELL. This is not stock. It is represented by the stock of the National City Co., yes; and what the officers had to deal with, the tools that they had——

Senator BROOKHART (interposing). The stockholders of the National City Co. were the same as of the National City Bank, and they were only to get 8 per cent out of it.

Mr. MITCHELL. I shall have to go on, Senator Brookhart, to really make this picture clear, and if I might just explain this briefly, and then if it is not clear I will go back to it.

Senator BROOKHART. All right. I will get it.

Mr. MITCHELL. This group first paid 8 per cent for the tools. Then they received, as a group, in the management fund 20 per cent of the profits of the year, current operating profits, after this deduction of 8 per cent on the capital, surplus, and undivided profits. Now, that fund was made up and divided among the officers, as follows: The officers were periodically asked to express themselves by vote to the executive committee as to what portion of that fund should go to the president, myself, and subsequently to the chairman. Having determined that, they were requested—well, I am getting too far——

Mr. PECORA (interposing). Pardon me, Mr. Mitchell, but who determined the apportionment of the management fund as between you, the president, and subsequently the chairman, and the others when that fund was created?

Mr. MITCHELL. Let me just go back one moment, because I have neglected a rather vital point as to how this fund was distributed. The fund was theoretically divided into two parts, and at the outset

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of the year the executive committee determined what portion each and every officer should have of one half of the fund that might accumulate during that year. That was what we called the forward look, because, of course, hardly any two men can be judged to be worth exactly the same amount, and they were all getting the same salary, and this differentiation in the value to the company of these various men was represented in the percentage of this first half of the management fund of which I speak.

Senator BROOKHART. Then they were to get all as among its officers?

Mr. MITCHELL. They were to get one half of the management fund to be created during the coming year on the basis of fixed percentages, of which they were advised. And the differentiation of those percentages represented what would ordinarily be considered a differentiation in their salaries. You understand that they start from an even salary basis, and then these differentiations were put in as to the first half of the fund. That was what we considered the forward look——

Senator BROOKHART (interposing). And this fund was made up of the earnings over and above that 8 per cent?

Mr. MITCHELL. Twenty per cent of the earnings after 8 per cent had been deducted.

Senator COUZENS. What did you do with the other half of the fund?

Mr. MITCHELL. The other half was determined usually twice a year, in July and in January. The officers who participated in this fund were generally asked at that time to submit a vote, which was not a signed vote and was not submitted to me but to some representative of the executive committee, as to what——

Senator COUZENS (interposing). Was it a secret vote?

Mr. MITCHELL. It was a secret vote as to what portion should be mine. And then they were asked, having made that vote, for a signed vote as to what proportion each officer should get as to the balance, leaving themselves out of consideration.

Those figures were presented to the executive committee, compiled for them by someone whom they might designate, and they determined then just what that distribution should be.

Mr. PECORA. But since 1926 there has been no executive committee.

Mr. MITCHELL. Then it was referred to the board. The board acted instead of the executive committee.

Mr. PECORA. In what year was the largest amount realized for that management fund of the National City Co.?

Mr. MITCHELL. I should say, without having figures for reference, that it occurred in 1928, Mr. Pecora.

Mr. PECORA. What was the amount of the management fund that year?

Mr. MITCHELL. I should have to check again on that.

Mr. PECORA. Can you check it now, while we are on the subject?

Senator COUZENS. Is that practice being continued, Mr. Mitchell?

Mr. MITCHELL. No. There was a provision, Senator Couzens, through all these management funds that they should apply only as the regular and customary dividend was maintained, and when, in 1929, we ran into losses all management funds were suspended.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator COUZENS. Are they still suspended?

Mr. MITCHELL. They are still suspended.

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

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

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

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

Senator COUZENS. You would not see it. Only the customers would see it after they had gotten the securities. May I ask you at that point—if you have not the figures convenient, you may furnish them, perhaps, later—how many securities that you have sold are now in default?

Mr. MITCHELL. That is a rather difficult figure. I carry in my mind these general figures, Senator Couzens. During a 10-year period, our total sales, which included Governments and States and Canadians and other things that perhaps are not in those first figures I gave you, were about $20,000,000,000, and I think that there has been difficulty of one sort and another—a good deal of it, of course, developing during this latter period of depression—with something under $1,000,000,000.

Senator COUZENS. Did that include all your South Americans, and all?

Mr. MITCHELL. Oh, yes.

Senator COUZENS. And so, after counting in all of your sound State, municipal, and Government bonds, which aggregated $20,000,000,000, you say less than $1,000,000,000 are in default or trouble?

Mr. MITCHELL. That is my recollection. If I am wrong in regard to that, I would like to have the opportunity of correcting it.

Senator BROOKHART. Did you sell these securities through the stock exchange?

Mr. MITCHELL. No, Senator Brookhart. Of course, the National City Co. has maintained offices throughout the United States, and in many foreign countries.

Senator BROOKHART. You sell them direct, then?

Mr. MITCHELL. We sell a great many securities direct. We also act as wholesalers, selling to dealers everywhere, who, in turn, are selling to their customers.

Senator BROOKHART. You conduct no direct operations on the stock exchange?

Mr. MITCHELL. No; none whatsoever.

Senator BROOKHART. Let me ask you a question or two about these salaries, before we leave that. What did these individual salaries amount to, after these commissions were added to the $25,000?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. I beg your pardon?

Senator BROOKHART. Read the question.

(The reporter read the question.)

Mr. MITCHELL. There have just been handed to me the figures on the management fund for the year 1927–28. The management fund for 1927 was $1,567,500. The management fund for 1928 was $2,240,938.98.

Senator BROOKHART. What is the portion of that that you got?

Mr. MITCHELL. That, again, I should have to check. In 1927 my portion of the management fund was $527,000.

Mr. PECORA. That is in addition to your salary?

Mr. MITCHELL. Of $25,000; yes, sir. In 1928 my proportion of the management fund was $750,515.53.

Mr. PECORA. Also in addition to your salary?

Mr. MITCHELL. Yes.

Senator BROOKHART. That indicates a big increase in the sale of these inflated securities, does it not?

Mr. MITCHELL. It indicates a larger profit in a legitimate business.

Senator BROOKHART. Compared to present price levels, practically all the securities you sold in 1928 were inflated, were they not?

Mr. MITCHELL. A great many of those securities have since been paid in one way or another. Of course there is scarcely a security, as you know, outside of possibly United States Government bonds and one or two of the primest States and municipals in the United States, which is worth in the market what it was selling for in the years 1928 and 1929.

Senator BROOKHART. Does not that big commission encourage the officers of a company like this to put off those securities on the public, regardless of their real soundness?

Mr. MITCHELL. I think not, Senator Brookhart.

Mr. PECORA. Mr. Mitchell, I observe from the figures you have given concerning your participation in the management fund for the years 1927 and 1928 that your participation amounted to about one-third of the management funds for those respective years. Was that the ratio that was followed in determining the amount of your participation in the management funds?

Mr. MITCHELL. I think it was changed almost every year, one way or the other.

Mr. PECORA. Generally it was about one-third?

Mr. MITCHELL. I should say it was about a third.

Mr. PECORA. Did not the National City Bank during these same years also have a management fund for the benefit of its senior executives?

Mr. MITCHELL. It did.

Mr. PECORA. Can you tell the committee how much you received, as either president or chairman of the National City Bank, from the bank's management fund for the year 1927?

Mr. MITCHELL. May I, Mr. Pecora, just show the difference as to how that fund was set up?

Mr. PECORA. If you will answer this question now, it will be more orderly for you to give us the information you want to give us later.

Senator COUZENS. Is Mr. Winston your attorney?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. He is one of my counsel; yes.

Senator COUZENS. Is he attorney for the bank or just for you personally?

Mr. MITCHELL. No. He is counsel for the institution. He is of the firm of Shearman & Sterling.

Senator COUZENS. He is not attorney for the National City Bank or the National City Co.?

Mr. MITCHELL. He is counsel for the National City Bank, the National City Co., and general counsel for the trust company.

Senator COUZENS. Is he on a salary roll, per diem, or fee basis?

Mr. MITCHELL. The firm of Shearman & Sterling?

Senator COUZENS. Mr. Winston.

Mr. MITCHELL. Mr. Winston is not employed by us directly.

Senator COUZENS. You say he is not?

Mr. MITCHELL. No, sir.

Senator COUZENS. I thought if he was, he might take the witness stand himself, but as long as he is not we will not ask him to.

Mr. PECORA. Can you answer my question, Mr. Mitchell, as to the amount you received from the management fund of the National City Bank for the year 1927?

Mr. MITCHELL. I can not, offhand, but I will be glad to produce that.

Mr. PECORA. Was it as great as the amount you got from the National City Co. that year—that is, from its management fund?

Mr. MITCHELL. I can not answer that, quite frankly, Mr. Pecora.

Mr. PECORA. How long would it take you to get the data to answer the question?

Mr. MITCHELL. I presume that we can get it in some of our papers. We have a volume of papers down here, and if it is not here I can get it certainly from New York quite promptly for you.

Mr. PECORA. Mr. Mitchell, have you produced here, in response to the subpœna served upon you, the minute books of the board of directors of the National City Co. for the years 1927 to 1932, inclusive?

Mr. MITCHELL. We have produced the minute books as called for by the subpœna.

Mr. PECORA. The minute books called for by the subpœna included the minute books of the National City Co. for those years. Are those minute books here, do you know—the minute books of the National City Co.?

Mr. GUY CARY. The minute books we thought were here this morning. They have been sent for. They will be here this afternoon. The minute books of the bank covered by the subpœna are here. The oversight on the others was due to the fact that they understood you wanted certain statements from them, and not the books, so I have sent for the books and they will be here in a short time.

Senator COUZENS. Mr. Mitchell, I understand you have quite a national reputation as a salesman and as a financier, both?

Mr. MITCHELL. I can not tell you what my popular reputation is, Senator.

Senator COUZENS. We usually know, do we not?

Mr. MITCHELL. I do not know whether we do, or not.

Senator COUZENS. Which are you, a better salesman or a better financier?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Is that a fair question?

Senator COUZENS. Yes. I would be able to answer that question if somebody asked me.

Mr. MITCHELL. I will say this, Senator Couzens: I have rarely seen an executive who had to do with the public and the management of a great corporation who was not inherently, by personality or otherwise, in the class that might be called a good salesman.

Senator COUZENS. That is what I understand; and from my observations of you here, and on numerous occasions, I should judge you to be a better salesman than a financier—and that is no disparagement on your financial ability at all.

Mr. MITCHELL. I thank you for the compliment.

Mr. PECORA. Measured by the amount of compensation you received, both by way of salary and by way of participation in the management funds of the National City Co. and the National City Bank for the years 1927 and 1928, would you say that your services as a salesman reaped a greater return for you than your services as a financier?

Mr. MITCHELL. My services as rendered are not those of a salesman, Mr. Pecora.

Mr. PECORA. The business of the National City Co. is that of selling securities to the public, is it not?

Mr. MITCHELL. That is only one phase of it.

Mr. PECORA. That is the most important phase of it, is it not?

Mr. MITCHELL. I should certainly say not.

Mr. PECORA. Is not the greater part of its earnings derived from its sale of securities to the general public?

Mr. MITCHELL. That is where they show themselves, but where they are created is in the production end prior to the time that they ever go into the sales end. An analogy is the manufacturing concern. We have a certain portion of our organization—and it amounts to a large force—devoting itself to the manufacture of long-term credits suitable for public distribution, and for the analysis of the production of other manufacturers, if I may continue to use the analogy——

Senator COUZENS. I think the word is unfortunate—manufacturing securities.

Mr. MITCHELL. It may be in your mind, Senator Couzens. At the same time that has an analogy that I do not consider amiss. A large part of the business of the National City Co., and a large part of the executive brains, is devoted to the development of long-term credits suitable for public investment, and the organization in number would have a preponderance along the sales line, but the gray matter of the organization is certainly devoted in no small measure—and I should say in preponderance—to the production of long-term credits.

Senator BROOKHART. Does not that come up this way? Do not various enterprises apply to you for this credit, submit their proposition, and you just check them?

Mr. MITCHELL. They come up in various ways, Senator Brookhart. Of course, they come often by applications from corporations or States or municipalities and others who have need of long-term financing.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. They are the ones that originate the production proposition, then?

Mr. MITCHELL. They are the ones who show the opportunity for it, but the study of it, the ways of developing to a suitable issue to give to the public, are a matter that takes considerable experience and a great deal of understanding.

Mr. PECORA. Various propositions are presented to the National City Co.'s executives from time to time for the purpose of having your company consider the financing of those propositions?

Mr. MITCHELL. Quite so.

Mr. PECORA. Is that what you mean by the production end of the work, done by the National City Co. executives?

Mr. MITCHELL. No. It is not merely the primary consideration of that which comes in, because I think I scarcely need say that far more propositions are turned down than are accepted. Yet they all have to be studied. Then as we determine that something is acceptable, or indications are that it may be acceptable, we have a great deal of work to do—engineers studying properties, accountants working over the figures, men versed in the make-up of these issues, finding that which would be safe and proper to issue under the circumstances; how the issues should be set up; and ultimately, coming to the point where the price range and the spreads, and so forth, that you were interested in, Senator Couzens, are considered. That is the last thing that is considered in the production side of our business.

Mr. PECORA. But the earnings of the company are all reflected, or substantially reflected, from that end of its business which refers to the sale of securities to the public?

Mr. MITCHELL. That is where you find it, just as you find, in a mercantile or manufacturing concern, that the sale of the product is the last thing that occurs, and the profit for the business shows itself there.

Mr. PECORA. In the sale of those securities, or products, as you choose to call them, to the public, you do not mean to imply, do you, that the National City Co. creates that product, or makes that product, consisting of those securities?

Mr. MITCHELL. The product which it makes is the form of the issue. Of course, the obligor is always some debtor extraneous to the National City Co.

Mr. PECORA. Exactly. The National City Co. is the vehicle by which the product is sometimes set up, and the vehicle by which it is sold to the public.

Mr. MITCHELL. That is true; yes.

Mr. PECORA. And, according to the earnings it derives from those sales, the contributions or commissions or bonuses paid to its executive officers through the operation of the management fund are determined.

Mr. MITCHELL. That is so.

Senator COUZENS. May I ask him to elaborate on the statement he made a while ago? I understood you to say that the sale of these securities, or the production of them, was extraneous to the National City Co. Did you say that?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. No. I said that the obligation of these securities, the promise to pay—in other words, the debtor—is apart from the National City Co. itself.

Senator COUZENS. But they may be a part of it through directorship or otherwise, may they not?

Mr. MITCHELL. No; I do not recall any case that I think would come under your category.

Senator COUZENS. You do not know of any director of the National City Bank or the National City Co. interested in selling any securities that were sold to your company?

Mr. MITCHELL. Oh, I would not say that. There have been cases where the National City Co. has bought issues and distributed issues, where the obligor company on that issue had a director of our bank or our company on their board.

Senator COUZENS. That is what I meant. Then, it is not quite correct to say that the obligor has no relation with the National City Co.?

Mr. MITCHELL. From that angle, I think you are correct, Senator Couzens.

Senator COUZENS. And, so, as a matter of fact, the director, or the connection between the obligor on the security, and the National City Co., might be quite close, as a matter of fact?

Mr. MITCHELL. Yes; but the direct obligation was what I was referring to, Senator Couzens.

Senator COUZENS. I understood, of course, that there was no obligation of the National City Co., because if there had been, undoubtedly you would not have taken some of the chances that were taken, is that true?

Mr. MITCHELL. I do not think we would ever have started business.

Senator COUZENS. In other words, you sold securities that you possibly would not want yourself, or would not want retained in the portfolio of the National City Co.?

Mr. MITCHELL. That does not seem to me quite fair.

Senator COUZENS. I do not want to be unfair.

Mr. MITCHELL. I realize that.

Senator COUZENS. I am trying to determine the difference between an investment——

Mr. MITCHELL. We sell a large amount of United States Government bonds, for instance. It is not that we are selling those bonds to the public because we do not think they are fit for our own portfolio. We are selling those Government bonds because a public is seeking to buy Government bonds.

Senator COUZENS. Is that quite fair? Is it not a fact that in the negotiations that take place between the officers and directors of the trust company or a bank or an investment house, that directors sometimes say, "Well, I don't like it very much. I would not want any of that in my portfolio, but I am willing to O.K. it for sale"?

Mr. MITCHELL. I can conceive of that occurring very readily, because you might be sitting on such a board, and your judgment would be very good, but you might say, "For my own box, I want only a certain class of securities. I realize that there are plenty of people who want a different class of security for their box, but I personally

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

do not want it, but, realizing the demand that there is for that class of security, I certainly would approve this. It is not a security for my own box, but I realize that there is a public demand for it."

Senator COUZENS. That is what I am trying to get at. You being a supersalesman, of course, can sell that to your directors. You can sell them the idea. You do not always have to sell a security. Sometimes you can sell an idea.

Mr. MITCHELL. I think you compliment me unduly, Senator.

Senator COUZENS. I do not think so. I have observed you very closely since you have been here.

Mr. MITCHELL. I presume I have some influence, but I certainly think that with certain of the hard heads that I attempt to gather around me, they are not overinfluenced by what you call my salesmanship.

Senator BROOKHART. They give you a good deal bigger proportion of this fund than the others, do they not?

Mr. MITCHELL. They do, sir.

Mr. PECORA. Mr. Mitchell——

Senator BROOKHART. Wait just a minute. I want to get some idea what your compensation was in the National City Bank.

Mr. PECORA. We are getting that information.

Mr. Mitchell, is it not a fact that for the year 1928, the total compensation you received, from both the National City Bank and the National City Co., by way of salary and participations in the management fund, was $1,238,324.42?

Mr. MITCHELL. If you have the record there, Mr. Pecora, it is doubtless taken from certain records that prove that your figure is accurate.

Mr. PECORA. Will you jot that figure down, and afterwards see if you can confirm it?

Mr. MITCHELL. What is the figure?

Mr. PECORA. For the year 1928, $1,238,324.42.

Mr. MITCHELL. I will check it and confirm it.

Senator COUZENS. Did not that amount make you envious of Mr. Grace, of the Bethlehem Steel Co., and Mr. Hill, of the Tobacco Co.?

Senator BROOKHART. In view of that compensation, Congress is making a big noise about reducing the salaries of these $1,600-a-year Government employees. Would not it be a good idea for them to consider regulating the salaries of these national-bank presidents, first?

Mr. MITCHELL. That is something you will have to answer yourself.

Mr. PECORA. Mr. Mitchell, is it not also the fact that for the year 1929 you received, by way of both salary and commissions, or participations in the management fund of the National City Co. and the National City Bank, a sum aggregating $1,206,195.02?

Mr. MITCHELL. May I have that figure again, because I have to check it up?

Mr. PECORA. $1,206,195.02.

Mr. MITCHELL. I will be glad to check that figure, and confirm it, or question it.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator COUZENS. For the matter of the record, I want to say that this testimony is being elicited, not with the idea of going into the personal affairs of Mr. Mitchell, or the National City Co., but for the purpose of demonstrating publicly, if possible, that these unreasonable salaries and these bonuses lead to unsound banking and unsound sales of securities. I, as temporary chairman, want to make it plain that this committee is going into that for that very purpose, and not for the purpose of headlines or for the purpose of delving into individual people's personal affairs. I personally dislike this sort of thing, but I think that the public should know what inspires some of these sales, and some of these securities being foisted on the public. When I say that, it does not mean any reflection on the National City Co. particularly, but it is quite general, that where there are excessive profits and bonuses to employees and officials, it has been very detrimental to the public interest. I thought I ought to say that, because I disapprove of some of the questions that have been asked of Mr. Mitchell, but I see no other way of getting at it.

Mr. PECORA. I may say, Mr. Chairman, that one purpose I had in going into these items of evidence, was simply to establish what you have just given expression to, namely, that this sort of an arrangement constitutes, either consciously or unconsciously, an incentive to perhaps unwise security selling methods, and unwise and unsound banking methods.

Senator COUZENS. That is exactly what I said. I want to say that I would not have permitted some of these questions to be asked, if it had not been that they relate to the public interest.

Mr. PECORA. Mr. Mitchell, was there an increase made in the capital stock of the National City Bank in the year 1927?

Mr. MITCHELL. There was.

Mr. PECORA. And what was the amount of increase?

Mr. MITCHELL. Let me see if I have that here. I can not recall the exact amount, that is my difficulty. (After examining papers.) I think I can give it to you here, through the annual report. I thought I might have it here, but I am just 1 year back.

Senator COUZENS. What was the question?

Mr. PECORA. About the increase of the capital stock of the bank in 1927.

Mr. MITCHELL. Is the amount essential? I can jot it down and bring that in here.

Senator COUZENS. Mr. Mitchell has a number of questions to answer, and if the committee is in agreement, we will adjourn until 2 o'clock.

(Whereupon, at 12 o'clock noon, a recess was taken until 2 o'clock p. m.)

AFTER RECESS

The subcommittee resumed at 2 o'clock p. m., on the expiration of the recess.

The CHAIRMAN. I will ask Senator Fletcher to take the chair, and I will return in a few minutes.

Senator FLETCHER (presiding). You may proceed, Mr. Pecora.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

TESTIMONY RESUMED OF CHARLES E. MITCHELL, PRESIDENT OF THE NATIONAL CITY BANK, NATIONAL CITY CO., AND CITY BANK FARMERS TRUST CO., NEW YORK CITY

Mr. PECORA. Mr. Mitchell, you made notations during your examination this forenoon of certain items with respect to which you wanted to obtain information or confirmation from the records of the bank and the company. Have you done so during the recess?

Mr. MITCHELL. I have, I think, covered the questions you asked, Mr. Pecora.

Mr. PECORA. All right. You may proceed to answer them.

Mr. MITCHELL. Your first question had to do with the trustees under the National City Co. trusteeship. The first trustees were James Stillman, F. A. Vanderlip, and S. S. Palmer.

Mr. PECORA. All right.

Mr. MITCHELL. Then you asked how these trustees are appointed. Under the agreement they are appointed by the members of the board, not by the board as a board, but by the members of the board delegated as individuals to sit for the election.

Mr. PECORA. When you say "by the board" do you mean the board of the National City Bank?

Mr. MITCHELL. Yes, sir; members of the board.

Mr. PECORA. In other words, members of the board of directors of the National City Bank, select the three trustees, who act as trustees for the shareholders of the bank in connection with their ownership of the stock of the National City Co.

Mr. MITCHELL. They act as trustees of the shareholders of the bank.

Mr. PECORA. And as vacancies occur among these trustees for the shareholders, how are those vacancies filled.

Mr. MITCHELL. They are filled by an appointment that is made by the individuals sitting as a group, not as a board.

Mr. PECORA. What individuals do you mean?

Mr. MITCHELL. The individuals who constitute the board of directors of the National City Bank.

Mr. PECORA. And are any of those trustees removable by anyone other than the board of directors of the bank?

Mr. MITCHELL. I think under the trustee agreement there is a differentiation between the board of directors and those who are designated and delegated to the power of trustee reappointment and removal. A majority of those individuals signing a paper may remove any trustee and may replace any trustee.

Mr. PECORA. Now, let me see, Mr. Mitchell, about this: How many constitute the full membership of the board of directors of the bank, how many individuals?

Mr. MITCHELL. I think we have authority for 27 at the moment.

Mr. PECORA. How many of that board compose the group that you speak of as having the power to designate the trustees?

Mr. MITCHELL. Twenty-seven individual men.

Mr. PECORA. Twenty-seven individual men.

Mr. MITCHELL. Yes.

Mr. PECORA. Do you mean to say that when they act in any manner involving the designation of a trustee, they disassociate themselves from their relationship to the bank as its directors?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Is that in pursuance of any provision of the original trust agreement that was made back in 1911 when the National City Co. was organized?

Mr. MITCHELL. I so understand it.

Mr. PECORA. Have you a copy of that trust agreement?

Mr. MITCHELL. I haven't it here, and the information I have gotten has been received by telephone from New York.

Mr. PECORA. Has any one of your associates or the other officers of the bank who are present a copy of that trust agreement, do you know?

Mr. MITCHELL. I tried to get it, and we had to get this information by telephone, so I think I can answer your question "no." But I will inquire. [After making inquiry of some of his associates.] I will say "no."

Mr. PECORA. How is it possible for those 27 individuals who compose the board of directors of the bank, to function not as directors but as individuals when they designate trustees for the shareholders of the bank to represent them as shareholders of the stock of the National City Co.?

Mr. MITCHELL. I can only draw the assumption that when that agreement was drawn, the stockholders appointed a group of men to act for them, and they as individuals should be the individuals who constitute a board of directors of the National City Bank.

Mr. PECORA. Was the identity of the members of that group coincident with the identity of the members of the board of directors of the bank at that time?

Mr. MITCHELL. I cannot really give you anything more than I have already given you. That comes from reading over the telephone what that provision is.

Mr. PECORA. Well, then, that leaves the situation in this fashion, does it not, namely, the persons who own all the capital stock of the National City Co. are the shareholders of the National City Bank? In substance is that correct?

Mr. MITCHELL. It seems to me you are asking something that might have a legal angle to it that I would not understand. I can state it very definitely: That these three trustees are the shareholders of all the stock of the National City Co., and under the agreement they hold that stock for the benefit of the shareholders of the National City Bank.

Mr. PECORA. Yes; but those three trustees are in no way chosen today by the shareholders themselves, are they?

Mr. MITCHELL. No. This goes back to the original provision, and——

Mr. PECORA (interposing). And that provision was inserted in the trust agreement at the very outset of the existence of the National City Co.

Mr. MITCHELL. I think that is true.

Mr. PECORA. So that at no time since the National City Co. was organized have any of the shareholders had any voice in the designation of the trustees who hold their stock for them, is that correct?

Mr. MITCHELL. I should say that is correct, except as they have the right to appoint the individuals as members of the board of di-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

rectors, and do so appoint them, and those individuals, year by year, whoever they may be, are the designating body of the trustees.

Mr. PECORA. Well, as a matter of fact, has there been at any time since you became the president of the National City Bank any action at the annual meetings of the shareholders which was attended in person by more than a few actual shareholders of the bank?

Mr. MITCHELL. You are speaking of shareholders now of the bank?

Mr. PECORA. Yes, sir.

Mr. MITCHELL. Oh well, we have a room two-thirds the size of this, which is crowded at every annual meeting.

Mr. PECORA. And you have how many shareholders of record?

Mr. MITCHELL. Something over 85,000.

Mr. PECORA. So that if they were to crowd that room, two thirds the size of this, to its utmost capacity, you wouldn't have more than a very small fraction of 1 per cent of the shareholders actually attending meetings at which this group is chosen.

Mr. MITCHELL. Yes; as to the number of shareholders. But we have a very large percentage, of course, of the capital stock represented by shareholders who are present.

Mr. PECORA. To whom are the directors of the National City Co. accountable or responsible for their acts and for their administration of the company?

Mr. MITCHELL. Accountable to the trustees, who are the shareholders.

Mr. PECORA. They are accountable to these three men who are chosen by a group of the directors of the bank, aren't they, in fact?

Mr. MITCHELL. They are selected by a group of men who constitute as individuals the board of the National City Bank.

Mr. PECORA. Whenever in pursuance of the laws of the State of New York, under which the National City Co. was organized, it is necessary to have a stockholders' meeting of that company, the meeting is confined to these three trustees?

Mr. MITCHELL. That is so.

Mr. PECORA. Do these three trustees ever make a report at a stockholders' meeting, to the shareholders themselves?

Mr. MITCHELL. No.

Mr. PECORA. Have you ever known them to do it?

Mr. MITCHELL. No.

Mr. PECORA. Have you ever known those trustees to keep any minutes or record of any proceedings that they have had as such trustees for the stockholders of the National City Co.?

Mr. MITCHELL. You asked me this morning if the trustees had meetings and if they kept minutes. I read from a memorandum of the cashier of our bank answering that question [reading]:

Referring to your inquiry regarding minutes of proceedings of the trustees who hold the stock of the National City Co. I wish to advise that I am the custodian of the records of the trustees, which consists of the trust agreement, documents relating to the appointment of present and former trustees, dividend orders executed by the trustees, powers of attorney given by them to agents to indorse stock certificates, and incidental papers. There is no minute book or minutes of proceedings of the trustees in my possession. Action taken by the trustees has been recorded so far as my knowledge extends, which goes back a good many years, in the documents and standing orders and appointments above referred to.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. That means that they have never kept any minutes of any proceedings of theirs, doesn't it?

Mr. MITCHELL. I should think that that means that.

Mr. PECORA. And to your knowledge have those trustees ever made any report to the stockholders of the company for whom they act as trustees?

Mr. MITCHELL. I think I answered "no" to that.

Mr. PECORA. They have not.

Mr. MITCHELL. No.

Mr. PECORA. Has the National City Co. made any public report to the holders of its stock, of its corporate proceedings?

Mr. MITCHELL. I do not understand just what you mean as to its corporate proceedings.

Mr. PECORA. Let me put it this way: Does the National City Co. make any annual report of its business operations?

Mr. MITCHELL. As chairman of the three institutions, we make a report to the shareholders at their annual meeting, and I report at that time on the operations of the National City Co. for the past year.

Mr. PECORA. So that the report which you as the chairman of the three institutions make every year is an oral report, is it not?

Mr. MITCHELL. It is printed and sent to every shareholder.

Mr. PECORA. Insofar as that annual report alludes to the business of the National City Co., it is very general and sketchy, isn't it?

Mr. MITCHELL. Well, I do not consider that it is more general and sketchy than with respect to the bank. It used to be that way; no report of earnings or the balance sheet of the National City Co. was furnished to our shareholders.

Mr. PECORA. When for the first time did the National City Co. furnish that information to its shareholders?

Mr. MITCHELL. I think two years ago.

Mr. PECORA. Prior to that it never gave any such information even to its shareholders?

Mr. MITCHELL. It did not. Now, may I continue with the questions you asked this morning?

Mr. PECORA. If you will.

Mr. MITCHELL. You asked me if I knew whether there was provision, either in the original charter or the by-laws, providing that no contract should be invalidated by the participation therein by a director. I find that that is a provision in the original charter of the company, in 1911. Now, do you care to have me answer the further questions you asked?

Mr. PECORA. Yes, sir; whatever they are. I have not a note of them.

Mr. MITCHELL. You asked me regarding the management funds and my participation therein. You asked me particularly my participation therein and gave me certain figures for 1928 and 1929 to corroborate.

Mr. PECORA. Yes.

Mr. MITCHELL. I judge that the figures you gave were the amounts that I received in 1928 and 1929. Now, I call attention to the fact that the management fund of a given year is distributed in part in the middle of the year and in part in the following year. So that

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the amounts that you have that I received do not indicate the amounts that were subject to distribution for that particular year. In other words, my return would be different than the actual management fund and my participation therein. But I am now prepared to give you, if you desire, the amount of the management fund accrued during those years, and what proportion thereof I received.

Mr. PECORA. Well, were the figures which I embodied in my questions this forenoon correct for the 12-month period on each occasion?

Mr. MITCHELL. Well, I assume that the figures you used were the figures shown that I received as a result of the management fund during those periods.

Mr. PECORA. And your salary?

Mr. MITCHELL. And my salary. Now, I have not been able to check these. But I have the management funds for the two years and what part of the management funds I did receive, which I assume is what you were getting to, from the bank and the company during those years in question.

Mr. PECORA. Well, give us your figures then. Take first the year 1928.

Mr. MITCHELL. Well, now, you see the figures for 1928 cover in large part the figures of the management fund for 1927, because the accumulations of 1927 were distributed in smaller part in July of 1927. The balance would have been distributed in 1928. But the fund would have been closed in 1927. So that what I received from the accumulation of the management fund of 1927 would have been received in part in 1927 and in part in 1928.

Mr. PECORA. Can't you make a computation or calculation which will give us the amount you received by way of salary and participation in the management funds of the National City Co. and the National City Bank for the year 1928?

Mr. MITCHELL. Well, perhaps these figures which I have obtained from New York by telephone, will give you the figures you want.

Mr. PECORA. All right. Go ahead.

Mr. MITCHELL. The accumulations of the management fund of the bank in the year 1927 were $1,356,999.53, of which I received $529,230, a part of it of course in 1927 and a part in 1928. But that was the proportion that I received of the 1927 management fund accumulations of the bank for that year.

The National City Co. accumulated in the 1927 management fund the sum of $1,988,000, of which my proportion was $527,000. Therefore the total amount which I received from the management funds from the accumulations of that year was $1,056,230.

In the year 1928 the accumulation in the management fund of the bank was $1,401,585.47, from which my proportion amounted to $566,634.19.

Mr. PECORA. About one-third.

Senator BROOKHART. Oh, no. More than that.

Mr. MITCHELL. Over one-third.

Mr. PECORA. Well. Go ahead.

Mr. MITCHELL. The company accumulation in 1928 was $2,739,438.98, and the amount apportioned to me was $750,000.

Mr. PECORA. How about 1929?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. In 1929 the accumulation in the management fund of the bank was $1,725,177.96, of which the amount apportioned to me was $608,868. The accumulation in the management fund of the National City Co. was nil.

Mr. PECORA. That is, for the year 1929?

Mr. MITCHELL. Yes; and the amount given to me was nil. As to the Trust Co.——

Mr. PECORA (interposing). For the entire year there were no accumulations in the management fund of the National City Co.?

Mr. MITCHELL. There was an accumulation in the first part of that year, but it was wiped out by losses in the latter part of the year, so that the management fund at the end of the year had nothing in it.

Mr. PECORA. But wasn't there a distribution made at some time during the year of that portion of the management fund which had been accumulated up to that time?

Mr. MITCHELL. A portion of the amount accumulated was distributed in July.

Mr. PECORA. In July of 1929?

Mr. MITCHELL. Yes. But when we came to the end of the year we found the management fund as a whole was in the minus, and therefore provision was made that the amount should stand as advances to the officers, payable out of future accumulations in the management fund.

Mr. PECORA. In other words, the officers did not refund at the end of the year that portion of the management fund which had accumulated up to July of 1929 and had been distributed?

Mr. MITCHELL. There was a portion only of that distributed at that time.

Mr. PECORA. But that portion which was distributed in July of 1929 was not refunded by the officers to whom it had been distributed, at the end of the year, was it?

Mr. MITCHELL. No.

Mr. PECORA. They were permitted to keep it as an advance against future accumulations in the management fund in subsequent years.

Mr. MITCHELL. That is quite true. Then there was——

Mr. PECORA (interposing). And how much of that participation did you get for the first 6 months of 1929, of the National City Co.'s management fund, do you know?

Mr. MITCHELL. I do not recall the exact figure.

Mr. PECORA. Can you tell us approximately?

Mr. MITCHELL. I carry in my mind the figure of—well, now, let me see.

Mr. PECORA. Was it a figure around $500,000?

Mr. MITCHELL. I should think so. It is a matter of record, but I can not recall definitely. Quite frankly, I always felt that the officers could claim that as a final payment, because the original provision regarding the management fund was that the directors could distribute at any time during the year such proportion of the management fund then accumulated as seemed to them wise, and that was a payment of that character. But when the year ended there being nothing in that management fund it seemed wise to me and I recommended to the directors at the time, that the officers

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

should be willing to consider that purely as an advance upon future accumulations of the management fund, and it was so arranged.

Mr. PECORA. Might it not have been more in the interest of the company if it had been then decided that the officers should refund, at the end of the year, the distributions that had been made to them out of the first half year's accumulations in the management fund?

Mr. MITCHELL. I think it would be fairer from the officers' standpoint if they had, on their side, been insistent that it was an actual payment to them.

Mr. PECORA. But I asked you if it would not have been fairer to the company for them to have made a refund.

Mr. MITCHELL. I do not think so. Under the original provisions for distribution of the management fund I would not say so.

Senator FLETCHER. And were there future accumulations?

Mr. MITCHELL. You see, from that time on the earnings have been comparatively small and the management fund has not been operative since that time.

Mr. PECORA. Now, as I have jotted down the figures you have just given, your total participation in the distribution of the management fund of both the bank and the company, for the years that you have covered, namely, 1927, 1928, and 1929, are $3,481,732. That is, estimating an approximate figure of $500,000 as your share of the management fund of the National City Co. for the first six months of 1929. Is there anything wrong with that calculation?

Mr. MITCHELL. Except that I think the estimation is wrong, if that $500,000 which I am to return out of some future earnings, is included.

Mr. PECORA. Well, you have not been called upon to return it. You actually have received it and still retain it.

Mr. MITCHELL. But on any reestablishment of the management fund there would be accruals from which that would have to be paid. In other words, that has to be paid out of future accruals in the management fund.

Senator BROOKHART. That cannot happen in the depression, can it?

Mr. MITCHELL. It certainly cannot, I am sorry to say.

Senator BROOKHART. And the depression will not get over as long as the farmers cannot buy anything.

Mr. PECORA. These compensations paid to you only have reference to compensations you have received by way of participation in the management funds of the bank and of the National City Co. for the period of time indicated. There has to be added to those figures whatever you received by way of salary, has there not?

Mr. MITCHELL. Yes.

Mr. PECORA. And there also has to be added whatever you received by way of salary and participation in the management fund of the City Bank Farmers Trust Co.?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Which City Bank Farmers Trust Co. of course did not come into existence as a trust affiliate of the bank until 1929.

Mr. MITCHELL. No. I started to give you the management fund figures of the City Bank Farmers Trust Co. for the year 1929.

Mr. PECORA. Well, you can give us the precise figures on that.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. There was accumulated in that half year, from July to December 31, 1929, $283,497.38, in which I participated to the amount of $15,997.38.

Mr. PECORA. That is outside of the matter of salary.

Mr. MITCHELL. Yes.

Mr. PECORA. You are also chairman of the board of the City Bank Farmers Trust Co., are you not?

Mr. MITCHELL. I am chairman of the board of that company, the same position I occupy in the others.

Mr. PECORA. And receive a salary for your services as chairman of the board of that institution?

Mr. MITCHELL. No. I receive no salary there.

Senator FLETCHER. How was this management fund created?

Mr. PECORA. He discussed that this morning.

Senator FLETCHER. Well, all right. Was it created out of profits?

Mr. PECORA. Out of earnings.

Mr. MITCHELL. I was interrupted this morning I think in showing the difference in the method of distribution of management funds in the bank as against the company. I did not want to leave the impression that the same method of distribution obtains in the bank that obtains as in the company. In the bank twice a year, so long as the management fund prevailed under the old resolution, a vote is taken of all the officers, three ballots being cast: The first ballot is an unsigned ballot lodged in a ballot box with the cashier of the bank, as to what portion of the management fund accumulated I personally should receive.

The second is a signed ballot as to how much of the management fund after the proportion which I receive is deducted, should be distributed to each other eligible officer, each man voting eliminating himself. The third ballot is a signed ballot indicating what men other than the eligible officers should be considered in the distribution of the fund, what men have contributed most effectively during the period under review to the advancement of the interests of the institution.

Those ballots are presented by the cashier, after he has made a computation of their showing, to the executive committee, who, with myself absent, determine what proportion I shall receive. My only insistence to the executive committee of the bank has been that I shall never receive in excess of the proportion voted me by the officers. The other percentages are computed and tabulated by the cashier, and against those percentages amounts are set.

Those are given to me by the executive committee to iron out what I consider unfairnesses that might have crept in. Then, with my recommendations, they determine how that portion of the fund shall be given.

As far as employees who are not regularly eligible for the fund, we took those who received the highest recommendations, the greatest number of votes from the official staff, and those were reconsidered by the officers, and we selected from six to a dozen such men for special consideration in the management fund. That is done twice a year. And it is under that kind of provision, where, as you will see, I do the rather bold thing of placing myself on a pedestal where the officers can throw all the stones that they will at me without my

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

knowing from whom the stone comes, and I take their final net as the maximum which I will receive.

Mr. PECORA. And those officials who can throw those stones at you are all subordinate officers, aren't they, subordinate to you?

Mr. MITCHELL. They are, but their ballots are unsigned.

Mr. PECORA. And you, in turn, have a voice in fixing the apportionments to be given to them out of this management fund?

Mr. MITCHELL. I do, but I do not know what their votes have been as to me.

Senator FLETCHER. What portion of the earnings goes into this management fund?

Mr. MLTCHELL. Twenty per cent of the net earnings after 8 per cent of capital, surplus, and undivided profits have been deducted from the net operating earnings of the year.

Mr. PECORA. Now, may I ask you, Mr. Mitchell, if the minute books of the board of directors of the National City Co. have arrived here?

Mr. MITCHELL. I do not know.

Mr. PECORA. Are they in New York, Mr. Carey?

Mr. CAREY. They are on the way now.

Mr. PECORA. When do you expect them, later on this afternoon?

Mr. CAREY. Yes.

Mr. PECORA. In the absence of the minute books I will have to rely somewhat upon your recollection. Do you recall now that there was an increase of the capital stock both of the National City Co. and of the National City Bank in February of 1927?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. How much increase in the capital stock of the bank was effected at that time?

Mr. MITCHELL. There was an increase in the capital of the bank from $50,000,000 to $75,000,000.

Mr. PECORA. How was that apportioned as between capital and surplus, if there was any such apportionment made?

Mr. MITCHELL. There were issued to shareholders 250,000 shares of additional stock at $200 per share. The avails of that ran to an aggregate of $50,000,000, which was divided, $25,000,000 to the bank's capital, $12,500,000 to the company's capital, and $12,500,000 to the company's surplus.

Mr. PECORA. That is, the $50,000,000 raised through the issuance and sale of those 250,000 shares of stock of the bank, at $200 a share, were divided equally between the bank and the company?

Mr. MITCHELL. That is true.

Mr. PECORA. But the allotment of $25,000,000 that went to the company was divided equally between its capital and its surplus account.

Mr. MITCHELL. That is true.

Mr. PECORA. Now, coincidentally with that increase in the capital and surplus of $25,000,000 in the National City Co., did the National City Co. have any business transactions with a corporation called the General Sugar Corporation?

Mr. MITCHELL. In connection with this increase.

Mr. PECORA. No; coincidentally with it. That is, at about the same time as this increase of $25,000,000, which was made to the capital and surplus account of the National City Co.?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. I can not remember the dates. I will get it. [After consulting with an associate.] The National City Co. purchased on February 16, 1927, 1,500,000 shares of the General Sugar Co. for $25,000,000.

Mr. PECORA. And the increase of capital and surplus of the National City Co. was effected the day before that transaction, was it not?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. In other words, on February 15, 1927.

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Now, was there any relationship, other than that of time, between those two transactions?

Mr. MITCHELL. Well, I should think probably, yes. I do not recall the situation directly, but I think one would have to realize what the stock of the General Sugar Co. was to see the relationship there.

Mr. PECORA. But was there a relationship, other than that of time, between those two transactions, namely, between the issuance of the stock and——

Mr. MITCHELL (interposing). I should think probably, yes.

Mr. PECORA. Isn't it fair to say that the primary reason for this increase in the capital and surplus of the National City Co. of $25,000,000 was to enable the National City Co. to take over with that specific sum $25,000,000 of the capital stock of a corporation called the General Sugar Corporation?

Mr. MITCHELL. Yes; I should think so. I think that is a fair assumption.

Mr. PECORA. Now, this $25,000,000 that went into the capital and surplus account of the National City Co. on February 15, 1927, came from the shareholders of the bank and the company who purchased those 250,000 shares at $200 a share?

Mr. MITCHELL. That is right.

Mr. PECORA. When was the General Sugar Corporation organized?

Mr. MITCHELL. I think it was organized right then. I will have to inquire.

Mr. PECORA. That is, at the same time.

Mr. MITCHELL. Yes; the General Sugar Co. must have been formed just about that time.

Mr. PECORA. Well, the General Sugar Co. is a different corporation from the General Sugar Corporation, isn't it?

Mr. MITCHELL. No.

Mr. PECORA. Wasn't there a General Sugar Co. formed prior to 1927?

Mr. MITCHELL. Let me inquire. [After consulting an associate.] There was a General Sugar Co. formed, as a management company, for the management of sugar properties in which the bank was interested.

Mr. PECORA. That was formed in 1921 or 1922, wasn't it?

Mr. MITCHELL. It was not in 1921. I should say it must have been formed in late 1922 or early 1923.

Mr. PECORA. Yes. Now, then, when you speak of the General Sugar Co. I want you to please bear in mind that that is the name of this corporation that was formed in 1922 or 1923.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. That is right.

Mr. PECORA. And when you speak of the General Sugar Corporation will you please bear in mind that that is the name of the company which was formed in February of 1927?

Mr. MITCHELL. Yes.

Mr. PECORA. Now, have you in mind, within your own recollection, Mr. Mitchell, the outstanding facts with regard to the formation of the General Sugar Corporation in 1927?

Mr. MITCHELL. Yes.

Mr. PECORA. So that you think you will be able to answer my questions concerning that company and its operations without seeking assistance from anyone else?

Mr. MITCHELL. I would not say so entirely. My associate, Mr. Rentschler, the president of the bank, is far better qualified to answer those questions directly than I would be, but I will be glad to do my best for you.

Mr. PECORA. All right, sir.

Senator FLETCHER. What proportion of the total shares of the General Sugar Corporation did your company take over?

Mr. MITCHELL. All of them.

Senator FLETCHER. One and one half million shares?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. In other words, the $25,000,000 that the National City Co. obtained in February of 1927 through the sale of 250,000 additional shares of the capital stock of both the bank and the company was immediately turned over to the General Sugar Corporation in return for all of its capital stock?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Now, the General Sugar Corporation had, just prior to that transaction, acquired all the capital stock of the General Sugar Co., which was organized in either 1922 or 1923?

Mr. MITCHELL. That is right.

Mr. PECORA. Now, then, when this General Sugar Co. was organized in 1922 or 1923, wasn't it organized for the purpose of taking over the equities of four or five sugar-producing companies in Cuba?

Mr. MITCHELL. I think that that was a management company.

Mr. PECORA. It was a management company?

Mr. MITCHELL. Yes.

Mr. PECORA. And as a management company didn't it acquire the equities of the producing companies, which were some 4 or 5 in number, 1 of them being the Camaguey Sugar Co., and then 2 or 3 other companies generally referred to as the Oriente sugar group—do you recall those names?

Mr. MITCHELL. Oh, yes.

Mr. PECORA. Now, this management company, called the "General Sugar Co."' was organized in 1922 or 1923 after you as the president of the National City Bank and as the president of the National City Co. had made a survey of the sugar industry down in Cuba, was it not?

Mr. MITCHELL. Yes.

Mr. PECORA. And you were accompanied to Cuba on that occasion by Mr. Rentschler, whose name you just mentioned a few moments ago?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Yes, sir.

Mr. PECORA. And this Mr. Rentschler is now the president of the National City Bank, is he not?

Mr. MITCHELL. He is.

Mr. PECORA. Was he an officer of the National City Bank when he accompanied you to Cuba in 1922 to survey the sugar industry there?

Mr. MITCHELL. He was not.

Mr. PECORA. Was he connected with the sugar industry in Cuba at that time, in 1922?

Mr. MITCHELL. He had been a manufacturer, who, incidentally, produced a large quantity of sugar machinery, and his company had sold that sugar machinery over the island of Cuba for a long series of years, and he had been there and was acquainted very thoroughly with the sugar properties of the island, and the leading personalities in the sugar business in Cuba.

Mr. PECORA. He was acquainted with the sugar industry as a manufacturer of machinery used in sugar production?

Mr. MITCHELL. Yes.

Mr. PECORA. He was not a banker at that time?

Mr. MITCHELL. No.

Mr. PECORA. When did he first become affiliated in any official capacity with the National City Bank?

Mr. MITCHELL. He became a director. I should not want to commit myself as to what year, but I should say he became a director about the year 1924 or 1925. It is a matter of record.

Mr. PECORA. Now, were you also accompanied on that trip to Cuba by a Colonel Deeds?

Mr. MITCHELL. Yes.

Mr. PECORA. Was Colonel Deeds at that time connected with either the National City Bank or the National City Co.?

Mr. MITCHELL. No, sir.

Mr. PECORA. You regarded him also as well posted on the sugar industry in Cuba at that time, did you?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. What was his relationship at that time to the sugar industry in Cuba, if you can tell us?

Mr. MITCHELL. Colonel Deeds had been general manager of the National Cash Register Co. at one time. He had been a leading manufacturer of automotive apparatus, and a large owner in a prominent company in that field which company he finally sold to the General Motors Co., and became a retired man. But Colonel Deeds is of that type that can never retire, he will die with his boots on.

Mr. PECORA. And he still has his boots on, I assume?

Mr. MITCHELL. Yes; he still has his boots on. He went to Cuba first I think, thinking it would be a good place for pastime or a holiday. And he immediately became interested in the sugar situation there. He is a business man of very substantial acumen, and has been a friend of our institution for many years, and finding him there with that time on his hands and with the business background that he had, we asked him if he would not look into our situation down there. And he did so, at an expenditure of a very large amount of time, and he spent that time most intelligently.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Now, Colonel Deeds at that time was in no way connected with the National City Bank or the National City Co., was he?

Mr. MITCHELL. No, sir.

Mr. PECORA. Did he thereafter become connected with either or both of those companies?

Mr. MITCHELL. He became a director of the National City Bank. Again reaching for a date out of my memory, I should say about 1928.

Mr. PECORA. And he still is a director of that bank?

Mr. MITCHELL. And still is a director.

Mr. PECORA. Now, you said a few minutes ago that you asked Colonel Deeds to accompany you to help look over your situation. That may not be the exact terminology you used, but it is the substance. What was that situation? Was it one in which the National City Bank had some loans outstanding amounting to millions of dollars which you had previously made to these sugar-producing companies whose management was taken over in 1922 or 1923 by the General Sugar Co.?

Mr. MITCHELL. The National City Bank made some very large loans on the sugar business in Cuba.

Mr. PECORA. Prior to 1922?

Mr. MITCHELL. Prior to 1922. This was in 1918, I think. It was before I was connected with the bank, Mr. Pecora. And as you will perhaps——

Mr. PECORA (interposing). Before you were connected with the bank?

Mr. MITCHELL. Before I was connected with the bank; these loans.

Mr. PECORA. But it was while you were connected with the National City Co.?

Mr. MITCHELL. While I was connected with the National City Co., but I knew nothing of these operations. If you will recall, sugar reached the price, I think, of about 28 cents a pound in Cuba in 1919 or 1920, and it had a collapse that was very sudden, dropping about 90 percent of that——

Senator BROOKHART (interposing). Who was behind that manipulation? I remember carloads of sugar coming on the track in the city of my State, and it sold five times right there on the track and a higher price every time, to keep up with the New York manipulation.

Mr. MITCHELL. I do not know of New York manipulation. I can give you my impression of what happened, Senator Brookhart. As you know, during the war many of the European countries who had been large beet-sugar producers on their own account lost their beet fields in the war, and with men going away the beet factories were shut down and sugar became extremely valuable. At that time the facilities for producing sugar in Cuba were materially increased.

Senator BROOKHART. That offset this European trouble, didn't it?

Mr. MITCHELL. No; it did not offset it. The loss of production in Europe was very substantial, and following the war it took some time for these European fields and factories to get back into production. In the meantime the high price had stimulated production all over the world. The Philippines, Puerto Rico, places that could not begin to approach Cuba's cost of production, began to set up

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

their facilities for production very, very rapidly, and suddenly this production that had been started after the people began to recover themselves from the effects of the war came into the market and the Cuban sugar prices dropped precipitously. Of course, I imagine there must have been a great deal of speculation in it. It is a situation, as I say, that my associate, Mr. Rentschler, can talk on very much more intelligently than I. Mine is a recollection of it.

But to get back to your question, Mr. Pecora: During the period of 1917 and 1918 and 1919, 1920 probably, the early part of it, our bank had been lending to sugar producers in Cuba. They were building new properties, and there was a good deal of activity there, and we had branches at that time in Habana and in all of the principal cities.

Senator BROOKHART. Do you still have those interests in Cuba?

Mr. MITCHELL. Yes. We haven't as many branches as we had, but we have a large branch in Habana and we have branches through the principal cities.

Senator BROOKHART. It is charged that the National City Bank is sustaining the Machado government.

Mr. MITCHELL. That is absolutely false, because the National City Bank, neither in Cuba, nor the United States, nor in any other part of the world, has anything to do with politics or the promotion of any régime or the maintenance of any régime in office; and I say that positively and am glad to have the opportunity to do it, because it is a thing that is often charged up against us and with absolute untruth.

Mr. PECORA. Now, Mr. Mitchell, what was the total amount of loans which the National City Bank had made to the sugar-producing companies prior to 1922 whose managament was shortly taken over by the General Sugar Co.?

Mr. MITCHELL. I don't think I can give you that exact amount. When I first started to look into the situation in Cuba I found that they had made many loans to individuals and to corporations and to properties, which, with the collapse that had taken place, were truly valueless, and those we did not attempt to do anything with except to start to write them off our books. There were certain properties that our examination showed as having a promise in one way or another.

Mr. PECORA. What was the total amount of the loans that had been made and which were outstanding in 1922 to these sugar companies by the National City Bank? That was the question.

Mr. MITCHELL. Well, I can not answer that without reference.

Mr. PECORA. Was it around $30,000,000?

Mr. MITCHELL. I should think it was at least that.

Mr. PECORA. And did the bank continue to hold those loans up to 1927, when the General Sugar Corporation was organized?

Mr. MITCHELL. Many of them.

Mr. PECORA. Did the bank transfer or assign those loans to anyone in 1927 after the incorporation of the General Sugar Corporation and the purchase of its stock for $25,000,000 cash by the National City Co.?

Mr. MITCHELL. Not as far as I know. When the General Sugar Corporation became holden of this money that had been put in by

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the National City Co. they paid off a substantial amount of obligations of those various companies to the National City Bank.

Mr. PECORA. In other words, with the moneys realized from the sale of this additional capital stock in February, 1927, amounting to $25,000,000, the National City Co. paid off over $20,000,000 of those loans to the bank?

Mr. MITCHELL. I can not tell you just how much they paid off, but they paid off a substantial amount. You see——

Mr. PECORA. Is there any one of your associates who can give us those figures? I am sorry you haven't the minute books here, Mr. Mitchell, because I could get those figures, or you could get them, directly out of the minute book.

Mr. MITCHELL. I am prompted to this effect: That at that time the General Sugar Corporation took over from the bank approximately $25,000,000.

Mr. PECORA. Didn't it take over from the bank approximately $31,000,000 in loans?

Mr. MITCHELL. No; not at that time. I think at that time it took over about $25,000,000, and it, furthermore——

Mr. PECORA (interposing). Mr. Carey, have you got the minute book of the board of the bank?

Mr. CAREY. Yes.

Mr. PECORA. Of 1927?

(A minute book was produced.)

Mr. MITCHELL. I was just going to say in the meantime, Mr. Pecora——

Mr. PECORA. Let me finish this question, will you, please?

Mr. MITCHELL. Why, certainly.

Mr. PECORA. Now, let me read to you, Mr. Mitchell, from the minute book of the board of directors of the National City Bank the following entry from its proceedings held on February 15, 1927, found at page 238 of the minute book:

> The president asks the particular attention of the board to the action taken by the executive committee to-day with reference to the investment by the National City Co. of the sum of $25,000,000 in the stock of General Sugar Corporation and sale by this bank to said General Sugar Corporation for approximately $20,893,198 in cash and $11,000,000 of 5-year 6 per cent secured notes, of all this bank's interest in and loans to Cia. Azucarera Vertientes, Cia. Azucarera de Camaguey, and Cia. Azucarera San Cristobal, and the companies grouped under the control of the Santa Clara Sugar Co., with the exception of bonds held for investment and of current loans to said group of companies on pignorated sugars and of such portion of current unsecured loans of producing companies as this bank is satisfied to retain.

Does that entry refresh your recollection as to whether or not on February 15, 1927, that being the date when the National City Co. obtained $25,000,000 through the increase of capital stock of the company and the bank, that being the date on which the General Sugar Co. was organized, and that being the date referred to in the minute entry which I have just read to you?

Mr. MITCHELL (interposing). Yes; it does.

Mr. PECORA. Does that refresh your recollection as to the fact that on that date loans of the National City Bank which it had made in previous years to these various sugar-producing companies in Cuba, aggregating over $31,000,000, were taken over by the General

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Sugar Corporation in return for nearly $21,000,000 in cash and $11,000,000 of 5-year notes?

Mr. MITCHELL. That is right.

Mr. PECORA. And the General Sugar Corporation raised that twenty-odd million dollars in cash that same day by receiving $25,000,000 in cash from the National City Co. in return for the entire outstanding capital stock of the General Sugar Corporation?

Mr. MITCHELL. That is correct.

Mr. PECORA. How many of those 5-year 6 per cent secured notes for an aggregate of $11,000,000 have since been paid by the General Sugar Corporation to the National City Bank?

Mr. MITCHELL. Apparently 2,000,000 of them were retired, and there has since been written off of the books of the National City Bank a value so that they stand on the books of the National City Bank at a present value of $2,000,000.

Mr. PECORA. So that by this process the National City Bank was enabled to obtain something like $23,000,000 in cash for these loans?

Mr. MITCHELL. Yes.

Mr. PECORA. And those loans at this time, in February, 1927, were in default, were they not, to the bank?

Mr. MITCHELL. They were short-term obligations.

Mr. PECORA. As originally created. They were created away back prior to 1922?

Mr. MITCHELL. Yes.

Mr. PECORA. And were being carried as bad loans by the bank in February, 1927, were they not?

Mr. MITCHELL. I think not all of them were created prior to that time, but they were the residue of loans created prior to that time, plus some additions in the way of losses that had crept in during the subsequent years.

Mr. PECORA. They were regarded as bad loans by the bank in the years between 1922 and 1927, were they not?

Mr. MITCHELL. Well, they were regarded as certainly slow and doubtful, so long as the sugar industry remained in its existent state, and this was a process by which they were transferred from the bank, which we desire to keep as liquid as we possibly can, and were turned over to the National City Co. as a long-term investment. And now, as a matter of fact, the investment has depreciated by virtue of the tariff laws very largely, that we have not only in this country but elsewhere, which result in the production of uneconomic cost sugar, the sugar business in Cuba, as well as all Cuba economy, as everybody knows, has been very, very discouraging.

So much so that the National City Co., with respect to that stock of the General Sugar Corporation which it accepted at that time, has wiped out through write-offs every dollar of it.

Mr. PECORA. In other words, the National City Co. has written down to $1 this $25,000,000 investment that it made in 1927 in the stock of these sugar companies?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. But the bank's loans were paid through the process of raising $25,000,000 for the National City Co. by the issuance of 250,000 additional shares of the capital stock of the bank in February 1927?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. That is one way to put it; yes.

Mr. PECORA. Is that what is known in the vernacular as a "bailing out" of the bank of a bad loan?

Mr. MITCHELL. I don't think you would call it that. It was a transfer at the time of a short-term questionable investment that the bank had, putting it into a long-term investment in the City Co., which, under any return of the sugar industry to normal would have been an excellent investment, because these properties that are owned by the General Sugar are the lowest-cost producers, or among the lowest-cost producers, on the entire island of Cuba, and Cuba in itself is the lowest-cost producer in the world.

Mr. PECORA. Without going into all the details that you have given us of the sugar industry, I am confining myself to these loans. The bank succeeded in having the greater part of these $31,000,000 worth of slow and doubtful loans, as you call them, taken over by the National City Co., and the money, amounting to some $23,000,000, which the bank has received for those loans to the present time, was raised by this process of issuing 250,000 additional shares of capital stock of the bank and the company in 1927 and selling them to the shareholders for $50,000,000?

Mr. MITCHELL. If I may put it in my own way, Mr. Pecora——

Mr. PECORA. Is that an unfair way of putting it, Mr. Mitchell?

Mr. MITCHELL. Yes; without just one additional word, I am inclined to think it is, Mr. Pecora.

Mr. PECORA. Will you add the additional word?

Mr. MITCHELL. Yes; I will add the additional word if I may. This may be regarded as a contribution by shareholders in the light of the write-offs that have been taken since that date, a contribution by shareholders in cash to make up for losses which would otherwise have affected the capital and surplus and undivided profits, the capital structure of the bank. It may be regarded in the light of the subsequent write-offs as a repairment of the condition of the institution.

Mr. PECORA. With that additional word to the facts assumed in my question, have we a complete picture of the disposition made of these loans by the bank to the company?

Mr. MITCHELL. I should say so; yes.

Mr. PECORA. Now, when the stockholders or shareholders of the bank in 1927 were asked to subscribe to these 250,000 shares of additional capital stock at $200, and when they did so by paying this $50,000,000 for that additional stock, were they told that they were going to make this sort of a reparation that you have just referred to?

Mr. MITCHELL. I called your attention to the fact that it was the transfer of a questionable short-term investment that the bank had into what we hoped was a good long-term investment, which we intended to permanently keep in the City Co.

Mr. PECORA. But when the shareholders were asked to subscribe for those 250,000 additional shares, for $50,000,000, were they told that $25,000,000 of that money, of $23,000,000 of that sum, were going to be used to enable the National City Co. to take over these slow and doubtful loans of the bank?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. I don't think so, but the record would show it.

Mr. PECORA. You have no recollection of any such thing being told the shareholders?

Mr. MITCHELL. No; I have not, Mr. Pecora.

The CHAIRMAN. In other words, the bank had what had become a bad loan? The bank relieved itself by various processes, but the result of it was in the end that the public held long-time securities for it without having knowledge why these issues were made, but which afterwards turned out not to be so very good; is that it?

Mr. MITCHELL. This was not an issue that went to the public, Senator Norbeck. These transfers that have been discussed here were transfers that were made possible through the issuance of stock of the National City Bank.

The CHAIRMAN. Yes; but somebody bought them without having information as to the loss that was being taken up by them?

Mr. MITCHELL. The loss did not exist at that time, Senator Norbeck. These were transferred as a long-term investment for the National City Co.

The CHAIRMAN. But the National City Co. had relieved the bank of this slow and doubtful paper?

Mr. MITCHELL. Short-term loan.

The CHAIRMAN. Yes.

Mr. MITCHELL. The process was taking it out of short term and putting it into long term, and the stockholders when they got through it had exactly what they had before.

Senator FLETCHER. These 250,000 shares of the National City Bank were not offered to the public?

Mr. MITCHELL. By law any increase in capital stock has to be offered to the shareholders pro rata to their existent holdings.

Senator FLETCHER. And that is the way they were disposed of?

Mr. MITCHELL. Yes, sir.

Senator FLETCHER. Not to the public generally?

Mr. MITCHELL. They were offered to our shareholders.

Senator BROOKHART. Listed on the stock exchange?

Mr. MITCHELL. No. Let's see—well, that occurred in 1927. I think our stock was listed on the stock exchange then, but there were no dealings in it.

Mr. PECORA. Now, Mr. Mitchell, as a matter of fact, in February 1927, when these transactions took place between the bank, the company, and the General Sugar Corporation, didn't you and the other directors of the bank know that these loans which the bank then held, which it had made to these sugar companies, were bad loans and were not good investments, even as long-term investments?

Mr. MITCHELL. They were bad short-term loans, Mr. Pecora, and nothing but a turn in the tide would make them suitable for short-term classification.

Mr. PECORA. As a matter of fact, don't you recall that at the meeting of the board of directors of the National City Co. on January 25, 1927, when action was taken with respect to the set-up of the management fund for that year, a resolution of the board with respect to the management fund, after reciting the manner in which that man-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

agement fund was to be derived out of current earnings, contained this language:

Except that for the purpose of computation—

meaning the computation of the management fund from earnings—

the stock of the General Sugar Corporation which it is intended to introduce into the balance sheet on or about February 15, 1927, in the amount of $25,000,000, shall not be considered as a part of capital surplus and undivided profits, and any dividends or returns thereon shall not be considered as a part of current earnings.

Don't you recall that resolution?

Mr. MITCHELL. I recall it perfectly well, and I will tell you why it was put in.

Mr. PECORA. Wasn't it put in because the board at that time regarded these loans as bad loans?

Mr. MITCHELL. No, sir.

Mr. PECORA. Not merely slow or doubtful loans, but bad loans?

Mr. MITCHELL. No, sir; it was not, and I have just suggested you let me tell you why it was put in.

Any profit that might come from that investment, any loss that might come from that investment, would be a profit or a loss for which no officer of the National City Co. who might participate in that management fund was in any way responsible. This was a transfer of assets for the convenience of the institution. The debt had been created by a long prior management in the bank. The introduction of that as an investment in the City Co. was not anything that the management at that time had to do with, and if there was a profit or if there was a loss that group of men who were participating in that management fund had nothing to do with it, and so it was eliminated from the computation of the management fund. And that was the sole reason for it to be handled in that way.

Mr. PECORA. But if they had known that was going to be a loss to the company, that would be just the kind of action they would take in order to be fair to the company in the process of computing the management fund, would it not?

Mr. MITCHELL. I think very likely, but that is an assumption. I have given you the truth.

Mr. PECORA. But it is not an unsound assumption or a violent one, is it?

Mr. MITCHELL. No; I think it is quite a reasonable assumption, but it does not happen to be the proper one.

Mr. PECORA. Now, the sugar industry in Cuba collapsed after the war period, didn't it?

Mr. MITCHELL. Yes.

Mr. PECORA. That is about in 1921 or 1922?

Mr. MITCHELL. 1920.

Mr. PECORA. And it has been in a state of collapse practically ever since, hasn't it?

Mr. MITCHELL. That is true.

Mr. PECORA. And continuously since 1920 up to virtually the present time?

Mr. MITCHELL. I think in 1923 or 1924, or 1925, there was a slight breath of hope that came into the situation for a brief period, but by and large your statement is deplorably correct.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. You mean unfortunately correct?

Mr. MITCHELL. Both.

Mr. PECORA. Well, now, Mr. Mitchell, isn't it a fact that in this period between 1920 and the present time the National City Co. sold to the public bonds of the Cuban Dominican Sugar Co.?

Mr. MITCHELL. Yes.

Mr. PECORA. At a price very nearly par?

Mr. MITCHELL. Yes. I don't recall when that issue was, but that is a fact.

Mr. PECORA. It was about in 1928, wasn't it, that some of those bonds were sold to the investing public by the National City Co., 1927 or 1928?

Mr. MITCHELL. No; 1926, I should say.

Mr. PECORA. And how large an issue did the National City Co. then put out of these sugar bonds?

Mr. MITCHELL. Again, on these specific questions, I really would appreciate it if you would ask one of my associates, Mr. Ripley, who is here and who knows the Cuban Dominican Sugar situation and the issuance of those securities from A to Izzard. I have not attempted to refresh my mind on it, and I think really that you would be losing time with me, though I should be glad, Mr. Pecora, to give you anything that rests in my memory about it.

Mr. PECORA. I will exhaust your memory, and then if that does not prove adequate to the presentation of the facts, why, I will call on Mr. Ripley. When these Cuban Dominican Sugar bonds were offered to the investing public by the National City Co. did you pass upon the wisdom of that offering?

Mr. MITCHELL. Yes.

Mr. PECORA. As the chief executive officer of the company?

Mr. MITCHELL. I passed on it with my associates; yes, sir.

Mr. PECORA. You said this morning that these offerings had to meet the approval unanimously of all the officers of the company, who exercised their judgment about them before they were taken over by the National City Co.?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. So that that means that when these Cuban Dominican Sugar bonds were offered to the public in 1926 or 1927 by the National City Co. the offering was made after you as one of the officers had approved of it?

Mr. MITCHELL. Yes; and I thought it was such a good investment that I went away behind the bonds myself and bought stock in the open market and put it away in my box, and it is there today.

Mr. PECORA. And you gave that approval of this offering to the investing public here, despite the knowledge you then possessed of the collapse of the sugar industry, which you say took place in 1920 and has continued almost continuously from that year until the present time?

Mr. MITCHELL. That is so. And bear in mind that Cuban Dominican has a portion of its assets only in Cuba, where these difficulties were occurring, and the properties that they had there were among the best, and the bonded debt, as I recall it, was exceedingly small. There had been wiped out in that organization of Cuban Dominican at that time very large values that had gone into those properties.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator FLETCHER. What was the bonded debt, do you remember?

Mr. MITCHELL. I can not recall that, Senator Fletcher. That is why I asked that Mr. Ripley be called. He has those figures all at his tongue's end.

Mr. PECORA. The offering price to the public of those bonds was $97.50, was it not, for each hundred dollar par value?

Mr. MITCHELL. I can not remember that, but I should think it likely.

Mr. PECORA. Let me refer you, Mr. Mitchell, for the purpose of possibly refreshing your recollection, to this table [handing document to Mr. Mitchell]. See the notation I have made?

Mr. MITCHELL. Yes.

Mr. PECORA. Does that refresh your recollection concerning the issue of Cuban Dominican Sugar bonds?

Mr. MITCHELL. Yes.

Mr. PECORA. That we are speaking about?

Mr. MITCHELL. It does, as to the amount offered, the date, and so forth.

Mr. PECORA. What was the amount of the issue, total amount?

Mr. MITCHELL. $15,000,000.

Mr. PECORA. And when was it made?

Mr. MITCHELL. October 23, 1924.

Mr. PECORA. That was during this period in which the sugar industry was in a state of collapse?

Mr. MITCHELL. It was in a period where the sugar industry was being reorganized under what was then considered to be a more normal period into which we were reaching.

Mr. PECORA. A few minutes ago you referred to that period as being a slight flurry which was only a hope. Was it sufficient of a hope in 1924 to justify your company, in your opinion, in offering those bonds to the public at two and a half points below par?

Mr. MITCHELL. Distinctly so; yes.

Senator BROOKHART. How did you offer those, on the stock exchange?

Mr. MITCHELL. No; they were offered in the usual way, through dealers and through our own organization in one way and another.

Senator BROOKHART. You did not sell them for any less?

Mr. MITCHELL. No. They were sold in the same way. I can not tell you exactly how the marketing was done.

Senator BROOKHART. What are they worth now?

Mr. MITCHELL. The company has gone through another reorganization very lately.

Senator BROOKHART. What did these bonds realize?

Mr. MITCHELL. I can not tell you that. If you will only get Mr. Ripley here on the stand he will give you anything you want on this, but I personally can give it only from memory.

Senator FLETCHER. You sold the whole $15,000,000 to the public?

Mr. MITCHELL. Well, apparently we had a participation. We must have had some partners in this deal. I don't remember who they were, Senator Fletcher. We had a participation ourselves of a little over $11,000,000 in it, and we actually sold five million five of those bonds.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Who sold the others? Were there any participants with the National City Co. in the offering?

Mr. MITCHELL. Yes; I assume so. There must have been. And then, of course, we sold through dealers over the country and others. Our own sales are stated in this memorandum that you laid before me, which is a memorandum that I submitted before the Senate Finance Committee investigation at one time.

Senator FLETCHER. Did you sell any stock in that company?

Mr. MITCHELL. No.

Senator BROOKHART. Eleven million dollars of this were your own bonds you were selling?

Mr. MITCHELL. We participated in the purchase of those bonds apparently.

Senator BROOKHART. Who else participated with you?

Mr. MITCHELL. Well, I cannot tell you without a further record.

Senator BROOKHART. Perhaps some other New York banks?

Mr. MITCHELL. I cannot tell you who participated in that.

Mr. PECORA. What was the spread to the National City Co. on this offering?

Mr. MITCHELL. I can only tell you by looking at this memorandum. There was a gross spread in that business of 7½ points.

Mr. PECORA. That means the company got them at 90 and offered them at 97½?

Mr. MITCHELL. You mean the company sold them at 90. The Cuban Dominican Sugar Co. sold them——

Mr. PECORA. I mean the National City Co. got them at 90 and sold them at 97½.

Mr. MITCHELL. That is correct.

Mr. PECORA. Now, in any of its sales literature or circulars relating to this offering did the National City Co. indicate to the investing public the fact that these bonds had been taken over by the National City Co. at 90?

Mr. MITCHELL. No. And that, of course, is a practice that has never been followed in America in any issue that I can recall. It is an English practice, but it is not an American practice at all.

Mr. PECORA. Well, the practice is made by the investment houses themselves, isn't it?

Mr. MITCHELL. Yes; and the investment houses themselves, for all the years that I have known anything about the investment business, have never stated the spreads.

Mr. PECORA. They made their own custom in that respect?

Mr. MITCHELL. Yes. It is a custom that has grown up over the decades.

Mr. PECORA. There never has been any law which prevented these companies from indicating to the investing public the prices at which they had acquired the issues that they were offering to the public?

Mr. MITCHELL. No; nor any law that called upon them to do so.

Mr. PECORA. And because of that custom of withholding that information from the investing public, the public has never been able to learn and has no means of ascertaining at the time it is asked to subscribe to an offering just what the financial interest is of the company or concern making the offer?

Mr. MITCHELL. Well, of course, Mr. Pecora, you are getting down to a fundamental of the business, and I myself am somewhat per-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

plexed about it. If I go in and buy a pound of coffee there is no indication as to what the grocer paid for it and what profit he got for it. It is not the custom that I know anywhere in America, whatever is sold, to show what it cost when it was sold to the consumer.

Mr. PECORA. But when a person goes to a store to buy a pound of coffee he knows the merchandise that he is buying, doesn't he?

Mr. MITCHELL. Well, from some of the coffee that I have drunk I wouldn't think he did.

Mr. PECORA. And that usually is the fact with regard to the average investor, isn't it; he doesn't know the offers except as to such information as is vouchsafed to him by the offering house?

Mr. MITCHELL. That is correct. I do not know just exactly how pertinent the cost of that issue to the investment banking house is to the buyer. If it is a desirable thing, then it is something that I feel very strongly should be regulated into our system.

Mr. PECORA. Do you think it is a desirable thing?

Mr. MITCHELL. I have been unable myself to really see the desirability of it. I do think, Mr. Pecora, that in all of our American investment banking practice we ought to work toward giving additional information to the public. But whether that information is pertinent, whether it is something that would really aid a buyer to determine the true intrinsic merit of that which he buys, I must say I am very much in doubt. I think we ought to give them a lot more of information, but as to that particular information I do not know.

Mr. PECORA. Would it not be an aid to the investor in determining the real value of a security which he is asked to buy if he knew how much of the price that he was paying for it was actually going to be turned into the treasury of the company issuing the security?

Mr. MITCHELL. Well now, let's see whether it would or not. I think we can conceive cases where it would not. Supposing a company is being formed and you as an investment banker interested in its formation say, "I will take a million dollars of bonds of your company when it is formed and I will pay you 85 for them." The company goes on with its organization. It gets set up. This favorable thing or that favorable thing may happen, and by the time you get ready to issue that bond—you may have bought it with the idea that you could put it out at, say, 89 as a proper price to the public—at the time you get ready to offer it, that bond has assumed a very much better position, to the point where it has a worth of at least 95.

Now, supposing you went to the public and said, "Now, here is a bond. You can all recognize it to be a fine bond. And we offer it at 95. We paid 85 for it." The public immediately stops, looks, and listens and says, "This bond must be no good, because there is a 10-point spread in this bond."

Mr. PECORA. And frequently that would be a very fair conclusion, would it not?

Mr. MITCHELL. Yes, sir; but in this particular case that I have mentioned it certainly would not.

Mr. PECORA. Are you giving us the exceptional case, Mr. Mitchell, conjuring up an exceptional case?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. I am giving you an exceptional case, yes; because the exception in this particular phase of the investment banking business seems to me to be worth while to bring up.

Senator BROOKHART. It would not hurt the public any if they did buy it at a lower price, would it?

Mr. MITCHELL. No. We are talking here about a bond that might have a 10-point spread in it, when as a matter of fact the normal spread would be really, say, 2 points.

Senator BROOKHART. If the public had this information it might only have a 5-point spread; it would be 5 points better for the public if they knew about that, wouldn't it?

Mr. MITCHELL. Senator Brookhart, my only point is that the spread does not always indicate the merit classification of the bond.

Mr. PECORA. It is a factor that always should be considered, isn't it? Doesn't it enter into the real value of the bond?

Mr. MITCHELL. Not into the real value of the bond. There are certain bonds that can be put out to the public with ease because the public may know all about the company. There may be millions and millions of bonds outstanding of that company, and they may have a very good position and the spread may be justified of 2½ points. You can find an equally meritorious bond, and with perhaps as good or better background. But the public does not know about the debtor, and the difficulty of introducing this credit obligation to the public and educating them regarding this bond may be far greater than in the first instance, and you may have to have it——

Mr. PECORA. You do not mean to imply by that that it is better to keep the public in ignorance of that element of value?

Mr. MITCHELL. I do not think that the public is in a position to judge it, Mr. Pecora.

Mr. PECORA. It has never had a chance to judge of that fact, has it, because of the custom you referred to before?

Mr. MITCHELL. I come back to what I said. I don't see the advantage, but if it will do any good, then let us regulate so that the investment companies will have to show the spreads.

Senator BROOKHART. Let me ask a question on that: I got the Federal Reserve Board to make me some charts of English stocks in comparison with American stocks. Of course, as you say, the information is given to the public much more fully there than ours is, and this up and down of stock speculation in the United States is eight or ten times more than it is in Great Britain.

Mr. MITCHELL. Yes; it is——

Senator BROOKHART. Doesn't that information, then, help the public somewhat to stabilize these prices and prevent these speculative profits which are really criminal?

Mr. MITCHELL. I do not think that this particular information does. If it would stabilize the industry, if it would really be honestly indicative to the investing public and to the buyer, I should be heartily in favor of it. Personally, I do not care whether it is done or not. I would be perfectly willing to put the cost price on all of our circulars if it would accomplish any good.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Mr. Mitchell, as you sit there now, are you attempting to justify the custom of the past which has hidden that knowledge of the spread from the American investor?

Mr MITCHELL. Well, I didn't say——

Mr. PECORA. Or are you merely calling attention to the fact that that has been the custom without attempting to justify it?

Mr. MITCHELL. I am taking the latter course, Mr. Pecora.

Mr. PECORA. You are not attempting to justify it, then?

Mr. MITCHELL. I am questioning. I am giving you the reasons that are in my mind to question it.

Mr. PECORA. You have not given us any definite conclusion one way or the other that you may have reached, then, have you?

Mr. MITCHELL. I told you at the outset that here was a question that I was pondering——

Mr. PECORA. You are still in doubt about what conclusion should be drawn from it?

Mr. MITCHELL. I can not yet convince myself that the American practice has been wrong.

Senator FLETCHER. Let me ask you this: Isn't there another side to that question? Suppose in the case of the Dominican Sugar Co. you stated that you paid 90 for these bonds; wouldn't that persuade the public, wouldn't that be more likely to cause them to buy in that case? Say, the National City pay 96 or 95 or 92, or say they buy at 90, and suppose I had bought a thousand dollar bond—you would not pay any attention to it unless it is a million, but a thousand is quite enough for me—suppose I had bought a thousand dollar bond at 90, the same as you paid for it, and I was induced to do that because you had paid 90. What would be my situation with regard to that bond now?

Mr. MITCHELL. You would be just in the position that anybody else that bought it at 90 would be.

Senator FLETCHER. I am trying to find out what would be my position now.

Mr. MITCHELL. You see, Senator, that this company has gone through a reorganization, and the fellow that held that bond is holding something else in place of it. And as I said before, Mr. Ripley can tell you just what chance that fellow has had from the time he bought his bond and the chance he has got now, and his chance for the future, and I would not pretend to give the answer on that. I only say this, that this company has been through a reorganization, which was examined by the court all the way through, and when the court finished up they complimented the reorganization committee as having had a very fair reorganization plan, and he approved it heartily.

Now, just exactly what each one of these bondholders got in the reorganization is a matter that Mr. Ripley can tell you about, and doubtless you will call him.

Mr. PECORA. Now, Mr. Mitchell, the obligation of the company that issues the bond is to pay that bond at maturity, isn't it?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Pay it in full?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. At par?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Yes, sir.

Mr. PECORA. If a company putting out those obligations in the form of bonds actually receives for them 10 points under par, or, in other words, only 90 per cent of the par value, because it has made a deal of that kind with an underwriting syndicate or an underwriter of any kind, the company's financial position to redeem that bond would not be nearly so good as if it had received par; isn't that right?

Mr. MITCHELL. No; that is not particularly a fair——

Mr. PECORA. It would have that much less money in its treasury, wouldn't it?

Mr. MITCHELL. Now let us take a case again and see if it is right. Supposing a company has got a confirmed credit, an established credit in the market, for its long-term securities on a 5 per cent basis. It could put out then, tomorrow, blank dollars of additional bonds, 5 per cent bonds, at par.

Now, let us assume that that company says, "We don't want 5 per cent coupons on our bonds over a period of years. Therefore, we want to issue blank dollars of new bonds, but we want to put them out as 3 per cent bonds on a 5 per cent basis to the public.

You can see if you put out a 20-year 3 per cent bond on a 5 per cent basis to the public you must sell your bonds at a very large discount. I do not know just what that would figure, but I should think it would figure about—let's see; two points for 20 years would be 40, wouldn't it? That bond would be selling, I should say, at 78. Perhaps some of my expert assistants could figure that.

The CHAIRMAN. It would depend entirely on how long it had to run?

Mr. MITCHELL. Yes; it would depend entirely on how long it had to run, Senator. That is right.

The CHAIRMAN. Does that case illustrate your situation?

Mr. MITCHELL. It illustrates this: If that company came out with a bond at 78, let us say, would you forthwith question its standing or the worth of that bond? That same company could have put out a bond that same day, a 5 per cent bond, at 100.

The CHAIRMAN. Is that a parallel case with the one that you are being questioned about?

Mr. MITCHELL. I think it is pertinent to Mr. Pecora's question.

Mr. PECORA. Look; see if this also is not pertinent: Let's see whether this is not an analogy reduced to its simplest terms: If I were to borrow a thousand dollars from you and you were to give me $900 in return for my obligation or note or bond to pay you a thousand dollars, I would be thereby impaired to the extent of that $100 that I do not get from you in my ability to pay back that $1,000 when the note falls due, wouldn't I?

Mr. MITCHELL. No.

Mr. PECORA. I have suffered an impairment to that extent, haven't I?

Mr. MITCHELL. No. If it was payable to-morrow and you borrowed that money from me, you would have me arrested overnight, so that you would not have to pay me, because it would be usury. But let us assume that it is a long-term obligation. What is the difference as to whether you amortize, let us say, over a 20-year period

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

a discount of 22 points or whether you pay yearly a higher interest rate, the difference between 3 and 5 per cent, on your obligation? That is the point I make.

The CHAIRMAN. It all makes a difference who gets the money, whether the company or the broker gets the money or the bank gets the money.

Mr. MITCHELL. Well, I frankly do not see the purpose of your question.

The CHAIRMAN. If they only get 90 per cent, doesn't it make a difference to them whether they get 90 per cent or 100 per cent of an issue?

Mr. MITCHELL. You mean an issuing debtor?

The CHAIRMAN. A company borrowing; whatever the commission is, they are minus that; if it is 10 per cent, they are that much short.

Mr. MITCHELL. I judge for the moment that we are not discussing the discount or commission. We are now discussing the price at which a bond is sold.

Mr. PECORA. I am discussing in connection with that the matter of withholding information from the investing public to whom the bonds are ultimately sold concerning the spread which the offering house has in the issuing. That is what I am discussing.

Mr. MITCHELL. Mr. Pecora, on that frankly I say that if I could be convinced, as you evidently are, that that is in the interest of the investor, nothing would stop me in forcing through our organization a practice which would be contrary, 100 per cent contrary, to the usual practice of investment banking to publish the cost price of every issue. I frankly do not see that it is in the interest of the public that that should be, and I wish——

Mr. PECORA. Is it harmful to the public to have that information?

Mr. MITCHELL. No; but it would not be harmful or beneficial as to whether the circular was printed on red paper or gray paper or yellow paper.

Mr. PECORA. I am not discussing the best color. The color of the paper gives no information, does it, of the security to the public?

Mr. MITCHELL. And I do not consider that spread is pertinent information. Maybe it is.

Mr. PECORA. Can you conceive of any harm that the giving of that information would do to the investing public?

Mr. MITCHELL. I can not see, in the first case, in the illustration that I gave you, where it would be misleading.

Mr. PECORA. Do you know of any instance where the giving of that information has proved misleading or detrimental to the British investing public, to whom that information is given because of the British practice?

Mr. MITCHELL. I am not familiar enough to know whether there are cases or not, Mr. Pecora.

Mr. PECORA. You are familiar with the investment market all over the world, aren't you?

Mr. MITCHELL. Yes. But to point out any particular case out of the hundreds and hundreds of British issues that are made, one would have to be in daily contact with that market and remember over a long period of years. I do not.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. You have not heard the British investing public complaining of this information that the law requires investment houses to give them, have you?

Mr. MITCHELL. No; but I know of——

Mr. PECORA. And you have heard——

Senator BROOKHART (interposing). Let me ask a question.

The CHAIRMAN. Wait till the counsel completes his question.

Senator BROOKHART. It is right on that point that I want to ask this question: He said he had not heard the British public complaining about it. As this committee adjourned at 12 o'clock to-day I was surrounded by a dozen people in this room who said they had lost all their life's savings by buying securities in the National City Co. or the National City Bank, and they are complaining about this situation. There they are right here in this room.

Mr. MITCHELL. Yes. You see, the securities, whether issued by the National City Co. or other investment bankers, have gone down and caused enormous losses. Even last year, you know the United States issued 3 per cent bonds, and we bankers lost millions and millions and millions of dollars because of the price at which those bonds were offered.

The CHAIRMAN. They will still be paid with interest?

Mr. MITCHELL. They certainly will; and there are a lot of bonds that the National City Co. has issued that are down to-day that will be paid with interest.

The CHAIRMAN. Well, of course, it depends on what is back of them. The United States Government is back of United States Government bonds, of course. But speaking of losses, you mean simply market losses, don't you?

Mr. MITCHELL. Market losses. That is what exists to-day.

The CHAIRMAN. In other words, if the Government issues a good deal, the market is liable to sag because there are not buyers for them?

Mr. MITCHELL. Certainly.

The CHAIRMAN. But it has not changed the security at all, has it?

Mr. MITCHELL. No; and it has not with a lot of the other issues; but, Senator Norbeck, just as long as men are human and judgment has the element of error in it, just so long there will be mistakes made by the National City Co. or any investment banking house that puts out securities.

The CHAIRMAN. No member of this committee will dispute that, but that does not go to the question of whether the public should have fuller information than they are getting.

Mr. MITCHELL. I think they should, Senator Norbeck, and I would be——

The CHAIRMAN. Aren't other countries doing that? You have twice referred to the fact that in England full information is required.

Mr. MITCHELL. Yes.

The CHAIRMAN. Simply telling half the truth does not go. All of the truth has got to be told. Isn't that true of other European countries?

Mr. MITCHELL. Not to the extent——

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The CHAIRMAN. They do not go quite so far, but most of them go farther than we do, do they not?

Mr. MITCHELL. I would not say that most did. The English law is very complete as to the first issuance of securities.

The CHAIRMAN. You remember the lord that was sent to prison——

Mr. PECORA. Lord Klysant.

The CHAIRMAN. For a year, because he had failed to tell it all. The statement put out was truthful.

Mr. MITCHELL. Yes. He had eliminated a very vital fact.

The CHAIRMAN. Or he said it was to pay 6 per cent dividend. He failed to say in which way it was earned.

Mr. MITCHELL. But I am heartily in favor of fuller information. I wish we could regulate it all through the investment banking business.

Mr. PECORA. The National City Co. is the biggest investment house in the country isn't it? Do you know of any bigger?

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

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

Mr. PECORA. Yes; but isn't the National City Co. the largest investment company selling securities to the public?

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

Mr. PECORA. It would not have been unbecoming for the National City Co. to have taken the lead in bringing about a change in custom with regard to putting out fuller information to the public?

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

Mr. PECORA. When did you commence to blaze that trial?

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

Mr. PECORA. But you have not yet blazed the trail to the point where you are giving the investing public information concerning the price at which the company acquires these securities that it offers to the public?

Mr. MITCHELL. And I have told you why.

Mr. PECORA. I mean you have not yet reached that stage in the blazing of the trail?

Mr. MITCHELL. No.

Mr. PECORA. All right. Now, as originally organized and operated for many years following its incorporation in 1911, what kind of securities did the National City Co. confine itself to?

Mr. MITCHELL. Fixed maturity securities.

Mr. PECORA. You mean by that, bonds?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Bonds and notes.

Mr. PECORA. Bonds and notes, debentures?

Mr. MITCHELL. Bonds, notes, debentures, acceptances.

Mr. PECORA. Not stocks?

Mr. MITCHELL. No, sir.

Mr. PECORA. When for the first time did the National City Co. depart from that policy and include stock securities in its offerings to the public?

Mr. MITCHELL. I think it was in 1927 or 1928—1927, I guess—might have been 1926, when we first offered Southern Railway and Baltimore & Ohio stock.

Mr. PECORA. That was 1927, wasn't it?

Mr. MITCHELL. Well, you probably have checked the offering. My recollection would have been 1926 or 1927, probably 1927. You are probably right.

Mr. PECORA. But its operations along that line in 1927 consisted of an offering of common shares, shares of the common stock of the Southern Railway?

Mr. MITCHELL. Yes.

Mr. PECORA. To the public?

Mr. MITCHELL. Yes.

Mr. PECORA. Then in 1928 it enlarged upon that scheme, did it not, and offered to the public common stocks of several other corporations?

Mr. MITCHELL. I doubt if it was several. I am trying to think. I should think not over a half a dozen, but if you have the record and have checked it you know.

Mr. PECORA. Well, say a half dozen different issues of common stock?

Mr. MITCHELL. Yes.

Mr. PECORA. Were acquired or accumulated by the National City Co. in 1928 for sale to the public?

Mr. MITCHELL. Yes. I would not think there were that many.

Mr. PECORA. In 1929, up to October, 1929, the National City Co. accumulated common stock of still more corporations and sold them to the public?

Mr. MITCHELL. We did not sell through our organization. We accumulated quite a portfolio of common stocks, but very few, I would not say in more than two or three cases, were a part of those sold or offered to the public.

Mr. PECORA. What were those that were offered to the public in 1928 and 1929, if you remember?

Mr. MITCHELL. We offered Baltimore & Ohio, Anaconda Copper.

Mr. PECORA. Penn Road?

Mr. MITCHELL. No.

Mr. PECORA. Oliver Farm Equipment Co.?

Mr. MITCHELL. Preferred, I think.

Mr. PECORA. Not the common?

Mr. MITCHELL. A very small amount.

Mr. PECORA. Any other companies that you can think of whose common stock or preferred stock you offered to the public in 1928 and 1929?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. If you come to preferreds, I think there were several. There was Cannon Mills.

Mr. PECORA. United Aircraft?

Mr. MITCHELL. We offered a unit of preferred stock and some common with it.

Mr. PECORA. Of what corporation?

Mr. MITCHELL. Of the United Aircraft. Grasselli Chemical Co. and Hershey Chocolate Co.

Mr. PECORA. How about Wesson Oil and Snowdrift?

Mr. MITCHELL. Preferred stock.

Mr. PECORA. Have the minutes arrived yet, Mr. Cary?

(There was no audible response.)

Mr. PECORA. Now, to go back for a moment to the $15,000,000 bond issue of the Cuban-Dominican Sugar Co. which the National City Co. offered to the public at 97½ in 1924, do you recall whether the National City had any representation on the board of the Cuban-Dominican Co. at that time?

Mr. MITCHELL. Mr. Ripley, our vice president, who is with the City Co., was a member of the board. Oh, Mr. Russell—excuse me—Mr. Stanley Russell.

Mr. PECORA. Mr. Stanley A. Russell?

Mr. MITCHELL. Yes; vice president.

Mr. PECORA. And how about Mr. Gordon S. Rentschler, the present president of the National City Bank?

Mr. MITCHELL. I should have to refresh my recollection, but I think very likely he was, because he was regarded as one who knew more about our sugar interests than anybody else.

Mr. PECORA. How about Mr. Guy Cary?

Mr. MITCHELL. He did not represent us in any way. I think Mr. Guy Cary was counsel for the Cuban-Dominican Sugar.

Mr. PECORA. He or his firm is counsel for the National City Co.?

Mr. MITCHELL. That is correct.

Mr. PECORA. And also counsel for the National City Bank?

Mr. MITCHELL. That is so.

Mr. PECORA. And he is on the board of directors of the bank?

Mr. MITCHELL. I am reminded that Mr. Cary or his firm were not counsel for the Cuban-Dominican. He went on that board representing certain private interests, for which he was counsel, and those interests were not related to the National City Co. or bank.

Mr. PECORA. By the way, in 1928 when you received those sums that you have testified to out of the management funds of the National City Bank and the National City Co., how many other companies were you an officer or director in?

Mr. MITCHELL. It is hard for me to remember dates or any particular year. I should say that—the list is a matter of record in the directory of directors, but I would assume in answer to your question that I was a director of perhaps 10 or a dozen companies.

Mr. PECORA. Not any more than that?

Mr. MITCHELL. I would not say so. If we had a directory of directors it would give that clearly.

Mr. PECORA. Do you know just the number of different corporations of which you were an officer or director at any one time?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. No; I do not. But I think that would cover it quite completely, outside of the National City Bank, the National City Co., the City Bank Farmers Trust Co., and perhaps some companies that were our own companies for one purpose or another.

Senator BROOKHART. How much stock did you own in the bank?

Mr. MITCHELL. At what time or what year?

Senator BROOKHART. Say in 1927.

Mr. MITCHELL. Oh, I should think, and I have not the exact figure on that date and it is difficult to say, but in the neighborhood of 30,000 or 35,000 shares of stock.

Senator BROOKHART. Did you sell any of that stock?

Mr. MITCHELL. I bought, sir.

Senator BROOKHART. In what years did you buy?

Mr. MITCHELL. I bought the largest amount of stock in 1929.

Senator BROOKHART. Before or after the collapse?

Mr. MITCHELL. In the midst of the panic.

Senator BROOKHART. Trying to sustain the value of the stock?

Mr. MITCHELL. Yes, sir; trying to protect our shareholders.

Senator BROOKHART. Do you remember what price you paid?

Mr. MITCHELL. I can not tell you exactly, but in the neighborhood of $375 a share I should think.

Senator BROOKHART. And it has been as high as $600 or $700 a share.

Mr. MITCHELL. No. I think its high was somewhere around $570 a share or something like that.

Senator BROOKHART. $576 a share?

Mr. MITCHELL. Something of that sort.

Senator BROOKHART. All right.

Mr. PECORA. Well, Mr. Mitchell, did you also sell during the year 1929 any substantial portion of your holdings of National City Bank stock?

Mr. MITCHELL. I held in the midst of the panic all the stock I had owned for a long, long time, and in order to keep the market from collapsing where it would be destructive to the interests of our shareholders I permitted the National City Co. to put into an account which I established for them of my own, stock which they might purchase from our shareholders to the tune of $12,000,000. In other words, I put all that I had back into this institution, and for its stability. Some of that stock was subsequently sold. There were personal transfers through the years. To-day I hold the largest amount of stock of the National City Bank that I have ever held.

Mr. PECORA. No; I asked you this: You stated in answer to Senator Brookhart's question that you bought the bank's stock very extensively in 1929, and that a portion of that was embraced within the period of the stock-market collapse. Now, my question was: Have you also sold very extensively of your holdings in that period or before the end of that year?

Mr. MITCHELL. Well, I bought 28,300 shares, which I had hoped to hold only temporarily. It was done in order to help the situation.

Mr. PECORA. To sustain the market?

Mr. MITCHELL. Yes. Of that, 10,000 shares were sold, leaving me at that time the holder of 53,300 shares of stock. There were some personal transactions of a part of that holding in the latter part of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

1929, and since that time I have bought that stock back, so that today I am the holder of that and a little more.

Senator BROOKHART. A little more than 53,000 shares?

Mr. MITCHELL. Yes, sir.

Senator BROOKHART. At what price did you buy those back?

Mr. MITCHELL. I paid for those 18,300 shares—I can not tell you offhand just what it would be, but I can give you an approximate figure. Let me see, at $375 or $380 a share——

Senator BROOKHART (interposing). That was during the panic?

Mr. MITCHELL. Yes, sir.

Senator BROOKHART. Then you sold 10,000 shares?

Mr. MITCHELL. I am giving you the net of that 18,000 shares. I am counting that as this extra stock that I bought at that time, Senator Brookhart.

Senator BROOKHART. All right.

Mr. MITCHELL. I should say roughly, and I do not recall exactly, but that the net price of the 18,300 shares of stock was about $375 to $380 a share, as a guess.

Senator BROOKHART. If I understood your statement, then, afterwards you sold a part of that stock.

Mr. MITCHELL. I did.

Senator BROOKHART. And then still later bought it in, recently.

Mr. MITCHELL. I, frankly——

Senator BROOKHART (interposing). How much did you buy in recently?

Mr. MITCHELL. I bought in all that I sold, and I bought a few shares more in the meantime.

Senator BROOKHART. What price did you pay for those last purchases?

Mr. MITCHELL. I sold this stock, frankly, for tax purposes.

Senator BROOKHART. That was to avoid income tax?

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

Senator BROOKHART. In other words, by making a sale of it that showed a loss in your income.

Mr. MITCHELL. That certainly did.

Senator BROOKHART. And then you bought it back afterwards?

Mr. MITCHELL. Yes, sir.

Senator BROOKHART. And, now, those are the prices I want to get, what you sold at and what you bought it back at.

Mr. MITCHELL. The prices are a matter of record, but the one to whom I sold this stock, a person of some means, had no ability to take the loss that existed in that stock and at the end of last year I bought the stock back at what had been paid for it.

Senator BROOKHART. At the same price?

Mr. MITCHELL. Yes, sir.

Senator BROOKHART. That sale was just really a sale of convenience, to reduce your income tax?

Mr. MITCHELL. You can call it that if you will.

Senator BROOKHART. Well, is that right?

Mr. MITCHELL. Yes; it was a sale, frankly, for that purpose, where you hoped the buyer would be able to make a profit. And it was

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

bought with the idea of making a profit. But the accumulated loss was so great that I offered, and did buy, the stock back this year at what had been paid for it.

Senator BROOKHART. This buyer was a friend of yours, of course. He had favored you and you wanted to favor him.

Mr. MITCHELL. It was not that kind of negotiation. But I simply could not see that buyer take that loss. And I hold today that stock.

Senator BROOKHART. You did not have a similar sympathy for all these buyers here in the room and buy that stock back, did you?

Mr. MITCHELL. If anybody here in the room, or anybody that you know, has suffered a loss in gross that I have in City Bank stock, then you know somebody that I do not. I, individually have suffered a greater loss from the market failure in National City Bank stock than any other individual in the United States.

Senator BROOKHART. Well, the real fact is, then, that neither yourself nor any of the big financial crowd realized that this thing was inflated beyond all reason in 1929?

Mr. MITCHELL. I did not realize this, and I was looking over today——

Senator BROOKHART (interposing). The fact is that the public cannot rely on the judgment of the big financial crowd in these financial matters at all.

Mr. MITCHELL. With respect to the future and on market prices and on the economics of the situation, there are so many factors over which the men in finance have no control and really have comparatively little knowledge, that it is just as impossible for them to predict a definite future as it is for anybody else.

Senator BROOKHART. Then, shouldn't they state that fact in every prospectus that they put out to the people? Shouldn't they state: We do not know and nobody can tell what will happen, and it is impossible to tell.

Mr. MITCHELL. Well, I will tell you for all of them, myself included, that we are human, we are filled with error, and it does not matter how good our intention may be we are going to make mistakes at times. I only hope that we can learn something from all this and be able to reach that period when we can put into constructive effort the lessons that we have learned during this period.

The CHAIRMAN. The committee will now——

Senator FLETCHER (interposing). Mr. Mitchell, what were your holdings in the National City Co. at this time?

Mr. MITCHELL. You see, the stock of the National City Co., the investment affiliate, is not a stock that is owned by the public at all, Senator Fletcher.

Senator FLETCHER. Yes.

Mr. MITCHELL. That is owned by these three trustees for the benefit of the shareholders of the National City Bank. So that every shareholder of the National City Bank has an interest ratably to his holdings as to the total of the assets and earnings of the National City Co. And that beneficial interest is evidenced by a stamp on the back of the shares of the National City Bank, so that the beneficial interest in the company goes along with the bank shares.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator FLETCHER. And if there is a loss in the company that is reflected.

Mr. MITCHELL. It is reflected in the bank shares.

Mr. PECORA. Mr. Mitchell, you spoke of a sale of thousands of shares of your bank stock in 1929 for tax purposes. How much loss did that sale enable you to show?

Mr. MITCHELL. My recollection is $1,600,000 or $1,800,000.

Mr. PECORA. It was nearly $3,000,000, wasn't it?

Mr. MITCHELL. No; I think not. It must have been about the difference between—let me see, I will take $370 and $380 a share—well, I should say, about $150 a share on 18,000 shares. That would be somewhere near it.

Mr. PECORA. Wasn't the amount nearer $2,800,000 as the loss that you were able to show for your tax purposes by that transaction?

Mr. MITCHELL. No; it could not have been. I should have said $150 a share on 18,000 shares.

Senator BROOKHART. Doesn't that run pretty close to the figure Mr. Pecora mentioned?

Mr. MITCHELL. That was a figure of about $2,700,000?

Mr. PECORA. That figure was about $2,800,000?

Mr. MITCHELL. Yes; I think so. It would be a matter of record, but probably that.

Mr. PECORA. And that enabled you to avoid an income tax payment for the year 1929?

Mr. MITCHELL. Yes. My losses had been such that I did not have to pay it.

Mr. PECORA. Now, Mr. Mitchell, while we are discussing the stock panic of 1929, do you recall whether any action was taken by the directors of the National City Bank, early in November of 1929, whereby a fund of $2,000,000 was set aside by the bank to be used for the making of loans without interest or security to certain officers of the bank? Do you recall that action?

Mr. MITCHELL. I think it was not only to the officers, but to officers and employees of the bank. Yes; if you will amend your question to that extent.

Mr. PECORA. By the way, that sale of this bank stock that you referred to in the latter part of 1929 was made to a member of your family, wasn't it?

Mr. MITCHELL. It was; yes, sir.

Senator FLETCHER. Did you do anything to check this wild speculation up to October of 1929 that occurred on the stock exchange?

Mr. MITCHELL. Did I do anythink to check it?

Senator FLETCHER. Yes.

Mr. MITCHELL. Yes.

Senator FLETCHER. You did that?

Mr. MITCHELL. Oh, yes, Senator Fletcher. And if the committee would like to give me the opportunity I should be glad to go into a long discussion of that, but it is a subject by itself.

Senator FLETCHER. Well, as I understand about that time brokers' loans mounted to something like six to eight billion dollars, and call loans were paying somewhere near 20 per cent at the peak.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Yes.

Senator FLETCHER. You recognized that as an unhealthy situation, didn't you?

Mr. MITCHELL. Most decidedly.

Senator FLETCHER. Could you briefly state what you did to stop it?

Mr. MITCHELL. One of the greatest difficulties was, of course, loans for account of others, which very materially swelled the credit structure, and that was the very source from which came those large brokers' loans. Bankers, in other words, did not have control of the money situation. It was in the control of the so-called "others". And we did everything in our power to find a correction of that fundamental fault. Furthermore, I always myself felt that this tax on capital gains and losses was creating, in a period of inflation, a demand for securities which could only be corrected by a change in the law. I largely wrote a bulletin which our bank published in April of 1929, pointing that particular fact out, and pointing out what I believed to be true, that the situation could not be corrected by ordinary methods, that we needed to loosen up the stocks and make more stocks available, and then your prices would not have risen as they did. I think the prices of stocks rose largely as a result of what I regard as a defect in the law.

Senator BROOKHART. How much brokers' loans did your bank make?

Mr. MITCHELL. We always carried a certain amount of brokers' loans, but we did not lean on the Federal Reserve Bank.

Senator BROOKHART. Didn't you increase your brokers' loans during this very speculative period?

Mr. MITCHELL. No, sir. Our brokers' loans were increased only as the demand of industry and commerce subsided. And, of course, after the break, and then all those people who had been lending on call for their own account and not through the banks rushed and took their money out; then every bank in New York was obliged to make up that deficiency and was forced to go to the Federal reserve bank for borrowings. So that following the period of the collapse the record will show that all New York banks leaned heavily on the Federal reserve credit, and that was the only thing that saved the situation at that time. But prior to that time and while this speculation was going on we did not lean on the Federal reserve bank credits at all, or for only a day or two here and there, to even our position up.

Mr. PECORA. Mr. Mitchell, don't you recall that it was in March of 1929 the Federal Reserve Board sounded a public warning with regard to this tremendous inflation of the credit structure?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. As represented by brokers' loans and loans for others?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Loans that had up to that time reached an unprecedented amount?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. And, in order to apply a corrective to that inflation of prices, the Federal Reserve Board raised the rediscount rate in March of 1929, didn't it?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Yes; but they were very slow in being permitted to do it. I can not tell you offhand just whether that occurred at that particular date or not.

Mr. PECORA. Well, subject to confirmation of the date, do you recall the episode?

Mr. MITCHELL. The episode you refer to?

Mr. PECORA. Yes.

Mr. MITCHELL. I think I understand it.

Mr. PECORA. Do you recall that at the same time the National City Bank threw $25,000,000 into the call-loan money market at rates of 16 per cent and more?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. And that that was regarded as a flaunt on the warning sounded by the Federal Reserve Board?

Mr. MITCHELL. It was regarded as that in certain quarters; yes.

Mr. PECORA. In certain responsible quarters?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. In other words, at the time when the Federal Reserve Board was seeking to apply the brakes to this inflationary process the National City Bank was nullifying that to the extent that it threw this $25,000,000 into the call-loan money market.

Mr. MITCHELL. That I deny, Mr. Pecora.

Mr. PECORA. Well, didn't it have the opposite effect from that which was intended by the Federal Reserve Board in raising its rediscount rate at that time?

Mr. MITCHELL. I think not.

Mr. PECORA. Didn't it contribute to the opposite effect?

Mr. MITCHELL. I think not. What happened—and since the question has been brought up I think I should be permitted to reply to it—was this: We had not been borrowing from the Federal reserve bank at all. The Federal Reserve Board's warning was a warning against banks leaning on Federal reserve credit to support speculation. We were not leaning upon Federal reserve credit to support speculation. There developed in New York, at a time when we were not borrowing a penny from the Federal reserve bank, and not rediscounting, when we had plenty of Government bonds and eligible loans for discount at the Federal reserve bank—as I say, there developed one day at the money post on the exchange a period when there was no money to lend.

The rate has gone up, I think, to 15 or 16 per cent. We stepped in there to allay what was becoming a money panic, an inability of the legitimate borrower to borrow for his day contracts the money that was essential if they should be maintained.

Senator BROOKHART. Do you consider 16 per cent a legitimate charge for money borrowed?

Mr. MITCHELL. No. And of course that was not a renewal rate. But what we did at that time was to say: We are not prepared to support this situation by lending money at any rate that is posted, but if there are legitimate borrowers who have an honest need for this money overnight, we are prepared to lend $5,000,000, and I

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

think we offered to lend $5,000,000 at every few points of interest up. We did not want to lend it.

Mr. PECORA. It was an increase of 1 point for every $5,000,000 of those $25,000,000, wasn't it?

Mr. MITCHELL. No; my recollection is it was more than 1 point in interest. But perhaps you are right.

Senator BROOKHART. Who were those honest borrowers? Weren't they speculators?

Mr. MITCHELL. No. Those were brokers who had to make good the contract that day, for overnight. We went in and loaned——

Senator BROOKHART (interposing). That was a speculative contract. It was one of those gambling deals, wasn't it?

Mr. MITCHELL. This was not in support of the speculative market. This was to prevent a money panic, which was sudden, and developed overnight, and we went to the Federal reserve bank for two days only. I take the opportunity of asking if you will just let me read a paragraph from our bulletin? This pertains to what occurred in March of 1929. It won't take but a moment. And four days later——

Mr. PECORA (interposing). Four days after what date?

Mr. MITCHELL. After the date when we made these loans, which I think were about March 26 or 27, 1929. On the 1st day of April our monthly bulletin was issued, and I caused this paragraph to be put in:

During the last week of March these large credit demands, including shifting of balances in connection with income-tax payments and in preparation of quarterly disbursements of dividends and interest, combined with the substantial withdrawal of funds from the New York call-loan market, resulted in a scarcity of call money that sent the rates up to 20 per cent and caused a sharp reaction in stock prices. Prompt action by New York City banks, however, in offering to provide funds to take care of the market's requirements, served to avert any fears of a money panic.

The National City Bank fully recognizes the dangers of overspeculation and endorses the desire of the Federal reserve authorities to restrain excessive credit expansion for this purpose. At the same time, the bank, business generally, and it may be assumed the Federal reserve banks, whose policies over the past year have been marked by moderation, wish to avoid a general collapse of the securities markets such as would have a disastrous effect on business.

It is evident from the way money has acted here in the past few days that the crisis has passed and the incident is a closed book. At the same time it would be unfortunate that any action taken by this bank during the emergency should have created the thought that our views, again and again expressed, as to undue expansion of the credit structure have changed.

That there has been a most unusual expansion in credit is a fact that is generally admitted and that the largest element in that expansion is so-called speculative loans must also be, and is, recognized.

With this crisis passed, the people of the country would be generally well advised to bear in mind the condition of the credit structure and voluntarily see to it that in their loan accounts they maintain wider margins and lean less heavily on borrowed money.

Mr. PECORA. Now, this expansion of the credit structure that is referred to in that bulletin, Mr. Mitchell, was due primarily, wasn't it, to the unprecedented amount of speculation in the stock market over a period of two or three years prior to March of 1929?

Mr. MITCHELL. It was the development of excessive speculation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. If you had let it collapse in March that would have saved hundreds of thousands of dollars to people who invested later on, prevented them from buying, and the collapse would not have suffered such purchases to mean a loss; is not that a fact?

Mr. MITCHELL. I do not believe that any man who has it within his power to stop a money panic is going to take the responsibility of seeing the money panic develop.

Senator BROOKHART. That is what is wrong with our financial system; nobody is going to stop this speculation.

Mr. MITCHELL. I may be an inferior banker, but so long as I am in the banking business and can find a way to stop a money or a credit panic every bit of the weight I can put into the situation is going to be put in.

Senator BROOKHART. You helped to inflate matters later and on up to the 25th of October, and you could not stop it then.

Mr. MITCHELL. No; I beg pardon, Senator Brookhart. We stepped in in a critical moment, and we stopped the development of a panic at a critical moment. The warning of the Federal reserve bank was against the fostering of a speculative market by lending upon Federal reserve credit.

Senator BROOKHART. You did not take that as a general warning against speculation, then?

Mr. MITCHELL. It was the same kind of warning that we gave in what I just read you, that we gave through 1929 and prior thereto, again and again.

Senator BROOKHART. I do not think that any bank has any business at any time in working up an unnatural boom in stock prices or farm values whether in a critical moment or any other kind of moment.

Senator FLETCHER. The depreciation in securities that resulted in October in a drop of some $25,000,000,000, as I recall, would not have been as great——

Senator BROOKHART (interposing). Would not have been at all, would it?

Senator FLETCHER. Would not have been as great if this collapse had occurred in March, would it? If that collapse had occurred in March 1929, what would have been the situation?

Mr. MITCHELL. The banker could not see a panic occurring because of a money squeeze that was minor in its character. Security prices were high, speculators and investors everywhere were borrowing more money than they should; that was a fact that we all appreciated and that we were trying to preach against and educate the public in regard to.

Senator BROOKHART. And the way you did it was to lend them more money. That is what it means.

Mr. MITCHELL. Well, of course, you are viewing it through different eyes than I would view it. I would view it purely as a monetary money squeeze, one that any banker who has a responsibility to a public, if it is within his power, should avert.

Senator BROOKHART. You admit that the big financial minds did not foresee this October panic. But it was along about that time that I wrote an article in Plain Talk predicting that we were

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

headed into the greatest panic in the history of the world. And I did not see very far into it, either. Now, don't you think the financial crowd had better begin to look at this thing from the standpoint of facts rather than from the standpoint of profit making?

Mr. MITCHELL. I certainly think we have been looking at it from the standpoint of the facts.

The CHAIRMAN. May I ask a couple of questions now?

Mr. MITCHELL. Certainly.

The CHAIRMAN. Mr. Mitchell, you have stated that you averted a shortage of money, and that as a result business went right on on the exchange. You have stated also that at that particular time you thought stocks were high. If I may ask, how much higher did they go before they broke off—by three or four times, some of them, didn't they?

Mr. MITCHELL. Oh, I think not.

The CHAIRMAN. Didn't the big loss to the public take place between the period when you and the Federal Reserve Board disagreed on policy and the time when the breakdown came?

Mr. MITCHELL. We did not disagree on the policy, Senator Norbeck, fundamentally. I think there was a misunderstanding due to a quotation that had been put in a New York paper by a newspaper reporter who talked with me that evening, and it was regarded as a statement that I had given out. He had gone out and tried to remember what I had said as to our reasons for stepping in, and that was referred to as defiance of the Federal Reserve Board. I never issued any statement.

The CHAIRMAN. It has been repeatedly interpreted by Senator Glass as your saying to the Federal Reserve Board to go to hell. Isn't that so?

Mr. MITCHELL. Senator Glass took that attitude at the time, and it was an exaggerated statement made as the result, not of any statement made by me, but as the result of the newspaper article. I was not——

The CHAIRMAN (interposing). Well, wasn't the point that they were trying to get over, that of retrenchment, and you took the opposite view?

Mr. MITCHELL. No, sir.

The CHAIRMAN. You say you found a shortage of money in the market. Didn't the Federal Reserve Board take the view that there should be a restriction of credit?

Mr. MITCHELL. All banks were lending; not only banks but individuals were lending in the call market constantly. As a matter of fact, call loans were the most liquid of all the assets that we had. Now, we had an expansion in deposits and industry owing to the fact that industry had paid off large quantities of its debts through its ability to issue shares in the place of debts. That was not borrowing. So that there was a large amount of money resting in the banks, a large amount of credit that could be used only in the call market. We are always operating in competition with the fellow who was lending his own money. And yet we were not leaning on the Federal reserve bank at all. Of course, we had a cer-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tain proportion of our assets in call loans, but we were maintaining an even position.

We did not lend on call because we wanted to expand call loans but because they were the only available asset for us. This happened to be the situation when, with our position even, not leaning in any way on the Federal reserve bank, when this money squeeze developed and we stepped in. We were in the Federal reserve two days as a result.

I will say that I submitted a chart of the rates and borrowings on the call market, in the New York market, and our own borrowings from the Federal reserve bank, at my hearing before the Glass committee. And if you would like it in support of my statement in regard to this I should like very much indeed to introduce it and have it accompany this testimony, because it shows very clearly that the National City Bank was not throughout this period in any way leaning on Federal reserve credit for the support of the market during the so-called speculative era.

The CHAIRMAN. I do not think it has been claimed that you did. But the Federal Reserve Board had sounded a warning, and you have said already that you found them short of money up there and you put more money in the market, and of course the boom went on. I do not think there is any disagreement about the facts.

Mr. PECORA. It is simply one of motive.

The CHAIRMAN. Well, I do not attempt to interpret motives.

Mr. MITCHELL. It is one of method. I do not think anybody would say that an undesirable trend should be stopped by bringing about a collapse that would be the collapse not only of speculation but of industry too, which that would have meant.

The CHAIRMAN. I am not trying to interpret that. We are trying to get at the facts as to conditions at that time, and they seem to be agreed upon here. You were a Class A director of the Federal reserve bank over there at the time, were you not?

Mr. MITCHELL. Yes, sir.

The CHAIRMAN. And as soon as the squeeze came they appealed to you for help and say you took the opposite course, and you deny that.

Mr. MITCHELL. I doubt if the Federal Reserve Bank of New York would support that view at all, that what was done by our bank at the time was in violation of the spirit of what they were attempting, I mean attempting to get member banks to do in the conduct of their affairs.

The CHAIRMAN. I see that you have carefully selected your words. You do not say Federal Reserve Board but Federal Reserve Bank of New York.

Mr. MITCHELL. I cannot speak for the Federal Reserve Board.

The CHAIRMAN. But the Federal Reserve Board is the only one whose action is referred to. No one has referred to the action of the Federal Reserve Bank of New York except you, and you say you doubt very much if they had that view. I say the Federal Reserve Board had a certain view.

Mr. MITCHELL. Yes, but they were bound to express their view through the Federal reserve bank controlling our district. We are

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

not in direct touch with the Federal Reserve Board, you will bear in mind.

The CHAIRMAN. I know that the impression has grown that the Federal Reserve Board has been entirely subordinated to New York influences. I know that that influence has developed.

Senator COUZENS. Is there anybody with the Federal Reserve Bank of New York whom this committee could call to substantiate your viewpoint?

Mr. MITCHELL. Governor Harrison is the governor of that bank.

Senator COUZENS. Was he active at the time this incident occurred of which Senator Glass complained?

Mr. MITCHELL. Yes, sir; he was the governor of the bank at that time.

Mr. PECORA. Do you recall at that time saying this, either in words or substance, which was published in one of the papers:

> This question of stock prices is inextricably bound up with that expansion of credit, and this is one point that the Federal Reserve authorities apparently did not dare discuss.

Mr. MITCHELL. No; I do not remember that.

Mr. PECORA. Do you recall that you were quoted to that effect in the New York Times of March 30, 1929?

Mr. MITCHELL. No; I do not. I might have been quoted that way, but I do not remember the interview of which you speak, or the article.

The CHAIRMAN. Well, the committee will adjourn at this time until 10 o'clock tomorrow morning.

Senator COSTIGAN. Mr. Chairman, it is my understanding that Miss Grace van Braam Roberts, of Ulster County, New York, who has heretofore testified before this committee, has a brief supplemental statement which she desires to make. She has a written statement which she is willing to read, or if the committee prefers, she will submit it for the record.

Senator COUZENS. I suggest that the statement be printed in the record at the request of the witness.

The CHAIRMAN. Without objection that will be done.

ADDITIONAL STATEMENT BY MISS GRACE VAN B. ROBERTS, ULSTERDORP FARMS, HIGHLAND, ULSTER COUNTY, NEW YORK

In order to clarify some points in a case which has already been considered by this committee, and which offers an interesting field for further investigation, I wish to place in the records of these hearings two documents, which are here attached. The first is a transcript of part of Mr. Richard Hoyt's testimony for the defense in Miss Grace van Braam Roberts's suit against Hayden, Stone & Co. This transcript includes Mr. and Mrs. Hoyt's joint account in Atlantic, Gulf, and West Indies stock, his personal account for some of his dealings in the same stock, and the pool account. This pool, as was proved in court, was admitted by Mr. Hoyt, an officer of Hayden, Stone & Co., to have been formed to support Atlantic, Gulf, and West Indies stock. It operated during the six weeks from November 17 through December 31, 1920, while, as was afterwards disclosed, members of the firm of Hayden, Stone & Co. were secretly unloading their stock under cover of an active campaign by their customers' men directed by Mr. Richard Hoyt, urging the stock as a splendid investment.

The second document is a transcript of figures from the New York Times for part of the period covered by the suit, showing selling prices and amounts sold

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

daily of Atlantic, Gulf, and West Indies stock from October 1 through December 31, 1920.

Excerpts from the testimony filed with the court (pp. 55, 63–65):

NEW YORK, *May 28, 1925.*

Memorandum of transactions in common stock of Atlantic, Gulf & West Indies Steamship Lines by Richard F. Hoyt from January 1, 1920, to December 31, 1921

[S298 account in which Mr. Hoyt had one-half interest and Mrs. Hoyt one-half interest]

1920	Purchases	Amount	1920	Sales	Amount
Jan. 1	1,000 balance, $148.90	$148,895.00	Mar. 5	200	$30,002.00
23	200	32,440.00	Mar. 9	100	15,476.00
Mar. 5	600	87,920.00	Mar. 10	100	15,926.00
8	100	14,970.00	Mar. 16	300	46,728.00
Apr. 1	100	17,245.00	Mar. 17	100	16,476.00
Nov. 5	100	13,970.00	Apr. 7	100	17,226.00
			June 1	100	16,376.00
			Dec. 21	100	10,381.00
			Dec. 23	100	10,281.00
			Do	100	10,218.50
			Do	100	10,231.00
			Dec. 24	100	10,581.00
			Do	100	10,481.00
			Do	100	10,381.00
			Do	100	10,281.00
			Do	100	10,181.00
			Dec. 29	200	19,212.00
				(1)	45,001.50
Total	2,100	315,440.00		2,100	315,440.00
Dec. 31	204 from joint account	14,885.28			
	Margin from joint account	6,500.00			
1921			1921		
Jan. 1	204 balance, $104.83	21,385.28	Jan. 12	100, $72¾	7,256.00
			Jan. 13	4, $74¼	295.84
			Do	100, $75	7,481.00
			Jan. 31	(1)	6,352.44
Total	204	21,385.28		204	21,385.28
Nov. 9	Tax	4.00	Nov. 4	100, $29½	2,931.00
			Nov. 17	100, $32½	3,231.00
	ON RICHARD F. HOYT ACCOUNT				
1922			1921		
Mar. 15	300, $41.09	12,459.07	Dec. 31	300, $26.81	8,043.00
			1922		
			Mar. 31	(1)	4,416.07
Total	300	12,459.07		300	12,459.07

[1] Trading operation, losses.

In account with Hayden, Stone & Co., New York, record of pool operations

[Account No. 418]

Date, 1920	Bought or received	Sold or delivered	Description	Price	Debit	Credit balance
Nov. 17	100		Atlantic Gulf	114	$11,415.50	
	100		do	115	11,515.00	
	100		do	114¼	11,440.00	
18	100		do	110½	11,065.00	
	200		do	109	21,830.00	
	100		do	109	10,915.00	
	100		do	111	11,115.00	
	100		do	111½	11,165.00	
	100		do	112	11,215.00	
	100		do	113	11,315.00	
	100		do	113½	11,365.00	
	100		do	112½	11,265.00	
19	100		do	108½	10,865.00	
	100		do	108	10,815.00	
	100		do	107	10,715.00	

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In account with Hayden, Stone & Co., New York, record of pool operations—Con.

Date, 1920	Bought or received	Sold or delivered	Description	Price	Debit	Credit balance
Nov. 10	100		Atlantic Gulf	106½	$10,665.00	
	100		do	107½	10,765.00	
22	100		do	104	10,415.00	
	100		do	105¼	10,540.00	
	100		do	105¼	10,540.00	
	100		do	106	10,615.00	
	100		do	105¼	10,540.00	
	100		do	104¼	10,440.00	
	100		do	105	10,515.00	
	100		do	103¾	10,390.00	
	100		do	105½	10,565.00	
	100		do	104½	10,465.00	
23		100	do	110		$10,981.00
		100	do	110½		11,031.00
		100	do	111½		11,131.00
		100	do	111		11,081.00
26	100		do	101½	10,165.00	
	100		do	103	10,315.00	
	100		do	105½	10,565.00	
	100		do	101½	10,165.00	
	100		do	101¾	10,190.00	
	100		do	102	10,215.00	
	200		do	102¼	20,480.00	
	100		do	103¼	10,340.00	
	100		do	104¼	10,440.00	
	100		do	104	10,415.00	
	100		do	103½	10,365.00	
	100		do	103¾	10,390.00	
	100		do	105¾	10,590.00	
	100		do	105¼	10,540.00	
	100		do	106½	10,665.00	
	100		do	107	10,715.00	
	100		do	107½	10,765.00	
	100		do	108	10,815.00	
	100		do	104½	10,465.00	
	100		do	105	10,515.00	
	100		do	104¾	10,490.00	
	100		do	106	10,615.00	
29	100		do	102½	10,265.00	
	100		do	102¼	10,240.00	
	100		do	102	10,215.00	
	100		do	99⅝	9,977.50	
	100		do	99½	9,965.00	
	100		do	103	10,315.00	
	100		do	100¾	10,090.00	
	100		do	100½	10,065.00	
	100		do	100	10,015.00	
	100		do	101¾	10,190.00	
	200		do	101	20,230.00	
	100		do	100¼	10,040.00	
	100		do	101½	10,165.00	
	1,000		do	100	100,150.00	
	100		do	102¾	10,290.00	
	100		do	102	10,215.00	
Dec. 2		100	do	108		10,781.00
3		100	do	111		11,081.00
		100	do	111½		11,131.00
		100	do	112½		11,231.00
		100	do	112		11,181.00
6		100	do	114		11,381.00
		100	do	114½		11,431.00
		100	do	113½		11,331.00
		100	do	113		11,281.00
7	100		do	108	10,815.00	
	100		do	108½	10,865.00	
	100		do	109½	10,965.00	
	100		do	109	10,915.00	
	100		do	110	11,015.00	
10	100		do	107½	10,765.00	
	100		do	108	10,815.00	
13	100		do	107	10,715.00	
	100		do	106½	10,665.00	
14	100		do	105	10,515.00	
	100		do	105½	10,565.00	
	100		do	106	10,615.00	
15		100	do	110		10,981.00
20	100		do	105	10,515.00	
	100		do	104½	10,465.00	
	200		do	103¼	20,680.00	
	100		do	103	10,315.00	

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In account with Hayden, Stone & Co., New York, record of pool operations—Con.

Date, 1920	Bought or received	Sold or delivered	Description	Price	Debit	Credit balance
Dec. 22	100		Atlantic Gulf	100	$10,015.00	
	100		do	100½	10,065.00	
	100		do	101½	10,165.00	
	100		do	100¾	10,090.00	
	100		do	102	10,215.00	
	100		do	102½	10,265.00	
23	100		do	99¼	9,940.00	
	100		do	99	9,915.00	
	100		do	98	9,815.00	
	100		do	97½	9,765.00	
	100		do	98½	9,865.00	
	100		do	99¼	9,940.00	
		100	do	101		$10,081.00
		100	do	100½		10,031.00
		100	do	100		9,981.00
		100	do	104½		10,431.00
24		100	do	105½		10,531.00
		100	do	102½		10,231.00
		100	do	103½		10,331.00
		100	do	106½		10,631.00
		100	do	101¾		10,156.00
28	100		do	97	9,715.00	

(Signed) R. F. HOYT.

Account long 8,000 shares, delivered proportionately to participants against payment for same on December 31, 1920.

Closing prices and amounts of daily sales of Atlantic, Gulf & West Indies stock, 1920

[Taken from the New York Times]

Date	Closing price	Amount sold	Date	Closing price	Amount sold
Oct. 1	143	700	Nov. 17	110	7,200
Oct. 2	145½	1,000	Nov. 18	107¾	7,000
Oct. 4	(1)		Nov. 19	105¼	12,700
Oct. 5	150½	2,000	Nov. 20	107	2,600
Oct. 6	(2)		Nov. 22	111¼	6,600
Oct. 7	148	600	Nov. 23	110	3,300
Oct. 8	145	700	Nov. 24	102¼	9,600
Oct. 9	142	1,200	Nov. 25	102¼	17,800
Oct. 11	141½	700	Nov. 27	104	3,100
Oct. 13	146	400	Nov. 29	105	6,000
Oct. 14	144	100	Nov. 30	106¾	5,300
Oct. 15	146	700	Dec. 1	109¾	5,900
Oct. 16	144¼	200	Dec. 2	111¼	16,000
Oct. 18	143½	300	Dec. 3	111	6,400
Oct. 19	146	600	Dec. 4	114½	7,000
Oct. 20	147½	2,600	Dec. 6	110	8,500
Oct. 21	145	300	Dec. 7	112½	8,600
Oct. 22	144¾	2,200	Dec. 8	110½	6,100
Oct. 23	145⅞	2,300	Dec. 9	108½	7,200
Oct. 25	145½	2,800	Dec. 10	109½	7,200
Oct. 26	144½	800	Dec. 11	106⅝	3,300
Oct. 27	142¾	1,100	Dec. 13	105⅝	7,000
Oct. 28	142	5,700	Dec. 14	110	7,700
Oct. 29	142	1,100	Dec. 15	107½	4,800
Oct. 30	142	300	Dec. 16	108	2,400
Nov. 1	143½	100	Dec. 17	107¼	1,700
Nov. 3	139⅜	1,100	Dec. 18	103½	6,700
Nov. 4	139½	2,200	Dec. 20	103¾	4,100
Nov. 5	132¾	9,500	Dec. 21	101⅛	8,200
Nov. 6	131¼	4,600	Dec. 22	100¾	14,700
Nov. 8	124¼	10,200	Dec. 23	105½	8,200
Nov. 9	123½	7,100	Dec. 24	102	3,700
Nov. 10	123	8,300	Dec. 27	97¾	10,800
Nov. 11	118¼	21,000	Dec. 28	93¼	19,600
Nov. 12	113	19,600	Dec. 29	89¼	16,800
Nov. 13	114½	4,700	Dec. 30	75⅝	23,300
Nov. 14	113⅛	7,900	Dec. 31	75⅛	29,600
Nov. 15	114	5,500			

[1] Bid 145½, asked 147.

[2] Bid 148, asked 150.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In connection with these records and with the testimony already given by me before this committee the following questions rise:

(1) To what extent were members of Hayden, Stone & Co. and their families selling stock under their own names or through dummies while they were urging their customers to buy?

(2) When the members of the firm contributed to the pool 17½ per cent of its stock, did they buy this stock in the open market, or did they merely transfer some of their personal holdings?

(3) When the pool relinquished considerably over 17½ per cent of its stock during its lifetime, did this percentage include the stock belonging to Mr. Hayden and Mr. Stone, and did they then sell it before the expiration of the pool?

(4) Did members of the firm or their families, while selling stock in their possession to customers whom they could persuade to hold that stock, at the same time sell short before the expiration of the pool and also from time to time in 1921, while they were still advising me to hold my stock?

(5) While officers of the stock exchange, the most powerful institution in the world, have declared themselves unable to answer the foregoing questions, can investigators working under the direction of the Committee on Banking and Currency learn the answers?

I wish to call attention, also, to the following paradoxical situation. The Supreme Court of New York judged Hayden, Stone & Co. guilty of fraud. Mr. Whitney has repeatedly asserted that he sees nothing worthy of censure in the firm's conduct. Yet on October 28, 1930, Mr. Whitney said before an audience consisting of the junior league and their friends, "We endeavor to have righteous men as our members and to have their conduct of business done in a straightforward way." The difference between the standards of the court and those of the stock exchange invites further investigation.

Some light is thrown upon the attitude of bankers toward stock-exchange practices in letters from several of the most influential New York banks, of which the following letter from Mr. J. P. Morgan's office is typical:

NOVEMBER 16, 1932.

J. P. MORGAN, ESQ.,
New York City.

MY DEAR SIR: I am venturing to send you under separate cover a copy of part 3 of the hearings before the Senate Banking and Currency Committee investigating stock-exchange practices, and to request that you read pages 1127 through 1144, including the correspondence between Senator Burton K. Wheeler and Mr. Richard Whitney, president of the New York Stock Exchange.

I testified at that hearing with the understanding that the committee would take action if abuses were found. Senator Norbeck planned to have Mr. Whitney down to answer my charges and to have me return in surrebuttal.

Just recently I have heard from another Senator that a group of bankers, headed by the chairman of one of the large city banks, is endeavoring to have the proceedings quashed on the plea that they are delaying business recovery. Mr. Whitney and an influential brokerage house are under fire.

After you have read the above-mentioned evidence I hope that you will write me how you feel about allowing these dishonest groups to conspire to rob the public, the most contemptible and cruel form of robbery possible. Also, do you believe that recovery can be built on a rotten foundation?

Sincerely yours,

G. VAN B. ROBERTS.

DECEMBER 12, 1932.

J. P. MORGAN, ESQ.,
New York City.

MY DEAR SIR: I have received no acknowledgment of my letter to you of November 16, and feel that I must write again in order to make your attitude on the issue of stock-exchange connivance with fraud clear beyond question.

Your great house cannot be afraid of Mr. Richard Whitney or of Mr. Charles Hayden; and if you refrain from censure of their acts, you will be understood to approve them. Hayden was adjudged a cheat, and did not appeal. Whitney is his defender, and says that the Supreme Court was wrong. I have sent you the evidence as printed by the Senate Banking and Currency Committee.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

This is no trivial matter. I cannot allow this thieving to be covered up. Hayden, Stone & Co. not only has a large amount of my money but also is still cheating trusting clients. For the financial district to defend these cheats is to invite sweeping condemnation. If the members of this firm had cheated at cards or in a yacht race, they would have been expelled from their clubs. Why is stealing money from trusting customers more respectable? Will Mr. Whitney's false statements tend to establish public confidence at a time when the stock exchange needs confidence?

The law in England is very much more severe against one who recommends securities that he knows are unsound than it is here. The need for reform here is evident.

I hope that you will write me that your house disapproves of the conduct of Mr. Whitney.

Yours very truly,

G. VAN B. ROBERTS.

NEW YORK, *January 27, 1933.*

Miss GRACE VAN B. ROBERTS,
Highland, Ulster County, New York.

DEAR MADAM: Mr. Morgan directs me to acknowledge receipt of your letters of November 16 and December 12 and to say that he has the highest regard for both gentlemen you mention, and feels sure that you are misinformed.

Yours very truly,

V. AXTEN, *Secretary.*

JANUARY 29, 1933.

Mr. J. P. MORGAN, Esq.,
New York City.

MY DEAR SIR: The most fitting comment on the letter that you requested Mr. Axten to write for you is, "Whom the gods would destroy they first make mad."

When you hold in your hand a Supreme Court decision against them, can you deceive yourself into believing that adjudged cheats or tricksters—nay more, criminals, if I had handed the decision to the district attorney—can by the mere declaration of your faith in them be rehabilitated? We shall not get the country back on an even keel by any such unsound policy. We need sobriety, common sense, and honesty. Can you believe that your statement of January 27 will do more than serve public notice where you stand, to your own undoing? The letter of January 27 is in reply to my letters of November 16 and December 12, and hence seems not to have been written in haste.

This matter is very important. I urge you, if possible, to correct the unfortunate impression made by your message. If, however, the letter really conveys the matured answer upon which you have determined in the months since my letters reached you, then, unless I hear from you to the contrary, I shall consider that I have your permission to make that answer public.

Very truly yours,

G. VAN B. ROBERTS.

The CHAIRMAN. The subcommittee will now stand adjourned until to-morrow morning at 10 o'clock.

(Thereupon, at 4.40 o'clock p. m., Tuesday, February 21, 1933, the committee adjourned to meet at 10 o'clock on the following morning.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

STOCK EXCHANGE PRACTICES

WEDNESDAY, FEBRUARY 22, 1933

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

The subcommittee met, pursuant to adjournment on yesterday, at 10 o'clock a. m., in room 301 Senate Office Building, Senator Peter Norbeck presiding.

Present: Senators Norbeck (chairman), Townsend, Costigan, and Fletcher.

Present also: Ferdinand Pecora, special counsel to the committee; Julius Silver and David Saperstein, associate counsel to the committee.

The CHAIRMAN. The subcommittee will come to order. Mr. Pecora, you may resume with Mr. Mitchell.

TESTIMONY RESUMED OF CHARLES E. MITCHELL, CHAIRMAN NATIONAL CITY BANK OF NEW YORK, NATIONAL CITY CO., AND CITY BANK FARMERS TRUST CO.

Mr. PECORA. Mr Mitchell, are you an officer of the General Sugar Corporation?

Mr. MITCHELL. I am a director of the General Sugar Corporation. I do not think that I am an officer—let me ask an associate—yes; I am a director.

Mr. PECORA. Have you been an officer of it, other than a director?

Mr. MITCHELL. I think not.

Mr. PECORA. Poor's Manual of Directors lists you as chairman of that corporation. Do you know about that?

Mr. MITCHELL. I may have been chairman of the board of directors but never an executive officer.

Mr. PECORA. Who is the executive head of that corporation?

Mr. MITCHELL. I think Col. E. A. Deeds is the president of it.

Mr. PECORA. He is a director of the National City Bank?

Mr. MITCHELL. He is, at the present time.

Mr. PECORA. There was some testimony given yesterday by you concerning loans that the National City Bank had made over a period of years and which aggregated upwards of $30,000,000. Do you recall that testimony?

Mr. MITCHELL. I recall that the question was raised; yes.

Mr. PECORA. Now, were any other loans made to the sugar companies that were taken over by the General Sugar Corporation,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

either since the transaction of February 15, 1927, that was referred to in your testimony of yesterday or before that date?

Mr. MITCHELL. Oh, yes. There were loans made to the integral companies, whose stock was held by General Sugar.

Mr. PECORA. And those loans were made since February of 1927?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Are you familiar with those loans?

Mr. MITCHELL. Not in detail; no, sir.

Mr. PECORA. What is the aggregate amount of the loans that have been made since February of 1927?

Mr. MITCHELL. I can not give you that without refreshment.

Mr. PECORA. How many such loans have been made?

Mr. MITCHELL. They have been made during the grinding season, large loans made constantly on pignorated sugar, and there have been some dead-season loans, if you understand those terms.

Mr. PECORA. I do not.

Mr. MITCHELL. Well, pignoration loans are loans that are made against sugar in warehouse, with the sugar securing the loan. Dead-season loans are loans that are made for preparing the crop in advance of the harvest; and under the Cuban laws they are well protected by a lien on the crop to be taken off.

Mr. PECORA. And those loans have been made since and during this period of collapse in the sugar industry in Cuba?

Mr. MITCHELL. With respect to the collapse of the sugar industry in Cuba, you questioned me yesterday when my mind had not been refreshed with regard to prices of sugar and the movements over a period of years. I wish you would give me an opportunity to correct some impressions that prevailed at that time, because overnight I have studied the situation and can now give you a very much clearer picture, and one that is very much fairer to this presentation.

The CHAIRMAN. Well, Mr. Mitchell, if it is brief there could be no objection to it. But we do not want to get into a long statement or speech here this morning.

Mr. MITCHELL. I can understand that, Senator Norbeck.

The CHAIRMAN. If it is too long we can have some of it printed in the record. We would like to accommodate you, however, to clear up any wrong impression that might have been developed yesterday.

Mr. MITCHELL. Quite so; and that is what I am asking now, Senator Norbeck.

Mr. PECORA. First, Mr. Mitchell, will you answer the question I put to you, and then you may make a statement if you desire to make it.

Mr. MITCHELL. I am not prepared to admit, and this presentation will indicate it, that the collapse of the sugar industry was a continuing thing from 1920 and 1921 through this period. I mentioned yesterday in my testimony that the market had improved at various times.

Mr. PECORA. You mentioned it as of one period, and you placed it at about 1926.

Mr. MITCHELL. Well, I was wrong about that.

Mr. PECORA. When you stated there was only a slight flurry upward.

Mr. MITCHELL. Well, I was wrong about that, and that is what I desire now to correct.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Well, the chairman has indicated you may state it briefly.

Senator FLETCHER. I think he has a right to correct it.

Mr. PECORA. Is it merely a correction that you wish to make of your testimony on yesterday?

Mr. MITCHELL. I wish to correct an impression that I gave on yesterday as to the conditions of the sugar industry over a period of years, my mind not then being fresh on the subject. It is vital to this question that you are asking.

Mr. PECORA. Well, if the statement will be a brief one the committee will hear it.

Mr. MITCHELL. I have before me official statistical charts of sugar prices from 1920 to the close of 1932.

The high price of sugar in 1922 was 22½ cents. It dropped to a low of approximately 3½ cents per pound during that year.

The following year, in 1921, Cuban sugar reached a high of 5¼ cents, and a low of approximately 2.41 cents.

In 1922 sugar opened the year at a low of about 1.81 cents. It improved throughout that year, and it was assumed that sugar was coming back into a position of stability. In the closing months of that year sugar reached 4 cents a pound, and closed the year at 3.71 cents a pound. It was during the last quarter of that year that the financing of the Vertientes and Camaguey companies, which you mentioned on yesterday, was done.

Senator FLETCHER. Are those New York prices of sugar?

Mr. MITCHELL. Those are f.o.b. Cuba.

Mr. PECORA. What you have just referred to as financing was in reality refinancing, wasn't it?

Mr. MITCHELL. No, sir. That was financing incident to the completion and rebuilding of those properties, which——

Mr. PECORA (interposing). The properties were in operation and had been producing, and had been given certain loans by the National City Bank, and in 1922 the General Sugar Co. was organized to take over the management of those underlying producing companies, and it was the General Sugar Co. that was financed in 1922, is that correct?

Mr. MITCHELL. The General Sugar Co. was formed in 1922, and money was furnished through them for the development of the Vertientes and Camaguey companies, and the National City Co. made bond issues to which I referred on yesterday, at that time for the Vertientes company and for the Camaguey company. And I have before me the circulars that were issued with regard to those companies incident to the bond issues. The estimates, incidentally, showed that with sugar at 4 cents per pound, which it reached, where it was on November 25, 1922, that property would earn $4,130,000. And I have the range at lower prices. The year, as I say, closed at 3¾ cents. At 3½ cents it was estimated the earnings would be $3,420,000 per annum.

Mr. PECORA. Those are all estimated earnings, on which that circular was based, are they not?

Mr. MITCHELL. They are estimated earnings, and the balance sheet was given. This company had been in operation, and had been a profitable company.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Were those earnings realized as a matter of fact?

Mr. MITCHELL. The cost per pound of sugar produced at the Vertientes mill was less than was estimated, less than any estimate that was made.

Mr. PECORA. But the question I asked is: Were those estimated earnings actually realized that year?

Mr. MITCHELL. They were realized on the basis of the price of sugar prevailing during that year and the following years.

Mr. PECORA. But the question I asked you was: Did the company actually get those earnings? Did they realize those estimated earnings?

Mr. MITCHELL. You see, this plant was in process of building.

Mr. PECORA. My question, Mr. Mitchell, was: Were the estimated earnings referred to in that circular actually realized in that year by the company?

Mr. MITCHELL. They were not estimated for that year, Mr. Pecora. They were estimated for the years 1923, 1924, and 1925 in the circular, during which time the property was being completed.

Mr. PECORA. Do you mean that in 1922, when that circular offering the bond issues of those sugar companies was put out, the value of the bonds was based upon estimated earnings for the next three years?

Mr. MITCHELL. It was in part on estimated earnings. But——

Mr. PECORA (interposing). For three years ahead?

Mr. MITCHELL. For three years ahead; yes, sir. But——

Mr. PECORA (interposing). On a crop like sugar?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Were those estimated earnings for those three years actually realized?

Mr. MITCHELL. The estimates, as I recall them, were all under as to the production of the mill, the cost of sugar, and were in accordance with various prices at which the earnings were estimated. This was not a new property.

Mr. PECORA. The question is: Were the estimated earnings for those three years actually realized by the company?

Mr. MITCHELL. This estimate was made on the basis of certain production. I can not tell you, without further reference, exactly what the production was in those years.

Mr. PECORA. Well, if you are going to give us a complete explanation of these things, wouldn't it be better to first fortify yourself as to the facts of actual earnings instead of taking merely estimated earnings?

Mr. MITCHELL. Mr. Pecora, I think you are very unfair to me. I stated to you yesterday in connection with this sugar matter, and in connection with certain other matters that you brought up, that there were associates of mine who were thoroughly familiar with every detail of these companies, and you have summoned them to appear here, and they are here.

Mr. PECORA. Who were those associates?

Mr. MITCHELL. The associates of mine that have to do or know about this far more in detail than I do, are Mr. Rentschler, who is now president of the National City Bank, and Mr. Russell and Mr. Ripley, both vice presidents of the National City Co.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Were Mr. Russell and Mr. Ripley with you and Mr. Rentschler when you made this trip to Cuba in 1922 to survey the sugar industry there?

Mr. MITCHELL. Mr. Rentschler was.

Mr. PECORA. I asked you if Mr. Russell and Mr. Ripley were. I know that Mr. Rentschler was, because that was brought out yesterday.

Mr. MITCHELL. I think neither of them was. But they have been; and they are a part of our organization who have kept in daily touch with this sugar industry.

Mr. PECORA. And you think it is unfair for me to ask you about this sugar situation rather than Mr. Ripley and Mr. Russell, who did not go down to Cuba in 1922 to make the survey that you made?

Mr. MITCHELL. Mr. Rentschler has been very closely identified with our interests in sugar from the time that I came into the National City Bank and started to make the study incident to the heavy loans which then existed. He made that study in detail, and he lived with it for several months. He is familiar, I think, with every step that has been taken in that matter, and, personally, I have relied very largely on him and the men he has gathered about him in connection with this phase of our work.

Mr. PECORA. Is Mr. Ripley an officer or director of the National City Bank?

Mr. MITCHELL. No, sir.

Mr. PECORA. You went down to Cuba not only as an officer of the bank but as an officer of the National City Co., both of which organizations were interested in those sugar loans; isn't that so?

Mr. MITCHELL. The National City Co. at that time, I think, was not interested in it in any way.

Mr. PECORA. It became vitally interested in it in 1927, didn't it?

Mr. MITCHELL. It did.

Mr. PECORA. When it took those loans over from the bank.

Mr. MITCHELL. It did. And I wish to correct your statement, or make a clear statement of what occurred on yesterday.

Mr. PECORA. By whom was the statement made of which you complain, you or me?

Mr. MITCHELL. I wish to clear up the statement that was made by you, which in the passage of testimony was slipped over and which left an incorrect impression.

Mr. PECORA. What was slipped over on yesterday?

Mr. MITCHELL. The impression was slipped over to this effect: You spoke of these loans being "unloaded" by the National City Co., and you indicated that they were no good as of the time they were turned over, and that we were misleading our shareholders with regard to that particular increase in stock which gave the National City Co. $25,000,000, to take these over.

Mr. PECORA. Did I slip that over, or did you make answers to my questions which created that impression?

Mr. MITCHELL. I remember distinctly your words "unloading of these" and the intimation of your questions was distinctly that this was the equivalent of something that was misleading and a fraud upon the stockholders, which it was not.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Didn't I ask you whether the turn that these transactions took in 1927 was an unloading?

Mr. MITCHELL. You used the words——

Mr. PECORA (interposing). I used the words "bailing out"?

Mr. MITCHELL. Yes.

Mr. PECORA. Wasn't it you that made the answers to the questions that I put to you, that created whatever impression is in your mind concerning them?

Mr. MITCHELL. I hardly think so, and I should like the opportunity to make clear the situation, as I have requested here, and if you would let me go on with this, then you could come back to your questioning. This would, it seems to me, clarify the situation.

Mr. PECORA. Was there any limitation placed upon your answering the questions that you answered yesterday?

Mr. MITCHELL. No. But there was only this impression: I was asked at that time about these matters, and I stated there were men who were more familiar than I, and who were in this room, and I asked that they be permitted to testify on this. But you asked me to testify from memory, and I did the best I could, scratching my memory for things that happened years and years ago upon which I had not refreshed myself. Since that time and overnight I have refreshed myself, and I am prepared to give the general situation in a very brief picture and that is what I have asked the chairman of this committee the privilege of doing.

Mr. PECORA. I think, Mr. Chairman, it ought to be done, but not at this time. I do not think the examination of this witness should be interrupted by a statement which is going to concern other things besides the General Sugar Corporation, or that my examination should be diverted to allow the witness to make explanations which he had every chance to make in answer to the questions put to him by me yesterday and which he then answered.

Mr. MITCHELL. I call your attention to the fact that you forced me to answer from what I said at the time was a vague memory.

The CHAIRMAN. Mr. Mitchell, you may proceed to make your explanations, with the understanding that they will be brief and you will keep to the point. If there were mistakes made yesterday, correct those few mistakes, if you will, and then let counsel for the committee go on with his examination.

Mr. MITCHELL. I presume, Senator Norbeck, your committee is after the facts, and not after the creation of a wrong impression in regard to these matters.

Mr. PECORA. Whatever wrong impression was created yesterday was created by your testimony, because you were the only witness who testified yesterday, isn't that a fact?

Mr. MITCHELL. I think it was created by the questions and not permitting me——

Mr. PECORA (interposing). By the answers you made to my questions. I was not testifying. I was asking you questions, and certainly if anything that I assumed in my questions was incorrect you had every opportunity in answering those questions to point that out. Now, you want to point it out, after 24 hours.

The CHAIRMAN. Mr. Mitchell, you may proceed.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. I resent the witness' statement that the wrong impression was created by my questions rather than by his answers.

The CHAIRMAN. You may proceed, Mr. Mitchell.

Mr. MITCHELL. The point I desired to make clear was that there had been a very definite improvement in the sugar market. The market in 1922 advanced from 1.81 cents per pound to 4 cents per pound, and it was in the latter part of that year that the financing was done for the Vertientes and Camaguey companies. The first financing for Sugar Estates and Orientes was done at that time, and the General Sugar Co. came into being.

Now in 1923, after some drop in the market, there was an advance in Cuban sugars to a high of 6.625 cents per pound, with a drop later in the year to 4 cents per pound, and the year closed, after going to 6 cents a pound, at 5.625 cents per pound. You will see that the industry had begun to stabilize itself markedly.

The CHAIRMAN. That was in what year?

Mr. MITCHELL. It was in 1923. The following year the high was 5.625 cents per pound. In the middle of that year there was a drop in price to 3.2 cents, but in the latter part of that year sugar again stabilized itself around 4¼ cents, in January being as high as 4.375 cents. And at that time the Cuban-Dominican bonds spoken of yesterday were put out and a small additional issue of Orientes bonds.

In the following year—1925—the price of sugar varied from 3.03 cents per pound to a low of 1.94 cents, but closed the year at 2¼ cents.

In 1926 the year was bad at the start, the price of sugar running down to 2.19 cents per pound, and closed the year at 3.375 cents per pound.

In 1927 sugar opened the year at 3½ cents per pound, stabilized itself during the months of January and February at about 3.10 cents to 3.15 cents, and closed the year, never going below 2.69 cents per pound.

It was in 1927, in the early months, January and February, when sugar was around a low of 3.06 cents per pound, and with a high point during January and February of 3½ cents, that the General Sugar Corporation was formed, and these accounts which were in the bank and which I referred to on yesterday as slow and doubtful as current accounts, were taken from the bank and placed in the National City Co., where they could be held as a more permanent investment through the holding of the common stock of the General Sugar Co., and at that time the $25,000,000 was furnished by the shareholders which was used to purchase the common stock of the General Sugar Corporation. And it was estimated——

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

Mr. MITCHELL. They knew it was going to go into the National City Co.

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

Mr. MITCHELL. I hardly think there was any necessity for it.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Just answer my question: Did they or did they not know what was going to be done with it?

Mr. MITCHELL. As far as I know, they did not.

Mr. PECORA. All right.

Mr. MITCHELL. But at the time that went in, that investment was considered by the officers and directors a sound investment for the National City Co. And it was estimated that on the average of prices for sugar over a long period of years the General Sugar Co. would earn, as I recall, approximately $6,000,000 a year applicable to that $25,000,000 of stock which the National City Co. took over.

Mr. PECORA. Now, if the officers and directors of the National City Co. considered it was going to be such a fine transaction for the company, why didn't they tell the stockholders who put up that money to purchase additional stock of the bank and the company, what was going to be done with $25,000,000 of that $50,000,000?

Mr. MITCHELL. I have not been able to go over our records to see whether or not any indication was given to the shareholders at that time, but from time to time the shareholders, at their annual meetings, have been advised of this investment, and it has been common knowledge that the National City Co. has had this investment in General Sugar.

Mr. PECORA. And by the use of the term " from time to time " you mean after the investment was made?

Mr. MITCHELL. I assume so; yes.

Mr. PECORA. And not before?

Mr. MITCHELL. I can not answer on that.

Mr. PECORA. Can't you answer whether or not the shareholders were notified that $25,000,000 of their money was going to be put into this sugar transaction? Do you mean to say you can not answer that?

Mr. MITCHELL. I can not; no.

Mr. PECORA. Who prepared the circular announcing the addition to the capital stock effected in 1927 that was sent out to the shareholders?

Mr. MITCHELL. If you ask who signed it, I think I did.

Mr. PECORA. Was there anything said in that circular to the effect that $25,000,000 of the $50,000,000 was to go into the possession of the General Sugar Corporation?

Mr. MITCHELL. I would not have considered it necessary. That was not an investment of the shareholders of the bank that they did not already have. They had it in the form of obligations that were in the bank in one way and another, and it seemed advisable to the directors that that be taken out and put in the form of a more permanent investment, because it was not sufficiently liquid as a current account to be held in a commercial bank.

Mr. PECORA. It was not sufficiently liquid because of the disturbed condition of the sugar industry all through those years?

Mr. MITCHELL. Because the sugar industry was not earning enough to pay off the current loans that then existed.

Mr. PECORA. And because the sugar industry was in a state of collapse.

Mr. MITCHELL. Oh, I hardly think you can say that, and especially——

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA (interposing). Let me read your own language out of your minute book right on that. I am reading from page 283 of the minute book of the executive committee of the National City Bank:

> The collapse of the raw-sugar industry in Cuba, which occurred during the year 1921, and the banking crisis in the island which followed the collapse, left the National City Bank of New York with very large sums tied up in loans and credits to companies and individuals engaged in constructing and operating sugar estates.

Do you recall that language of yours?

Mr. MITCHELL. I think I do.

Mr. PECORA. All right. Go ahead.

Mr. MITCHELL. That refers to the state of collapse resulting from 1920 and 1921 price drop.

Mr. PECORA. But you were making this statement on February 8, 1927, with the advantage of all that had happened since 1921.

Mr. MITCHELL. What was that resolution in connection with?

Mr. PECORA. In connection with this sugar transaction, in connection with this $25,000,000 bailing out.

Mr. MITCHELL. This was a transfer. You speak of it as a "bailing out" and I am afraid again that that creates in the public mind an incorrect impression. That was the passage from the part of the institution where it is vital that liquidity prevail, of certain loans that were bound to be slow under the condition of the industry, and in the stockholders' interest it seemed far better to carry those in the form of a permanent stock investment in the National City Co. And at that time it was estimated that under normal conditions in the sugar industry that company would earn, as I say, about $6,000,000 a year applicable to that stock.

Mr. PECORA. Now, Mr. Mitchell, were not the loans of those sugar companies with the bank the subject of frequent criticism by national bank examiners, to your personal knowledge?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. And that criticism was made year after year, wasn't it?

Mr. MITCHELL. Yes, sir; and we granted, and I granted to you on yesterday, that they were not sufficiently quick in their possible liquidation for us to hold them there.

Mr. PECORA. And so, in response to those criticisms and because of other considerations, in 1927 the bank was relieved of those loans to an amount agregating upwards of $30,000,000 through the process of the issuance of additional stock of the bank and of the National City Co., and the turning over of $25,000,000 of the moneys raised through the sale of that additional stock to the National City Bank, which thus received payment of those loans almost in full. Isn't that a correct statement of what took place?

Mr. MITCHELL. I cannot support from my knowledge your exact figures.

Mr. PECORA. Well, let us assume the figures are not quite exact, is that substantially the process followed in 1927 with regard to those loans?

Mr. MITCHELL. The process was to finance the National City Co. so that without a further leaning on their funds, in the matter of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

this particular investment, and we regarded it as an investment, that it would be worked out over the years and could be carried as a separate entity.

Mr. PECORA. And do you still say that that process was not a bailing of the bank out of those loans?

Mr. MITCHELL. Your words "bailing out"——

Mr. PECORA. That is rather a harsh term, perhaps, but it is a term used on the street with reference to a situation such as this was.

Mr. MITCHELL. I think it is used too often in connection with other situations not to create a wrong impression when used in connection with this.

Now, in 1929 the market varied from 2 cents to 2⅓ cents per pound for sugar. In 1930 it stood at a little over 2 cents per pound.

At that time in my remarks to the shareholders, copies of which were mailed to each and every shareholder, I made this statement, and it is a brief statement:

Occasional uninformed comment regarding our interest in Cuban sugar properties prompts a word with respect thereto. Since the post-war collapse of the sugar industry in 1921, which caused wide distress in Cuba and forced banking creditors to take over actual properties for the protection of their accounts, we have had proprietary interests in certain properties, which have been assembled in the General Sugar Corporation, the stock of which is owned by the National City Co. While these properties are among the best in the island, with thoroughly modern mills and production costs well below the average, their aggregate output is only a small factor in the industry, contrary to what has sometimes been supposed, being only about 6 per cent of the output of the island as a whole. The post-war condition of world-wide overproduction has resulted in a period of abnormally low prices, from which producers in all countries have suffered. The properties, inventories, and accounts in the balance sheet of the corporation reflect values based on a sugar price equal to 60 per cent of the average sugar prices ruling over a period of 30 years. The investment of the National City Co. is carried at about three-fourths of the book value thus shown. Under these circumstances, we are prepared to support this investment until, with the inevitable turn of the agricultural cycle, a normal degree of prosperity asserts itself, and it can be disposed of to advantage.

The 30-year average price for sugar was 3.39 cents per pound. The 20-year average was just under 4 cents per pound. We spoke here of the 30-year average and as if these properties were appraised on that basis. Sugar properties have to be appraised on three items: Their potential production, cost of operation, and selling price; and selling price of course reflects volume demand for sugar as well. But I call attention to the fact that on the basis of a 30-year average price and these other factors these properties were at that time appraised on the books of the National City Co. at 60 per cent of the value, and were then carried at $25,000,000, and we advised the shareholders that we were prepared to support the investment of $25,000,000 on that basis.

Mr. PECORA. Mr. Mitchell, does that complete your explanation in order to clarify whatever confusion arose from the testimony of yesterday?

Mr. MITCHELL. I think so.

Mr. PECORA. Concerning the American Sugar Corporation?

Mr. MITCHELL. I think so, Mr. Pecora.

Mr. PECORA. Now, that explanation does not——

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL (interposing). Except if I might be permitted to show what has happened since then. In 1930, before the year was done, sugar had gone to about 1.04 cents per pound. In 1931 it went to 1.09 cents per pound. In 1932, last year, it dropped at one time to about fifty-seven one hundredths of 1 cent per pound.

Mr. PECORA. That is quite a toboggan slide.

Mr. MITCHELL. That is a toboggan slide; yes; but a thing over which no man has control, so far as I know, and it represents what has happened in agricultural prices generally.

Mr. PECORA. And knowing that that is what generally happens in agricultural prices, you continued to put out bond issues based on future estimated earnings of these perilous undertakings.

Mr. MITCHELL. Excuse me, but the average price over a period of 30 years, as I have shown by the figures, was well over 3½ cents per pound. And I think a 30-year average was a fair basis to take. Taking a 20-year average would certainly be considered fair, it seems to me, and that average was just under 4 cents per pound.

Mr. PECORA. And this entire $25,000,000 investment at the end of the period covered by this explanation of yours simmered down to $1 of value, didn't it?

Mr. MITCHELL. It did, because we have attempted to make it the practice in our institution to keep our values in accordance with the condition of the times, regardless of what they are, and when we saw the price of sugar drop to approximately half a cent a pound it was perfectly obvious that, at that moment, that investment had no value. And it was written down accordingly on our books.

Senator FLETCHER. What is the price to-day?

Mr. MITCHELL. The price of sugar?

Senator FLETCHER. Yes.

Mr. MITCHELL. About eight-tenths of a cent a pound. It has improved somewhat, Senator Fletcher.

Mr. PECORA. Now——

Mr. MITCHELL (interposing). The point I want to stress to the subcommittee is, and it is a point which I very strongly feel should be made clear, that it is unfair to look upon this as something that has been foisted on an unsuspecing public or that there is anything criticizable in this. I contend an examination of this entire matter from the time that we had that first collapse, where those loans were made on actual sugar, and those credits got into trouble, and we had to step into the situation, down to date, there is nothing which from the standpoint of the banker, in that which he has done, that is criticizable. If there is, I can not find it.

Mr. PECORA. The national-bank examiners found it criticizable every year since 1922, didn't they?

Mr. MITCHELL. Mr. Pecora——

Mr. PECORA (interposing). Won't you please answer the question?

Mr. MITCHELL. I will not answer it by a yes or no. It is unfair.

Mr. PECORA. Isn't it susceptible of a yes-or-no answer?

Mr. MITCHELL. It is not; no, sir.

Mr. PECORA. Did not the national-bank examiners at your bank criticize all these sugar loans year after year since 1922?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. I refuse to answer that with a yes or no, but I will answer it this way: They criticized those loans as not being quickly liquidatable, and as a current asset for the bank they were subject to criticism.

Mr. PECORA. Are you sure that is all they said about? [There was a pause.] Are you sure that was all they said about it, Mr. Mitchell?

Mr. MITCHELL. Well, Mr. Pecora, with the hundreds of thousands of questions and problems and papers that have passed over my desk in 10 years, I think that I could not be expected to say that I am sure of an answer that I might give to your question. That is distinctly my impression.

Mr. PECORA. Do you recall a criticism along these lines:

It is questionable whether or not the management is according stockholders and depositors the proper protection in continuing to operate these properties—

meaning the sugar properties—

at a loss of several millions each year.

Mr. MITCHELL. I recall that we had various discussions. You will bear in mind that operating those properties during a low and unfavorable market meant that as we had to make advances for dead season—that is, while the crop was being prepared—we were making loans that might by chance at the time the crop came in be impossible of liquidation, and those loans were very large. We were operating those properties through the General Sugar Co. and in the interest of the bank and in the interest of the shareholders. But what a bank examiner could know about the detail of operation of these great properties in Cuba was always a question in our mind.

Mr. PECORA. Well, let us assume bank examiners do not know anything.

Mr. MITCHELL. That is not true.

Mr. PECORA. Do you recall, Mr. Mitchell, that particular criticism having been made within very recent years of these sugar loans?

Mr. MITCHELL. I don't remember that particular criticism; no, Mr. Pecora.

Mr. PECORA. That is an answer to my question.

Mr. MITCHELL. I am ready to take your word for it.

Mr. PECORA. All right; that is an answer to my question.

Now, Mr. Mitchell, I believe toward the end of your testimony of yesterday afternoon's session—I haven't a transcript of the minutes before me—you reached the point where you stated that it was in 1927 that the National City Co. departed from the policy it had theretofore followed of not accumulating and selling common stocks to the public. Do you recall that?

Mr. MITCHELL. Yes, sir; not selling common stocks to the public.

Mr. PECORA. Did you take part in any discussion between the officers and directors of the National City Co. at which it was determined to depart from that policy?

Mr. MITCHELL. I remember that we discussed very broadly, and I should say both in the officers' meetings and in the meetings of the executive committee, or directors, the question as to whether the conditions in Southern Railway stock were such that we could properly make an offering of that stock to the public. That was the first offering that was made.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. That was the time when your policy theretofore observed was first departed from?

Mr. MITCHELL. Yes. It was not departed from as a general rule. It was departed from in a particular case, consideration to which was specifically given.

Mr. PECORA. After that original departure in that particular case which involved the common stock of the Southern Railway, were there many departures in many other particular cases?

Mr. MITCHELL. Yes. We offered stock during 1928 and 1929; not many issues, but some.

Mr. PECORA. Do you know how many common-stock issues were offered to the public?

Mr. MITCHELL. You did ask me that, Mr. Pecora, but overnight I have not—I have been looking up other things, and that particular thing escaped my mind. I told you yesterday, I think.

Mr. PECORA. Have you any way of ascertaining by conference with any of your associates in the company who are in the room now how many issues of common stock the company sold to the public in 1928 and 1929?

Mr. MITCHELL. I will be glad to confer. [After a pause.] That will be produced, Mr. Pecora.

Mr. PECORA. All right, sir. Was that policy the result of a conference and deliberation on the part of officers and directors of the National City Co.?

Mr. MITCHELL. You mean at the time of the Southern Railway——

Mr. PECORA. Or subsequently, when it became more of a custom.

Mr. MITCHELL. Oh, yes; it was always discussed.

Mr. PECORA. Did you advocate the policy of the National City Co. engaging in the selling of common stock issues to the public, or did you oppose it?

Mr. MITCHELL. No; I think I went along with the views of my associates.

Mr. PECORA. Who originated those views, you or some of your associates?

Mr. MITCHELL. I cannot say. It seems to me immaterial; that we are talking about this, I assume this study is being made not as a personal matter but as a company matter. I am prepared to say for the company that my associates considered anything could not have been done if I had opposed it; it could not have been done if anybody else opposed it. Therefore, it was the unanimous view of our group that we should proceed.

Mr. PECORA. Do you recall about when that decision was made?

Mr. MITCHELL. In connection with Southern Railway?

Mr. PECORA. No; in connection with the general policy which was thereafter adopted or followed of selling common stocks to the public.

Mr. MITCHELL. I think I have made it clear in my testimony that it was not taken up as a general policy; it was taken up as a specific question in connection with the Southern Railway. It was taken up as a specific question in regard to each and every other issue that was made.

Mr. PECORA. One of the issues that was most exclusively dealt in by the National City Co. during the year 1929 was the common stock of the Anaconda Copper Mining Co., was it not?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Yes.

Mr. PECORA. Were you a member of the board of directors at that time of the Anaconda Copper Mining Co.?

Mr. MITCHELL. No, sir; I was not.

Mr. PECORA. Were you ever a director of the Anaconda Copper Mining Co.?

Mr. MITCHELL. I became a director in May, 1929.

Mr. PECORA. And how long did you continue serving as a director of that company thereafter?

Mr. MITCHELL. I am still a director.

Mr. PECORA. When did the National City Co. commence the accumulation and sale of common stock of Anaconda Copper?

Mr. MITCHELL. I have some Anaconda papers here. I may be able to answer. I think, Mr. Pecora, I ought to say with respect to Anaconda Copper Mining Co. I have been before this committee for an extensive investigation, drawn here in connection with Mr. Ryan, who died last week, and that investigation was so exhaustive I can not conceive of the committee having further interest in it.

Mr. PECORA. Have you any further interest in it?

Mr. MITCHELL. In pursuing the Anaconda investigation here?

Mr. PECORA. Yes.

Mr. MITCHELL. Most decidedly no.

Mr. PECORA. No. Well, I have just a little additional interest in following up certain lines that apparently were not pursued when you were before the committee last year.

Now, let me ask you this: Did you ever, either individually or in behalf of the National City Co., take part in any pools or syndicate accounts in the common stock of Anaconda Copper Mining Co. or any of its subsidiary companies?

Mr. MITCHELL. No, sir.

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

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

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

Mr. MITCHELL. If you are referring to what we generally know as pool accounts, and what the public understands as pool accounts, my answer is distinctly no. I think there were times when, as recorded in the previous testimony probably—and I state this from recollection—where there was some accumulation for one purpose or another in connection with some entity of Anaconda Copper Co. directly. But as far as pool operations, no. And it was assumed that there were several pools in the street, in none of which did we ever participate in any way, shape, or manner, and none of our men, to my knowledge, except, as it appeared in the last investigation, there was one of our vice presidents who, much to my surprise at that time, and I didn't know it, had a small interest in what was called a pool operation. I didn't know it until it was produced before me on this stand.

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

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

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

Mr. PECORA. I simply used the term "syndicate account," Mr. Mitchell, in my question without any definition of it. I have simply used the phrase "syndicate account," haven't I?

Mr. MITCHELL. Yes.

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

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

Mr. PECORA. Have you any present recollection of the subject?

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

Mr. PECORA. Let me refer to it then as a joint account.

Mr. MITCHELL. I think that there was a joint account which was discussed here at the last meeting when I appeared before this committee with respect to Anaconda Copper Co.; I think that there were perhaps two or three joint accounts.

The CHAIRMAN. Perhaps, Mr. Mitchell, you may recall that the first time you were before this committee it was in connection with the banking bill, and while Anaconda Copper was mentioned, there was no mention as to trading in Anaconda Copper by your bank or your company or as to any syndicate or pool in which you might have been. The only thing which appears in that record is the fact that you did recommend it at a certain high figure.

Mr. MITCHELL. That was before the banking——

The CHAIRMAN (interposing). That was the first time. Then there came a second hearing last summer.

Mr. MITCHELL. Yes.

The CHAIRMAN. But let us get down to the fact that there was only one hearing that this committee——

Mr. MITCHELL (interposing). Oh, yes, sir; the first hearing was before the Committee on Banking and Currency.

The CHAIRMAN. But it was before another subcommittee than this one.

Mr. MITCHELL. The Glass committee.

The CHAIRMAN. And these matters were not gone into except very incidentally at that time.

Mr. MITCHELL. That is correct.

The CHAIRMAN. You were not sent for to testify in that matter.

Mr. MITCHELL. No, sir.

The CHAIRMAN. So that any reference to having been here twice is misleading. You have only been here once, at which time Mr. Gray, who was counsel for the committee, went into the Anaconda matter to some extent.

Mr. MITCHELL. If I said twice I was wrong about that. The only time that I was referring to, Senator Norbeck, was when I appeared here to discuss nothing but Anaconda, if I recall correctly. That was at least the only subject that was under discussion at the time.

Mr. PECORA. Do you recall a joint account that was participated in by the National City Co. in the common stock of the Andes Copper Mining Co.?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. There was some account—may I refer to the testimony before this same investigating committee?

Mr. PECORA. Mr. Mitchell, can't you refer to your own recollection of the facts? If you have no recollection of the facts, and will indicate that, I would then suggest that you refresh your recollection by anything that would serve to do it.

Mr. MITCHELL. I think I really will have to do that, because that subject I had assumed to have been exhausted before; I remember that there was a joint account built up at the time of the conversion of Andes into Anaconda, and I should have to refresh my mind. My mind is not sufficiently refreshed at the moment to answer, Mr. Pecora, in regard to that in detail. I had assumed that that subject was exhausted.

Mr. PECORA. Perhaps I can refresh it a little, Mr. Mitchell. Let me ask: Do you recall that on or about December 12, 1928, you in behalf of the National City Co. entered into an agreement with the Anaconda Copper Mining Co. to accumulate for joint account up to 200,000 shares of the common stock of Andes Copper Mining Co. on a 50–50 basis?

Mr. MITCHELL (after referring to paper). Yes; my mind is refreshed in connection with this now. There was an arrangement made on December 13, 1928, between the Anaconda Copper Co. and the National City Co. for 200,000 shares of the common stock of the Andes copper, and under that agreement 151,045 shares were accumulated on our books, of which 127,945 shares were offered to the public and 23,100 shares were sold through brokers. The account was closed on January 18, 1929. That was the sale of Andes Copper stock. In July, 1929, an offer was made to exchange that stock for Anaconda stock.

Mr. PECORA. Mr. Mitchell, are you now reading your answer from a statement prepared by you?

Mr. MITCHELL. I am not.

Mr. PECORA. Who prepared the statement from which you are reading your answer?

Mr. MITCHELL. This was a memorandum that has been handed to me that happened to be in my files at the time that I appeared before this committee before and is not a statement at all. I am making it a running story from notes before me.

Mr. PECORA. Who prepared the memorandum to which you are referring as you make your answers?

Mr. MITCHELL. I should have to find out the handwriting of this. This was just in my files.

Mr. PECORA. Who handed it to you?

Mr. MITCHELL. It was handed to me by one of my counsel.

Mr. PECORA. Now, the trading in this joint account continued for about five weeks, didn't it?

Mr. MITCHELL. I haven't the information. The account was made on December 13 and closed on January 18.

Mr. PECORA. That is about five weeks?

Mr. MITCHELL. About five weeks; yes.

Mr. PECORA. Who conducted the trading for this joint account or under whose direction was the trading conducted?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. It was conducted in the trading department of the National City Co. It was doubtless prompted by my own examination of it and the examination of Mr. Baker from day to day. Whether any of the other officers had to do with the accumulation I can not say, but it is more than likely that it was under the dominance of Mr. Baker and myself.

Mr. PECORA. The Mr. Baker you refer to is the gentleman who was then and is now the president of the National City Co.?

Mr. MITCHELL. Yes.

Mr. PECORA. Do you recall the joint-account agreement that you entered into on behalf of the National City Co. at that time with Mr. John D. Ryan as chairman of the board of the Anaconda Mining Co.?

Mr. MITCHELL. No; I do not.

Mr. PECORA. Let me show you this paper, which purports to be a copy of a letter sent by you under date of December 12, 1928, to Mr. John D. Ryan, and also this paper which purports to be a copy of a letter addressed to you by Mr. John D. Ryan under date of December 13, 1928. Will you look at those papers and tell us if they are true copies of the correspondence that constituted the agreement with respect to this joint-account trading operation?

Mr. MITCHELL. Yes; I should be willing to accept your statement that these were copies.

Mr. PECORA. I may say that those were given to me by the attorney for the late John D. Ryan within the last two or three weeks.

Mr. MITCHELL. I should be willing to accept them as valid.

Mr. PECORA. I ask that they be spread on the record.

The CHAIRMAN. Without objection, that will be done.

(The two documents are as follows:)

THE NATIONAL CITY CO.,
NATIONAL CITY BANK BUILDING,
New York, December 12, 1928.

Mr. JOHN D. RYAN,
Chairman Anaconda Copper Mining Co.,
25 Broadway, New York.

DEAR MR. RYAN: This is to confirm that you, acting for the Anaconda Copper Mining Co., and I, for the National City Co., have agreed to accumulate up to 200,000 shares of the common stock of Andes Copper Mining Co. for joint account on a 50–50 basis.

The National City Co. will run this account as you and I personally, from time to time, may deem wise. As stock is accumulated the National City Co. may deliver your share at the approximate cost basis and upon final liquidation, accounting will take into consideration cost-plus carrying charges and the two companies will share equally any profit or loss on the transaction.

An acknowledgement will be appreciated.

Sincerely yours,

C. E. MITCHELL.

DECEMBER 13, 1928.

Mr. C. E. MITCHELL.
President the National City Co.,
55 Wall Street, New York.

DEAR MR. MITCHELL: I beg to acknowledge receipt of yours of December 12 confirming our understanding that you, for the National City Co., and I, for the Anaconda Copper Mining Co., have agreed to accumulate up to 200,000 shares of the common stock of Andes Copper Mining Co. for a joint account on a 50–50 basis, the account to be run by the National City Co. as stated.

Very truly yours,

JOHN D. RYAN.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. You will observe that under the agreement evidenced by these two letters that have just gone into the record you were to run this account.

Mr. MITCHELL. Yes.

Mr. PECORA. Do you recall how you ran it?

Mr. MITCHELL. Not specifically. I recall in general the account, that I would be in touch with Mr. Ryan more or less constantly, and I would instruct our trading department the limitation of their buying for accumulation.

Mr. PECORA. The Andes Copper Mining Co. referred to in that joint account correspondence is a subsidiary of the Anaconda Copper Mining Co.?

Mr. MITCHELL. It is.

Mr. PECORA. And it was back in 1928, also, was it not?

Mr. MITCHELL. Yes.

Mr. PECORA. What broker or brokers were employed in the operation or trading in this joint account?

Mr. MITCHELL. I could not answer that.

Mr. PECORA. To what extent were purchases and sales in the common stock of Anaconda Copper Mining Co. made for the purposes of this joint account by the trading department of the National City Co.?

Mr. MITCHELL. May I have that question?

Mr. RANDOLPH (shorthand reporter). To what extent were purchases and sales in the common stock of Anaconda Copper Mining Co. made for the purposes of this joint account by the trading department of the National City Co.?

Mr. MITCHELL. I should say that they were made to the extent that resulted in this accumulation, Mr. Pecora, but I haven't the detail of that before me.

Mr. PECORA. Do you know the profit that accrued from this joint account?

Mr. MITCHELL. The memorandum before me indicates that there was a total profit in the account of $335,000.

Mr. PECORA. Was there any profit also not included in that sum which was represented by stock on hand at the time the account was closed?

Mr. MITCHELL. I see no indication of it whatsoever. The memorandum that I have here, which I will stand by as being authentic, is that there was a total profit in the account of $335,043.42, of which $167,521.22 was paid to the Anaconda Copper Co. and we retained an equal amount. In other words, the profit to the National City Co. was $167,000 plus.

Mr. PECORA. The Andes Copper Mining Co.'s common stock at that time was listed on the New York Stock Exchange, wasn't it?

Mr. MITCHELL. It was.

Mr. PECORA. Were the tradings that were had for the purposes of this account made on the market?

Mr. MITCHELL. Undoubtedly, completely.

Mr. PECORA. On the exchange?

Mr. MITCHELL. Completely, I should say.

Mr. PECORA. And the effect of these trades in part at least, was to maintain certain market prices for the stock?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Oh, I think not.

Mr. PECORA. Wasn't that effect produced in any way, shape, or form?

Mr. MITCHELL. It might have been produced in some shape or form, but that was not the purpose of the account.

Mr. PECORA. I did not ask you if that was the purpose; I asked you if that was one of the effects.

Mr. MITCHELL. I can not say. I haven't got the market range before me to indicate what the effect might have been.

Mr. PECORA. Who financed the transactions in this joint account?

Mr. MITCHELL. The letters that have passed and made a part of this record indicate that the National City Co. was to have the right, as it purchased stock, to deliver to the Anaconda Copper Mining Co. its portion of the stock. Am I not correct in that? The letter says:

As stock is accumulated the National City Co. may deliver your share at the approximate cost basis, and upon final liquidation accounting will take into consideration cost plus carrying charges, and the two companies will share equally any profit or loss on the transaction.

Therefore, whether the City Co. carried the full burden and asked the Anaconda Copper Co. to pay its interest in accordance with this agreement, or whether it turned over its one-half approximately of the stock as accumulated to the Anaconda Copper Co., I can not say without further reference to records.

Mr. PECORA. Well, under that provision that you have just read——

Mr. MITCHELL (interposing). It might.

Mr. PECORA. Who was called upon to finance it?

Mr. MITCHELL. The initial purchase the National City Co. obviously, if they were to accumulate the amount, but they had the privilege as the stock was accumulated to deliver the share of the Anaconda Copper Co.'s proportion to it.

Senator FLETCHER. The letter says your company was to "run the account", whatever that means.

Mr. MITCHELL. Yes; that means it was to accumulate the stock, but it goes on to say that as it is accumulated one-half of the amount accumulated may be turned over to the Anaconda Copper Co.

Mr. PECORA. Does not that phraseology, that your "Company will run this account," mean something more than the fact that your company was to accumulate the stock? Doesn't it mean that the tradings in the account were to be under the direction of the National City Co.?

Mr. MITCHELL. It says:

The National City Co. will run this account as you and I personally from time to time may deem wise.

That is Mr. Ryan and myself, I acting for the National City Co. and he acting for the Anaconda Copper Co.

Mr. PECORA. Do you recall how this account was run?

Mr. MITCHELL. No; I do not.

Mr. PECORA. And what course the trading took under it?

Mr. MITCHELL. No; I do not, Mr. Pecora.

Mr. PECORA. Do you know anyone that could tell us?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Not without reference to papers and to markets during that period. I think it would be surprising if we had anything here that would indicate that.

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

Mr. MITCHELL. Yes.

Mr. PECORA. So the National City Co.——

Mr. MITCHELL (interposing). And as to surplus from its earnings as well.

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

Mr. MITCHELL. The money came from the shareholders of the National City Bank, but you bear in mind that in one of our share increases there was set up, and announced to the shareholders there would be set up, and the stock was in part issued, in order that there might be set up a fund which could be used for the purchase and sale and holding of securities, shares, and so forth, on a term basis, the holding of which would inure to the benefit of the company and the bank.

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

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

Mr. PECORA. When did you first reach that conclusion?

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

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

Mr. MITCHELL. That is right.

Mr. PECORA. What was the date when you reached the conclusion?

Mr. MITCHELL. Oh, I should say in recent months, Mr. Pecora. I would not be carried off my feet by any immediate movement of a market.

The CHAIRMAN. What was the date on which it advanced those 25 million that you testified to yesterday? I have forgotten.

Mr. PECORA. That was in February, 1927—February 15, 1927. That is correct?

Mr. MITCHELL. Yes, but that is not the kind of account that I am referring to now and that we are discussing.

The CHAIRMAN. No; but that was at the time the Federal Reserve Board was trying to slow down the boom.

Mr. PECORA. No; that was 1929, Senator, March, 1929.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The CHAIRMAN. I know the banking committee here reported favorably on the resolution in the spring of 1928, forecasting a breakdown, and there were very few bankers on this committee, very few of them who had any expert knowledge. It came a year and a half later.

Mr. PECORA. The $25,000,000 you referred to, Senator, was that the $25,000,000 thrown into the call loan money market?

The CHAIRMAN. Yes.

Mr. PECORA. That was in March, 1929.

The CHAIRMAN. That is what I thought. The boom was about to break and he testified yesterday that he found the market short of money.

Mr. PECORA. That was March, 1929.

The CHAIRMAN. And advanced them 25 million. And the boom went on. The break came in the fall of 1929.

Mr. PECORA. Yes, sir. I thought, Mr. Chairman, you were referring to the $25,000,000 that went into General Sugar Corporation.

Now, was there any other joint account in the common stock of the Anaconda Copper Mining Co. or any of its subsidiaries to which the National City Co. became a party in 1928 or 1929?

Mr. MITCHELL. I find before me a memorandum similarly prepared when I was before this committee before.

Mr. PECORA. And likewise a memorandum not prepared by you?

Mr. MITCHELL. No. It is some facts that were developed from the books.

Mr. PECORA. But it is not a memorandum prepared by you?

Mr. MITCHELL. No, sir.

Mr. PECORA. That is all I asked.

Mr. MITCHELL. There was an agreement dated January 14, 1929, between Mr. John D. Ryan on the one part, Mr. Daniel and Harry Guggenheim, second, and the National City Co. third, for an account of 100,000 shares of common stock of Chile Copper Co., the account to be handled by Mr. John D. Ryan personally. That account was extended, and under the agreement 140,500 shares were purchased and 29,400 were sold.

Mr. PECORA. 140,000 purchased and 29,000 sold?

Mr. MITCHELL. 29,400, leaving 111,100 shares long, which were exchanged for 81,103 shares of Anaconda stock, of which 51,103 shares were sold, leaving on February 14, 1929, a long position of 30,000 shares. This is all in the testimony given before this particular subcommittee before.

As a part of that operation we carried 78,840 shares, of which 68,840 shares were delivered on instruction of Mr. Ryan, leaving 10,000 in our investment account which we held. The stock of the Guggenheims was sold and a check given to them for that. The stock of Mr. Ryan's, I recall he testified, went into his hands and continued in his personal account.

Mr. PECORA. What were the total profits that flowed from that joint account?

Mr. MITCHELL. As I told you, there were 30,000 shares when they got through, and Mr. Ryan took his 10,000 shares and put them away in his box, and the National City Co. put 10,000 in its investment account, which it continued to hold and did still hold, I think,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

at the time that I last testified here, and the only stock that was sold and showed a profit was the stock that was the Guggenheims' share, and Mr. Daniel Guggenheim, now dead, and Harry Guggenheim, were the ones interested in that. From this I would judge that was $400,000, as the check that went to the Guggenheims was in that amount.

Mr. PECORA. They had a one-third interest in the profits of this account?

Mr. MITCHELL. They did.

Mr. PECORA. That would indicate total profits of about $1,200,000?

Mr. MITCHELL. It would if it had been sold, but as a matter of fact, it was taken by us for accumulation and went down, and to-day of course there would be a loss on it.

Mr. PECORA. But if that stock had been liquidated, if the stock that remained over as a profit from this account had been liquidated, by the National City Co., as the Guggenheims liquidated their portion of the stock, the company also would have reaped a profit of about $400,000?

Mr. MITCHELL. That would seem to be a fair conclusion from this statement. My testimony again I say was offered before this committee before.

Mr. PECORA. Now, that joint account dealt in the common stock of the Chile Copper Co.?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Which was then and still is a subsidiary of the Anaconda Copper Mining Co.?

Mr. MITCHELL. Yes. That was at the time, if I recall it, where a conversion was offered. I do not think that prior to that the Chile Copper Co. was a subsidiary of Anaconda. I think that was the time at which the control was exchanged for Anaconda stock.

Mr. PECORA. Mr. Mitchell, was one of the effects of the operation of this joint account a maintenance or a support or an increase in the market value of that common stock during the period covered by the joint account?

Mr. MITCHELL. My recollection, Mr. Pecora, is that it was an account established not in any sense to increase the price but to stabilize the price as between the Chile Copper stock and Anaconda stock during the period of offer of conversion. That is my recollection.

Mr. PECORA. Then one of the purposes was to produce a certain effect on the market quotations of the stock during the period of the operations in the joint account?

Mr. MITCHELL. The account was formed in order to facilitate the conversion. Now, what the effect was on the market I simply can not tell you. It may be in previous testimony there.

Mr. PECORA. Was it not to facilitate conversion at a certain ratio of exchange?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. And in order to facilitate that conversion was it not necessary to stabilize the market quotations?

Mr. MITCHELL. It was necessary, as I would recall it, to maintain that ratio of exchange that was offered.

Mr. PECORA. So it is a fair inference or a fair assumption that one of the purposes of this joint account was to produce an effect on the market quotations of the stock traded in?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Well, I can not answer that. It was to facilitate the exchange, and that is the best I can say.

Mr. PECORA. And one of the ways of facilitating the exchange was to maintain certain market prices for the stock during the period of the exchange?

Mr. MITCHELL. To maintain an equality on the basis of the ratio established as between the two stocks, I think would be a better expression of it.

Mr. PECORA. That produced a certain effect on the market quotations, did it not, and it was designed to produce such an effect, was it not?

Mr. MITCHELL. No; it was not designed to produce—it was designed to facilitate the conversions.

Mr. PECORA. In order to facilitate the conversions, certain market values for the stock had to be maintained?

Mr. MITCHELL. That is right.

Mr. PECORA. And one of the purposes of this joint account was to help maintain those market values?

Mr. MITCHELL. Correct, Mr. Pecora.

Mr. PECORA. And that manifests itself in the effect on market values during the period of operations, doesn't it?

Mr. MITCHELL. During the period of the conversions; yes, sir.

Mr. PECORA. What is the difference between a joint account and syndicate account?

Mr. MITCHELL. A syndicate account is scarcely a recognized term unless it is qualified. It may be a selling syndicate account or it may be a syndicate buying account or a syndicate holding account. But a syndicate to my mind at least carries with it a very large group of people who are entering into an agreement one with the other for a specific purpose. I do not think you can just say "syndicate account" and have it mean anything to the average man. It means nothing to me.

Mr. PECORA. Do you mean that a syndicate account is the same as a joint account except that there are more participants than is usually found in what is called a joint account?

Mr. MITCHELL. I think so.

Mr. PECORA. That just about represents the difference in principle?

Mr. MITCHELL. I should say so; yes.

Mr. PECORA. So there is really no difference in principle; it is simply in the number of participants?

Mr. MITCHELL. I think when two parties or three parties enter into an agreement for their joint venture that that is different—you call that the joint account. I just can not conceive in my own mind calling that a syndicate account.

Mr. PECORA. What is the difference between a joint account and a pool to trade in stocks—that is, as you understand the term "pool"?

Mr. MITCHELL. It is very difficult for me to make a broad definition that I could be certain would stand without finding a loophole in it. A pool indicates to me a blind operation entered into by a group with some one manager whom the group itself does not perhaps know of in a business way or have any contact with but is

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the operator of the pool. It is a condition that has to do with stocks particularly and operations in stocks, and I am not familiar with these pools, because we have not been members of pools of this sort.

Mr. PECORA. Well, don't you know the difference between a joint account and a pool other than the one you have stated?

Mr. MITCHELL. No; I do not.

Mr. PECORA. Then, there is no difference with the exception of the difference that you have just called attention to?

Mr. MITCHELL. I should want to sit down and work a couple of hours if I were to try to make a clean-cut definition and differentiation between these terms in giving you again my impression of the differences, Mr. Pecora.

Mr. PECORA. The principal impression I got of the difference, Mr. Mitchell—and if I got the wrong impression I wish you would clear it up—is that in a pool most of the members have nothing to do or say about the operation of it, and in the joint account all of the members know in advance the purposes and the operation. Does that summarize it?

Mr. MITCHELL. I think that under actual operation of business that that would be considered a fair differentiation; yes, Mr. Pecora.

To make complete the record since you asked me a question, I will have to state one other account.

Mr. PECORA. I was just coming to it—the one in Greene Cananea?

Mr. MITCHELL. Yes.

Mr. PECORA. In the early part of 1929 was there any other joint account trading in the common stock of the Anaconda Copper Co. or any of its subsidiaries to which the National City Co. was a party?

Mr. MITCHELL. This seems to say 1928, Mr. Pecora; December 13, 1928. Does that check with your records?

Mr. PECORA. Yes, sir; December. How long did the operation in that pool—I beg your pardon—in that joint account continue?

Mr. MITCHELL. It was cleared in March, 1929; March 21, 1929.

Mr. PECORA. Commenced in December 4, 1928?

Mr. MITCHELL. The agreement apparently, from the notes that I have here, is one that was made in December 13, 1928, between John D. Ryan et al. and the National City Bank.

Mr. PECORA. The respective shares of the participants in that joint account were as follows, were they not: The National City Co., one-half; John D. Ryan, one-sixth; C. F. Kelley, one-sixth; W. D. Thornton, one-sixth? Is that correct?

Mr. MITCHELL. I do not know that I personally knew of who Mr. Ryan had in his account and the amounts. I am sure that he did not tell me. I presume that that again was offered in the previous testimony when the Anaconda accounts were under consideration by this committee. But so far as my information is concerned, it runs completely to John D. Ryan et al., and I presume that "et al." means some of his friends. I should have to see the agreement.

Mr. PECORA. How many shares were involved in that joint account?

Mr. MITCHELL. This shows that the account was for 100,000 shares. The account was to be run by Mr. J. D. Ryan. Under the agreement there were 226,000 purchased and 151,100 sold, leaving 75,000

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

shares long in the account. Of that amount we took that half which we converted into Anaconda Copper Co. stock on the basis of one and a half shares of Anaconda for each share of Greene-Cananea.

Mr. PECORA. Who financed that joint account?

Mr. MITCHELL. Perhaps you have the agreement before you, Mr. Pecora. If you have, I would be glad to accept it as authentic. I haven't a copy of the agreement here.

Mr. PECORA (handing paper to Mr. Mitchell). Let the record show I handed the witness a paper.

Mr. MITCHELL. The agreement provided that Mr. Ryan should run the account as he and I personally from time to time might deem wise; that as the stock was accumulated he might deliver our share at the approximate cost basis, and upon final liquidation, accounting would take into consideration cost plus carrying charges, and our two interests were to share equally in any profit or loss on the transaction.

Mr. PECORA. Do you recall who actually financed that joint account?

Mr. MITCHELL. No; I do not, Mr. Pecora.

Mr. PECORA. Does the paper which I handed you a few moments ago embody the terms of this joint account?

Mr. MITCHELL. This paper that I have in my hand, you mean?

Mr. PECORA. Yes.

Mr. MITCHELL. Yes.

Mr. PECORA. I ask that it be spread in full on the record.

The CHAIRMAN. If there is no objection, it will be so ordered.

(The document is as follows:)

THE NATIONAL CITY BANK,
New York, January 14, 1929.

Mr. JOHN D. RYAN, *New York.*

DEAR MR. RYAN: This is to confirm that (1) you, acting for yourself and associates, and (2) Mr. Harry F. Guggenheim, and (3) I, acting for the National City Co., have agreed to accumulate up to 100,000 shares of the common stock of Chile Copper Co. for joint risk and profit, each of the aforesaid parties having a one-third interest in the account.

You will be responsible for all purchases, sales, and accumulations of the account and for all accounting with relation thereto. As stock is accumulated you may deliver in blocks at an approximate cost basis to the National City Co., which in turn upon one day advance notice shall be privileged to deliver for carrying purposes approximately one third of any stock accumulated to each of the other parties to this joint account, but all such stock shall be at your call as manager.

Any member of the account carrying stock shall be entitled to receive interest at the rate of 6 per cent per annum.

Upon final liquidation or dissolution of the account, your accounting will take into consideration cost plus carrying charges and the three parties to the account shall share equally any resulting profit or loss.

This letter is sent to you in duplicate in order that you may lodge one copy with Mr. Guggenheim. An acknowledgment and an acceptance of the terms from yourself and from Mr. Guggenheim will be appreciated.

Yours very truly,

C. E. MITCHELL.

Mr. PECORA. I show you with respect to the joint account in Chile Copper Co. what purport to be copies of three letters signed respectively by yourself, John D. Ryan, and Daniel Guggenheim. Are those the letters which embody the terms of the joint-account transactions with respect to which you have testified?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. They seem to be, and on your statement that you have taken these copies from our files I should say——

Mr. PECORA (interposing). No; I got those copies from an attorney for the late John D. Ryan * * *

Mr. MITCHELL. I am willing to accept them.

Mr. PECORA. * * * with Mr. Ryan's knowledge and consent.

Mr. MITCHELL. I am ready to accept them.

Mr. PECORA. I ask that those three letters be spread in full in the record.

The CHAIRMAN. Without objection, it will be so ordered.

(The three documents are as follows:)

THE NATIONAL CITY CO.,
New York, December 12, 1928.

Mr. JOHN D. RYAN,
New York.

DEAR MR. RYAN: This is to confirm that you, acting for yourself and associates, and I, for the National City Co., have agreed to accumulate up to 100,000 shares of the common stock of Greene Cananea Copper Co. for joint account on a 50–50 basis.

You will run this account as you and I personally from time to time may deem wise. As stock is accumulated you may deliver our share at the approximate cost basis and upon final liquidation, accounting will take into consideration cost plus carrying charges and our two interests will share equally any profit or loss on the transaction.

An acknowledgment will be appreciated.

Sincerely yours,

C. E. MITCHELL.

JANUARY 14, 1929.

Mr. C. E. MITCHELL,
President National City Co., New York.

DEAR MR. MITCHELL: I am in receipt of your letter of January 14 confirming our verbal understanding covering the joint account in Chile Copper Co. stock, and I accept for myself and associates the terms as stated.

Very truly yours,

JOHN D. RYAN.

JANUARY 15, 1929.

Mr. JOHN D. RYAN, *New York City.*

DEAR MR. RYAN: This will acknowledge receipt of a copy of Mr. Charles E. Mitchell's letter to you of January 14, and is an acceptance of its terms. In his letter he refers to (2) Mr. Harry F. Guggenheim. This should be for the joint account of Harry F. Guggenheim and myself.

Yours faithfully,

DANIEL GUGGENHEIM.

Mr. PECORA. Now referring to this joint account in Greene Cananea common stock——

The CHAIRMAN. That was a copper company also, was it not?

Mr. PECORA. Yes. Was that company a subsidiary of Anaconda Copper?

Mr. MITCHELL. No.

Mr. PECORA. It is now, is it not?

Mr. MITCHELL. Yes. The Anaconda Copper Co. had a substantial interest, but it was the resulting conversion of Greene Cananea for Anaconda stock on the basis of one and a half shares of Anaconda for each share of Greene that resulted in Anaconda Co. getting its controlling position in Greene, which incidentally is the lowest cost producer at the moment, I think, that exists in the world.

The CHAIRMAN. Located where?

Mr. MITCHELL. It is located in Mexico.

Mr. PECORA. One of the purposes, if not the main purpose, of this joint account with the Greene Cananea stock was to maintain a market in that stock?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. No; not at all.

Mr. PECORA. Was it to facilitate the exchange of Greene Cananea stock for Anaconda Copper Mining Co. stock?

Mr. MITCHELL. Yes.

Mr. PECORA. And in order to facilitate that exchange the market had to be maintained, did it not?

Mr. MITCHELL. No; I think that did not occur during that time, Mr. Pecora. This Greene Cananea stock was acquired between December 13, 1928, and March 21, 1929. In July of 1929 a conversion was worked out. This was very definitely an account to acquire stock which would give the base for a conversion in due course and permit the Anaconda Copper Co. to obtain control of this very valuable property, a property which even under the existing copper prices is profitable.

Mr. PECORA. At the time the joint account in Greene Cananea was closed in what form were the profits distributed, in the form of cash or in the form of stock?

Mr. MITCHELL. Well, from our standpoint we took our share of the stock and we held it in our box and we ultimately converted it into Anaconda stock. I see a memorandum here that there was delivered to Mr. Kelley 12,500 shares for a cash payment. I do not know whether that had anything to do with this account, however.

Mr. PECORA. I think you will find it did, because Mr. Kelley had one-sixth interest, taken out of Mr. Ryan's one-half interest in this joint account. By the way, who is the Mr. Kelley to whom you have just referred?

Mr. MITCHELL. Cornelius F. Kelley, the President of the Anaconda Copper Co.

Mr. PECORA. And Mr. Ryan was chairman of the board of the Anaconda Co.?

Mr. MITCHELL. He was chairman of the board of the Anaconda Copper Co.

Mr. PECORA. And you were a member of the board?

Mr. MITCHELL. Not at that time; not until May of the following year.

Mr. PECORA. Now, do you find by your memorandum that Mr. W. D. Thornton had some of the profits of this joint account at the closing of it?

Mr. MITCHELL. No; I do not find that here. I am sure that Greene-Cananea was covered in the previous hearings here, and an examination of the testimony will develop any facts that you desire in connection with it; but I have not that information.

Mr. PECORA. Well, what profit accrued in the operation of this joint account to the participants in it?

Mr. MITCHELL. Well, we got some stock.

Mr. PECORA. How much stock?

Mr. MITCHELL. We got—you see, there were left 75,000 shares of stock.

Mr. PECORA. Now, those 75,000 shares were 75,000 shares of Greene-Cananea; is that right?

Mr. MITCHELL. Yes; that was Greene-Cananea stock.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And that Greene-Cananea, some 3 or 4 months after the closing of this account, was changed for a larger number of shares of Anaconda Copper?

Mr. MITCHELL. No; less, I think. There was 1½ shares of Anaconda given for each share of Greene-Cananea.

Mr. PECORA. That is a larger number?

Mr. MITCHELL. No.

Mr. PECORA. If 1½ shares——

Mr. MITCHELL (interposing). Yes; a larger number of shares.

Mr. PECORA. That is what I asked you.

Mr. MITCHELL. Yes, sir. That 75,000 shares, we took half of that and put it in our box. I see some shares were delivered to Mr. Kelley. I could not tell you from my papers here——

Mr. PECORA (interposing). At the market price for Anaconda Copper at the time you received this profit in the form of shares, what would have been the profit in dollars and cents from this joint account?

Mr. MITCHELL. I do not see an indication here of that figure in my memorandum. I can say that that must have been in the previous testimony before this committee.

Mr. PECORA. Now, the common stock of the Anaconda Copper Mining Co. was accumulated and sold to the investing public by the selling organization of the National City Co. during the year 1929 in very large amounts, was it not?

Mr. MITCHELL. It was; yes, sir.

Mr. PECORA. Do you recall the total number of shares of Anaconda Copper common stock which the National City Co. sold through its selling agencies throughout the country in 1929?

Mr. MITCHELL. I am referring to the testimony before this committee, because I know the questions were exactly along the same line, and I think that we can——

The CHAIRMAN (interposing). I want to say, Mr. Mitchell, if you had time to read that testimony, you would not be referring to it so many times, because there is not so much in that testimony.

Mr. MITCHELL. The testimony was very complete.

The CHAIRMAN. Maybe on one or two things. On some things. The old testimony is not an alibi.

Mr. MITCHELL. No; I am not attempting to establish an alibi; but I think every question that is asked me here was asked either of myself or Mr. Ryan in the previous appearance before this committee.

Mr. PECORA. Well, do you remember that the total number of shares of Anaconda Copper common stock accumulated by the National City Co. in 1929 and sold to the public was upward of 1,300,000 shares?

Mr. MITCHELL. Yes; here I see the counsel said before:

Do you know whether you sold, out of that lot 1,315,830 shares?

Senator BROOKHART. Did you sell it?

Mr. PECORA. The Senator is asking whether that was sold.

Mr. MITCHELL. That stock was sold very largely through our sales organization and through dealers in the country.

Senator BROOKHART. This 37,500 shares was your profit?

Mr. MITCHELL. No——

Senator BROOKHART (interposing). That is what it is.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Oh, yes.

Mr. PECORA. I am talking now about the general operations in Anaconda Copper stock.

Senator BROOKHART. Yes.

Mr. PECORA. Now, I believe you testified last year before this committee that most of those shares were accumulated at prices at par around $100, and sold at prices around $130. Does that accord with your recollection? I did not want to go into that.

Mr. MITCHELL. I think at the first we did accumulate stock, and bought it in block for our permanent account. I remember the first block was 50,000 purchased as a block, and then we accumulated, through the market, and built up an inventory there, and I should say our cost on that inventory was something around $100 a share.

Mr. PECORA. And the sales to the public were made at prices ranging about $130 a share?

Mr. MITCHELL. Well, we bought stock from time to time, and I think that when we made our initial offering to the public it was made around $120, and it followed the market up and down as we had stock to offer through our organization.

Mr. PECORA. Now, you, as an officer of the National City Co., approved of your company selling this Anaconda stock to the public?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. You considered it a good investment stock——

Mr. MITCHELL (interposing). I did.

Mr. PECORA (continuing). I believe, at the time.

Mr. MITCHELL. Yes, sir.

Mr. PECORA. And your company was so advising prospective buyers of it?

Mr. MITCHELL. Undoubtedly.

Mr. PECORA. You considered the copper industry in a very stable condition that justified the view that the common stock was a good investment?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Had you studied the copper industry at that time, Mr. Mitchell?

Mr. MITCHELL. Oh, yes.

Mr. PECORA. Thoroughly?

Mr. MITCHELL. Perhaps not as thoroughly as someone else might have studied it, but we made it a subject of intensive study.

Mr. PECORA. Mr. John D. Ryan, who was then chairman of the board of Anaconda Copper, was also a member of the board of the National City Co.?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. And he had made a study of it?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. And approved it?

Mr. MITCHELL. Most decidedly.

Mr. PECORA. Do you know an organization called Copper Exporters, Inc.?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Were you connected with that?

Mr. MITCHELL. No, sir.

Mr. PECORA. Was the Anaconda Copper Co. connected with it?

Mr. MITCHELL. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And these subsidiaries were connected with it, nearly all——

Mr. MITCHELL (interposing). Several of the large subsidiaries. Several were not included.

Mr. PECORA. I think the Greene-Cananea was not included.

Mr. MITCHELL. I just cannot tell you, but I think there were 1 or 2 that were not.

Mr. PECORA. Now, this Copper Exporters, Inc., was sort of a price-fixing organization, was it not, for the copper metal?

Mr. MITCHELL. No, sir.

Mr. PECORA. Was it not?

Mr. MITCHELL. No, sir.

Mr. PECORA. Was it not a price-fixing organization for the export trade?

Mr. MITCHELL. Under the—what is the name of that law?

Mr. PECORA. The Webb-Pomerene law?

Mr. MITCHELL. Yes. This is what is known as a Webb corporation.

Mr. PECORA. Yes.

Mr. MITCHELL. Formed with the full knowledge and consent of the Government and the operations were constantly a matter of open knowledge to the authorities, to the Washington authorities. It was an agency formed in order that these American copper exporters could unite with respect to the foreign market——

Mr. PECORA (interposing). That is just what I said.

Mr. MITCHELL (continuing). And not compete with one another, but as a unit group face the foreign market, which is just what the Webb-Pomerene law had in contemplation.

Mr. PECORA. In other words, this organization called Copper Exporters (Inc.) was avowedly designed to enable the domestic copper producing companies that were represented in the organization to avoid competition with one another in the export trade of the copper metal.

Mr. MITCHELL. Yes, sir.

Senator BROOKHART. Were all the copper companies in that?

Mr. MITCHELL. Practically all the American companies were in it.

Senator BROOKHART. And by being combined in that way it gave you more power to ask and secure a price on the foreign market?

Mr. MITCHELL. Yes; it made the foreign market a place where we could market in an orderly way.

Senator BROOKHART. Do you not think that sort of an organization would improve farm prices?

Mr. MITCHELL. I think we ought to have a lot more of them, Senator Brookhart.

Senator FLETCHER. It enabled the corporation to be exempt from antitrust laws?

Mr. MITCHELL. I beg your pardon?

Senator FLETCHER. It enabled the corporation to be exempt from antitrust laws?

Mr. MITCHELL. That is what the Webb-Pomerene bill did.

Mr. PECORA. To that extent this organization called Copper Exporters (Inc.), had a very definite control over the price of copper for the export trade?

Mr. MITCHELL. Quite so.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And do you think that that power which it had was reflected in the ability to peg the price for the copper metal even for domestic use or domestic sales?

Mr. MITCHELL. No, sir.

Mr. PECORA. The office of Copper Exporters (Inc.) was in the same building as the Anaconda Copper Co. offices?

Mr. MITCHELL. I do not know.

Mr. PECORA. Twenty-five Broadway?

Mr. MITCHELL. Twenty-five Broadway is the building where Anaconda offices are located. I was never in the offices of Copper Exporters (Inc.).

Mr. PECORA. Do you know of the action taken by Copper Exporters (Inc.), in the latter part of the year 1928 with respect to the making of a world-wide announcement concerning the condition of the copper industry at that time?

Mr. MITCHELL. No.

Mr. PECORA. That never came to your knowledge or notice?

Mr. MITCHELL. No; not that I recall.

Mr. PECORA. You made a study of the copper industry for the purpose of enabling you to determine whether or not the common stock of the Anaconda Copper Co., was a good investment security for your company to sell to the public?

Mr. MITCHELL. The study was made in the office; yes.

Mr. PECORA. Now, when you say it was made in the office, do you mean that some one other than yourself made it?

Mr. MITCHELL. Oh, yes; I mean that we had the benefit of the judgment of the group.

Mr. PECORA. Did any member of your group call to your attention at the time the officers of the National City Co. were discussing the advisability of offering Anaconda Copper common stock to the public, or ever say anything about this pronouncement of October 29, 1928, of the Copper Exporters (Inc.)?

Mr. MITCHELL. Not that I recall, Mr. Pecora.

Mr. PECORA. Let me read to you a document that I have, and that is over the signature of Mr. R. R. Eckert, manager of Copper Exporters (Inc.), and addressed to Chadbourne, Stanchfield & Levy, 25 Broadway, New York City [reading]:

GENTLEMEN: The following is a true and accurate copy of the minutes of the meeting of the board of directors of Copper Exporters (Inc.) of October 29, 1928:

"In view of the continued exceptional demand for copper, the great volume of sales of Copper Exporters (Inc.) during the current and past month, and the belief that buyers are contracting in excess of their requirements, thereby creating a condition that might lead to an unstable and artificial situation in the industry, the following statement was authorized:

"Directors of Copper Exporters (Inc.) authorized the following statements:

"The urgent demand for copper has forced the Copper Exporters (Inc.) to raise the price of copper for export to 16¼ cents c. i. f. European ports. In the opinion of the producers and refiners forming the membership of Copper Exporters (Inc.) consumers are buying in excess of actual requirements, thereby creating the danger of a runaway market; they believe that the increased mine production (September 7,000 tons over August and 20,000 tons over January) will be sufficient to satisfy any reasonable demand.

"Unfilled orders on the books of producers and refiners, as shown by available statistics, were 353,000 tons at the end of September as compared with 257,000 at the end of August and have undoubtedly been further increased during this month.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

"It is believed that if buyers would confine their purchases to actual requirements, the situation should be relieved by increased mine production coming upon the market.

"The secretary was directed to cable this statement to Brussels with the request that they issue it to the press."

You never heard of that before?

Mr. MITCHELL. No; this is the first time I ever heard that letter, or saw it.

Mr. PECORA. I ask that this be marked, Mr. Chairman. It has already been spread on the record by my reading it.

(The letter, on the letterhead of Copper Exporters (Inc.), 25 Broadway, New York, dated February 6, 1933, addressed to Chadbourne, Stanchfield & Levy, 25 Broadway, New York City, signed by R. R. Eckert, manager, was marked "Mitchell Exhibit 10," and is in the files of the committee.)

Senator TOWNSEND. Did Copper Exporters (Inc.) get any profit by buying up the copper, or by payment of the companies that were a part of the organization?

Mr. MITCHELL. Senator Townsend, I do not personally know. I never had anything to do with it. It was a joint venture of all of those companies, and this company, itself, never made any money except for the benefit of its own shareholders and those interested, who were the copper companies.

Senator TOWNSEND. Well, it was a joint venture for some specific purpose, of course.

Mr. MITCHELL. It was a joint venture in order to join the American producers as they faced the export market, so as to avoid a competition as between American consumers with the foreign market.

Mr. PECORA. As I understand it, Senator, it was simply an organization, around the council table of which sat the representatives of the big copper producing companies here, and through the medium of which they reached understandings in regard to the prices at which they would sell copper to the export trade. In other words, a price-fixing organization with the permission of the Webb-Pomerene Act to enable them to eliminate competition and control prices of copper for the export trade. That is correct, is it not, Mr. Mitchell?

Mr. MITCHELL. I think that is a fair statement.

Senator BROOKHART. What effect did that have on the domestic prices?

Mr. MITCHELL. I do not think it had any effect at all on the domestic prices, Senator.

The CHAIRMAN. What effect did it have on the foreign prices?

Mr. MITCHELL. It stabilized the prices.

The CHAIRMAN. Those people joining controlled the foreign market?

Mr. MITCHELL. They met always the competition of the foreign producers wherever they were. It unified the American producers.

Mr. PECORA. It eliminated competition?

Mr. MITCHELL. It unified the producers.

Mr. PECORA. It unified them by eliminating competition?

Mr. MITCHELL. Yes, sir.

Senator BROOKHART. How many producers were selling abroad before this organization was formed?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. I could not tell you exactly, but my recollection is there were possibly 35.

Senator BROOKHART. About as many as there are cotton exporters and competing with each other?

Mr. MITCHELL. Yes, sir.

The CHAIRMAN. Mr. Mitchell, it had the effect of raising and getting a better price for the foreign metal, did it not?

Mr. MITCHELL. Well, it had the effect of eliminating what might have been a destructive competition among American interests if they went into the export trade, Senator.

The CHAIRMAN. And that thing which you call elimination of destructive competition raised the price?

Mr. MITCHELL. Yes; I think so.

The CHAIRMAN. In other words, it raised the price in foreign lands? It must have, if it had the effect that you said it did.

Mr. MITCHELL. These latter evidences are the reverse of this, it seems to me. In other words, if these consumers had been allowed to go on and take copper far in excess of their requirements and there had not been a set price put on it by this combination the American price might have advanced rather than gone down.

The CHAIRMAN. We are going afield now.

Mr. MITCHELL. Yes.

The CHAIRMAN. The purpose was to eliminate destructive competition?

Mr. MITCHELL. Yes, sir.

The CHAIRMAN. Which would have brought it to a lower price?

Mr. MITCHELL. Yes; probably would.

The CHAIRMAN. Therefore, it was for the purpose of getting a higher price, which you admit they got.

Mr. MITCHELL. Yes, sir.

The CHAIRMAN. Now did it not also have the effect of giving a somewhat higher level in the United States, as well as outside?

Mr. MITCHELL. I expect if you had a level on the market you would get a steady and better condition for the amount left for distribution and consumption here.

The CHAIRMAN. What one would call a better condition, and another man might call worse?

Mr. MITCHELL. Yes, sir.

The CHAIRMAN. Is that not correct?

Mr. MITCHELL. Yes, sir.

The CHAIRMAN. The buyer might not call it a good condition, and the seller might think it was a good condition?

Mr. MITCHELL. Yes, sir.

The CHAIRMAN. The buyer in this case was the American public.

Mr. MITCHELL. The great advantage of this sort of thing is that you bring competitors to where they are forced to know one another, at least as they sit around the table. They would not have any commune regarding the domestic situation at all. But here is a point where they did reach——

The CHAIRMAN (interposing). I think I understand that fully. You have answered it well. In other words, I think we get your idea of it.

Now can you describe what this word "Anaconda" means today? What does it include; what properties?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. It includes the Anaconda properties in Montana, especially at Butte.

The CHAIRMEN. Yes.

Mr. MITCHELL. It includes, I think, a principal ownership—not complete—of Inspiration Copper.

The CHAIRMAN. Where is that located?

Mr. PECORA. The Senator wants to know where the mines are located which are owned by the Anaconda Mining Co. Is that it?

The CHAIRMAN. Yes; where is that located?

Senator FLETCHER. The Greene-Cananea is in Mexico.

Mr. MITCHELL. Well, the principal properties of the Anaconda are the group in Butte; the Inspiration Co., which is in Arizona; the Greene-Cananea Co., which is in Mexico, and the Chile and Andes Cos., which are in Chile.

The CHAIRMAN. Have you property in Canada and Alaska, too?

Mr. MITCHELL. No; neither one.

The CHAIRMAN. Now what percentage of the production was this when these were taken over, which are the big ones?

Mr. MITCHELL. I thought your question had to do with where they produced copper.

The CHAIRMAN. Yes.

Mr. MITCHELL. Of course, they have a very large fabricating company——

The CHAIRMAN (interposing). No; you understood my question.

Mr. MITCHELL. I thought I did.

The CHAIRMAN. At the time they were taken over, what was the production, say, at those mines, in percentage, or any other way?

Mr. MITCHELL. I would have to scratch my memory. I would be glad to get those figures up for you and give them to you.

The CHAIRMAN. Could you confer with your associates who are sitting here? I want to get at the percentage that was produced by those companies here or abroad.

Mr. PECORA. I might say, Senator, that the late John D. Ryan told me, just a week or two before his recent death, that the Anaconda Copper Mining companies controlled or produced about 55 percent of the copper of this country and about 22 percent of the copper of the world.

The CHAIRMAN. Well, with that statement, I am willing to pass it over, Mr. Mitchell.

Mr. MITCHELL. Yes; it is a very large production. I am sure that I covered that in my previous testimony.

The CHAIRMAN. The witness has repeatedly stated that copper produced in Mexico is produced so much cheaper than by any of the other companies; for instance, the Mexican company, the Greene-Cananea Co., has the lowest production cost. What is the principal reason for that? There may be more than one.

Mr. MITCHELL. Principally, at the moment, because they are working on high-grade ores. That is a pocket property. The Anaconda, you know, is a deep-vein property. This is a different kind of property.

The CHAIRMAN. What is the difference in wages at the Anaconda (Mont.) property and the Anaconda property, the Greene-Cananea property in Mexico?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. I can not give you those figures.

The CHAIRMAN. Who is there in your group that knows that?

Mr. MITCHELL. I do not know anyone in my group knows it in detail.

Senator FLETCHER. Generally, the labor cost in Mexico is lower?

Mr. MITCHELL. Oh, generally, the labor cost in Mexico is lower. In Chile the labor cost is very much cheaper; very much, indeed.

Mr. PECORA. May I ask the name of the gentleman who just gave you some information?

Mr. MITCHELL. Judge Covington.

Mr. PECORA. Is he connected with any of the copper companies, the Anaconda?

Judge COVINGTON. I happen to know considerable about copper.

Mr. PECORA. Are you connected with the Anaconda?

Judge COVINGTON. No; not in the slightest degree.

Senator FLETCHER. Are any of these mines closed down?

Mr. MITCHELL. They are not closed down, but ought to be, Senator. In other words, copper at this moment is selling very low. It is lower than it has been in the history of the decades, and these mines are constantly producing. They are kept open simply to give labor a chance to work. They are being operated at a loss day by day, and the copper industry would be very much better, and the companies themselves would be very much better off if the mines could be definitely closed for a period.

The CHAIRMAN. What percentage of the men have been laid off at the Anaconda?

Mr. MITCHELL. I could not give it to you on a percentage basis; but a good many men have been laid off, and they are dividing the work, Senator; they are giving part time to a great many men.

The CHAIRMAN. Well, is your pay roll one-fifth of what it was when you were running full blast?

Mr. MITCHELL. No; I would not say so.

The CHAIRMAN. One tenth?

Mr. MITCHELL. Well, you are getting down to a figure that one of the management would have to give.

The CHAIRMAN. That is all right. In the Greene-Cananea Co., what percentage of the men have you laid off there?

Mr. MITCHELL. I think there—the operation is not as great as it was. I cannot give you the figures.

The CHAIRMAN. That is running pretty nearly full blast, is it not?

Mr. MITCHELL. Oh, no; it is not running full blast.

The CHAIRMAN. How about the Inspiration?

Mr. MITCHELL. That is in the same category as Butte.

Senator BROOKHART. Now the principal reasons the demand for copper has fallen off is that there are about 35,000,000 people on the farms that cannot buy anything at present prices; is that true?

Mr. MITCHELL. Well, they are not only on the farms, I am sorry to say.

Senator BROOKHART. But if the farmers could buy they would put these people to work, would they not, not only in copper, but many other things?

Mr. MITCHELL. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. These 12,000,000 people who are out of jobs cannot buy anything either, and that is what is deepening the depression all around the ring.

Mr. MITCHELL. That is quite true.

Senator FLETCHER. The Anaconda stock is now about $7 a share?

Mr. MITCHELL. I do not know what it is.

Mr. PECORA. About seven.

Mr. MITCHELL. It has been running between 7 and 10, something of that sort.

Senator FLETCHER. At the peak it was 170?

Mr. MITCHELL. Not far from that, according to my recollection. Very high.

Mr. PECORA. Now when this study was made of the copper industry by officers of the National City Co. which led to their decision to accumulate large blocks of Anaconda Copper common stock and sell it to the American investing public, was it learned that in March of 1929 the price of copper, the metal, was 24 cents a pound, and that within a month thereafter it dropped to 18 cents a pound?

Mr. MITCHELL. Of course, the facts were known to us.

Mr. PECORA. Do you recall that particular fact?

Mr. MITCHELL. Well, I know that there was a big rise and subsequent dip there. But we never work on the top bulge price of that sort. We would work on a basis of long-term average.

Mr. PECORA. No; but I mean, was it known to you——

Mr. MITCHELL (interposing). Oh, yes; of course it was known.

Mr. PECORA. In other words, the fact that the price of copper, the metal, slumped 33⅓ percent in the world markets within a period of one month during the spring of 1929 was known to the officers of your company when they decided, in the early spring of 1929, to sell Anaconda Copper common stock to the public as an investment stock?

Mr. MITCHELL. If you tell me that you have looked up those records of the prices of copper, and that that was the price, I will accept that. When you say those were the prices of copper, and did our people know, of course we knew. But, I repeat, that we were not recommending Anaconda Copper Co. shares on the basis of 26 cents or an 18-cent price.

Mr. PECORA. You were talking about the profits that would be earned by Anaconda Copper on the basis of those prices, were you not?

Mr. MITCHELL. We may have been. I do not know what they were talking about, but from my standpoint I was working on the basis of long-term averages of the price of copper, to determine the intrinsic value of those properties.

Mr. PECORA. So the common stock of a company dealing in a commodity the price of which could slump in the world's market by one third within a month's period was the kind of stock that your company, through its officers, marketed as a good sound investment security?

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

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

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

Mr. MITCHELL. Instability at the moment, certainly.

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

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

Senator BROOKHART. Were you selling your own stock then?

Mr. MITCHELL. Yes, sir.

Senator BROOKHART. Had you reached the conclusion that it was about time to get rid of it; is that the idea?

Mr. MITCHELL. That is not the way——

Senator BROOKHART. That is the way you did it?

Mr. MITCHELL. That is not the fair way to do it.

Senator BROOKHART. I admit it is not.

Mr. PECORA. Do you know that the copper producing companies that were centered in Anaconda copper, when the slump of the price in the metal came, in March and April, 1929, pegged the price at 18 cents a pound in order to prevent its slipping further?

Mr. MITCHELL. Well, I do not know anything about pegging the price. I know that the copper companies are free agents within themselves. The bankers do not control that, and do not control the price of copper.

Mr. PECORA. No; but the National City Co. made a decision, based upon a judgment that the common stock of a company dealing in a commodity which was subject in price to such violent fluctuation, was a good investment stock.

Mr. MITCHELL. I think I have answered that.

Mr. PECORA. Yes. Now this stock was sold through the medium of salesmen?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Making almost house-to-house canvasses for customers?

Mr. MITCHELL. Well, we had salesmen located all over this country and Europe. Large quantities were sold here and in Europe, and large quantities sold through other investment dealers who were interested.

Mr. PECORA. But the National City Co. itself had on its pay roll probably 1,500, or more, salesmen who were confining their selling activities to this country, did it not?

Mr. MITCHELL. Three hundred and fifty salesmen.

Mr. PECORA. Three hundred and fifty salesmen?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. In this country?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Is that all it had?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. What was its total personnel?

Mr. MITCHELL. Total personnel of 1,900.

Mr. PECORA. And of that 1,900, only 300 were salesmen?

Mr. MITCHELL. That is correct.

The CHAIRMAN. Three hundred and fifty.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Three hundred and fifty.

Mr. PECORA. Three hundred and fifty?

Mr. MITCHELL. Yes, sir.

Mr. PECORA. What were the others?

Mr. MITCHELL. Well, I tried to explain to you yesterday that, just as in a manufacturing concern, the sales department is just the tail end of the funnel; that is where the goods finally leave your plant.

Mr. PECORA. Well, the others were not turning out securities which were sold by the sales force, were they?

Mr. MITCHELL. Mr. Pecora, a business like the National City Co. is an institution within itself with buyers, with engineers, with accountants, with a large bookkeeping and clerical force, telephone operators, telegraph operators, office boys, policemen. You run the number of your personnel up very rapidly when you——

Senator BROOKHART (interposing). Let me ask you a question there: How long were you engaged in this operation of selling this stock?

Mr. MITCHELL. I can not tell you, without referring——

Mr. PECORA (interposing). Let me see if I can refresh your recollection.

Mr. MITCHELL. Yes, sir.

Mr. PECORA. Was it not from August 6, 1929, to October 1, 1929?

Mr. MITCHELL. Well, if you have looked it up I will take your word for it, Mr. Pecora. I could not tell.

Mr. PECORA. Is there any one of your associates that can confirm that? They seem to nod their heads in approval.

Mr. MITCHELL. That is about it.

Mr. PECORA. It was two months?

Mr. MITCHELL. Yes, sir.

Senator BROOKHART. What did the stock market do during that operation of selling?

Mr. MITCHELL. What were the dates?

Mr. PECORA. August 6, 1929, to October 1, 1929.

Senator BROOKHART. Did it go up, or down?

Mr. MITCHELL. Has anybody got a record on it here? I have not.

The CHAIRMAN. It was a rising market, was it not?

Mr. MITCHELL. I just do not remember.

Mr. PECORA. It reached a high of 178¾ some time in September, did it not?

Mr. MITCHELL. No; on October 1—I have got those quotations in this previous testimony. Those same questions have come up before.

Mr. PECORA. Not all of them, Mr. Mitchell.

Mr. MITCHELL. Let me repeat this (reading):

The high during the first week in August was 122½. The high in the second week was 123⅛. The high in the third week was 122½. The high during the next week was 129. The high during the next week was 133. The high during the next week was 133⅛. The high during the next week was 126⅛.

And then the question:

And on October 1, when you quit, it was back to 114 again?

That is a question by counsel, and I answered:

One hundred and fourteen low, 117 high.

Mr. PECORA. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. In other words, during that operation of selling the price had a comparatively small range and at the close of our selling was approximately back to where it was when we started.

Mr. PECORA. Mr. Mitchell, in how many different cities did the National City Co. at that time, that is, in the late summer and early fall of 1929, maintain branch or district offices?

Mr. MITCHELL. Fifty-eight cities.

Mr. PECORA. Were they connected with the head office in New York by any private wire service?

Mr. MITCHELL. Not all of them. Some of them were.

Mr. PECORA. How many private wire services did the National City Co. maintain at that time between its head offices and its branch or district offices throughout the country?

Mr. MITCHELL. I think we had a wire up and down the coast, and a wire across the continent, with loops to Minneapolis and St. Paul, and so forth. The principal cities of the country were covered by our offices, and the principal cities were connected by wire.

Mr. PECORA. A private wire system?

Mr. MITCHELL. A private wire system.

Mr. PECORA. What was the extent of it?

Mr. MITCHELL. Well, I thought that I had just given that.

Mr. PECORA. I mean, in mileage.

Mr. MITCHELL. I think it was 11,000 miles.

Mr. PECORA. Was it 11,300 miles?

Mr. MITCHELL. Well, I do not know. The figure given me was 11,000 miles.

Mr. PECORA. Well, the figures I gave you in my questions are taken from the figures you gave at one of the annual meetings.

Mr. MITCHELL. Yes; anything I said at those meetings I stand by.

Mr. PECORA. Eleven thousand three hundred miles?

Mr. MITCHELL. Yes, sir.

Senator BROOKHART. Now that market was booming up about all the time you were selling that stock, and at the time you got through it was down again. How do you account for that?

Mr. MITCHELL. If you will go back to those very hectic days, that was a comparatively mild fluctuation that occurred there, Senator.

Senator BROOKHART. Well, did you have any operations on the stock exchange yourself?

Mr. MITCHELL. No; I think not, other than buying stock, which we were constantly doing. We found the investment demand for that stock very much greater than we had anticipated when we started selling.

Senator BROOKHART. So you were buying stock on the exchange at the same time your agencies were selling it?

Mr. MITCHELL. That is correct, sir. You see——

Senator BROOKHART (interposing). You paid those higher prices to get that stock you bought?

Mr. MITCHELL. Yes; undoubtedly.

Senator BROOKHART. And how much did you buy in that way?

Mr. MITCHELL. I cannot say. That has all been in the previous record of this committee. I could best refer you, if you would take time, Senator, to read it. I am sorry that you were not present

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

when I appeared before this committee discussing this Anaconda situation before the committee.

Senator BROOKHART. If you do not remember I will look in the record.

Mr. MITCHELL. Yes, sir.

Senator BROOKHART. You did not buy nearly as much as you sold?

Mr. MITCHELL. Oh, yes; we had to. Do you think we sold it short?

Senator BROOKHART. Well, you had the stock of your own to sell through your agencies, as I understand it.

Mr. MITCHELL. We had stock, but that was quickly distributed.

Senator BROOKHART. This was a sort of a syndicate operation then?

Mr. MITCHELL. Oh, no, no, no. This was an operation of the National City Co.

Senator BROOKHART. All by yourselves?

Mr. MITCHELL. Yes, sir.

Senator BROOKHART. A syndicate all by yourselves.

Mr. MITCHELL. I refer to that testimony, Senator, and I will just read these two or three sentences (reading):

> But being bankers for the company, even though we promptly sold that 300,000 shares which we owned and had under option, it became our duty, or so we conceived it, so long as our customers viewed that stock as an investment stock, to buy in the market and to sell additional shares to them. Which we did. And thus it came about that we bought this very large amount of stock during August and September and distributed it through our organization.
>
> Senator WALCOTT. In addition to the 300,000?
>
> Mr. MITCHELL. In addition to the 300,000 shares. And we closed the account early in October.

Senator BROOKHART. That does not say how much.

Mr. MITCHELL. I think we can probably pick that out.

Senator FLETCHER. Mr. Mitchell, yesterday morning I had two committee engagements and I could not hear your testimony. I do not want to go over in detail this set-up that you had, but it is not quite clear in my mind about how the National City Co. was constituted. As I understand the shares in the National City Co. were held by three trustees; they controlled these shares, voted them, and so forth.

Mr. MITCHELL. That is right.

Senator FLETCHER. They did not have to do actively with the operation of the company—the trustees?

Mr. MITCHELL. No, sir.

Senator FLETCHER. Did they elect the officers of the company?

Mr. MITCHELL. They elected the directors, and the directors elected the officers.

Senator FLETCHER. I see. And that is the set-up that carries on the operations of the company, independent of the trustees?

Mr. MITCHELL. That is quite correct.

Senator FLETCHER. How many directors do you have?

Mr. MITCHELL. I think in the company we have nine directors.

Senator FLETCHER. And who is the president of that company?

Mr. MITCHELL. Mr. H. B. Baker is the president of the National City Co.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The CHAIRMAN. The committee will recess until 2.30 o'clock this afternoon. Those under subpœna will be here at that time.

(Whereupon, at 12.50 o'clock p. m., a recess was taken until 2.30 o'clock p. m. of the same day.)

AFTER RECESS

The subcommittee resumed at 2.30 p. m., on the expiration of the recess.

The CHAIRMAN. The subcommittee will come to order. Who will you have, Mr. Pecora?

Mr. PECORA. Mr. Rentschler. In calling this gentleman now, Mr. Chairman, it is understood that the examination of Mr. Mitchell is simply being suspended for the time being. I am calling Mr. Rentschler out of turn in order to enable him to return to New York, where he feels he ought to be to-morrow for the purposes of his bank. Is that correct?

Mr. RENTSCHLER. That is quite correct.

The CHAIRMAN. You will stand, hold up your right hand, and be sworn: You solemnly swear that you will tell the truth, the whole truth, and nothing but the truth regarding the matter now under examination by this subcommittee, so help you God.

Mr. RENTSCHLER. I do.

The CHAIRMAN. You may proceed, Mr. Pecora.

TESTIMONY OF GORDON S. RENTSCHLER, PRESIDENT OF THE NATIONAL CITY BANK, NEW YORK CITY

Mr. PECORA. Mr. Rentschler, will you give your full name, address, and business or occupation, please?

Mr. RENTSCHLER. Gordon S. Rentschler, New York City——

Mr. PECORA (interposing). What is the address?

Mr. RENTSCHLER. 933 Fifth Avenue, New York City. I am president of the National City Bank of New York.

Mr. PECORA. How long have you been president of the National City Bank?

Mr. RENTSCHLER. Since April of 1929.

Mr. PECORA. When did you first become connected in any official capacity with that bank?

Mr. RENTSCHLER. In October of 1923.

Mr. PECORA. In what capacity did you become affiliated with that bank then?

Mr. RENTSCHLER. As director.

Mr. PECORA. And did you hold any office in the bank other than that of director? In other words, did you hold any office in the bank before you became its president in April of 1929?

Mr. RENTSCHLER. Yes, sir; I was a vice president of the bank beginning in January of 1925.

Mr. PECORA. As vice president of the bank at that time were you also assistant to the president?

Mr. RENTSCHLER. Yes.

Mr. PECORA. And you held the office of vice president and assistant to the president until you were made president in April of 1929?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. Prior to your becoming a vice president and assistant to the president of the bank in 1925 had you been an officer of any other bank?

Mr. RENTSCHLER. I had not been.

Mr. PECORA. What was your business or occupation before you became a vice president of the National City Bank?

Mr. RENTSCHLER. I was engaged in manufacturing.

Mr. PECORA. What line?

Mr. RENTSCHLER. Heavy machinery, at Hamilton, Ohio, with the Hooven, Owens, Rentschler Co., of Hamilton, Ohio.

Mr. PECORA. You are also a director of the bank, of course?

Mr. RENTSCHLER. Yes, sir; I have been a director since 1923.

Mr. PECORA. Do you recall a meeting of the board of directors of the bank held on or about November 13, 1929, at which certain action was taken with respect to setting aside a fund of $2,000,000 or more for the purpose of making loans to the officers of the bank?

Mr. RENTSCHLER. Yes, sir; I recall that meeting.

Mr. PECORA. You were present and took part in the discussion?

Mr. RENTSCHLER. I am quite sure I did.

Mr. PECORA. And the date was November 13, 1929?

Mr. RENTSCHLER. I would have to check that before I would be sure of it.

Mr. PECORA. At any rate, it was within about a fortnight after the first big break in the stock market at the end of October?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. Who brought up that matter for discussion or consideration?

Mr. RENTSCHLER. I do not recall just what individual brought it up. It was a matter that had been discussed by a great many of the directors informally prior to that meeting. So I would not recall exactly as to who brought it up. It might well have been Mr. Mitchell or myself who initiated the discussion.

Mr. PECORA. Is it your best recollection that it was either you or Mr. Mitchell?

Mr. RENTSCHLER. It would be very likely that one or the other of us would bring it up in the way that we did our business. That would probably come through the executive committee first, and then to the board. Yes; I find that it was November 13, 1929, when this matter came up in the executive committee.

Mr. PECORA. Have you before you now a copy of the resolution which was adopted by the board at that meeting with respect to this $2,000,000 fund?

Mr. RENTSCHLER. Yes, sir; or rather I have a resolution adopted by the executive committee, and I think it is probably identical with the one that was later voted by the board.

Mr. PECORA. I have before me the minute book of the board meeting of that date. If you will read the resolution you have I will hold mine and compare it with yours.

Mr. RENTSCHLER. It reads:

Resolved, That the proper officers are hereby authorized to advance to Eric P. Swenson and James H. Perkins, as trustees and not individually, upon their unsecured note or collateral loan agreement, signed by them as such trustees without personal responsibility, such sum or sums as such trustees

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

may call for, not exceeding a total of $2,000,000, and without interest, in order to enable such trustees to make loans or advances, either with or without security as in their complete discretion they may deem proper, to such officers of the bank and its affiliate corporations as they may deem proper, for the purpose of making loans to such officers in the present emergency, and thereby sustaining the morale of the organization.

Mr. PECORA. Well, that reading corresponds to the resolution embodied in the minute book of the board of directors.

Mr. RENTSCHLER. All right.

Mr. PECORA. Now, as a matter of fact, was not more than $2,000,000 made available to Mr. Swenson and Mr. Perkins as trustees, for the purpose set forth in the resolution?

Mr. RENTSCHLER. Yes, sir. There were subsequent resolutions that permitted a total sum of something like $2,366,000 to be so loaned.

Mr. PECORA. As a matter of fact, wasn't it $2,400,000?

Mr. RENTSCHLER. I am trying to find the other resolution. It might have been. No; I do not have that here. If you have that figure, all right.

Mr. PECORA. Now, the two men named as trustees in this resolution, Mr. Swenson and Mr. Perkins, were both directors of the National City Bank, were they not?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. Mr. Perkins at the time was also president of the City Bank Farmers Trust Co.?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. Which is the trust affiliate of the National City Bank?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. What officers of the National City Bank and of its affiliates participated in the loans that were made from this fund?

Mr. RENTSCHLER. There were probably 100 different men, men of various ranks in the organization.

Mr. PECORA. What was the largest amount loaned to any one officer out of this fund?

Mr. RENTSCHLER. I am sorry, but I have not got that information here.

Mr. PECORA. Have any of your associates possession of it?

Mr. RENTSCHLER. You, Mr. Pecora, may have it.

Mr. PECORA. I have the working sheets of our accountants. I will have it looked up. But in the meantime let me ask you: Those loans were all made without interest, weren't they?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. And they were made to those various officers without security?

Mr. RENTSCHLER. Some of them with and some without security.

Mr. PECORA. Did any of the officers of the bank who participated in the distribution of the management funds also participate in the loans that were made out of this fund?

Mr. RENTSCHLER. I would have to determine that by looking at the list. But I think there were some. There must have been some.

Mr. PECORA. Have those loans been repaid to the bank?

Mr. RENTSCHLER. Some have and some bave not.

Mr. PECORA. What proportion of them have been paid and what proportion have not been paid?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RENTSCHLER. Again, I would have to consult the record.

Mr. PECORA. Will you please do so?

Mr. RENTSCHLER. I should say not over 10 per cent, or perhaps not over 5 per cent has been repaid.

Mr. PECORA. Not over 5 per cent of them have been repaid?

Mr. RENTSCHLER. Yes; I think that is right. Of course, those loans were closed out as of December 15, 1930.

Mr. PECORA. By that do you mean they were written off and charged up against undivided profits?

Mr. RENTSCHLER. Some were, and the balance were taken over on new loans made by the National City Co.

Mr. PECORA. Those were then transferred to the National City Co.?

Mr. RENTSCHLER. That is right.

Mr. PECORA. Is that what you would call a bailing-out process of the bank as regards the respective loans referred to?

Mr. RENTSCHLER. No. But those loans that were at that time definitely determined not to be current, or not obligations which could be paid back within six months or a year, and therefore not a proper bank asset, were turned over to the National City Co. where they could be on a long-time basis.

Mr. PECORA. Well, would you say that the bank was bailed out of those loans under that process?

Mr. RENTSCHLER. Whatever word you wish to use. The bank was relieved of those loans; yes, sir.

Mr. PECORA. You have heard that term used before, "bailed out," haven't you?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. Haven't you heard that term used?

Mr. RENTSCHLER. Oh, yes.

Mr. PECORA. It is used in the common parlance of Wall Street, isn't it?

Mr. RENTSCHLER. Well, I suppose so. But I do not use it.

Mr. PECORA. You think it has a harsh sound to the ear, is that it?

(Witness does not respond but simply smiles.)

Mr. PECORA. Well, do you know any politer term for it?

Mr. RENTSCHLER. Well, those loans were taken over by the National City Co., is the answer to your question.

Mr. PECORA. Were any loans out of this fund which were made to those officers who had participated in the management fund distribution, repaid out of any interest of those officers in the management fund?

Mr. RENTSCHLER. Well, there has been practically no management fund since 1929. There was quite a small management fund, if I recall it correctly, and there I would have to get the exact figures, in the bank at the end of 1929, but there has been practically nothing since then.

Mr. PECORA. In the resolution which sets forth the purpose for which this fund of $2,000,000 was set aside, it is stated that this was done—

for the purpose of protecting such officers in the present emergency, and thereby sustaining the morale of the organization.

Just what did you mean by that?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RENTSCHLER. That was the crash of the market of 1929, and the resultant confusion that came from it, which at that time was looked upon as a crisis and an emergency.

Mr. PECORA. That is, a personal emergency to those officers?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. Who benefited by borrowings from this fund because of their own commitments in the stock market; is that right?

Mr. RENTSCHLER. Well, they may have been bank loans or other market commitments, or personal obligations, which when incurred were incurred on the basis of a very reasonable margin, and on the basis where they could be looked upon as very safe borrowings.

Mr. PECORA. Now, at the time when the National City Bank set aside this fund of $2,400,000 to relieve those officers in their emergency, was the bank selling out other customers, not officers of the bank, who had loans at the bank secured by collateral?

Mr. RENTSCHLER. That may well be, because it is the absolute rule of the bank to preserve its assets that are secured in any manner.

Mr. PECORA. Did you consider that the bank was taking a step to preserve $2,400,000 of its assets when it made that sum available to officers who have not yet repaid 5 percent of it to the bank?

Mr. RENTSCHLER. Yes. At the time when this loan was made it was made to men who had up to that time earning power and who had assets in one form or another, that made it look like their obligations were good obligations to take. But now taking a hind look at it, it is a different picture.

Mr. PECORA. In the three years or more which have elapsed since that time the responsibility of those men to the bank has not proven as good as you thought it would in November of 1929?

Mr. RENTSCHLER. As a financial responsibility it has not proven so good, because their things have shrunk like everybody else's.

Mr. PECORA. Most of these officers are still officers of the bank?

Mr. RENTSCHLER. A great many of them are.

Mr. PECORA. And of the affiliated companies?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. Did the bank have any legal opinion from anybody concerning the validity of those loans?

Mr. RENTSCHLER. Yes. This was done under the guidance of the bank's counsel.

Mr. PECORA. Who?

Mr. RENTSCHLER. Shearman and Sterling.

Mr. PECORA. Did they submit a written opinion as to its legality to the bank's officers, supporting this action?

Mr. RENTSCHLER. I do not think so. It is not a regular custom usually for us to receive written opinions from them. But they were closely in touch with this situation.

Mr. PECORA. As the president of the National City Bank are you familiar with the essential provisions of the national banking act?

Mr. RENTSCHLER. I think so.

Mr. PECORA. Well, you are not guessing now, are you? Do you feel that you are familiar with the main features of the national banking act?

Mr. RENTSCHLER. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Do you know of any provision of the national banking act which justifies loans that are unsecured to officers?

Mr. RENTSCHLER. Well, these loans were made to the trustees. That was the way this matter was arranged, and we think it is entirely within the provisions of the national banking act.

Mr. PECORA. Do you think the adoption of the trustee form of these loans took it out of the operation of the provisions of the national banking act?

Mr. RENTSCHLER. No. It could be considered a straight loan and then be a proper loan.

Mr. PECORA. And which was a loan to its officers.

Mr. RENTSCHLER. Quite so.

Mr. PECORA. We might say that two of the officers were designated as trustees for the other officers who were to benefit by those loans?

Mr. RENTSCHLER. Quite right.

Mr. PECORA. When were those loans taken out of the National City Bank and transferred to the National City Co.?

Mr. RENTSCHLER. In December of 1930.

Mr. PECORA. Some time in 1927 a stock-purchase plan under which officers and employees of the National City Bank were permitted to subscribe for shares of the capital stock of the bank was put into effect, wasn't it?

Mr. RENTSCHLER. A stock-purchase plan in 1927?

Mr. PECORA. Yes.

Mr. RENTSCHLER. Yes; February 15, 1927.

Mr. PECORA. And a modification of that plan was put into effect in December of 1929, wasn't it?

Mr. RENTSCHLER. Yes, sir. And I think I have a memorandum I could refresh my memory from and give you what you want.

Mr. PECORA. Do you need that memorandum in order to refresh your recollection?

Mr. RENTSCHLER. Yes.

Mr. PECORA. If you do I will say there is no objection, but I want the record to show it if you do.

Mr. RENTSCHLER. Yes, sir; I should like to use it.

Mr. PECORA. Did you prepare that memorandum?

Mr. RENTSCHLER. No. It was prepared by one of my associates.

Mr. PECORA. Which one?

Mr. RENTSCHLER. Mr. Lancaster.

Mr. PECORA. And he is the cashier of the bank?

Mr. RENTSCHLER. This is a memorandum by Mr. Lancaster, one of our attorneys.

Mr. PECORA. Is he an officer of the bank?

Mr. RENTSCHLER. No, sir. He is an attorney associated with Shearman & Sterling.

Mr. PECORA. Now, under the modification of the stock-purchase plan which was put into effect in December of 1929, the scope of that plan or the benefits of it were enlarged so as to permit employees of the bank and of its affiliates, in the lower grades, down to clerks, to participate?

Mr. RENTSCHLER. Quite so.

Mr. PECORA. The general feature of the plan was, as modified in 1929, to enable those employees of the bank and of its affiliates to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

subscribe for and purchase shares of the capital stock of the bank and to pay for them over a 4-year period in installments?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. With interest charged against them on the unpaid balances?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. Through the 4-year period?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. How many shares of the bank's stock were disposed of under this stock purchase arrangement on the installment plan?

Mr. RENTSCHLER. Something between 40,000 and 50,000 shares. I think I can get it exactly for you.

Mr. PECORA. Wasn't it more than 100,000 shares?

Mr. RENTSCHLER. No. Well, there were more than 100,000 shares applied for but not allotted.

Mr. PECORA. Were not more than 100,000 shares subscribed for?

Mr. RENTSCHLER. They were subscribed for but not allotted. I do not remember now the total of the subscriptions, but I can get it for you.

Mr. PECORA. Weren't they all allotted but many of the allotments thereafter canceled?

Mr. RENTSCHLER. No, sir.

Mr. PECORA. Are you sure of that?

Mr. RENTSCHLER. I am very sure of it, because those subscriptions were all cut down on the basis of what we thought at that time would be a very prudent size subscription for these various employees to carry.

Mr. PECORA. Let us see about that. Don't you recall that some time after December of 1929, at a meeting of the board of directors of the bank, the chairman, Mr. Mitchell, made a statement to the effect that the shares had been oversubscribed—that more than 100,000 shares had been subscribed for?

Mr. RENTSCHLER. Yes; but——

Mr. PECORA (interposing). Pardon me until I conclude my question.

Mr. RENTSCHLER. Pardon me.

Mr. PECORA. And that it was necessary to allot another 10,000 shares under the plan in order to take care of all the subscriptions? Do you recall that?

Mr. RENTSCHLER. Yes; that is quite true, that there were 10,000 extra shares provided, but the whole 100,000 shares were not allotted.

Mr. PECORA. If the 100,000 shares were not allotted, why was it necessary to allot another 10,000 shares to take care of subscriptions?

Mr. RENTSCHLER. Because we had only provided in the first place a smaller number of shares, either 40,000 or 50,000 shares. But if you will give me an opportunity to go over this memorandum for a minute I think I can give that information to you absolutely exactly.

Mr. PECORA. All right.

Mr. RENTSCHLER. There was a total number of shares acquired by the stock-purchase plan of 50,000 which were offered to the employees for subscription. But there were subscriptions from the employees of 100,000 shares. And I do not see here just what that final allot-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

ment was, but I know it was not in excess of 50,000 shares, and possibly an additional 10,000 shares.

Mr. PECORA. Do you think if you conferred with some of your associates here you might get more specific information on that?

Mr. RENTSCHLER. Yes. Here it is. There were total allotments of 60,000 shares.

Mr. PECORA. What were the total subscriptions?

Mr. RENTSCHLER. Over 100,000 shares. But we provided 50,000 shares before subscriptions were offered, and then it was necessary to provide 10,000 additional shares to take care of the 60,000 shares.

Mr. PECORA. At what price was the capital stock of the National City Bank made available to its employees under this installment purchase plan?

Mr. RENTSCHLER. At $200 a share, and $220 a share.

Mr. PECORA. And that was after the crash in October and November of 1929?

Mr. RENTSCHLER. That is right. This was in December of 1929.

Mr. PECORA. And the installment payments required to be made by the employees under this stock purchase plan were deducted from their monthly salary checks?

Mr. RENTSCHLER. Quite right.

Mr. PECORA. Are employees still being held to the purchase price for their stock?

Mr. RENTSCHLER. Yes, sir; they are still paying on these amounts.

Mr. PECORA. What is the market for National City Bank stock now?

Mr. RENTSCHLER. About $40 a share.

Mr. PECORA. It has been below $100 a share for the greater part of the time since this stock purchase plan was effected in December of 1929, hasn't it?

Mr. RENTSCHLER. No. During 1930 it stood above $100 a share, and since then I think it has been below $100 a share the most of the time.

Mr. PECORA. It has gone down to as low as $25 a share, hasn't it?

Mr. RENTSCHLER. I think so.

Mr. PECORA. And the National City Bank has not done anything to sustain the morale of its employees with regard to those stock commitments of theirs under this plan, has it?

Mr. RENTSCHLER. I think the employees are, far and wide, entirely well satisfied with the fact of their part in this plan. I think from the standpoint of the morale, Mr. Pecora, well, I doubt very much if there is an organization in this country where the morale has kept as strong and fine as in this institution.

Mr. PECORA. As a matter of fact, after paying their installments as they have fallen due since December of 1929 to date, most of the employees who subscribed for stock under this installment plan still owe more than the stock is worth in the market; isn't that so?

Mr. RENTSCHLER. Yes, sir; more than the market value of the stock to-day.

Mr. PECORA. And they are still content to pay it?

Mr. RENTSCHLER. Right.

Mr. PECORA. And the only way they could be relieved of payments is by resigning their positions; isn't that so?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RENTSCHLER. Yes.

Mr. PECORA. Now, as a matter of fact the morale of the officers in the emergency that confronted them in November of 1929 because of the stock market crash was due in large part to their own commitments for shares of stock of the bank; isn't that so?

Mr. RENTSCHLER. Quite right—oh, I beg pardon. I answered that question too quickly. It is due to their commitments for various things. It may have been bank stock or for their houses or for something else.

Mr. PECORA. Don't you know it was principally commitments in the stock of the bank?

Mr. RENTSCHLER. I think that was the principal item, perhaps; yes, sir.

Mr. PECORA. You know that to be a fact, don't you?

Mr. RENTSCHLER. I have not been over all these loans enough to say.

Mr. PECORA. Isn't that a fact which has been called to your attention as the president of the bank, through the examinations of the bank?

Mr. RENTSCHLER. Yes. I think you are probably correct, that a majority of it represents stock; yes.

Mr. PECORA. Now, let us get back to the identity of the officers who received the largest loans——

Mr. RENTSCHLER (interposing). In passing, I should like, if I may, to add to the statement about the stock-purchase plan and the reason I think the employees are so well satisfied with what happened, that this whole idea came from a committee of 13, which is a committee annually elected by the various departments of the bank and which represents the employees of the bank in dealing with the officers. This was their plan and suggestion. They pressed it very definitely as an opportunity, as they saw it, to get a bigger part in the bank. And at that time they stood ready to be committed to twice the amount that they are actually committed to at the present time.

Mr. PECORA. Which officer of the bank received the largest individual loan?

Mr. RENTSCHLER. You have the record there, haven't you?

Mr. PECORA. Is there a man in your organization named Barrett, a vice president?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. Do you know that he received a loan originally of $260,000 out of this fund, and thereafter two additional loans for $10,000 and $26,000, respectively?

Mr. RENTSCHLER. Yes, sir; if you have that record there, I will say it is correct.

Mr. PECORA. That would make a total of $296,000?

Mr. RENTSCHLER. Correct.

Mr. PECORA. Do you know how much of that loan he has paid back?

Mr. RENTSCHLER. No; I do not.

Mr. PECORA. Wasn't it $11,000?

Mr. RENTSCHLER. I haven't it here in my records. If you have it there, all right.

Mr. PECORA. Consult your own records.

Mr. RENTSCHLER. I have not a record of that.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Somebody in your group must have a record of that.

Mr. RENTSCHLER. My associate says he gave these records to Mr. Pecora and we have none here.

Mr. PECORA. We did not take your records. We made notations from your records.

Mr. RENTSCHLER. Yes, sir; but you have a copy.

Mr. PECORA. Now, do you recall what was done with the remaining $285,000 of the loan made to Mr. Barrett out of this fund?

Mr. RENTSCHLER. No; unless that was taken over by the National City Co. in December of 1930. If you have the record and if I may use that I will be glad to testify from it.

Mr. PECORA. According to the records made by our accountants from your records.

Mr. RENTSCHLER. All right.

Mr. PECORA. The unpaid balance of $285,000 was written down to $65,000 by the National City Co.

Mr. RENTSCHLER. Yes; and is an obligation, of course, still retained.

Mr. PECORA. What was that?

Mr. RENTSCHLER. Is an obligation, of course, still retained.

Mr. PECORA. He has not been required to make any payments on account out of his salary as an officer, has he?

Mr. RENTSCHLER. That, again, I cannot answer.

Mr. PECORA. Do you think that to have done so might have impaired his morale?

Mr. RENTSCHLER. [Witness smiles without replying.]

Mr. PECORA. I am asking that question seriously, Mr. Rentschler.

Mr. RENTSCHLER. No. I do not know what other obligations he might be paying on. That would have to depend entirely on the conditions in order to give you a frank and complete answer as to his individual situation, of which I am not entirely familiar.

Mr. PECORA. Who is the officer who received the next largest loan?

Mr. RENTSCHLER. I will be glad if you will tell me.

Mr. PECORA. Was it Mr. Lee Olwell?

Mr. RENTSCHLER. If your records show it.

Mr. PECORA. That is what our record shows. That is, our notations from your records.

Mr. RENTSCHLER. All right.

Mr. PECORA. They show that he received $175,000 originally and then an additional amount of $170,272, making a total of $345,272, and that he has paid nothing back on account. Does that accord with your recollection?

Mr. RENTSCHLER. Yes.

Mr. PECORA. And that loan account of $345,000 was written off to $200,000 by the National City Co. after the transference of the loan to that company?

Mr. RENTSCHLER. Yes; that is in accord with my recollection.

Mr. PECORA. He is no longer an officer of the bank?

Mr. RENTSCHLER. No; he is no longer an officer of the bank.

Mr. PECORA. Have any proceedings been taken to enforce that obligation.

Mr. RENTSCHLER. No, sir.

Mr. PECORA. Do you think it was necessary to sustain the morale of the officers of your organization in this fashion, in view of the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

fact that many of those officers had been permitted to participate in handsome bonuses out of the management fund?

Mr. RENTSCHLER. Well, I can answer that by saying that at the time we were dealing with this situation, in October of 1929, it was absolutely essential for the good of the bank and for the good of the enormous number of contacts that we had that every officer and every employee of that organization should be functioning at his very best, entirely leaving aside any of his personal interests. And I think the answer as to whether or not it was wise to do it is definitely shown in the way that those men, officers, and on down to the most casual employees, paid, day in and day out, did their job. And from that standpoint I will therefore answer your question yes.

Mr. PECORA. The morale of the employees has been sustained without relieving them of the burden of paying several times more than the market price of the stock even to-day.

Mr. RENTSCHLER. The officers are a part of this plan just as much as the employees; I mean the officers just as much in proportion. A great many of the officers are in the stock-purchase plan and have had large amounts of the stock, and have exactly the same relative position to deal with as the employees.

Mr. PECORA. But the employee was not given the benefit of unsecured loans, borrowed with no interest, to tide him over the emergency, in order to sustain his morale, was he?

Mr. RENTSCHLER. Well, I think the answer there is that the morale of our employees has been sustained, and we have been very careful to see that it is done.

Mr. PECORA. Not by relieving them of the burden of these subscriptions or commitments, however.

Mr. RENTSCHLER. No.

Mr. PECORA. And you admit it was necessary to do that in order to sustain the morale of the officers.

Mr. RENTSCHLER. We did not relieve the officers of any of their stock purchase plan commitments. They were all treated exactly alike.

Mr. PECORA. But the officers were relieved of their commitments, outside of the stock purchase plan, to the extent of $2,400,000, which the bank is still out.

Mr. RENTSCHLER. That is right.

Mr. PECORA. Now, as of February of this year do you know how much is due from employees under this installment stock purchase plan?

Mr. RENTSCHLER. Let me see if I have it here. No; I haven't got that figure. If your accountants have it I will be glad to testify from their transcript.

Mr. PECORA. I understand the amount due from employees as of February 18, 1933, according to an examination of your records by our accountants, is $5,303,276.96.

Mr. RENTSCHLER. All right.

Mr. PECORA. What was the total amount represented by the subscriptions of employees under this stock purchase plan as modified in December of 1929?

Mr. RENTSCHLER. Originally about $12,000,000.

Mr. PECORA. So the employees have paid subscriptions down to date without having had any of their subscriptions marked off?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RENTSCHLER. Mr. Pecora, let me correct you there: The stock purchase plan is composed of officers and employees, of which about 20,000 shares have been subscribed for by employees without officer title, and the other is subscribed for by officers with title, and that burden is carred in that fashion.

Mr. PECORA. By employees and officers alike?

Mr. RENTSCHLER. Yes; both alike.

Senator FLETCHER. How many shares altogether?

Mr. RENTSCHLER. Sixty thousand shares altogether.

Senator FLETCHER. And the employees had 20,000 shares?

Mr. RENTSCHLER. Yes; about 20,000 shares.

Mr. PECORA. Now, Mr. Rentschler, did you as a vice president of the National City Bank participate in the distribution of this management fund in the year 1927?

Mr. RENTSCHLER. Yes; I did.

Mr. PECORA. To what extent?

Mr. RENTSCHLER. I think I have a memorandum here, which I got over the telephone this morning, so I am not at all sure it is accurate. Will you check me with your memorandum?

Mr. PECORA. My record shows $154,760.53.

Mr. RENTSCHLER. Yes.

Mr. PECORA. To what extent did you participate in the management fund of the bank for the following year?

Mr. RENTSCHLER. $125,000.

Mr. PECORA. This was all in addition to your salary?

Mr. RENTSCHLER. Yes.

Mr. PECORA. And what were your salaries for those 2 years?

Mr. RENTSCHLER. $50,000 each year.

Mr. PECORA. By the way, Mr. Rentschler, are the moneys accruing to this management fund kept on deposit in the National City Bank?

Mr. RENTSCHLER. They are not separated from any other fund until the actual payment to the officers. It is just an accrual, in the bank month by month, and is finally determined at the end of 6 months, and then at the end of the next 6 months.

Mr. PECORA. Where are the funds deposited during their accrual?

Mr. RENTSCHLER. Just with the funds in the bank.

Mr. PECORA. Are you sure of that?

Mr. RENTSCHLER. Yes.

Mr. PECORA. They are carried there up to the day of payment?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. Are they paid out of the funds of the bank as represented by checks drawn against the bank?

Mr. RENTSCHLER. No. They are paid by checks drawn on other banks to which the funds have been transferred from the bank itself to the other bank.

Mr. PECORA. What was the reason for that?

Mr. RENTSCHLER. All of our salary checks go through other banks rather than through our own employees, where the——

Mr. PECORA (interposing). What is the reason for it?

Mr. RENTSCHLER. Well, the same reason that any other pay roll or any other salary roll is kept in a confidential relationship in the organization. It has not been a custom of ours or of any other

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

business organization I know of, to discuss with each other in the organization or outside the amount of our compensation.

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

Mr. RENTSCHLER. Quite so.

Mr. PECORA. To employees and other officers of the bank, of the identity of the officers participating in the management fund and the extent of their respective participations?

Mr. RENTSCHLER. That is the quite definite reason; yes, sir.

Mr. PECORA. That is the reason?

Mr. RENTSCHLER. Quite definitely so.

Mr. PECORA. Mr. Rentschler, to what extent, generally speaking, has the bank financed the securities business of the National City Co.?

Mr. RENTSCHLER. Financed the securities business of the National City Co.?

Mr. PECORA. Yes.

Mr. RENTSCHLER. Not at all. The National City Co. has always stood absolutely on its own feet.

Mr. PECORA. Does not the National City Co. at times borrow money from the National City Bank?

Mr. RENTSCHLER. Well, the National City Co. has had the bank's limit in unsecured loans, and has also had loans in addition to its limit secured by United States Government bonds.

Mr. PECORA. What is the limit of unsecured loans available to the National City Co.?

Mr. RENTSCHLER. It would be 10 per cent of our capital and surplus at what they are from time to time.

Mr. PECORA. In other words, they have a borrowing capacity or credit up to the legal limit?

Mr. RENTSCHLER. That is right.

Mr. PECORA. How much is that in dollars and cents?

Mr. RENTSCHLER. About $20,000,000, and I think I have the exact figure.

Mr. PECORA. Well, that will do.

Mr. RENTSCHLER. If they borrow more than that, they borrow against United States Government bonds issued up to 1917, and they get 15 per cent more. But that has not happened.

Mr. PECORA. Has the National City Co. availed itself of this loan credit?

Mr. RENTSCHLER. Not often.

Mr. PECORA. How frequently?

Mr. RENTSCHLER. At the present time they owe nothing. At other times they will be using their entire amount for, say, a week or a month, depending upon what their needs may be.

Mr. PECORA. You know that in the year 1928 and in the year 1929 and in the year 1930, or in portions of those years, the National City Co. engaged in an intensive campaign for the sale of the capital stock of the bank to the public, don't you?

Mr. RENTSCHLER. Yes; they were selling stock right along.

Mr. PECORA. Do you know how many shares of the bank's stock were distributed to the public through the National City Co.?

Mr. RENTSCHLER. No; I do not.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Have you any idea of the amount?

Mr. RENTSCHLER. I have not seen those figures.

Mr. PECORA. It is a very large amount, isn't it?

Mr. RENTSCHLER. I should think it would be a very large amount.

Mr. PECORA. What would strike you as a very large amount?

Mr. RENTSCHLER. We may have those figures available and can get them rather than to be guessing. Maybe you have them.

Mr. PECORA. I want to see how much you know about it.

Mr. RENTSCHLER. I do not know, in the buying and selling, what it would run into.

Mr. PECORA. Several hundred thousand shares?

Mr. RENTSCHLER. At least that.

Mr. PECORA. It would run into seven figures, as a matter of fact?

Mr. RENTSCHLER. I should think so in taking all those years, with sales in and out as folks do in regard to bank shares, as well as other shares. During that period we went up from 10,000 or 15,000 stockholders to where we have now 86,000 stockholders. So it must have been quite a large figure.

Mr. PECORA. For the 3½ year period ending December 31, 1930, our accountants report as a result of an examination of the records of the National City Co. approximately 1,950,000 shares of the bank's stock, at an approximate cost of $650,000,000, were sold to the public. Would that be in accord with your general knowledge?

Mr. RENTSCHLER. Yes. If you have the figures I should say that is right, and I will testify to it.

Senator BROOKHART. What was the total number of shares of the bank?

Mr. RENTSCHLER. 5,500,000 shares.

Senator BROOKHART. And those shares were owned by the bank itself?

Mr. RENTSCHLER. Not at all. The National City Bank has never owned a share of its own stock so far as I know.

Senator BROOKHART. Well, how did you happen to be selling them?

Mr. RENTSCHLER. They were shares, so far as the National City Co. was concerned, that were bought from one person and sold to another.

Senator BROOKHART. It was not the bank making the sales?

Mr. RENTSCHLER. No, sir. It was where the National City Co. sold to one stockholder, or rather sold for one stockholder who wanted to sell, to somebody else who wanted to become a stockholder, and the City Co. was the trading post past which those trades were made.

Mr. PECORA. Don't you know that the National City Co. always had a very extensive position during those three and a half years in the stock of the bank?

Mr. RENTSCHLER. I don't know what you would call extensive. I think some figures were furnished to you showing exactly what the net amount of stock was at the end of each month or at the end of each week.

Mr. PECORA. Don't you know that the company had a long position at the end of 1930 of 99,227 shares of the capital stock of the bank?

Mr. RENTSCHLER. Yes; that was one—well, I think that was the longest position we had probably had.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. That is a pretty extensive position, isn't it?

Mr. RENTSCHLER. That is a big position; yes, sir.

Mr. PECORA. And that was at the end of the three and a half year selling campaign in which very nearly 2,000,000 shares were disposed of.

Mr. RENTSCHLER. Yes, sir; and in which we had a most unsettled world-wide market situation such as we had ever had to deal with.

Mr. PECORA. Do you know that in 1929 alone the National City Co. acquired and disposed of approximately 1,355,000 shares of the bank's stock?

Mr. RENTSCHLER. If that is the figure that your accountants have taken from our records, all right.

Mr. PECORA. Well, that knowledge does not surprise you, does it?

Mr. RENTSCHLER. No.

Mr. PECORA. And it accords with your general knowledge?

Mr. RENTSCHLER. Yes; I knew it was a very large amount, because that was a period when there was a tremendous demand for bank stocks and a great deal was changing hands.

Mr. PECORA. Do you know of any single person or group that has traded in the bank's stock to any greater extent than the National City Co. during this period?

Mr. RENTSCHLER. Of my own knowledge I do not.

Mr. PECORA. You know that a national bank may not buy or sell its own shares.

Mr. RENTSCHLER. Yes, sir; I do.

Mr. PECORA. Do you consider that those provisions of the national banking act were violated in spirit if not in letter through this medium of its investment affiliate, called the National City Co., engaging in those transactions?

Mr. RENTSCHLER. I do not think so, either in spirit or in letter. But I think from the experience of that period we determined some time last year not to have a long position or a short position in National City Bank stock so far as the National City Co. was concerned, and to do nothing more with it than to simply fill orders as they come in, passing one customer's order over to somebody else to execute it.

Mr. PECORA. Don't you know that the National City Co. during this period of time was going out in the byways and highways soliciting customers for the stock of the bank?

Mr. RENTSCHLER. That may quite well be, because it seemed, looking back, that it was a very desirable thing for us to broaden our contacts, that is, for the banking institution to broaden its contacts to make it possible for more people to become stockholders in our bank. There were a great many collateral conditions flowing to the bank because of it, and it was prompted to let those shares be sold, and for a long while they proved to be one of the best investments that folks had. And I do not question at all that there was very broad selling of National City Bank shares.

Mr. PECORA. By the National City Co.?

Mr. RENTSCHLER. By the National City Co.; yes, sir.

Mr. PECORA. You do not regard that as in effect the selling or buying of bank shares by the bank itself?

Mr. RENTSCHLER. No, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Because in form at least it was done by the National City Co.

Mr. RENTSCHLER. Right. But in the light of experience I am perfectly willing to say to you I prefer that the National City Co. not sell shares.

Senator BROOKHART. Why did you do that if it was all right?

Mr. RENTSCHLER. I do not think any of us had foresight to see the great catastrophe that was coming across the world in this last two or three years, Senator Brookhart. I know I didn't have.

Senator BROOKHART. In a speech back in 1925 Senator Shipstead reasoned it out quite clearly, even then.

Mr. RENTSCHLER. Well, more power to him.

Senator BROOKHART. There was not apparently any power, because the financial crowd paid no attention to his good sense.

Senator FLETCHER. What was the peak of the National City Bank stock?

Mr. RENTSCHLER. How high did it go?

Senator FLETCHER. Yes.

Mr. RENTSCHLER. Sometime in September or October there were relatively few shares sold at somewhere around 575 to 580.

Senator FLETCHER. 1929?

Mr. RENTSCHLER. 1929. There were the peak months where the stock went up. I think it was around $400 a share somewhere in early August. All of these things the peak was in August or September or early October, where we had this very violent run up, and then came down, and in the beginning of November again it was selling down around two hundred and some odd dollars a share, $200 or $220 a share.

Mr. PECORA. Mr. Rentschler, what was the par value of the stock when it was selling at its peak of 578 or 579?

Mr. RENTSCHLER. $20 par.

Senator BROOKHART. $20; and it was selling for 500——

Mr. RENTSCHLER. $585; yes, sir.

Senator BROOKHART. It never could earn a return on that kind of price, could it?

Mr. RENTSCHLER. No; looking back at it now, it could not have.

Senator BROOKHART. Then why didn't you advise the poor people that were buying it of that fact? Why didn't you stop the sale of it at such exorbitant price as that?

Mr. RENTSCHLER. It was not our stock they were buying, Senator Brookhart. They were buying stock from each other. They were making their own market.

Mr. PECORA. When you say it was not your stock they were buying, what do you mean, Mr. Rentschler?

Mr. RENTSCHLER. If you have the figures there of what the National City Co. had net long at the end of each day or the end of each week during those months under discussion, why, that would show what proportion of the stock actually was owned by the National City Co. The balance of it, Mr. Pecora, would be the stock that was bought and sold during the day of the trading when one customer came to buy and the other customer came to sell.

Mr. PECORA. Don't you know something about the long or short position of the National City Co. in the stock of the bank, inasmuch as you yourself are president of the bank?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RENTSCHLER. I don't know it exactly, and I would have to refresh my mind.

Mr. PECORA. Well, don't you know approximately?

Mr. RENTSCHLER. Yes. The general policy was to keep within 5,000 shares one way or the other, but there were times when it went above that. I would not know without consulting the records again just how much it did go above that.

Mr. PECORA. For instance, it does not surprise you to learn, does it, that at the end of 1930 the City Co. had a position of nearly a hundred thousand shares of the stock?

Mr. RENTSCHLER. Yes. As I explained to you, that was a very unusual situation that came as a result of the 1930 situation.

Mr. PECORA. Do you know what its position is to-day in the stock?

Mr. RENTSCHLER. City Co.?

Mr. PECORA. Yes, sir.

Mr. RENTSCHLER. Why, they do not have a share left at the end of each month. City Co. has no City Bank stock and has not had any City Bank stock since about January 1, 1932. From that day on the City Bank has been out of business of carrying any City Bank stock for its own account.

Mr. PECORA. Why was it necessary for the National City Co. under any circumstances to be long of the stock if it was merely acting as a broker?

Mr. RENTSCHLER. They were long with what in comparison was a small amount. They really, as a matter of fact, should have had very little stock. It was the general policy for years to keep very little.

Mr. PECORA. Do you mean to say that a long position on a hundreed thousand shares was——

Mr. RENTSCHLER. Now, Mr. Pecora, the hundred thousand shares that you keep mentioning, sir, is the result of 1930, and if you will be good enough to take the figures that you have I will be glad to give that to you if I can.

Mr. PECORA. Well, for instance, prior to the break in the market in October, 1929, according to the examination by our accountants, the long position of the company in the stock of the bank on the 1st of February, 1929, reached as high as 77,000 shares.

Mr. RENTSCHLER. Yes. Well, now, that——

Mr. PECORA (interposing). That was months before this abnormal condition which was precipitated in October.

Mr. RENTSCHLER. Yes. I will be glad to explain that to you, sir. That was at a time when a new issue of stock of the City Bank came out, in February, I think, of 1929. It was authorized at the stockholders' meeting of January, 1929, and at that time, as at each other time when there was an increase in the shares of the bank, rights are traded in, and this represented the accumulation of rights during that period, and this stock again was disposed of as promptly as possible, and you will find here, if you consult these other figures—take, for instance, here when you come back to July of 1929, July the 5th, you get 9,500 shares, you go back to a comparative day in June, June 7, and there were 8,170 shares; for May 3, 7,811 shares; on April 25, 24,679 shares; on March 1, there were 23,607. That was the beginning of the run-off of the new rights.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. Let me ask you there: Did this National City Co. buy stock of the bank at the same time it was selling these stocks?

Mr. RENTSCHLER. They were selling shares that had come by reason of rights. Yes; they would be buying and selling both, because they would be doing one thing for one customer and the other for the other customer.

Senator BROOKHART. As long as they had shares and tried to favor the customer, they did not need to buy any to supply the demand, did they?

Mr. RENTSCHLER. In the normal trading, Senator Brookhart, they would be doing something else.

Senator BROOKHART. That is, this trading to make a market or affect the price?

Mr. RENTSCHLER. No, no. A man running a grain elevator, Senator Brookhart, will buy corn and bring it in and sell it, and someone else will buy it.

Senator BROOKHART. We haven't any schemes like that in the corn business, among the farmers; I know that.

Mr. RENTSCHLER. The same process goes on, because corn comes into one side and goes out the other—you are buying and selling all the time, and that is exactly what takes place in every commodity.

Senator BROOKHART. Our corn does not get juggled until it gets in to the board of trade.

Mr. PECORA. Mr. Rentschler, in this large volume of trade in the bank's stock in which the City Co. was engaged, do you know whether it assumed the relationship of a broker or a principal to those trades?

Mr. RENTSCHLER. Oh, it was a principal in those trades, Mr. Pecora.

Mr. PECORA. Did not charge brokerage?

Mr. RENTSCHLER. Now I don't think so.

Mr. PECORA. You don't think so?

Mr. RENTSCHLER. No; I don't think so. Somebody here can tell me. Just a block or so.

Senator FLETCHER. It was testified this morning that the National City Co. had some 350 branches of separate agents throughout the country.

Mr. PECORA. No; salesmen.

Mr. RENTSCHLER. No; 56 branches, Senator Fletcher, and there are 350 salesmen who work from those branches.

Senator FLETCHER. Did they all work on commission?

Mr. RENTSCHLER. No; they worked on salary and commission both.

Mr. PECORA. For a while during this 3½-year period that I have already mentioned, you know, don't you, that the salesmen of the National City Co. were given an additional premium upon any sales of the bank's stock which they made?

Mr. RENTSCHLER. I knew there were premiums for certain periods. I don't know whether that was a general rule or not, Mr. Pecora.

Mr. PECORA. At certain times——

Mr. RENTSCHLER. That may be well so.

Mr. PECORA. They were given a premium for effecting sales of the bank's stock?

Mr. RENTSCHLER. Part of their compensation was in premiums they received in the selling of all kinds of securities, and it may well

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

be that they might have received premiums on the City Bank's stock, although as to that I have no immediate or personal recollection.

Mr. PECORA. You are not an officer of the National City Co., are you?

Mr. RENTSCHLER. No; I am not.

Mr. PECORA. As president of the bank did you give any instructions or directions to the employees of the bank in any of its branches to sell stock of the bank for the account of the National City Co.?

Mr. RENTSCHLER. Branch of the bank managers? No.

Mr. PECORA. Are you quite sure of that, Mr. Rentschler?

Mr. RENTSCHLER. The managers or the bank officers themselves directly are not selling stock of any kind. It may be that there may be instances where a branch officer might find a customer who wanted to buy this or that and he would turn him over to a City Co. man to effect the sale.

Mr. PECORA. Did he get a commission on those sales?

Mr. RENTSCHLER. No, sir.

Mr. PECORA. Are you sure of that?

Mr. RENTSCHLER. Absolutely. No bank officer would have any right so far as I know to get it.

Senator FLETCHER. Has the National City Bank branches throughout the country?

Mr. RENTSCHLER. No; the National City Bank has branches in the city of New York, as permitted under the national banking act. We have 75 branches in Greater New York now. In addition to that we have branches scattered around the world in various countries, as permitted under the Federal reserve act of 1913.

Mr. PECORA. At annual meetings of the shareholders of the bank has it been the custom in recent years to submit to them a report of the operations of the National City Co., its investment affiliate?

Mr. RENTSCHLER. Yes. Mr. Mitchell, the chairman, at each annual meeting for a number of years has given the shareholders the essential story of the operation of the City Co., and that has been incorporated and printed in the annual reports. To that extent the report has been made to them.

Mr. PECORA. I have before me what is described as the annual report of the National City Co. and its subsidiary corporations for the year ended December 31, 1929, summarizing the operating results and various activities of the year, and on the last page thereof appears this statement:

> With the closing of our Jacksonville (Fla.) office 69 district and representative offices were in operation at the year end, all served either directly or indirectly by our private-wire system of 11,386 miles. Sales facilities are also available at 26 of the bank's Greater New York City branches, each connected with our home office by private line, telephone, or teletype service.

Mr. RENTSCHLER. That was the end of 1929.

Mr. PECORA. This is the report for the year 1929.

Mr. RENTSCHLER. That has all been done away with.

Mr. PECORA. I have not asked you about that.

Mr. RENTSCHLER. Oh, I beg your pardon.

Mr. PECORA. Let me read further.

Mr. RENTSCHLER. I am sorry.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Reading where you interrupted me:

This makes a total of 95 points offering National City Co. facilities to investors through its own staff, proof of the excellent service rendered for our account by bank employees at offices where City Co. men are not yet located.

Did you hear that report made?

Mr. RENTSCHLER. Yes; I am familiar with that.

Mr. PECORA. Did that bring home to you knowledge for the first time that the employees of the bank were supplementing the selling efforts of the sales force of the company in the sale of securities in which the company was engaged?

Mr. RENTSCHLER. Yes; they would take orders for them, unquestionably.

Mr. PECORA. I did not ask you if they would take orders; I asked you if you learned for the first time that that was being done.

Mr. RENTSCHLER. No.

Mr. PECORA. Well, you knew of it currently, didn't you?

Mr. RENTSCHLER. Certainly.

Mr. PECORA. Was that done with your consent and knowledge and approval as president of the bank?

Mr. RENTSCHLER. Yes. I knew that was the practice.

Mr. PECORA. You approved of it?

Mr. RENTSCHLER. Surely.

Mr. PECORA. And you knew that the National City Co. was paying commissions and bonuses and premiums to the employees of the bank——

Mr. RENTSCHLER. No.

Mr. PECORA. In so far as they rendered service for the City Co. in selling its securities to the public?

Mr. RENTSCHLER. No. If there was any compensation given for that it was given to the credit of the bank and not to the credit of any individual. That is the reason I said that no officer of the bank was receiving compensation because of his sales of securities.

Mr. PECORA. That is, the branch of the bank got the benefit of those commissions?

Mr. RENTSCHLER. Of those commissions.

Mr. PECORA. If any were paid?

Mr. RENTSCHLER. If any were paid.

Mr. PECORA. And the branch accounted to the bank for them, is that it?

Mr. RENTSCHLER. Exactly. There would be nothing to the individual.

Mr. PECORA. So that the bank profited through commissions on those sales?

Mr. RENTSCHLER. If there was any profit awarded to anybody it would be to the bank, but I don't know, I would have to look that up to see exactly how that was handled.

Mr. PECORA. I think you were asked before by Senator Brookhart what was the capital of the National City Bank in 1929.

Mr. RENTSCHLER. I answered that—5,500,000 shares.

Mr. PECORA. With a par value of $110,000,000?

Mr. RENTSCHLER. That is right, $110,000,000.

Mr. PECORA. Do you know what the market value of those shares was in September, 1929?

Mr. RENTSCHLER. It was a lot more than that. In September?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Yes. sir.

Mr. RENTSCHLER. Roughly, $500 a share.

Mr. PECORA. Yes, sir. That made a market value of around two and three-fourth billion?

Mr. RENTSCHLER. Yes, sir.

Mr. PECORA. What was the book value at that time? Can you tell us?

Mr. RENTSCHLER. Let me see—I would only have to guess at that.

Mr. PECORA. Your best guess is what?

Mr. RENTSCHLER. Not over $70 a share, $60 to $70 a share.

Mr. PECORA. 60 or 70—around $70 a share?

Mr. RENTSCHLER. Around $70 a share. So that the market was seven times book value if you want to put it that way.

Senator BROOKHART. Do you think it is right for the Government of the United States to charter a bank or permit a market that will kite its stock up to levels like that?

Mr. RENTSCHLER. Well, Senator Brookhart, it all depends on whether you say we permitted the market to go up. I can not answer that question.

Senator BROOKHART. You were, through your affiliates, part of the great organizations that were boosting all these prices of all these securities?

Mr. RENTSCHLER. Senator Brookhart, these prices of securities and of values all over the world were being boosted by the competition of men to get these things that somebody else had. It was away beyond the ability of anybody connected with the National City Bank. As a matter of fact, it was away beyond the ability of anybody connected with the banking system of this country. We had no control over that.

Senator BROOKHART. Do you think it is right for the charter banks to assist in that kind of a performance? (No response.)

Senator FLETCHER. What dividends did the bank pay?

Mr. RENTSCHLER. $4 a share.

Mr. PECORA. Mr. Rentschler, $70 a share, the highest figure you mentioned as the book value of the capital stock of the bank in September, 1929, would give us $385,000,000, and the market value then was upwards of $3,200,000,000?

Mr. RENTSCHLER. Right.

Mr. PECORA. I have no further questions to ask him, Mr. Chairman.

The CHAIRMAN. You may be excused from further attendance.

Mr. RENTSCHLER. Thank you very much.

Mr. PECORA. Mr. Chairman, Senator Brookhart has asked that Mr. Mitchell resume the stand, as he wants to ask him two or three questions.

The CHAIRMAN. Very well; Mr. Mitchell. After which we will probably recess till to-morrow.

FURTHER TESTIMONY OF CHARLES E. MITCHELL, CHAIRMAN THE NATIONAL CO., THE NATIONAL CITY BANK OF NEW YORK, CITY BANK FARMERS TRUST CO., AND INTERNATIONAL BANKING CORPORATION, NEW YORK CITY

Senator BROOKHART. You stated, Mr. Mitchell, as I recollect, that the National City Co. handled some twenty billions of securities and

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

that only about 1,000,000,000 were in default or that you had trouble with or something of that kind?

Mr. MITCHELL. Yes. I have not attempted to get a clean checking on that. In fact, I do not think we can do it until we get back, but in general——

Senator BROOKHART. You can not tell exactly.

Mr. MITCHELL. No. That figure of $20,000,000,000 is apparently the figure of the originations and the participations by ourselves in these securities issued by others.

Senator BROOKHART. One billion of that, you say, has turned out bad?

Mr. MITCHELL. It is something less than that.

Senator BROOKHART. How about the other nineteen billions? Haven't they depreciated a third or half or more?

Mr. MITCHELL. Oh, no. A great deal of that has already been paid off. It is matured and paid.

Senator BROOKHART. Well, how about the stocks?

Mr. MITCHELL. Well, of course, the stocks——

Senator BROOKHART. They are included in that, aren't they?

Mr. MITCHELL. They would be included in the total; yes.

Senator BROOKHART. And they have all depreciated enormously?

Mr. MITCHELL. Oh, yes.

Senator BROOKHART. So that that 1,000,000,000 you mentioned would only be a little fraction of what the public has lost by dealing in these twenty billions?

Mr. MITCHELL. A great deal of it, of course, that the public paid less for than the par value. It has been paid off at par value. A great deal of it has been called at premiums.

Senator BROOKHART. That would be bonds?

Mr. MITCHELL. Yes; that is bonds; and it applies to some extent to stocks, to preferred stocks, Senator Brookhart, that have been retired. I think of one case offhand where a stock I think was put out at 45 and several millions of it retired later at 55.

Senator BROOKHART. All of that portion that you have handled since 1929, that has been a loss to the people that purchased it?

Mr. MITCHELL. I do not think that we have generally offered common stocks since 1929.

Senator BROOKHART. I believe that is all.

Mr. PECORA. Will the Chairman direct the witnesses still under subpœna to attend to-morrow morning?

The CHAIRMAN. Mr. Mitchell, you are excused until to-morrow morning at 10 o'clock. All who are under subpœna will remain here until they are excused and will return here at 10 o'clock to-morrow morning. The committee will now adjourn until to-morrow morning at 10 o'clock.

(Accordingly, at 3.57 o'clock p. m., the committee adjourned, to meet again at 10 o'clock a. m. of the next day, Thursday, February 23, 1933.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

STOCK EXCHANGE PRACTICES

THURSDAY, FEBRUARY 23, 1933

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

The subcommittee met, pursuant to adjournment on yesterday, at 10 o'clock a. m., in room 301 Senate Office Building, Senator Peter Norbeck presiding.

Present: Senators Norbeck (chairman), Townsend, Fletcher, and Costigan.

Present also: Senator Brookhart.

Further present: Ferdinand Pecora, special counsel to the committee; Julius Silver and David Saperstein, associate counsel to the committee.

The CHAIRMAN. The subcommittee will come to order. Mr. Pecora, who will you have first this morning?

Mr. PECORA. Call Mr. Baker.

The CHAIRMAN. Mr. Baker, please stand, hold up your 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 under investigation by this subcommittee, so help you God.

Mr. BAKER. I do.

TESTIMONY OF HUGH B. BAKER, NEW YORK CITY, PRESIDENT NATIONAL CITY CO.

Mr. PECORA. Mr. Baker, will you kindly give your full name, residence, and business or occupation?

Mr. BAKER. Hugh B. Baker, 834 Fifth Avenue, New York City; president National City Co.

Mr. PECORA. How long have you been president of the National City Co.?

Mr. BAKER. Since April of 1929.

Mr. PECORA. Before that were you connected with the National City Co. in any other capacity?

Mr. BAKER. Well, I was vice president.

Mr. PECORA. How long had you been vice president?

Mr. BAKER. Well, for several years. I am not exactly sure of the year, but probably 1917 or 1918.

Mr. PECORA. When you became a vice president of the National City Co., did you also become a member of its board of directors?

Mr. BAKER. No, sir.

Mr. PECORA. When did you first become a member of its board of directors?

Mr. BAKER. In 1929.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. What is the business generally of the National City Co.?

Mr. BAKER. Dealing in investment securities.

Mr. PECORA. You have heard the preceding witnesses testify this week?

Mr. BAKER. Yes, sir.

Mr. PECORA. I ask you that in order to save time. The other witnesses whom you have heard testify have been questioned with regard to the business of the National City Co. and its affiliation with the National City Bank. Is there anything that you want to add to what those witnesses testified to on that subject?

Mr. BAKER. I think not, Mr. Pecora.

Mr. PECORA. Now, among the securities sold by the National City Co. was there included the capital stock of the National City Bank?

Mr. BAKER. Yes, sir.

Mr. PECORA. Did you hear the testimony of Mr. Gordon S. Rentschler, president of the National City Bank, yesterday afternoon?

Mr. BAKER. Yes, sir.

Mr. PECORA. Did you hear him testify, either in words or in substance, to the effect that the National City Co. in selling the capital shares of the National City Bank to the public, sold as principal instead of as broker?

Mr. BAKER. Well, I do not remember the exact statement he made, but I think in substance that is it.

Mr. PECORA. In substance he testified that in connection with the selling of that stock the National City Co. went into the market and bought the stock which it had sold, or which it needed to fill the buying orders it had received from the public.

Mr. BAKER. That is right.

Mr. PECORA. Was that testimony substantially correct?

Mr. BAKER. I think so.

Mr. PECORA. In other words, whatever shares the National City Co. bought were bought for the purpose of meeting orders which it had received from customers for the stock.

Mr. BAKER. Well, do you mean received prior to the time it was bought?

Mr. PECORA. Yes.

Mr. BAKER. No; that is not quite it.

Mr. PECORA. That is what I understood Mr. Rentschler's testimony to mean. Do you ascribe a different meaning to that testimony of Mr. Rentschler's?

Mr. BAKER. Well, I did not understand it that way, Mr. Pecora. That would mean that we had orders definitely in hand for any amount of stock that we might have purchased.

Mr. PECORA. What do you understand was the fact in that respect?

Mr. BAKER. Well, I did not quite get the question, Mr. Pecora, as it relates to the former question.

Mr. PECORA. Let me ask it in this way: How many shares, all told, of National City Bank stock were sold to the investing public by your company in the year 1929?

Mr. BAKER. Of the total number of shares sold I can not differentiate as between the investment public and dealers. I do not know how those individual amounts might be, but the total amount sold to dealers, investors, and everybody, was 1,359,000 shares.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Now, at the time when your company made the sales which aggregated that total, did it have the stock on hand or did it go out into the market in turn and buy the stock with which to fulfill those sales?

Mr. BAKER. We bought the stock.

Senator BROOKHART. Before or after the sales?

Mr. BAKER. Well, Senator, in some cases it might have been before—yes; always before, I should say. The exact balance of the buying orders may not have coincided exactly with the transaction.

Senator BROOKHART. You bought the stock and then went out to sell it, is that it?

Mr. BAKER. Well, the buying and selling was going on concurrently.

Mr. PECORA. From the large volume of sales in that stock made by your company in 1929 I fancy that the sales it was making every business day during that year were quite large, is that correct?

Mr. BAKER. Well, I do not know about every business day, and of course I have not those sales by days.

Senator FLETCHER. Did you buy and sell on the stock exchange?

Mr. BAKER. No, sir. Those shares were not listed on the stock exchange.

Mr. PECORA. They had been listed prior to 1929? That is to say, until January of 1928, hadn't they?

Mr. BAKER. Yes, sir.

Mr. PECORA. They had been listed for many years prior to January of 1928 on the New York Stock Exchange, hadn't they?

Mr. BAKER. Well, I do not know for how many years, but I assume that is correct.

Mr. PECORA. And they were taken from the listing on the exchange in January of 1928 after the National City Bank had requested that to be done. Do you know that to be a fact?

Mr. BAKER. Yes; that is approximately correct.

Mr. PECORA. Do you know that the request of the National City Bank to remove its shares from the trading list of the New York Stock Exchange was made back in July of 1928 originally, and that the exchange authorities refused to accede to the request at first? Do you recall that, Mr. Baker?

Mr. BAKER. Well, I do not recall that date exactly, Mr. Pecora. I do not think that was the date, as a matter of fact.

Mr. PECORA. It was several months prior to January of 1928 that the bank requested the exchange to strike its shares from the trading list.

Mr. BAKER. Yes; but I understood you to say in July of 1928. Of course I don't remember that date.

Mr. PECORA. If the date was not in July it was several months prior to January of 1928?

Mr. BAKER. Well, if so, I do not know about that.

Mr. PECORA. Well, I will get the specific dates.

Mr. BAKER. All right.

Mr. PECORA. Senator Fletcher asked you if your company bought through the exchange the shares of bank stock which it sold to the public in 1929, and your answer was that it was then not listed.

Mr. BAKER. That is right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Will you state how the National City Co. acquired the 1,359,000 shares of that stock which it sold in 1929?

Mr. BAKER. Well, I can only approximate it because I haven't any records to show how much stock we may have purchased directly from holders of stock, because we were maintaining bid and asked prices on the stock regularly, and whether the stock was offered to us for sale by dealers or whether it was offered by private individuals did not make any difference to us.

Mr. PECORA. Well, what was the fact in relation to that? From whom did you buy it principally?

Mr. BAKER. From individuals and dealers.

Mr. PECORA. Did the company ever have or maintain a long position in this stock during the year 1929?

Mr. BAKER. Yes.

Mr. PECORA. Did it always maintain a long position in the stock during that year?

Mr. BAKER. Yes, sir.

Mr. PECORA. Are you sure of that?

Mr. BAKER. Well, according to my records here I think that is right.

Mr. PECORA. According to your records, what was the long position of the company in the shares of the National City Bank at the end of January of 1929?

Mr. BAKER. Well, according to my figures that would be—I am not sure whether these figures are at the end of the month or at the first of the month, the figures that I have, but on February 1 they would show 21,500 shares.

Mr. PECORA. That you were long of?

Mr. BAKER. Yes.

Mr. PECORA. What was its long position on the 1st of March?

Mr. BAKER. 18,932 shares.

Mr. PECORA. And the 1st of April.

Mr. BAKER. 7,704 shares.

Mr. PECORA. The 1st of May?

Mr. BAKER. 8,692 shares.

Mr. PECORA. Now, did the company ever go short of the stock at any time after the 1st of April, 1929?

Mr. BAKER. I think not, sir.

Mr. PECORA. Will you see if you can make certain of that?

Mr. BAKER. Well, in my records by the month we did not.

Mr. PECORA. Did the company borrow any National City Bank stock in the month of April 1929, in order to cover a short position in the stock?

Mr. BAKER. I have not any record here to show that. I don't know.

Mr. PECORA. Apart from having any record, have you any recollection on that?

Mr. BAKER. No; I have not any recollection on that at all, Mr. Pecora. There were times during, perhaps that year, and I am not sure whether it was that year or not, where there were rights for the stock and where we may not have actually had the definite certificates of stock, but we had the right which when converted would produce the definite certificates of stock. And in the mean-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

time to facilitate deliveries of that stock we would borrow some stock.

Mr. PECORA. Do you recall whether the National City Co. borrowed any shares of National City Bank stock during the month of April, 1929, from anybody?

Mr. BAKER. No—Well, now, yes; I have a record here now which shows——

Mr. PECORA (interposing). Are you now answering on the basis of some paper that has been handed to you?

Mr. BAKER. Yes, sir.

Mr. PECORA. Since you started to answer my question in the negative?

Mr. BAKER. That is right.

Mr. PECORA. And the handing of that paper to you has served to refresh your recollection so that instead of making a negative answer to the question you are now about to make an affirmative answer, is that right?

Mr. BAKER. Well, in the first place, I answered you from my recollection. I did not know the answer to the question. According to this memorandum I am now trying to answer that question.

Mr. PECORA. And your answer will be as your recollection has been refreshed by that memorandum?

Mr. BAKER. Well, from this memorandum, and I am not depending upon my recollection now for this, you will understand.

Mr. PECORA. Mr. Baker, is your recollection generally good or bad?

Mr. BAKER. Well, I would not boast about it.

Mr. PECORA. Do you think your recollection generally is bad?

Mr. BAKER. Probably about the average.

Mr. PECORA. I do not know what the average is.

Mr. BAKER. Neither do I.

Mr. PECORA. I merely want to know the state of your recollection. Is it generally good or is it generally bad?

Mr. BAKER. I do not know how to answer that question, Mr. Pecora.

Mr. PECORA. You can not tell us whether you think you have a poor memory or a good one, is that it?

Mr. BAKER. No; I can not answer that question.

Mr. PECORA. What is the answer to the question as to whether or not the National City Co. borrowed any National City Bank stock in the month of April, 1929?

Mr. BAKER. According to this memorandum, on April 23 we borrowed 15,000 shares of National City Bank stock.

Mr. PECORA. Borrowed from whom?

Mr. BAKER. From Mr. Mitchell.

Mr. PECORA. Was it Mr. Mitchell who refreshed your recollection a moment or two ago by handing you that written memorandum?

Mr. BAKER. No. One of my associates here, who was behind me, and I do not know just who handed it to me.

Mr. PECORA. Had you completely forgotten about that transaction when I asked you about it?

Mr. BAKER. Well, as to the records on any particular date, Mr. Pecora, yes. I did not know what the date was at all.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Had you completely forgotten that the National City Co. had borrowed any bank stock in 1929 regardless of the period of the year, when I asked you about borrowing stock?

Mr. BAKER. Oh, I think I answered that question that we had.

Mr. PECORA. Now, with your memory refreshed by the memorandum handed to you, are you ready to give this committee the details of the transaction and the circumstances under which the National City Co. borrowed 15,000 shares of National City Bank stock from Mr. Mitchell in April, 1929?

Mr. BAKER. I wanted to see about those rights. Are they in here? [Apparently addressing the question to some associate.] Well, I do not find here the exact position of rights at that particular time. But there were rights which we had accumulated covering our sales entirely; and that is the time that we borrowed this stock from Mr. Mitchell.

Senator BROOKHART. What is the difference between that situation and what you would call a straight short sale?

Mr. BAKER. Well, that we had purchased those rights which called for stock.

Senator BROOKHART. At the same time?

Mr. BAKER. At some specific date.

Senator BROOKHART. But here now I mean: At the particular time when you needed this stock for delivery?

Mr. BAKER. That is right.

Senator BROOKHART. So you borrowed, and in fact at that particular moment you were short?

Mr. BAKER. I shouldn't say so, because otherwise if we had bought in the open market the actual stock, and at the same time bought these rights, which is the equivalent of a certain number of shares of stock, we would have doubled up our investment.

Senator BROOKHART. But those rights could not be executed at once, so you borrowed this stock; otherwise you would not have borrowed this stock.

Mr. BAKER. No; but there was a specific date, within a comparatively short time.

Senator BROOKHART. In the future, so that at that particular time you were short, regardless of those rights?

Mr. BAKER. It does not seem that way to me.

Mr. PECORA. When were the rights issued to which you have just referred?

Mr. BAKER. I cannot find that date.

Mr. PECORA. They were issued January 12, 1929, weren't they?

Mr. BAKER. Well, I just haven't got that figure right here.

Mr. PECORA. In other words, some three months or more before those 15,000 shares were borrowed.

Mr. BAKER. That may be entirely correct, Mr. Pecora, but I haven't got the date of those rights.

Mr. PECORA. And you say that the company had not obtained the stock in the exercise of those rights by April of 1929?

Mr. BAKER. Well, I am not trying to tie those dates together, because I do not recall the date when the rights were exercisable.

Mr. PECORA. Can you refresh your recollection on that, Mr. Baker, by any records or data you might have here?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. I thought there were some papers here on that, but I do not seem able to find them.

Senator FLETCHER. When were those 15,000 shares returned that you borrowed?

Mr. BAKER. They were returned July 10.

Senator FLETCHER. July 10, 1929?

Mr. BAKER. Yes, sir.

Mr. PECORA. Have you now consulted any data?

Mr. BAKER. Yes; but I have not got the date of that here, I am sorry to say. I can probably have it for you during the day.

Mr. PECORA. Mr. Law, the secretary of the company, is here in attendance, isn't he?

Mr. BAKER. Yes, sir.

Mr. PECORA. Can't you ascertain from him the date when the rights were issued? Isn't some officer of the company here who knows about that?

Mr. BAKER. Well, I don't know. I just asked him and he did not give me the date.

Mr. PECORA. Suppose you ask him now or ask some of those men who are right back of you.

Mr. BAKER. Well, as I understand that, the rights expired on February 15, but——

Mr. PECORA (interposing). Well, now, when were the rights issued?

Mr. BAKER. In January.

Mr. PECORA. Let us get it in chronological order.

Mr. BAKER. January 15.

Mr. PECORA. January 15, 1929?

Mr. BAKER. I think I am right about that.

Mr. PECORA. When did the right to exercise those rights expire?

Mr. BAKER. February 15, but——

Mr. PECORA (interposing). February 15, 1929?

Mr. BAKER. Yes.

Mr. PECORA. Did the National City Co. have any rights issued on January 15 which it had failed to exercise by February 15?

Mr. BAKER. Oh, yes; I think so.

Mr. PECORA. How many shares were affected by failure to exercise those rights?

Mr. BAKER. I am sorry to detain you in this way, but——

Mr. PECORA (interposing). I did not hear that.

Mr. BAKER. I say I am sorry to delay you in this way, but as I understand that transaction we did exercise the rights, but we held the stock.

Mr. PECORA. How is that?

Mr. BAKER. But we held a certain amount of stock on account of delays from all over the world of people who had the right to exercise or participate in those rights, we held it open for perhaps a couple of months or more.

Mr. PECORA. When you say " we held it open " whom do you mean by " we? "

Mr. BAKER. The National City Co. held this stock.

Mr. PECORA. The National City Co. had the right to acquire certain shares of National City Bank stock under the rights that it owned, on January 15, 1929, didn't it?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. That is right.

Mr. PECORA. How many shares did it have the right to acquire in the exercise of those warrants?

Mr. BAKER. Well, I haven't that figure, but I am assuming it covered this amount of stock which we bought.

Mr. PECORA. We do not want any assumptions on that. I do not know why you can not give us exact figures. Your records would show the exact situation, wouldn't they?

Mr. BAKER. Certainly.

Mr. PECORA. And the records are here, aren't they?

Mr. BAKER. Well, I do not think they are on that particular point.

The CHAIRMAN. If the records are not here, we will send for them.

Mr. BAKER. I will be glad to do that.

The CHAIRMAN. We must first know whether they are here or not. And we have got to progress better with this examination than we are now doing. With all of you here, it would not seem to be a fact that nobody knows anything about it. And the records are here, and you say you can not find it from the records. If there is anything missing, let us send for it. What is missing?

Mr. BAKER. Well, evidently the figures showing the exact amount of those rights that we had are missing.

Mr. PECORA. Mr. Baker, will you say now that prior to April, 1929, the National City Co. had permitted any of its warrants or rights to lapse?

Mr. BAKER. No; I think not.

Mr. PECORA. You stated before that the reason for borrowing those 15,000 shares from Mr. Mitchell in April, 1929, was in order to have that stock to take the place of stock which had not yet been issued to you in the exercise of your rights. Now, do you say that is not so?

Mr. BAKER. Well, I was incorrect in my date on that.

Mr. PECORA. All right. Then what was the real purpose for which the National City Co. borrowed 15,000 shares of the National City Bank stock from Mr. Mitchell in April of 1929?

Mr. BAKER. Well, that is the same as I said, in order to facilitate deliveries.

Mr. PECORA. To facilitate the delivery of what? Of shares the company had already sold?

Mr. BAKER. That is right, that were in the course of being sold day by day.

Mr. PECORA. In other words, the company had sold shares of bank stock which it had not owned or did not own and did not have on hand to deliver. Is that right?

Mr. BAKER. I do not think that is correct.

Mr. PECORA. Will you tell me what is correct?

Mr. BAKER. I have already said that we owned those rights covering a sufficient amount of stock to make those deliveries.

Mr. PECORA. You said that the rights had all been exercised prior to February, 1929.

Mr. BAKER. No, February 15.

Mr. PECORA. Yes, February 15, 1929. And the stock you borrowed from Mr. Mitchell was borrowed on April 25, 1929, wasn't it?

Mr. BAKER. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Nearly two and a half months after your company had exercised its rights, is that correct?

Mr. BAKER. Well, that would seem to be correct.

Mr. PECORA. So that if those 15,000 shares which were borrowed near the end of April, 1929, were needed, as you say, to facilitate the making of deliveries by the National City Co. to customers to whom it had sold National City Bank stock, wouldn't it be a fact that in making those sales the National City Co. had sold bank shares which it did not own and which it needed for delivery?

Mr. BAKER. No; I do not think so.

Mr. PECORA. Then, why was the stock of Mr. Mitchell borrowed for the purpose of facilitating delivery?

Mr. BAKER. Because the stock that we acquired through the exercise of rights were held for a substantial period in order to take care of stockholders' rights from various parts of the world that were delayed in reaching New York.

Mr. PECORA. Will you kindly produce a single record or book of your company which shows the amount of shares held in reserve for this purpose, for customers all over the world? See if you can do it.

Mr. BAKER. Well, I am sure I haven't those records here, but I can produce those records certainly.

Mr. PECORA. Where are they, in New York?

Mr. BAKER. Yes, sir.

Mr. LAW. No. I have them here.

Mr. PECORA. Well, then, why didn't you show those records to the committee's accountants?

Mr. BAKER. Well, I can not answer that. As I understand it, they had access to all these books. But I can not answer that.

Mr. PECORA. They had access merely to whatever books they called for.

Mr. LAW. Would I be permitted to answer that question?

Mr. PECORA. I do not know why the president of the National City Co. can not answer it.

Mr. BAKER. Here seems to be a record of that. There were unsubscribed shares at the close of that period, which was February 15, 1929, of 51,590 shares, which were delivered to the National City Co. against payment.

Mr. PECORA. When?

Mr. BAKER. I presume at that particular time.

Mr. PECORA. At what particular time?

Mr. BAKER. February 15.

Mr. PECORA. February 15, 1929?

Mr. BAKER. Yes, sir. That was the date we made payment. Those were held pending delayed subscriptions on the part of stockholders. And the last one of those subscriptions was received May 3, 1929.

Mr. PECORA. Do you mean received by the company or by the bank?

Mr. BAKER. Well, the company undertook in the interest of the stockholder who for one reason or another was delayed, or happened to be away, or did not get his rights in at just the proper time, to protect over a period of a reasonable time, two or three months.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And that was done voluntarily by the company?

Mr. BAKER. That is right.

Mr. PECORA. And did it protect all stockholders in that way?

Mr. BAKER. I think any stockholder who was delayed.

Mr. PECORA. With respect to those stockholders who, for any reason whatsoever, failed to exercise their rights—what happened? Did the National City Co. exercise the rights for them and get the stock?

Mr. BAKER. That is right.

Mr. PECORA. And how many shares did the National City Co. get for itself in that fashion, Mr. Baker?

Mr. BAKER. Well, at that time as I say there were delivered to us 51,590 shares.

Mr. PECORA. Now, let me see—those rights expired on February 15, 1929?

Mr. BAKER. That is right.

Mr. PECORA. Those rights attached to all the outstanding shares of the capital stock of the National City Bank at that time; is that right?

Mr. BAKER. That is right.

Mr. PECORA. And the holders of those shares were scattered all over the world; is that right?

Mr. BAKER. That is right.

Mr. PECORA. And the National City Co. gratuitously undertook to protect those shareholders in remote parts of the world for a certain period of time, without any request from those shareholders to do that for them; is that it?

Mr. BAKER. That is right.

Mr. PECORA. And in doing that the National City Co. was enabled to acquire thousands of shares under those rights belonging to other shareholders who had permitted them to lapse; is that right?

Mr. BAKER. That is not quite correct.

Mr. PECORA. Well, in what way is it not quite correct? Give us a correct statement about that.

Mr. BAKER. The correct statement is, that at the expiration, at that time——

Mr. PECORA (interposing). What time are you referring to?

Mr. BAKER. The last subscription was received May 3, 1929, and the balance left unsubscribed was 437 shares.

Mr. PECORA. What happened then?

Mr. BAKER. They were purchased at the price.

Mr. PECORA. And you purchased only 437 shares under the preferential rights?

Mr. BAKER. That was the net result of it.

Mr. PECORA. And the other shares which you acquired were acquired for the benefit and account of those shareholders all over the world?

Mr. BAKER. That is right.

Mr. PECORA. How many shares were so acquired and held?

Mr. BAKER. Well, it seems to me that gets back to the figure I gave you before.

Mr. PECORA. And what figure is that?

Mr. BAKER. 51,590 shares.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Are you now testifying that that is the number of shares your company acquired and held in trust for those shareholders all over the world?

Mr. BAKER. I do not quite understand your term, "held in trust." We had the stock; yes.

Mr. PECORA. Well, what were you holding them for? Did you hold them for the account of your company?

Mr. BAKER. We bought the stock and we held it to take care, as I say, of delayed subscriptions from stockholders.

Senator BROOKHART. Let me ask this question right there: Was the price of this stock greater or less at this period than those shareholders had agreed to pay for them?

Mr. BAKER. The stock had advanced in price.

Senator BROOKHART. Above the agreement of the stockholder?

Mr. BAKER. That is right.

Mr. PECORA. When did your company receive those 51,590 shares?

Mr. BAKER. Well, we paid for them on February 15, 1929.

Mr. PECORA. When did the company receive them?

Mr. BAKER. I suppose on the same day.

Mr. PECORA. How long did the company hold those shares?

Mr. BAKER. Of course, they were not held as a whole until any specific date, because, as those rights came in, we were assigned that stock.

Mr. PECORA. Wasn't the company also using that stock for the purpose of filling orders which its salesmen had received for the purchase of National City Bank stock?

Mr. BAKER. Well, I do not know that the particular block of stock was segregated from any other stock.

Mr. PECORA. What was the long position of the company in the stock of the bank on February 28, 1929?

Mr. BAKER. Well, I can not give it to you on that date.

Mr. PECORA. Well, give it to me on the 1st of March.

Mr. BAKER. On the 1st of March it was 26,781 shares, I think.

Senator TOWNSEND. Then you had sold a part of those 51,590 shares in that interim?

Mr. BAKER. You see, these people had sent their rights in and we were delivering stock against those delayed rights. It was merely an accommodation to them, to protect them from losing their privilege.

Senator TOWNSEND. Were they given stock at the same price at which the rights were subscribed for?

Mr. BAKER. Yes.

Mr. PECORA. Did the company keep a special account or record at that time of the shares it had acquired for the account of those shareholders all over the world who had failed to exercise their rights?

Mr. BAKER. I do not know how we accounted for them on our books, whether it was kept in a special account or not, but we were prepared to deliver the stock.

Mr. PECORA. Well, now, you just consulted Mr. Law, the secretary of the company.

Mr. BAKER. And he tells me it was held in a separate subscription account.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Will you ask Mr. Law to give you a transcript of that subscription account so that you can testify with respect to it? Will you do that, Mr. Law?

Mr. LAW. I haven't that with me, but will be glad to get it by telephone.

Mr. PECORA. Have you any recollection of the account, Mr. Law?

Mr. LAW. I know the account was opened and held open until the subscriptions were filled, some time in May, May 3.

Mr. PECORA. Mr. Chairman, may I suspend the examination of Mr. Baker for the moment and put Mr. Law on the stand, to see what evidence he can give us?

The CHAIRMAN. Yes.

Mr. PECORA. Just change seats, Mr. Law.

Senator FLETCHER. Mr. Law, please stand, hold up your 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 this subcommittee, so help you God.

Mr. LAW. I do.

TESTIMONY OF HARRY S. LAW, SECRETARY NATIONAL CITY CO., NEW YORK CITY

Mr. PECORA. Mr. Law, please give your full name, address, and business or occupation.

Mr. LAW. Harry S. Law, secretary, The National City Co., 55 Wall Street, New York City; residence, No. 28 Outlook Place, Glen Ridge, N. J.

Mr. PECORA. What is your business?

Mr. LAW. Secretary of the National City Co.

Mr. PECORA. How long have you been its secretary?

Mr. LAW. Since March, 1931.

Mr. PECORA. Were you connected with the company prior to March, 1931?

Mr. LAW. I have been with the organization for 14 years.

Mr. PECORA. What was your position in the organization immediately prior to March, 1931?

Mr. LAW. Comptroller.

Mr. PECORA. As its comptroller did you have charge of its records and books of accounts?

Mr. LAW. I did.

Mr. PECORA. You heard the testimony of Mr. Baker, the witness who preceded you?

Mr. LAW. Yes, sir.

Mr. PECORA. He referred in his testimony to certain subscription rights which the National City Co. exercised between January 15 and February 15, 1929, in connection with the capital stock of the National City Bank.

Mr. LAW. Yes, sir.

Mr. PECORA. Did you hear his testimony?

Mr. LAW. Yes, sir.

Mr. PECORA. Are you familiar with that subject?

Mr. LAW. Yes, sir.

Mr. PECORA. Can you testify from your recollection concerning the extent to which the National City Co. exercised those rights, the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

extent to which it acquired stock by the exercise of those rights, and what it did with the stock so acquired?

Mr. LAW. In connection with each capital increase of National City Bank, the National City Co. underwrites the unsubscribed shares, which are held subject to subscriptions.

Mr. PECORA. Talk a little louder.

Mr. LAW. In connection with each capital increase of the National City Bank, the National City Co. underwrites the unsubscribed shares and holds them subject to future subscriptions or delayed subscriptions of people who are abroad or ill or for some other reason have failed to exercise on the expiration date.

Mr. PECORA. That is done by the company gratuitously?

Mr. LAW. Yes, sir.

Mr. PECORA. That is not done at the request of those shareholders who might be ill or in remote parts of the world, is it?

Mr. LAW. Indirectly; yes.

Mr. PECORA. All right, go ahead and tell us about this subscription account.

Mr. LAW. In addition to the shares taken over under that agreement we are entitled to the rights on our own position in this stock at the time the rights are issued.

Mr. PECORA. Yes; go ahead.

Mr. LAW. So that the stock we received on the date of issue is a combination of the unsubscribed shares on the part of shareholders, and our own amount as represented by the stock in our inventory. We acquired in connection with the unsubscribed shares, 51,590 shares.

Mr. PECORA. How many?

Mr. LAW. 51,590 shares.

Mr. PECORA. When did the National City Co. get those shares?

Mr. LAW. February 15, 1929.

Mr. PECORA. Yes. And how many of those shares did it get under its subscription for its own account? That is, upon shares of stock that the National City Co. itself held?

Mr. LAW. Whatever we received, Mr. Pecora, would be in addition to the 51,590 shares. Those are shares not subscribed by stockholders other than the National City Co. in its capacity of dealer. I mean by that that we were entitled to rights on the shares which we held in our own portfolio momentarily at the effective date.

Mr. PECORA. How many shares was the National City Co. entitled to subscribe for, and how many shares did it subscribe for under the warrants or rights attaching to its own shares of capital stock of the National City Bank in January of 1929?

Mr. LAW. I have not before me the number of rights issued, but we did have a balance on January—well, the nearest date is January 11, and I suppose our next day's balance was not materially changed—we did have 10,579 shares on which we would be entitled to rights to subscribe for the new stock.

Mr. PECORA. Well, to subscribe for how many shares of new stock?

Mr. LAW. As I say, I have not the ratio of exchange before me.

Senator TOWNSEND. You do not remember the number of rights given to each share?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. LAW. No, sir; I do not. I am sorry, but I will be glad to get that.

Mr. PECORA. The ratio was 5 shares of the new stock, having a value of $20, for every 9 shares of the old stock having a par value of $100, was it not?

Mr. LAW. I think that is correct, Mr. Pecora, as I recall it.

Mr. PECORA. So that if the company had 10,579 shares of the old stock on hand on January 15, how many shares of the new stock was it entitled to subscribe for under these rights?

Mr. LAW. Five ninths.

Mr. PECORA. Which at that rate would be five-ninths of 10,579 shares——

Mr. LAW. That is approximately it.

Mr. PECORA. Something around 6,000 shares?

Mr. LAW. Yes.

Mr. PECORA. How many subscriptions did the National City Co. make and exercise on the rights attached to shares of stock held by others, sick or remote from the city of New York?

Mr. LAW. Out of the 51,590 shares received for that particular purpose all but 437 shares were subscribed.

Mr. PECORA. When were those shares received under those subscriptions by your company?

Mr. LAW. You refer to the 51,590 shares?

Mr. PECORA. Yes.

Mr. LAW. They were received on February 15, 1929.

Mr. PECORA. And what did the company do with those shares?

Mr. LAW. They set up a special account entitled "Subscription account," which was held open until the last subscription was accepted in May 1929.

Senator FLETCHER. Was the company dealing in the stock all this while outside of this fund?

Mr. LAW. Yes, sir.

Senator FLETCHER. Buying and selling?

Mr. LAW. We filled orders as they came to us, Senator Fletcher; yes.

Senator TOWNSEND. During this period you borrowed this 15,000 shares from Mr. Mitchell?

Mr. LAW. Yes, sir.

Senator TOWNSEND. If you had 51,000 shares delivered to you what was the necessity for borrowing 15,000?

Mr. LAW. Senator, we know that there are always people who delay their subscriptions, and it would not be fair to them, if they are ill or abroad and not able to exercise their rights——

Senator TOWNSEND. Could you not have just as well delivered a portion of these shares?

Mr. LAW. Then we would have been unable to fill the subscriptions from the people who were legitimately entitled to these particular shares.

Senator BROOKHART. Did you get those shares at a less price than they paid for them?

Mr. LAW. No, sir; we took them at the subscription price.

Senator BROOKHART. They took them at the subscription price?

Mr. LAW. They pass hands both ways, from the bank to us and from the National City Co. to the subscriber.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. Then you got them on the 15th of February, the 51,000, and they advanced after that, and you got that profit then?

Mr. LAW. No, Senator. They were delivered to the subscribers at the original subscription price. The National City Co. made no profit whatever from those unsubscribed shares.

Senator BROOKHART. Then that would be the market price on the 15th of February?

Mr. LAW. No, sir; that would be the subscription price.

Mr. PECORA. The subscription price was less than the market price, wasn't it?

Mr. LAW. It was $100 a share, as I recall it, Mr. Pecora.

Mr. PECORA. And the market price was how much for the new shares at that time?

Mr. LAW. On February 15 the market was 319 to 348.

Senator BROOKHART. And you let them have it at 100?

Mr. LAW. They were subscribers, Senator, which was necessary under the original contract.

Senator BROOKHART. Did your company pay the price 300 and over on them?

Mr. LAW. No, sir. We paid the original subscription price to the bank.

Senator BROOKHART. I do not understand how you got that stock from the holders of it then when it was worth three times that much and more.

Mr. LAW. We got it directly from the bank, Senator, for the subscription price, and merely held it——

Senator BROOKHART. Oh, you got it from the National City Bank itself?

Mr. LAW. At the subscription price and as a service to the——

Senator BROOKHART (interposing). Regardless of the market price?

Mr. LAW. Yes, sir; under the orginal agreement. It was a service to holders who had not been able to subscribe for their shares due to illness or absence from the country or for some other cause.

Mr. PECORA. Now, Mr. Law, to make this thing clear: The holders of the $100 par value stock had the right on January 15, 1929, to subscribe for new stock which was to be issued on a $20 par value basis in this proportion; they had the right to subscribe for five shares of the new stock for every nine shares of the old stock they owned. Is that correct?

Mr. LAW. I think that is substantially correct, Mr. Pecora.

Mr. PECORA. Yes. That did not mean that there was to be an exchange of the old shares for the new, but merely that by virtue of their ownership of the old shares they had the right to subscribe at $100 each for five shares of the new stock for every nine shares of the old stock which they owned on the date when subscriptions closed, which was January 16; is that correct?

Mr. LAW. I think that is substantially correct, as I recall it. That was brought out, par $20.

Mr. PECORA. At what price were they entitled to subscribe for the new shares if they elected to exercise their rights?

Mr. LAW. $100.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. At $100?

Mr. LAW. Yes, sir.

Mr. PECORA. At that time what was the market value of the new shares for which the old shareholders were entitled to subscribe at $100 a share?

Mr. LAW. The quotation I have here for February 15, which is taken from the New York Times, is 319 bid and 348 asked.

Mr. PECORA. So that one in a position to exercise those rights could acquire for $100 a share, stock which had a market value of upwards of $300 a share. Is that correct?

Mr. LAW. Substantially.

Mr. PECORA. Now you say the National City Co. subscribed on behalf of such shareholders as were ill, or as might be in remote places of the world, for these new shares at $100 apiece?

Mr. LAW. No, Mr. Pecora. I said that the National City Co. had taken these up under an underwriting agreement and held them subject to subscription. We had no right to subscribe for holders who had failed to exercise their own rights.

Mr. PECORA. With whom was that underwriting agreement made?

Mr. LAW. With the National City Bank.

Mr. PECORA. How was the National City Co. to learn what shareholders had failed to exercise their right to acquire this new stock at $100 a share which then had a market value of more than $300 a share?

Mr. LAW. Through subscriptions which came in.

Mr. PECORA. Came in to whom?

Mr. LAW. The National City Bank.

Mr. PECORA. To the bank. And the bank gave the benefit of that information to the National City Co.; is that correct?

Mr. LAW. I believe the reason for that, Mr. Pecora——

Mr. PECORA (interposing). No. Is that correct? Is that what was done?

Mr. LAW. I think it should be qualified.

Mr. PECORA. Well, tell us what the fact is.

Mr. LAW. The National City Bank has no right to hold its own stock after the subscription date, as I understand it.

Mr. PECORA. Yes.

Mr. LAW. Therefore, it is necessary to have the stock transferred.

Mr. PECORA. Yes.

Mr. LAW. To some other medium.

Mr. PECORA. Yes.

Mr. LAW. At the time of the payment, the payment dated February 15.

Mr. PECORA. And the medium chosen was its affiliate, the National City Co., is that right?

Mr. LAW. Absolutely.

Mr. PECORA. The deliveries of stock to subscribers closed on February 15, 1929, is that correct?

Mr. LAW. To those who exercised their rights.

Mr. PECORA. To those who exercised their rights, deliveries of the new stock were made at $100 a share, when it was worth more than $300 a share.

Mr. LAW. Which is in accordance with the usual practice.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Yes, I know that is the practice; but those deliveries were made by the bank on February 15?

Mr. LAW. Correct.

Mr. PECORA. On that date how many shares of the new stock subscribed for at $100 a share were delivered by the bank to the National City Co. on those rights which had not been exercised by the record holders of the old stock?

Mr. LAW. I think I answered the question before that the unsubscribed shares were 51,590 delivered to us against payment on February 15, 1929.

Mr. PECORA. And did the company make payment for those 51,000 shares on February 15?

Mr. LAW. It did.

Mr. PECORA. Then what did the company do with those 51,000 and odd shares?

Mr. LAW. It segregated the shares in a subscription account, as I have previously testified, and held them until the last subscription came in.

Mr. PECORA. And when did the last subscription come in?

Mr. LAW. During May, 1929.

Mr. PECORA. What date in May?

Mr. LAW. The subscription was actually received on May 3. It always takes a few days to transfer the stock. I have not the exact date, but it was probably between the 3d and the 10th.

Mr. PECORA. Was a separate record kept of these 51,000 and odd shares for this subscription account?

Mr. LAW. The special subscription account was on the ledgers which your men examined.

Mr. PECORA. And you haven't this special subscription account with you, have you?

Mr. LAW. I am sorry, Mr. Pecora, but I was not asked to bring the books.

Mr. PECORA. How many shares of that subscription stock, so-called, did the National City Co. have long on February 28, 1929, if you can tell us.

Mr. LAW. I am sorry; without the books I haven't that, but I will be glad to get it if you wish, by telephone.

Senator FLETCHER. Did not the company charge these subscribers—say the person who put in his subscription in May—did not your company charge him interest from February to May and take service charges also?

Mr. LAW. No, Senator; these went directly to the subscribers at $100 a share. There was no profit or interest charge or carrrying charge of any kind to the National City Co., as far as I know. I would prefer to refresh my memory, but that is my recollection.

Senator FLETCHER. You were doing all this for the benefit of the shareholders. It would have been fair, would it not, to charge them interest for carrying them and service charges?

Mr. LAW. I am reminded that there may have been an interest charge. I would have to check. But we do perform a great many services without charge in our institution, which is usual in institutions such as ours and any commercial bank.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Mr. Law, were these 51,590 shares acquired for this subscription account held intact by the company from February 15 until some time in May, 1929?

Mr. LAW. The physical shares, Mr. Pecora, may have been merged with the regular shares of the organization.

Mr. PECORA. And sold to the public?

Mr. LAW. Undoubtedly used to fill orders, because simultaneously we had purchases coming from all over the world which would be used to replace these shares.

Mr. PECORA. Then the company used shares which it had acquired under these subscription rights for persons other than itself in order to make deliveries of capital stock of the bank which it had sold to the general public; is that correct?

Mr. LAW. We were not under any contract rights to deliver this to anyone at the time it was taken over.

Mr. PECORA. Will you please answer that question, Mr. Law?

Mr. LAW. It must be qualified, Mr. Pecora.

Mr. PECORA. What must be qualified, the question, or your answer?

Mr. LAW. My answer.

Mr. PECORA. Well, answer the question without qualification first, and then qualify it if you want to.

Mr. LAW. Will you please repeat the question?

Mr. RANDOLPH (shorthand reporter). "Then the company used shares which it had acquired under these subscription rights for persons other than itself in order to make deliveries of capital stock of the bank which it had sold to the general public; is that correct?"

Mr. LAW. That can not be answered yes or no.

Mr. PECORA. Why can't that be answered yes or no? It either did or did not do that.

Mr. LAW. This was not acquired under subscription rights. It was acquired under an agreement to take the unsubscribed stock over.

Mr. PECORA. I thought you said it was acquired on account of unsubscribed rights.

Mr. LAW. That is correct.

Mr. PECORA. Held by stockholders who might be ill or in remote places of the world?

Mr. LAW. That is correct.

Mr. PECORA. And whose rights the National City Co. wanted to protect?

Mr. LAW. That is right.

Mr. PECORA. Is that correct?

Mr. LAW. But——

Mr. PECORA (interposing). But after the City Co. acquired 51,000-odd shares of stock in that manner, for the protection of those shareholders as you say, did the National City Co. use any of that stock to make deliveries to those customers to whom it had sold National City Bank stock in the meantime?

Mr. LAW. It may have done so, but there was——

Mr. PECORA (interposing). Did it or did it not?

Mr. LAW. I haven't the slightest recollection without referring to the inventory of stock in our boxes.

Mr. PECORA. Can't you answer that question yes or no after consulting whatever records you have before you?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. LAW. The answer is yes, with the qualification that we had the right to use those shares because the subscribers had not exercised their rights at the time, and we were able to secure other shares to meet their rights as they came in.

Mr. PECORA. The shareholders for whose benefit the company exercised these subscription rights meanwhile were kept in ignorance of this gratuitous protection that the company was giving them, weren't they?

Mr. LAW. I would not say that, Mr. Pecora. They have done the same thing in every issue——

Mr. PECORA (interposing). Whether they did it before or since, the question is, were they kept in ignorance of this gratuitous protection that your company was giving them?

Mr. LAW (after apparently conferring with associates). My associates inform me that correspondence was carried on with these various stockholders who had not subscribed their rights in an endeavor to get them to subscribe during this period.

Mr. PECORA. And you had to be told that by your associates before you learned it?

Mr. LAW. These subscriptions, as you understand, were not——

Mr. PECORA (interposing). Mr. Law, won't you please answer the question put to you? Were you in ignorance of that up to the moment your associates gave you the information?

Mr. LAW. Not in complete ignorance, but I wanted confirmation of the thought that I had. The subscriptions came into the bank, which is what I started to tell you, but you just didn't wait.

Mr. PECORA. The subscriptions came into the bank?

Mr. LAW. Absolutely.

Mr. PECORA. The subscriptions on the rights which had already been exercised by the National City Co. came into the bank?

Mr. LAW. For the stock taken over by the National City Co. The rights had not been exercised because they were still held by the stockholders.

Mr. PECORA. The subscriptions which came into the bank after February 15, 1929, were the delayed subscriptions from these shareholders of record?

Mr. LAW. That is true.

Mr. PECORA. Other than the company?

Mr. LAW. That is true.

Mr. PECORA. Meanwhile the bank on February 15, 1929, had issued to the company these 51,000-odd shares under the subscription which the City Co. had made for those shareholders in default of the exercise of their rights; is that right?

Mr. LAW. Not for the subscription, Mr. Pecora, but under the agreement we took the shares and were prepared to let them exercise their subscriptions.

Mr. PECORA. When did the City Co. pay for those 51,000-odd shares?

Mr. LAW. On February 15, 1929.

Mr. PECORA. And it paid how much then?

Mr. LAW. $5,159,000.

Mr. PECORA. And what did it do with the 51,000 shares after that date?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. LAW. Held them subject to subscriptions, which subscriptions were received and filled, leaving a residue of 437 shares in the hands of the National City Co. representing unsubscribed shares.

Mr. PECORA. When was that residue left there?

Mr. LAW. As of May 3.

Mr. PECORA. Now, how many of those shares did it have as of April 15?

Mr. LAW. I haven't that exact date before me, Mr. Pecora.

Mr. PECORA. About?

Mr. LAW. The nearest date that I have was April 12, then it had eighteen or twenty thousand shares, I should say, somewhere between eighteen and twenty thousand. Your men may have the exact figures.

Mr. PECORA. Is it the subscription account that you are talking about now?

Mr. LAW. No; I am talking about the balance, the total amount of shares held by the company at that particular time.

Mr. PECORA. The total amount of shares held by the company as of what date?

Mr. LAW. The nearest date that I have is April 12.

Mr. PECORA. What was that total amount on April 12?

Mr. LAW. That was 18,000 in the box.

Mr. PECORA. Did that include shares which the company had received from the bank on February 15 in exercise of those subscription rights as to which the other shareholders had defaulted?

Mr. LAW. It included those particular shares, but it did not include shares contracted for all over the world and which had not yet arrived in our box.

Mr. PECORA. Then on April 12 the company had 18,000-odd shares all told of National City Bank stock?

Mr. LAW. In its box.

Mr. PECORA. In its box?

Mr. LAW. In its box in New York, without regard to what it owned and was coming into New York from various parts of the world.

Mr. PECORA. How many shares did it have in its subscription account, if any, at that time?

Mr. LAW. I haven't that record with me, Mr. Pecora. As I say, the books were not requested and I haven't them with me.

Mr. PECORA. Wasn't it about 492 shares?

Mr. LAW. I would prefer not to say. If your men have checked that I will be glad to take their word for it.

Mr. PECORA. Will you look at these work sheets taken from your records and see if they are correct?

Mr. LAW. I presume this is an exact ledger transcript?

Mr. PECORA. Yes, sir.

Mr. LAW. That appears to be right.

Mr. PECORA. It appears to be right. So that on April 12 the total long position of the National City Co. in stock of the National City Bank was only 492 shares? That is, on account of the subscription rights? Is that correct?

Mr. LAW. Assuming that your men have copied the record correctly; yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. I am assured that that is what they have done, and you can send for your own records to check up.

Now, have you the records of your own company showing its long position in its own holdings of the National City Bank stock on April 12, 1929?

Mr. LAW. That figure is 492?

Mr. PECORA. That other figure is 492.

Mr. LAW. Exclusive of stock contracted for, which had not arrived in New York, we had in our box 17,818 shares.

Mr. PECORA. Making a total of 18,310 shares with the 492 that were held in its subscription account?

Mr. LAW. That is correct, exclusive of contracts again.

Mr. PECORA. Now just forget for a moment those contracts and let us confine ourselves to the shares actually in its possession. All the shares actually in its possession, both for its own account and for this subscription account, were 18,398 shares on April 12, 1929?

Mr. LAW. It is impossible to segregate the two factors.

Mr. PECORA. I want to know the number of shares it actually had in its possession on April 12, 1929. Was it or was it not 18,398?

Mr. LAW. In its possession, but not subject to its control; that is correct.

Mr. PECORA. But it had actually received into its possession 51,590 shares on February 15, 1929, by the exercise of these subscription rights for other shareholders, had it not?

Mr. LAW. That is correct.

Mr. PECORA. What had become of the difference between this 18,000 figure and the 51,000 figure? What had become of the shares represented by that difference?

Mr. LAW. Your transcript of the subscription account will show that those shares were used largely for the filling of subscribed rights between February 15 and the date to which you refer.

Senator BROOKHART. Just a minute. I don't quite understand that. Had you used up all of this 51,000 except the 492 on the 12th of April?

Mr. LAW. Apparently, Senator; yes.

Senator BROOKHART. That had all been gone and this extra 17,000 were other shares that you had acquired from other sources?

Mr. LAW. Yes, sir; that is correct, Senator.

Senator BROOKHART. This 492 was the same number you had on May 3 when that transaction was closed, was it not?

Mr. LAW. The shares left on May 3 were about 437; that was just slightly under the 492.

Senator BROOKHART. Then on May 3 the 437 were turned back to the National City Bank?

Mr. LAW. No, Senator; they cannot hold their own stock.

Senator BROOKHART. Where was it?

Mr. LAW. We had to retain those.

Senator BROOKHART. You retained those at the $100 price yourself?

Mr. LAW. At the $100 price is correct.

Mr. PECORA. Do you know on what date the company borrowed 15,000 shares of the stock of the bank from Mr. Mitchell?

Senator FLETCHER. April 29, he said.

Mr. LAW. April 23, 15,000 shares.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Why did it borrow those shares?

(There was a pause.)

Mr. PECORA. Why is it taking you such a long time to answer the question, Mr. Law?

Mr. LAW. I am not familiar with the details of the borrowing, except from a mechanical standpoint.

Mr. PECORA. Do you know anyone who is familiar with the details of this transaction? Mr. Baker did not seem to know, and he is the president. You are the secretary. Can you refer us to any other officer who knows more about it?

(There was another pause.)

Mr. PECORA. Well, do you know anything about this transaction, Mr. Law?

Mr. LAW. From the mechanical standpoint only.

Mr. PECORA. Do you know anything about it otherwise?

Mr. LAW. Not a great deal.

Mr. PECORA. Do you know anything about it other than the fact that the stock was borrowed?

(There was a pause.)

Mr. PECORA. What is the answer, Mr. Law?

Mr. LAW. That is just what I am trying to get, Mr. Pecora.

Mr. PECORA. I think the record should show the lapse of time that this witness allows to ensue in answering the question.

Who do you think knows about it, Mr. Law?

Mr. LAW. Why, I should say that Mr. Mitchell having loaned the stock probably should be able to.

Mr. PECORA. Would not anyone in the company know something about the transaction? The company, you know, was the other party to this transaction.

Mr. LAW. That is the idea.

Senator BROOKHART. Let me ask a question or two there:

Now, Mr. Baker testified, I believe, that this 15,000 loan was on account of the 51,000 obligations to these stockholders, those rights that had been acquired. There was only between 492 and 437 out on the 29th of April at the time this last loan was made, was there not?

Mr. LAW. That I believe is correct, Senator.

Senator BROOKHART. Then it could not be on account of that obligation that this second 15,000 loan of shares was made by Mr. Mitchell to your company?

Mr. LAW. I was not a party to the contract, Senator Brookhart. I was in charge of the records and recorded what came to me. I thought probably a brief study of this would give some indication. I am sorry that it does not.

Mr. PECORA. Does your brief study of the records before you give any indication of the purpose for which these 15,000 shares were borrowed on April 23 from Mr. Mitchell.

Mr. BAKER. Mr. Pecora, I think probably——

Mr. PECORA. What is the answer?

Mr. LAW. It was to fill deliveries; there is no doubt in the world.

Mr. PECORA. It has taken us a half hour to find that out.

Mr. LAW. That is not an unusual street practice.

Mr. PECORA. Whether it is usual or unusual, we want to find out what the fact is.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. LAW. Well, naturally it was to fill deliveries.

Mr. PECORA. It has taken us a half hour to ascertain that it was to fill deliveries of the stock which the company had already sold to other customers, has it not?

Mr. LAW. That is the purpose of the purchase or obtaining of any stock; yes, sir.

Mr. PECORA. So that when it made those sales it was selling stock it did not have for delivery, is that right?

Mr. LAW. That it did not momentarily have for delivery, yes. Again you get into the question of the contracts outstanding which had not been delivered.

Senator BROOKHART. Mr. Chairman, I want to make one correction with reference to my question. I asked about this 15,000 loan of stock as the second loan. It was the first loan, I am informed, Mr. Mitchell made to the company. However, there was a second one, I am informed, of the same amount later.

Mr. LAW. 15,000 shares later; yes, sir.

Mr. PECORA. I was going to ask Mr. Baker about that, yes. Now we will suspend with you, Mr. Law, and let Mr. Baker resume.

TESTIMONY OF HUGH B. BAKER, PRESIDENT NATIONAL CITY CO., NEW YORK CITY—Resumed

Mr. PECORA. Now, Mr. Baker.

Mr. BAKER. Yes, sir.

Mr. PECORA. Will you produce the letter which you wrote to Mr. Mitchell under date of April 23, 1929, relating to the borrowing of 15,000 shares of capital stock of the bank by your company from him?

Mr. BAKER. Yes, sir; I have that.

Mr. PECORA. Let me have it.

(A document was handed to Mr. Pecora.)

Mr. PECORA. Who signed this letter in behalf of the company?

Mr. BAKER. I think I probably did. (After examining document.) Yes, sir.

Mr. PECORA. Have you the original letter?

Mr. BAKER. No; I haven't that. That is a copy of it.

Mr. PECORA. Have you any reply to that letter which the company received from Mr. Mitchell?

Mr. BAKER. No; I haven't that.

Mr. PECORA. What other letters have you in connection with this transaction? How about those letters Mr. Law just gave you?

Mr. BAKER. This is a later transaction, another letter.

Mr. PECORA. Is that the transaction of May?

Mr. BAKER. Yes.

Mr. PECORA. May I see those letters?

(Mr. Baker handed a document to Mr. Pecora.)

Mr. PECORA. Let me see them all, if you will.

(Additional documents were handed to Mr. Pecora.)

Mr. PECORA. Now, let me have the first letter, the one of April 23.

(Mr. Baker handed a document to Mr. Pecora.)

Mr. PECORA. I ask that this letter, dated April 23, 1929, addressed to Mr. C. E. Mitchell, from the National City Co., by the witness as president, be spread upon the record.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The CHAIRMAN. Without objection, it is so ordered.

Mr. PECORA. Shall I read the letter, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. PECORA (reading):

APRIL 23, 1929.

MR. C. E. MITCHELL,
55 Wall Street, New York.

DEAR MR. MITCHELL: We desire to borrow from you 15,000 shares of the National City Bank of New York stock from date hereof to July 10, 1929, against which we will advance to you forthwith the sum of $380 per share as security for the return of the stock, stock in like number of shares to be returned by us to you on July 10, 1929, against reimbursement to us in the amount now advanced. We will hand you on July 10, 1929, our check for any cash dividend declarations on such stock in the interim.

Pursuant to verbal agreement, in lieu of delivery of check to you in accordance with the above, we will credit your account on our books with the sum of $5,700,000, which will be considered as a loan by you to us and upon such loan account we will pay you interest at the rate of 6 per cent per annum, you to be free, however, to withdraw any portion of this loan on demand, the understanding being, however, that such portion as is withdrawn will be repaid to us on July 10, 1929.

Your acceptance of the foregoing proposal by initialing the carbon copy hereof and delivery of the said 15,000 shares of stock to us will complete the arrangement.

Yours very truly,

THE NATIONAL CITY CO.,
By HUGH B. BAKER, *President.*

In the month of May, 1929, Mr. Baker, did your company borrow any additional shares of the National City Bank from Mr. Mitchell?

Mr. BAKER. Yes, sir.

Mr. PECORA. On what date and in what number?

Mr. BAKER. May 13 we borrowed 15,000 shares.

Mr. PECORA. That is in addition to the 15,000 shares borrowed on April 23?

Mr. BAKER. That is right.

Mr. PECORA. And you have produced here what purports to be a true copy of the letter addressed by you on behalf of the National City Co. to Mr. Mitchell with respect to this borrowing of 15,000 shares on May 13, 1929?

Mr. BAKER. Yes, sir.

Mr. PECORA. I ask that this be spread on the record.

The CHAIRMAN. If there is no objection, it will be spread on the record.

Senator FLETCHER. Was this an individual transaction with Mr. Mitchell or Mr. Mitchell for the National City Bank?

Mr. BAKER. For Mr. Mitchell individually.

Mr. PECORA. The letter is dated May 13, 1929, and is as follows (reading):

MAY 13, 1929.

MR. C. E. MITCHELL,
55 Wall Street, New York.

DEAR MR. MITCHELL: We desire to borrow from you 15,000 shares the National City Bank of New York stock from date hereof to July 10, 1929, against which we will advance to you forthwith the sum of $400 per share as security for the return of the stock, stock in like number of shares to be returned by us to you on July 10, 1929, against reimbursement to us in the amount now advanced. We will hand you on July 10, 1929, our check for any cash dividend declarations on such stock in the interim.

Pursuant to verbal agreement, in lieu of delivery of check to you in accordance with the above, we will credit your account on our books with the sum

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of $6,000,000, which will be considered as a loan by you to us and upon such loan account we will pay you interest at the rate of 6 per cent per annum, you to be free, however, to withdraw any portion of this loan on demand, the understanding being, however, that such portion as is withdrawn will be repaid to us on July 10, 1929.

Your acceptance of the foregoing proposal by initialing the carbon copy hereof and delivery of the said 15,000 shares of stock will complete the agreement.

Yours very truly,

THE NATIONAL CITY CO.,
By HUGH B. BAKER, *President.*

Now, when July 10, 1929, came around the National City Co. returned on account of these borrowings 30,000 shares of the capital stock of the bank to Mr. Mitchell, did it not?

Mr. BAKER. That is right, July 10.

Mr. PECORA. And accompanying the 30,000 shares of stock so returned did your company cause this letter to be sent to Mr. Mitchell [handing document to Mr. Baker]?

Mr. BAKER. That is right.

Mr. PECORA. I ask that that be spread on the record.

The CHAIRMAN. There being no objection, it is so ordered.

Mr. PECORA. The letter is as follows (reading):

THE NATIONAL CITY CO.,
July 10, 1929.

Mr. C. E. MITCHELL,
55 Wall Street, New York, N. Y.

DEAR MR. MITCHELL: With reference to our letters to you of April 23 and May 13 of this year, borrowing from you the aggregate of 30,000 shares of the capital stock of the National City Bank of New York, we take pleasure in handing you herewith, against receipt, 30,000 shares of this stock, registered in your name, represented by certificates No. E838 to No. E843, inclusive, in denominations of 5,000 shares each.

We also enclose our check to your order for $128,850 as the interest due you, in addition to our check for $30,000, representing the July 1 dividend on this stock.

Yours very truly,

F. J. MAGUIRE,
Assistant Treasurer.

Is it or is it not the fact, Mr. Baker, that these 30,000 shares of the stock of the bank were borrowed by your company from Mr. Mitchell in order to enable it to make deliveries of that stock to customers to whom it had sold the bank stock, when as a matter of fact the City Co. did not have the stock for such delivery in its own account?

Mr. BAKER. That is true to the extent that we did not have the stock in New York.

Mr. PECORA. Did you have it anywhere else?

Mr. BAKER. I cannot answer.

Mr. PECORA. You cannot answer?

Mr. BAKER. Whether we had the stock en route to New York or not, in what amount. I am sorry I cannot give the exact answer to that. It is probable—possible that we did. We were buying Farmers Loan and Trust stock at that time, which was converted into City Bank stock later.

Mr. PECORA. Would you say that these shares of the stock of the bank sold by the company at this time, to deliver which it was necessary for the bank to borrow 30,000 shares of that stock from Mr.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mitchell, were short sales by the company of the bank stock at that time?

Mr. BAKER. Well, the answer would be "no" if we take into consideration that we were accumulating Farmers Loan & Trust stock to be exchanged into City Bank stock, or that we had stock coming in on delivery of purchases that we had made throughout the United States. If figured directly against our immediate holding at that moment, the answer would be "yes."

Mr. PECORA. The answer would be "yes" under those circumstances?

Mr. BAKER. Yes.

Mr. PECORA. Now, as a matter of fact, wasn't the company selling thousands of shares of the City Bank stock in excess of the number of those shares which it was buying?

Mr. BAKER. Well, as to some specific time I would have to answer.

Mr. PECORA. About the time these 30,000 shares were borrowed from Mr. Mitchell?

Mr. BAKER. Not when you take into consideration the purchase of Farmers Loan & Trust stock, Mr. Pecora.

Mr. PECORA. Was the company selling thousands of shares of the bank stock to the public, between April 12 and May 13, 1929, in excess of the number of shares it was buying?

Mr. BAKER. Between April—well, that is best answered by our inventory figures.

Mr. PECORA. I don't care how it is answered. But what is the answer?

Mr. BAKER. The answer is, in April that our balance of stock on hand was 7,704 shares.

Mr. PECORA. That is including the 15,000 shares borrowed from Mr. Mitchell, isn't it?

Mr. BAKER. That is including that, and this is giving consideration to the stock that we actually had in New York; and in May it was 8,692 shares.

Mr. PECORA. And that includes the 30,000 which had been borrowed from Mr. Mitchell by that time?

Mr. BAKER. It probably does. That is May 13, that stock came in, and in June at the end of that——

Mr. PECORA (interposing). Now never mind June. I want to get down to this period covered by these borrowings.

Senator BROOKHART. Let us have June there. You still had the 30,000 during June up to about the 10th of June?

Mr. BAKER. June shows a balance on hand of 17,291.

Senator FLETCHER. How much Farmers Loan & Trust Co. stock did you buy?

Mr. BAKER. I will get that by telephone, Senator.

Senator BROOKHART. The fact is, Mr. Baker, you filled every order for this stock that came to you at a satisfactory price, whether you had the stock on hand or not?

Mr. BAKER. Whether we had it ready for delivery, probably, yes.

Senator BROOKHART. And then you borrowed this of Mr. Mitchell to cover that sort of transaction?

Mr. BAKER. To be able, yes, to make those deliveries.

Senator TOWNSEND. Mr. Baker, would the 30,000 shares you borrowed show on this side of the ledger as purchase stock?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. I think so.

Mr. PECORA. Mr. Baker, you are familiar with the relationship that existed at all times between that company and the National City Bank since the National City Company was organized in 1911, aren't you?

Mr. BAKER. Well, I was not, of course, with the company in 1911.

Mr. PECORA. I know that. You are familiar with the relationship between the two institutions in so far as that relationship is indicated by the fact that all the shares of the National City Co.'s capital stock are owned by three trustees who represent all the shareholders of the National City Bank?

Mr. BAKER. That is right.

Mr. PECORA. And that the bank and the company had various executive officers in common?

Mr. BAKER. Yes.

Senator BROOKHART. On that, so far as any beneficial interest was concerned in the buying and selling of this National City Bank stock by the National City Co., it all went to the stockholders of the National City Bank?

Mr. BAKER. Well, let me see if I get that just exactly, Senator Brookhart. May I have that repeated again?

Senator BROOKHART. So far as any beneficial interest arising now, coming out of the profits of dealing in this National City Bank stock——

Mr. BAKER. Yes.

Senator BROOKHART. It ultimately all goes back to the stockholders of the National City Bank?

Mr. BAKER. That is right.

The CHAIRMAN. Then the bank was in effect selling its own stock short while the public was buying it?

Mr. BAKER. I don't think that.

The CHAIRMAN. If you sell what you haven't got, isn't that selling it short?

Mr. BAKER. But we had it coming in from various parts of the world.

The CHAIRMAN. You had the money with which to get it?

Mr. BAKER. And it was en route for delivery.

The CHAIRMAN. It was in existence somewhere?

Mr. BAKER. On the way to us.

Mr. PECORA. You did not know what was on the way to you, did you?

Mr. BAKER. Well, our figures show where we stood at the end of that period.

Mr. PECORA. And your figures, as testified to by Mr. Law, show that on April 12, before the first borrowing of 15,000 shares from Mr. Mitchell, the company had received all but 492 shares on account of these subscriptions from all over the world?

Mr. BAKER. I heard that; yes.

Mr. PECORA. So that when this stock was borrowed there were only 492 shares of the new stock which might be coming eventually to the National City Co. from all over the world?

Mr. BAKER. Of that particular block of stock.

Mr. PECORA. Of that particular lot; yes. So these 30,000 shares were all used, were they not, to enable your company to deliver to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the persons to whom it had previously sold National City Bank stock, the stock which it had sold?

Mr. BAKER. I assume it is; yes, of course.

Mr. PECORA. Do you know, Mr. Baker, the peak of the short position of the National City Co. in the National City Bank's stock?

Mr. BAKER. No; I do not think there was any short position, Mr. Pecora.

Mr. PECORA. You do not think there was a short position because the Company had borrowed 30,000 shares of the stock from Mr. Mitchell; isn't that correct?

Mr. BAKER. And as I have said, because stock was en route to us.

Mr. PECORA. But you had received all but 492 shares of that stock, had you not?

Mr. BAKER. We are talking about——

Mr. PECORA. Prior to April 12, 1929.

Mr. BAKER. We are talking about two different things. On that particular subscription stock that is correct.

Mr. PECORA. Well, now, what else are you bringing into the picture? What other stock?

Mr. BAKER. Only the stock that we had purchased in various places of the United States that had not as yet been delivered.

Mr. PECORA. You were selling more than you were buying at that time anyway, wern't you?

Mr. BAKER. In the month of April——

Mr. PECORA. In the month of April and in the month of May?

Mr. BAKER. We did.

Mr. PECORA. Yes. So that what you were selling even currently at that time was more than what you were buying from people all over the United States, wasn't it?

Mr. BAKER. In that particular month our purchases were 92,000 and our sales 103,000.

Mr. PECORA. So there was a short position there of 11,000 shares?

Mr. BAKER. But, of course, we had——

Mr. PECORA (interposing). Taking into account all this stock which you had purchased all over the United States and which you say was on its way into your box, you still were 11,000 short, were you not?

Mr. BAKER. Of course, these are ledger figures that we are using.

Mr. PECORA. Of course they are ledger figures we are using. But you would not have any other figures; you won't tell that from memory.

Mr. BAKER. Oh, yes; but it would not show stock that is en route to us. These are shares that are in the box.

Mr. PECORA. Don't they show the number of shares you had purchased even for future delivery?

Mr. BAKER. Not on a specific date. That simply shows the stock that is delivered to us.

Mr. PECORA. Doesn't that show the stock purchased even against future delivery?

Mr. BAKER. No.

Mr. PECORA. Are you sure of that?

Mr. BAKER. I am quite sure of that. (After a pause.) This shows the stock actually delivered to us and paid for. Yes, that is right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. What is right?

Mr. BAKER. It does not show contracts on stocks that we have contracted to buy and have out that is en route to us.

Mr. PECORA. Does it also show sales which you have made and against which you have not yet made deliveries?

Mr. BAKER. It shows deliveries.

Mr. PECORA. What?

Mr. BAKER. That shows stock delivered out.

Mr. PECORA. Have you a separate record of those purchases? Ask Mr. Law if he has.

Mr. BAKER. This is our ledger acount.

Mr. PECORA. That includes purchases which had been contracted for, does it not?

Mr. BAKER. No, sir.

Mr. PECORA. Doesn't it, Mr. Law?

Mr. LAW. No, Mr. Pecora.

Mr. PECORA. Have you any record of those transactions?

Mr. LAW. We have not, sir. That did not enter into the picture at the time we were asked to bring records.

Mr. PECORA. Where did you get the 30,000 shares of stock which were returned to Mr. Mitchell on July 10, 1929?

(Mr. Baker conferred with Mr. Law.)

Mr. PECORA. Well, who is answering now, Mr. Baker or Mr. Law?

Mr. LAW. I am, sir.

Mr. PECORA. Mr. Baker, do you consider yourself qualified, as the president of the company, to answer these questions, or do you think that some one else can answer them more accurately?

Mr. BAKER. Well, probably there are others who can answer better, but——

Mr. PECORA (interposing). Is there anyone who knows more about the company's transactions than you?

Mr. BAKER. I don't think so.

Mr. PECORA. Then suppose you answer these questions and not have Mr. Law whisper the answer in your ear. Will you?

Mr. BAKER. Yes; I will try to.

Mr. PECORA. If you need Mr. Law's help, say so on the record so the record will show that you need it.

Mr. BAKER. Very well.

Mr. PECORA. Now go ahead.

Mr. BAKER. Well now, what is the question?

Mr. PECORA. The question is, Where did the company get the 30,000 shares of bank stock which it returned to Mr. Mitchell on July 10, 1929.

Mr. BAKER. From purchases in the market and from exchange of Farmers Loan & Trust stock into City Bank stock.

Mr. PECORA. And does not that still prove that the company took a short position in the stock of the bank in April and May and June?

Mr. BAKER. If you are unwilling to include in that that we had this other stock coming to us.

Mr. PECORA. You mean that it was coming to you?

Mr. BAKER. Yes.

Mr. PECORA. Not that you had it in possession?

Mr. BAKER. That is probably right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator FLETCHER. Mr. Baker, may I ask what was the profit or loss to the National City Co. on these operations?

Mr. BAKER. As pertains to what, this particular operation with Mr. Mitchell?

Senator FLETCHER. Yes; with the bank stock.

Mr. BAKER. Over the whole period of time?

Senator FLETCHER. Well, take up to July.

Mr. BAKER. I have got that for the whole year here, Senator.

Senator FLETCHER. State it then for the whole year.

Mr. BAKER. There was a loss for 1929 of $10,393,000.

Senator BROOKHART. That included the panic?

Mr. BAKER. Yes.

Mr. PECORA. That is when the loss accrued, subsequent to October?

Mr. BAKER. That is right. There was a profit up to the middle of the year.

Senator FLETCHER. Of how much? Can you give that?

Mr. BAKER. I will get that for you.

Senator BROOKHART. Did you have a profit on this handling of this 30,000 shares of Mr. Mitchell?

Mr. BAKER. I assume so, Senator. Of course, that depends upon the general movement up and down in the market price of the stock.

Senator BROOKHART. Did you have to pay him any interest?

Mr. BAKER. Yes; 6 per cent.

Senator BROOKHART. And had a profit over and above that that the market ran up to the 10th of July?

Mr. BAKER. Yes. That would depend upon the general market movement.

Senator BROOKHART. That means, then, that you were using Mr. Mitchell's stock just as a matter of stock transactions as if it were your own, does it not?

Mr. BAKER. Yes; just the same as a loan to us.

Mr. PECORA. In other words, you were using it to cover a short position?

Mr. BAKER. Well——

Mr. PECORA. That is what actually was done, wasn't it?

Mr. BAKER. A short position as far as actual stock in the box to deliver; yes.

Mr. PECORA. Yes; the actual, physical operation consisted of the borrowing and the use of that stock to cover a short position, did it not?

Mr. BAKER. Well, as I have just said.

Senator FLETCHER. That borrowing is usually done for this purpose on the exchange, isn't it?

Mr. BAKER. Yes. But as I tried to explain, Senator, if we had no other stock coming in to offset that, I would readily admit that it would be a short sale.

Senator BROOKHART. You mean you had contracts at some time in the future that would bring in other stock?

Mr. BAKER. Yes.

Senator BROOKHART. But you did not pay any attention to those to see whether they amounted to the full amount of your sales or not, as long as you had this 30,000 share loan to cover sales, did you?

Mr. BAKER. I think we probably knew exactly at that time.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Why, as a matter of fact, you could not have known at that time, could you?

Mr. BAKER. Could not have—I don't quite get the question.

Mr. PECORA. You undertook to pay Mr. Mitchell 6 per cent interest, which amounted to $128,000, for these borrowings of 30,000 shares, didn't you?

Mr. BAKER. Yes.

Mr. PECORA. And you did that without knowing whether or not you would need that stock with which to make deliveries of the stock you had sold?

Mr. BAKER. I say we did need it to make delivery.

Mr. PECORA. Of course you did.

Now, Mr. Baker, was it the policy of the National City Co. to seek to exercise any control of the market in the shares of the bank?

Mr. BAKER. We tried to keep the price of our bank stock, the City Co. did, in general line with other bank stock, the general market conditions.

Mr. PECORA. Did you seek to control the market for that purpose?

Mr. BAKER. Oh, no, I should not say so.

Mr. PECORA. Wasn't it the——

Mr. BAKER (interposing). We were prepared to make a bid for the stock as well as make an offering for the stock, at any time.

Senator BROOKHART. Was that advertised to the public?

Mr. BAKER. No, sir.

Senator BROOKHART. Did you make it in the stock exchange?

Mr. BAKER. No, sir.

Mr. PECORA. Wasn't it the studied purpose and policy of the company to try to control the market on City Bank stock?

Mr. BAKER. I don't think so; no. We could not possibly. There were many, many dealers in bank stocks in New York. I don't know how many thousand shares of bank stocks they were dealing in, but certainly we were only a very small part of the market.

Mr. PECORA. Are you familiar with the circumstances under which the bank applied to the New York Stock Exchange in the fall of 1928 to take its stock from the trading list of the exchange?

Mr. BAKER. Yes; somewhat.

Mr. PECORA. What were those circumstances?

Mr. BAKER. Mr. Mitchell was in Europe in the latter part of 1927, and there had been very little trading on the stock exchange in City Bank stock or any other bank stock until late in the fall of 1927 there were some arrangements made whereby the trading in bank stocks was begun, and we noticed these transactions, in fact I saw on one particular day sales in National City Bank stock ranging five points difference between one transaction of 10 shares each.

Mr. PECORA. What was the market quotation for the stock on the exchange at those times when you saw those 5-point differences?

Mr. BAKER. 1927?

Mr. PECORA. Yes; the fall of 1927.

Mr. BAKER. In the fall of 1927 the price of City Bank stock ranged from 668 in October to 747 in December.

Senator BROOKHART. That is for $20 par share?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. No, that was the $100 par share. When I saw this activity in bank stocks I wired Mr. Mitchell. This is after discussing with others. And I said to him:

City Bank stock and stocks of other large banks of New York, although listed on the New York Stock Exchange for many years, have infrequently, if at all been traded in. Last week they were transferred to one trading post in order to facilitate active trading. Trading principally our stock active, and Chase also traded in and quite active, with wide fluctuations, our stock indicating manipulation. Mr. Garver requests that we advise you that he regards this as distinctly disadvantageous, and probably at times might even be dangerous, and with your approval he proposes to discuss with the executive committee of the bank next Tuesday recommending to board to have steps taken to withdraw from listing if possible.

Mr. PECORA. When was that communication sent by you to Mr. Mitchell?

Mr. BAKER. September 23, 1927.

Mr. PECORA. Was Mr. Mitchell then out of the city or the country?

Mr. BAKER. He was in Paris.

Mr. PECORA. The fluctuations that you had observed were 5-point fluctuations in small lots?

Mr. BAKER. Yes. There were sales, I think five sales, one right after another.

Mr. PECORA. And what was the aggregate of those five sales?

Mr. BAKER. Fifty shares.

Mr. PECORA. Fifty shares?

Mr. BAKER. Yes; 10 shares each.

Mr. PECORA. And you thought that indicated manipulation of the stock on the floor of the exchange?

Mr. BAKER. It seemed to offer those possibilities, with a spread of five points in between each transaction on a small lot of 10 shares.

Mr. PECORA. And what were the number of shares the bank had outstanding at that time? That is in September, 1927?

Mr. BAKER. I think that is 750,000 shares, Mr. Pecora.

Mr. LAW. 750,000.

Mr. PECORA. And from a total volume of sales aggregating 50 shares on that date you thought there was a manipulation in the stock of the bank?

Mr. BAKER. Thought it was possible that there was.

Mr. PECORA. Thought it was possible?

Mr. BAKER. Yes.

Mr. PECORA. Did you complain to the exchange authorities about that manipulation?

Mr. BAKER. No; I did not. I had nothing more to do with that transaction other than to notify Mr. Mitchell.

Mr. PECORA. After you made that suggestion and sent those advices to Mr. Mitchell, what followed?

Mr. BAKER. He replied, saying:

I have been much disturbed regarding recent speculative movement of National City Bank stock and believe activities on New York Stock Exchange only intensify speculative interest which can not be of any possible advantage to us. I therefore concur fully in Mr. Garver's suggestion.

Mr. PECORA. And that was what? To apply to the New York Stock Exchange——

Mr. BAKER. Yes.

Mr. PECORA. To strike the stock from its trading list?

Mr. BAKER. That is right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And the Mr. Garver whom you have mentioned is an attorney at the head of the law firm of Shearman & Sterling?

Mr. BAKER. Yes.

Mr. PECORA. The attorneys for the bank and also the National City Co.?

Mr. BAKER. That is right; yes.

Mr. PECORA. Now, thereafter was formal application made by the bank to the exchange to strike its stock from the list?

Mr. BAKER. Yes, sir.

Mr. PECORA. When?

Mr. BAKER. Let me see if I can find a copy of the actual letter here. [After a pause.] I find a letter under date of January 11 from Mr. Simmons—copy of letter—who was then president of the stock exchange.

Senator FLETCHER. 1928?

Mr. BAKER. Yes; January 11, 1928, stating:

At a meeting of the governing committee of the New York Stock Exchange held to-day your letter of January 11, 1928, was presented, and after discussion the governing committee voted to remove from the list of securities dealt in on the exchange the stock of the National City Bank.

Senator BROOKHART. What date was that?

Mr. BAKER. That was January 11, 1928. Then there are various minutes here showing the action of the bank prior to that.

Senator BROOKHART. What was the price quotation of the stock at that time?

Mr. BAKER. January?

Senator BROOKHART. Yes.

Mr. BAKER. $780 a share on January 7.

Senator BROOKHART. That is sufficient for my purpose. That is on par at $100?

Mr. BAKER. $100; yes, sir.

Senator BROOKHART. When was it changed to $20?

Mr. PECORA. February, 1929.

Mr. BAKER. That was in 1929.

Senator BROOKHART. 1929?

Mr. BAKER. Yes.

Senator BROOKHART. After this 1928 transaction you took charge of the dealing of the National City Bank's stocks in the National City Co. itself?

Mr. BAKER. Yes, sir; and the National City Bank——

Senator BROOKHART (interposing). And the exchange sold no more; they were not listed over there at all?

Mr. BAKER. Yes. It was not traded in.

Senator BROOKHART. Then after you took charge in the National City Co. and after this change to $20 par, what did the stock go to?

Mr. BAKER. Well, that price varied. In 1928 the price on January 7 was 780.

Senator BROOKHART. That would be 7.8 to 1; that is, 780 per cent of the par?

Mr. PECORA. No; the par was $20.

Mr. BAKER. At this time the par in 1928 was $100 a share.

Senator BROOKHART. So it was 780 per cent at that time. Now, I want to get the percentage it went to after you took charge of it yourself in the National City Co.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Shall I run down a few of these here?

Senator BROOKHART. Yes; run down to when——

Mr. BAKER (interposing). January 14, 762; January 21, 760——

Senator BROOKHART (interposing). I don't care about the date along there. I want to know later.

Mr. PECORA. The general rise.

Senator BROOKHART. The general rise in 1929.

Mr. BAKER. After the par value was reduced to $20, is that right, Senator?

Senator BROOKHART. Yes.

The CHAIRMAN. Do you want it immediately after it was reduced?

Senator BROOKHART. No; it is all right immediately, but I wanted to find out which was the more efficient booming of this stock, the stock exchange or the National City Co. That is what I want to know.

Mr. BAKER. Well, let's see—that exchange of old shares took place January 15, I think it was, 1929.

The CHAIRMAN. And you have given the market on that then.

Mr. BAKER. That is right.

Senator BROOKHART. What did it go to during the months before the panic?

Mr. BAKER. It went as high as $580 a share.

Senator BROOKHART. On a $20 par?

Mr. BAKER. That is right.

Senator BROOKHART. That would be 2,500 per cent of the——

Mr. BAKER (interposing). Yes; about that.

Senator BROOKHART. So your company was about five times as efficient as the exchange was in booming this stock?

Mr. BAKER. That with all other—with the whole general trend of the market. It moved right with it.

Senator BROOKHART. There were a lot of other companies organized doing something like that to assist the exchange along in this inflation period, weren't there?

Mr. BAKER. Well, I don't know about that.

The CHAIRMAN. Then may I ask you: Prior to dividing the stock into five points what dividends had the company been paying?

Mr. BAKER. It has paid—the last year?

The CHAIRMAN. Yes; the year before that. If you don't know, give us the average.

Mr. BAKER. The dividend on the old stock was $20 per share. The dividend on the new stock was——

The CHAIRMAN (interposing). On that $100 investment, was that earning $20 each year? Or don't I understand you?

Mr. BAKER. No; that was the dividend paid out of earnings.

The CHAIRMAN. Twenty per cent?

Mr. BAKER. Yes; $20 per share.

The CHAIRMAN. That is the common stock?

Mr. BAKER. That is the National City Bank stock.

The CHAIRMAN. Then after it had been split into five parts what was the dividend after that?

Mr. BAKER. $4 a share.

Mr. PECORA. It was the same rate?

Mr. BAKER. Twenty per cent.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. On the new par value?
Mr. BAKER. That is right.
Mr. PECORA. And that went to 500 and what, did you say?
Mr. BAKER. 580.
Mr. PECORA. And went down to what?
Mr. BAKER. 23.
Mr. PECORA. And is what price now?
Mr. BAKER. I think about 40.
Mr. PECORA. And paying——
Mr. BAKER. $2.
Mr. PECORA. And paying $2 a share?
Mr. BAKER. A share, yes.
Senator BROOKHART. A little correction: I mentioned your efficiency as five times as great, but that was a lightening calculation, and I, on figuring it again, see it was only a little over three times as great. So I don't want to advertise you too strongly.
Mr. BAKER. All right. Thank you.
Mr. PECORA. The application to strike the stock from the list of the New York Stock Exchange was made by the bank on September 30, 1929, wasn't it?
Mr. BAKER. I thought it was a little later than that.
Mr. PECORA. Look at a letter signed by Mr. Swenson, chairman of the board of the National City Bank of New York——
Mr. BAKER. I haven't that letter.
Mr. PECORA. Addressed to the president of the New York Stock Exchange, dated September 30, 1927. Have you that letter?
Mr. BAKER. No, I don't think I have. Just a moment.
Mr. PECORA. There is a photostatic copy of it [handing document to Mr. Baker].
Mr. BAKER. Yes. I haven't that letter. That is September 30.
Mr. PECORA. And what reply did the exchange make to that application?
Mr. BAKER. I haven't a copy of the reply that they made to Mr. Swenson's letter, but there were some complications about it; that is, difficulties about it as to the method, and so forth, to have it removed.
Mr. PECORA. Haven't you the reply signed by Mr. Simmons, president of the New York Stock Exchange, dated October 13, 1927? Isn't that among your files there?
Mr. BAKER. I don't think I have that. No; I haven't that. This shows the discussion and the notice to the shareholders, and so forth.
Mr. PECORA. See if that is not a photostatic copy of the stock exchange reply to the bank [handing document to Mr. Baker].
Mr. BAKER. Of course, I never saw this reply, so I would not know whether it is or not.
Mr. PECORA. Can you get from any of your associates the files of the correspondence between the bank and the New York Stock Exchange on this subject of striking the bank stock from the list?
Mr. BAKER. I don't know whether we have such file here. [After conferring with associates.] I don't know where these letters were. I am willing to accept this, Mr. Pecora. I haven't a copy of it myself.
Mr. PECORA. I ask there be spread upon the record letter dated September 30, 1927, addressed to Mr. E. H. H. Simmons, president of the New York Stock Exchange, by Mr. E. P.—is that Swenson?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. That is right.

Mr. PECORA. Swenson, chairman of the board of the National City Bank of New York, reading as follows [reading]:

THE NATIONAL CITY BANK OF NEW YORK,
New York, September 30, 1927.

Mr. E. H. H. SIMMONS,
President New York Stock Exchange, New York.

DEAR Mr. SIMMONS: The directors of the National City Bank of New York have had under consideration the question of requesting the stock exchange to remove the stock of the bank from the exchange list.

The subject came up again at the meeting of our board held Tuesday, September 27, and it was the sense of the board that such a request should be made.

Will you be so good as to advise me what steps, if any, other than this request, the bank should take to bring the matter formally to your attention?

With assurances of our highest esteem,

Very sincerely yours,

E. P. SWENSON,
Chairman of the Board.

I also ask that there be spread upon the record the reply to this letter received from the stock exchange by the National City Bank, the letter reading as follows [reading]:

OCTOBER 13, 1927.

Mr. E. P. SWENSON,
Chairman Board of Directors, The National City Bank of New York,
New York City.

DEAR Mr. SWENSON: I beg to acknowledge receipt of your letter of September 30 requesting on behalf of the board of directors of the National City Bank, that the stock of the bank be removed from the list of the New York Stock Exchange, and asking me to advise you what steps, if any, other than such request, the bank should take to bring the matter formally to the attention of the exchange.

While the stock exchange is most desirous of complying with the wishes of your board, it feels that it would not be justified in removing the stock of the National City Bank from its list upon the request of the board of directors alone, and without the sanction and approval of the stockholders of the bank.

It appears that the stock of the National City Bank has been listed in the stock exchange for many years, and that, since the original listing of the stock, the bank has made applications from time to time for the listing of additional amounts of stock when the capital of the bank has been increased. Under these circumstances, the removing of the stock of the National City Bank from the list of the stock exchange would effect the rights of the stockholders of the bank, in that it would deprive them of a market for their stock which has existed for many years. The stock exchange, therefore, can not consider and act upon any request or application to remove the stock of the National City Bank from the list, unless such request or application be authorized by the stockholders of the bank at a special meeting at which no substantial number of the stockholders vote against the proposed action.

Regretting very much that the stock exchange can not see its way clear to comply with the request contained in your letter, I am

Very truly yours,

———— ————, *President.*

The stock was eventually stricken from the list by the exchange some time in January, 1928?

Mr. BAKER. That is right.

Mr. PECORA. And thereafter it was traded in in so-called over-the-counter transactions?

Mr. BAKER. That is right.

Mr. PECORA. Mr. Baker, can you tell us the largest number of shares of bank stock which was sold by the National City Co. on any one day subsequent to January, 1928, or that date in January when it was stricken from the list of the exchange?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Of course, there began to be—there was great increased activity in all trading of all character as time went on there during 1928 and 1929, in the whole markets, bonds and stocks.

Mr. PECORA. Yes; but what was the largest number of shares of the stock of the National City Bank sold by the National City Co. on any one day subsequent to January, 1928, when it was stricken from the exchange list?

Mr. BAKER. The highest number that I see—I have this only here by the week. I haven't this by the day.

Mr. PECORA. Can you tell us, Mr. Law?

Mr. LAW. I can not. I did not have that.

Mr. BAKER. I haven't it by the day.

Mr. PECORA. Were there days when the company sold tens of thousands of shares of the bank stock in one day?

Mr. BAKER. I suppose there have been days where there was as much as perhaps thirty or forty thousand shares sold.

Mr. PECORA. On single days?

Mr. BAKER. In one day.

Senator TOWNSEND. You have it by the week there?

Mr. BAKER. I have it by the week; yes.

Senator TOWNSEND. That might give us what we are trying to get.

Mr. PECORA. For instance, take the week commencing February 21, 1929, or the week ending February 21, 1929.

Mr. BAKER. All right.

Mr. PECORA. The National City Co. alone sold 92,709 shares of the bank stock, didn't it, according to your records?

Mr. BAKER. According to my records.

Mr. PECORA. In September, 1927, on September 23, 1927, to be exact, you saw five sales of 10 shares each recorded on the Stock Exchange ticker, and you thought that indicated a manipulation of the stock, didn't you?

Mr. BAKER. I thought it merely showed that manipulation of the stock would be very easy.

Mr. PECORA. Yes. And did you think that sales amounting to tens of thousands of shares a day might also be sales that would indicate manipulation of the price of the stock in over-the-counter transactions?

Mr. BAKER. I don't think you can draw that conclusion necessarily, because the activity of markets generally had so tremendously increased that it was difficult to find a basis of comparison.

Senator BROOKHART. Wasn't that general activity due to manipulation, to general manipulation of everything?

Mr. BAKER. Well, I don't think so. I think the public was insisting on buying things.

Senator BROOKHART. And they had been worked up to that state of mind by the manipulation in selling things? Is that correct?

(There was no response.)

The CHAIRMAN. How much money did you spend encouraging them? How much did you spend monthly or by the year encouraging them in that idea that it was a good time to buy?

Mr. BAKER. Well, of course, we were dealing in investment securities, Senator, and we tried to——

The CHAIRMAN. In other words, you helped it along?

Mr. BAKER. I didn't—I certainly was not trying to stop business.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. You were interested in selling and not in protecting the public?

Mr. BAKER. I was interested in both.

Senator BROOKHART. What did you do to protect the public? I have not seen anything yet that was done to stop all this vast loss they have sustained as a result of all these transactions.

Mr. BAKER. Well, I haven't any answer to that. There was not anything we could do that we did not do, as far as I know, to protect the public as regards its investments.

Senator BROOKHART. Were you going to excuse Mr. Baker, Mr. Chairman?

The CHAIRMAN. We were about to recess.

Senator BROOKHART. I wanted to ask a few questions on an entirely different line.

The CHAIRMAN. The committee will recess until 2.30. Those under subpœna will appear here at that time. The witness will continue.

(Accordingly, at 12.43 o'clock p. m., a recess was taken until 2.30 o'clock p. m., of the same day.)

AFTER RECESS

The subcommittee resumed at 2.30 o'clock, on the expiration of the recess.

The CHAIRMAN. The subcommittee will resume. Senator Brookhart desires to ask a few questions of Mr. Baker before counsel to the committee resumes his questions.

TESTIMONY OF HUGH B. BAKER, PRESIDENT THE NATIONAL CITY CO., NEW YORK CITY—Resumed

Senator BROOKHART. Mr. Baker, Mr. Mitchell testified that your company handled some $20,000,000,000 of securities altogether since its organization. That is about right, is it?

Mr. BAKER. For the last 10 years.

Senator BROOKHART. And he said there was only about $1,000,000,000 of that that you had trouble with. Now, the things you handled were stocks and bonds both, were they not?

Mr. BAKER. Yes, sir.

Senator BROOKHART. Take those stocks that you handled: How does their value to-day compare with what you sold them at?

Mr. BAKER. Oh, as to that——

Senator BROOKHART (interposing). Just in a general way. I am not asking you to come down to any particular figures. I want to get a general view of the economic situation of the country.

Mr. BAKER. Well, I think they are in line with the general decline in the market as a whole.

Senator BROOKHART. But very much lower than the selling prices?

Mr. BAKER. Yes; they are lower.

Senator BROOKHART. And yet I have a chart prepared by the Federal Reserve Board that shows they are still, I mean at the present time, on an average, higher than the level of 1914.

Mr. BAKER. That may be correct, but I do not know.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. Now, bonds have depreciated considerably, too, haven't they?

Mr. BAKER. Some of them. Of course, a great many of those bonds, of that $20,000,000——

Senator BROOKHART (interposing). He said $20,000,000,000.

Mr. BAKER. Yes; of the $20,000,000,000, have been paid.

Senator BROOKHART. I understand that, but in the prices they now represent, those that are outstanding, they are depreciated. In other words, all values are down now.

Mr. BAKER. Well, that is true in the case of certain bonds. That would not be true as to anywhere near the total, because in that total are a great many municipal and State bonds.

Senator BROOKHART. They have held up better in value?

Mr. BAKER. Yes; they are better.

Senator BROOKHART. United States Government, State, and municipal bonds have held up better?

Mr. BAKER. Yes; and public-utility bonds.

Senator BROOKHART. But private business bonds are all depreciated, or nearly all of them, to-day?

Mr. BAKER. Yes; they have declined, the most of them.

Senator BROOKHART. Now, what rate of interest do those bonds generally carry?

Mr. BAKER. Well, that varies, of course, considerably. Utility bonds would perhaps carry a 5 per cent coupon, and municipal bonds probably would carry 4 per cent coupons, or thereabout, and so on through the list.

Senator BROOKHART. Do they vary in that way?

Mr. BAKER. Yes, sir.

Senator BROOKHART. Take the stocks that you advertised and sold, what kind of return did your prospectuses indicate for those as a general thing?

Mr. BAKER. Well, of course that was in accord with the general dividend that was being paid on those stocks.

Senator BROOKHART. They all expected 6 or 7 or 8 or 9 per cent dividends, did they not?

Mr. BAKER. Well, it varies, of course. I just can't recall any average.

Senator BROOKHART. What would be the low level of dividends that they would carry? That is, as to the prospectus and the idea you put out to the public to whom you sold them?

Mr. BAKER. As to the prospective dividends in the future, do you mean?

Senator BROOKHART. Yes.

Mr. BAKER. Well, of course we were quite in line with the earnings and the earning prospects, and it looked to us as if the earnings were safe on the existing basis at the time. We felt that those dividends were justified and felt at the time that they would continue to be paid.

Senator BROOKHART. Well, I wasn't interested in that proposition, but was interested in what those dividend levels might be. You did not advertise anything as low as 4 per cent, did you?

Mr. BAKER. Well, I am not sure just what the various dividends on the various issues might have been.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. The most of those stock issues were trying to get 5 per cent at least, or as much as 10 per cent and some of them even more, were they not?

Mr. BAKER. Well, not 10 per cent, but 5 per cent, or something like that.

Senator BROOKHART. I want to ask you whether you know what the general and capital earnings in the United States are, taking them over a period of years, and that covers prosperity as well as depression, cutting out the present worst of all depressions.

Mr. BAKER. All right.

Senator BROOKHART. Do you know what the average capital earning has been in the United States during its history?

Mr. BAKER. No; I do not.

Senator BROOKHART. You have never made any study of that basic proposition?

Mr. BAKER. I haven't that.

Senator BROOKHART. Well, suppose I said to you that the census estimates, together with a scientific study made by Senator Howell, of Nebraska, show that throughout the entire history of the country the possibility of production has been less than 4 per cent a year, and then I ask you if that continues possible, but, of course, since 1929 it has not been that, has it?

Mr. BAKER. No.

Senator BROOKHART. It has gone the other way?

Mr. BAKER. Yes.

Senator BROOKHART. And would now be way below 4 per cent if we used these times as a level to go by. But to use a prosperity as well as a depression period, the American people have the ability to produce, say, 4 per cent, and that includes all value of new territory we acquired, all increases in values, and everything else, it has been less than 4 per cent a year, has it not?

Mr. BAKER. Perhaps so.

Senator BROOKHART. If that be true, isn't it going to unsettle business in this country always if institutions like yours are out selling stocks and bonds at a price higher than the ability of the American people to produce?

Mr. BAKER. Well, I should assume that it is because of that average rate of 4 per cent that you mention—I mean that is the result of some companies having a much higher rate than others, and perhaps some having no dividend rate at all, or no earnings.

Senator BROOKHART. Your theory is that they should have a higher dividend rate if the risk is greater.

Mr. BAKER. No; I think the dividend rate should be in line generally with the earnings of the company.

Senator BROOKHART. Well, the earnings of the company should be greater when it has a greater risk to carry; is that it?

Mr. BAKER. Not always, because into that enters the question of efficiency of management.

Senator BROOKHART. Well, assuming that the management of all is good, and all the same, then as to an enterprise where there is a bigger risk or a bigger element of uncertainty, you would expect ultimately a bigger dividend, wouldn't you?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Well, yes; if you assume that all management is equally able, and the profit possibilities in industry are equal, then I should say yes to that.

Senator BROOKHART. On that basis, then, agriculture would be entitled to the biggest dividend of anybody, wouldn't it?

Mr. BAKER. Well, I would certainly like to see it get it.

Senator BROOKHART. But it never has yet that you know of, has it?

Mr. BAKER. Not that I know of.

Senator BROOKHART. Well, now, the thing I am getting at is this: We have investigated the stock exchanges, the New York Stock Exchange, and its operations of all sorts to boom stocks and bonds to extortionate levels. Then we get into your company, and you beat the stock exchange three or four times over in percentage. How can we ever have stable prosperity in this country as long as we permit that kind of business to go on in the big wholesale way you people conduct it?

Mr. BAKER. Well, that is a big question. [Laughter in the room.] I am afraid it is too big for me to try to answer without any preparation.

Senator BROOKHART. Well, you are one of the big men in this game.

Mr. BAKER. I am not so sure of that.

Senator BROOKHART. In 1921 you people, through Mr. Mellon and his associates, got practically control of this Government, in the executive and legislative branches, and even the judicial branch, for you have had two-thirds at least of the Supreme Court all the time. The management of politics has been through the influence of those sources. And then the big economic affairs of the country have been managed by you people, and this is what you brought us to.

Mr. BAKER. Well, of course, I did not realize that that was the situation.

Senator BROOKHART. You did not?

Mr. BAKER. No.

Senator BROOKHART. You have been friendly with Mr. Mellon and his financial ideas all through those times, haven't you?

Mr. BAKER. Well, I have known Mr. Mellon, but not at all intimately.

Senator BROOKHART. Well, of course, we have known that his influence has been paramount in every branch of the Government here since Harding became President.

Mr. BAKER. Well, I certainly had no influence with Mr. Mellon at all one way or other.

Senator BROOKHART. Well, you were friendly to his policies and his way of managing things, weren't you?

Mr. BAKER. Well, I could not say yes to that without saying that in so far as I regarded him as a conservative and a gentleman with ability; yes.

Senator BROOKHART. And you belong to the conservative class yourself.

Mr. BAKER. I want to be conservative; yes, sir.

Senator BROOKHART. Well, now, supposing that when this new administration comes in the Congress would enact a farm bill that

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

would reestablish farm prices—and you are aware of the fact that at the present time farm prices are fixed by the sale of the surplus in the free trade markets of the world. You are aware of that proposition, are you not?

Mr. BAKER. Yes, sir.

Senator BROOKHART. Suppose we were to enact a bill that would remove that surplus from having an influence on agricultural products in this country, and were to raise the price level up, as President Wilson did during and after the World War, to a cost-of-production level to farmers, which would restore their buying power, and that is a third or more of the buying power of the whole country, isn't it?

Mr. BAKER. Yes.

Senator BROOKHART. And were to send that buying power into the channels of business. And then supposing the incoming administration would also put on public works to employ about one-third of the unemployed labor of this country—and I think agricultural prosperity would put a third of them to work; then with two-thirds going to work would put the other one-third to work. Now, supposing some such arrangement were done by the new administration, wouldn't that start immediately a gigantic stock boom again in New York?

Mr. BAKER. Well, I would doubt that. If the unemployment situation of the country were reduced through the methods you suggest, and business were improved, there is no doubt but that that would be reflected in an improvement of prices for securities. But as to that producing a boom beyond reasonable prices for existing securities, I do not know, and I doubt that very much.

Senator BROOKHART. With all your propaganda and selling machinery down there in New York, and in the stock exchange itself, wouldn't you be able again to kite values up far above the earning capacity of the country, above this 4 per cent I am talking about?

Mr. BAKER. Well, I do not like to be put in the class of having kited those things up. I am not just exactly sure that I know what that means.

Senator BROOKHART. Well, when you increased your own stock 2,500 per cent beyond its fair value, that was a pretty high kite itself, wasn't it?

Mr. BAKER. Of course, Senator Brookhart, after all it is the consumption of the stock, the buying of a stock or issue of bonds, which controls the price. And in our particular case that you mentioned, we felt very strongly that the more stockholders that we had in the bank, the more contacts we would have and the better our business possibilities for the bank would be.

Senator BROOKHART. But you knew all the time that the bank could not earn on a 2,500 per cent increase of its par capital.

Mr. BAKER. Well, of course, with the general growth of the country, of business and industry generally, banking facilities must keep up with it; and the value of bank stocks, of this kind of bank, is determined not only from the current dividend earning, but from the increase in its capital requirements, which affect favorably the holder of stock.

Senator BROOKHART. Then the speculative fever and manipulation sent it very much higher still.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Well, I should hate to think that is the controlling factor in it.

Senator BROOKHART. Now, if you would look at the history of the country, and study what the earning level had been through its prosperous periods, and if you had known that they were less than 4 per cent, then you would have known that there was no such increase possible as 2,500 per cent for conservative banks, or for a bank like your bank, isn't that so?

Mr. BAKER. Well, I don't quite see how you can measure the value of any particular industry, whether it is farming or banking or manufacturing, by an average.

Senator BROOKHART. Let us concede that you would not absolutely follow the average. Yet when we charter corporations, when the law charters corporations to combine their capital and go out and earn against individuals, and when the Congress permits them to come into interstate commerce and into the mails and into the telegraphs and telephones and all those things, shouldn't the Congress have something to say, and shouldn't the law have something to say about the profits they would charge people, when they have these great special privileges that the law gives them?

Mr. BAKER. Well, I certainly believe in proper regulation, if that is what you mean.

Senator BROOKHART. Well, is it proper regulation when the Congress sits by and lets your stocks go up to 2,500 per cent of their par value?

Mr BAKER. Well, I think the public buying will control that of itself.

Senator BROOKHART. Now, there is this final question: Supposing when we start this prosperity in agriculture and of labor again, when we have them reemployed, and when that starts general prosperity, if all your affiliates, and all stock exchanges get busy again and put on another gigantic boom, and then when that bubble bursts, won't we come back again into depression just as we did this time?

Mr. BAKER. Well, I hope not.

Senator BROOKHART. You hope not, but that will be the fact if you go in the same way again, and if we leave you unrestrained to do things on the stock exchanges, and in the affiliates, won't that have to be the result?

Mr. BAKER. Of course, I can not speak for the stock exchange at all because we are not members of the stock exchange, and have nothing whatever to do with its control or operation.

Senator BROOKHART. Yes; I see that you pulled out, but you thought they were not going fast enough to suit you then, didn't you?

Mr. BAKER. I am sorry if you think that.

Senator BROOKHART. I believe that is all I have to ask.

Mr. BAKER. Mr. Pecora, before you resume, let me say: I tried to draw on my memory this morning in order to answer one of your questions, and I fear I did not do it very well. During the luncheon recess I telephoned to get the real situation that existed on our books as regards that period of time when we borrowed that stock from Mr. Mitchell. I did say to you that the Farmers Loan & Trust Co.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

was entering into that, but I did not have those dates before me. I now have the position that we had in the Farmers Loan & Trust Co. stock, which a few weeks later was to be converted into National City Bank stock. And if you would like for me, or will permit me to do it, I should like to give you those figures at this time.

Mr. PECORA. When was that conversion to take place?

Mr. BAKER. The formal announcement to shareholders was made on April 1.

Mr. PECORA. When was the exchange of stock or the conversion to take place?

Mr. BAKER. The actual exchange of stock took place on July 8.

Mr. PECORA. On July 8?

Mr. BAKER. Yes.

Mr. PECORA. Well, that was fully two and a half months after the first borrowing of 15,000 shares of stock from Mr. Mitchell, wasn't it?

Mr. BAKER. Yes; but we had that stock at that time.

Mr. PECORA. You had what stock?

Mr. BAKER. We had the Farmers Loan & Trust Co. stock, which would be definitely exchanged for National City Bank stock.

Mr. PECORA. The National City Co. had a number of shares of the old Farmers Loan & Trust Co. stock in April?

Mr. BAKER. Yes; on April 22 we had 3,569 shares.

Mr. PECORA. Under the ratio of exchange that had been agreed upon, into how many shares of National City Bank stock would they be convertible?

Mr. BAKER. Seventeen thousand five hundred and odd shares.

Mr. PECORA. Now, as a matter of fact, how could you tell in April, 1929, that this merger of the Farmers Loan & Trust Co. with the National City Bank would receive the approval of the stockholders of both banks?

Mr. BAKER. We could not, except that the principal stockholders had informally agreed to it. It had been approved by the boards of directors and the announcement was made.

Mr. PECORA. And the stockholders of both institutions—that is, of the Farmers Loan & Trust Co. and of the National City Bank—were not called upon to approve or disapprove the merger until June 28, 1929; isn't that correct?

Mr. BAKER. The formal announcement went to the shareholders on April 1.

Mr. PECORA. Not the announcement. You mean the proposal, dont' you?

Mr. BAKER. And then the ratification by the stockholders was on June 28.

Mr. PECORA. Was to be on June 28?

Mr. BAKER. That is right.

Mr. PECORA. When was the proposed agreement of merger between the National City Bank and the Farmers Loan & Trust Co. actually made?

Mr. BAKER. Well, the discussion of the thing was prior to that by a good many weeks.

Mr. PECORA. And this was a discussion that was participated in by a handful of persons, wasn't it, and not by this large army of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

thousands of shareholders in all parts of the world to whom you referred this morning?

Mr. BAKER. Well, of course, the boards of directors of both institutions had approved it.

Mr. PECORA. The directors of both institutions proposed to present a plan to the stockholders of both institutions some time in April, is that correct?

Mr. BAKER. Well, they approved it before that, because on April 1 the formal announcement went out to stockholders.

Mr. PECORA. All right. The actual agreement, or the proposed agreement calling for the merger of the two institutions, was not entered into until late in May of 1929, was it, or, to be specific, on May 28, 1929?

Mr. BAKER. You mean the actual formal approval by the stockholders?

Mr. PECORA. The actual merger, the proposed merger, the agreement upon which the merger was to be effected.

Mr. BAKER. Yes.

Mr. PECORA. Was not entered into until May 28, 1929, was it?

Mr. BAKER. To be approved by the stockholders?

Mr. PECORA. No; not by the stockholders.

Mr. BAKER. I am sorry, but I do not quite understand you.

Mr. PECORA. The approval by the stockholders was not until June 28, 1929, was it?

Mr. BAKER. June 28; yes.

Mr. PECORA. Now, about a month before that the terms of the proposed merger between the two banks were reduced to writing and signed by the officers of the two banks, isn't that correct?

Mr. BAKER. Well, I do not believe so, because on April 1 formal announcement of this proposal went to the stockholders.

Mr. PECORA. When was the actual agreement signed?

Mr. BAKER. Well, May 3 then, as I understand it now, was the formal announcement.

Mr. PECORA. May 3 and not in April?

Mr. BAKER. Just let me check on that.

Mr. PECORA. I thought you had checked on that during the recess.

Mr. BAKER. I thought I had this correct. Let me ask Mr. Law—well, the information I have on this is that April 1 the formal announcement to shareholders was made.

Mr. PECORA. What was the nature of that announcement? Let us go one step at a time now.

Mr. BAKER. Of course, I telephoned to New York for this, and this was in the evening papers I think in New York on that day.

Mr. PECORA. What was the nature of the announcement that was made on April 1?

Mr. BAKER. Outlining the exchange proposal and terms of it.

Mr. PECORA. And then what was the next step?

Mr. BAKER. Well, of course, then on June 28 was the actual vote by the stockholders.

Mr. PECORA. Wasn't there any step in the interim?

Mr. BAKER. I do not know what papers might have gone out in between April 1 and June 28. I haven't those here.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Now, the situation was that the directors of the two institutions had had some sort of informal negotiations with each other.

Mr. BAKER. Yes; that had been taken.

Mr. PECORA. Wait a minute. Sometime in the spring of 1929, is that right?

Mr. BAKER. That is right.

Mr. PECORA. As a result of those informal conferences and negotiations between the officers and directors of those two banks, an announcement was caused to be made by advertisement in the newspapers to the shareholders of both institutions concerning the proposal for a merger of the two banks.

Mr. BAKER. That is right.

Mr. PECORA. Did any of the directors or officers of the National City Co. participate in those preliminary conferences and negotiations with the officers and directors of the Farmers Loan & Trust Co.?

Mr. BAKER. Well, the directors of the National City Bank were, of course——

Mr. PECORA (interposing). I have asked about the National City Co. Just answer that question.

Mr. BAKER. The directors of the National City Co., who at that time were directors of the National City Bank, would naturally participate.

Mr. PECORA. Were you one of those directors of the bank?

Mr. BAKER. I was elected a director of the bank during the month of April, but whether this was while that—no, that was April 1, I find. No; I don't know.

Mr. PECORA. You would answer in the affirmative the question as to whether any officers or directors of the National City Co. participated in those preliminary conferences and negotiations looking to the merger of the two banks.

Mr. BAKER. Well, as officers or directors of the National City Co. as such, no. But those same individuals might have been directors in the National City Bank.

Mr. PECORA. And there were some such individuals who were officers or directors of both the bank and the City Co. at the one time?

Mr. BAKER. That is right.

Mr. PECORA. And they took part in those preliminary negotiations and conferences, did they?

Mr. BAKER. That is right.

Mr. PECORA. Now, as a result of those conferences did those officers and directors assume that the stockholders of both institutions—that is, the Farmers Loan & Trust Co. and the National City Bank—would ratify a proposal to merge the two institutions?

Mr. BAKER. Yes.

Mr. PECORA. They felt quite certain that that would follow, did they?

Mr. BAKER. Yes. Both boards of directors had approved it.

Mr. PECORA. And you know that to be the fact, do you?

Mr. BAKER. Yes. I just wanted to give you those facts.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Did the National City Co. take a position in the market with regard to the stock of the National City Bank because of that advance knowledge which they had?

Mr. BAKER. Well, we bought Farmers Loan & Trust Co. stock.

Mr. PECORA. Because of that knowledge?

Mr. BAKER. We knew that that was to take place.

Mr. PECORA. And you figured that if that merger took place it would——

Mr. BAKER (interposing). Well, we——

Mr. PECORA (interposing). Wait a minute until I finish.

Mr. BAKER. I beg pardon.

Mr. PECORA. You figured that if that merger took place it would redound to the benefit—Mr. Law, let me ask this question of Mr. Baker, and don't interrupt him.

Mr. LAW. I beg pardon.

Mr. PECORA. You figured that if this merger took place it would redound to the benefit of the shareholders of both institutions, and for that reason the National City Co. started to acquire the stock of the Farmers Loan & Trust Co. in order to be able to take advantage of the proposed merger through exchange of stock?

Mr. BAKER. Not that at all. This announcement was on April 1, and our accumulation of stock there was April 22.

Mr. PECORA. And that was before any agreement was actually arrived at for the merger, wasn't it?

Mr. BAKER. Well, the stockholders had not formally approved, but the directors had, and we assumed that the stockholders would, which they did.

Mr. PECORA. When was this matter of the proposed merger first discussed at any meeting of the board of directors of the bank, if you can tell me?

Mr. BAKER. I cannot tell you. I was not on the board of directors at that time.

Mr. PECORA. Now, the Farmers Loan & Trust Co. was a State bank, wasn't it?

Mr. BAKER. Yes, sir.

Mr. PECORA. It was not a national bank?

Mr. BAKER. That is right.

Mr PECORA. And the National City Bank was a national bank?

Mr. BAKER. That is right.

Mr. PECORA. And the Farmers Loan & Trust Co., being a State bank, could only merge with another banking institution with the approval of the State superintendent of banks in New York; isn't that so?

Mr. BAKER. Well, I assume that is true, that it would be through the regular procedure there, whatever it was.

Mr. PECORA. Don't you know that is a requirement of the law?

Mr. BAKER. I think that is right.

Mr. PECORA. You are not guessing at it, are you? You are a director of the bank, aren't you, Mr. Baker?

Mr. BAKER. Yes; I am entirely in accord with that, of course.

Mr. PECORA. Did the directors and officers of the National City Co., before they started to accumulate the shares of the Farmers

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Loan & Trust Co., in anticipation of this merger, know that the State superintendent of banks of New York would give his approval?

Mr. BAKER. No; I do not know the answer to that.

Mr. PECORA. You did not feel that they were taking any risks, did you, in accumulating the stock of the Farmers Loan & Trust Co. in anticipation of the merger and the benefits that would thereby be acquired by your company as a stockholder?

Mr. BAKER. No; I did not think there was any risk. My only reason for getting this information was merely that I wanted to clear up the point, which I could not give you the figures on this morning, because I was certain we were not short of National City Bank stock, and yet I had to have these figures.

Mr. PECORA. Well, as a matter of fact, doesn't that still leave you short of National City Bank stock in April and May, when you borrowed 30,000 shares from Mr. Mitchell to cover that position?

Mr. BAKER. On that technicality, yes.

Mr. PECORA. Isn't it something more substantial than a mere technicality?

Mr. BAKER. It does not seem so to me.

Mr. PECORA. As a matter of fact, you did not know and could not know until June 28, when the stockholders of the two banks acted upon the proposal to merge, that such a merger would in fact be effected, did you?

Mr. BAKER. No; we could not be absolutely certain.

Mr. PECORA. So that——

Mr. BAKER (continuing). But we were morally certain that that would be effected.

Mr. PECORA. You still say that your company's selling of the capital stock of the National City Bank in April and May and June of 1929 was not of a character that required and compelled you to borrow 30,000 shares in order to protect a short position?

Mr. BAKER. Oh, yes, because this stock we held of the Farmers Loan & Trust Co. was not converted into National City Bank stock until July 8.

Mr. PECORA. You could not know and did not know at any time prior to June 28 whether it would be effected by a merger or not?

Mr. BAKER. I say, I could not tell, but it seemed practically certain it would be ratified by the stockholders.

Mr. PECORA. The number of shares your company could have obtained from that merger at the most was about 17,000 shares.

Mr. BAKER. At the date of April 22 that is what it would have been. On the date of the conversion, which was July 8, we had 5,446 shares.

Mr. PECORA. When was the first public announcement made of the proposal to merge the two banks?

Mr. BAKER. April 1, I think.

Mr. PECORA. Are you sure of that?

Mr. BAKER. I am sure if this information given me from New York is correct and I think it is.

Mr. PECORA. Isn't it a fact that it was on April 1, 1929, that the subject was first discussed or proposed at a meeting of the directors——

Mr. BAKER. No, sir——

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA (interposing). Let me finish. At a meeting of the directors of the National City Bank?

Mr. BAKER. No, sir. I am quite sure it was prior to that.

Mr. PECORA. Will you look at the minutes of a special meeting of the board of directors—well, while I am having some records examined let me ask you this question: Your statement was that as a result of the certainty, or moral certainty, on the part of the officers and directors of the National City Co. in April, 1929, that a merger of the National City Bank with the Farmers Loan & Trust Co. would be ratified and become effective on June 28, 1929, your company accumulated several thousand shares of the stock of the Farmers Loan & Trust Co.?

Mr. BAKER. That is right.

Mr. PECORA. And that as a result of this accumulation, and through the ownership of this stock, your company would be enabled to acquire on some ratio of exchange about 17,000 shares of National City Bank stock when that merger became effective, is that right?

Mr. BAKER. That is right, on the basis of our purchases.

Mr. PECORA. When did you buy those three or four thousand shares of Farmers Loan & Trust Co. stock?

Mr. BAKER. April 22.

Mr. PECORA. Isn't it a fact that on that date, April 22, the National City Co. was short over 25,000 shares of stock of the National City Bank which it had previously sold to customers throughout the country?

Mr. BAKER. No; I am quite sure not.

Mr. PECORA. Will you look at your records in verification of those figures?

Mr. BAKER. I have not the records by days, Mr. Pecora.

Mr. PECORA. Will you see if it was not short 25,181 shares at one time within that period?

Mr. BAKER. No. My figures do not show a shortage at all at any time.

Mr. PECORA. Your figures do not show a shortage because of the borrowing of those 30,000 shares from Mr. Mitchell?

Mr. BAKER. Yes; but borrowing those and applying this conversion of this stock into National City Bank stock eliminates any possibility of a short position.

Mr. PECORA. Then you felt sure you could sell short 17,000 shares because you could cover by the merger of the two banks in the latter part of June; is that right?

Mr. BAKER. In other words, by converting that into National City Bank stock we were not short.

Mr. PECORA. And if the stockholders of either of the banks on June 28, 1929, had kicked those plans for a merger into the wastebasket, your company would have been short 17,000 shares.

Mr. BAKER. We would have been short on that date in that event; yes.

Mr. PECORA. And yet in April and in June you went ahead, assuming that the merger would take place on June 28, and sold shares of National City Bank stock which the City Co. did not have.

Mr. BAKER. That is right.

Mr. PECORA. Does that complete your explanation?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. That is all I wanted to say. I just wanted to get those figures to you.

Mr. PECORA. Now, Mr. Baker, in answer to one of Senator Brookhart's questions in the last few minutes you stated, either in words or in substance, as follows: We, meaning the National City Co., felt very strongly that the more stockholders the bank had the more contacts we would have; do you recall that?

Mr. BAKER. Yes.

Mr. PECORA. What did you mean by that?

Mr. BAKER. I meant the more business possibilities, the more people would be interested in our institution.

Mr. PECORA. That is to say, you would have a larger army of prospective customers for the securities which the National City Co. was selling to the public; is that right?

Mr. BAKER. That, plus whatever facilities the bank had that could be used.

Mr. PECORA. In other words, it would also enlarge the facilities which the National City Bank could place at the disposal of the National City Co. in the sale of the latter company's securities to the public?

Mr. BAKER. Oh, no; I didn't have that in mind.

Mr. PECORA. What did you have in mind by the addenda that you made?

Mr. BAKER. It seemed to me that the more stockholders that the National City Bank had in the United States the more business opportunities there would be opened to the bank and the more people there would be interested in the business of the bank.

Mr. PECORA. Well, why was that the concern of the National City Co. as the securities selling organization.

Mr. BAKER. Because those same people with whom we were doing business throughout the United States, and others, and we were constantly increasing our business range, they would be prospective customers of the bank and of the company and of any other facility we had in banking.

Mr. PECORA. In other words, the stockholder of the bank would become a potential customer of the National City Co. for its securities.

Mr. BAKER. If he were an investor; yes.

Mr. PECORA. And that was the special desire of the National City Co. in enlarging the number of shareholders of the National City Bank, wasn't it?

Mr. BAKER. Oh, no; not particularly.

Mr. PECORA. It was one of them, wasn't it?

Mr. BAKER. It was one, certainly.

Mr. PECORA. And it was not an insignificant feature of its desire in that respect, was it?

Mr. BAKER. Not at all.

Mr. PECORA. Was it in order to serve that purpose or to further that purpose in some fashion, that the National City Co., from the time when the National City Bank was taken off the trading list of the New York Stock Exchange, in January of 1928, embarked upon an intensive campaign to sell the stock of the National City Bank throughout the country?

Mr. BAKER. Will you let me have that question repeated?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. The committee reporter will please repeat it. [Which was done.]

Mr. BAKER. Well, there are a good many different points in that question, I think.

Mr. PECORA. Was that one of the purposes that actuated or prompted your company to sell the stock of the bank throughout the country?

Mr. BAKER. One of the purposes, of course, was to increase the business in the National City——

Mr. PECORA (interposing). For whom?

Mr. BAKER. For the bank and the company.

Mr. PECORA. Was the company engaged in increasing the business of the bank?

Mr. BAKER. No; but we were interested in promoting the interests of the bank in any way we could, of course.

Mr. PECORA. Because you were an integral part of the bank, weren't you, in substance if not in form?

Mr. BAKER. Because we were all stockholders, and we were all interested in the general progress of the institution.

Mr. PECORA. Well, the National City Bank was a national banking institution under its charter, and the National City Co. was an investment company under the charter given to it by the State of New York. They were two separate legal entities, but in truth and in fact they were inseparably interwoven with each other, weren't they?

Mr. BAKER. Well, we certainly were a part of the same institution.

Mr. PECORA. They were so inseparably interwoven with each other that it was not possible for anyone not a stockholder of the bank to have any interest in the stock of the company.

Mr. BAKER. That is correct.

Mr. PECORA. And the bank was helping the company, and the company was helping the bank, all along the line, isn't that the conclusion?

Mr. BAKER. Actually helpful all the time.

Mr. PECORA. For that reason, among other reasons, your company was desirous of enlarging the number of stockholders of the bank?

Mr. BAKER. That is right.

Mr. PECORA. You know that a bank under the law can not trade in its own stock, don't you?

Mr. BAKER. Yes; that is right.

Senator BROOKHART. Where did you get this stock to enlarge the number of stockholders?

Mr. BAKER. Of course, there is a general market prevailing on the stock in New York, quotations all the time, people wanting to sell and people wanting to buy.

Senator BROOKHART. You got it from other stockholders and thereby reduced the number, as you bought it, didn't you?

Mr. BAKER. But where some estate, for instance, had to be settled and out of that estate came, perhaps, a block of a few thousand shares of stock, that stock would be purchased and we would sell it.

Senator BROOKHART. How much did you increase the number of stockholders of the bank?

Mr. BAKER. From 15,000 to 84,0000 or 85,000.

Senator BROOKHART. In how long a period of time?

Mr. BAKER. In three and a half years or four years.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. And that increase all occurred before the stock broke down in price, didn't it?

Mr. BAKER. No. The number of stockholders in 1927 was 15,854. In 1928 the number of stockholders was 18,402. The number of stockholders in 1929 was 62,868. The number of stockholders in 1930 was 68,491. The number of stockholders in 1931 was 79,260, and the number of stockholders in 1932 was 84,892.

Senator BROOKHART. But the price increased more rapidly, or I mean the number of stockholders increased more rapidly since the stock declined.

Mr. BAKER. Well, of course the largest increase was from the 1928 figures to the 1929 figures, and on account of the fact that the stock was split at that time.

Mr. PECORA. Mr. Baker, in order to enable the company more easily to find new stockholders for the bank, wasn't the par value of the stock of the bank reduced from $100 to $20 in February of 1929?

Mr. BAKER. It seemed to us that the price of the old stock was getting to such a high figure that the average investor could not afford to buy it.

Mr. PECORA. Well, the stock was placed, wasn't it?

Mr. BAKER. Yes; but——

Mr. PECORA (interposing). The bank did not own any of it and could not own any of it; isn't that a fact?

Mr. BAKER. That is true.

Mr. PECORA. The public had the stock when it was $100 in par value?

Mr. BAKER. But the bank was growing and more stock was being issued from time to time.

Mr. PECORA. And in order to increase the number of shareholders the stock of the bank was reduced in par value from $100 to $20 in February of 1929, wasn't it?

Mr. BAKER. Yes, that is right.

Mr. PECORA. All right. Now, Mr. Baker, are you reading something that helps you to answer any of my questions?

Mr. BAKER. I was just reading this paper to get the date and the announcement we made at the time the stock was split from $100 par value to $20 par value. If I may read to you what the board said about that matter.

Mr. PECORA. I know what the board said. I simply want the fact to appear in the record that there was a change in par value from $100 to $20 effective in February of 1929, and that one of the immediate effects of that change was to facilitate enlarging the number of shareholders of the bank.

Mr. BAKER. That is right, that it was then within the reach of the smaller investor.

Mr. PECORA. And the larger the number of shareholders the greater the number of prospective customers the National City Co. had for its securities.

Mr. BAKER. That is right.

Mr. PECORA. All right. Now I want to ask you: Did the National City Co. in the selling campaign which it instituted in the shares of the bank's stock, after those shares were taken from the trading

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

list of the New York Stock Exchange, ever seek to control the market?

Mr. BAKER. No, except that there were times when the market would seem to be moving too fast one way or the other due to some extraordinary situation of the moment, and there we would undertake to do it.

Mr. PECORA. Let me ask you a few questions about the selling facilities and organization of the National City Co.: How many departments did it have to handle its securities, and by what names were they designated or known?

Mr. BAKER. You are not referring to the sales organization particularly, but to the entire organization?

Mr. PECORA. To the general setup and operation of the company in its business of buying and selling securities.

Mr. BAKER. Well, our buying work is in the hands and is the responsibility of vice presidents. For instance, there is a vice president in charge of industrial work, and a vice president in charge of municipal work, and a vice president in charge of railroad work, and a vice president in charge of foreign work, and a vice president in charge of the selling organization.

Mr. PECORA. And you had a vice president in charge of securities issued by industrial corporations?

Mr. BAKER. Yes.

Mr. PECORA. And you had a vice president in charge of securities issued by railroad corporations?

Mr. BAKER. That is right.

Mr. PECORA. And you had a vice president in charge of securities issued by foreign governments and by foreign corporations?

Mr. BAKER. That is right.

Mr. PECORA. And you had a vice president in charge of municipal issues?

Mr. BAKER. That is right.

Mr. PECORA. And also of State and Federal Government issues?

Mr. BAKER. Well, that came under the same vice president.

Mr. PECORA. That would come under municipal issues generally?

Mr. BAKER. That is right.

Mr. PECORA. And you had a vice president in charge of securities issued by utility companies, didn't you? Wasn't that another subdivision in charge of a vice president?

Mr. BAKER. That is right, but that particular vice president was also in the industrial end as well.

Mr. PECORA. That is, utility securities came under the supervision of the vice president who had the industrial issues also in charge?

Mr. BAKER. That is right. And I did not mention a vice president in charge of accounting and treasury work.

Mr. PECORA. How many branch offices or district offices did the National City Co. have at the end of 1927?

Mr. BAKER. We had fifty-some odd.

Mr. PECORA. Can you get that information?

Mr. BAKER. Yes. I find it is 67.

Mr. PECORA. You had 67 district and representative offices, is that right?

Mr. BAKER. That is right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And they were linked up by 11,100 miles of private wire services, weren't they?

Mr. BAKER. That is correct.

Mr. PECORA. That is exclusive, isn't it, of service and sales facilities which the company had at 10 of the metropolitan branches of the bank in the city of New York?

Mr. BAKER. Yes, sir. I don't remember exactly what the dates were when we had the representatives in those branch offices of the bank. We established in those offices—or the fact is that when the offices were determined upon for the bank we generally had facilities, there, either a room of our own or a desk, and so forth, for the National City Co.

Mr. PECORA. Mr. Baker, have you before you a copy of the annual report of the operations of the National City Co. and its subsidiary corporations for the fiscal year ending December 31, 1927, which was made by Mr. Mitchell as the then president of the company to its board of directors?

Mr. BAKER. Yes, sir.

Mr. PECORA. Turn to the last page of it, please.

Mr. BAKER. The chart page?

Mr. PECORA. No, just ahead of the charts. Do you follow this statement concluding the textual portion of the report:

> Sales and service facilities have recently been established at 10 banks, metropolitan branches, but as these are not yet ready as additional offices, the year closed with a total of 67 district and representative offices supplemented by 11,100 miles of private wire service.

Mr. BAKER. That is correct.

Mr. PECORA. Now, Mr. Baker, do you know that frequently depositors of a bank seek the advice of officers of their bank with respect to making investments?

Mr. BAKER. Yes, sir.

Mr. PECORA. And in order for a bank to give that kind of advice disinterestedly it should not be interested in pushing any particular security, should it?

Mr. BAKER. Well, I think it is distinctly to the advantage of a bank if it has the benefit of the study of securities which our organization, we thought, was able to give.

Mr. PECORA. Isn't every well-organized and functioning bank possessed of certain facilities for informing its clients of security issues generally; I mean the soundness of security issues generally?

Mr. BAKER. It is, but of course that is in the matter of degree. There is a tremendous amount of study and research work required in the development of issues of securities and then in following their progress afterwards.

Mr. PECORA. Mr. Baker, you would not hesitate to say, would you, that the advice which a bank gives to a depositor, in response to the depositor's request for such advice concerning investments, should be wholly unselfish and disinterested on the part of the bank and should be designed to serve the depositor's interests?

Mr. BAKER. It should certainly serve the depositor's interests all the time.

Mr. PECORA. And do you think that a bank which has an affiliation with an investment company, sponsoring its own issues or the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

issues of others, is in a position to give that kind of unselfish and disinterested advice to a depositor seeking such advice?

Mr. BAKER. I think so.

Mr. PECORA. Do you recognize that to such a bank and its officers and employees there is the temptation of favoring the securities in which its affiliate is interested?

Mr. BAKER. That may be true, but the——

Mr. PECORA (interposing). Well, it is true, isn't it?

Mr. BAKER. But the point is, as I see it, that where the investment house has the facilities to determine the value of securities, that is a distinct advantage to have.

Mr. PECORA. But the investment house has not given the same consideration to all securities offered to the public as it has to those in which it is particularly interested, has it?

Mr. BAKER. That is right.

Mr. PECORA. So that a bank with that kind of investment affiliate, functioning even through the bank's own branches, is in the position of having the affiliate particularly interested in certain issues of which it has made a special study and of having the temptation always present to advise a depositor seeking its advice for investment purposes to invest in the securities which its investment affiliate is sponsoring.

Mr. BAKER. There is no doubt about that, and yet——

Mr. PECORA (interposing). And to that extent isn't there always lurking the danger that the depositor seeking disinterested advice won't get it?

Mr. BAKER. That depends upon the ability of the investment banking house in its research work, and in its investment in securities it recommends, to try to keep on hand a diversified list that will fit all classes of investors.

Mr. PECORA. Mr. Baker, do you still think it is good banking practice for a bank to have itself so interwoven with an investment affiliate, as the National City Bank is with the National City Co.?

Mr. BAKER. Yes, sir.

Mr. PECORA. You do?

Mr. BAKER. Yes, sir.

Mr. PECORA. Do you think it is good banking practice for a bank to have on its board interlocking directors?

Mr. BAKER. I do not see any objection to that.

Mr. PECORA. All right. I simply wanted to get your views about it. Now let me take up——

Senator BROOKHART (interposing). Mr. Baker, have you seen Senator Norris's spiderweb of Wall Street interlocking directorates down here?

Mr. BAKER. No.

Senator BROOKHART. I think you better go down and study that.

Mr. BAKER. All right.

Mr. PECORA. I will come back to the National City Bank stock matter later, but I want to take up something else for the moment: Mr. Baker, around the beginning of December, 1931, at which time you were a director of the National City Bank, and also president of the National City Co., did you purchase 1,500 shares of the stock of the bank?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. In 1931?

Mr. PECORA. Yes.

Mr. BAKER. You are referring, I assume, there to——

Mr. PECORA (interposing). I am referring to a transaction, or I am asking you about any transaction you might have had, involving the purchase by you of 1,500 shares of National City Bank stock.

Mr. BAKER. Yes.

Mr. PECORA. Now, have you in mind the transaction to which I have directed your attention?

Mr. BAKER. Yes.

Mr. PECORA. How much did you pay for that stock?

Mr. BAKER. I paid $50 a share, and——

Mr. PECORA (interposing). That means $75,000 for the 1,500-share block?

Mr. BAKER. That is right, and——

Mr. PECORA (interposing). In order to enable you to make that purchase did you borrow the total purchase price, $75,000?

Mr. BAKER. Yes, that is correct.

Mr. PECORA. From whom?

Mr. BAKER. From the Stock Purchase Corporation of our institution.

Mr. PECORA. From whom?

Mr. BAKER. From the Stock Purchase Corporation.

Mr. PECORA. Well, now, just what is that Stock Purchase Corporation which you refer to?

Mr. BAKER. Well, that is a corporation that was discussed here on yesterday, I think.

Mr. PECORA. That was the corporation which was set up to enable the officers and employees of the bank and its affiliates——

Mr. BAKER (interposing). Yes.

Mr. PECORA (continuing). To buy the capital shares of the bank on the installment plan?

Mr. BAKER. Yes.

Mr. PECORA. At what price was the stock made available to the officers and employees under that plan?

Mr. BAKER. Well, that was in 1929, when the stock was selling at about $200 a share. And, later on, there were additional offerings I think, in there, at $80 a share. But if you will permit me to tell you what this transaction was that I had?

Mr. PECORA. I am going to permit you to tell us all about it. I will ask you a number of questions, and I want to bring out all the facts connected with it.

Mr. BAKER. All right.

Mr. PECORA. Now, when this stock plan was set up, to enable the officers and employees of the bank and its affiliates to purchase shares of the bank on the installment plan, those shares were to be purchased generally at the market, weren't they?

Mr. BAKER. Yes; about the market or a little below the market.

Mr. PECORA. That plan was set up originally some time in 1927, wasn't it?

Mr. BAKER. Well, there was a plan in 1927. I am not particularly familiar with that. The first time that I knew about it, particularly, was the 1929 plan.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. The plan as originally set up in 1927 was not designed to include in its participation the lower-grade employees of the bank and its affiliates, was it?

Mr. BAKER. I am not sure about that.

Mr. PECORA. Well, the modification made in 1929 was intended to bring in the lower-grade employees, wasn't it?

Mr. BAKER. Yes; anybody in the organization.

Mr. PECORA. Then the inference is that prior to that time it was not possible, under this stock purchase plan, to admit to its benefits and participation the lower-grade employees.

Mr. BAKER. Well, that may be perfectly correct.

Mr. PECORA. Now, when it was modified in that way in 1929, the purpose was to enable officers and employees in the lower grades, getting a salary of $1,600 a year or more, to participate in this plan and to purchase shares of the National City Bank stock on the installment plan over a period of four years; is that right?

Mr. BAKER. That is right.

Mr. PECORA. And it was also intended under that modification to enable them to get that stock at about the general market price, which in December of 1929 was around $200 to $220 a share?

Mr. BAKER. That is right.

Mr. PECORA. And all employees who subscribed to the purchase of stock under that modified plan had the stock allocated to them at prices of $200 to $220 a share; is that correct?

Mr. BAKER. Yes.

Mr. PECORA. Now, in December of 1931 did something happen which enabled you to acquire 1,500 shares under this plan at $50 a share?

Mr. BAKER. Well, now, that is what I want to answer.

Mr. PECORA. First answer the question yes or no. Did something happen which had that effect?

Mr. BAKER. It had that effect.

Mr. PECORA. Well, now, what happened?

Mr. BAKER. What happened was this: I had loaned 1,500 shares of my stock——

Mr. PECORA (interposing). To whom?

Mr. BAKER. To my brother, and he used it to support a position as a partner in a stock exchange house. In the crash of 1929 he suffered serious losses, and this stock of mine of course was there supporting his——

Mr. PECORA (interposing). Supporting his margin account.

Mr. BAKER. Supporting his position as a partner in this firm. And I did not want to lose that stock. So that in reality I bought my own stock back again. And I could take my stock out only by putting in the amount of cash represented by the market value of the stock as of that day.

Mr. PECORA. Was that the complete explanation of it?

Mr. BAKER. Yes, sir.

Mr. PECORA. Now, let us make sure that we understand you. At the time of the market crash in October, 1929, a brother of yours had a partnership interest in a stock brokerage house?

Mr. BAKER. That is right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And in order to enable him to come through the emergency of that crash you loaned him 1,500 shares of capital stock in the National City Bank which you then had?

Mr. BAKER. No. I had loaned him 1,500 shares which represented his capital in that firm.

Mr. PECORA. Did you have any beneficial interest in your brother's interest in that firm?

Mr. BAKER. Not at that time.

Mr. PECORA. So you did that simply as an accommodation for your brother?

Mr. BAKER. That is right.

Mr. PECORA. After the stock-market crash did you lose your 1,500 shares which you had loaned to your brother to support his position in his firm?

Mr. BAKER. No; but I would have lost it except that I took it up, as I said.

Mr. PECORA. You took it up?

Mr. BAKER. I let the stock stay there, of course.

Mr. PECORA. Yes?

Mr. BAKER. And as his own personal affairs were in the red, were at a loss, with losses on account of the capital account, my stock therefore was tied up in this situation, and I wanted to get the stock out, and the only way I could get it out was to put cash in in its place.

Mr. PECORA. When did you get those 1,500 shares out of your brother's firm?

Mr. BAKER. That was some time in 1931. I don't remember the exact month.

Mr. PECORA. And how did you get them out?

Mr. BAKER. I arranged with the stock-purchase plan of our organization to take the stock up for me.

Mr. PECORA. At $50 a share?

Mr. BAKER. That was the market at that time.

Mr. PECORA. That was the market at that time?

Mr. BAKER. That is right.

Mr. PECORA. None of the other officers or employees who had subscribed for stock at $200 or $220 a share were ever permitted to replace that stock by stock which they could buy at $50 a share, were they?

Mr. BAKER. No; but neither was I replacing the stock. I had paid for this stock once, you see. It was my own stock, which I had loaned.

Mr. PECORA. But you had loaned it to your brother to support his position in his brokerage firm?

Mr. BAKER. Yes; that is right.

Mr. PECORA. And it was in danger there, wasn't it?

Mr. BAKER. Well, I don't know exactly that it was in danger, but I wanted to get the stock back, and the market price at that time was $50 a share, and I could get it back by putting up that additional amount. So, in effect, the $50 a share which I paid to get it back was $50 in addition to what I had originally paid for the stock years ago.

Mr. PECORA. I still don't understand it, Mr. Baker, and I do want to.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. I am sorry. I did not make that very clear.

Mr. PECORA. Let me see.

Mr. BAKER. I owned the stock, to begin with. I bought it some years ago. I loaned the stock to my brother.

Mr. PECORA. Prior to the crash in 1929?

Mr. BAKER. Oh, yes. And when the crash came along and he ran into serious losses his account was in the red, in the vernacular, and there was no way, of course, that he could release my stock back to me. So that the holders of the stock at that time were willing to take the market value of the stock in cash instead of holding the stock, and I wanted the stock back in my possession, and therefore I wanted to take the stock up, which I did.

Mr. PECORA. So you borrowed $75,000 from this stock-purchase plan in order to enable you to do that, didn't you?

Mr. BAKER. That is right.

Mr. PECORA. So it was not a purchase of stock under the installment plan, as that plan was originally proposed and conducted?

Mr. BAKER. No. That is right.

Mr. PECORA. Has that loan been repaid?

Mr. BAKER. It is being paid monthly.

Mr. PECORA. Is it secured, or otherwise?

Mr. BAKER. Just with the stock itself.

Mr. PECORA. It is not secured with stock that is now worth less than $50 a share, is it?

Mr. BAKER. Of course, there have been payments every month since it was put in there, which have reduced the amount of it substantially.

Senator BROOKHART. You mean the bank accepts its own stock as security?

Mr. BAKER. No. This is a separate corporation, Senator.

Senator BROOKHART. The stock is the bank stock, isn't it?

Mr. BAKER. Yes; that is right.

Senator BROOKHART. Is that what you put up for the security for this loan?

Mr. BAKER. Yes; but the loan——

Senator BROOKHART (interposing). To the corporation?

Mr. BAKER. To the corporation.

Senator BROOKHART. And not to the bank?

Mr. BAKER. That is right.

Senator BROOKHART. Of course, the bank furnished the money to the corporation?

Mr. BAKER. No. That loan supplying that money is made outside; the stock purchase corporation.

Senator BROOKHART. I thought the bank set that corporation up.

Mr. BAKER. No. The City Co. advanced a certain amount of money, but the principal part of that loan is outside.

Mr. PECORA. Mr. Baker, this merger of the bank with the Farmers Loan & Trust Co. that we discussed earlier this afternoon was proposed in the spring of 1929 and became effective on June 28, 1929, didn't it; that is, on that date it was ratified by the stockholders of both banks?

Mr. BAKER. Yes; that is right, June 28.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And from the commencement of the negotiation you felt sure that that merger would receive the approval of the stockholders?

Mr. BAKER. Yes, sir.

Mr. PECORA. Later that year were similar negotiations undertaken by the bank with the officers and directors of another bank in New York for a merger?

Mr. BAKER. That is right.

Mr. PECORA. That was with the Corn Exchange Bank, wasn't it?

Mr. BAKER. That is right; yes, sir.

Mr. PECORA. And when was that first proposed?

Mr. BAKER. I do not know just when the discussion first began on that, but it must have been some time in the early part or the middle of 1929.

Mr. PECORA. And were you just as sure at the outset of those negotiations that that merger would be ratified?

Mr. BAKER. Felt reasonably certain it would.

Mr. PECORA. Yes; just as reasonably certain as you felt that the earlier one with the Farmers Loan & Trust Co. would be ratified; is that right?

Mr. BAKER. Yes.

Mr. PECORA. As a matter of fact——

(Mr. Law handed Mr. Baker a document.)

Mr. PECORA. Did you ask Mr. Law while I was asking you a question to hand you any papers?

Mr. BAKER. Just now?

Mr. PECORA. Yes.

Mr. BAKER. No, sir.

Mr. PECORA. He did, didn't he?

Mr. BAKER. Yes, sir. He handed me this paper. It is the history of the Corn Exchange deal.

Mr. PECORA. Was that proposed merger with the Corn Exchange Bank ratified by the stockholders of any other bank?

Mr. BAKER. No; it was not.

Mr. PECORA. So that in that instance your moral certainty was proved utterly unfounded by the action of the stockholders?

Mr. BAKER. That is right.

Mr. PECORA. And you had no more reason to believe that that proposal to merge those two banks would be disapproved by the stockholders than you had to believe that the earlier proposal to merge with the Farmers Loan & Trust Co. would not be ratified, had you?

Mr. BAKER. Not at that time; no, sir.

Mr. PECORA. Mr. Baker, did the National City Co. ever grant anyone any option on a large block of National City Bank stock?

Mr. BAKER. Yes, sir.

Mr. PECORA. On how many occasions did it do that?

Mr. BAKER. Well, once that I recall definitely. I don't think of any other.

Mr. PECORA. And to whom did it grant the option on the one occasion that you recall definitely?

Mr. BAKER. Dominick & Dominick.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. What is the business of Dominick & Dominick?

Mr. BAKER. They are members of the stock exchange and investment bankers.

Mr. PECORA. Was a Mr. Dominick who is a member of that firm also a director of the bank or of the National City Co.?

Mr. BAKER. He is now a director of the bank. He was not at that time.

Mr. PECORA. Was he a director of the company?

Mr. BAKER. No, sir.

Mr. PECORA. At any time?

Mr. BAKER. Not at any time, nor is he now.

Mr. PECORA. When did he become a director of the bank?

Mr. BAKER. Some time in 1932.

Mr. PECORA. When did you grant his firm the option?

Mr. BAKER. Well, let's see what that date was. (Mr. Law handed document to Mr. Baker.) January 27, 1930.

Mr. PECORA. Have you the record, or rather the original correspondence between your company and Dominick & Dominick?

Mr. BAKER. Yes, sir.

Mr. PECORA. With respect to that option?

Mr. BAKER. Yes, sir.

Mr. PECORA. Will you produce it, please?

(Mr. Baker handed document to Mr. Pecora.)

Mr. PECORA. Now, the option which your company granted to Dominick & Dominick on January 27, 1930, extended to 30,000 shares of the stock of the bank, didn't it?

Mr. BAKER. That is right.

Mr. PECORA. At prices which changed with each—well, I will say at the following prices: 5,000 shares at $212½ a share; 5,000 shares at $215 a share; 5,000 shares at $217½ per share; 5,000 shares at $220 per share; 3,000 shares at $225 a share; 3,000 shares at $230 a share; 3,000 at $235 a share; and 3,000 at $240 a share.

This option has no time limit?

Mr. BAKER. Not at all; subject to cancellation.

Mr. PECORA. Except that your company reserves the right to cancel on five days' notice at any time?

Mr. BAKER. At once, I think it is.

Mr. PECORA. No.

Mr. BAKER. Isn't it?

Mr. PECORA. Upon five days' written notice, isn't it?

Mr. BAKER. Oh, yes. I am sorry.

Senator BROOKHART. What is the date of that?

Mr. PECORA. January 27, 1930.

Mr. BAKER. Yes; that is right.

Mr. PECORA. Do you know what the market value of the stock was on January 27, 1930?

Mr. BAKER. It was about $212 a share, I think, or $210.

Mr. PECORA. Wasn't it from 223½ to 225½ on that date?

Mr. BAKER. No, not at the time that—no, I am quite sure not.

Mr. PECORA. Have you the quotations for January 27, 1930, before you?

Mr. BAKER. No; I have not.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Will you please get them and then see if my figures are correct?

Mr. BAKER. I don't know that I have them exact. Their idea of this placement, you see——

Mr. PECORA (interposing). First I want to settle this one item and then we will get the idea.

Mr. BAKER. All right. The date of that is the 27th.

Mr. PECORA. January 27, 1930.

Mr. BAKER. I have got on the 24th——

Mr. PECORA (interposing). No, the 27th.

Mr. BAKER. Yes; but I haven't quite got that.

Mr. PECORA. What is the date that you have nearest to the 27th?

Mr. BAKER. The 24th.

Mr. PECORA. And what were the quotations on that day?

Mr. BAKER. 213.

Mr. PECORA. And what is the next date of which you have the quotations?

Mr. BAKER. January 31, and it is 223.

Mr. PECORA. I see. Now, you would not be surprised to know that the actual quotation on January 27, the day this option was granted, was 223½ bid, 225½ asked, would you?

Mr. BAKER. Well, I would be a little; but it might readily be.

Mr. PECORA. It was 223 on the 30th?

Mr. BAKER. Yes; that might very readily be.

Mr. PECORA. Now, you started to tell us something about an idea. What was it?

Mr. BAKER. The idea only connected with that was that they regarded the stock at that time—there was a group of houses connected with that, I think five. Dominick was acting for 3 or 4 or 5 houses.

Mr. PECORA. You mean stock brokerage houses?

Mr. BAKER. Yes; investment houses.

Mr. PECORA. Yes.

Mr. BAKER. And they wanted to offer the stock to their own customers, and they had no stock, and they made this arrangement with me.

Senator BROOKHART. They never exercised that option?

Mr. BAKER. Yes.

Mr. PECORA. Yes, they did.

Senator BROOKHART. All of it?

Mr. BAKER. Yes; they exercised the full option.

Mr. PECORA. Now, do you know when Dominick & Dominick first drew upon the City Co. for stock under this option?

Mr. BAKER. January 29; we delivered 15,100 shares to them.

Mr. PECORA. 15,100 shares?

Mr. BAKER. That is right.

Mr. PECORA. At what prices?

Mr. BAKER. I would have to refer to that. I haven't figures to show that.

Mr. PECORA. Wasn't it 5,000 shares at 212½, 5,000 shares at 215, 5,000 at 217½, and 100 at 220?

Mr. BAKER. Yes. That is in the confirmation. That is right.

Mr. PECORA. And do you know what the market value of those shares was on January 29, 1930?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Well, let's see if I have that. (After referring to paper.) January, 1930—January 31 shows, as I said a while ago, 223 on——

Mr. PECORA (interposing). 223; is that the bid or the asked price?

Mr. BAKER. Yes, that was the bid, 223.

Mr. PECORA. What is the asked price? The asked price is usually higher than the bid?

Mr. BAKER. Yes.

Mr. PECORA. Give us the range bid and asked and not just the lowest.

Mr. BAKER. 223 bid, 227 asked.

Mr. PECORA. And that was January——

Mr. BAKER. That is for that week.

Mr. PECORA. For that week?

Mr. BAKER. Yes.

Mr. PECORA. And it was when the range of prices in the market for the stock was 223 bid and 227 asked that under this option 5,000 shares were delivered at 212½, 5,000 shares at 215, 5,000 shares at 217½, and 100 shares at 220?

Mr. BAKER. That is right.

Mr. PECORA. The company was giving Dominick & Dominick quite a bargain then, wasn't it?

Mr. BAKER. Yes, it was a bargain, of course, and a deal that I made, and I went through with it. The market moved up.

Mr. PECORA. The market was considerably up beyond these prices of 212½ and 215 when you made the deal, wasn't it?

Mr. BAKER. Just slightly above.

Mr. PECORA. Do you call a 10-point spread an insignificant spread?

Mr. BAKER. No. I haven't that. My figure does not show that was a 10-point spread.

Mr. PECORA. My figures show that the bid was 223½ and the asked price 225½ on January 27, 1930. You would not dispute those figures would you?

Mr. BAKER. No. No, I don't care to dispute those figures.

(Mr. Baker conferred with Mr. Law.)

Mr. PECORA. Does Mr. Law know more about this transaction than you do, Mr. Baker?

Mr. BAKER. No.

Mr. PECORA. Have you asked him to give you any assistance to answer this question?

Mr. BAKER. No; but I would like to have him where I could get these papers from time to time, if you don't object.

Mr. PECORA. I have no objection. Will the papers that he turned over to you help some?

Mr. BAKER. Not in this market price, because I haven't that.

Mr. PECORA. How much was lost to the National City Co. by giving this option at these prices to Dominick & Dominick, as compared with the market prices?

Mr. BAKER. I could not answer that, except as I had the exact price or figures each day and compared with the deliveries to them.

Mr. PECORA. The amount was rather considerable, wasn't it?

Mr. BAKER. I don't think so, but I can not answer that.

Mr. PECORA. Perhaps your idea of a considerable amount and mine would differ.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. I don't know.
Mr. PECORA. What do you think was the loss?
Mr. BAKER. I just don't know.
Mr. PECORA. Perhaps Mr. Law can help you.
Mr. BAKER. No; he does not know.
Mr. PECORA. He does not know either?
Mr. BAKER. No.
Mr. PECORA. Did you know when you gave this option that you were doing it upon terms that would represent a loss to the National City Co. as compared with the market prices?
Mr. BAKER. I thought the prices—of course, I am drawing on my memory again—I thought the prices were approximately the market prices.
Mr. PECORA. Well, now, when you agreed on January 27, 1930——
Mr. BAKER. Yes.
Mr. PECORA. To give Dominick & Dominick an option on 5,000 shares, the first 5,000 shares——
Mr. BAKER. Yes.
Mr. PECORA. At 212½ you could have found out the market price within 10 minutes, couldn't you?
Mr. BAKER. Yes. I knew it then, of course.
Mr. PECORA. What was it then?
Mr. BAKER. I say I knew it then. I don't remember what it was on that day.
Mr. PECORA. Do you now recall that 212½ was around 10 points below the market on that day?
Mr. BAKER. I don't know that.
Mr. PECORA. Did you ascertain what the market price was at the time you agreed to this option?
Mr. BAKER. Oh, yes. Certainly I knew.
Mr. PECORA. So that if the market was 10 points or more above this price in the option, you gave the option knowing that fact, did you?
Mr. BAKER. If it were; yes.
Mr. PECORA. Was it your purpose to give them an option at that much below the market? Did you do that advisedly, intentionally?
Mr. BAKER. I don't recall, as I say, that there was that difference between the market and the option.
Mr. PECORA. Well, assuming that there was that difference, you gave the option with knowledge of the difference, didn't you?
Mr. BAKER. With a knowledge of the difference, certainly.
Mr. PECORA. Did you know Christmas time had passed by a month when this option was given.
Mr. BAKER. Yes.
Mr. PECORA. Did you intend to favor Dominick & Dominick to that extent?
Mr. BAKER. Why, no; of course not. They were interested in offering this stock to their customers.
Mr. PECORA. You know that Dominick & Dominick——
Mr. BAKER (interposing). I was delighted for them to do it. They were good customers.
Mr. PECORA. Good customers to whom, to Dominick & Dominick or the National City Co.?
Mr. BAKER. Dominick & Dominick and Brown Bros. & Co.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Was the National City Co. looking out for the customers of another investment dealer?

Mr. BAKER. No; but they would become stockholders of the National City Bank.

Mr. PECORA. If they did not become stockholders some one else would, wouldn't they?

Mr. BAKER. Probably.

Mr. PECORA. Did you know who the customers of Dominick & Dominick were?

Mr. BAKER. No.

Mr. PECORA. Why did you think they would be good customers for your company?

Mr. BAKER. Because they are good houses.

Mr. PECORA. Are you sure you did not know who were going to participate in the account which was maintained by Dominick & Dominick under this option?

Mr. BAKER. You mean their customers?

Mr. PECORA. Yes.

Mr. BAKER. Absolutely positive.

Mr. PECORA. You notice that in Dominick & Dominick's letters to you with regard to this account, this option rather, they write as follows:

> We have formed an account, of which we are the managers, with full discretionary powers as such, including the right to terminate the account at any time, and in which account we will participate for the purpose of dealing in the capital stock of the National City Bank of New York.

You noticed that language in their letter at the time, didn't you?

Mr. BAKER. Yes, certainly.

Mr. PECORA. Didn't that language strike you as being a reference to a trading account and not an investment account?

Mr. BAKER. Not at all. Because we discussed that very point, Mr. Pecora, in this thing.

Mr. PECORA. Who discussed it?

Mr. BAKER. I discussed it with some of the partners of Dominick.

Mr. PECORA. After you received this letter?

Mr. BAKER. No, no, no, no, no.

Mr. PECORA. Before?

Mr. BAKER. Prior to that.

Mr. PECORA. And in that discussion did you learn that these shares upon which you were giving an option to Dominick & Dominick at prices below the market were not going to be used in a trading account?

Mr. BAKER. That is right.

Mr. PECORA. When you got the letter did not the letter contain sufficient information to indicate to you that they were to be used in a trading account and not in an investment account?

Mr. BAKER. No; because——

Mr. PECORA (interposing). Now look at the caption of the letter itself and read what it says.

Mr. BAKER. That is what the caption is, but I discussed——

Mr. PECORA. Read it. What is it?

Mr. BAKER. I had discussed this——

Mr. PECORA (interposing). Read the caption out loud so the record will show it.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. "National City Bank of New York Capital Stock Trading Account." [Laughter.]

Mr. PECORA. All right.

Mr. BAKER. That is because they have an investment department that is distributing securities, not through the stock exchange, but as permanent investors.

Mr. PECORA. Now they say: "We are the managers of the account."

Mr. BAKER. That is right.

Mr. PECORA. They are not managing an investment account, are they?

Mr. BAKER. They have a group in this account of five houses, all with investment-distributing departments.

Mr. PECORA. Despite the fact that their letter to you with respect to this option and confirming the option is headed "National City Bank Trading Account"——

Mr. BAKER. Yes.

Mr. PECORA. You still say that when you received that letter you believed that these shares upon which you gave them an option were intended for investment purpose distribution?

Mr. BAKER. Yes, because I had that positive verbal understanding with Mr. Bellamy.

Mr. PECORA. Well, that verbal understanding was shattered by that letter, wasn't it?

Mr. BAKER. Not when their word is perfectly good.

Mr. PECORA. The letter to the company conforms with the word, doesn't it?

Mr. BAKER. That is the title that they put on there, but that did not mean more than that——

Mr. PECORA (interposing). They were not putting that title on there to deceive you, were they?

Mr. BAKER. No; I don't think so.

Mr. PECORA. They put that title on there in order to tell you in so many words that they were operating a trading account in this stock, didn't they?

Mr. BAKER. I don't think so.

Mr. PECORA. That was what they said in the letter, didn't they, in substance?

Mr. BAKER. That is the heading they put on it?

Mr. PECORA. Yes. Now, about Dominick & Dominick drawing down stock from your company on this option; didn't they always draw the stock down at the prices fixed by the option quotations, but on days when the market for the shares was way above the option prices?

Mr. BAKER. I don't know that.

Mr. PECORA. It would not surprise you to know that that was the fact, would it?

Mr. BAKER. No.

Mr. PECORA. May I have the letter?

(Mr. Baker handed a document to Mr. Pecora.)

Mr. PECORA. When was the last stock delivered to Dominick & Dominick under this option agreement?

Mr. BAKER. The actual delivery seems to be March 24, where the stock was actually delivered.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Yes; and how many shares were delivered then?
Mr. BAKER. Seven thousand shares.
Mr. PECORA. What was the market for the shares on March 24, 1930?
Mr. BAKER. March 21 I have; 236 was bid and the high asked that day was 252.
Mr. PECORA. 236 bid; 252 asked?
Mr. BAKER. That is right.
Mr. PECORA. And on that day——
Mr. BAKER. That is for the week.
Mr. PECORA. That is for the week?
Mr. BAKER. Yes.
Mr. PECORA. That is of March 21?
Mr. BAKER. Yes; March 21.
Mr. PECORA. And you know that the prices rose from day to day thereafter for a period of at least several days?
Mr. BAKER. Well, the following week the market was 240, with a high of 248, 247, 245, and 242. Now the market was dropping there a little. The market declined there the few weeks following.
Mr. PECORA. Don't you know that on March 24, 1930, the closing bid and asked prices for City Bank stock were 246 and 248, respectively?
Mr. BAKER. I do not, but that is probably correct.
Mr. PECORA. And that was the day on which you delivered under this option 1,335 shares at 230, 5,000 shares at 235, and 500 shares at 240; is that right?
Mr. BAKER. That is probably right. I haven't the exact figures here. I have the deliveries, but I haven't the prices. You have them there.
Mr. PECORA. Yes. Was anything paid by Dominick & Dominick to the City Co. for this option?
Mr. BAKER. No; I think not.
Mr. PECORA. Do you know what profit Dominick & Dominick made as managers of this trading account?
Mr. BAKER. No.
Mr. PECORA. Under this option?
Mr. BAKER. No; I do not know.
Mr. PECORA. Would it surprise you to know that it was $354,088.10?
Mr. BAKER. No; but I haven't any idea. I didn't know a thing about that.
Mr. PECORA. And you do not know the participants in that trading account, do you?
Mr. BAKER. I know two of them, and I am not sure about the other two, but I am quite sure that one was Brown Bros., and another was Cassatt & Co., but I don't know—recall who the others were.
Mr. PECORA. Do you know of any other option that your company ever gave to anyone else under generally similar circumstances?
Mr. BAKER. No; I do not.
Mr. PECORA. I want to ask that the correspondence relating to this option between the National City Co. and Dominick & Dominick be spread on the record, sir. I have photostatic copies so that we will not have to have your——

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER (interposing). That is my original. If you do not need that I would like to have it.

Mr. PECORA. Certainly.

The CHAIRMAN. Without objection, it is so ordered.

(The correspondence is as follows:)

DOMINICK & DOMINICK,
New York, January 27, 1930.

THE NATIONAL CITY BANK OF NEW YORK, CAPITAL STOCK

TRADING ACCOUNT

THE NATIONAL CITY CO.,
New York City.

(Attention of H. B. Baker, Esq.)

DEAR SIRS: We have formed an account of which we are the managers with full discretionary powers as such, including the right to terminate the account at any time, and in which account we shall participate, for the purpose of dealing in the capital stock of the National City Bank of New York.

We beg to confirm that you have extended to us, for and on behalf of the account, the right to purchase from you, in whole or in part, capital stock of the National City Bank of New York as follows:

		Per share
5,000	shares at	$212.50
5,000	shares at	215.00
5,000	shares at	217.50
5,000	shares at	220.00
3,000	shares at	225.00
3,000	shares at	230.00
3,000	shares at	235.00
3,000	shares at	240.00

said options to be exercisable by us at any time and from time to time and to continue in full force and effect for the life of the account, subject, however, to the right on your part to cancel these options in whole or in part upon five days' written notice to us.

Please confirm that the above is in accordance with your understanding and is the agreement between us by signing and returning to us the inclosed duplicate of this letter.

Very truly yours,

_____.

Confirmed and agreed to:

THE NATIONAL CITY CO.,
H. B. BAKER, *President.*

JANUARY 28, 1930.

THE NATIONAL CITY BANK OF NEW YORK, CAPITAL STOCK

THE NATIONAL CITY CO.,
New York City.

(Attention of Mr. H. B. Baker.)

DEAR SIRS: Confirming our telephone conversation of today, we have called from you, for delivery tomorrow, January 29, the following:

		Per share
5,000	shares at	$212.50
5,000	shares at	215.00
5,000	shares at	217.50
100	shares at	220.00

representing a portion of the above stock which we have under option from you, as outlined in the agreement between us dated January 27, 1930.

After exercising the above options there still remain under option to us a balance of 16,900 shares, at the following prices:

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

	Per share
4,900 shares at	$220.00
3,000 shares at	225.00
3,000 shares at	230.00
3,000 shares at	235.00
3,000 shares at	240.00

as specified in the above-mentioned agreement.

Very truly yours,

———— ————.

FEBRUARY 10, 1930.

THE NATIONAL CITY CO.,
New York City.

(Attention of H. B. Baker, Esq., President.)

DEAR SIRS: Referring to the agreement dated January 27, 1930, between us, under the terms of which you ceded us as managers of an account, option to purchase from you all or any part of 32,000 shares of capital stock of the National City Bank of New York, at prices ranging from $212.50 to $240 a share, we now confirm the understanding between us, that our option to purchase 3,000 shares at $240 a share has been reduced to 500 shares at that price and the difference canceled.

In all other respects the terms of the above contained agreement of January 27 continues in full force and effect.

Very truly yours,

———— ————.

THE NATIONAL CITY BANK,
New York, February 11, 1930.

DOMINICK & DOMINICK,
New York, N. Y.

(Attention of Mr. Beach.)

GENTLEMEN: Agreeable to your request over the telephone today relative to our delivery of 2,000 shares of National City bank stock, I wish to state that this stock was delivered at the following prices:

	Per share
200 shares at	$251¾
100 shares at	252¼
50 shares at	252¾
100 shares at	252¾
500 shares at	252¾
200 shares at	252¾
400 shares at	253¼
25 shares at	253¼
400 shares at	253¼
25 shares at	253¾

In connection with this delivery, we have charged you transfer tax of $25.64.

Very truly yours,

R. O. BALDWIN, *Treasurer.*

FEBRUARY 11, 1930.

THE NATIONAL CITY BANK OF NEW YORK, CAPITAL STOCK ACCOUNT

THE NATIONAL CITY CO.,
New York City.

(Attention of Mr. Meyer.)

DEAR SIRS: The participants in the above account, including ourselves, have to-day taken down a total of 7,565 shares of the above stock at $249 a share, for regular delivery.

We have received your letter of this date confirming that you sold in the market yesterday, 2,000 additional shares at prices ranging from $251.75 to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

$253.75 a share. As you have informed us that you were unable to cover any of this stock to-day at or below the mutually agreed upon price of $250 a share, we will therefore call 2,000 shares under our options in addition to the 7,565 shares above mentioned, as follows:

	Per share
4,900 shares at	$220
5,000 shares at	225
1,665 shares at	230

If agreeable to you, we will accept delivery of 7,565 shares on Thursday against payment of the amount due and will exchange checks with respect to the 2,000 shares.

Very truly yours,

——— ———, *Managers.*

MARCH 21, 1930.

THE NATIONAL CITY CO.,
New York City.

DEAR SIRS: Referring to the agreement of January 27, 1930, between us, we confirm having called from you all of the unexercised options to purchase capital stock of the National City Bank of New York, as follows:

	Per share
1,335 shares at	$230
3,000 shares at	235
500 shares at	240

for delivery to us on Monday, March 24, against payment of the amount due.

We also confirm the understanding between Mr. H. B. Baker and Mr. Bellamy of our firm, that you have sold us for delivery on the same date, 2,165 shares of capital stock of the National City Bank of New York at $249 a share, in order to complete delivery of stock against withdrawals of participants in the account.

Very truly yours,

——— ———.

Mr. PECORA. And I also want to include in that request, Mr. Chairman, the copy of the statement of the account of Dominick & Dominick with respect to its trades under this option.

Senator TOWNSEND. Does that give the participants in the pool?

Mr. PECORA. Yes, sir.

Senator BROOKHART. Who are the participants?

Mr. PECORA. The participants according to their statement of the account are Hornblower & Weeks, Abbott, Hoppin & Co., Dominick & Dominick, C. D. Barney & Co., Cassatt & Co., Brown Bros. & Co.

Senator BROOKHART. Is that all?

Mr. PECORA. Yes, sir. That is in the major trading account.

The CHAIRMAN. Without objection, it is so ordered.

(The accounts are as follows:)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

National City Bank trade account

Date	Shares		Less tax	Amount	Date	Shares		Less tax	Amount
1930					1930				
Jan. 29	5,000	Account option exercised, National City Co.	$212.50	$1,062,500.00	Jan. 29	500	D. D. Post	$222.30	$109,493.64
29	5,000	do	215.00	1,075,000.00	29	2,000	do	222.30	437,974.56
29	5,000	do	217.50	1,087,500.00	29	500	Brown Bros. & Co	222.30	109,493.64
29	100	do	220.00	22,000.00	29	2,000	do	222.30	437,974.56
30	100	do	222.00	22,200.00	29	1,000	Hornblower & Weeks	222.30	218,987.28
31		Balance		59,706.64	29	2,000	Cassatt & Co	222.30	437,974.56
					29	2,000	C. D. Barney & Co	222.30	437,974.56
					29	500	Cassatt & Co	222.30	109,493.64
					29	500	Hornblower & Weeks	222.30	109,493.64
					29	1,000	do	222.30	218,987.28
					29	100	D. D. Post	222.30	21,898.72
					29	500	C. D. Barney & Co	222.30	109,493.64
					29	500	Hornblower & Weeks	222.30	109,493.64
					29	500	Cassatt & Co	222.30	109,493.64
					29	500	Brown Bros. & Co	222.30	109,493.64
					29	500	D. D. Post	222.30	109,493.64
					29	500	C. D. Barney & Co	222.30	109,493.64
					30	100	D. D. Post	222.30	22,198.72
				3,328,906.64					3,328,906.64
Feb. 13	4,900	National City Co., account option exercised		1,078,000.00	31		Balance		59,706.64
13	3,000	do		675,000.00	Feb. 13	200	As of Feb. 10, National City Bank	251.75	50,247.44
13	1,665	do		382,950.00	13	100	do	252.25	25,173.72
28		Balance		289,312.30	13	850	do	252.75	214,401.66
					13	825	do	253.75	208,508.23
					13	25	do	253.75	6,330.89
					13	1,500	C. D. Barney	249.30	368,980.92
					13	1,500	D. D	249.30	368,980.92
					13	1,515	Hornblower & Weeks	249.30	372,670.68
					13	1,500	Cassatt & Co	249.30	368,980.92
					13	50	Abbott Hoppin & Co	249.30	12,299.36
					13	1,500	Brown Bros. & Co	249.30	368,980.92
				2,425,262.30					2,425,262.30

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

National City Bank trade account—Continued

Date	Shares		Less tax	Amount	Date	Shares		Less tax	Amount
1930					1930				
	1,335	National City Co	$230.00	$307,050.00	Feb. 28		Balance		$289,312.30
24	3,000	do	235.00	705,000.00	Mar. 24	1,400	Hornblower & Weeks	$251.30	347,182.16
24	500	do	240.00	120,000.00	24	1,400	Cassatt & Co	251.30	347,182.16
24	2,165	National City Co	249.00	539,085.00	24	1,400	C. D. Barney & Co	251.30	347,182.16
24		State and Federal taxes on 7,000 shares		89.04	24	1,400	D. D. Post	251.30	347,182.16
31		Balance		354,088.10	24	1,400	Brown Bros	251.30	347,182.16
					24		Deposit National City Co. State and Federal taxes on 7,000 shares		89.04
				2,025,312.14					2,025,312.14
					31		Balance		354,088.10
Apr. 21		Check, Hornblower & Weeks, profit in participation of 19.8 percent		63,098.50					
21		Check, Abbott Hoppin & Co. profit on participation 1 percent		3,186.79					
21		Check, Dominick & Dominick, 10 percent managers' fee		35,408.81					
21		Check, Dominick & Dominick, profit on participation 19.8 percent		63,098.50					
21		Check, C. D. Barney & Co., profit on participation, 19.8 percent		63,098.50					
21		Check, Cassatt & Co., profit on participation, 19.8 percent		63,098.50					
21		Check, Brown Bros. & Co., profit on participation, 19.8 percent		63,098.50					
				354,088.10					354,088.10

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

National City Bank trade account of D. D. Past

Date	Shares		Less tax	Amount	Date	Shares		Less tax	Amount
1930					1930				
Jan. 29	500	Traded	$222.00	$110,993.64	Jan. 29	100	Irving Slipka	$222.00	$22,198.72
29	2,000	do	222.00	443,974.56	29	5	Frank Jalmel	222.00	1,109.88
29	100	do	222.00	22,198.72	29	500	B. S. P., Inc., No. 2	222.30	109,493.64
29	500	do	222.00	110,993.64	29	4	John O. Polak	222.00	887.88
30	100	do	222.00	22,198.72	29	5	Robert Haberman	222.00	1,109.88
31		Interest	5.50	15.17	29	10	Paul Gurridge	222.00	2,219.84
					29	10	Mary M. Sanford	222.00	2,219.84
					29	20	Alex Creekmore	222.00	4,439.72
					29	50	Auerbach, Pollack & Richardson	222.00	11,099.36
					29	100	Huicks	222.20	21,998.72
					29	100	Mrs. Delia Walker	222.00	22,198.72
					29	50	M. Lazarus	222.00	11,099.36
					29	5	Charles Blumenthal	222.00	1,109.88
					29	25	Andrew Baxter	222.00	5,549.64
					29	25	Andrew Baxter, Jr	222.00	5,549.64
					29	125	Edw. M. Dalley	222.00	27,748.36
					29	50	Geo. A. Easley	222.00	11,099.36
					29	100	Samuel A. Mahlman	222.00	22,198.72
					29	100	Mrs. Ethel Sugerman	222.00	22,198.72
					29	100	Gilbert W. Kahn	222.00	22,198.72
					29	100	H. Hoffman, *Special*	222.00	22,198.72
					29	500	Alfred Lubman	222.00	110,993.64
					29	300	Interstate Corporation	222.00	66,596.16
					29	200	Mrs. Delia Walker	222.00	44,397.44
					29	100	Securities Management Corporation	222.00	22,198.72
					29	100	Elizabeth Glendenning	222.00	22,198.72
					29	100	Philip Lewis	222.00	22,198.72
					30	100	Irving Slifka	222.00	22,198.72
					31		Balance		49,665.01
				710,374.45					710,374.45
31		Balance		49,665.01	Feb. 3	16	Middleton Rose	222.00	3,551.72
31	216				3	200	B. Patterson, Jr	222.00	44,397.44
Feb. 13	1,500		249.00	373,480.92	11	25	F. J. Reinhart	249.00	6,224.64
					13	100	R. C. Li	249.00	24,898.72
					13	150	Auerbach, Pollack & Richardson	249.00	37,348.08
28		Interest	4.75	24.87	13	125	Mrs. Viola V. V. N. Waldron	249.00	31,123.36
					13	100	Henry A. Arthur	249.00	24,898.72
					13	100	Interstate Corporation	249.00	24,898.72
					13	100	Joseph Price	249.00	24,898.72
					13	100	Bridgeport City Co	249.00	24,898.72
					13	50	John Biro	249.00	12,449.36
					13	50	do	249.00	12,449.36

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

National City Bank trade account of D. D. Past—Continued

Date	Shares		Less tax	Amount
1930				
Feb. 28				$423,170.80
		Balance		1,740.96
Mar. 24	25	Hait, Rose & Foster	$25.00	6,275.00
24	1,400	Trade	251.00	351,382.16
24	25	J. R. Schmeltzer	251.00	6,275.00
24	50	R. W. P. Barnes	251.00	12,550.00
31		Interest	4.25	165.12
				378,388.24
31		Balance		194,012.84
	765	Shares		
30		Interest	4.50	553.00
				194,565.84
Apr. 30		Balance		54,084.81
30	665			
May 31		Interest	3.75	44.69
		Balance		17,083.00

Date	Shares		Less tax	Amount
1930				
Feb. 13	10	Chas. A. Bauer	$249.00	$2,489.84
13	50	Chatham Phenix Corporation	249.00	12,449.36
13	100	Bridgeport City Co	249.00	24,898.72
13	100	Philip Lewis	249.00	24,898.62
13	100	do	249.00	24,898.72
13	200	Mrs. Delia Walker	249.00	49,797.44
13	40	Hugo Lehman	249.00	9,959.48
28		Balance		1740.96
				423,170.80
Mar. 24	10	John C. MacCarthy	251.00	2,509.84
	10	Charles H. Base	251.00	2,509.84
	100	Noble & Corwin	250.00	24,998.72
	100	Auerbach, Pollack & Richardson	251.00	25,098.72
	50	Bank of South Dayton	251.00	12,549.36
	25	R. H. Forschull	251.00	6,274.64
	25	Philip Hall	251.00	6,274.64
	50	Geo. A. Earley	251.00	12,549.36
	50	W. H. Jessup	251.00	12,549.36
	15	M. J. Hammer	251.00	3,764.76
	100	Jos. Guli	251.00	25,098.72
	100	Chas. Samuel	251.00	25,098.72
	100	Auerback, P. R	251.00	25,098.72
24		Balance		194,012.84
				378,388.24
Apr. 14	50	V. V. N. Waldron	241.00	12,049.36
17	50	Dr. Geo. Seffers	238.60	11,924.36
21		Dep. 10 per cent managers fee		35,408.81
21		Dep. $3 per share Selling Commission on 6,000 shares		18,000.00
21		Dep. 19.8 percent profit on participation in trade		63,098.50
30		Balance		54,084.81
				194,565.84
May 5	5	N. Fishman	207.00	1,034.88
7	25	J. K. Rice	192.00	4,799.64
7	10	Clinton Gilbert	192.00	1,919.84
7	50	J. K. Rice, Jr	194.00	9,699.36
7	25	Grannis & Doty	194.00	4,849.64
7	25	J. R. Schmeltzer	192.00	4,799.64
7	25	J. R. Schmeltzer	194.00	4,849.64
9	50	J. R. Schmeltzer	193.50	9,674.36

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

								9	50	Laird Bissell, & Meeds	194.00	9,699.36
								12	50	Hart Rise & Trustees	195.00	9,749.36
								19	25	Broomhall K. & Co	203.00	5,074.64
								19	25	Clinton Gilbert	202.50	5,062.14
						71,212.50						71,212.50
	31	300	Shares				May	31		Balance	149.50	17,083.00
June	23		Transferred to P. L. Invest. Department			12,059.04	June	20	10	Charles B. Whipple		1,494.84
	30		Balance			6,518.80						
						18,577.84						18,577.84
	30	290	Shares					30		Balance		6,518.80
Aug.	31		Balance			6,818.80	July	1		Div. 300 shares		300.00
						6,818.80						6,818.80
	31	290	Shares.				Aug.	31		Balance		6,818.80
Oct.	3		Transferred to B. D. Inc. account			750.44	Sept.	11	20	W. W. Lanahan Co	173.50	3,469.72
	3		Transferred to J. A. B. Special			750.44		11	25	J. K. Rice, Jr. & Co	173.00	4,324.64
	3		Transferred to A. V. S., Sr. Inc			750.44		11	25	Hart Rice Trustees	172.50	4,312.14
	3		Transferred to B. S. P. Inc			750.44		11	20	J. R. Schmeltzer	174.50	3,479.72
	4		Ck National Bond & Share Corporation profit in participating			1,500.87		18	25	Laird Bissell & Meeds	166.50	4,162.14
							Oct.	1		Div. 290 shares		290.00
	16		Transferred to P. L. Stock & Bond, 1930 1st half			45,764.83		1	75	Schmeltzer	135.50	10,161.58
								2	100	Schmeltzer	132.50	13,248.72
						50,267.46						50,267.46

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Now, those firms that I have just mentioned you know to be brokers—brokerage firms?

Mr. BAKER. Yes; I know most of them.

Mr. PECORA. And they all had close business affiliations and dealings with your company, did they not?

Mr. BAKER. Well, some of them.

Mr. PECORA. Throughout the years that it has been in business?

Mr. BAKER. That is right.

Senator TOWNSEND. Was this stock you gave purchased from time to time?

Mr. BAKER. Yes; that is right, sir.

The CHAIRMAN. The committee will recess until 10 o'clock in the morning. All witnesses under subpoena will report here at that time.

(Accordingly, at 4.17 o'clock p. m., the subcommittee adjourned until 10 o'clock a. m. of the next day, Friday, February 24, 1933.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

STOCK EXCHANGE PRACTICE

FRIDAY, EEBRUARY 24, 1933

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

The subcommittee met, pursuant to adjournment on yesterday, at 10 o'clock a.m., in room 301 Senate Office Building, Senator Peter Norbeck presiding.

Present: Senators Norbeck (chairman), Couzens, Townsend, Fletcher, and Costigan.

Present also: Senators Brookhart and Reynolds.

Further present: Ferdinand Pecora, special counsel to the committee; Julius Silver and David Saperstein, associate counsel to the committee.

The CHAIRMAN. The subcommittee will come to order. Mr. Pecora, who will you have this morning?

Mr. PECORA. Mr. Baker will please resume his testimony.

TESTIMONY OF HUGH B. BAKER, PRESIDENT NATIONAL CITY CO., NEW YORK CITY—Resumed

Mr. PECORA. Mr. Baker, did you participate in the management fund distribution for the year 1929 of the National City Co.?

Mr. BAKER. Yes, sir.

Mr. PECORA. To what extent?

Mr. BAKER. Well, of course as to the year 1929 there really wasn't a fund, you might say.

Mr. PECORA. I did not hear you.

Mr. BAKER. I say, in 1929 the fund entirely disappeared before the end of the year. I don't remember what the amount was.

Mr. PECORA. Wasn't there a distribution for the first six months of that year?

Mr. BAKER. Yes, sir.

Mr. PECORA. And wasn't the distribution a very substantial amount?

Mr. BAKER. Yes.

Mr. PECORA. What was your participation in that fund?

Mr. BAKER. From memory, and I haven't that figure before me, I think it was $225,000 or thereabouts.

Mr. PECORA. For the first six months?

Mr. BAKER. Yes.

Mr. PECORA. What was the extent of your participation in the management fund of the National City Co. for the year 1928?

Mr. BAKER. It was $266,670.41.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And that was exclusive of your salary?

Mr. BAKER. Yes, sir.

Mr. PECORA. What was the extent of your participation in the management fund for the year 1927 of the National City Co.?

Mr. BAKER. It was $185,250.

Senator FLETCHER. And what has been your salary?

Mr. BAKER. Twenty-five.

Mr. PECORA. What was that?

Mr. BAKER. Twenty-five.

Mr. PECORA. For the year?

Mr. BAKER. Yes, sir.

Senator COSTIGAN. When you said "25", did you mean that your salary was $25,000?

Mr. BAKER. Yes, sir.

Mr. PECORA. Did you say it was about $250,000 for the first 6 months?

Mr. BAKER. I was guessing at the figure. I am not sure about it.

Mr. PECORA. But was the figure that you guessed at $250,000?

Mr. BAKER. I guessed it was $225,000.

Senator TOWNSEND. Mr. Baker, you may have covered this heretofore, but how were the profits made that were included in this particular division?

Mr. BAKER. In this management fund?

Senator TOWNSEND. Yes.

Mr. BAKER. The earnings of the company first had deducted from them 8 per cent of the capital surplus and undivided profits, that was first deducted, and then of the balance the deductions were 80 per cent and 20 per cent, 20 per cent going into the management fund to be allotted to various executives.

Senator TOWNSEND. You mean that a management fund was set up out of capital?

Mr. BAKER. No; it depends upon the current earnings of the company.

Senator TOWNSEND. And you say 8 per cent was what?

Mr. BAKER. Before any management fund is figured at all there is allotted out of current earnings, capital, surplus and undivided profits, 8 per cent, and then of the balance 20 per cent goes into the management fund.

Senator TOWNSEND. Of the surplus of the National City Co.?

Mr. BAKER. Yes, sir.

Senator TOWNSEND. All right.

Mr. PECORA. Mr. Baker, it has already been testified, either by you or one of the preceding witnesses, that during the year 1929 your company sold to the public upwards of 1,300,000 shares of the capital stock of the National City Bank. Do you recall that testimony?

Mr. BAKER. Yes, sir.

Mr. PECORA. It is correct, is it?

Mr. BAKER. Yes.

Mr. PECORA. Mr. Baker, in effecting those sales, and in making purchases of stock that your company found it necessary to buy in order to make deliveries for those sales, did the National City Co. employ stock brokerage houses to accumulate stock for it?

Mr. BAKER. No; I should not say that. But we bought stock from brokers.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. To what extent, in percentage?

Mr. BAKER. Well, that would only be an estimate, Mr. Pecora. I should estimate that to be, perhaps—oh, I should think 75 per cent.

Mr. PECORA. How many brokerage firms did you have transactions of that kind with?

Mr. BAKER. That would be quite a large number.

Mr. PECORA. About how many, whether large or small?

Mr. BAKER. I should think 15 or 20, and probably 20.

Mr. PECORA. With which firm, according to your best recollection now, did you have the largest number of such transactions in that year?

Mr. BAKER. Well, sir, I do not know that I can answer that. I have never studied the division of where those orders went, and through what brokers they were placed, to try to get that in my mind. It made no difference to me to what brokers they went.

Mr. PECORA. Do you recall a brokerage firm known as J. R. Schmeltzer & Co.?

Mr. BAKER. Yes; I know that name, but I do not know the individual members of the firm.

Mr. PECORA. Were they specialists in your bank stock?

Mr. BAKER. I think they were specialists in bank stocks generally but not in any one particular bank.

Mr. PECORA. Do you recall that you had a large volume of transactions with that brokerage firm in the stock of the National City Bank during the year 1929 particularly?

Mr. BAKER. Well, I do not know how large the volume amounted to. There were transactions with that firm and I think in substantial amount.

Mr. PECORA. Now, Mr. Baker, was there any security of any kind whatsoever in which the National City Co. traded in the year 1929 to a greater volume than National City Bank stock—any other single security I mean?

Mr. BAKER. Well, I can only answer that after referring to our records, Mr. Pecora, and seeing just the amounts of the different issues, because during the year 1929 our total volume of business in all our different offerings ran into a very substantial volume.

Mr. PECORA. It ran into a volume of over $2,000,000,000, didn't it?

Mr. BAKER. Yes.

Mr. PECORA. Now, of that volume did you deal in any single issue or security to a greater extent than you dealt in the capital stock of the National City Bank?

Mr. BAKER. Well, I do not know. I would have to refer to our complete records on that to answer the question.

Mr. PECORA. As you sit there now, can you recall any other issue in which your dealings were greater than in the bank stock for that year?

Mr. BAKER. I do not recall any.

Mr. PECORA. Did you have anything to do with the trading in National City Bank stock on behalf of your company in that year?

Mr. BAKER. Do you mean in the placing of orders?

Mr. PECORA. Did you have anything whatsoever to do with it?

Mr. BAKER. Oh, yes; certainly.

Mr. PECORA. What did you have to do with it?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Well, I was the president of the company, and I was interested in all of our purchases and in all of our sales.

Mr. PECORA. And gave directions for the making of purchases and sales?

Mr. BAKER. Yes; but not always in detail. In a general way I gave the directions controlling that.

Mr. PECORA. Was the execution of your instructions or directions entrusted to the supervision of any particular individual?

Mr. BAKER. Yes, sir.

Mr. PECORA. To whom?

Mr. BAKER. Mr. Morrison.

Mr. PECORA. And Mr. Morrison was the head of your trading department?

Mr. BAKER. Yes; and a vice president of the company.

Mr. PECORA. And he is here under subpœna?

Mr. BAKER. Yes, sir.

Mr. PECORA. Did the National City Co. make the market for that stock?

Mr. BAKER. No; I would not say that at all. We were prepared to make quotations, either to buy or sell, at any time in exact line with the prevailing general market.

Mr. PECORA. Do you know of any other trader or dealer in securities who had anything like the volume of trading in National City Bank stock in the year 1929 that the National City Co. had?

Mr. BAKER. Well, I could not give you that, because I do not know the records of other houses. I do know that there were perhaps 60 or more houses advertising in the newspapers as bank-stock specialists or dealers in bank stocks, and as to what the volume of their business may have been I have no way of knowing. But my estimate would be that our volume as it related to the entire volume of trading, would not exceed somewhere around perhaps 10 or 15 per cent.

Mr. PECORA. No, my question was: Do you know of any other dealer or trader who dealt in the stock of the National City Bank to as great an extent as the National City Co.? Have you knowledge of any such?

Mr. BAKER. No, I do not know that, because I do not know what the trading of any particular firm was.

Mr. PECORA. Weren't you in constant touch with the over-the counter market in the bank's stock?

Mr. BAKER. Yes, sir.

Mr. PECORA. Wouldn't that enable you to learn whether there was any other single dealer or trader whose business compared with that of the National City Co. in that stock?

Mr. BAKER. No; I could not possibly know that.

Mr. PECORA. You say you could not possibly know that?

Mr. BAKER. No.

Mr. PECORA. You have no idea or information on that subject to-day?

Mr. BAKER. I, of course, knew that there were a great many people trading in bank stocks, our and other bank stocks, but as to the amount of their volume, I do not know that.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Now, one day in September of 1927 you noticed that five sales of 10 shares each of the National City Bank stock were made on the New York Stock Exchange?

Mr. BAKER. Yes, sir.

Mr. PECORA. And the spread between the bid and asking prices was 5 points, as I recall your testimony.

Mr. BAKER. That was between sales?

Mr. PECORA. Yes, between sales.

Mr. BAKER. Yes, sir.

Mr. PECORA. And you thought that indicated a manipulation of the stock on the floor of the exchange, didn't you?

Mr. BAKER. No. I thought——

Mr. PECORA (interposing). Isn't that what you testified to yesterday?

Mr. BAKER. Well, I don't remember my exact words, but——

Mr. PECORA (interposing). Well, I do remember your exact words, and I think I have quoted them textually.

Mr. BAKER. Well, if you will permit me to explain my thought on that, it is this: That it showed to me that a sudden order came on to the stock market without any particular stock there for sale at that same time, and that it would be a very easy thing if anyone wanted to do it to manipulate the stock.

Mr. PECORA. You said yesterday that those five sales of 10 shares, each made on the Stock Exchange one day in September of 1927, so impressed you with the thought that they were the result or gave evidence of manipulation, that you sent a cable to Mr. Mitchell who was then in Paris.

Mr. BAKER. That is right.

Mr. PECORA. And called his attention to the startling manipulation evidenced by five sales grossing 50 shares.

Mr. BAKER. The possibility of it.

Mr. PECORA. The possibility of it?

Mr. BAKER. Yes, sir.

Mr. PECORA. How many wires did you have in the trading department of your company?

Mr. BAKER. Telephones connecting with brokers, do you mean?

Mr. PECORA. Yes.

Mr. BAKER. Well, I don't know, probably 20 or 30.

Mr. PECORA. And how many men did you have in the trading department?

Mr. BAKER. I should think about that same number, 15 to 20.

Mr. PECORA. Wouldn't that indicate that the National City Co. in those days was engaged in a volume of trading in the bank's stock far, far exceeding what alarmed you in September of 1927 when 50 shares gross were traded in on the Stock Exchange in 5 transactions?

Mr. BAKER. Mr. Pecora, I misunderstood your question just prior to this. I thought you meant how many telephone connections or wires there were with brokers generally for the conduct of our general business, our entire business. My reply was with that thought in mind. I do not think there was over one—well, I don't know that there was any particular wire strictly confined to trading in National City Bank stock. I think that was just over any of our wires, of which we had perhaps 15 or 20.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. In other words, you made trades over your 20 wires connecting with different brokerage houses?

Mr. BAKER. Over any wire, with any broker.

Mr. PECORA. Didn't that indicate a volume and kind of trading that far exceeded the trading amounting to 50 shares in 1 day which alarmed you in September of 1927 when those 50 shares were dealt in on the New York Stock Exchange in 5 transactions of 10 shares each?

Mr. BAKER. Well, except of course, I repeat, that those wires were being used for the conduct of our general business.

Mr. PECORA. They were being used extensively too for your trades in National City Bank stock?

Mr. BAKER. Any time we had trades to make they were made over the telephone.

Mr. PECORA. And you sold as many as 90,000 shares in a single week, didn't you, in 1929?

Mr. BAKER. No, sir— yes, that is right, for the week of February 21. But that—let me see—but that was after the old stock had been exchanged on a 5-to-1 basis.

Mr. PECORA. Of course, that volume of trading did not indicate any manipulation of the market, did it?

Mr. BAKER. Not necessarily.

Mr. PECORA. When does a volume of trading indicate manipulation, and when doesn't it?

Mr. BAKER. That is—I can not answer that, because I think each case there has to be studied in itself. There might be a great many buying orders received on any particular security, and selling orders on the same day, and that might not have any feature of manipulation in it, but would simply be the execution of buying and selling orders.

Mr. PECORA. Isn't it easier to control the over-the-counter market for a security than the Stock Exchange market?

Mr. BAKER. That again depends upon its activity and how many buyers and sellers there may be.

Mr. PECORA. Well, generally speaking isn't it easier to control the over-the-counter market for a security than the Stock Exchange market?

Mr. BAKER. Well, there may be cases where that is true; yes.

Mr. PECORA. Isn't that true with bank shares particularly?

Mr. BAKER. I do not know why it should be.

Mr. PECORA. Well, is it true?

Mr. BAKER. With outside dealers trading over the counter, traders in any volume at all, with anybody who is interested to buy and sell, there is a free and open market on it.

Mr. PECORA. I am not inquiring into the why of it but whether or not it is a fact.

Mr. BAKER. It may be, but I don't know.

Mr. PECORA. You are market wise, aren't you?

Mr. BAKER. I don't know that I am.

Mr. PECORA. Do you think you would be the president of the National City Co. if you were not a keen student and observer of the markets for securities, all markets?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Well, I certainly don't know the answer to that question. That is somebody else's decision to make.

Mr. PECORA. It is not an unfair assumption that you were chosen for the chief executive position of this great investment company because you were market wise, is it?

Mr. BAKER. Well, I doubt if that was the consideration of it. I don't think that was the idea, as to whether I was market wise or not.

Senator BROOKHART. That was one of the things, wasn't it?

Mr. BAKER. I do not know, Senator. I was not there when the matter was being discussed.

Mr. PECORA. Now, Mr. Baker, in the month of October, 1929, do you know the volume of transactions in National City Bank stock that your company had with J. R. Schmeltzer & Co.?

Mr. BAKER. No.

Mr. PECORA. Have you any figures in mind that would indicate to you what they were?

Mr. BAKER. No; I have not.

Mr. PECORA. None at all?

Mr. BAKER. No, sir.

Mr. PECORA. You have no personal recollection of it?

Mr. BAKER. No; I have not at all, I am sorry to say.

Mr. PECORA. Is your mind a blank on that point as you sit there now?

Mr. BAKER. Yes, sir.

Mr. PECORA. An utter blank?

Mr. BAKER. So far as the amount of the transactions we had with Schmeltzer is concerned.

Mr. PECORA. What was the general course of the transactions you had with J. R. Schmeltzer & Co. in the stock of the bank?

Mr. BAKER. Well, we gave them—we would buy stock or sell stock from them the same as we would any other dealer in bank stocks. As to whether or not the volume ran greater with any particular house than some other house I assume would depend entirely upon the character of service and so forth rendered by that house in that particular issue.

Mr. PECORA. Would you give them orders to accumulate shares of National City Bank stock for you and have those paid for by the National City Bank?

Mr. BAKER. No, sir.

Mr. PECORA. Did you do anything in the course of your transactions in National City Bank stock with J. R. Schmeltzer & Co. that included the National City Bank in the process?

Mr. BAKER. Not to my knowledge.

Mr. PECORA. Have you with you here the correspondence passing between J. R. Schmeltzer & Co. and the National City Bank?

Mr. BAKER. No.

Mr. PECORA. Will you ascertain whether any of your associates has it?

Mr. LAW. Your Mr. Saperstein has that, Mr. Pecora.

Mr. PECORA. Let me read, for instance, what purports to be a copy of a letter addressed to the National City Bank by J. R. Schmeltzer & Co. under date of October 11, 1929:

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

NATIONAL CITY BANK.
(Attention of Mr. West.)

DEAR SIR: We having to deliver to the National City Co. 2,100 shares of National City Bank stock, hereby ask you for an additional overcertification of $1,000,000.

Thanking you for your courtesy, we are,
Very truly yours,

What does that letter indicate?

Mr. BAKER. Of course, I know nothing about that. It is the first time I have heard it. It is directly a bank matter in which I had no voice or knowledge.

Mr. PECORA. You know nothing about it?

Mr. BAKER. No.

Mr. PECORA. Well, here J. R. Schmeltzer & Co. say that they have to deliver to your company 2,100 shares of National City Bank stock. Now, that stock had to be paid for by your company?

Mr. BAKER. And would be as soon as delivered.

Mr. PECORA. How would your company pay for it?

Mr. BAKER. We would pay with check.

Mr. PECORA. With funds obtained from whom?

Mr. BAKER. Ourselves.

Mr. PECORA. What would be the occasion for a letter of the kind I have just read to you, then?

Mr. BAKER. That would be a matter, Mr. Pecora, which was strictly a banking matter between the firm you mention and the National City Bank, in which the National City Co. would have nothing whatsoever to do.

Mr. PECORA. What would be the occasion for a letter of this kind written by J. R. Schmeltzer & Co. to the bank in connection with a transaction in which they were to deliver shares of stock to your company?

Mr. BAKER. I have not the slightest idea. That is strictly a bank matter.

Mr. PECORA. And you do not know the purpose of it?

Mr. BAKER. Of which I knew absolutely nothing.

Mr. PECORA. And you do not know the purpose of it?

Mr. BAKER. Of that letter to the National City Bank?

Mr. PECORA. Yes, sir; of the transaction indicated by this letter.

Mr. BAKER. Not the slightest.

Mr. PECORA. This letter is utterly meaningless to you?

Mr. BAKER. It is absolutely a bank routine matter of which I know nothing.

Mr. PECORA. And is utterly meaningless to you?

Mr. BAKER. Yes, sir; so far as any relation between J. R. Schmeltzer & Co. and the bank are concerned, I know absolutely nothing.

Mr. PECORA. And the letter is utterly meaningless to you? That is, you do not know what it means.

Mr. BAKER. They are evidently applying for a loan, if that is what you mean.

Mr. PECORA. I want to know what it means to you. What does it mean to you?

Mr. BAKER. Mr. Pecora, I am not in the bank. I am not in the Commercial Bank, and do not have anything to do with loans that

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

are made between brokers and the National City Bank. I would not know anything about it.

Mr. PECORA. What does this particular letter I have read mean to you?

Mr. BAKER. May I read it, please?

Mr. PECORA. Yes; here it is.

Mr. BAKER. It would seem to me that they are applying for accommodation for the day.

Mr. PECORA. To enable them to do what?

Mr. BAKER. To enable them to conduct their regular business.

Mr. PECORA. To enable them to take up the 2,100 shares they were delivering or were going to deliver to your company; is that it?

Mr. BAKER. That would seem to be included in it.

Mr. PECORA. That is the most important part of the idea, isn't it; not merely an incidental part?

Mr. BAKER. That would seem to be included in it, but I don't know what it was.

Mr. PECORA. Despite the fact that your company is wound up in the transaction to which that letter refers, you don't know anything more about it than you are telling us now; is that what you mean to say?

Mr. BAKER. Not the slightest. May I say this: As far as our relations with dealers with whom we deal in buying and selling securities, that does not have any connection at all with the method that they may use in facilitating deliveries to and from their offices in any particular day. We would not know anything about it.

Mr. PECORA. You don't think this letter indicates that the bank was extending accommodation to the brokerage house which was picking up shares of stock on behalf of the National City Co., do you?

Mr. BAKER. It would seem so, yes; but I do not know anything about it.

Mr. PECORA. Is this the first time you have heard of this kind of dealing between J. R. Schmeltzer & Co. and the National City Bank where the brokers take up stock of the bank for the National City Co.?

Mr. BAKER. Yes; and it is perfectly natural it should be, because I haven't any contact or knowledge of the loan arrangements made between brokers and the National City Bank.

Mr. PECORA. Now, under date of October 15, 1929, J. R. Schmeltzer & Co. wrote to the National City Bank, attention of Mr. West, as follows:

DEAR SIR: We having to deliver to the National City Co. 1,600 shares of National City Bank stock, hereby ask you for an additional overcertification of $800,000.

Thanking you for your courtesy, we are,

Very truly yours,

———— ————.

That indicates also that on that date, October 15, 1929, the writers of this letter had picked up 1,600 shares of the bank's stock for delivery to your company, and needed an accommodation or loan from the bank in the amount of $800,000 to enable them to pick up the stock and deliver it to your company, doesn't it?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. That would seem to be similar to the other transaction.

Mr. PECORA. Now, I have here another letter, written October 16, 1929, by the same firm of brokers to the National City Bank, attention of Mr. West:

DEAR SIR: We having to deliver to you the National City Co. 1,547 shares of National City Bank stock, hereby ask you for an additional overcertification of $800,000.

Thanking you for your courtesy, we are,

Very truly yours,

_____ _____.

That is evidence of a similar transaction in which those brokers had picked up 1,547 shares of the bank's stock for delivery to your company and needed an accommodation or loan in the sum of $800,000 from the bank to enable them to do so, is that right?

Mr. BAKER. Well, from some bank.

Mr. PECORA. And this indicates that the National City Bank was the bank that was asked to extend the accommodation, which apparently it did.

Mr. BAKER. Evidently. And that is all I know about it.

Mr. PECORA. You are learning about this for the first time, aren't you?

Mr. BAKER. Yes. I have no contact with those deliveries at all. I do not know anything about it. We buy and when delivery is made to us we pay for it.

Mr. PECORA. I thought you said you would give directions to the head of your particular department regarding these transactions.

Mr. BAKER. That is true, but that has nothing to do with that matter.

Mr. PECORA. With the bank's financing these transactions?

Mr BAKER. No.

Mr. PECORA. Financing brokers that were picking up stock for your company?

Mr. BAKER. Not at all.

Mr. PECORA. It is all news to you?

Mr. BAKER. Yes, sir.

Mr. PECORA. That is being imparted to you for the first time in this fashion?

Mr. BAKER. Yes; we have nothing to do with that.

Mr. PECORA. You have nothing to do with the bank either, have you?

Mr. BAKER. No, sir.

Mr. PECORA. The only thing you have to do with the bank is that all your stockholders own the stock of the bank?

Mr. BAKER. Yes, sir.

Mr. PECORA. Through three trustees.

Mr. BAKER. And that is——

Mr. PECORA (interposing). And the fact that you do business under the same roof.

Mr. BAKER. Well, just one minute there: It is just the reverse of that to which you referred. The stockholders of the bank, through three trustees, own our stock.

Mr. PECORA. That is what I meant to say.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Yes.

Mr. PECORA. And that you do business under the same roof as the National City Bank.

Mr. BAKER. That is right.

Mr. PECORA. And that you have among your officers and directors persons who hold executive offices and places on the board of directors of the bank?

Mr. BAKER. That is right.

Mr. PECORA. Is that right, now?

Mr. BAKER. Yes, sir; that is right.

Mr. PECORA. And a report is made to the bank every year, or every 6 months, of the operations of your company?

Mr. BAKER. Yes.

Mr. PECORA. Outside of that you have nothing to do with the bank?

Mr. BAKER. I have nothing to do with the current daily business operations of the bank.

Mr. PECORA. Now, I have here another letter addressed by J. R. Schmeltzer & Co. to the bank, attention of Mr. Rave, under date of October 23, 1929, readings as follows:

DEAR SIR: We having to deliver to the National City Co. 900 shares of National City Bank stock, we hereby ask you for an additional overcertification of $500,000.

Thanking you for your courtesy, we are,

Very truly yours,

——— ———.

That is another one of these transactions, is it?

Mr. BAKER. Evidently; yes, sir.

Mr. PECORA. And here is another letter, dated the same day, October 23, 1929, addressed to the National City Bank, attention of Mr. Rave, readings as follows:

DEAR SIR: We having to deliver to the National City Co. 1,750 shares of National City Bank stock, we hereby ask you for an additional overcertification of $900,000.

Thanking you for your courtesy, we are,

Very truly yours,

——— ———.

That letter indicates a similar transaction, doesn't it?

Mr. BAKER. Yes, sir.

Mr. PECORA. Here is one dated the following day, October 24, 1929, addressed to the National City Bank, and reading as follows:

DEAR SIR: We having to deliver to the National City Co. 1,650 shares of National City Bank stock, hereby ask you for an additional overcertification of $800,000.

Thanking you for your courtesy, we are,

Very truly yours,

J. R. SCHMELTZER & Co.

That would indicate a similar transaction, wouldn't it?

Mr. BAKER. Yes, sir.

Mr. PECORA. Here is one dated October 25, 1929, addressed to the National City Bank, attention of Mr. Rave, reading as follows:

DEAR SIR: We having to deliver to the National City Co. 8,100 shares of National City Bank stock, hereby ask you for an overcertification of $3,500,000 additional. We believe, however, that it will not be necessary for us to ask for all the above overcertification as in all probability all of this stock will

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

not be delivered to us, but we are asking at the moment for $1,000,000 additional.

Thanking you for your courtesy, we are,

Very truly yours,

J. R. SCHMELTZER & Co.

Now, you probably notice that the phraseology of this letter is somewhat different from those which preceded it. What does this letter indicate to you?

Mr. BAKER. Well, I do not know what it is. It does not mean a thing to me. As I said before, if we contracted to buy the stock and it is delivered we would pay for it. That is the only interest I would have in it.

Mr. PECORA. What does this letter, which you say you are now learning about for the first time, mean to you?

Mr. BAKER. Just the same as the others prior to that.

Mr. PECORA. Oh, no. Doesn't it depart from the others in a slight way, for instance——

Mr. BAKER (interposing). The only departure I can see in it, from your reading of it, would be that they probably did not expect all that stock in hand to deliver that particular day. That would be all I would understand about it.

Mr. PECORA. But that they had picked up 8,100 shares for which they had committed themselves. In other words, you had asked these brokers for your company to pick up 8,100 shares of National City Bank stock. They had picked them up, but were only going to deliver——

Mr. BAKER (interposing). They had sold to us, and in the delayed purchases——

Mr. PECORA (interposing). They say, "We believe, however, that it will not be necessary for us to ask for all the above overcertification", which was for 3½ million dollars, "as in all probability all this stock will not be delivered to us." What did they mean?

Mr. BAKER. I haven't any idea.

Mr. PECORA. Is this meaningless to you?

Mr. BAKER. Yes; it is. If they had sold to us 8,100 shares of stock, or whatever the amount was that you mentioned, we would certainly expect delivery of the stock, and as delivered we would pay for it.

Mr. PECORA. It says, "will not be delivered to us"—or, to get back, "as in all probability all this stock will not be delivered to us." Why should these brokers ask the bank for an overcertification or loan to cover 3½ million dollars for stock which they had picked up for the account of your company but which was not going to be delivered to them?

Mr. BAKER. I would not know what they meant by that, unless they meant that the stock might not be delivered that particular day. That would be the only explanation I could see to that.

Mr. PECORA. Is there any possibility that the other stock was to be delivered to the bank directly?

Mr. BAKER. Oh, absolutely not.

Mr. PECORA. Or to the City Co., directly, by the brokers?

Mr. BAKER. I do not think so. But that is the first time I have ever heard of that and I don't know. I can't imagine that that would be the case.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. You are hearing of other things about your company for the first time, aren't you?

Mr. BAKER. These are all new to me.

Mr. PECORA. Here is another letter, dated October 28, 1929, from J. R. Schmeltzer & Co. to the National City Bank, attention of Mr. Rave, reading as follows:

DEAR SIR: Referring to our letter of October 25—

And that is the one I have just read.

we are asking for an additional overcertification of $1,000,000. Thanking you for your courtesy, we are, very truly yours.

Now, that would indicate that they had to make deliveries to you which they had not expected to make the day before, or rather on October 25, wouldn't it?

Mr. BAKER. Might I ask you the date of the first letter?

Mr. PECORA. October 25, and the one I have just read is October 28.

Mr. BAKER. Well, I would not, or I could not understand what that meant there, only as I said a few moments ago, it was because the stock which they had purchased had been delayed in being delivered to them. Otherwise I can not see any reason for that.

Mr. PECORA. Here is another letter, Mr. Baker. And I wish you would follow me while I read it. It is addressed by J. R. Schmeltzer & Co. to the National City Bank, attention of Mr. Rave, and is dated October 29, 1929, and reads as follows:

DEAR SIR: We having to deliver to National City Co., 20,000 shares of National City Bank stock, hereby ask you for an overcertification of $9,000,000 additional. We believe, however, that it will not be necessary for us to ask for all the above overcertification, as in all probability all of this stock will not be delivered to us, but we are asking at the moment for $2,000,000 additional.

Thanking you for your courtesy, we are,

Very truly yours,

J. R. SCHMELTZER & Co.

What does that indicate to you?

Mr. BAKER. I think the same as the former letter.

Mr. PECORA. What?

Mr. BAKER. That all the stock they had sold to us would not be delivered to them on one particular day; in the course of a few days, possibly.

Mr. PECORA. And that they needed $9,000,000 to finance those deliveries, that is, all deliveries, but in view of the fact that the deliveries were not to be made all at one time, they only sought accommodation, called overcertification, to the extent of $2,000,000.

Mr. BAKER. Well, that would seem to be the explanation of it.

Mr. PECORA. Now, I have another letter here addressed by J. R. Schmeltzer & Co. to The National City Bank, attention of Mr. Rave, dated October 30, 1929, and reading as follows:

DEAR SIR: We having to deliver to the National City Co., 4,100 shares of National City Bank stock, hereby ask you for an overcertification of $1,500,000 additional.

Referring to our letter of October 29, we will also ask you for an additional overcertification of $2,000,000.

Thanking you for your courtesy, we are,

Very truly yours.

What does that mean to you?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. I should think just as I have stated to you formerly.

Mr. PECORA. And what is that?

Mr. BAKER. I want to make it clear that I am not an officer of the bank nor an employee of the bank. I haven't anything to do with their loans or loan arrangements with brokers. I do not know anything about that.

Senator BROOKHART. Were those stocks delivered to you as these letters indicate?

Mr. BAKER. Well, as they would deliver them to us we would pay for them. I just have not, of course, the records here of the amounts of the delivery to us each day. But as they made deliveries we would pay for them.

Mr. PECORA. Well——

Senator BROOKHART (continuing). It is quite plain from this that the bank is financing directly the sale of its own stock, is it not?

Mr. BAKER. Well, that is a bank matter having to do with loans, and I do not know anything about that.

Senator BROOKHART. For purchases and sales.

Mr. BAKER. I say, that is a purely bank matter with which I have no contact at all.

Mr. PECORA. Mr Baker, have you ever had any banking affiliation? I mean, have you ever been an officer or director of any bank?

Mr. BAKER. Yes; I am a director of the National City Bank.

Mr. PECORA. You are a director of the National City Bank?

Mr. BAKER. Yes, sir.

Mr. PECORA. How long have you been such director?

Mr. BAKER. Since 1929.

Mr. PECORA. Since you became president of the National City Co.?

Mr. BAKER. Yes, sir.

Mr. PECORA. Is that the extent of any banking experience you have had?

Mr. BAKER. That is right.

Senator BROOKHART. Were you a director at the time of these sales?

Mr. BAKER. Yes.

Mr. PECORA. You were a director when these letters were written, in October of 1929, by J. R. Schmeltzer & Co.?

Mr. BAKER. That is correct.

Mr. PECORA. And you were also the president of the National City Co. during this entire period?

Mr. BAKER. Yes, sir.

Mr. PECORA. Here is another letter I want to read, under date of——

Senator COUZENS (interposing). Prior to that let me ask: Mr. Baker, from your banking experience do you justify these practices?

Mr. BAKER. Well, Senator Couzens, I have just stated, before you came in and since, that as far as the general practice between brokers and their banks as to the accommodations which they have from day to day, it is something with which I have no contact at all, and know absolutely nothing about. I am not familiar with the practice on these things, and I do not know.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator COUZENS. I did not ask you that question. I asked you if in view of these developments, if you would indorse this practice?

Mr. BAKER. Well, I assume it is perfectly in accord with banking practice, and if so I would indorse it.

Senator COUZENS. You are too evasive. Perhaps I may have to ask you more pertinent questions as we do not seem to be able to get direct answers from you. I asked you whether you indorsed this practice or not. And I now ask you whether, regardless of banking practice or not, you indorse this practice?

Mr. BAKER. Yes, I think I would.

Senator COUZENS. That is all right, now. That answers my question.

Mr. PECORA. In other words, Mr. Baker, you think it is sound banking practice?

Mr. BAKER. So far as I know, yes, I think so.

Mr. PECORA. You do not claim to be ignorant of sound banking practices, do you?

Mr. BAKER. Well, perhaps not. I think that is all right.

Mr. PECORA. All right. Now, here is another letter, dated October 31, 1929, written by J. R. Schmeltzer & Co. to the National City Bank, attention of Mr. Rave, reading as follows:

DEAR SIR: We having to deliver to the National City Co. 5,000 shares of National City Bank stock, hereby ask you for an additional overcertification of $2,000,000.

Thanking you for your courtesy, we are,

Very truly yours.

That letter indicates the same sort of situation as the letters preceding it, doesn't it?

Mr. BAKER. Yes.

Senator COUZENS. Mr. Baker, have you any information as to how many accounts you had on the books of the National City Bank?

Mr. BAKER. No, sir.

Mr. PECORA. Senator Couzens, he said in the earlier part of this examination that he thought his company had as many as 15 or 20 brokerage houses trading in National City Bank stock at that time, and this is only one of them.

Senator COUZENS. Mr. Baker, may we assume that this practice was continued with all these brokerage firms?

Mr. BAKER. I would assume so, if they had banking relations with the bank.

Senator BROOKHART. Other accounts than with these deals for purchases and sales of National City Bank stock; other accounts than these deals were permitted and financed almost altogether by the National City Bank itself?

Mr. BAKER. Well, I do not know what proportion of that business that you have just read there is to the total business done.

Senator BROOKHART. Well, if all brokerage houses proceeded in the same way, then the answer to my question would be yes.

Mr. BAKER. It would be facilitating the delivery of securities.

Mr. PECORA. It was more than the facilitating of the delivery of securities. It was facilitating the purchase of them in the first instance for the account of the company, wasn't it?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. No, sir; because our purchases were direct purchases and sales to us.

Mr. PECORA. That is, you mean from the broker to you?

Mr. BAKER. That is right.

Mr. PECORA. And the broker in picking up the stock to deliver to your company in fulfillment of the company's orders, was borrowing money from the National City Bank through the medium of this so-called overcertification?

Mr. BAKER. According to those letters it would seem so, to some extent.

Mr. PECORA. Isn't that a species of transaction in which the bank is virtually trading in its own stock?

Mr. BAKER. Well, it does not seem so to me.

Mr. PECORA. And you say that in the light of the language of these letters, all of which indicates that the broker has to deliver shares of the capital stock of the bank to your company and is calling upon the bank for a loan to enable the broker to pick up the shares to deliver to your company?

Mr. BAKER. It seems to me that is just the same transaction that any broker would have with his bank on the delivery of any securities that he might have sold.

Mr. PECORA. But here the bank is put on notice by the broker, through the medium of these letters, that the transaction is one which he has with the National City Co. and involves the capital stock of the National City Bank; isn't that a fact?

Mr. BAKER. That would seem to be the case.

Senator COUZENS. Mr. Baker, do you know if this was the general practice in New York banks during the time you were doing it?

Mr. BAKER. I do not. And again I apologize for, as you say, being evasive, but it is because I am not in contact with the banking end of it at all.

Senator COUZENS. You were a director?

Mr. BAKER. Yes, sir; but, of course, this is routine or daily business of the bank.

Senator BROOKHART. Did it ever come to the attention of the directors?

Mr. BAKER. Not specific transactions; no, sir.

Senator COUZENS. Did you ever have any banking experience before you went on the National City Bank board?

Mr. BAKER. No, sir.

Senator COUZENS. After you went on the National City Bank board did you ever come in contact with or associate with other bankers in New York, other big bankers?

Mr. BAKER. Yes; with quite a few.

Senator COUZENS. And did you discuss at that time the general practices of banks in those matters?

Mr. BAKER. Not at all as regards matters of this kind, loans, and so forth, from brokers by the banks, or I mean by banks to brokers, and the way they conduct their daily business. I know nothing about that.

Senator COUZENS. Did you hear or read any of Mr. Aldrich's statement before the Finance Committee with relation to the banking situation, made a few days ago?

Mr. BAKER. I have not yet; no, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator COUZENS. In the light of what we can now see back behind us, do you approve of continuing those practices?

Mr. BAKER. Such as has been read here, do you mean?

Senator COUZENS. Yes.

Mr. BAKER. Well, I have not sufficient knowledge of commercial banking transactions to really have any very definite opinion on that. So long as it is the general banking practice in New York, or any other place, and in accordance with banking laws; yes, it is, I would say, but I don't know.

Senator COUZENS. Let us forget about that technical answer, and ask the question from a moral and ethical standpoint: Do you believe commercial banking should be continued in the future as it has been in the past, according to the testimony we have developed here?

Mr. BAKER. I do not see that the bank has taken the slightest risk. The sale has been made and upon delivery will be paid for.

Senator COUZENS. In other words, as long as the bank does not take any risk you justify any conduct on its part, do you?

Mr. BAKER. Oh, no.

Senator COUZENS. You substantially stated that.

Mr. BAKER. Oh, no. We are talking about daily transactions between its customers and itself.

Mr. PECORA. Mr. Baker, have you any reason to believe that the transactions evidenced by these letters were anything other than routine transactions, and that similar transactions were not had between the bank and other brokers whom your company was using to accumulate shares of the bank's stock for you?

Mr. BAKER. Well, Mr. Pecora, I absolutely have no knowledge of that at all. I do not know what the relations between brokers and the bank were.

Mr. PECORA. Didn't the bank, or anyone in the bank, ever call you up to find out whether it was proper to extend this credit to J. R. Schmeltzer & Co., amounting to millions of dollars in the course of a few days' time?

Mr. BAKER. No one called me. But I would not be surprised if they may have called to find out if we had made those purchases.

Mr. PECORA. Who would be called for that purpose, do you think?

Mr. BAKER. Well, I think that would be perhaps the treasurer of our company or the vice president in charge of its finances.

Senator COUZENS. In one of the letters, dated October 11, 1929, addressed to the National City Bank, attention of Mr. West—who is Mr. West?

Mr. BAKER. He is one of the officers in the bank.

Senator COUZENS. Is he still employed?

Mr. BAKER. Yes.

Senator COUZENS. And in view of the fact that this letter is addressed to his attention, I assume he had complete authority to do what was requested in the letter.

Mr. BAKER. I assume so, with his other associates in that particular department.

Senator COUZENS. In the other letters I see here they are addressed to the attention of Mr. Rave. What is his position?

Mr. BAKER. He is an officer.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator COUZENS. Is he still with the company?

Mr. BAKER. Do you mean with the bank?

Senator COUZENS. Yes.

Mr. BAKER. I think so.

Senator COUZENS. And he would have authority by himself apparently to extend the accommodations requested in the letters?

Mr. BAKER. Well, I assume he has that authority. It has to come from the president of the bank to him.

Senator COUZENS. Is there any evidence on the minutes of the board of directors giving him authority for this practice?

Mr. BAKER. I do not know that, Senator Couzens.

Mr. PECORA. Mr. Baker, an overcertification by a bank is really an authorized overdraft, is it not?

Mr. BAKER. I must repeat to you that I do not know about those phases of banking operation. It is not my function. I have not had anything to do with it. I know nothing about it.

Mr. PECORA. In order to save time, will you ask one of your associates from the bank who knows about it to give you the information?

Mr. BAKER. I do not know that there is anyone here that would know that.

Mr. PECORA. Mr. Mitchell is here. Mr. Law is here.

Senator BROOKHART. Just for the record, let me state that I have totaled those shares handled in this way from October 10 to October 30, 1929, and they are 46,749, $21,800,000.

Mr. PECORA. May I just ask Mr. Mitchell a question? Have him recalled and suspend the examination of Mr. Baker. Stay right where you are, Mr. Baker. It will only be a question or two.

TESTIMONY OF CHARLES E. MITCHELL, NEW YORK CITY, CHAIRMAN THE NATIONAL CITY BANK OF NEW YORK, CITY BANK FARMERS' TRUST CO., INTERNATIONAL BANKING CORPORATION, THE NATIONAL CITY CO., AND THE NATIONAL CITY CO. (LTD.), OF CANADA—Resumed

Mr. PECORA. Mr. Mitchell, have you heard me read in the course of my examination of Mr. Baker, certain letters written in the month of October, 1929, by J. R. Schmeltzer & Co. to the National City Bank?

Mr. MITCHELL. I have.

Mr. PECORA. Are you familiar with the transactions referred to in these letters?

Mr. MITCHELL. Not the specific transactions, but I would be glad to explain.

Mr. PECORA. Are you familiar with the nature of these transactions?

Mr. MITCHELL. Oh, yes, indeed.

Mr. PECORA. Will you kindly tell the committee the nature of the transactions evidenced by these letters?

Mr. MITCHELL. Since the national bank act was adopted immediately following the Civil War there has been a practice among all banks of giving what we call day loans. They are clearance loans. When any dealer in securities or broker has securities to deliver to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

some other he has to have temporary accommodation to make that delivery. All banks give lines to brokers for such accommodations. The lines are usually established—I know they are in our bank—for day loan accommodation, clearance day loans.

Senator COUZENS. Do you have any securities for those?

Mr. MITCHELL. None. No security but a day-loan contract that has become a set form, Senator Couzens, is in use, and the day loans given by banks, the day loan accommodations, are very large. They have to be.

Senator COUZENS. But in effect they are continuous, are they not?

Mr. MITCHELL. No.

Senator COUZENS. I mean if they go from one day on to the next day and the next day, they amount in substance to a continuous loan almost?

Mr. MITCHELL. Oh, no, they are paid off each day. They are paid off during the day.

Senator COUZENS. Yes; but they are renewed the next day so that in effect it is the same as a continuous loan?

Mr. MITCHELL. They may, and they may not be, Senator Couzens.

Senator COUZENS. I notice in one of the reports I have here made by one of our examiners, and as I understand it this is substantially correct:

Accordingly it appears that the aforesaid brokers had a credit of $500,000 for day-loan purposes with the National City Bank.

Mr. MITCHELL. That is right. We give in our banks to recognized dealers, and especially stock exchange members, a day-loan line. In our bank we figure that line usually on the basis of the cash position of the brokerage firm shown in his return to the stock exchange. That we require, in order to know the credit upon which we are extending that day line. Then if, as and when that broker has extraordinary calls upon him by virtue of the volume of securities under delivery, he advises us that he for that day will have to have or would like to have additional accommodations. It becomes a loan that is again good on the basis of the contract.

Under such circumstances the bankers' question is, Does the person to whom he is to deliver this security, another broker or investment house, recognize his contract to receive those securities, and if he does, those larger lines are often extended for the day. The loan is wiped out during the day. The New York Clearing House Association has a regular charge established at, I think, 1 per cent for those loans during the day.

Now the loans are very large. We do in our bank a smaller amount of that business than a number of the other New York banks, but I presume that at times the clearance loans or day loans in New York banks, when markets are active, would run to three, four or five hundred million dollars perhaps. They are all wiped out during the day.

Senator COUZENS. When you said 1 per cent, what do you mean by 1 per cent?

Mr. MITCHELL. We charge 1 per cent for the accommodations.

Senator BROOKHART. One per cent a year?

Mr. MITCHELL. At the rate of 1 per cent per annum.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. That is the way I understood it.

Mr. MITCHELL. It is a pure accommodation based upon contracts.

Senator COUZENS. Does this line that you speak about, a line of daily credit, have to be passed upon by your directors or any executive committee?

Mr. MITCHELL. The lines are all approved, Senator Couzens.

Senator COUZENS. And these officers to whom these letters are addressed do not have authority to exceed the lines approved by the board?

Mr. MITCHELL. They do not have authority. The lines are set up, for instance, by a group of senior officers. Those are junior officers and operating officers to whom those letters have been addressed. We have one vice president in the bank who is responsible for what we call street loans of any kind, and this junior to whom these letters are addressed is an operating officer reporting to him.

Senator COUZENS. In other words, this practice grew to great size during the boom, did it not?

Mr. MITCHELL. It has always been of substantial size, but of course as markets become more active and there are more securities to be delivered and to be received by the Street, the necessity for increase in day loans becomes obvious.

Senator COUZENS. But you never have any actual possession of the securities that are being transferred?

Mr. MITCHELL. No, sir. The loan is based entirely upon the contracts.

Senator COUZENS. In other words, it is this practice, as I understand it, that Senator Glass has particularly objected to?

Mr. MITCHELL. I have not known of Senator Glass objecting to this particular practice. He may have, Senator Couzens, but I don't recall it.

Senator COUZENS. What was the basis of his controversy with you, then, on that practice of lending money on these day loans?

Mr. MITCHELL. No. That had nothing to do with day loans. That controversy had to do with lending money to the loaning post on the New York Stock Exchange. That was for the carriage of securities over night, or for a day or two.

Senator COUZENS. There is not much difference between these and those, is there?

Mr. MITCHELL. Oh, yes. This is a pure operating problem. The other is a loan-carrying problem. This has nothing to do with that, Senator.

Senator COUZENS. No; but I mean they are in the same category, because they have to do with stock-market activities. You may classify them as different.

Mr. MITCHELL. Oh, if you put it in that class, yes; but I am quite certain that Senator Glass has never raised any question in regard to this class of loans. In fact, I never have heard a question on this class of loan raised in any investigating committee.

Senator COUZENS. But it all contributes, however, to the diversion of capital from industry and commerce to stock-market transactions, whether it be through this scheme or whether it be through the scheme which you stated Senator Glass specifically complained about.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Well, I would hardly say so. This class of loan is made on the basis of a contract between 2 people on the Street, 1 to receive and 1 to deliver. The risk is really a matter of a few moments, in the process of which the bank, lending itself to the facilitation of that operation, takes a risk that is, in part, measured by the capital strength of the broker, and, secondly, the strength of the contracts between the one to deliver and the one to receive.

Senator COUZENS. So when these requests were made for overdrafts of $2,000,000 you examined the purchaser to see if he was able to make good upon the purchase from the broker; is that not true?

Mr. MITCHELL. That is what is ordinarily done. I can not tell you specifically in this case. I think it very likely that when that man received that letter he would call up the treasurer of the City Co. and say: "Are you prepared to receive so many shares of stock to-day from this particular firm and pay for it as it is delivered?" He said "Yes."

All right, there is a good contract between two houses on the Street, and he makes that arrangement for a day loan and credits the amount requested to the broker, so that when he presents his checks for delivery of the stock to him for redelivery they can be certified against that amount so established.

Senator COUZENS. Do you do that with every other broker the same way?

Mr. MITCHELL. Every broker.

Senator COUZENS. Every one——

Mr. MITCHELL (interposing). Everyone that we have on our list. As I say, we do not have as much of this class of business as a great many banks. Some banks have made a great play at this. It is the safest kind of banking operation, as a matter of fact.

Senator COUZENS. Is it what you would construe real banking business to facilitate the interchange of commerce and industry?

Mr. MITCHELL. Oh, yes, sir; I should say so, distinctly. It is facilitating exchanges on perfectly good contracts during a single day.

Senator BROOKHART. Speculative contracts the same as any other?

Mr. MITCHELL. It may be; we have this same arrangement between bond houses. The largest we have are in connection with dealers in United States Government bonds. You can realize that the transactions there are very, very heavy, and those dealers demand usually very heavy day loans.

Senator COUZENS. What do you think, Mr. Mitchell, is the extent to which the Federal Government can go in selling their bonds or securities? You are the leading banker of New York, and you are not only that but a good salesman. We may have to have you to sell our Government securities before we get through.

Mr. MITCHELL. Senator Couzens, it all depends upon the credit of the United States Government, and if the United States Government does that which everybody else is trying to do at the moment, balance its Budget, it can sell all of the bonds that it can possibly need for its requirements.

Senator COUZENS. So you have not fixed in your mind just what specifically we have got to do to issue a number of bonds without limit almost? I said that badly. In other words, you think that

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

if we did certain things here in Congress we could sell up to thirty-five or forty billions of Government securities?

Mr. MITCHELL. Well, that is a pretty big order.

Senator COUZENS. Well, I presume so. I am trying to get at it. I put it up big so as to get your sane judgment on it.

Mr. MITCHELL. It can sell as many bonds as are required to meet what the investing public regard as sound and not as affecting the credit. What they are interested in is the strength of the credit. No concern can go on, whether it is a Government or a business, and continue to issue more evidences of debt, except as their basic principles are sound, and one of those principles, of course, must be the balancing of their day-to-day budget. These bonds cannot be issued, for instance, to pay for deficits. There we run immediately into a limitation, Senator Couzens.

Senator COUZENS. I hope the committee will excuse me for asking extraneous questions. When you speak of balancing the budget and making up of deficits through the issuance of securities what do you include as budgetary items?

Mr. MITCHELL. Well, of course—

Senator COUZENS (interposing). Would you include your sugar loss and all of those things in one year's budget and expect it to be paid out by earnings, so that you balance your budget.

Mr. MITCHELL. No, but I think if that went on—let me put it another way: If we are an operating concern and our yearly income and outgo shows in red, then our credit position is weak. If we have got some losses—you speak of sugar losses, writeoff—if we have got writeoffs and we indefinitely continue those writeoffs, every writeoff we make is harmful, not only to the shareholders, but to our strength. There has got to be a limitation to that sort of thing.

Senator COUZENS. Do the banks ever defer writeoffs or divide them up over the years?

Mr. MITCHELL. Yes; but not——

Senator COUZENS (interposing). Don't put any "but", but do they?

Mr. MITCHELL. Oh, yes. Yes, indeed.

Senator COUZENS. So you would not say now that the banks of the country had written off all they ought to have written off, would you, or that was possible to write off?

Mr. MITCHELL. No.

Senator COUZENS. When we come to balancing the Federal Budget, do you assume that all of the bond buyers, all of the note buyers, of Government securities, differentiate between the $2,000,000,000 that we have borrowed practically for the R. F. C.—$125,000,000 for the Federal land banks, $125,000,000 for the home-loan banks—those are all outgoes?

Mr. MITCHELL. Yes.

Senator COUZENS. But they are not current outgoes, are they?

Mr. MITCHELL. No, sir.

Senator COUZENS. And do you assume that when a buyer of these bonds analyzes the Government's accounts to know whether this excess of outgo over income is made up of items to which I have just referred, or whether they are made-up items of actual operating expenses of the Government?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. I think they differentiate.

Senator COUZENS. You do?

Mr. MITCHELL. Yes; I do.

Senator COUZENS. All right; now we will take the figures of today. How many bonds that are in the market today that were issued for those items to which I have just referred and how many bonds are in the market for carrying operating expenses?

Mr. MITCHELL. I would have to refresh my memory on that, Senator Couzens.

Senator COUZENS. I do not imagine there is anybody in the room can answer that question. If there is anybody in the room, I would ask the chairman to invite them to stand up and tell us.

I only mention that because of the absurd discussion all the time about balancing the Budget when I venture to say there is not one man in a million knows what it means. Certainly they do not contemplate that you are going to take out of taxes in one year the $2,000,000,000 advanced by the R. F. C.?

Mr. MITCHELL. No, no.

Senator COUZENS. Or the $500,000,000 handed to the Farm Loan Board?

Mr. MITCHELL. Certainly not.

Senator COUZENS. Then what are you talking about when you are talking about balancing the Budget, and who knows what you mean by it when you are talking about balancing the Budget?

Mr. MITCHELL. Well, we know what are received from taxes, and we know what the revenues of the Government are.

Senator COUZENS. Certainly. So do we all.

Mr. MITCHELL. And we know what the current operating expenses are.

Senator COUZENS. What are the current operating expenses of the Government for 1932?

Mr. MITCHELL. You mean what are they in character?

Senator COUZENS. No; what are they in amount?

Mr. MITCHELL. I would have to refresh my memory on that.

Senator COUZENS. So when the Treasury issues statements under its perfectly absurd bookkeeping system that they expended a billion dollars more than they received, that does not mean anything, does it?

Mr. MITCHELL. They paid out a billion dollars more than they received, you mean?

Senator COUZENS. Yes.

Mr. MITCHELL. It does not, unless they say what it is for.

Senator COUZENS. They do not say what it is for.

Mr. MITCHELL. Yes.

Senator COUZENS. They show in their reports as published in the press from day to day that the Government paid out a billion dollars more than it took in, and immediately you great bankers and industrialists and captains of industry assail the Government for spending so much more than they receive, and yet no consideration is given to the fact that billions are spent out for emergency purposes, which obviously cannot be balanced in a year.

Mr. MITCHELL. That is certainly true.

Senator COUZENS. Well, why doesn't somebody explain that to the public? When you great bankers, like Mr. Aldrich and all of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

this group, appear before the Finance Committee and tell us poor dubs what we ought to do, they just nonchalantly say, "Balance the budget." I would like to know what in hell it means. They don't tell us. [Laughter.]

Now we have one of the greatest, I understand, and best bankers and salesmen in New York, and I would like to get the benefit of his advice.

Mr. MITCHELL. I think, Senator, that expenditures, that is, any outgo of the Treasury Department, has very definitely got to be analyzed before one can reach a conclusion as to whether it continues to be a sound one or not.

Senator COUZENS. You have got one of your advisors here, one of the greatest Under Secretaries of the Treasury since Alexander Hamilton had one. I think he ought to be able to tell you what we ought to do so that you in turn could tell us. [Laughter.]

Mr. MITCHELL. I will ask him and see if he might give you the benefit of his advice, Senator Couzens.

Senator BROOKHART. Now I want to ask a question or two about that. You say, let us assume that running expenses are greater than the revenues, without reference to these other items. How would you balance the Budget then? What kind of taxes would you levy to balance it?

Mr. MITCHELL. That is not a question it seems to me to be answered definitely off hand.

Senator BROOKHART. That is what I supposed he would say. The sales tax is what you are for, is it not?

Mr. MITCHELL. I am for whatever is necessary to get the revenue that is required, Senator.

Senator BROOKHART. Is that not the thing you think is necessary, the sales tax?

Mr. MITCHELL. I am inclined to think that before we get through we may have to come to some sales tax.

Senator BROOKHART. Well, now; then I propose that we levy the first sales tax on the sales of stocks and bonds. What do you say to that.

Mr. MITCHELL. I think that you have a sales tax there now. There is a tax.

Senator BROOKHART. Yes; but it is not enough to get a revenue. It is just nominal. You would not be in favor of that, would you?

Mr. MITCHELL. Well I think we have a tax there now. You may consider that you want to increase it, but I am sure that you would not be in favor of increasing it to a point where you would interrupt the proper financing of commerce and industry.

Senator BROOKHART. I would not want to interrupt the proper financing, but I would want to interrupt all this speculation. I would like to interrupt and stop all that.

Mr. MITCHELL. I would not mind if you could find the way to do it, but as long as humans are humans, I do not think that can be stopped.

Senator BROOKHART. What do you say to this proposition: Senator Glass offered an amendment to the tax bill which levied a tax of 5 per cent on all sales on the stock exchange where they were

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

resold in 60 days. What would you say the effect of that would be on the speculation?

Mr. MITCHELL. I think it would materially dampen it.

Senator BROOKHART. So do I.

Mr. MITCHELL. Is that all, Mr. Pecora.

Mr. PECORA. No. Mr. Mitchell, let us get back to these Schmeltzer & Co. day-by-day loans and overcertifications as reflected in these letters that have been read in evidence this morning.

Mr. MITCHELL. Yes.

Mr. PECORA. The overcertifications referred to in these letters are extensions of credit in excess of the day-by-day credit that J. R. Schmeltzer & Co. had been accorded by your bank, are they not?

Mr. MITCHELL. Apparently.

Mr. PECORA. Do you know what the day-by-day credit of J. R. Schmeltzer & Co. at your bank was in October, 1929?

Mr. MITCHELL. I have been told that our day loan accomodation to them was $500,000.

Mr. PECORA. That accords with my information.

Mr. MITCHELL. Yes.

Mr. PECORA. These overcertifications are in effect a species of authorized overdrafts, are they not?

Mr. MITCHELL. No; they are not overdrafts, and an overcertification is not the proper word for that.

Mr. PECORA. That is the word which has been used in the correspondence passing between the bank and the broker.

Mr. MITCHELL. It has, and it is quite a general term on the Street, overcertification. As a matter of fact, the machinery is that a definite credit for that day is placed against the account of the one to whom the day loan is made and is——

Senator BROOKHART (interposing). Do you get any note or any evidence of that debt?

Mr. MITCHELL. We have what we call a day-loan contract which covers the amount of the application, Senator Brookhart.

Senator BROOKHART. Is there a contract signed for every day, or is that a general contract?

Mr. MITCHELL. That is a general day-loan contract, and where these special amounts, added amounts, are put onto the day loan, my recollection is that they are signed up for that additional amount. It is an arrangement by which that amount of money is placed to the credit of that concern against the checks which come in, and that those checks may be certified, but they are certified, as you will see, over and above the amount which the concern would ordinarily have in the bank, and therefore you get this overcertification.

Senator BROOKHART. This contract begins then by your making a contract with the broker that you will extend to him in day loans a limit of so much or for a period of time?

Mr. MITCHELL. Each day a limit.

Senator BROOKHART. Each day a limit?

Mr. MITCHELL. That is right.

Senator BROOKHART. And you have no note, no security, and no evidence of that except this contract?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. That is very true. It is a clearance loan. It is a loan made to facilitate clearances between the one who delivers it and the one who receives.

Senator BROOKHART. What is the basis for extending credit to these brokers? What is the basis of your contract?

Mr. MITCHELL. The basis with us in establishing a day-loan limit, as I have told you, is a study of their own balance sheet. Now we have a rule——

Senator BROOKHART (interposing). You mean of the amount of daily business that they transact?

Mr. MITCHELL. No, sir. The amount of their quick assets really. We take—and I don't know the practice of other banks; I can only give you the practice of our bank—we take their return to the New York Stock Exchange of their position, which is submitted to us, and the rule in our bank is that the day loan line shall not exceed the cash and securities ready for delivery and government bonds that are in the balance sheet of that house. In other words, we do not give any credit for the value of their Stock Exchange membership or real estate or furniture and fixtures, or anything else. We establish that day loan line on the basis of their quick assets.

Senator BROOKHART. It would not be possible for a farmer to get a loan on those terms at your bank then, would it?

Mr. MITCHELL. I am afraid not. The farmer's loans ordinarily go beyond the day.

Senator BROOKHART. Yes, but for 50 years the farmer was the best security our banks had, and then we got you fellows and your speculation and your gambling and breaking up of all prices and of everything, and now a farmer can not get a loan anywhere.

Mr. MITCHELL. Yes; but I call your attention, in all fairness, Senator Brookhart, to the record of these day loans. Since I have had any connection with the National City Bank we have never lost a penny in all of our day loan accommodations.

Mr. PECORA. Did you lose any during the stock market crash in 1929?

Mr. MITCHELL. Not a penny.

Senator BROOKHART. There are some fellows I have heard running poker games that could tell you the same thing as that. The fact that you succeed in a gambling operation does not make it any more desirable than if you failed.

Mr. MITCHELL. I would not consider the day-loan operation, and I don't think under any stretch of imagination you cauld call the day-loan system a form of speculation or gambling. It, of course, has inherent in it that which every transaction has that is made by a bank, which is a continuing risk of some sort or another. But I mentioned that record on day loans to indicate that perhaps there is no business done in Wall Street where the risk as far as the banker is concerned is as light as it is in day loans.

Senator BROOKHART. But conceding that it is still supporting and promoting a speculation in these stocks, and in this case in your own stock?

Mr. MITCHELL. It does not seem to me that it is supporting it any more than is our very presence there as a credit institution. We are there. We facilitate the making of deposits and the passage of checks. We facilitate the speculative markets, if you say so, by our

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

presence there, and usual regular operation, but we do not facilitate it to any substantially greater degree by this kind of an operation, which, as I say, has been the standard form of operation since the National Bank Act came into being in, if I recall right, 1865.

Senator BROOKHART. It seems to me it is a mighty convenient way of getting easy money.

Senator REYNOLDS. Mr. Chairman, I would like to ask Mr. Mitchell a question.

The CHAIRMAN. Senator Reynolds.

Senator REYNOLDS. Mr. Mitchell, speaking of these loans that are under discussion here, I understand that it has been brought out here in the testimony before this committee by Mr. Pecora that the vice presidents of your institution borrowed some $2,000,000 from the bank. Is that right?

Mr. MITCHELL. Not entirely. I think perhaps the impression was given by Mr. Rentschler's testimony to that effect. The resolution of the board of directors out of which came those particular loans provided that the board authorized a loan initially of $2,000,000 tc members of that board acting as trustees. The provision was that there should be no interest charged against the trustees. Those trustees were authorized to make loans, not only to officers but to officers and employees, and the number of employees I think far exceeds the number of officers to whom those loans were made. Now they did make those loans to officers. The officers paid interest.

Senator REYNOLDS. What interest did they pay?

Mr. MITCHELL. I think 5 per cent.

Senator REYNOLDS. Five per cent?

Mr. MITCHELL. Yes.

Senator REYNOLDS. Have those loans been repaid?

Mr. MITCHELL. No. They have not been repaid. I think some portion of them have been repaid. The far greater portion has not been repaid.

Mr. PECORA. About 5 per cent has been repaid, according to Mr. Rentschler.

Senator REYNOLDS. Five per cent of the $2,000,000?

Mr. PECORA. $2,400,000.

Senator REYNOLDS. Now, do you owe the bank anything?

Mr. MITCHELL. No, sir.

Senator REYNOLDS. You do not owe the bank anything?

Mr. MITCHELL. No, sir.

Senator REYNOLDS. I wanted to pursue that inquiry directed by Senator Couzens a moment ago, with your kind permission, gentlemen.

Speaking of balancing the Budget, suppose we do not balance it for the next two or three years. How many millions of dollars of bonds under the present conditions could we market with the American public?

Mr. MITCHELL. Senator Reynolds, I am distinctly under the impression that unless there is an honest attempt to balance the Budget by income or vice versa; that is, by cutting expenditures in the course of time—it may be six months and it may be five years; I can not be wise enough to state—but if this balancing process does not establish itself within a reasonable time, the public will lose confidence in the credit of the Government to a point where the amount of securities

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

that can be floated on a creditable basis to the Government will be restricted.

Senator REYNOLDS. Then you haven't any definite idea as to the exact amount or the approximate amount that we might be able to market?

Mr. MITCHELL. No. The more we market from month to month the nearer we come to the end of the road.

Senator REYNOLDS. I see. That is all, Mr. Chairman.

Senator BROOKHART. On that proposition, if we would go directly to the people, as we did in financing the war and the campaigns, and cut out the investment companies and the stock exchange for the sale of bonds, there is not much limit to the amount of bonds the people would buy direct, is there?

Mr. MITCHELL. That is what we are doing now in connection with Government bonds. The banker and the investment banker does not buy Government securities from the Government at one penny less than anybody else has the opportunity to do.

Senator BROOKHART. The amount of credit the Government could carry is limited by its taxing power only, isn't it?

Mr. MITCHELL. Its taxing power and the exercise thereof.

Senator BROOKHART. Yes. And if it wanted to float more bonds, and pay more interest, why it could levy higher taxes on the big upper brackets and get the money to pay that interest, could it not?

Mr. MITCHELL. You will bear in mind that the minute you pay higher interest you depreciate the value in the market of the securities that are already existing, and continually feeding a higher interest rate will be a red flag to——

Senator BROOKHART (interposing). I did not mean a higher interest rate; I meant a greater amount of bonds. It may be a lower interest rate.

Mr. MITCHELL. The more bonds that you put out, whether the effect is momentary or not, sooner or later they will be reflected in the interest yield on the outstanding bonds, and the rate that must be paid by the Government on any new issues that it puts out.

Senator BROOKHART. Now, as these new issues and this increase of indebtedness has come about through depreciation, the interest rate over in the Treasury has gone down all the time.

Mr. MITCHELL. Yes; it has gone down, but you will bear in mind that for a long period now the Government has done its financing on the basis of short term. The short-term issues have, of course, been taken up by the banks of the country very largely because they did not find a demand from a good borrower in commerce and trade and agriculture, and banks have used their money to hold Government bonds.

Senator BROOKHART. Is not the specific reason why they have taken these Government loans coming from the fact that they had been loaded up on advice of the big banks, with private bonds, and the bank examiners, and all advised, that this list of bonds were good, and they have depreciated so much that nearly all the banks of the country are in trouble and they are buying the Government bonds to be safe?

Mr. MITCHELL. Well, it is not altogether right to say that it is entirely bonds. Bonds have affected the situation adversely. There

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

is no question about that. But you bear in mind that we have had a great deal of trouble throughout the country with mortgages. We have had a slowing up in the power of debtors to pay their current obligations at banks. We have had as a result of this depression a tightening process all along the line.

Senator BROOKHART. It was preceded by a swelling process where all these things were inflated enormously above any just level, everything, land, and so forth, and the bubble burst and now we are getting the reaction that follows, due to the bad management of you people that are running the finances and Government of the United States.

Mr. MITCHELL. I do not think that we acting in finance had anything to do with the high price of agricultural commodities at a certain time, and the introduction of tariff barriers and the development of uneconomic production of agricultural products in various parts of the world that affected agricultural price.

Senator BROOKHART. You are quite aware on that, are you not, that agricultural prices have not been high since 1920 and that they did not boom up with the boom of your stocks and bonds?

Mr. MITCHELL. I realize that they——

Senator BROOKHART (interposing). They stayed low all the way through. You reached a point where you thought you could be prosperous without the buying power of a prosperous agriculture.

Mr. MITCHELL. You recall, Senator Brookhart, that we had quite a drop in wheat, if I recall, along in 1930, that was very disastrous to the farmers of the West.

Senator BROOKHART. That was after the panic. It not only hit other business but it hit agriculture another jolt, and sent it still lower, until now we are on the lowest price level that ever I can remember.

Mr. MITCHELL. Or I can remember either.

Senator BROOKHART. Or you either. Now then, these agricultural prices were held down in part by the raise of railroad rates of 60 per cent on agricultural products and railroad securities were sold on the value of seven or eight billion dollars higher than the market value at the time the valuation was fixed by the law. That inflated the railroad stuff. Then Insull came in and inflated his stuff two or three billion dollars, Morgan did, and then you got your bank stock up to, I said, 2,500 per cent, but it is over 2,800 per cent nearly 2,900 per cent, above its par, and everything was inflated in this country, in a country that in good times produces only about 4 per cent a year on an average, and that, of course, produced a result that when that burst, why, there was a general calamity in the whole country, and you are not offering us any way to get out of it. That is the worst part. You got us in, but how about getting us out?

Mr. MITCHELL. Well, I think it is something that is going to take the cooperation of everybody in the system.

Senator BROOKHART. The fact is there is nobody with an organization strong enough to do it but the Government of the United States itself, and it has got to do that by taking charge of this agricultural surplus and employing these unemployed men instead of loans we have been talking about to do it.

The CHAIRMAN. Senator Brookhart, I agree with you in so much of what you say, but I think I shall have to raise a point of order.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

This is not the matter under investigation, and we will have to limit our time more closely to the matter that we are here for. So give us a chance part of the time anyway.

Senator BROOKHART. Very well; I am through.

Mr. PECORA. Mr. Mitchell, just before you leave the stand, to get back to the Schmeltzer & Co. overcertifications of October, 1929, were you aware that those overcertifications were being granted to Schmeltzer & Co. at that time?

Mr. MITCHELL. I did not know anything about these particular transactions. They would not naturally come to my attention. They would not get beyond the attention of the vice president in charge of the street loan, Mr. Pecora.

Mr. PECORA. Who was that vice president in October, 1929?

Mr. MITCHELL. This would be a matter that would be attended to by either Mr. Brady or Mr. W. A. Simonson.

Mr. PECORA. As you heard these letters read, you caught the implication of them, didn't you?

Mr. MITCHELL. Oh, yes.

Mr. PECORA. And they indicated, did they not, that these brokers were buying large blocks of capital stock of the National City Bank for the account of the National City Co.?

Mr. MITCHELL. They had sold to the National City Co. I do not believe that any of those brokers were commissioned to buy for the account.

Mr. PECORA. Where the brokers were asking the bank for extensions of their day-by-day line of credit, as these brokers were through these requests for overcertification, did not that fact indicate that they were acquiring these shares of stock for delivery to the National City Co.?

Mr. MITCHELL. I presume that there were many, many days possibly through that very period where the National City Co. was delivering stock to Schmeltzer. Schmeltzer is a broker. He would be buying and selling during the day, and they may have bought from the National City Co. so that the National City Co. had large deliveries to make to them.

Mr. PECORA. All these letters refer to deliveries which the brokers were to make to the National City Co.?

Mr. MITCHELL. Yes.

Mr. PECORA. Let us confine ourselves to the subject matter of these letters and the transactions indicated by these letters.

Mr. MITCHELL. They indicate that on the transactions of the day before this broker, Schmeltzer & Co., had sold to the National City Co. blank shares of stock which required a substantial amount of money, and their day loan would have to be increased that day in order to enable them to clear that transaction.

Mr. PECORA. They would have to get money to clear the transaction when they had the stock?

Mr. MITCHELL. They had to pick up the stock.

Mr. PECORA. Exactly. These brokers had to pick up the stock for delivery to the National City Co.?

Mr. MITCHELL. Absolutely.

Mr. PECORA. And the value of the stock which they had to pick up for delivery to the National City Co. was such that they required these loans in excess of their $500,000 daily credit?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. Their clearance was increased that day, so that had to be covered as an excess.

Mr. PECORA. Does not that indicate, Mr. Mitchell, that where the bank granted those overcertifications to the broker, the bank was loaning money to enable that broker to acquire stock of the bank for delivery to the National City Co.?

Mr. MITCHELL. Yes; but they did it on the basis of the contract of the National City Co. to receive.

Mr. PECORA. In other words, the bank gave these overcertifications to the broker because it knew the responsibility of the customer of the broker to whom the broker was to deliver the stock, the customer in these instances being the National City Co.?

Mr. MITCHELL. They knew that there was a contract there that would be fulfilled.

Mr. PECORA. Yes; exactly. Wasn't that a species of trading by the bank in its own stock?

Mr. MITCHELL. I do not think you could conceive it to be that at all, Mr. Pecora.

Mr. PECORA. Well, I realize that the delivery of the stock was to be made not to the bank, of course, but to the National City Co.

Mr. MITCHELL. Yes.

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

Mr. MITCHEL_. Yes, it is; but it would not——

Mr. PECORA (interposing). It is like one body with two heads, isn't it? It has the same body; it has the same blood, meaning the capital derived from the sale of the capital stock of the bank to the bank's shareholders. But instead of having one head it has two heads, and the two heads seem to be the one head in your personality. You were the chairman of both institutions. But in form it had two heads, didn't it?

Mr. MITCHELL. Yes.

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

Mr. MITCHELL. One entity, institutional entity, yes. But, Mr. Pecora, I do not want to prolong this, but ordinarily a broker applying for a day loan would not state what this was for, and it was not at all necessary for him to state it there.

Mr. PECORA. They did state it here?

Mr. MITCHELL. They did state it here, but what I am getting at is that the National City Bank when they received that letter undoubtedly paid no attention to the name of the security that was involved. They were interested only in one thing. Here was a delivery to be made to the National City Co. of something against which——

Mr. PECORA. It was not of something; it was of a specific thing set forth in the letters, was it not?

Mr. MITCHELL. Yes; but these excess day loans are built up on the basis of the contract and not on the security. The banker that handled that paid no attention whatsoever to the security involved. He paid attention to the question, Is the contract good between his entity as a deliverer and this entity as a receiver?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. I know that to a certain extent this transaction did not depart from the routine of many other similar transactions.

Mr. MITCHELL. Yes.

Mr. PECORA. But the transactions reflected by these letters are of particular interest now because the broker, either fortunately or unfortunately, specified the particular security, namely, the stock of the National City Bank, which he was delivering to the National City Co., and it is that feature which interests me.

Mr. MITCHELL. Yes.

Mr. PECORA. When the bank got these letters the bank was informed specifically that Schmeltzer & Co. were picking up stock of the National City Bank for delivery to the National City Co. to an amount that required an extension of credit in excess of the $500,000 daily line which the bank had accorded these brokers?

Mr. MITCHELL. That is correctly stated.

Mr. PECORA. That is correct, is it not?

Mr. MITCHELL. That is correctly stated.

Mr. PECORA. Now, in view of the knowledge which the bank thereby acquired of the specific character of these transactions through many of these letters, did not the bank have notice that it was loaning moneys or extending credits to the brokers to enable them to finance transactions for the benefit of themselves and the National City Co. in connection with the capital stock of the bank?

Mr. MITCHELL. Well, there is no prohibition that I know in banking against lending to a broker or anybody else without collateral.

Mr. PECORA. May a bank loan on its own stock as collateral?

Mr. MITCHELL. A bank may not loan on its own stock at all; no.

Mr. PECORA. And in these transactions wasn't that virtually what the bank was doing?

Mr. MITCHELL. I would not say so. I do not agree with you on that. I am sorry. I wish I could, Mr. Pecora. [Laughter.] But I just can not.

Mr. PECORA. Well, the bank was put on notice by these letters that the overcertification or extension of credit was required by the brokers from the bank in order that the brokers might be enabled to make delivery to the National City Co. of large blocks of the capital stock of the bank?

Mr. MITCHELL. That I have granted. That is clear from the——

Mr. PECORA (interposing). And those overcertifications or extensions of credit were granted, were they not?

Mr. MITCHELL. The day loan was increased by that amount.

Mr. PECORA. And you still say that this was not an extension of credit or a loan made upon the bank's own stock?

Mr. MITCHELL. I do.

Mr. PECORA. You would not have granted, or the bank would not have granted, an overextension or an overcertification to the amount of $9,000,000 to J. R. Schmeltzer & Co. without knowing something definite about the transaction, in view of the fact that the amount is so far in excess of its daily line of $500,000?

Mr. MITCHELL. If J. R. Schmeltzer or any other sound broker that happens to be on our credit books would come and say, "I have contracts for delivery of securities to-day to J. P. Morgan or the National City Co., or any other house of sound credit and reputation

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

on the Street," and we got word from the one that was to receive the securities that he was under agreement to receive them and would make payment upon receipt, we would have granted that just as readily as though it was on National City Bank stock.

Mr. PECORA. But in these cases you knew, through the medium of letters, that the loans to the brokers were required to enable the brokers to finance their transactions with the National City Co. in the stock of the bank?

Mr. MITCHELL. Yes. The broker mentioned this specific security in this case. I tell you it is not customary and that fact would be passed over immediately by an operating officer.

Mr. PECORA. It was passed over by your bank's operating officer in that case, was it not?

Mr. MITCHELL. Yes; it was.

Mr. PECORA. What is the difference in principle, Mr. Mitchell, between the granting of this certification to Schmeltzer & Co. and permitting Schmeltzer & Co. to draw overdrafts against their credit or against their account with the bank? Is there any difference in principle?

Mr. MITCHELL. Oh, yes.

Mr. PECORA. What is the difference?

Mr. MITCHELL. In this particular case there is not an overdraft. The operation of the day loan is that when acceded to and it is known that it is to be used there is set up on the books of the bank a credit against which the checks are certified. It is not an overdraft; it is a form of loan.

Senator BROOKHART. Why isn't that an overdraft until the other party pays for it or until it is paid back?

Mr. MITCHELL. Well, because in the meantime it is a loan to this concern.

Senator BROOKHART. The only thing I can see that protects it from being an overdraft is that contract you have there.

Mr. MITCHELL. That is right.

Senator BROOKHART. Supposing they did not pay it after you gave them that credit? Then what would you do? You would have to go back and sue on your original contract?

Mr. MITCHELL. If there was fraud and the amount was not forthcoming and they went over at the end of the day with a part of that day loan unpaid, it would be a very unusual case, and the only way it could be covered then would be by that concern making a regular loan on its credit, either secured or unsecured, in some place or another. Of course, they could not borrow from us over——

Senator BROOKHART (interposing). Then the whole loan is in that same condition until it is paid after it goes on your books?

Mr. MITCHELL. Paid during the same day.

Senator BROOKHART. So far as the looks of the books are concerned it is a straight overdraft then?

Mr. MITCHELL. Well, we don't——

Senator BROOKHART (interposing). You do not call it that, but it would look just like an overdraft that you had allowed, would it not?

Mr. MITCHELL. It might. It might look that way to you, but that is not the operation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. I do not contend that it is an overdraft in form, but in principle or effect it is similar to an authorized overdraft, is it not?

Mr. MITCHELL. It has much the same effect, Mr. Pecora, certainly.

Mr. PECORA. Yes. Well, that is what I mean to indicate.

The CHAIRMAN. The committee will recess until 2 o'clock. All witnesses will be here again at 2 o'clock.

(Whereupon, at 12.10 o'clock p. m., the subcommittee recessed until 2 o'clock p. m. of the same day.)

AFTER RECESS

The subcommittee resumed at 2 o'clock p. m. on the expiration of the recess.

The CHAIRMAN. The subcommittee will come to order. Whom will you have, Mr. Pecora?

Mr. PECORA. Mr. Robinson.

The CHAIRMAN. Please stand, hold up your 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 this subcommittee, so help you God.

Mr. ROBINSON. I do.

TESTIMONY OF EDWIN S. ROBINSON, BROOKLYN, N. Y.

Mr. PECORA. Mr. Robinson, will you give your full name, address, and business or occupation to the reporter?

Mr. ROBINSON. Edwin S. Robinson, 9229 Shore Road, Brooklyn, N. Y.

Mr. PECORA. And your occupation or business.

Mr. ROBINSON. Stockbroker.

Mr. PECORA. How long have you been connected with the stock brokerage business?

Mr. ROBINSON. Oh, about 12 years.

Mr. PECORA. With what office or firm in that business are you now connected?

Mr. ROBINSON. With Hardy & Co.

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

Mr. ROBINSON. Two years.

Mr. PECORA. Immediately prior to that with what firm were you connected?

Mr. ROBINSON. J. R. Schmeltzer & Co.

Mr. PECORA. With J. R. Schmeltzer & Co.

Mr. ROBINSON. Yes, sir.

Mr. PECORA. Were you associated with the brokerage firm of J. R. Schmeltzer & Co. in the years 1928, 1929, and until about September of 1930?

Mr. ROBINSON. Yes, sir.

Mr. PECORA. In what capacity?

Mr. ROBINSON. Manager of the bank stock department.

Mr. PECORA. Did you say manager of the bank stock department?

Mr. ROBINSON. Yes.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Bank stocks are usually dealt in on the over-the-counter markets, aren't they, as distinguished from the exchange markets?

Mr. ROBINSON. They are.

Mr. PECORA. In January of 1928 the capital stock of The National City Bank was taken from the stock exchange trading list, as you know.

Mr. ROBINSON. Yes, sir.

Mr. PECORA. From that time until September of 1930 did you as a member of J. R. Schmeltzer & Co. handle any transactions in the capital stock of the National City Bank for and on behalf of the National City Co.?

Mr. ROBINSON. I would have to correct you there. I was not a member of the firm but a salaried employee.

Mr. PECORA. With that correction to my question, will you now make answer?

Mr. ROBINSON. Well, that is, that I traded with the National City Co.

Mr. PECORA. Yes.

Mr. ROBINSON. I either sold stock to them or bought stock from them.

Mr. PECORA. You had transactions with them?

Mr. ROBINSON. Yes, sir.

Mr. PECORA. In the stock of the National City Bank?

Mr. ROBINSON. That is correct.

Mr. PECORA. You were known as the specialist in the over-the-counter market in the stock of the National City Bank during those times, weren't you?

Mr. ROBINSON. Commonly but not officially known.

Mr. PECORA. I know. There is no such official designation.

Mr. ROBINSON. That is what I am trying to bring out.

Mr. PECORA. But that was the common report about you.

Mr. ROBINSON. Yes.

Mr. PECORA. That you were the specialist in that stock; is that right?

Mr. ROBINSON. That is correct.

Mr. PECORA. Now, during the time I have mentioned did you have daily transactions in the stock of the National City Bank with the National City Co.?

Mr. ROBINSON. I presume I did.

Mr. PECORA. Were they of an extensive character, would you say?

Mr. ROBINSON. Well, no; I do not think so. They varied from time to time, with one day more with the National City Co. and another day more with somebody else. There was no steady volume so far as I could say.

Mr. PECORA. But the total volume of those transactions in that period of time greatly exceeded the total volume of the transactions you had in any other bank stock, didn't it?

Mr. ROBINSON. Well, I was only specializing in National City Bank stock.

Mr. PECORA. You only had trades in that stock?

Mr. ROBINSON. Oh, occasionally we did get orders in other stocks, but the most of it was done in National City Bank stock.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Who was the gentleman in the National City Co. with whom you came most frequently in contact in connection with those transactions?

Mr. ROBINSON. That would be the manager of their bank stock department or trading department.

Mr. PECORA. And who was he?

Mr. ROBINSON. A man named Mr. Pritchard.

Mr. PECORA. Mr. Pritchard?

Mr. ROBINSON. Yes, sir.

Mr. PECORA. Do you know who Mr. Pritchard's superior was?

Mr. ROBINSON. I do not really know. I could imagine; but I don't know.

Mr. PECORA. Don't you know it was Mr. Morrison?

Mr. ROBINSON. I believe it was Mr. Morrison.

Mr. PECORA. Do you know where Mr. Pritchard is now?

Mr. ROBINSON. I do not.

Mr. PECORA. When did you last have any contact with Mr. Pritchard?

Mr. ROBINSON. Business or personal?

Mr. PECORA. Of any kind.

Mr. ROBINSON. I had personal contact with him the day after you served the subpœna on me.

Mr. PECORA. That is, to come to this hearing?

Mr. ROBINSON. Yes, sir.

Mr. PECORA. Was Mr. Pritchard then connected with the National City Co.?

Mr. ROBINSON. No, sir.

Mr. PECORA. Did you know that he had severed his connection with the National City Co. several months ago?

Mr. ROBINSON. Yes, sir.

Mr. PECORA. Did Mr. Pritchard then indicate to you that he was going to leave New York City for any extended stay?

Mr. ROBINSON. He told me that he planned to leave, a month or so ago.

Mr. PECORA. And do you know whether he left?

Mr. ROBINSON. I imagine he did. I have not talked to him since that day.

Mr. PECORA. You have not seen nor heard from him since, have you?

Mr. ROBINSON. No, sir.

Mr. PECORA. Will you describe generally but briefly for the committee the procedure that was followed in the transactions you had with the National City Co. in connection with stock of the National City Bank?

Mr. ROBINSON. Well, there would be various ways. One way would be that I either had some stock for sale for the firm's account or one of their various customers, and I would offer that stock to the National City Co. at a set price and they would buy it. If they did not buy it I would attempt to sell it elsewhere, or vice versa.

Mr. PECORA. Would you go to the trading department of the National City Co. to find out the market they were making for the stock?

Mr. ROBINSON. I would call them and attempt to find out if they were maintaining or quoting a market.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. You would go or call on the telephone to find out if they were maintaining or quoting a market; is that right?

Mr. ROBINSON. Correct.

Mr. PECORA. What do you mean by maintaining a market?

Mr. ROBINSON. Well, maintaining and quoting are two different ways. You maintain a market by——

Mr. PECORA (interposing). I am asking you now to talk about both ways. But first, about the meaning of the term "maintaining a market."

Mr. ROBINSON. To maintain a market is to establish a bid and an offering price on stock. That would obligate you to trade with anyone who called you. If I make a price on a stock, at such and such a price you obligate me to trade. If you quote a market you are not obligated to trade. I could quote you a price right now, but I am not obligated to trade with you.

Mr. PECORA. You found it of exceeding value to you as a specialist in the stock of the National City Bank to know what market the National City Co. was maintaining or quoting, as the case may be?

Mr. ROBINSON. Yes, sir; at times I did.

Mr. PECORA. And their action in maintaining or quoting the market had something to do with the daily quotations, didn't it?

Mr. ROBINSON. Through the day?

Mr. PECORA. Yes.

Mr. ROBINSON. Well, they would change. The market they were making would not necessarily mean that it was maintained during that day. There might be other houses making prices, and if they were——

Mr. PECORA (interposing). How many times a day would you call upon the National City Co. to tell you what market it was maintaining, or what prices it was quoting, on the stock of the bank?

Mr. ROBINSON. You are going back now three and one half years ago. This is from memory. There wasn't a record kept of every conversation.

Mr. PECORA. I understand that; but all I expect of you is your general recollection of the matter.

Mr. ROBINSON. Well, I would call very frequently, maybe every three or four minutes.

Mr. PECORA. And you found it advisable to keep in touch with them to that extent during your day's transactions, regarding the market they were maintaining or quoting for the stock of the National City Bank, did you?

Mr. ROBINSON. Yes, sir.

Mr. PECORA. How would you communicate with them—through a direct wire that was available to your office and to the National City Co.'s office?

Mr. ROBINSON. Through a direct wire.

Mr. PECORA. Now, do you recall particularly the transactions you had with the National City Co. in the stock of the National City Bank during the month of October, 1929?

Mr. ROBINSON. I believe I do.

Mr. PECORA. Were your transactions with the National City Co. in that month much greater in volume than they were for other months during the period from January, 1928, to September, 1930?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. ROBINSON. I believe in accordance with general business conditions they were.

Mr. PECORA. Were you in this hearing room this forenoon while letters written to the National City Bank in the month of October, 1929, by J. R. Schmeltzer & Co. were spread upon the record and were read aloud?

Mr. ROBINSON. Yes, sir.

Mr. PECORA. Are you familiar with the transactions referred to in those letters?

Mr. ROBINSON. Not in the least.

Mr. PECORA. Not in the least?

Mr. ROBINSON. No, sir.

Mr. PECORA. Do you know who in the organization of J. R. Schmeltzer & Co. was familiar with those letters?

Mr. ROBINSON. I do not; but I imagine it would be under the partnership or one of the partners.

Mr. PECORA. Mr. Robinson, did you know at any time that the National City Co. gave options for tens of thousands of shares at a substantial number of points below the market to others?

Mr. ROBINSON. Not until yesterday.

Mr. PECORA. And the first time you learned of it was through the medium of testimony adduced at the hearing before this committee yesterday?

Mr. ROBINSON. That is correct.

Mr. PECORA. If you had known of those option prices at the time when an option was given and when the option was exercised by Dominick & Dominick, would it have made any difference in the open market on the question of the value, or the market value or quotations, for the National City Bank stock?

Mr. ROBINSON. That is a hard question, Mr. Pecora. It all depends upon the market conditions at the time. For me to answer now would be guesswork.

Mr. PECORA. Well, it would affect market values generally if it were known, wouldn't it?

Mr. ROBINSON. It should.

Mr. PECORA. With options covering 32,000 shares of stock given by the company to others at prices well below the market?

Mr. ROBINSON. Well, I have known of them to affect market prices on other options, but I have not known of the National City Bank. But it is not the rule.

Mr. PECORA. But if knowledge of these options and the prices at which they were given, had become public property it would have affected prices, wouldn't it?

Mr. ROBINSON. I believe it would.

Mr. PECORA. So, in order not to affect prices by the granting of these options below the market, the options are secretly given, isn't that right?

Mr. ROBINSON. I believe that is correct.

Mr. PECORA. What was the daily line of credit awarded J. R. Schmeltzer & Co. by the National City Bank in October of 1929? 1929?

Mr. ROBINSON. It is impossible for me to answer that. As a salaried employee I would not know.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. You do not know?

Mr. ROBINSON. No, sir.

Mr. PECORA. Was any other person connected with J. R. Schmeltzer & Co. in the month of October 1929 engaged in those transactions in the bank's stock with the National City Co.?

Mr. ROBINSON. No.

Mr. PECORA. Did you handle all those transactions in the market?

Mr. ROBINSON. Well, that is hard to answer, too. There were two private wire systems, and occasionally someone might be on a part of some trade. But on the whole I would say that I handled all the trades. We have an assistant who does the details of the work. In the course of the business, for a part of the day, it might be handled by someone else.

Mr. PECORA. Weren't you to a considerable extent guided in your quotations for the stock by the advices you would receive every 3 or 4 minutes throughout the day from the National City Co. concerning their prices for the stock?

Mr. ROBINSON. Not as to the whole of the day. I might be momentarily for that, but not for the length of the day.

Mr. PECORA. But your inquiries would generally be made throughout the day, wouldn't they?

Mr. ROBINSON. That is correct.

Mr. PECORA. And the information you received from them was of very considerable guidance to you in your market operations in the stock?

Mr. ROBINSON. I would say to that, Mr. Pecora, no.

Mr. PECORA. They were of some guidance to you?

Mr. ROBINSON. They were of some guidance to me.

Mr. PECORA. Do you know of any other dealer in that stock whose advices on that matter would have been of greater guidance to you?

Mr. ROBINSON. Not greater in the long run but greater at that one moment. There were 30 or 40 other large exchange houses maintaining markets.

Mr. PECORA. But in the long run the advices you received concerning the position of the National City Co. were of more guidance to you than advices you received from any other dealer in that stock, weren't they?

Mr. ROBINSON. The position in the stock of the National City Bank by the National City Co. was never revealed to me.

Mr. PECORA. I am not asking about the position of the National City Co. but its market quotations for the stock.

Mr. ROBINSON. Well, there were no advices received. I can not answer that, because no one gave me any advice.

Mr. PECORA. I said "advices." I did not mean advice in the sense that some one was counseling you, but advices. The word "advices" was used by me as synonymous with information. Now, so understanding my question, will you answer it?

Mr. ROBINSON. Advices, as you put it, did help me in trading at times.

Mr. PECORA. Didn't it always help you?

Mr. ROBINSON. No, sir.

Mr. PECORA. Did you ever ignore it?

Mr. ROBINSON. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Completely?

Mr. ROBINSON. Well, it is a case of either ignoring it or not ignoring it.

Mr. PECORA. When you ignored it, do you mean that you ignored it completely?

Mr. ROBINSON. At that moment; yes, sir.

Mr. PECORA. In the long run were the advices so given of greater guidance to you than information received from any other dealer?

Mr. ROBINSON. I would say their information or advices were of more help than others.

Mr. PECORA. Yes. In order to be specific, Mr. Robinson, if you were bidding 250, we will say, at a given time for the stock of the National City Bank and you received advices or information that the National City Co. was bidding 240 for the stock, you wouldn't continue to bid 250, would you?

Mr. ROBINSON. Not unless any other house or our connections were bidding 250.

Mr. PECORA. Do you remember having an interview with me in my office in New York, or in the office of this committee in New York, about three weeks ago?

Mr. ROBINSON. I do.

Mr. PECORA. Do you recall telling me there, in words or substance, that as the specialist in the over-the-counter market in National City Bank stock you considered that you handled about 70 per cent of the volume of trades in that stock?

Mr. ROBINSON. I remember that.

Mr. PECORA. That was true, wasn't it?

Mr. ROBINSON. It was true in the handling of 70 per cent, I think, of the stock over a length of 2 years, but not daily.

Mr. PECORA. I mean over the period of time we are now discussing.

Mr. ROBINSON. Which is mere guesswork.

Mr. PECORA. That is your best estimate?

Mr. ROBINSON. It is guesswork.

Mr. PECORA. You say it is guesswork?

Mr. ROBINSON. Surely.

Mr. PECORA. It is your best estimate, whether you call it guesswork or not, isn't it?

Mr. ROBINSON. Right.

Mr. PECORA. Since you first told me that you have not had any reason to revise that guess, have you?

Mr. ROBINSON. No, sir.

Mr. PECORA. And you do not want to revise it now, do you?

Mr. ROBINSON. No. But I don't want to be guessing now.

Mr. PECORA. If you were asked to give us your best guess now, you would give that guess, wouldn't you?

Mr. ROBINSON. Certainly.

Mr. PECORA. As the specialist who handled about 70 per cent of the over-the-counter trades in that stock, you found it necessary or advisable to keep in constant touch throughout the day with the National City Co. for the purpose of learning what they were doing to maintain the market or "prices"; isn't that right?

Mr. ROBINSON. That is right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Who handled the financial end of those trades on behalf of your firm in October of 1929?

Mr. ROBINSON. The financial end of it would be handled by any one of the partners.

Mr. PECORA. Who is A. B.? What person in the office had a name the initials of which were A. B.?

Mr. ROBINSON. I believe, although I may be wrong on this, but I believe he was one of the clerks in the cage.

Mr. PECORA. Was there any advice or instruction or direction given to you by anybody in the firm during that month concerning the extent to which you could commit the firm in transactions in National City bank stock with the National City Co.?

Mr. ROBINSON. Only regarding their own position, that is, the position they wanted to be in over the night, was all.

Mr. PECORA. Who gave you your directions or instructions in that respect?

Mr. ROBINSON. Mr. Clifford.

Senator FLETCHER (presiding). Did Mr. Pritchard tell you why he was going away?

Mr. ROBINSON. No, sir.

Mr. PECORA. In the over-the-counter market isn't it true that the largest buyer and seller has a greater influence, or exercises a greater influence, on market quotations than anyone else?

Mr. ROBINSON. That would be natural in any market.

Mr. PECORA. Yes.

Mr. ROBINSON. Yes, sir.

Mr. PECORA. And in connection with the market for National City Bank stock wasn't the National City Co., by and large, through that period of time the largest buyer and the largest seller so far as you know?

Mr. ROBINSON. So far as I know they were.

Mr. PECORA. By what percentage did the volume of their transactions exceed the next largest buyer and seller of that stock in that period of time?

Mr. ROBINSON. I can not answer that without the record and I haven't the record.

Mr. PECORA. Give us the best answer you can make. We understand that it is not to be accepted as mathematically correct, but I want the best approximation you can give us from memory.

Mr. ROBINSON. I should say they bought from me about 30 to 40 per cent more.

Mr. PECORA. Than any other individual buyer or seller, is that right?

Mr. ROBINSON. Yes, sir.

Mr. PECORA. The National City Co. was your biggest customer for National City Bank stock?

Mr. ROBINSON. That question was just answered.

Mr. PECORA. No further questions, Mr. Chairman.

Senator FLETCHER (presiding). You may be excused. Is he to be excused entirely, Mr. Pecora?

Mr. PECORA. Yes, sir. We are through with him.

Senator FLETCHER (presiding). You need not return.

(Thereupon the witness was excused from further attendance.)

Mr. PECORA. Mr. Baker will resume the stand, please.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

TESTIMONY OF HUGH B. BAKER, PRESIDENT NATIONAL CITY CO., NEW YORK CITY—Resumed

Mr. PECORA. Mr. Baker, there was some reference in the testimony yesterday about the selling organization of the National City Co., and some witness testified that the number of salesmen directly employed by the National City Co. throughout the country in the sale of its securities to the public was about 350. Do you recall that?

Mr. BAKER. Yes, sir.

Mr. PECORA. Now, in addition to selling securities to the public through the instrumentalities of those 350 salesmen, I mean employed salesmen, the company used other agencies or facilities for selling and distributing its securities to the public, didn't it?

Mr. BAKER. Well, other dealers.

Mr. PECORA. It referred to them as other instrumentalities or agencies. Did it or not?

Mr. BAKER. Yes. We did business with hundreds and hundreds of dealers.

Mr. PECORA. Now, those hundreds and hundreds of dealers were scattered throughout the country, weren't they?

Mr. BAKER. That is right.

Mr. PECORA. And the radius of their respective operations was rather large?

Mr. BAKER. Oh, yes.

Mr. PECORA. So that in addition to your own selling force of 350 salesmen, your company utilized the selling facilities of hundreds and hundreds of dealers throughout the country.

Mr. BAKER. Well, of course we had no control over them.

Mr. PECORA. Didn't it——

Mr. BAKER (continuing). Well, if I may explain that in this way: We had business relations with dealers all over the United States, perhaps not frequently, but when we had some new deal or some new issue we were then offering, we would then be in contact with dealers throughout the whole of the United States. So that when I say we did business with dealers throughout the country I mean it in that way.

Mr. PECORA. That is to say, you proceeded to market your securities to the investing public not only through your own 350 salesmen, but also through the selling facilities of hundreds of dealers scattered throughout the country.

Mr. BAKER. They were invited to participate in our deals.

Mr. PECORA. And they did participate in them, hundreds of them.

Mr. BAKER. Many of them did; yes, sir.

Mr. PECORA. Now, throughout the years 1928 and 1929 your company maintained marked activity in the sale of the bank's stock, didn't it?

Mr. BAKER. Yes, sir.

Mr. PECORA. Not only through its own 350 salesmen but also through dealers and houses throughout the country.

Mr. BAKER. Well, of course in only those cases with dealers where they had actual orders for the stock. There was no commission of any kind that would justify any effort on their part. If they had orders for the stock they might place the orders through us or somebody else.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. The National City Bank had correspondents or correspondent banks in the interior of the country, didn't it?

Mr. BAKER. Yes, sir.

Mr. PECORA. What was the number of those correspondent banks in the interior?

Mr. BAKER. I can not answer that. I do not know.

Mr. PECORA. Many?

Mr. BAKER. Yes, many.

Mr. PECORA. But the National City Co. also utilized the facilities of those correspondent banks and distributed its securities throughout the country?

Mr. BAKER. Well, some of those banks had bond departments, investment departments, and in those cases, many of them were invited, but it did not necessarily correspond with the fact that they were correspondent banks. If we regarded them as investment dealers probably they would be invited, the same as any other dealer.

Mr. PECORA. What I want to get at are the facts as distinguished from probabilities. What are the facts in that respect?

Mr. BAKER. Those are the facts.

Mr. PECORA. To put it simply: Your company in distributing securities to the investing public not only utilized the services of its 350 salesmen and hundreds of dealers throughout the country, but also the facilities of those correspondent banks throughout the country?

Mr. BAKER. Only where they had bond departments or investment departments, and other banks. It did not make any difference to us whether they were correspondents of the National City Bank or any other bank, if they had investment departments.

Mr. PECORA. And you found that most of those banks had investment departments, didn't you?

Mr. BAKER. I doubt if the most of them had, but quite a number.

Mr. PECORA. A substantial number had?

Mr. BAKER. Yes.

Mr. PECORA. Now, at various times during those two years, in selling the stock of the bank through its various agencies and selling facilities, the National City Co. offered a premium to selling agents, did it not, on whatever sales they made of the stock of the bank?

Mr. BAKER. That was to our salesmen. And the same thing is true in all securities which were on our list, as a part of their compensation.

Mr. PECORA. Do you mean to say that you offered premiums on all sales they made?

Mr. BAKER. Not necessarily all. There might be so-called buying orders for some security which we did not have and which was executed merely as a service execution.

Senator FLETCHER. Did you allot stock to your correspondents and signify to them that you desired they take that stock?

Mr. BAKER. No, sir.

Mr. PECORA. Did you give special discounts to the banks, the correspondent banks or banks in the interior, which sold the stock of your bank?

Mr. BAKER. Not at all. Never.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Never?

Mr. BAKER. Not to my knowledge.

Mr. PECORA. Well, did you get the same prices from them, or quote the same prices to them that you did to the general public?

Mr. BAKER. Yes.

Mr. PECORA. Well, now, let us understand: How were your salesmen compensated for their work?

Mr. BAKER. By salary and premiums; in other words, commissions.

Mr. PECORA. Did every salesman get both a salary and a commission?

Mr. BAKER. Yes.

Mr. PECORA. On the sales made by him for the company?

Mr. BAKER. Yes.

Mr. PECORA. Now, in addition to the salary and commission there were occasions when they also got premiums, didn't they?

Mr. BAKER. No. That word "premium" I am using with the same meaning as commission. Salary and premium, we call it.

Mr. PECORA. What was the commission they got?

Mr. BAKER. It varied with different issues. Usually on bonds the premium would be anywhere from $1 to $2 or $3.

Mr. PECORA. For how many shares?

Mr. BAKER. I said bonds.

Mr. PECORA. Of what units?

Mr. BAKER. $1,000.

Mr. PECORA. How about stocks?

Mr. BAKER. As to stocks, that varied also. It might be anywhere from 10 cents a share to 50 cents a share.

Mr. PECORA. Who fixed the amounts of those premiums or commissions?

Mr. BAKER. Well, that was generally fixed by Mr. Beebe in our office.

Mr. PECORA. What position did he have?

Mr. BAKER. Assistant vice president.

Mr. PECORA. And do you know what elements were considered by him in fixing the premiums within the range mentioned by you?

Mr. BAKER. Well, of course, there were at times new issues, not so well known, credits, in which the demand was not so great, and it required expense of operation, and so forth.

Mr. PECORA. The premiums were higher where the security was considered more difficult to sell, is that it?

Mr. BAKER. At times; yes, sir.

Mr. PECORA. At times?

Mr. BAKER. Yes, sir.

Mr. PECORA. And the premiums were also higher when the company desired to accelerate sales of any particular issue, weren't they?

Mr. BAKER. There were times when that was true; yes, sir.

Mr. PECORA. Now, were any of those times reached during the years 1928 and 1929 with respect to the stock of the National City Bank?

Mr. BAKER. Well, I don't know what the premium dates were on those. I haven't it.

Mr. PECORA. Can not you answer my question?

Mr. BAKER. No, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Can't you answer the question now, as to whether or not during 1928 and 1929 there were occasions when your company offered a higher premium or commission to its salesmen for selling the stock of the bank?

Mr. BAKER. Here is a paper which is now handed me which gives the premium lists of National City Bank stock from 1927, and it shows on the old stock 50 cents a share, and then when it was changed to the new stock, 20 cents a share. And then from April 2, 1929, until January 7, 1930, it was 50 cents a share.

Mr. PECORA. Did you have to get that information from Mr. Law before you were able to answer my question?

Mr. BAKER. Yes. I did not have it with me.

Mr. PECORA. In other words, until Mr. Law gave you some written memorandum which you consulted in making your reply, you were not able to answer the question as to whether or not during 1928 and 1929 there were occasions when your company raised the premium or commission which it gave to its salesmen for making sales of bank stock?

Mr. BAKER. I could not have answered it, because with our numbers of transactions, Mr. Pecora, through the National City Co. in the course of a year's time, will run 600,000 or 700,000. I cannot remember exactly what premiums were given on this, that, or the other issue without referring to the records.

Mr. PECORA. Did Mr. Beebe consult you on the matter of fixing the premiums for salesmen?

Mr. BAKER. Not always, but occasionally.

Mr. PECORA. Did he have the right to exercise his own independent judgment on that?

Mr. BAKER. Yes, sir.

Mr. PECORA. Did you give him that right?

Mr. BAKER. Yes, sir.

Mr. PECORA. And he is an assistant vice president?

Mr. BAKER. That is right.

Mr. PECORA. In selling your securities to the public through dealers, were the dealers given instructions by your company to maintain offering prices except for special discounts to banks and other dealers?

Mr. BAKER. Are you speaking now of general securities?

Mr. PECORA. Yes.

Mr. BAKER. Yes, sir; that is correct, where it was a syndicate or a new deal.

Mr. PECORA. So that they got those securities at prices lower than the prices at which they were offered to the general public?

Mr. BAKER. They were participating in the distribution of the issues, and were paid thereby.

Mr. PECORA. Can not you answer a simple question like that with a yes or a no?

Mr. BAKER. I am trying to explain——

Mr. PECORA (interposing). They either were permitted to get those securities at prices less than the general public paid, or they were not. Now, were they? Answer yes or no.

Mr. BAKER. The reason I can not answer that yes or no, is because it does not apply the same to all issues of securities.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Whether it applies the same to all issues of securities or not in those instances where dealers were given these discounts, can't you tell us whether or not they were permitted to get those securities at prices lower than the general public?

Mr. BAKER. Yes. In those cases; yes.

Mr. PECORA. All right. Do you know what I mean by the term "flashes" as applied to the business of the National City Co. in selling its securities to the public?

Mr. BAKER. Yes, sir.

Mr. PECORA. What are they?

Mr. BAKER. They are messages that we send to our organization, trying to keep them acquainted with information that we have at the head office, and to keep in touch with them regularly.

Mr. PECORA. And who composes those flashes?

Mr. BAKER. Various people in our organization. They were directly under my supervision at that time.

Mr. PECORA. You are willing to assume the responsibility for those flashes, are you?

Mr. BAKER. Yes, sir.

Mr. PECORA. Did you compose any of them yourself?

Mr. BAKER. Some of them I did.

Mr. PECORA. And did you generally supervise the flashes that were sent out to the sales force of the company?

Mr. BAKER. Yes, sir. I should say yes to that, with this addition: That I did not see all of them, but, whether I saw them or not, the men who wrote them were men with whom I placed that responsibility.

Mr. PECORA. Now, in order to keep the salesmen up on their toes, sales contests were arranged by the company at times, isn't that so?

Mr. BAKER. Yes, sir.

Mr. PECORA. Whose idea was that?

Mr. BAKER. Mine.

Mr. PECORA. Describe those sales contests which were your idea, will you?

Mr. BAKER. I suppose our sales organization is like all other sales organizations. There are times when they seem to slow down and are tired. In order to inject new life into the organization we would develop what we called sales contests, to add some competition.

Mr. PECORA. Have you produced flashes which emanated from the main office of your company to its sales force generally throughout the country?

Mr. BAKER. Yes. But you asked for specific ones.

Mr. PECORA. Have you the flash sent out under date of September 27, 1929?

Mr. BAKER. On what subject?

Mr. PECORA. On the Intercontrol Contest.

Mr. BAKER. I haven't that right here before me, but it is here I know.

Mr. PECORA. Perhaps Mr. Law can help you get it. And while Mr. Law is looking for that flash let me ask you this: Isn't it a fact that many of these flashes were sent out to the general sales organization?

Mr. BAKER. Yes, sir.

Mr. PECORA. Who prepared the flashes so sent out?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. They may have been prepared by any officer of the general sales organization.

Mr. PECORA. And submitted to you for approval before being dispatched?

Mr. BAKER. Not necessarily submitted to me. But, as I said before, I assumed that responsibility anyway.

Mr. PECORA. Now, Mr. Law, have you the September 27, 1929, flash, no. 5033?

Mr. LAW. Here it is.

Mr. PECORA. Now have you got it, Mr. Baker?

Mr. BAKER. Yes, sir.

Mr. PECORA. Well, please read the first paragraph there.

Mr. BAKER. It says:

We are pleased to announce this morning the beginning of one of the greatest sales contests ever held by the National City Co.

And there seems to have been written in here with pencil, and there is something scratched out, but the something written in is:

We are pleased to announce this morning the beginning of one of the greatest sales contests ever held by the National City Co.

Mr. PECORA. Is that the complete paragraph?

Mr. BAKER. Oh, I misunderstood you. I thought you said the first sentence.

Mr. PECORA. No.

Mr. BAKER. It goes on to say:

There will be liberal cash prizes for a large number of men in every part of the organization, and higher premium schedules. Contest will be organized and operated between control organizations and six contesting units, being territories controlled from San Francisco, Chicago, Philadelphia, Boston, New York metropolitan, and New York control offices outside New York City. Security issues with premium schedule and point ratings for prizes are as follows.

Mr. PECORA. What were the security issues?

Mr. BAKER. They were Beaux-Arts units; Cannon Mills, common; General Mills, common; Kendall Co., participating preferred; M. K. T., 7 per cent preferred; Oliver, prior preferred; Oliver, convertible participating; Wesson, convertible preferred; Pirelli, common; Lautaro, 6's; Minas Geraes, 6½'s; Finland Reserve Mortgage Bank, 6's.

Mr. PECORA. Now, the premiums offered on the list, as to the last three securities were at the rate of $4 per thousand, weren't they, and not $3?

Mr. BAKER. That is right.

Mr. PECORA. And the issues to which these higher premiums related were all foreign issues, weren't they?

Mr. BAKER. That is right.

Mr. PECORA. And the Lautaro 6's are Chilean nitrate bonds, aren't they?

Mr. BAKER. Yes, sir.

Mr. PECORA. And the Minas Geraes 6½'s are bonds issued by the State of Minas Geraes of the Republic of Brazil?

Mr. BAKER. That is right.

Mr. PECORA. And the Finland bonds were, as the name indicates, Finnish securities?

Mr. BAKER. That is right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. The other issues were all either common or preferred stocks, weren't they?

Mr. BAKER. Yes, sir.

Mr. PECORA. Now, the securities specified in that flash are all securities that were then owned by the National City Co., weren't they?

Mr. BAKER. Yes, sir.

Mr. PECORA. And the premiums on the common and preferred stocks referred to in this flash, range from 30 cents to 40 cents per share?

Mr. BAKER. That is right.

Mr. PECORA. Mr. Chairman, I ask that there be spread in full on the record the entire flash testified to by the witness, which is dated September 27, 1929, and known as "Flash 5033", signed "General Sales."

Senator FLETCHER (presiding). Without objection, it is so ordered.

FLASHES ON THE INTERCONTROL CONTEST

FLASH 5033

SEPTEMBER 27, 1929.

We are pleased to announce this morning the beginning of one of the greatest sales contests ever held by the National City Co. There will be liberal cash prizes for a large number of men in every part of the organization and higher premium schedules. Contest will be organized and operated between control organizations and six contesting units, being territories controlled from San Francisco, Chicago, Philadelphia, Boston, New York metropolitan, and New York control offices outside New York City. Security issue with premium schedule and point ratings for prizes are as follows:

Security	Premiums	Points	Security	Premiums	Points
	Per share	*Per share*		*Per share*	*Per share*
Beaux-Arts units	$0.40	5	Pirelli, common	$0.30	2
Cannon Mills, common	.30	1			
General Mills, common	.30	1		*Per thousand*	*Per thousand*
Kendall Co., part. preferred	.40	2			
M. K. T., 7 per cent, preferred	.40	4	Lautaro, 6's	$4.00	25
Oliver Prior, preferred	.40	2	Minas Geraes, 6½'s	4.00	40
Oliver convertible, part	.30	1	Finland, Reserve Mortgage Bank 6's	4.00	40
Wesson convertible, preferred	.30	2			

This premium schedule will hold straight through entire contest. Total prize money for entire organization will be $25,000 divided among various controls in proportion to the work done and to be subsequently divided among the highest ranking men in the various controls according to rules set forth below. At the end of the contest each control organization will receive a percentage of the total prize fund calculated ratio between the total number of contest points reported by that control and total contest points for whole organization. In any particular control organization there will be first prizes of equal amount for the number of men representing one tenth of all the salesmen in the control. These first prize men will divide equally 60 per cent of the controls prize money. Second prizes in equal amounts will go to the next highest ranking men representing one fifth of all the salesmen in the control organization who will divide equally the remaining 40 per cent of the controls prize fund. While this sounds quite complicated we believe it will work out simply in practice. For example, let us assume that our San Francisco control organization having 36 salesmen sells all of the issues in amounts as we will allot them the total for that control would be 37,245 points as compared with total points for the whole organization of 347,500 points. Out of the $25,000 prize fund this would give San Francisco $2,690. One tenth of the 36 men to the nearest whole number would be 4 men who would divide

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

60 per cent of the $2,690 giving each of the first prize men $403.50. Then the next highest 7 men representing one fifth of the total 36 would divide the remaining amount giving each of them a prize of $154. If, however, San Francisco should make more than 37,245 points, the prize fund for that control would be increased proportionately and the first and second prizes would be increased in corresponding amounts. In wires to follow we will advise each control of their proportionate share of the various issues included in the contract.

GENERAL SALES.

Mr. PECORA. Mr. Baker, I think I asked you yesterday if your company ever sought by its operations in the stock of the bank to control the market for those shares.

Mr. BAKER. Yes, you did.

Mr. PECORA. And your answer was that it did not.

Mr. BAKER. That is right. But I qualified the answer, as I remember, by saying that it depends on whether—or it depends on the way that word is used. If we had the stock we would try to prevent any wide move either way.

Mr. PECORA. Now, Mr. Baker, can you produce flash No. 3765, dated February 1, 1929, entitled "Strictly confidential to all managers?"

Mr. BAKER. I think so.

Mr. LAW. Is it on National City Bank stock, Mr. Pecora?

Mr. PECORA. Yes.

Senator FLETCHER. While you are finding that let me ask: This flash No. 5033 does not state the amounts of these securities. Suppose you had these numerous agents over the country and they sold your holdings, there is nothing here to indicate how many shares you have.

Mr. BAKER. No; and we would stop that immediately. We would take that one out.

Senator FLETCHER. How often did you get reports?

Mr. BAKER. Oh, right along during the day.

Senator FLETCHER. Regularly?

Mr. BAKER. Yes, sir; regularly.

Mr. PECORA. Now have you flash No. 3765?

Mr. BAKER. Yes, sir.

Mr. PECORA. Will you read that flash?

Mr. BAKER. It is as follows:

FLASH NO. 3765

FEBRUARY 1, 1929.

(Strictly confidential to all managers)

In the course of the last few weeks through the purchase of rights and otherwise we have acquired a small block of the new shares of National City Bank. Market has been one of increasing strength, and in order to keep it orderly we have been forced to lose some of our long position over the counter in the open market. This is defeating a plan which we had in mind of creating new stockholders who will be beneficial to the institution, as there is no doubt in our minds that perhaps a considerable part of the buying at present is speculative. We did not want to see the stock run up in price and then make a distribution through our organization to new customers. We therefore have decided very suddenly today that rather than lose any more of our stock in the open market we will ask your cooperation in the distribution of what we have left in small amounts and to holders who will be of definite value in the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

future to this institution and only to those who intend to hold the stock. The amount which we can give any one office will be very limited, and we will expect you to see to it that this stock is placed in accordance with the above program. As a stockholder yourself you will readily see why we are stressing this distribution to new holders. The direct and indirect results of such placement will add materially to the business of this institution. We have decided to make a very special price to such new holders of 5 points under the market. This is a very delicate distribution to handle, and we will require your utmost finesse to get the kind of placement we want without offending some of your present customers. A premium will be allowed, of course, as usual, and if you will give us your complete cooperation in this matter it will result in the addition of a substantial number of new business prospects for all of us.

H. B. BAKER.

Mr. PECORA. And that is signed by you.

Mr. BAKER. Yes, sir.

Mr. PECORA. When you said at the very end of this flash of February 1, 1929, "if you will give us your complete cooperation in this matter it will result in the addition of a substantial number of new business prospects for all of us," you meant to convey to your salesmen that additional holders of the stock of the bank would be regarded as new prospects of your company to whom other securities sponsored by your company could be more readily sold; is that correct?

Mr. BAKER. Absolutely.

Mr. PECORA. And in order to create these new prospects for the other securities that your company was selling to the public you were, in this flash, instructing your sales department and its men in the field to sell the stock of the bank at 5 points under the market?

Mr. BAKER. That is right.

Mr. PECORA. What did you mean when you said in this flash, "This is a very delicate distribution to handle, and we will require your utmost finesse to get the kind of placement we want without offending some of your present customers"?

Mr. BAKER. I meant that the price being under the market—that is, under the quoted market—it would be difficult in that placement to avoid selling to people who would immediately sell it back into the market, and that was not what we were after.

Mr. PECORA. In other words, you wanted this stock of the bank sold to persons who would keep it as a long-term investment?

Mr. BAKER. That is right.

Mr. PECORA. You did not want that stock coming back into the market, did you?

Mr. BAKER. That is right.

Mr. PECORA. And you wanted the salesmen to be especially careful about offending old customers in offering the stock of the bank to new customers at 5 points under the market?

Mr. BAKER. That is right.

Mr. PECORA. Your company at all times had access to the complete list of the stockholders of the bank, did it not?

Mr. BAKER. If we did I do not think it was ever used. I do not recall that we ever——

Mr. PECORA (interposing). Can't you answer that question yes or no?

Mr. BAKER. As I just said, I doubt if that was ever looked at by anybody in our organization.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. I did not ask you whether it was ever looked at; I asked you whether you had access to it.

Mr. BAKER. I don't remember the definite instructions as regards that, nor the restrictions, but I do know that the access to the stockholders books of the National City Bank is not open to the organization of the National City Co.

Mr. PECORA. Of course, I did not mean to suggest that it was open to everybody in the organization, but it was available to any of the executive officers, was it not?

Mr. BAKER. I probably could have looked at it.

Mr. PECORA. And other persons holding executive positions could probably have looked at it too, without any hindrance, could they not?

Mr. BAKER. Senior executives probably could have.

Mr. PECORA. In connection with the marketing of its securities to the public, your company made it a business, did it not, to continually feed the names of prospective new customers to your selling force in the field?

Mr. BAKER. Yes, sir.

Mr. PECORA. As a rule, how many new names a year were sent out to the selling force by the main office of the company?

Mr. BAKER. I haven't the slightest idea.

Mr. PECORA. You haven't the slightest idea?

Mr. BAKER. Not in my mind; no, sir.

Mr. PECORA. Are you familiar with the annual reports of your company.

Mr. BAKER. Yes, sir.

Mr. PECORA. Do not those annual reports contain references to the number of new names sent out?

Mr. BAKER. I think they probably do at times, but I don't remember exactly whether that is in the annual report or not. If it is there, why, that is the figure.

Mr. PECORA. And until I suggested that it might be in those annual reports you had absolutely no idea of the number of those customers?

Mr. BAKER. No.

Mr. PECORA. Of prospective customers whose names were sent out into the field?

Mr. BAKER. No. No; I would have to refer to that or some other file to know that.

Mr. PECORA. Let us take the annual report for the year ending December 31, 1927. I see the following statement:

A summary of the department's past year activities—

the department referred to being called the New Business Depart ment.

Mr. BAKER. Yes.

Mr. PECORA. " Comprise the preparation and issuance of "—then " names distributed to district offices 47,447."

Is that the number that would indicate——

Mr. BAKER (interposing). Yes; that is all right.

Mr. PECORA. The number of names of prospective customers sent out by the head office to its agents in the field?

Mr. BAKER. Yes; that is correct.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Do you know how many or approximately how many new names were sent out by the new business department to its men in the field for the year 1928? Look at page 19 of the annual report for 1928.

Mr. BAKER (referring to document). 1928, one hundred twenty-two thousand, three hundred and thirty-two.

Mr. PECORA. That compares with 47,447 sent out during the preceding year?

Mr. BAKER. That is right.

Mr. PECORA. Now, during the year 1928 the company was extensively engaged in selling the stock of the bank, was it not?

Mr. BAKER. Yes. We sold quite a substantial amount.

Mr. PECORA. And do you ascribe this very large increase of new names over the number sent out to your field agents for the year 1927 as in any way due to the increased number of holders of the bank stock which had developed during the year 1928?

Mr. BAKER. I doubt that very much, because the——

Mr. PECORA (interposing). Do you only doubt it?

Mr. BAKER. Well, I don't understand.

Mr. PECORA. Don't you know one way or the other? Was any part of this increase due to the increase in the number of stockholders of the bank's shares?

Mr. BAKER. I am trying to explain that, Mr. Pecora, if you will permit me to do it. The reason I said I doubted it is because the particular offices where new stockholders of the City Bank were developed would not need to have names sent to them, because they already have them.

Mr. PECORA. Where did they get this large number of additional prospects over the year 1927?

Mr. BAKER. I can not explain just where those lists are gathered together from, but wherever we can get lists that seem to be investors we put those through a department who study those and finally sort them out and send them out, tax lists, automobile owners, and all that sort of thing.

Mr. PECORA. It seems from the annual reports of your company for the years 1927 and 1928, respectively, that in 1927 forty-seven thousand new names were sent out to your field agents, and in 1928 approximately 75,000 more.

Mr. BAKER. Yes, sir; that is right.

Mr. PECORA. 75,000 more than in 1927 were sent out.

Mr. BAKER. That is right.

Mr. PECORA. That is a total of 122,000 new names?

Mr. BAKER. That is right.

Mr. PECORA. Now don't you know where those names came from?

Mr. BAKER. A good many of them come from automobile registrations, tax lists, and so forth.

Mr. PECORA. Who compiled these lists of new names for the company?

Mr. BAKER. We have a department—did have at that time—whose business was solely to develop names for the use of these offices.

Mr. PECORA. That was the so-called "new business department"?

Mr. BAKER. Yes; certainly.

Mr. PECORA. How many new names were sent out to your field forces during the year 1929 by the new business department?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Fifty-four thousand one hundred and seventeen.

Mr. PECORA. Those names were culled from similar sources?

Mr. BAKER. Yes.

Mr. PECORA. When Mr. Rentschler was on the stand the day before yesterday he gave some testimony, which you doubtless heard, to the effect that in some of the bank's metropolitan branches, where the National City Co. had no salesmen or representatives directly employed, the branch bank's employees sold securities to the investing public on behalf of your company. Do you recall that testimony?

Mr. BAKER. Yes. I do not remember the exact words in it, but I remember the sense of the statement.

Mr. PECORA. Yes. And did those bank employees receive premiums or commissions for those sales?

Mr. BAKER. No, sir.

Mr. PECORA. Who did?

Mr. BAKER. That was a result of—that only lasted a very short time—I think 3 or 4 or 5 months.

Mr. PECORA. In what year?

Mr. BAKER. 1931. When we were beginning to retract our operations somewhat, and where we had no representatives left in an office, customers who would come in to inquire about securities would be directed to some particular window or somebody that would talk with them intelligently, and if they wanted to buy a security of any kind that was transmitted to the head office and handled from there. Eventually the bond would be sent back to that particular branch, where they made deliveries to the customer who came in and inquired.

Mr. PECORA. My question was not how these bank employees functioned, but my question related to the payment of commissions on those sales. Were any commissions or premiums paid on those sales?

Mr. BAKER. No, no. There was a service allowance that we made at the branch to compensate them for the time and effort spent.

Mr. PECORA. Who got that allowance? To whom was it distributed?

Mr. BAKER. The branch itself.

Mr. PECORA. Well now, the branch itself is a part of the institution?

Mr. BAKER. That is right.

Mr. PECORA. The branch did not take the money and stow it away somewhere?

Mr. BAKER. That is right.

Mr. PECORA. It was given to employees, wasn't it?

Mr. BAKER. No, no, no, no. It was a part of the profit of that branch.

Mr. PECORA. In other words, the bank then got those commissions?

Mr. BAKER. It was a service charge paid by us for a service rendered by that branch.

Mr. PECORA. And you say that only happened for a period of about four or five months in 1921?

Mr. BAKER. Yes. I will give you the exact time. Six months.

Mr. PECORA. Will you look at the annual report of the National City Co. for the year 1928?

Mr. BAKER. What page?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Page 20. Do you find there at the very end of the report the following statement:

Sales facilities are now established in 20 of the bank's branches in New York City, and this service will be further expanded during 1929.

Mr. BAKER. That is right.

Mr. PECORA. Does that relate to promotion of sales by the bank's employees?

Mr. BAKER. Not at all.

Mr. PECORA. Just to the salesmen of your company stationed in the bank's branches?

Mr. BAKER. That is right.

Mr. PECORA. Now, will you look at the report of your company for the year 1929?

Mr. BAKER. What page, please?

Mr. PECORA. The last page, page 18. Do you find the following statement therein, referring to the sales facilities of the company during that year:

This makes a total of 95 points offering National City Co. facilities to investors through its own staff, exclusive of the excellent service rendered for our account by bank employees at offices where City Co. men are not yet located.

Mr. BAKER. Yes, sir.

Mr. PECORA. That relates to the year 1929, not 1931, does it?

Mr. BAKER. That is right; yes.

Mr. PECORA. So that as far back as 1929 employees of the bank in various of its metropolitan branches were promoting the sale of securities by the company?

Mr. BAKER. No; I do not so interpret that at all. What that means is that where there were opportunities for National City Co. business coming to the attention of the employees in the bank branch they would report that immediately to the nearest branch where there was direct City Co. representation.

Mr. PECORA. And that does not relate to actual promotion of sales by the bank employees?

Mr. BAKER. No; not at all. Now, there may have been orders from time to time that were transmitted that way, but there were no premiums, and it did not amount to anything. That refers really to leads sent to the other branches.

Mr. PECORA. Were the lists of depositors of the bank and its various branches used as a source from which your company gathered names of new prospects?

Mr. BAKER. No, sir.

Mr. PECORA. How do you know that?

Mr. BAKER. I know it because we would never have access to the names of depositors in the National City Bank. It is entirely possible that in some of the smaller branches there might be some discussion of that kind, in which the name might be given, but as far as a general policy of taking the names of the depositors of the National City Bank, so far as I can recall, that has never been done.

Mr. PECORA. You said yesterday you thought your memory was rather poor. Is it possible you have forgotten anything about that?

Mr. BAKER. It might be, but I don't think so.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

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

Mr. BAKER. That might possibly be, but the way the name might have come to the attention of the salesmen does not necessarily follow that it comes merely because he is a depositor of the bank, Mr. Pecora. He has business interests, and it is the business of every new business department to find out who the people are in the community who are investors, and so forth.

Mr. PECORA. Would it surprise you to know that many of the bank's depositors who never before had had any business with the company were approached directly by salesmen or representatives of the company and greeted with the remark that the salesman knew that they were depositors of the bank?

Mr. BAKER. Well, that could still be possible. I do not dispute that at all. But it was not from any general list of the depositors of the bank.

Mr. PECORA. If that could be possible, can you suggest any way by which the salesmen of your company were able to learn that these prospects upon whom they called were depositors of the bank——

Mr. BAKER (interposing). Oh, yes.

Mr. PECORA. Except from the bank itself?

Mr. BAKER. Oh, yes; that could easily be, because——

Mr. PECORA (interposing). Do you think it is easy to find out in which bank one deposits?

Mr. BAKER. A customer of the bank, let us say, in talking to some officer in the bank indicates that he is interested in making some investments. That would be transmitted to the National City Co., and that name would be called upon immediately.

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

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

Mr. PECORA. And that is the way the bank would advise such an inquirer on matters of investments?

Mr. BAKER. It all depends on the nature of the inquirer.

Mr. PECORA. If it was an inquiry for the making of investments that was the way he would be advised frequently?

Mr. BAKER. I think he would say that "the investment part of this organization is the National City Co. and I would be glad to refer you to them," some particular name.

Mr. PECORA. And if that depositor or customer then followed up that suggestion by calling upon the National City Co. for advice as to his investments, it was not an unusual thing for the National City Co. to suggest investment in securities that the company was sponsoring, was it?

Mr. BAKER. That is right.

Mr. PECORA. In fact, it was the usual thing, wasn't it?

Mr. BAKER. That is right. But he did not recommend——

Mr. PECORA (interposing). And do you consider, as a director of the bank, that that was a disinterested and unselfish way for the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

bank to advise a depositor concerning the making of investments generally?

Mr. BAKER. Well, as I told you yesterday, Mr. Pecora, the reason I say I do feel that is the proper way to do is because of the facilities which we had in the National City Co. for a study of investments, and based upon that we made our recommendations.

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

Mr. BAKER. Yes; I think that is good banking practice.

Mr. PECORA. And you would approve of its continuation, would you?

Mr. BAKER. Yes, sir.

Mr. PECORA. By the way, have you a sales letter dated February 6, 1929, entitled "Loaves from Crumbs"?

Mr. BAKER. Yes.

Mr. PECORA. Who prepared that?

Mr. BAKER. I can not tell the specific author of it, but it was undoubtedly prepared in the general sales department.

Mr. PECORA. Was it read over by you before it was sent out?

Mr. BAKER. I assume that it was, but whether it was or not, I take responsibility for it.

Mr. PECORA. That letter reads as follows:

February 6, 1929.

LOAVES FROM CRUMBS

It is the usual experience, when trading out one block of securities for another, to find that the client has a cash difference in his favor. More often than not these differences are too small to permit an immediate and satisfactory investment. As a consequence the cash balance goes into the customer's bank account to be lost sight of or spent.

The 5-to-1 split-up of National City Bank stock provides an excellent way to take immediate care of these cash differences.

Assuming that the client's circumstances are such that he can afford a current rate of income as low as that on National City Bank stock (and very few can not, the small amount of cash considered), you should make it a point to see that the crumbs resulting from an exchange of securities go at once into one or more shares of the stock. If the amount is insufficient to buy one share you can have the customer put up the remaining cash. If you will continue this practice it will not be long before each client and you will be agreeably surprised by the shares of National City Bank stock that he will have accumulated.

These shares of National City Bank stock should not only prove a very satisfactory investment over a period of time, but, as you know from experience, their ownership ties the customer in closer than ever. By following the practice suggested you will be able to work in odd shares of City Bank stock in a great many places where it has never been before as well as increase the holdings of some of your present owners.

Experience is admitted to be a trustworthy guide and your own experience indicates that National City Bank stock should be as desirable a medium as one can find for the investment of odd amounts.

By using the crumbs of cash resulting from exchanges to buy the new stock of the National City Bank and continuing that practice as opportunity arises you will work these crumbs into a loaf of substantial size with consequent advantages to the client, the National City Co., and yourself.

You assume responsibility for this letter?

Mr. BAKER. Yes, sir.

Mr. PECORA. The date of it is February 6, 1929. I offer it in evidence. It has already been spread upon the record by my reading of it.

When your salesmen were attempting to sell securities sponsored by your company, were they advising prospects to sell out securities

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

which they then owned and use the proceeds of the sale to buy securities sponsored by the company?

Mr. BAKER. That might be, depending upon the securities held by the customer.

Mr. PECORA. That was the common practice, was it not?

Mr. BAKER. Not necessarily a common practice; no, not at all, but it did occur frequently.

Mr. PECORA. It occurred very frequently, did it not?

Mr. BAKER. I don't know about "very", but frequently.

Mr. PECORA. Do you know how frequently?

Mr. BAKER. No, sir.

Mr. PECORA. The practice was not discouraged, was it, by you?

Mr. BAKER. Not where the exchange, in the judgment of our experts, was a desirable exchange to make.

Mr. PECORA. Who were the experts who exercised that judgment and gave the advice to the prospect—the field salesmen?

Mr. BAKER. We tried to maintain in New York control of that so that the judgment as to whether a security was desirable for a customer to hold as against some other security would be passed upon by some department in New York City in charge of that study, but it is true that exchanges were made from time to time. Whether on the recommendation of the salesman or whether at the suggestion of the holder of the security himself, I do not know.

Mr. PECORA. Well, don't you know that in many, many cases these exchanges were made on the advice and recommendation of your salesmen? Don't you personally know that, Mr. Baker?

Mr. BAKER. I say that I know where exchanges of such character have been made, yes.

Mr. PECORA. And don't you have that knowledge because of the avalanche of letters that have come to you and to your company from customers all over the country who told you of that practice?

Mr. BAKER. I have had some letters of that kind sent directly to me, yes.

Mr. PECORA. How many letters of that kind were sent directly to you and how many were sent to the company which were not addressed to you individually?

Mr. BAKER. I don't know.

Mr. PECORA. Well, a large number, were there not?

Mr. BAKER. I don't think a particularly large number, no.

Mr. PECORA. What would strike you as a number of such letters large enough to make you characterize them as large in number?

Mr. BAKER. I don't want to guess on that.

Mr. PECORA. I am not asking for a guess; I am asking you for some estimate.

Mr. BAKER. Well, I don't know.

Mr. PECORA. What number would strike you as being a large number of such letters?

Mr. BAKER. I don't know.

Mr. PECORA. So that when I say there was a large number why did you say "not a large number", if you don't know what a large number would mean?

Mr. BAKER. I will withdraw that statement, then.

Mr. PECORA. What statement are you withdrawing?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. I am saying that what you mean by a large number I may not mean the same. I don't know how many letters are received of that kind.

Mr. PECORA. Have you any reason to believe that the volume of those letters was kept from you by any of the employees of the company?

Mr. BAKER. Why, no; of course not.

Mr. PECORA. Well, how many were addressed to you personally?

Mr. BAKER. You are asking me to tell you how many letters I received? I can not answer that.

Mr. PECORA. I am asking you for general information, Mr. Baker. I don't expect you to give me a mathematically correct answer to a question like that.

Mr. BAKER. Why should you want me to guess at the number of letters I have received over the last year?

Mr. PECORA. Because you can guess better than anyone else as to the number of letters you received, and if I am going to find out from any one I can find out best from you, can I not?

Mr. BAKER. Yes. And the only way I can answer the question is to have my files gone over and determine the number and tell you.

Mr. PECORA. You could not give us an approximate idea without doing that?

Mr. BAKER. No; I would rather not.

Mr. PECORA. Did those letters run into the thousands?

Mr. BAKER. No; not at all.

Mr. PECORA. Into the hundreds? I mean those addressed to you personally?

Mr. BAKER. Well, of course, that is a guess again. I don't like to do it.

Mr. PECORA. Now will you produce Flash No. 3873, dated February 27, 1929, relating to sales of the bank stock? Let me read that to you first, Mr. Baker:

FLASH NO. 3873

FEBRUARY 27, 1929.

In the past few days the market on City Bank stock has been very erratic. It has been some time since we have had a position in the stock which would give us any working control of this market, and we have therefore been obliged to place on the street the orders which have been sent in to us through our organization. This has served to accentuate the wide fluctuations. Under these conditions you must realize there is little, if any, profit on these transactions, and we are therefore discontinuing premiums immediately.

GENERAL SALES.

Were you familiar with this flash when it was sent out?

Mr. BAKER. Yes; I must have been.

Mr. PECORA. In the face of the statement in this flash to the effect that "It has been some time since we have had a position in the stock which would give us any working control of this market" do you still say that the company never sought to control the market in the stock of the bank?

Mr. BAKER. The way that word is used there in that flash is meant that the orders that we had had for stock were of such a substantial amount that we were unable to continue to fill those orders. If we had a proposition that we were willing to sell to the point where

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

we would fill those orders rather than go into the market with the orders, it would prevent, of course, a move-up of the stock. And what was meant undoubtedly is the fact that we were not in a position at that time to avoid going into the market for the stock. We did not want to lose the position we had, and that shows, of course, that was the reason, because of the discontinuance of that premium.

Mr. PECORA. But the flash alludes specifically to the policy of your company in seeking to maintain or have a working control of the market, does it not?

Mr. BAKER. Only to prevent these wide swings, as I said.

Mr. PECORA. Well, the flash does not say that that was the purpose, does it?

Mr. BAKER. I think it very clearly says that we are not in a position to supply stock and thus we can not control the movement of the stock up and down.

Mr. PECORA. Don't you actually say that in order to enable you to keep a working control of the market you do not want to throw your own stock into the market for the purpose of filling the selling orders, which your salesmen were getting all over the country?

Mr. BAKER. That is all right; yes. That is all right.

Mr. PECORA. And the reason you did not want to part with any of your stock for that purpose was because to do so would have deprived the company of a working control of the market? Isn't that the fair meaning of that?

Mr. BAKER. No; I don't think it is. We just did not want to reduce our position at that time any lower than it was, and since we did not, with large orders coming into the market, there was no way—nothing we could do with them except to put them right into the market to buy the stock.

Mr. PECORA. That is what you had in mind when this flash was sent?

Mr. BAKER. Yes.

Mr. PECORA. And the language used by you in conveying that impression was this language in the flash?

Mr. BAKER. That is right. I did not write it very well.

Mr. PECORA. Now, you notice the date of this flash, don't you, February 27, 1929?

Mr. BAKER. Yes, sir.

Mr. PECORA. That is just about two months before the time when your company found it necessary to borrow 15,000 shares of the bank's stock from Mr. Mitchell, isn't it?

Mr. BAKER. That was.

Mr. PECORA. April the 23d?

Mr. BAKER. Yes; that is right.

Mr. PECORA. Do you remember sending out a sales letter to your salesmen over your own name which ended with this expression: "Enough said. We will let your imagination do the rest." Do you recall that?

Mr. BAKER. What is the number of that, please?

Mr. PECORA. No; before you go to your file, do you recall that?

Mr. BAKER. I just don't recall it, but I certainly will if it is here. What is the number of it?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. The date of it is May 3, 1928. No, it is the letter of March 23, 1928; just after you sent flash No. 1912, March 23, 1928.

Mr. BAKER. I have it; yes.

Mr. PECORA. Let me read it to you:

FLASH NO. 1912

MARCH 23, 1928.

For your information we quote from letter which will go out to shareholders of National City Bank of New York to-night:

"You will find inclosed a formal notice of a special meeting of the stockholders to be held on April 24, 1928, for the purpose of acting upon the recommendation of your board of directors that the capital stock at the bank"——

That should be "of the bank," shouldn't it?

Mr. BAKER. Yes.

Mr. PECORA (reading):

"Be increased from $75,000,000 to $90,000,000, the surplus remaining at $50,000,000, and that the capital stock of the National City Co. be increased from $25,000,000 to $45,000,000 and its surplus from $25,000,000 to $50,000,000.

"It is proposed that each shareholder in the bank be given the right to subscribe for one additional share of stock of the bank for every five shares registered in his name on the books of the bank at the close of business on April 28, 1928, upon the payment of $400 in respect of each share subscribed, of which $100 shall be applied to increasing the capital stock of the bank and $300 shall be applied to increasing the capital stock and surplus of the National City Co. in the amounts mentioned.

"As regards the bank this increase of capital is in line with our traditional policy referred to on the occasion of the last previous increase of maintaining a larger ratio of capital and surplus to deposits than is dictated by general banking practice. As regards the National City Co. the board is of the belief that these additional capital resources should be provided to permit the company to acquire from time to time for short or long investment account bonds, stocks, or other equity interests, the holding of which will facilitate the development of its regular business or generally inure to the benefit of the bank and the company, and that such resources can be thus profitably employed."

Enough said. We will let your imagination do the rest.

H. B. BAKER.

Do you recall that flash?

Mr. BAKER. Yes, sir.

Mr. PECORA. Now tell us what you meant by the expression after the quotes: "Enough said. We will let your imagination do the rest."

Mr. BAKER. It was my opinion, with that move that was being made there, that it was adding great value to the stock of the National City Bank.

Mr. PECORA. Was that in preparation for a selling campaign to be made by the company in the shares of the bank?

Mr. BAKER. No; no particular selling campaign. Simply I felt that that should be called to the attention of every stockholder and pointed out to him.

Mr. PECORA. Why were you calling upon the salesmen to let their imagination do the rest? What conclusion did you expect their imaginations to reach from the information conveyed to them in this flash?

Mr. BAKER. I expected the conclusions to be very constructive on that, and that should be featured with every shareholder in their territory as distinctly desirable.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Do you think the constructive conclusions would be reached by a lively working of the imagination?

Mr. BAKER. Yes, sir; that was all right.

Mr. PECORA. The day following that flash there was another flash sent out over your signature numbered 1915. Have you that flash before you?

Mr. BAKER. Yes; I have.

Mr. PECORA. Please follow me while I read it:

FLASH NO. 1915

MARCH 24, 1928.

The program for City Bank City Co. as told you yesterday is featured on front pages of New York morning papers and is causing tremendous excitement. We are flooded with orders, some to sell but mostly to buy, and are unable as yet to determine which of these buy orders are speculative. We necessarily will deal recklessly in executing orders——

Mr. BAKER. "Ruthlessly," I said.

Mr. PECORA. "In executing orders."

Mr. BAKER. I did not say "recklessly."

Mr. PECORA. What did you say?

Mr. BAKER. "Ruthlessly."

Mr. PECORA. "Ruthlessly"?

Mr. BAKER. Yes.

Mr. PECORA. We have it "recklessly," but we will adopt your term "ruthless."

Mr. BAKER. Yes. [Laughter.]

Mr. PECORA. Thanks for the correction.

Mr. BAKER. I like that much better.

Mr. PECORA. So do I.

We necessarily will deal ruthlessly in executing orders. You realize, of course, that we have none to sell and all orders will be executed in the street. It would be extremely unfair to our customers to throw all our buying orders into the street at one time, and we will therefore use our own judgment. We request you to assist us as far as possible by using the utmost care in the character of orders accepted. This market must be handled in as orderly a way as possible, and we do not want to permit prices to run above reasonable figures, resulting, therefore, in sudden drops or wild fluctuations. We ask your utmost cooperation.

H. B. BAKER.

I have correctly read it?

Mr. BAKER. Yes, sir.

Mr. PECORA. With the correction you made?

Mr. BAKER. That is right.

Mr. PECORA. Now, the news referred to in this flash as having been featured on the front pages of New York morning papers and causing tremendous excitement was the news about the proposed increase of the capital stock both of the bank and your company?

Mr. BAKER. Yes.

Mr. PECORA. Which the last flash alluded to, the one prior to this?

Mr. BAKER. Yes.

Mr. PECORA. The one on March the 23d?

Mr. BAKER. Yes.

Mr. PECORA. In the light of the statement you made in this flash of March 24, 1928, do you still say that your sole purpose in com-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

municating the information embodied in the flash of March 23, 1928, to your salesmen was simply to inform them of the proposed increase, or would you rather say that the purpose of the flash of March 23 was to indicate to them the commencement of a selling campaign for the stock of the bank?

Mr. BAKER. Oh, no. I did not have that in mind. What I said before on that subject was that I thought it was distinctly desirable to call to the attention of our customers and stockholders that it would be of great added value to the National City Bank and the National City Co.

Senator FLETCHER. Was this proposal on March 23, 1928, actually accomplished and carried out?

Mr. BAKER. Yes, sir.

Senator FLETCHER. About the increase of capital?

Mr. BAKER. Yes, sir.

Mr. PECORA. May I, Mr. Chairman, suspend with the witness at this point and ask that Mr. Mitchell be recalled?

The CHAIRMAN. It is so ordered.

TESTIMONY OF CHARLES E. MITCHELL, NEW YORK CITY, CHAIRMAN THE NATIONAL CITY BANK OF NEW YORK, CITY BANK-FARMERS' TRUST CO., INTERNATIONAL BANKING CORPORATION, THE NATIONAL CITY CO., AND THE NATIONAL CITY CO., (LTD.), OF CANADA—Resumed

Senator FLETCHER. Mr. Mitchell, while they are conferring about another matter I want to ask you, based on your experience and from your knowledge of the public and of conditions, could you offer any suggestion respecting legislation by Congress that might tend to protect and safeguard the interests of the public, either as to banks, investment companies, or stock-exchange operations?

Mr. MITCHELL. I think there should very definitely be legislation enacted; yes, sir.

Senator FLETCHER. Of what character? Now can you give us an idea about what should be done?

Mr. MITCHELL. Well, take for instance, this matter of investment affiliates of banks: I have a feeling that the whole system should be revamped, that there should be in an institution some portion of it dealing with the long-term credit market. I subscribe to that. I think there must be that.

But it is this contact with the public that disturbs me, coming as it does through the investment affiliate, and I think we have got to find some different means of distribution.

Furthermore, I think there should be added controls with respect to the character of securities handled. The investment affiliate is an established thing. It is handling apparently something over 50 per cent of the total volume of the long-term credit business. I do not think that you can eliminate it, certainly carelessly, without very definitely retarding any period of recovery, because there is a great deal of financing to be done and the machinery is there.

I think the investment affiliate should be put under regulation and control, because that after all is the one place where the Government

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

has got a chance to regulate and control. If you take the investment affiliate and throw it out completely and say, "Let all of this business develop through private agencies," you have taken the long-term credit machinery away from the place where you can control it and put it in a place where you can not control it.

Therefore, I think we ought to look for legislation and control of the long-term credit market, which is handled so largely by the investment affiliate, under stronger regulation.

Senator FLETCHER. Do you think the investment affiliate should be separated from a commercial bank?

Mr. MITCHELL. No; I think that its methods of doing business should be regulated and controlled.

Senator FLETCHER. As distinguished from the bank itself?

Mr. MITCHELL. The control and regulation should be separate from the control and regulation of the bank itself, because they constitute two different problems. But there is a vast amount of financing that must be done over such a period as we have been through. You take, for instance, the Insull properties that have been a matter for your study here. Those properties come into a period like this, where they have got to be financed on new lines. The banks who handle short credits for them and who have handled them in quantity are going to get rid of those credits by putting them into perfectly sound long-term securities. Those banks really are the ones to do that. It means, perhaps, as it did in that case, actually carrying a considerable quantity of new perfectly sound securities for some time awaiting a market, and it was largely the affiliates of banks who found the long-term market for those securities.

We are trying in our company to-day, Senator, as a result of all these things that we have learned to be along the path of error, to find regulation for ourself, and I think we will find it little by little, and as a matter of fact, I think we have got to go a long way further than we have.

Answering your question directly, I do not believe in the elimination of the investment affiliate, but I do believe in legislation by Congress to put such companies under very definite regulation and control, which would be exactly the kind of regulation and control that we are trying to build up for ourselves at the present moment.

Mr. PECORA. Mr. Mitchell, I have come right to a subject collateral to that. Are you familiar with the opinion that was rendered to the Attorney General of the United States in November, 1911, by Frederick W. Lehmann, at that time Solicitor General of the United States?

Mr. MITCHELL. I am not; no, sir.

Mr. PECORA. Did you ever hear of that?

Mr. MITCHELL. I have heard of that, and at one time I read it, but I don't recall it now. It has been many, many years since I saw it.

Mr. PECORA. Well, I happen to have a copy of it before me.

Mr. MITCHELL. Yes.

Mr. PECORA. Let us see how far we can recall it. It is dated November 6, 1911, addressed to the Attorney General, and I will just read a few excerpts from it, Mr. Mitchell, and then, Mr. Chairman,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

I propose to have the entire opinion spread in full on the record here [reading]:

NOVEMBER 6, 1911.

The ATTORNEY GENERAL.

SIR: You advise me that the President desires that there shall be submitted to him upon his return to Washington a fuller discussion of the question of the legality of the agreements and arrangements existing between the National City Bank of New York and the National City Co., a corporation of the State of New York.

On August 1, 1911, I submitted to you an opinion, in which you concurred, that the agreements and arrangements in question were means of enabling the bank to carry on business and exercise powers prohibited to it by the national banking act.

I have reconsidered the question with the care demanded by its importance, and have reached the conclusion that both the bank and the company, whether considered as affiliated or as unrelated, are in violation of the law.

Now, there follows considerable matter after that which I have not the time to read but which relates to certain provisions of the national banking act and the United States Statutes. We come to this statement [reading]:

In Logan County National Bank *v.* Townsend (139 U. S. 67, l. c. 73), the court, speaking through Mr. Justice Harlan, said:

"It is undoubtedly true, as contended by the defendant, that the national banking act is an enabling act for all associations organized under it, and that a national bank can not rightfully exercise any powers except those expressly granted by that act, or such incidental powers as are necessary to carry on the business of banking for which it was established."

Then follows other matter. Then I want to read this excerpt [reading]:

It follows that while a bank may take the stocks of another corporation as collateral to a loan, or take them in payment of a debt previously incurred, it can not deal in stocks. The limit of its powers in this respect is stated by Chief Justice Waite in First National Bank *v.* National Exchange Bank (92 U. S. 122, 128).

Then follows other matter, and I come to this excerpt [reading]:

The investment by national banks of their surplus funds in other national banks, situated, perhaps, in distant States, as in the present case, is plainly against the meaning and policy of the statutes from which they derive their powers, and evil consequences would be certain to ensue if such a course of conduct were countenanced as lawful.

Then follows other matter and I now come to this excerpt [reading]:

Another evil that might result, if large and wealthy banks were permitted to buy and hold the capital stock of other banks, would be that, in that way, the banking capital of a community might be concentrated in one concern, and business men be deprived of the advantages that attend competition between banks. Such accumulation of capital would be in disregard of the policy of the national banking law, as seen in its numerous provisions regulating the amount of the capital stock and the methods to be pursued in increasing or reducing it. The smaller banks, in such a case, would be in fact, though not in form, branches of the larger one.

Then there is other matter and I come to this excerpt [reading]:

Section 5201 may also be referred to as indicating the policy of this legislation. This provision, forbidding a national bank to own and hold shares of its own capital stock, would, in effect, be defeated if one national bank were permitted to own and hold a controlling interest in the capital stock of another.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Then comes much other matter, and I reach this excerpt [reading]:

From the history of the national banking act, from its terms and provisions, and from the decisions of the Supreme Court construing it, these propositions are derived:

I. The banks are local institutions and independent of each other, none the less that they are creatures of Federal power and subject to Federal supervision and control.

II. A bank may in its by-laws regulate the manner in which its shares may be transferred, but it can not impair or limit the right of transfer.

III. As to business operations, the bank has such powers as are expressly granted by the act and such as are properly incidental to those expressly granted, and none other, and so can engage only in the business of banking as that business is defined by the act.

IV. It is neither banking nor an incident of banking to invest the funds of the bank in another business, in any manner or to any extent; and the bank has therefore no right to invest its funds in the stocks of another corporation, and especially not in the stocks of another national bank.

V. The powers of a national banking association are and can be granted only by the United States, and as no grant of such powers is made by the act to any State corporation, they may not be exercised by such a corporation.

These propositions relate to matters of substance, and so may be no more evaded than violated. Indirection, if it accomplishes the same purpose, stands upon the same footing with direction.

Then I come, after much other matter that follows, to this excerpt [reading]:

This, then, is the situation: The company was not independently organized, but was organized by the bank, its officers and shareholders acting as such.

This, of course, refers to the National City Co.

Only shareholders of the bank were permitted an interest in the company and these only in the proportion of their holdings in the bank. This constitution of the interests of the company must continue to end, for no one can ever come into the company without coming into the bank, and no one can ever go out of the company without going out of the bank. The bank, by declaration of a dividend, furnished the entire capital of the company. No person can be an officer or director of the company unless he is an officer or director of the bank.

This is not all. The company has no independence of action. It has no control or authority over its own affairs. It is to be remembered that all its stock is to be held by the trustees, and of course is to be voted by them. Plenary power over the company is therefore held by these trustees. Now, these trustees were not elected by the incorporators of the company, nor by its stockholders. They were nominated by the agreement between the bank, its officers and shareholders, made before the company was in existence. They can not be removed, nor can their successors be elected or determined by any power or interest of the company. The trustees, nominated by the agreement, perpetuate themselves. They appoint their own successors. The only power outside themselves which can make a change in their membership is the shareholding body of the bank. The shareholders by not continuing a trustee as an officer or director of the bank eliminate him as a trustee. The official organization of the company and the vesting of its powers are determined and can be determined only by the corporate action of the bank.

Then follows, after much other matter, the following excerpt [reading]:

And the National City Co., considered by itself and apart from its relations to the National City Bank, is also in violation of law. Its charter from the State of New York expressly prohibits it from the business of banking. And that charter could not confer the power to engage in the business of national banking. Such power could be conferred only by the laws of the United States.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Then follows much other matter, and I come to this concluding paragraph [reading]:

Here the National City Co. is not simply to control banks, but it may engage in any business whatever, even that forbidden by its charter, if, despite its charter prohibition as to certain kinds of business, it may invest in the stocks of companies conducting such business. The other enterprise in which the company is engaged may stand in need of credit and of funds, and it is too much to expect that the company's banks will deal simply as banks, equitably and impartially as between its own subsidiaries, and persons and corporations with whom it is not affiliated. The temptation to the speculative use of the funds of the banks at opportune times will prove to be irresistible. Examples are recent and significant of the peril to a bank, incident to the dual and diverse interests of its officers and directors. If many enterprises and many banks are brought and bound together in the nexus of a great holding corporation, the failure of one may involve all in a common disaster. And if the plan should prosper, it would mean a union of power in the same hands over industry, commerce, and finance, with a resulting power over public affairs, which was the gravamen of objection to the United States Bank.

I conclude the National City Co. in its holding of national-bank stocks is in usurpation of Federal authority and in violation of Federal law.

Respectfully submitted.

FREDERICK W. LEHMANN, *Solicitor General.*

Now, I may say, Mr. Chairman, that the Attorney General of the United States at the time when the Solicitor General rendered this opinion was the Hon. Charles W. Wickersham, and upon communication with his office, which communication I had for the purpose of requesting him or subpœnaing him to appear before this committee, I learned that he is now in Europe.

I ask that this opinion be spread in full upon the record.

The CHAIRMAN. There being no objection, it is so ordered.

Mr. PECORA. What I am submitting is a carbon copy produced from the files of the Department of Justice.

(The opinion is as follows:)

DEPARTMENT OF JUSTICE,
November 6, 1911.

The ATTORNEY GENERAL.

SIR: You advise me that the President desires that there shall be submitted to him upon his return to Washington a fuller discussion of the question of the legality of the agreements and arrangements existing between the National City Bank of New York and the National City Co., a corporation of the State of New York.

On August 1, 1911, I submitted to you an opinion, in which you concurred, that the agreements and arrangements in question were means of enabling the bank to carry on business and exercise powers prohibited to it by the national banking act.

I have reconsidered the question with the care demanded by its importance, and have reached the conclusion that both the bank and the company, whether considered as affiliated or as unrelated, are in violation of the law.

At the outset it is well to consider the purposes which the framers of the national banking act had in view. The first, the paramount purpose was to secure a uniform national system of currency, and to do this without the creation of a great central institution like the old United States Bank.

The opposition to such an institution was deep seated and widespread, and the sponsors of the various plans which took final shape in the national banking act were careful to point out that the objections to the United States Bank had been duly considered and had been avoided by them.

In August 1861 O. B. Potter of New York submitted to the Secretary of the Treasury a scheme to permit State banks and bankers to issue notes secured by United States bonds, saying, "None of the objections justly urged against a United States bank lie against this plan. It gives to the Government no power to bestow favors and does not place a dollar in its hands to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

lend. * * * It is impossible to see how such a system can be made use of for political ends." (The origin of the national banking system, S. Doc. No. 582, pp. 46–48, 61st Cong., 2d sess.)

Samuel Hooper, a member of the House from Massachusetts, was an active agent in the attainment of the end sought. In support of one of the early measures proposed, which, while it did not become a law, was a step in that direction, he said:

"Thus are secured all the benefits of the old United States Bank without many of those objectionable features which aroused opposition. It was affirmed that, by its favors, the Government enabled that bank to monopolize the business of the country. Here no such system of favoritism exists. * * * It was affirmed that frequently great inconvenience and sometimes terrible disaster resulted to the trade and commerce of different localities by the mother bank of the United States arbitrarily interfering with the management of the branches by reducing suddenly their loans and sometimes withdrawing large amounts of their specie, for political effect. Here each bank transacts its own business upon its own capital, and is subject to no demands except those of its own customers and its own business. It will be as if the Bank of the United States had been divided into many parts, and each part endowed with the life, motion, and similitude of the whole, revolving in its own orbit, managed by its own board of directors, attending to the business interests of its own locality and yet to the bills of each will be given as wide a circulation and as fixed a value as were given to those of the Bank of the United States in its palmiest days." (Cong. Globe, 37th Cong., 2d sess., part 1, p. 616.)

In the national banking act as passed in 1863 it was believed that the desired result had been obtained.

Mr. Hugh McCulloch, president of a leading bank at Indianapolis, and distinguished as a financier, was induced, at great sacrifice to himself, to accept the office of Comptroller of the Currency and inaugurate the new system. In a letter to a friend published in the Banker's Magazine, Vol. XVIII, pages 8 and 9, he said:

"The national system of banking has been devised with a wisdom that reflects the highest credit upon its author, to furnish to the people of the United States a national-bank-note circulation without the agency of a national bank. It is not to be a mammoth corporation, with power to increase and diminish its discounts and circulation, at the will of its managers, thus enabling a board of directors to control the business and politics of the country. It can have no concentrated political power. Nor do I see how it can be diverted from its proper and legitimate objects for partisan purposes. It will concentrate in the hands of no privileged persons a monopoly of banking. It simply authorizes, under suitable and necessary restrictions, any number of persons, not less than five in number, in any of the States or Territories of the Union, to engage in the business of banking, while it prevents them from issuing a single dollar to circulate as money which is not secured by the stocks and resources of the Government. It is, therefore, in my judgment (as far as calculation is regarded), not only a perfectly safe system of banking, but it is one that is eminently adapted to the nature of our political institutions."

In his first report as Comptroller of the Currency, made November 28, 1863, he says:

"By the national currency act the principle is for the first time recognized and established, that the redemption of bank notes should be guaranteed by the Government authorizing their issue. The national currency will be as solvent as the Nation of which it represents the unity. The country has at last secured to it a permanent paper circulating medium of a uniform value, without the aid of a national bank. This national system confers no monopoly of banking, but opens its advantages equally to all. It interferes with no State rights. It meets both the necessities of the Government and the wants of the people. It needs modifications and may require others than those which are suggested in this report; but it is right in principle, and of its success there can, I think, be no reasonable doubt."

And again in his second report, made November 25, 1864:

"This examination of the act, and the observation of the manner in which it is being administered, have resulted in the entering up of a popular judgment in favor of the national banking system; a judgment, not that the system is a perfect one, nor free from danger of abuse, but that it is a safer system, better adapted to the nature of our political institutions and to our commercial necessities, giving more strength to the Government, with less risk of its being

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

used by the Government against the just rights of the States or the rights of the people than any system which has yet been devised, and that by such amendments of the act as experience may show to be needful, it may be made as little objectionable, and as beneficial to the Government and the people, as any paper money banking system that wisdom and experience are likely to invent. It promises to give to the people that long-existing "desideratum," a national currency without a national bank, a bank-note circulation of uniform value without the creation of a moneyed power in a few hands over the politics and business of the country."

When in his letter and reports Mr. McCulloch speaks of "a national bank note circulation without the agency of a national bank," etc., he manifestly has reference to an institution national in the sense of being a central institution like the old Uinted States Bank, operating throughout the country by means of branches.

The banks created by the national banking act were, and were designed to be, local institutions and independent of each other, but under national control and supervision. Nationalization without centralization was the keynote of the law. This is demonstrated by the structure of the banks provided for.

Reference will be made to the national banking act as contained in the United States Compiled Statutes, 1901. It is title 62, and consists of four chapters. The first chapter deals with "organization and powers," the second with "obtaining and issuing circulating notes," the third with "regulation of the banking business," and the fourth with "dissolution and receivership." The entire act is too long for reproduction here, but pertinent sections will be set out in full, or in their substance.

Section 5133—"formation of national banking associations"—provides:

"Associations for carrying on the business of banking under this title may be formed by any number of natural persons, not less in any case than five. They shall enter into articles of association, which shall specify in general terms the object for which the association is formed, and may contain any other provisions, not inconsistent with law, which the association may see fit to adopt for the regulation of its business and the conduct of its affairs. These articles shall be signed by the persons uniting to form the association, and a copy of them shall be forwarded to the Comptroller of the Currency, to be filed and preserved in his office."

It should be noted in passing that only "natural persons" may engage in the formation of a bank.

Section 5134—"requisites of organization certificate"—provides:

"The persons uniting to form such an association shall, under their hands, make an organization certificate, which shall specifically state:

"First. The name assumed by such association; which name shall be subject to the approval of the Comptroller of the Currency.

"Second. The place where its operations of discount and deposit are to be carried on, designating the State, Territory, or District, and the particular county and city, town, or village.

"Third. The amount of capital stock and the number of shares into which the same is to be divided.

"Fourth. The names and places of residence of the shareholders and the number of shares held by each of them.

"Fifth. The fact that the certificate is made to enable such persons to avail themselves of the advantages of this title."

By this section the bank is distinctly localized, for it requires that "the place where its operations of discount and deposit are to be carried on" shall be designated as to State, county, and city, town, or village; and it allows but one place.

This is repeated in section 5190—"place of business"—which provides:

"The usual business of each national banking association shall be transacted at an office or banking house located in the place specified in its organization certificate."

By an act of May 1, 1886 (ch. 73, 24 Stat. 18), a bank was authorized to change its location, but not to a place more than 30 miles distant, and the new location must be within the same State. No provision has ever been made for increasing the number of cities, towns, or villages in which a bank may do business.

Section 5138—"requisite amount of capital"—provides:

"No association shall be organized with a less capital than $100,000, except that banks with a capital of not less than $50,000 may, with the approval of the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Secretary of the Treasury, be organized in any place the population of which does not exceed 6,000 inhabitants, and except that banks with a capital of not less than $25,000 may, with the sanction of the Secretary of the Treasury, be organized in any place the population of which does not exceed 3,000 inhabitants. No association shall be organized in a city the population of which exceeds 50,000 persons with a capital of less than $200,000."

This, because of the small amount of capital required in such case, extends the facilities of national banking to the smallest communities.

Section 5146—"requisite qualifications of directors"—provides:

"Every director must, during his whole term of service, be a citizen of the United States, and at least three-fourths of the directors must have resided in the State, Territory, or District in which the association is located, for at least one year immediately preceding their election, and must be residents therein during their continuance in office. Every director must own, in his own right, at least 10 shares of the capital stock of the association of which he is a director. Any director who ceases to be the owner of 10 shares of the stock, or who becomes in any other manner disqualified, shall thereby vacate his place."

Here the local character of the bank is secured. The directors must all be shareholders, they must all be citizens of the United States, and three-fourths of them must be residents of the State.

The powers of the bank are conferred in general terms by section 5136, and they are: to have a seal, and perpetual succession, to make contracts, sue and be sued, elect officers and define their duties, and further——

"Sixth. To prescribe, by its board of directors, by-laws not inconsistent with law, regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers appointed, its property transferred, its general business conducted, and the privileges granted to it by law exercised and enjoyed.

"Seventh. To exercise by its board of directors, or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title.

"But no association shall transact any business except such as is incidental and necessarily preliminary to its organization, until it has been authorized by the Comptroller of the Currency to commence the business of banking."

Section 5137 confers power to hold real property and limits it to such as may be necessary for "its immediate accommodation in the transaction of its business", and such as it may acquire in the way of securing payment of debts previously contracted, but real estate so acquired can not be held for a longer period than five years.

Section 5197 limits the rate of interest which may be taken to that "allowed by the laws of the State, Territory, or District where the bank is located."

This again emphasizes the local character of the institution.

Section 5201 prohibits a bank from loaning upon or purchasing its own shares.

It has been repeatedly held that the powers of a national bank are limited to those expressly granted by the act and such as are properly incidental to those granted.

In Logan County National Bank *v.* Townsend (139 U. S. 67, l. c. 73), the court, speaking through Mr. Justice Harlan, said:

"It is undoubtedly true, as contended by the defendant, that the national banking act is an enabling act for all associations organized under it, and that a national bank can not rightfully exercise any powers except those expressly granted by that act, or such incidental powers as are necessary to carry on the business of banking for which it was established. The statute declares that a national banking institution shall have power to 'exercise, by its board of directors, or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions' of title 62 of the Revised Statutes."

And in California Bank *v.* Kennedy (167 U. S. 362, l. c. 366), the court, through Mr. Justice White, said:

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

"It is settled that the United States statutes relative to national banks constitute the measure of the authority of such corporations, and that they can not rightfully exercise any powers except those expressly granted, or which are incidental to carrying on the business for which they are established. Logan County Bank *v.* Townsend (139 U. S. 67, 73). No express power to acquire the stock of another corporation is conferred upon a national bank, but it has been held that, as incidental to the power to loan money on personal security, a bank may in the usual course of doing such business accept stock of another corporation as collateral, and by the enforcement of its rights as pledgee it may become the owner of the collateral and be subject to liability as other stockholders. (National Bank *v.* Case, 99 U. S. 628). So, also, a national bank may be conceded to possess the incidental power to accept in good faith stock of another corporation as security for a previous indebtedness. It is clear, however, that a national bank does not possess the power to deal in stocks. The prohibition is implied from the failure to grant the power." (First National Bank *v.* National Exchange Bank, 92 U. S. 122, 128.)

The proposition is an elementary one in corporation law and needs no elaboration.

It follows that while a bank may take the stocks of another corporation as collateral to a loan, or take them in payment of a debt previously incurred, it can not deal in stocks. The limit of its power in this respect is stated by Chief Justice Waite in First National Bank *v.* National Exchange Bank (92 U. S. 122, 128):

"* * * In the honest exercise of the power to compromise a doubtful debt owing to a bank, it can hardly be doubted that stocks may be accepted in payment and satisfaction, with a view to their subsequent sale or conversion into money so as to make good or reduce an anticipated loss. Such a transaction would not amount to a dealing in stocks."

In First National Bank *v.* Converse (200 U. S. 425), a manufacturing company had failed, and the creditors, among whom was the bank, organized a new corporation to purchase the stocks, evidences of debt, and assets of the old, and to continue in the manufacture of the same articles that had been manufactured by the old company. This transaction was held to be without the powers of the bank. The court, p. 439, said:

"* * * To concede that a national bank has ordinarily the right to take stock in another corporation as collateral for a present loan or as security for a preexisting debt does not imply that because a national bank has lent money to a corporation it may become an organizer and take stock in a new and speculative venture; in other words, do the very thing which the previous decisions of this court have held can not be done."

As to acquiring the stocks of other national banks, the ruling of the court is very explicit.

In Concord First National Bank *v.* Hawkins (174 U. S. 364), the Bank of Concord, N. H., had bought and held as an investment 100 shares of the stock of the Indianapolis National Bank. The last-named bank failed and Hawkins as receiver sued the Concord bank to recover the assessment which had been made upon the stock of the Indianapolis bank. The Concord bank denied liability upon the ground that it had no right to hold the stock. The court refused so much as to apply the doctrine of estoppel in favor of creditors. Referring to previous decisions of the court and to the distinction made by the Circuit Court between the acquisition of stocks in national banks and of stocks in other corporations, the court, p. 368, said:

"No reason is given by the learned judge in support of the solidity of such a distinction, and none occurs to us. Indeed, we think that the reasons which disqualify a national bank from investing its money in the stock of another corporation are quite as obvious when that other corporation is a national bank as in the case of other corporations. The investment by national banks of their surplus funds in other national banks, situated, perhaps, in distant States, as in the present case, is plainly against the meaning and policy of the statutes from which they derive their powers, and evil consequences would be certain to ensue if such a course of conduct were countenanced as lawful. Thus, it is enacted, in section 5146, that 'every director must, during his whole term of service, be a citizen of the United States, and at least three-fourths of the directors must have resided in the State, Territory, or district in which the association is located for at least one year immediately preceding their election, and must be residents therein during their continuance in office'."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

One of the evident purposes of this enactment is to confine the management of each bank to persons who live in the neighborhood, and who may, for that reason, be supposed to know the trustworthiness of those who are to be appointed officers of the bank, and the character and financial ability of those who may seek to borrow its money. But if the funds of a bank in New Hampshire, instead of being retained in the custody and management of its directors are invested in the stock of a bank in Indiana, the policy of this wholesome provision of the statute would be frustrated. The property of the local stockholders, so far as thus invested, would not be managed by directors of their own selection, but by distant and unknown persons. Another evil that might result, if large and wealthy banks were permitted to buy and hold the capital stock of other banks, would be that, in that way, the banking capital of a community might be concentrated in one concern, and business men be deprived of the advantages that attend competition between banks. Such accumulation of capital would be in disregard of the policy of the national banking law, as seen in its numerous provisions regulating the amount of the capital stock and the methods to be pursued in increasing or reducing it. The smaller banks, in such a case, would be in fact, though not in form, branches of the larger one.

Section 5201 may also be referred to as indicating the policy of this legislation. It is in the following terms:

"No association shall make any loan or discount on the security of the shares of its own capital stock, nor be the purchaser or holder of any such shares, unless such security or purchase shall be necessary to prevent loss upon a debt previously contracted in good faith; and stock so purchased or acquired shall, within six months from the time of its purchase, be sold or disposed of at public or private sale; or, in default thereof, a receiver may be appointed to close up the business of the association."

This provision, forbidding a national bank to own and hold shares of its own capital stock, would, in effect, be defeated if one national bank were permitted to own and hold a controlling interest in the capital stock of another.

Here is an express recognition and assertion of the local and independent character of our national banks and the denial of any power which would tend to create what is in effect a central bank with branches.

As to the transfer of its shares, a national bank has power only "to prescribe, by its board of directors, by-laws not inconsistent with law, regulating the manner in which its stock shall be transferred." Manner relates to method or form and not to substance. So the by-laws may require a formal indorsement of the outstanding certificates, the issuance of a new one, and a register of the transfer upon the books of the bank. But no condition can be imposed which limits or impairs the right of transfer.

The national banking act as originally passed in 1863, by section 36, denied to the stockholder "power to sell or transfer any share held in his own right so long as he shall be liable, either as principal debtor, surety, or otherwise, to the association for any debt which shall have become due and remains unpaid," etc.; but this provision was repealed by the act of 1864, which, with amendments, is the act now upon the books. The purpose of the repeal was to make the shares more readily transferable. Banks thereafter, however, attempted to enforce the restrictions of the original act by means of by-laws, but these have been held always to be invalid. Speaking to this subject in Bank *v.* Lanier (11 Wall. 369, 1, c. 377–378), the court said:

"The power to transfer their stock is one of the most valuable franchises conferred by Congress on banking associations. Without this power it can readily be seen the value of the stock would be greatly lessened, and, obviously, whatever contributes to make the shares of the stock a safe mode of investment, and easily convertible, tends to enhance their value. It is no less the interest of the shareholder, than the public, that the certificate representing his stock should be in a form to secure public confidence, for without this he could not negotiate it to any advantage.

"It is in obedience to this requirement, that stock certificates of all kinds have been constructed in a way to invite the confidence of business men, so that they have become the basis of commercial transactions in all the large cities of the country, and are sold in open market the same as other securities. Although neither in form or character negotiable paper, they approximate to it as nearly as practicable. If we assume that the certificates in question are not different from those in general use by corporations, and the assumption is a safe one, it is easy to see why investments of this character are sought

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

after and relied upon. No better form could be adopted to assure the purchaser that he can buy with safety. He is told, under the seal of the corporation, that the shareholder is entitled to so much stock, which can be transferred on the books of the corporation, in person or by attorney, when the certificates are surrendered, but not otherwise. This is a notification to all persons interested to know, that whoever in good faith buys the stock, and produces to the corporation the certificates, regularly assigned, with power to transfer, is entitled to have the stock transferred to him. And the notification goes further, for it assures the holder that the corporation will not transfer the stock to any one not in possession of the certificates."

This ruling holding the restrictive by-law to be invalid was repeated in Bullard *v.* National Eagle Bank (18 Wall. 594), Third National Bank *v.* Buffalo German Ins. Co. (193 U.S. 581); and in many cases on the circuit and in the State courts.

If the law was changed to permit a transfer, when to deny it was in the immediate interest of the bank, it surely never was the purpose to authorize a restriction upon transfer in behalf of any interest foreign to the bank, and with which it is forbidden that the bank as a bank may be identified.

From the history of the national banking act, from its terms and provisions, and from the decisions of the Supreme Court construing it, these propositions are derived:

I. The banks are local institutions and independent of each other, none the less that they are creatures of Federal power and subject to Federal supervision and control.

II. A bank may in its by laws regulate the manner in which its shares may be transferred, but it cannot impair or limit the right of transfer.

III. As to business operations, the bank has such powers as are expressly granted by the act, and such as are properly incidental to those expressly granted, and none other, and so can engage only in the business of banking as that business is defined by the act.

IV. It is neither banking nor an incident of banking to invest the funds of the bank in another business, in any manner or to any extent; and the bank has therefore no right to invest its funds in the stocks of another corporation, and especially not in the stocks of another national bank.

V. The powers of a national banking association are and can be granted only by the United States, and as no grant of such powers is made by the act to any State corporation, they may not be exercised by such a corporation.

These propositions relate to matters of substances, and so may be no more evaded than violated. Indirection, if it accomplishes the same purpose, stands upon the same footing with direction.

Coming now to the case in hand, we have to consider what is the practical effect of the creation of the National City Co. and its affiliation with the National City Bank of New York.

So far as concerns matters of form, it may be conceded that the National City Co. was incorporated as an independent institution. Still, its certificate of incorporation while not compelling dependence upon or interrelation with any other institution, does provide for it. Its business powers and capacities are very extensive. They authorize the acquisition of any kind of property and the conduct of any kind of business, and the doing of whatever may be incident thereto. (See article second of the certificate of association.) The only limitation upon its business activities is to be found in paragraph VIII of article II, and this is:

"* * * but nothing herein contained shall be construed as authorizing the business of banking nor as including the business purpose or purposes of a money corporation or a corporation provided for by the banking, insurance, railroad, and the transportation corporations laws, or an educational institution or corporation which may be incorporated as provided in the education law, nor as authorizing or intending to authorize the performance at any time of any act or acts then unlawful."

As the business of banking, which must be taken to include the business of banking under the national banking laws, is expressly prohibited, the powers of the company as granted by its charter do not offend the Federal laws.

The tenth article provides in its first paragraph that "the directors of the company need not be stockholders", and in the second paragraph that—

"No transaction entered into by the company shall be affected by the fact that the directors of the company were personally interested in it, and every director of the company is hereby relieved from any disability that might

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

otherwise prevent his contracting with the company for the benefit of himself or any firm, association, or corporation in which he may be in anywise interested."

These provisions in and of themselves violate no Federal statutes, but they give a facility for serving two masters, which is, to say the least, unusual; and they do permit the use of the company as a mere instrumentality or convenience of some other institution.

The capital stock of the company is by the third article fixed at $10,000,000, but it is provided by paragraph 5 of article 10 that—

"The board of directors shall have absolute discretion in the declaration of dividends out of the surplus profits of the company, and they may accumulate such profits to such extent as they may deem advisable instead of distributing them among the stockholders, and may invest and reinvest the same in such manner as in their absolute discretion they may deem advisable."

Thus, while there is a limit placed upon the capital stock of the company, there is none upon the actual capital it may accumulate, and so none upon its possible financial power.

These various provisions of the certificate of incorporation are important to be considered in view of the use which has been made of the company.

The certificate is dated July 5, 1911, but prior to that date, on June 1, 1911, an agreement was entered into between the National City Bank of New York as the first party, James Stillman, Frank A. Vanderlip, and Stephen S. Palmer, trustees, as the second party, and Henry A. C. Taylor, Cleveland H. Dodge, William Rockefeller, Moses Taylor Pyne, J. Pierpont Morgan, and other subscribers, "who are shareholders of the said bank", as parties of the third part. In the agreement these parties are designated, respectively, as "the bank", "the trustees", and "the subscribers."

The trustees are all of them officers of the bank. Mr. Stillman is the chairman of the board of directors, Mr. Vanderlip is its president, and Mr. Palmer is a director.

The agreement, then, is one between the bank, its officers, and its shareholders, and, as will be seen, the officers and shareholders are dealt with not as individuals, but as officers and shareholders.

The preamble recites that—

"Opportunities and facilities for making desirable investments, other than those which are possible in the ordinary course of the banking business, are, from time to time, presented to the officers of the bank, which they desire to make available to the shareholders of the bank."

Here is the declared purpose to do something, make investments, not within the scope of the bank's powers. That the officers and shareholders of the bank as individuals may make such investments is conceded, but that the bank, or its officers or shareholders, as officers and shareholders, may do so, in other words, that the powers and facilities granted by the national banking act may be used for purposes outside the ordinary course of banking business, is denied.

The first article of the agreement provides for the organization of an investing company. It is here called the United States Investing Co. It is, however, the National City Co. under a provisional name.

It is not within the scope of the bank's powers to have part or lot in such an agreement, for the simple reason that the formation of an investing company under State corporation laws is not the conduct of banking under national laws. And what is true of the bank is true of its officers and shareholders acting as such.

The second article accords to each shareholder of the bank, as a right, a beneficial interest, through the trustees, in the capital stock of the investing company, to the extent of two-fifths of the par value of his capital stock in the bank, provided he exercises his right by executing the agreement or by having his bank stock stamped as thereafter provided in the agreement. If the shareholder does not exercise his right in time, the trustees may determine the conditions upon which he may do so thereafter.

The par value of the capital stock of the bank is $25,000,000, and two-fifths of this is ten millions, which is the par value of the stock of the investment company. Every shareholder of the bank exercising his right, the stock of the company is fully provided for.

It is contended that the shareholder of the bank is not required to take his allotted beneficial interest in the company, but manifestly he is under strong compulsion. The bank and the company, as will be seen from later

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

provisions of the agreement, are so closely bound together that the welfare of the company will always be the serious concern of the bank. For better or for worse the bank and the company are united. The shareholder, if he is not in the arrangement, must none the less hazard the worse and get none of the better, and so, inasmuch as against his will he is in for the worse, he will in self-protection go in further and entitle himself to the better.

The third article provides that in order to facilitate participation by the shareholders of the bank in the beneficial interests in the company, the trustees will recommend to the directors of the bank the declaration of a special dividend of 40 per cent on the capital stock of the bank, which will amount to $10,000,000, or the exact amount of the capital stock of the company. The subscribers, shareholders of the bank, agree to apply the dividend to the payment of the stock of the company.

The recommendation of the trustees, officers of the bank, assent to by the bank and by two-thirds of its shareholders, are sure to be adopted, but not even as against a dissenting or nonassenting minority, no matter how small that minority might be, was there a right to declare a dividend except as such declaration was made in the interest of the bank and its shareholders as such. And there is a larger interest, that of depositors and of the National Government, which requires that the bank shall be conducted as a bank pure and simple and not as a promoting agency of speculative investment companies.

The fourth article requires that the subscribers at once assign the special dividend to the trustees in order to enable the trustees to organize the investing company.

This only emphasizes the fact that the resources and facilities of the bank were utilized to create the investing company.

The fifth article provides (1 that the stock of the investing company shall be issued to the trustees and shall be held by them and their successors in trust, and (2) that the beneficial interest of the subscribers in this stock " Shall not be transferable separately, but only by the transfer of the shares of stock of the bank held by them respectively; and every sale or transfer of stock of the bank by a subscriber or his successor shall include the beneficial interest of such subscriber or his successor in the capital stock of the investing company attaching to the shares of the bank so sold or transferred."

The first clause of this article limits the number of stockholders in the company to three, the three being the trustees and their successors in trust.

Article 9 of the agreement provides:

" The number of trustees hereunder shall not be less than three. Any trustee may, at any time, resign. In case of any vacancy in the number of trustees, it shall be filled by the remaining trustees by the selection of someone who is an officer or a director of the bank; and any trustee who shall cease to be an officer or a director of the bank shall thereupon also cease to be a trustee hereunder; it being intended that only officers or directors of the bank shall act as trustees.

" No trustee shall be liable for the acts of any other trustee, but shall be liable only for his own willful misconduct.

" The trustees may act by a majority, either at a meeting or by writing with or without a meeting; and they may vote in person or by proxy."

Thus only officers or directors of the bank can ever be stockholders in the company, for the trustees held the stock and only officers and directors of the bank can be trustees. And the trustees are a self-perpetuating body. Any vacancy is to be filled by the remaining trustees.

By article 8 it is provided that the trustees and such other persons as they may designate, who shall be officers or directors of the bank, shall constitute the first board of directors of the company, and that no one shall ever be a director of the company who is not also an officer or director of the bank.

The certificate of incorporation of the company provides for five directors, but it has only three stockholders; therefore, it was provided in the certificate that directors need not be stockholders.

The second clause of article 5 prohibits transfer of beneficial interests in the company without a transfer of the corresponding shares of the bank, and, conversely, prohibits transfer of shares in the bank without a transfer of the corresponding beneficial interest in the company.

Article 6 provides for certain indorsements upon the certificate of bank shares and upon the certificates of beneficial interest in the company. These indorsements are in aid of the plan and purpose of the agreement.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Article 7 requires payment of company dividends to be made to shareholders of the bank, whose certificates of bank shares are stamped or indorsed as provided in article 5. Payments of these dividends may be made by the trustees to the bank, and such payment will relieve the trustees from further liability on their account.

Article 10 provides for the amendment, modification, or termination of the agreement. Any of these can be accomplished only "with the written consent of the trustees and of two-thirds in interest of those for whom the capital stock of the investing company is then held by the trustees."

This, then is the situation. The company was not independently organized, but was organized by the bank, its officers and shareholders acting as such. Only shareholders of the bank were permitted an interest in the company and these only in the proportion of their holdings in the bank. This constitution of the interests of the company must continue to the end, for no one can ever come into the company without coming into the bank, and no one can ever go out of the company without going out of the bank. The bank, by declaration of a dividend, furnished the entire capital of the company. No person can be an officer or director of the company unless he is an officer or director of the bank.

This is not all. The company has no independence of action. It has no control or authority over its own affairs. It is to be remembered that all its stock is to be held by the trustees and, of course, is to be voted by them. Plenary power over the company is therefore held by these trustees. Now, these trustees were not elected by the incorporators of the company nor by its stockholders. They were nominated by the agreement between the bank, its officers, and shareholders, made before the company was in existence. They can not be removed, nor can their successors be elected or determined by any power or interest of the company. The trustees, nominated by the agreement, perpetuate themselves. They appoint their own successors. The only power outside themselves which can make a change in their membership is the shareholding body of the bank. The shareholders by not continuing a trustee as an officer or director of the bank eliminate him as a trustee. The official organization of the company and the vesting of its powers are determined and can be determined only by the corporate action of the bank.

And the agreement which accomplishes all these things is beyond the scope of the legitimate action of the bank to change or terminate. Two-thirds of the shareholders of the bank and the trustees must agree before there can be a change in it or an end of it. In this matter, so material to the welfare of the bank, the shareholders and the directors have abdicated their powers and duties and abandoned them to a minority of their number and the three trustees.

To facilitate the conduct of the business of the company by the officers of the bank, article 10 of the certificate of incorporation of the company provides that no transaction entered into by the company shall be affected by the fact that its officers or directors are contracting for their own benefit, or for the benefit of any firm, association, or corporation in which they may be interested in any wise.

This arrangement between the bank and the company virtually consolidates them, unifies their every interest, and requires that all the powers and capacities of both shall always be exerted in unison—or it does not.

If we have two institutions, and not one, chartered as each one of them is by public authority, and by different sovereignties, then each has its own peculiar mission and its own distinctive rights and duties, powers, and obligations. The bank is not concerned with the company, except as it might be with any other possible borrower of its funds, and the company is not concerned with the bank except as it might be with any other institution whose funds it might wish to borrow. The bank will not be influenced to lend money in aid of any enterprise in which the company may be engaged, because of that fact, and the company will not, because of its relations with the bank, look to it the more readily for financial support. The business of each will be conducted with regard to its own distinctive advantage.

If these institutions are twain in the substantial sense indicated, then the arrangement which places the control of the company so absolutely and irrevocably under trustees appointed by the bank, and subject to change only by the corporate action of the bank, offends the fundamental law that "no servant can serve two masters; for either he will hate the one and love the other or else he will hold to the one and despise the other." This law is implied in every line of the charter of the bank, and the attempt to repeal it in the tenth article of incorporation of the company is vain and nugatory.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

If, however, the mission of the bank and the mission of the company are alike and linked always in interest and welfare, if the rights and duties of the two are necessarily harmonious and reciprocal, if the bank at all times must cooperate with the company and the company with the bank, if the officers and directors of the bank who are also the officers and directors of the company can not come into the predicament of divided allegiance, and, indeed, are in the service of but one master, then the bank is involved, engaged, participating in, and conducting the business of the company, business beyond its chartered powers, business that is not national banking.

Only the absolute unity and identity of interest between the two institutions would afford moral excuse for the fusion of their powers under one control, but that excuse can not justify transgression of the positive mandate of the national banking act, which, from considerations of public interest, has determined that national banking shall be a business apart to be conducted by institutions organized for that purpose and for no other.

I am constrained to conclude that as to the bank the agreement violates the law, in its details, because it impairs and limits the right of transfer of shares, and because it assumes to bind the bank beyond the possibility of release by the majority action of its shareholders and directors, and in its general plan and scope, because it embarks the bank in business and ventures beyond its corporate powers.

The operations under this agreement are proper to be considered, and what is said in this connection is based upon a letter of date July 26, 1911, from President Vanderlip to United States Attorney Wise.

At that date $9,679,000 of the capital stock of the company had been paid up, showing that more than 96 per cent of the shareholders of the bank had come into the arrangement.

The company had made investments in the shares of 16 different banks and trust companies, the aggregate number of shares being 29,178. The market value of these was not shown. In addition, approximately $3,200,000 had been invested in other companies of different character.

Of the banks, nine were national banks. The number of shares held by the company and the total number of shares of the capital stock of the banks is as follows:

Bank	Company's holdings	Total number of shares of capital stock of bank
Second National Bank of New York	10	10,000
Fletcher American National Bank of Indianapolis	167	20,000
American National Bank of Indianapolis [1]	250	
Fourth Street National Bank of Philadelphia	500	30,000
National Shawmut Bank of Boston	1,000	35,000
Riggs National Bank of Washington	2,240	10,000
National Butchers & Drovers Bank of New York	3,000	3,000
Lincoln National Bank of New York	4,324	10,000
National Bank of Commerce of New York	9,800	250,000

[1] No such bank shown in the American Bank Reporter.

Thus the company holds the entire capital stock of the National Butchers & Drovers Bank, not even deducting the shares, 10 each, which its 9 directors are by the law required to hold in their own right. This bank surely is not independent of the National City Bank in view of the relations of each to the company.

The company wants but 677 shares to hold a majority of the capital stock of the Lincoln National Bank, and practically it may be said that when 4,324 out of 10,000 shares are held in one ownership the control of the corporation has been secured.

If the National City Bank may extend its powers to the control of two other national banks, there is no limit to what it may do in that way. If the power exists, there is no restraint upon its exercise. By different methods and under other forms the National City Bank is doing, and in larger measure, what the Supreme Court in Concord National Bank *v.* Hawkins, supra, declared to be in contravention of the national banking act.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

And the National City Co., considered by itself and apart from its relations to the National City Bank, is also in violation of law. Its charter from the State of New York expressly prohibits it from the business of banking. And that charter could not confer the power to engage in the business of national banking. Such power could be conferred only by the laws of the United States.

Section 5133, quoted above, confers the power to form a national banking association only upon "natural persons." Other sections of the law restrict the place of operations of the association to a single city, town, or village and require that the directors shall be natural persons, all of whom have a substantial interest in the bank and three-fourths of whom must be citizens and residents of the State in which the association operates. Then, too, as we have seen, the bank may not as an investment acquire the shares of another bank, or, indeed, of any other corporation. The purpose and the result are that each national bank must be a local, independent, institution, managed by natural persons, and not linked by proprietary interest with any other business than that of national banking.

It is not necessary to consider whether the national banking act absolutely prohibits the holding of shares in a national bank by a State corporation to any extent or for any purpose, and it may be conceded that a State corporation may acquire such shares as an incident to securing payment of a debt and hold them to a convenient time for sale, or that an institution like a trust company may hold them in a fiduciary capacity, but certainly there can be no holding of such shares by any corporation when the result is to defeat the policy of the national banking act; that is, to destroy the local character of the bank, break down its independence, vest its control in another corporation, and link it in substantial proprietary interest with some other business than national banking.

The National City Co. may embark in almost any business whatever, and in fact has made large investments in other enterprises than banking. It has acquired ownership of all the stock of the National Butchers & Drovers Bank, a virtually controlling interest in the Lincoln National Bank, and interests of magnitude in other national banks.

The ownership of property implies duties as well as rights. As the company owns all the shares of the Butchers & Drovers Bank, it has a duty with respect to them. It must vote them at shoreholders' meetings, it must elect the directors of the bank, and decide important questions of policy. If this is not conducting the business of a national bank how shall it be characterized?

In *Anglo-American Land Co.* v. *Lombard* (132 Fed. Rep. 721, l. c. 736), the Court of Appeals for the Eighth Circuit, in an opinion by Judge Van Devanter, now a justice of the Supreme Court, held that the acquisition by a Missouri company of the stock and control of a Kansas company was illegal. He said:

"* * * Where it is not otherwise provided, the implication in a grant of corporate power and life is that the corporation shall exercise its powers and carry on its business through its own officers and employees, and not indirectly, through another corporation operated under its control, and that it shall maintain an independent corporate existence, and not surrender the control of its affairs or the exercise of its powers in another corporation. Conceding that a corporation of a private character, not charged with any public duties, may, in pursuance of appropriate action on the part of its stockholders, sell all of its property, wind up its affairs, and permanently retire from business, still, in the absence of express authorization, neither the corporation nor its stockholders can, incidental to the sale of its property or otherwise, clothe another corporation with the right to maintain the corporate life or exercise the corporate powers. These views are sustained, and the reasons therefor are fully set forth in *De La Vergne Co.* v. *German Savings Institution* (175 U. S. 40. 54, 20 Sup. Ct. 20, 44 L. Ed. 66), *Buckeye Marble & Freestone Co.* v. *Harvey* (*Tenn.*) (20 S. W. 427, 18 L. R. A. 252, 36 Am. St. Rep. 71), *Easum* v. *Buckeye Brewing Co.* (C. C. 51 Fed. 156), and in the cases there cited.

We are dealing with corporations of a public character, with national banks, which have public duties to perform, and of these it is a peculiar obligation "to maintain independent corporate existence and not surrender control of their affairs or the exercise of their powers to another corporation."

No authority is given by the Federal statutes to the national banking associations for assigning their powers and delegating their duties to a corporation created by a State, and which, under its charter from the State, may engage in a business and exercise powers denied to the banking association by the law of its creation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Here again it is to be observed that if the power in question exists, it exists without limit. The company may extend its power to the full control of all the banks into which it has made entrance. Nor need it stop with these. As it grows by what it feeds upon it may expand into a great central bank, with branches in every section of the country. It is, in incipient stage, a holding company of banks, with added power to hold whatever else it may find to be to its advantage.

Where public law and public policy are involved, forms and fictions are disregarded and the facts are dealt with as facts. In the Northern Securities Case (193 U. S. 197), the Securities Co. had acquired the majority of the shares of two great competing railway companies, and this was dealt with in effect as a consolidation of the railway companies. Judge Harlin, affirming the decree of the circuit court, said (p. 326):

The stockholders of these two competing companies disappeared, as such, for the moment, but immediately reappeared as stockholders for the holding company which was thereafter to guard the interests of both sets of stockholders as a unit, and to manage, or cause to be managed, both lines of railroad as if held in one ownership. Necessarily by this combination or arrangement the holding company in the fullest sense dominates the situation in the interest of those who were stockholders of the constituent companies; as much so, for every practical purpose, as if it had been itself a railroad corporation which had built, owned, and operated both lines for the exclusive benefit of its stockholders. Necessarily, also, the constituent companies ceased, under such a combination, to be in active competition for trade and commerce along their respective lines, and have become, practically, one powerful consolidated corporation, by the name of a holding corporation the principal, if not the sole, object for the formation of which was to carry out the purpose of the original combination under which competition between the constitutent companies would cease.

So in the Standard Oil case (221 U. S. 1), and in the Tobacco case (221 U. S. 106), the holding of stocks by the principal companies in the various subsidiary companies was recognized and dealt with as engaging in, directing and controlling the business of the subsidiary companies.

Here the National City Co. is not simply to control banks, but it may engage in any business whatever, even that forbidden by its charter, if, despite its charter prohibition as to certain kinds of business, it may invest in the stocks of companies conducting such business. The other enterprises in which the company is engaged may stand in need of credit and of funds, and it is too much to expect that the company's banks will deal simply as banks, equitably and impartially as between its own subsidiaries, and persons and corporations with whom it is not affiliated. The temptation to the speculative use of the funds of the banks at opportune times will prove to be irresistible. Examples are recent and significant of the peril to a bank, incident to the dual and diverse interests of its officers and directors. If many enterprises and many banks are brought and bound together in the nexus of a great holding corporation, the failure of one may involve all in a common disaster. And if the plan should prosper it would mean a union of power in the same hands over industry, commerce, and finance, with a resulting power over public affairs, which was the gravamen of objection to the United States Bank.

I conclude the National City Co. in its holding of national bank stocks is in usurpation of Federal authority and in violation of Federal law.

Respectfully submitted.

———— ————,
Solicitor General.

Mr. COVINGTON. Before you finish, Mr. Chairman, may I make a statement? I think I have a right so to do.

Mr. PECORA. Do you have a right so to do?

Mr. COVINGTON. I think that I have, Mr. Pecora. I am quite advised of the rights of an investigating committee.

Mr. PECORA. I will ask the chairman to determine whether or not he has any right to make a statement.

Mr. COVINGTON. I want to call attention to a pertinent fact in connection with that opinion, and I submit to the committee whether or not it should be permitted.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The CHAIRMAN. How long a statement?
Mr. COVINGTON. One minute.
Mr. PECORA. All right; let us hear him.

STATEMENT OF J. H. COVINGTON, WASHINGTON, D. C., COUNSEL FOR THE NATIONAL CITY BANK

The CHAIRMAN. Will you give your name on the record, Judge?
Mr. COVINGTON. J. H. Covington, counsel for the National City Bank.
The CHAIRMAN. Where is your office, Judge Covington?
Mr. COVINGTON. The Union Trust Building in Washington.
The Attorney General of the United States is charged with the responsibility of enforcing the law. This opinion was directed to him. This was simply the opinion of the Solictor General. The Attorney General qute obviously, in so high-minded a man as Mr. Wickersham, must have differed with it, for there has been no proceeding thereafter to undertake to charge the National City Bank with a violation of the law in conspiracy with the voting trustees and officers of the National City Co.
Mr. PECORA. I submit that is a gratuitous assumption of the learned gentleman who made it.
Mr. COVINGTON. Not so much a gratuitous assumption as some that you have made from time to time.
The CHAIRMAN. We want no more of that.
Mr. COVINGTON. But I want to call attention to the fact that if I heard it right Mr. Lehmann said that to the Attorney General, who was then Mr. Wickersham, and it was his opinion.
Mr. PECORA. He said that he agreed with him, in an earlier opinion referred to in this opinion, dated August 1, 1911, and for the benefit of the learned gentleman who has just placed his observation on the record, Mr. Chairman, I will repeat——
Mr. COVINGTON (interposing). I heard that, Mr. Pecora.
Mr. PECORA. This language from the opinion now spread on the record. [Reading.]

On August 1, 1911, I submitted to you an opinion in which you concurred that the agreements and arrangements in question were made to enable the bank to carry on business and exercise powers prohibited to it by the national banking act.

Did you hear that, Judge Covington?
Mr. COVINGTON. I heard that, Mr. Pecora.
Mr. PECORA. And you still say that the Attorney General did not concur, do you?
Mr. COVINGTON. I did not say that he did not concur.
Mr. PECORA. Then I misunderstood you. Excuse me.
Mr. COVINGTON. I said the Attorney General was charged with the responsibility of enforcing the law and obviously came to that ultimate conclusion, because he did not undertake to proceed against the National City Bank in creating the organization with the National City Co., and the fair presumption is that Mr. Wickersham always obeyed the law.
Mr. PECORA. I merely want to say, Mr. Chairman, that the only purpose I had in seeking to invite General Wickersham to a hearing before this committee was to have him state, not through an as-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

sumption by somebody else, but directly and upon his own responsibility whether or not he concurred in the opinion of the Solicitor General of the Department of Justice who served under his administration of that department, and what proceedings, if any, were ever instituted or contemplated to be instituted based upon that opinion.

The CHAIRMAN. The interesting thing to me is the observation made as to what would be the effect of it if it were done. He seems to have been a prophet.

Mr. PECORA. You mean Solicitor General Lehmann?

The CHAIRMAN. Yes.

TESTIMONY OF CHARLES E. MITCHELL, NEW YORK CITY, CHAIRMAN THE NATIONAL CITY BANK OF NEW YORK, CITY BANK FARMERS' TRUST CO., INTERNATIONAL BANKING CORPORATION, THE NATIONAL CITY CO., AND THE NATIONAL CITY CO. (LTD.), OF CANADA—Resumed

Mr. PECORA. Now, Mr. Mitchell, you said that you at one time had this opinion of the Solicitor General called to your attention. Did you give it any careful consideration?

Mr. MITCHELL. It was so many years ago, Mr. Pecora, that I just carry in mind that there was an opinion rendered.

Mr. PECORA. Well, have you any recollection of your having given that opinion serious consideration?

Mr. MITCHELL. I understood, as Judge Covington has truly stated, that the opinion was not acted upon by the Attorney General.

Mr. PECORA. For that reason did you give it no serious consideration?

Mr. MITCHELL. That opinion has not had serious consideration by me. At that time the subsequent line of development of the National City Co. was not contemplated. What was contemplated, I think—of course, this was long before I ever came to the City Co. or had anything to do with it—was the accumulation of stocks of other banks, making the National City Co. somewhat like the present group banking company which is operating extensively in this country.

Mr. PECORA. Mr. Chairman, according to a letter addressed to the chairman of this committee by the present Attorney General of the United States, bearing date of February 20, 1933, only a carbon copy of the opinion of the Solicitor General of November, 1911, is submitted to this committee. Apparently the original is not to be found among the files of the Department of Justice. I will put in evidence the letter addressed to you by the Attorney General of the United States, dated February 20, 1933, on this subject, and ask that it be spread on the records.

The CHAIRMAN. If there is no objection, it will be so ordered.

(The letter is as follows:)

OFFICE OF THE ATTORNEY GENERAL,
Washington, D. C., February 20, 1933.

Hon. PETER NORBECK,
Chairman Committee on Banking and Currency,
United States Senate.

MY DEAR SENATOR NORBECK: I have your letter of February 18 asking me for records of this department relating to the origin of the affiliate system in

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

connection with the affairs of the National City Bank of New York for the use of the subcommittee of the Senate Committee on Banking and Currency. I have caused a search to be made of the files of this department to ascertain whether there is anything in them of the kind you describe.

There is in the files a carbon copy of a memorandum prepared by Solicitor General Lehmann, addressed to the Attorney General (Wickersham), dated November 6, 1911, which deals with the legal question involved. I am inclosing this document for the use of the committee. We have not had time to copy it, and I will ask you to please preserve it for return to our files. It relates to the situation of the National City Bank of New York.

In May, 1932, a copy of this memorandum was handed to Senator Glass, and I believe it was published in the Congressional Record with the deletion of the name of the bank mentioned. It appears also from our files that under date of September 19, 1913, Attorney General McReynolds wrote the Hon. William G. McAdoo, Secretary of the Treasury, sending him a copy of Solicitor General Lehmann's memorandum, saying:

"In compliance with your request I am sending you herewith a photographic copy of what seems to be a carbon copy of a memorandum prepared by the Solicitor General on this subject. A careful search of the files here fails to disclose any opinion by the Attorney General in this matter."

It is apparent from Solicitor General Lehmann's memorandum that he had before him some information as to the situation of the National City Bank and National City Co., but there is nothing in the files of the department, that we have been able to find, showing how Mr. Lehmann obtained the information referred to in his memorandum, and there are no documents in the file containing any statement of the facts or any information respecting the situation of the National City Bank and affiliated companies.

The file opens with a letter from Solicitor General Lehmann to the Hon. Henry A. Wise, then the United States attorney for the southern district of New York, dated July 7, 1911, referring to an account appearing in the New York papers respecting the formation of corporations to hold shares of national banks, and requesting the United States attorney to ascertain the facts. and under date of July 10, 1911, a letter from the United States attorney stating that he would have the matter thoroughly investigated and would report as soon as possible, but no such report is contained in the files, although it may be inferred that the facts set forth in Solicitor Lehmann's memorandum may have been obtained from the United States attorney.

In short, the only document or record in the department that throws any light whatever on the situation of the National City Bank and its affiliated companies is the memorandum of Solicitor General Lehmann which is inclosed. I may add that there appears in the file a letter dated January 19, 1921, from the Comptroller of the Currency to Attorney General A. Mitchell Palmer requesting that the Comptroller of the Currency be furnished with a copy of the memorandum of November 6, 1911, prepared by Mr. Lehmann, and there is a notation on this letter as follows: "Request granted, F. K. N." The initials are apparently those of former Assistant Attorney General Nebeker.

In that connection there appears in the files a copy of a letter dated January 26, 1921, to the Hon. John Skelton Williams, Comptroller of the Currency, which reads as follows:

"I have examined the files relating to the so-called opinion of Solicitor General Lehmann, dated November 6, 1911. The paper you handed me is unsigned. It purports to be a photographic copy of a letter addressed to the Attorney General and intended for the signature of the Solicitor General. The original is not in the files. The copy bears an unsigned indorsement, dated April 24, 1913. to the effect that it is understood that Attorney General Wickersham prepared a letter summarizing the attached opinion of the Solicitor General but to whom this letter is addressed does not appear, and no record of such a letter is found in the files. The only thing of interest I find in the files is a letter of Attorney General McReynolds, dated September 19, 1913, addressed to Secretary McAdoo, in which it is stated:

"In compliance with your request, I am sending you herewith a photographic copy of what seems to be a carbon copy of a memorandum prepared by the Solicitor General on this subject. A careful search of the files here fails to disclose any opinion by the Attorney General in this matter."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Apparently what was sent to Secretary McAdoo at that time was a duplicate of the photographic copy which you have.

The only thing in our files is what purports to be a photographic copy of an unsigned letter to the Attorney General, apparently intended for the signature of the Solicitor General; I find no record of what action was taken by the Attorney General or of any subsequent action except the sending of a copy to Secretary McAdoo and, for this reason, I do not feel justified in authorizing the publication of the memorandum.

Respectfully yours,

WILLIAM D. MITCHELL,
Attorney General.

The CHAIRMAN. The committee will recess until 10 o'clock Monday morning, and those under subpœna will appear at that time.

(Accordingly, at 4.15 o'clock p. m., the subcommittee adjourned until 10 o'clock a. m. Monday, February 27, 1933.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

STOCK EXCHANGE PRACTICES

MONDAY, FEBRUARY 27, 1933

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

The subcommittee met, pursuant to adjournment on Friday, February 24, 1933, at 10 o'clock a. m., in room 301 Senate Office Building, Senator Peter Norbeck presiding.

Present: Senators Norbeck (chairman), Couzens, Townsend, Fletcher, and Costigan.

Present also: Senators Brookhart, Barkley, Gore, and Reynolds.

Further present: Ferdinand Pecora, special counsel to the committee; Julius Silver and David Saperstein, associate counsel to the committee.

The CHAIRMAN. The subcommittee will come to order. Mr. Pecora, whom will we have this morning?

Mr. PECORA. Mr. Baker will please resume the stand.

The CHAIRMAN. Mr. Baker will come around to the committee table. He has already been sworn.

TESTIMONY OF HUGH B. BAKER, PRESIDENT THE NATIONAL CITY CO., NEW YORK CITY—Resumed

Senator GORE. Mr. Chairman, I want to go over to the Senate, and I should like permission to ask a question or two here, if I may.

Senator COUZENS (presiding). Certainly.

Senator GORE. I do not want it to break in on questions propounded by counsel to the committee, who is developing his subject in a general way. If these questions have already been answered by Mr. Mitchell I do not want them answered now, because I do not want to tread the same path again. But I was not here at the time the inquiry was being made as to the National City Co. carrying on the campaign to sell the stock of the bank in this country.

Senator COUZENS (presiding). Go right along, Senator Gore.

Senator GORE. Was it also carrying on a campaign to sell its stock in foreign countries?

Mr. BAKER. There were offerings abroad, Senator Gore; yes.

Senator GORE. How many offices or branches have you abroad?

Mr. BAKER. We have an office in London, and—do you mean the National City Co., Senator Gore?

Senator GORE. Yes, sir; or the bank, whichever it is, or both.

Mr. BAKER. Well, the National City Co. has an office in London, and in Amsterdam, and in Geneva, and in Berlin.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator GORE. And then you have correspondents, I suppose, in other countries?

Mr. BAKER. Oh, yes.

Senator GORE. How many?

Mr. BAKER. Well, I don't know how many correspondents, but a large number, of course.

Senator GORE. And in South America as well as Europe?

Mr. BAKER. Yes.

Senator GORE. Well, now, at that time did you cable your representatives or offices in foreign countries to make offerings of your stock, of the National City Bank, I mean?

Mr. BAKER. We quoted the markets to them frequently, and gave our impressions of general conditions as they existed.

Senator GORE. In a selling campaign of the stock, so to speak?

Mr. BAKER. Well, I would hardly call it a campaign, but they were offerings.

Senator GORE. Yes. Can you insert into the record of your testimony some of those communications to your foreign correspondents?

Mr. BAKER. I have no doubt I can, but I would have to get those from the files in New York, Senator Gore.

Senator GORE. Yes; that is what I mean, about contemporaneously with the activity in this country to sell the stock of the bank.

Mr. BAKER. Yes. I can get that.

Senator GORE. Typical communications to European countries and to South American countries, for instance.

Mr. BAKER. Yes; I will be glad to do that.

Senator GORE. I have been informed that that is the case, and I wanted to get that information in the record.

Mr. BAKER. All right. A matter of two or three days would not make any difference on that, would it?

Senator GORE. No.

(The communications to correspondents in foreign countries requested in foreign countries requested by Senator Gore will, when furnished by Mr. Baker, be inserted at this point in the original transcript for use of the Government Printing Office in printing the record. See page 2050.)

Senator GORE. An amendment was included in the Glass bill, that recently passed the Senate but has not yet passed the House, making it unlawful for the officers of a bank to borrow from the bank of which they are officers, and unlawful for a bank to loan to its officers. Now, what is your judgment in regard to that?

Mr. BAKER. Senator Gore, I have to admit that I am not an expert on those things. My function is the investment banking end of the work.

Senator GORE. Well, I would not want you to answer if you do not feel qualified to do so.

Mr. BAKER. All right.

Senator GORE. That is all, Mr. Chairman. And I thank you for this opportunity.

Senator COUZENS (presiding). That is certainly all right, Senator Gore.

Senator REYNOLDS. Mr. Chairman, I should like to ask one question along that line, if I may.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator COUZENS (presiding). The Senator from North Carolina is recognized.

Senator REYNOLDS. Mr. Baker, what connection did Mr. Charles E. Mitchell have with the National City Co.?

Mr. BAKER. In these issues we were talking about in 1923?

Senator REYNOLDS. Yes.

Mr. BAKER. I am not sure just what time—yes, he was the president of the National City Co at that time.

Senator REYNOLDS. When did Mr. Mitchell resign?

Mr. BAKER. Well, he became chairman in 1929.

Senator REYNOLDS. He became chairman of the board of directors, do you mean?

Mr. BAKER. No. It is the office of chairman of the National City Co. That means the chief executive officer of the company.

Senator REYNOLDS. Does Mr. Mitchell owe the National City Co. any money?

Mr. BAKER. Not a cent, so far as I know. No; not a cent.

Senator REYNOLDS. All right. That is all, Mr. Chairman.

Senator COUZENS (presiding). You may proceed, Mr. Pecora.

Mr. PECORA. Mr. Baker, in the course of the testimony which you gave last week before this subcommittee you stated, among other things, that the National City Co., before sponsoring any security issues for sale to the public, held a conference of its executive officers, informal in character, at which the proposed issues were discussed. Do you recall that testimony?

Mr. BAKER. Yes. I am not sure that I recall those words, but that was the substance of it.

Mr. PECORA. That was the substance of it?

Mr. BAKER. Yes, sir.

Mr. PECORA. Did that procedure also apply to issues of foreign bonds?

Mr. BAKER. Yes, sir.

Mr. PECORA. Will you please tell the subcommittee, generally but concisely and comprehensively, just what steps were taken by the executive officers of the company before they reached any judgment or conclusion with respect to the wisdom or advisability of offering a foreign issue to the investment public in this company?

Mr. BAKER. Well, of course the general subject would be presented by the vice president in charge of that particular field. And he had made his studies, either through representatives of ours having been in that particular field, or through other contacts that we may have had there, so that he could present the important facts as regards the credit situation in that country, its general economic condition, history, and so forth; and of course that, following his statement, would be discussed, questions would be asked of various other executives, in which we tried to determine every important factor connected with that proposed loan.

Mr. PECORA. In other words, it was sought to make an intensive study of economic and political conditions, that is, political in so far as they might involve the stability of the Government, is that right?

Mr. BAKER. Yes, sir; that is right.

Mr. PECORA. For that purpose your company had representatives in various foreign countries.

Mr. BAKER. That is right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And that applied, of course, to South American republics?

Mr. BAKER. Yes, sir.

Mr. PECORA. Who was the——

Senator COUZENS (interposing). Let me ask a question at that point: Do you have any information as to how many South American bonds you sold during the years 1927, 1928, and 1929?

Mr. BAKER. I have not in my mind. I would have to refer to my records on that and compile them. I can easily do it for you, however.

Senator COUZENS. Do you know the approximate amount, can you give us an approximate estimate?

Mr. BAKER. I should not like to guess at that. But I will supply you with that information this afternoon.

Senator COUZENS. Thank you. What South American bonds are in default?

Mr. BAKER. That are now in default?

Senator COUZENS. Yes.

Mr. BAKER. Peru, Chile, State of Minas Geraes in Brazil, and—I think those are the principal ones.

Senator COUZENS. Those are the only governmental agencies that you recall that are in default?

Mr. BAKER. Yes; they are all that I now recall. And I think that is right.

Senator COUZENS. Are there any private or utility securities in default?

Mr. BAKER. The Lautaro Nitrate Co., which is an industrial corporation.

Senator COUZENS. How soon could you get your information from your records as to the governmental agencies that are in default, and also the private or utility or industrial bonds that are in default?

Mr. BAKER. Do you mean in their entirety, or the ones we have been interested in?

Senator COUZENS. The ones you are interested in.

Mr. BAKER. I can give you that by early afternoon.

Senator COUZENS. If you please.

Mr. BAKER. I think I can.

(Thereafter the following letter was presented for the record:)

THE NATIONAL CITY CO.,
New York, March 9, 1933.

HON. PETER NORBECK,
Chairman Subcommittee, Banking and Currency Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR NORBECK: In the examination of Mr. Baker at the hearing Monday, February 27, 1933, before your committee, Senator Gore asked for insertions in the testimony of typical communications from Mr. Baker to European countries and to South American countries in connection with the sale of National City Bank stock. The only general communications with reference to National City Bank stock were those delivered to counsel for the committee and from which he introduced in evidence certain communications. These communications were sent by telegraph or mail to local offices of the National City Co. in the United States but copies of them went by mail to European offices of the National City Co. and therefore represent the communications in which Senator Gore may have been interested. As the testimony discloses, such offices were in Europe and not in South America.

At the same day's hearing Senator Couzens inquired as to the South American bonds sold by the National City Co. which are in default. On the same page

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. Baker mentioned the Republic of Peru, Republic of Chile, State of Minas Geraes in Brazil and the Lautaro Nitrate Co. issues. I find that there should be added to that list certain issues of the United States of Brazil the Mortgage Bank of Chile, and the State of Rio Grande do Sul, in which we were interested as participants.

Very truly yours,

H. S. LAW, *Secretary.*

Senator COUZENS (presiding). You may proceed, Mr. Pecora.

Mr. PECORA. Who was the vice president of your company in charge particularly of South American loans during the years 1927 to 1930, inclusive.

Mr. BAKER. Well, there were two, Mr. Pecora; Mr. Byrnes was a vice president of the company a part of that time and he gave attention to those things. And he has since retired from our organization, but Mr. Schoepperle was also associated with him and carried on afterwards alone.

Mr. PECORA. Mr. Byrnes severed his connection with your company about two years ago, didn't he?

Mr. BAKER. Yes, sir; about that time.

Mr. PECORA. He has retired from business so far as you know, has he?

Mr. BAKER. Yes, sir.

Mr. PECORA. Do you know where he is now?

Mr. BAKER. Well, he is in this room.

Mr. PECORA. He is in this room now?

Mr. BAKER. Yes, sir.

Mr. PECORA. That is Mr. Ronald Byrnes, isn't it?

Mr. BAKER. Yes, sir.

Mr. PECORA. Now, it required a unanimous opinion on the part of those executives of the company before an issue was sponsored, didn't it?

Mr. BAKER. Yes; that is correct. It does not mean that we necessarily took a vote on it, but if there were any objections to it we would not proceed.

Mr. PECORA. Do you recall an issue of——

Senator GORE (interposing). That means that the issues that you did offer were agreed upon unanimously by those various executives?

Mr. BAKER. Yes, sir.

Senator GORE. All right.

Mr. PECORA. Mr. Baker, do you recall an issue of $15,000,000 of 7 per cent sinking fund gold bonds, issued on March 1, 1927, by the Republic of Peru?

Mr. BAKER. Yes, sir.

Mr. PECORA. Commonly referred to as the Tobacco Loan?

Mr. BAKER. Yes, sir; I remember it. Of course, I know of the loan generally.

Mr. PECORA. The National City Co. participated in the flotation of those bonds in this country, didn't it?

Mr. BAKER. Yes, sir.

Mr. PECORA. And, of course, it did so after the question of participation in the flotation of that issue had been discussed by the executive officers and unanimously approved by them?

Mr. BAKER. I am quite sure that is correct. Of course, that is sometime ago, and I was not the president of the National City Co. at that time.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator COUZENS (presiding). What was your participation?

Mr. BAKER. That is March 16, 1927, did you say, Mr. Pecora?

Mr. PECORA. There were issued on March 1, 1927, 7 per cent bonds due in 1959.

Mr. BAKER. Yes. There were $15,000,000 of those bonds.

Mr. PECORA. Yes.

Mr. BAKER. Yes, sir. And I beg pardon, Senator Couzens; what was your question to me?

Senator COUZENS (presiding). Did you handle the whole of the issue?

Mr. BAKER. No. We were not handling the entire issue.

Senator COUZENS. Who originated them?

Mr. BAKER. J. & W. Seligman & Co.

Senator COUZENS. Who were your associates in the distribution of those bonds?

Mr. BAKER. Well, of course they handled the syndication of it in their office. We had nothing to do with the development of that issue. The participants in the syndicate were J. & W. Seligman & Co. as managers; National City Co.; E. H. Rallins & Sons; Graham, Parsons & Co.; F. J. Lisman & Co., and Ames Emerich & Co.

Mr. PECORA. What was your portion of the syndicate?

Mr. BAKER. We had an original position of $3,000,000.

Mr. PECORA. And did you increase it or reduce it?

Mr. BAKER. We increased it.

Mr. PECORA. To what extent?

Mr. BAKER. In the distributing group we had a position of $5,000,000.

Mr. PECORA. And is that to be added to your original $3,000,000, or was that the aggregate amount?

Mr. BAKER. No; that was the total.

Mr. PECORA. Those bonds were offered to the public at 96½?

Mr. BAKER. That is right.

Mr. PECORA. What was the spread on that issue to the members of the syndicate?

Mr. BAKER. Approximately 5 points, or I think it was 5.53, according to my figures—no, I mean 5.03 points.

Mr. PECORA. Practically the entire issue was disposed of, wasn't it?

Mr. BAKER. Yes, sir.

Mr. PECORA. Do you know the present market quotation on those bonds?

Mr. BAKER. I do not, but I think it is about 10, or thereabouts.

Mr. PECORA. It is between 7 and 8, isn't it?

Mr. BAKER. That may be.

Mr. PECORA. Now, did your company——

Senator BARKLEY (interposing). Is anybody buying them now?

Mr. BAKER. Well, I don't know. There is a transaction occasionally.

Senator BARKLEY. You are not buying them, are you?

Mr. BAKER. No, sir.

Mr. PECORA. Mr. Baker, your company generally had a representative in Peru, who was referred to as an expert on South American issues and credits as far back as 1921, did it not?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. I do not think we had anybody stationed there, Mr. Pecora. We had representatives from time to time who visited South America.

Mr. PECORA. Well, do you recall a representative of your company by the name of Claude W. Calvin?

Mr. BAKER. I remember his name. I do not know him.

Mr. PECORA. Have you produced here from the files of your company a letter from C. W. Calvin to J. T. Cosby, a vice president of the National City Bank, dated December 9, 1921, on the subject of a Peruvian loan?

Mr. BAKER. Was that suppœnaed here?

Mr. PECORA. Yes, sir.

Mr. BAKER. I do not know, but I suppose it is here, then.

Mr. PECORA. Have you the letter in question now placed before you?

Mr. BAKER. Yes, sir; dated December 9.

Mr. PECORA. December 9, 1921.

Mr. BAKER. Yes, sir.

Mr. PECORA. J. T. Cosby at that time was a vice president of the National City Bank, wasn't he?

Mr. BAKER. That is right.

Mr. PECORA. I will read the letter into the record:

Copy of letter from C. W. Calvin to J. T. Cosby, vice president, National City Bank of New York, N. Y.

LIMA, PERU, *December 9, 1921.*

DEAR MR. COSBY:

Proposed Peruvian loan by Guaranty Trust Co.

You will doubtless be interested to have a word from us in regard to the doings of the committee sent to Peru by the Guaranty Trust Co. to make a report upon the proposed loan to the Peruvian Government. The committee has now been here about three weeks, and I understand have made a preliminary report upon the matter, but they are continuing their investigation and have made no announcement of any sort.

I have talked with the members of the commission and they speak in a very sophisticated manner with reference to conditions here, and appear to be very well informed. Their somewhat cynical comments in regard to the Government would ordinarily inspire doubt as to the seriousness of their intention, but this may be a cloak. No information is forthcoming as to when an announcement in regard to the proposed loan will be made, but I understand that the committee intends to make several trips into the interior of Peru.

In the meantime the conditions of Government finances is positively distressing. Treasury obligations are almost impossible to collect. Government officials and employees are months in arrears in their salaries, and, as one business man expressed it, the government treasury is "flat on its back and gasping for breath." With the export trade continuing small, customs revenues are not of a large amount, and, unless some sort of loan is forthcoming in the near future, I do not see how the government can continue functioning on the basis of its present income.

Very truly yours,

C. W. CALVIN.

Now, that letter has been in the files of the National City Co. since it was received in December of 1921, has it not?

Mr. BAKER. Yes, sir.

Mr. PECORA. Do you recall whether or not the information embodied in this letter concerning the financial and trade conditions in Peru, was discussed and considered by the executives of the company when they decided to participate in the flotation of this loan in 1927?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Well, I do not remember specifically that this letter was read or discussed, but of course that was several years later, and there were as full discussions as we could have on the situation. Mr. Schoepperle and Mr. Byrnes, of course, would be thoroughly familiar with the answer to your question.

Mr. PECORA. Yes. But you were one of the executives in 1927 that approved the flotation of this issue, were you not?

Mr. BAKER. Yes, sir.

Mr. PECORA. Do you recall whether the committee, or rather the executive officers in their informal discussions and considerations had before them the contents of the files of the company on Peruvian credits?

Mr. BAKER. Well, I do not recall that we had. But I think we must have undoubtedly had that.

Mr. PECORA. Have you produced here in response to the subpœna served upon you on behalf of this committee, a memorandum dated April 2, 1923, written by this Mr. Schoepperle whose name you mentioned a few minutes ago, and captioned "Memorandum re Peruvian Government Financing"?

Mr. BAKER. Yes; I have that.

Mr. PECORA. Now, will you follow me while I read the following extract from that memorandum——

Senator GORE (interposing). What is the date of that memorandum?

Mr. PECORA. April 2, 1923.

Senator GORE. All right. Excuse me.

Mr. PECORA. Oh, that is all right, Senator Gore. Now I read as follows:

EXTRACT FROM MEMORANDUM DATED APRIL 2, 1923, FROM VICTOR SCHOEPPERLE ENTITLED "MEMORANDUM RE PERUVIAN GOVERNMENT FINANCING"

As reasons for our declining the business, we cited the history of Peruvian credit, the political situation in Peru, and our feeling that the moral risk was not satisfactory. Mr. Eakins asked whether there was any prejudice toward A. B. Leach & Co. in reaching our conclusion, and I assured him that this was not the case, and that we had considered the matter purely as a proposition between the Peruvian Government and the National City Co. for purposes of reaching the conclusion which we had announced to him.

Do you find that extract in the memorandum that you have before you?

Mr. BAKER. Yes, sir.

Mr. PECORA. On the whole Mr. Schoepperle's report as embodied in this memorandum was against financing any Peruvian credits, wasn't it?

Mr. BAKER. Yes, at that time.

Mr. PECORA. Because it was considered a bad risk; isn't that so?

Mr. BAKER. I assume that must have been his reason there.

Mr. PECORA. Do you know whether that memorandum was considered by the executive officers of your company when in the early part of 1927 the company gave its consent to the flotation of this $15,000,000 issue?

Mr. BAKER. I am quite sure that that was discussed, although, as I say, the specific memorandum I do not recall. But certainly we went back into all those matters.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Well, now, if this memorandum was discussed there was nothing in it, was there, that encouraged the officers in floating this loan?

Mr. BAKER. Certainly not at that particular time.

Mr. PECORA. Who is the Mr. Eakins whose name is mentioned in this memorandum?

Mr. BAKER. He evidently was at that time representing the firm of A. B. Leach & Co.

Mr. PECORA. And they are an investment banking house, aren't they?

Mr. BAKER. Yes, sir.

Mr. PECORA. It is the practice among investment bankers and dealers to exchange information from time to time with regard to these foreign credits particularly; isn't that so?

Mr. BAKER. Yes, sir; that is so.

Mr. PECORA. Now, have you produced here from your files with regard to these Peruvian loans, a memorandum addressed to Mr. Cosby, a vice president of your company, from E. A. K., and E. A. K. is Mr. Eakins, isn't it?

Mr. BAKER. I am not sure about that.

Mr. PECORA. Well, anyway, it is signed by E. A. K.

Mr. BAKER. Yes, sir.

Mr. PECORA. Have you that memorandum now before you?

Mr. BAKER. Yes, sir; I have it.

Mr. PECORA. Do you find the following extract, and will you follow me while I read it:

EXTRACT FROM MEMORANDUM FOR MR. COSBY FROM E. A. K., MAY 8, 1923, DUNSMUIR RAILWAY CONCESSION IN PERU

As far as the attitude of the City Co. is concerned in connection with this financing, it may be mentioned that the history of Peruvian credit, the political situation in Peru, and the company's feeling regarding the moral risk have hitherto caused them to avoid Peruvian financing. Moreover, while the tobacco monopoly may be profitable, it appears very doubtful whether the railways will be profitable for a long time to come, and the Government appears to be determined to use all the tobacco monopoly's profits for railroad construction.

Do you find that?

Mr. BAKER. Yes, sir.

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

Mr. BAKER. 1923, May 8.

Mr. PECORA. It is dated May 8, 1923?

Mr. BAKER. Yes.

Mr. PECORA. Do you recall whether this memorandum was considered by the executive officers of the company when they decided to participate in this issue?

Mr. BAKER. Why, I answer that as I did the other, that I do not recall the specific memorandum, but I again say I have no doubt it was discussed.

Mr. PECORA. Can you tell the subcommittee who the E. A. K. referred to is?

Mr. BAKER. No. I am sorry I cannot answer that, unless I confer here.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Well, you may confer if that will enable you to answer.

Mr. BAKER. It is Mr. Kircher.

Mr. PECORA. What was his relationship to the National City Co.?

Mr. BAKER. He was with Mr. Schoepperle, in his department.

Mr. PECORA. That is, in the South American department?

Mr. BAKER. Yes.

Mr. PECORA. And this memorandum came from Mr. Kircher, in Peru at the time?

Mr. BAKER. I do not know whether he was in Peru at the time or not. I can not tell from my memorandum that I have here. Apparently this was made in the office in New York.

Mr. PECORA. Now, who is Mr. Dunham?

Mr. BAKER. He is not with us, but he was with us also as somewhat of a student of conditions in various parts of the world.

Mr. PECORA. Particularly in South America?

Mr. BAKER. Yes. I think his duties included South America among others.

Mr. PECORA. Have you produced here from your files a memorandum signed by Mr. Dunham, addressed to Mr. Byrnes, whom you have referred to as a vice president of the company at that time, with respect to Peruvian credits, dated July 11, 1923?

Mr. BAKER. Yes.

Mr. PECORA. Have you the original of that memorandum before you?

Mr. BAKER. Yes, sir; I have it.

Mr. PECORA. Now, let me read it for the purpose of the record:

MEMORANDUM FOR MR. BYRNES

JULY 11, 1923.

Mr. Eakins, of A. B. Leach & Co., has approached us again with a representative of the Foundation Co. in regard to a $6,000,000 Peruvian loan. Mr. Eakins says he had this business up with Mr. Schoepperle last April but on account of the little time available before a decision had to be made, we turned it down. In a memoradum dated April 2, in our files, Mr. Schoepperle says: * * * on Thursday, March 29, we advised Messrs. Eakins and Swetsch that we did not care to enter into negotiations for this business. As reasons for our declining this business we cited the history of the Peruvian credit, the political situation in Peru, and our feeling that the moral risk was not satisfactory.

I do not see any reason now to change our attitude. It is my feeling that, if we ever do go into Peruvian business, we ought to go in in a big way and not in these piecemeal propositions. We can not go in in a big way without making a real investigation, perhaps somewhat along the lines that the Guaranty made, with the idea of having foreign control of the customs and certain internal revenues.

I understand that most of the recommendations which the Guaranty made have not yet been put into force, except the establishment of a new bank of issue.

Our information shows that conditions in Peru are improving; the political situation is better but is largely dependent upon the continuance of the present administration in power, and a good deal of opposition is met in Congress when reforms are proposed by the President.

I have in mind to tell Mr. Eakins that we are not disposed to go into this business.

DUNHAM.

(Note in ink at bottom of memorandum:)

I notified Mr. Eakins that we would not be interested in this $6,000,000 proposition—that our ideas have not changed.

DUNHAM.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Now there is nothing in that memorandum which would give encouragement to the financing of Peruvian credits in this country, is there?

Mr. BAKER. No, sir; not as to that.

Mr. PECORA. Is Mr. Dunham still employed by the National City Co.?

Mr. BAKER. No, sir.

Mr. PECORA. How long ago was his connection with the company severed?

Mr. BAKER. I should think probably 3 years ago, or, say, 2 or 3 years ago.

Senator COUZENS (presiding). Your turnover seems to have been quite large.

Mr. BAKER. We had quite a large organization, and it is very much reduced on account of economy.

Mr. PECORA. Now, Mr. Baker, have you produced from your files a letter addressed to Mr. T. A. Eakins, care of Messrs. A. B. Leach & Co., New York City, dated July 12, 1923, and signed by the manager of your foreign department?

Mr. BAKER. Yes; I have that.

Mr. PECORA. Have you got it before you now?

Mr. BAKER. You said July 12?

Mr. PECORA. July 12, 1923.

Mr. BAKER. That is right.

Mr. PECORA. I will read the text of the letter:

LETTER TO MR. T. A. EAKINS, CARE OF MESSRS. A. B. LEACH & CO., NEW YORK CITY, N. Y.

JULY 12, 1923.

DEAR MR. EAKINS: Confirming our telephone conversation of this afternoon with your office, we have received the following cable from Mr. Schoepperle in London:

"Convey following message collect to A. B. Leach & Co. in answer to their direct cable. July coupons Peru 5 per cent loan 1920 now in default. Various coupons have been in arrears recent years. Peru has defaulted on earlier loans according Corporation Foreign Bondholders. Peruvian corporations contract situation confused. No indications Peruvian loans under discussion London, England. Would not consider new loan good without specific adequate pledge. Continuance of Cumberland in office subject entirely to wishes of Government, therefore much depends upon political situation even if adequate pledges available; 5 per cent 1920 loan quoted London, England, 45, 50; 5½ per cent loan 1909 quoted 94, 96. Recent 7½ per cent guano loan 98 par."

Very truly yours,

A. W. DUNHAM,
Manager, Foreign Department.

By whom is that letter signed?

Mr. BAKER. The initials are those of A. W. Dunham.

Mr. PECORA. Now, in determining whether or not the foreign credits should be sponsored by your company to the investing public here, was the past record of the prospective debtor nation taken into account?

Mr. BAKER. Yes, sir.

Mr. PECORA. The information embodied in this letter, which quotes a cable sent from London by the National City Co.'s representative, Mr. Schoepperle, called attention, did it not, to the fact that the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Peruvian Government in 1923 was in default on several of its prior issues?

Mr. BAKER. That is right.

Mr. PECORA. There was nothing in that situation which commended a Peruvian line of credit or a Peruvian loan, was there?

Mr. BAKER. Not at that time; no, sir.

Mr. PECORA. Now, to get back to this Peruvian tobacco loan of March 1927: Have you produced here, Mr. Baker, the original memorandum to Mr. Dunham of your company, signed by C. M. Bishop, under date of July 12, 1923?

Mr. BAKER. Yes, I have that here.

Mr. PECORA. I want to read the following extract from that memorandum:

> Peru has been careless in the fulfillment of contractual obligations. City of Lima 5 per cent loan coupons, due January 1, 1922, were not paid until the following May, 1922. The Peruvian 5 per cent gold bonds of 1920, due in January, 1922, were paid in September, 1922, and those due in July, 1922, were paid in October of 1922. The London Times, in its issue of March 30, 1922, alluded to Peru's "frequent unobservance of her undertakings to the Peruvian Corporation, her broken pledges over the Chimbote concession, and her flagrant disregard of guarantees given to the North Western Railway of Peru."
>
> C. M. BISHOP.

Now, who is Mr. Bishop?

Mr. BAKER. I just don't know that.

Mr. PECORA. He was connected with the foreign department of the National City Co. in July, 1923, wasn't he?

Mr. BAKER. May I ask Mr. Schoepperle who he was?

Mr. PECORA. Surely.

Mr. SCHOEPPERLE. He was an employee.

Mr. BAKER. He was; yes sir.

Mr. PECORA. Employed in the foreign department of the National City Co. in July, 1923?

Mr. BAKER. That is right.

Mr. PECORA. There is nothing in that memorandum which would give encouragement to the flotation of Peruvian bonds?

Mr. BAKER. No, sir.

Mr. PECORA. Have you produced here in response to subpœna from the files of your company a paper marked "Peruvian Study. A table of the revenues and expenditures of Peru for the years between 1915 and 1924"?

Mr. BAKER. I suppose that is in this file. I think if you have no objection Mr. Schoepperle can produce that for us.

Mr. PECORA. All right. Mr. Schoepperle can help you locate that?

Mr. BAKER. Mr. Schoepperle, can you help me locate that?

Mr. SCHOEPPERLE. Yes (handing documents to Mr. Baker).

Mr. BAKER. Is this it?

Mr. SCHOEPPERLE. Yes. We have a table here. I do not have the date. There is no date on it.

Mr. PECORA. I suggest that Mr. Schoepperle be sworn, Mr. Chairman, so that I may question him about this.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

TESTIMONY OF VICTOR SCHOEPPERLE, SHORT HILLS, MELBURN TOWNSHIP, ESSEX COUNTY, N. J., VICE PRESIDENT NATIONAL CITY CO.

Senator COUZENS (presiding). Mr. Schoepperle, do you swear to tell the truth, the whole truth, and nothing else but the truth in this investigation, so help you God?

Mr. SCHOEPPERLE. I do.

Mr. PECORA. Mr. Schoepperle, will you kindly give your full name, address, and business or occupation to the reporter?

Mr. SCHOEPPERLE. Victor Schoepperle; occupation, vice president of the National City Co.; address, Short Hills, Melburn Township, Essex County, N. J.

Mr. PECORA. How long have you been vice president of the National City Co.?

Mr. SCHOEPPERLE. Since about May, 1927, April or May.

Mr. PECORA. Prior to that time were you connected in any other capacity with the company?

Mr. SCHOEPPERLE. Prior to that time I was an assistant vice president of the National City Co.

Mr. PECORA. For what period of time?

Mr. SCHOEPPERLE. I think three or four years prior to 1927.

Mr. PECORA. Did you have any connection with the company prior to that period?

Mr. SCHOEPPERLE. Prior to that period, yes; I had been connected with the company as an officer in a minor capacity from 1916 on.

Mr. PECORA. Were you connected with any particular department of that company?

Mr. SCHOEPPERLE. I was connected with the foreign department of the National City Co. from about 1919 on.

Mr. PECORA. To the present time?

Mr. SCHOEPPERLE. To the present time; yes, sir.

Mr. PECORA. So that since 1919 practically all your services have been in connection with foreign loans and credits participated in by the National City Co.?

Mr. SCHOEPPERLE. Practically speaking; yes.

Mr. PECORA. For a period of time were you in charge of South American credits for the company?

Mr. SCHOEPPERLE. In a general sense; yes.

Mr. PECORA. You have been present at this hearing this morning since the examination of Mr. Baker was resumed, haven't you?

Mr. SCHOEPPERLE. I have.

Mr. PECORA. And have you heard the testimony he has given this morning?

Mr. SCHOEPPERLE. Yes; I have.

Mr. PECORA. You are the Mr. Schoepperle referred to in some of the communications that have been read either in whole or in part into the record this morning, are you not?

Mr. SCHOEPPERLE. I am; yes.

Mr. PECORA. Now, I will ask you, because of your greater familiarity with the files of your company with respect to Peruvian loans whether there has been produced here a table showing the revenues and expenditures of the Government of Peru for the years between 1915 and 1924.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SCHOEPPERLE. There has been, sir.

Mr. PECORA. Will you look at that table and tell us if it is not the fact that during that period the Government of Peru had succeeded in balancing its budget only for 3 years; that is, on only three occasions during that 10-year period?

Mr. SCHOEPPERLE. Yes; that appears on the table of expenditures which goes with this file, table on revenues.

Mr. PECORA. Yes; and that table shows that as a general rule the expenditures year by year exceeded the revenues by substantial amounts, does it not?

Mr. SCHOEPPERLE. Well, would you mind if I were a little more specific?

Mr. PECORA. Yes.

Mr. SCHOEPPERLE. In 1915 there appears according to these tables to be a deficit of 157,000 Peruvian pounds.

Mr. PECORA. A Peruvian pound is equivalent to what in American dollars?

Mr. SCHOEPPERLE. At that time it was equivalent to the pound sterling, $4.867.

Mr. PECORA. Go ahead.

Mr. SCHOEPPERLE. Now, to continue——

Mr. PECORA (interposing). What is the proportion of excess of the expenditures over the revenues for that year? I mean, give it to us approximately.

Mr. SCHOEPPERLE. Yes. I do not want to delay your proceedings at all, but I want to be fairly accurate; 2,829,000 divided into 157,000 [calculating]—for that year, 1915, under discussion, about 7 per cent.

Mr. PECORA. What other detailed answer do you want to make to the general question whether the expenditures did not exceed the revenues almost every year during that 10-year-period?

Mr. SCHOEPPERLE. I think I would prefer to accept the statement that you made in the first instance, that during three of those years there appears to have been, according to these tables, a surplus of revenues over the expenditures, and for the balance of the period under discussion there appears to have been a deficit.

Mr. PECORA. Yes. Now, I will resume the examination of Mr. Baker.

TESTIMONY OF HUGH B. BAKER, PRESIDENT THE NATIONAL CITY CO., NEW YORK CITY—Resumed

Mr. PECORA. Mr. Baker, have you produced from the files of your company with respect to the Peruvian loan a report dated December 16, 1925, signed by E. A. K.?

Mr. BAKER. Is it signed by E. A. K.?

Mr. PECORA. E. A. K., monographed by E. A. K.

Mr. BAKER. Well, I am very sorry; I do not find that report. I will be very glad to take any transcript you may have of it.

Mr. PECORA (handing document to Mr. Baker). Perhaps this will help you locate it.

(Mr. Baker and Mr. Schoepperle perused documents.)

Mr. SCHOEPPERLE. Mr. Pecora, for the purpose of the record and not to delay the proceedings, I think Mr. Baker would accept this as a transcript from that report. We will find it.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. I understand that a representative of the committee made that directly from your files.

Mr. SCHOEPPERLE. Yes. We will find that in due course.

Mr. PECORA. I want to read into the record from this memorandum or report the following extracts:

Apparently the internal debt of Peru has not yet been placed on a satisfactory footing. The internal debt of 1918, which bears 7 per cent interest, had its 1922 and 1923 amortizations in arrears early in 1925, and apparently there are also some arrears in interest, causing this issue to sell around 54 to 56 per cent in Lima, which is almost as low as the amortizable debt of 1898, which bears no interest and sells around 50. The default in the 7 per cent issue of 1918 apparently is responsible for the failure of the holders of the vales de consoladacion issued in 1889 and bearing 1 per cent interest to convert the same into internal 7's of 1918 at 14 per cent of their nominal value, which would secure approximately the same rate of return.

And also the following extract:

1925 setbacks: The presidential speech made only slight reference to the flood damages which caused heavy losses to railway property and agricultural products, which are bound to have a reflex action upon the present year's position. This year the government will have to find a considerable sum for repairs to railways, roads, and compensation to agricultural interests. Repairs to the Peruvian Corporations' railway lines alone have entailed an outlay of about 220,000 Peruvian pounds, apart from the loss of receipts during the interruption of traffic. In February and March the decrease in gross receipts was about 100,000 Peruvian pounds, while normal traffic was not restored until June. Over 35,000 tons of guano along the shore were dissolved, involving a 75 per cent decrease in the total guano collection anticipated. This loss has been increased by a decrease in the nitrate content in the remaining deposits. This is particularly disappointing, since the state relies upon the profits of the guano industry to exceed the high mark set last year, when 280,584 Peruvian pounds were received.

The improvement in the petroleum output, however, will help to counterbalance this. The sugar industry has suffered from the decrease in prices, while exportable supply has been considerably reduced. Cotton also has suffered, and those engaged in sugar and cotton raising have sustained considerable hardships. Unfavorable agricultural conditions here mentioned have resulted in several commercial failures, while bankers have curtailed credits to local retailers.

The State has been more punctual in payments of liabilities and pensions, while stricter economies have been introduced in the various ministries. It is calculated, that the new import tax will more than correspond to the calculations upon which it was based, and that customs receipts will continue to show a healthy advance.

Now, Mr. Baker, you do not consider there was anything in that report which was favorable to the flotation of Peruvian loans in this country, do you?

Mr. BAKER. It was not particularly enthusiastic, certainly.

Mr. PECORA. No. And do you know whether this report was discussed and considered by the executive officers of the company when they decided to participate in this Peruvian loan?

Mr. BAKER. I assume it was. I have no doubt but that it was.

Mr. PECORA. Have you produced from among your files a report addressed by Mr. Calvin to Mr. Byrnes, of your company, under date of November 3, 1925?

Mr. BAKER. November, you say?

Mr. PECORA. November 3, 1925, Re Peruvian Government Financing. That is the title of it.

Mr. BAKER. My date is December the 3. Are you sure that is right?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Does that start with a statement: "The general situation"?——

Mr. BAKER. Yes.

Mr. PECORA. That is the one I mean, then.

Mr. BAKER. Yes.

Mr. PECORA. You say that is dated December?

Mr. BAKER. Yes, December 3.

Mr. PECORA. That is about one and a quarter years prior to the flotation of this tobacco loan in March, 1927, is it not?

Mr. BAKER. Yes.

Mr. PECORA. Do you find the following statements embodied in that memorandum:

The general situation of the Peruvian Government has improved during the past two years to the extent that I feel renewed consideration should be given to the advisability of the National City organization interesting itself in Peruvian financing.

The poor credit standing of the Peruvian Government has been due, in my opinion, in a considerable measure to causes which to many are not fully understood.

Mr. BAKER. Just a minute, Mr. Pecora.

Mr. PECORA. These are just extracts.

Mr. BAKER. Oh, I see. Because you left out what they say there about the budget balance.

Mr. PECORA. Yes. There follows a historical résumé of Spanish colonies in South America and the increase in the tendencies toward stabilization, does there not?

Mr. BAKER. Yes; and he speaks about the stabilization.

Mr. PECORA. Yes. I am just quoting extracts. Then to resume:

The principal reason for Peru's delay in showing a like improvement was the war with Chile in 1879 to 1883, which left the country prostrated, with currency depreciated to nothing, many of its wealthy families ruined, and the treasury empty, and made it impossible for the country to attend to the service of its foreign indebtedness contracted prior thereto, largely for public improvements. Under such conditions a turbulent political condition logically continued until the election of President Leguia in 1919.

Then follows other matter I will not read into the record. Then I want to read this excerpt:

Despite the unsatisfactory condition of this country's finances and the continued hostility of most of the old aristocracy of the country, which has not been interested in building up and educating the lower classes, Leguia has made such progress that I feel the whole Peruvian situation merits renewed consideration by our institution.

Then follows a discussion of natural resources, and now I will read this extract:

In conclusion, attention is invited to the fact that the recent loan handled by White, Weld & Co. was put out at 7½ percent, as against the previous rate of 8 percent, which is a straw indicating the trend of affairs. I do not and would not suggest the consideration at this time of making loans to Peru upon the unsecured obligation of the Government, but with designated revenues specifically set aside to guarantee the service of loans affected and provisions whereby such revenues would be paid direct to the Lima branch of our institution by the collecting agencies, I feel that a Peruvian Government bond would offer no greater, if as much, risk as that involved in other issues which have been floated by the National City Co. I also feel that, when possible, within the limits of safe and conservative financing and without affecting unsound loans, efforts should be made to cooperate as much as possible in furthering the progress of the branches established abroad by the bank.

Do you find those extracts correct?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Yes, sir.

Mr. PECORA. Now, this Mr. Calvin, who sent that memorandum to Mr. Byrnes of your company in December 1925 was the gentleman who executed the Peruvian national loan agreement as attorney in fact of your company, wasn't he?

Mr. BAKER. Mr. Schoepperle will have to answer that question, having negotiated that.

Mr. SCHOEPPERLE. Yes.

Mr. PECORA. Was there anything in that memorandum which encouraged the flotation of this tobacco loan in the early part of 1927?

Mr. BAKER. The memorandum as a whole seems to show that progress was being made in the general situation in Peru.

Mr. PECORA. It also showed a picture of general conditions still somewhat unsettled and disturbed?

Mr. BAKER. Yes.

Mr. PECORA. Both economically and politically?

Mr. Baker. But with a favorable trend.

Mr. PECORA. With a favorable trend?

Mr. BAKER. Yes. In the early part there he speaks about the balancing of budget or nearly so.

Mr. PECORA. What did you understand by this expression embodied in Mr. Calvin's memorandum of December 3, 1925:

> I do not and would not suggest the consideration at this time of making loans to Peru upon the unsecured obligation of the Government, but with designated revenues specifically set aside to guarantee the service of loans affected and provisions whereby such revenues would be paid direct to the Lima branch of our institution by the collecting agencies, I feel that a Peruvian Government bond would offer no greater, if as much, risk as that involved in other issues which have been floated by the National City Co.

Mr. BAKER. Well, that would seem to indicate that he felt that this credit was sound and if we protected the payment through some delivery through our branch, collection through the branch of our institution, so that there would be no possibility of the moneys being diverted into other channels than for the service of this loan, he felt that it would be a safe risk.

Mr. PECORA. Did he feel it would be a safe risk, or did he feel that it would involve no greater risk than those assumed ordinarily in other loans floated by your company?

Mr. BAKER. I think his expression is a very general one, and certainly there is no possible way of covering our entire issues with one general expression, because there are so many different types. Municipal bonds of one State as compared with the municipal bonds of another cannot even be entirely——

Mr. PECORA. You have observed that in the communications I have read into the record from your files on the Peruvian loan studies, hazards were pointed out and perils were referred to, making a Peruvian loan a risky and hazardous thing? You have recognized that, have you not?

Mr. BAKER. Yes; extending back there to the early days.

Mr. PECORA. Also as late as 1925?

Mr. BAKER. Yes. There were some reports.

Mr. PECORA. Less than two years before this tobacco loan was floated?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Yes, that is right; but in this 1925 report here—isn't that 1925? Yes; that was 1925, where he was indicating progress, and with proper direct support of that loan, specific revenues pledged for it, he regarded it as a proper risk.

Mr. PECORA. In putting out a foreign loan you said before that the executives considered the credit history?

Mr. BAKER. That is right.

Mr. PECORA. Of the foreign government?

Mr. BAKER. That is correct.

Mr. PECORA. As an important element to be considered?

Mr. BAKER. That is correct; yes.

Mr. PECORA. And you have noticed that your files referring to the credit history of Peru show a pretty bad history?

Mr. BAKER. That was a bad history, but, of course, we would take into consideration improvements that are being made during that period and approaching that period of this loan of 1927, which was two years later than this, that if the economic situation and the political situation and so forth in Peru had sufficiently improved, our opinion as to what we would regard a good credit in 1927 might have been an entirely different thing in 1923 or 1924 or 1925.

Mr. PECORA. Do you think that a short period of three or four years is adequate upon which to revise a determination as to the risk and peril in a foreign loan——

Mr. BAKER. Well, I think that that is——

Mr. PECORA. When you consider the life of nations, do you think that an improvement that only manifests itself over a period of three or four years is sufficient to counterbalance a bad credit record for many years?

Mr. BAKER. I think that would require a very complete study of what those improvements are and how they have been developed.

Mr. PECORA. Was that very complete study given to the question of this Peruvian loan in 1927 by the executives of your company?

Mr. BAKER. I think so.

Mr. PECORA. What do you recall was ascertained about those improvements before you gave approval to it?

Mr. BAKER. Well, of course, I can not recall all of the detailed discussions that took place in those meetings at that particular time. But as they were discussed and presented to us by Mr. Schoepperle or Mr. Byrnes there was nothing in the conclusion with which I disagreed.

Mr. PECORA. Do you recall the testimony of Mr. Mitchell here last week, that among the factors which influenced the company in accumulating and selling to the public shares of the common stock of the Anaconda Copper Co., a 30 or 35 year period of earnings, and so forth, was taken into consideration?

Mr. BAKER. Yes; that is right.

Mr. PECORA. Before the decision was arrived at?

Mr. BAKER. That is right. Yes; I remember that.

Mr. PECORA. And that with respect to the putting out of sugar issues in 1923, 1924, and 1925, the Cuban-Dominican sugar bonds that were the subject of inquiry last week here——

Mr. BAKER. Yes, sir.

Mr. PECORA. Before the decision was arrived at?

Mr. BAKER. Yes.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. That a history of some 30 years of the sugar industry was taken into account?

Mr. BAKER. Yes, sir.

Mr. PECORA. In connection with this Peruvian loan your judgment in indorsing this loan seems to have been based on a résumé of three or four years of great improvement as against many years of bad credit record; is that right?

Mr. BAKER. Well, that is not entirely correct, because those studies even back in the troublesome days of Peru would have to be gone into in a most careful and thorough way to see the causes of each one and the general trend of the economic situation in Peru.

Mr. PECORA. Is there anything in your records—it seems there is nothing within your recollection at the moment—which will indicate what these improvements were that you witnessed in the two years preceding this March 1927 loan that caused you to arrive at a judgment not warranted by the prior long bad-credit record of Peru?

Mr. BAKER. I think if you would permit those engaged in that study and negotiation to answer that question we could give you the details of that.

Mr. PECORA. Who are those persons?

Mr. BAKER. Mr. Schoepperle.

Mr. PECORA. You have no recollection about those improvements, the nature of them, et cetera, have you?

Mr. BAKER. I have no recollection of the detailed discussion of that.

Mr. PECORA. Now, do you find among your files on the Peruvian loan study an unsigned memorandum containing the following notes:

Peru bad-debt record adverse moral and political risk. Bad internal-debt situation. Budgetary and trade position about as satisfactory as Chile in past three years. Natural resources more varied. On economy showing Peru should go ahead rapidly in next 10 years.

Do you find that among your files?

Mr. BAKER. Yes, sir.

Mr. PECORA. In whose handwriting is that memorandum, if you know?

Mr. BAKER. I think that is Mr. Schoepperle's handwriting.

Mr. PECORA. Will Mr. Schoepperle, please look at it and tell us.

Mr. SCHOEPPERLE. Yes; that is my memorandum.

Mr. PECORA. That is your memorandum. Mr. Baker, do you know when that memorandum was made by Mr. Schoepperle?

Mr. BAKER. No; I do not.

Mr. PECORA. Mr. Schoepperle, can you answer that question?

Mr. SCHOEPPERLE. No; I cannot. There is no date on it and I haven't much idea.

Mr. PECORA. Perhaps its place of insertion in the file would have a tendency to fix the date. Will you please look at it for that purpose?

Mr. SCHOEPPERLE. It stands in the file between December 3, 1925, and July 27, 1927.

Mr. PECORA. Would that indicate to you that the memorandum was written by you somewhere between those two dates?

Mr. SCHOEPPERLE. Oh, certainly. I think it must have been.

Mr. PECORA. That is between December, 1925, and March, 1927?

Mr. SCHOEPPERLE. I think so.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And in March, 1927, this loan was floated, this $15,000,000 tobacco loan?

Mr. SCHOEPPERLE. Tobacco loan; yes.

Mr. PECORA. Now, Mr. Baker, do you know whether that memorandum of Mr. Schoepperle was discussed by the executive officers when they agreed to float this loan or to participate in it?

Mr. BAKER. I do not, because I never have seen it before.

Mr. PECORA. Do you recall ever having had any discussion with your expert, Mr. Schoepperle, prior to giving your sanction to the flotation of these bonds in March, 1927?

Mr. BAKER. As I said, Mr. Pecora, in those meetings there were discussions that would last for days and hours at a time, in those days and, of course, I remember there were such discussions, but the specific points brought up in each one I can not remember.

Mr. PECORA. Do you recall discussions by the executives with Mr. Schoepperle or in which Mr. Schoepperle's advices and opinions were sought and obtained by the executives of the company?

Mr. BAKER. Oh, yes. Yes; certainly.

Mr. PECORA. Do you recall that Mr. Schoepperle had stated in substance that his opinion about a Peruvian loan was that it was a bad—"Peru had a bad debt record"; that "it was an adverse moral and political risk"; that "it had a bad internal debt situation", et cetera?

Mr. BAKER. Of course, those are headings for some memorandum that he evidently had prepared, or studies that he had made, in which he was getting the answer to some of those particular things himself, and one thing that I do know is that in these discussions every point that we could criticize during those discussions was brought up, and the man in charge of the study and the negotiation was relied upon to give us the answer to those questions.

Mr. PECORA. Who was the man in charge of these negotiations whose judgment and advices you relied upon?

Mr. BAKER. That would be Mr. Schoepperle, and at that time Mr. Byrnes; Mr. Schoepperle and Mr. Byrnes.

Mr. PECORA. Do you recall that Mr. Schoepperle approved the making of this loan?

Mr. BAKER. I do not recall a specific vote by Mr. Schoepperle, but I can assume with positive assurance in my own mind that he did approve it or we would not have gone ahead with it.

Mr. PECORA. Are you sure of that?

Mr. BAKER. I would be sure of that; yes, sir.

Mr. PECORA. Well, are you merely assuming that that was the case, or have you a present recollection that it happened?

Mr. BAKER. No; I can not recall definitely that Mr. Schoepperle was at a specific meeting and said, "Yes, I approve," but I am sure that except as he did approve we would not have proceeded.

Mr. PECORA. Are you sure, too, that before you reached your judgment to approve this loan you had before you all the written data and memoranda that I have read into the record and that those various reports and data were discussed?

Mr. BAKER. No; I can not say for sure that they were, but I am positive that the vice presidents in charge of those negotiations and studies called them to our attention.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Now, have you produced from your files with regard to this Peruvian loan study a letter dated March 10, 1926, addressed by Mr. R. M. Bishop, vice president, to Mr. Calvin, manager of the National City Bank of New York, in Lima, Peru?

Mr. BAKER. Yes, sir.

Mr. PECORA. I will read that letter into the record. The letter is written from Lima, Peru, is it not, or rather a letter addressed to Mr. Calvin in Lima, Peru?

Mr. BAKER. Yes.

Mr. PECORA (reading):

MARCH, 10, 1926.

Mr. M. C. D. CALVIN,
The National City Bank of New York,
Lima, Peru.

DEAR MR. CALVIN: I acknowledge receipt of your letter of February 23 inclosing copy of a letter of the same date to Mr. Cosby. I regret to say there has been no substantial modification in the attitude of the National City Co. toward South American credits since you left here in December. However, I hope this will not deter you from sending us from time to time such authentic information as you may have that would throw a proper light on the present and prospective economic, financial, and political situation in Peru.

Very truly yours,

R. M. BYRNES, *Vice President.*

You will notice from that letter, Mr. Baker, that up to March 10, 1926, which was just about one year before this loan was floated, the National City Co. had not modified its attitude, which was unfavorable toward a Peruvian loan.

Mr. BAKER. That is right.

Mr. PECORA. Now, do you find anything at all in your files with regard to these Peruvian loan studies subsequent to this letter of Mr. Byrnes's that has just been read into the record dated March 10, 1926, and up to March, 1927, when this tobacco loan was approved and floated, that gives you more information concerning the soundness of the proposed loan.

Mr. BAKER. I do not have it in this file, but again, as I say, that would be distinctly in the minds of the men who were making those studies week by week and month by month and keeping in constant touch with those situations.

Mr. PECORA. When the National City Co. in March, 1927, participated in the flotation of this $15,000,000 Peruvian loan it issued a circular or prospectus concerning the loan, did it not?

Mr. BAKER. Yes, sir.

Mr. PECORA. Have you a copy of the circular or prospectus before you?

Mr. BAKER. Yes; I have it.

Mr. PECORA. Do you find any mention in it whatsoever of the bad credit record of Peru which is embodied in the information I have read into the record from your files?

Mr. BAKER. I should have to read this over, Mr. Pecora. [After perusing document.] No; I do not see anything. It is a secured loan. I do not see any statements in there.

Mr. PECORA. No statement or information was given to the American investing public in your circular corresponding to the information that your company possessed in writing among its files concerning the bad debt record of Peru and its being a bad moral and political risk?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. No, sir.

Mr. PECORA. Who prepared that circular?

Mr. BAKER. I don't know who prepared it in our shop. Seligman evidently prepared the circular. They managed the offerings. It was under their leadership.

Mr. PECORA. But the National City Co. also approved the circular before it permitted its name to go on it with that of J. & W. Seligman & Co., did it not?

Mr. BAKER. Yes; that is correct.

Mr. PECORA. Do you recall what officer of the National City Co. approved that circular?

Mr. BAKER. That would either have been Mr. Byrnes or Mr. Schoepperle.

Mr. PECORA. Do you know any reason why no information was conveyed to the investing public on that circular——

Mr. BAKER. Not at all.

Mr. PECORA. Concerning the bad debt record of Peru——

Mr. BAKER. No; I do not.

Mr. PECORA. And its being a bad moral and political risk?

Mr. BAKER. I do not.

Mr. PECORA. And the unsatisfactory internal condition of the country?

Mr. BAKER. No, sir.

Mr. PECORA. Do you think it was fair to the investing public, to withhold from it knowledge which the participating bankers had of this issue when they offered it to the public?

Mr. BAKER. If the conclusions were that that was a thing of the past and the conditions were proper supporting this loan, which they evidently were in our minds, or we would not have participated in the loan.

Mr. PECORA. You think it was fair to the public to withhold the information which you had or your company had, do you, merely because somebody in your company reached the conclusion that the loan would be a sound loan?

Mr. BAKER. I think it was fair to present the facts as they existed.

Mr. PECORA. The facts as they existed included this bad-debt record, did they not?

Mr. BAKER. I am speaking about the facts that were then currently existing.

Mr. PECORA. You mean you think it was fair to present a conclusion based upon facts which could not have been more than a year old as against a bad-debt record for many, many years prior thereto?

Mr. BAKER. I think it would have been better if the whole story perhaps were included, a description of it, and it is quite possible that there was some supplemental publication which went into the history of it. I do not know.

Mr. PECORA. Can you produce any such supplemental publication that gave the whole history?

Mr. BAKER. I can see if it is in the files.

Mr. PECORA. Do you think if the circular that accompanies this offering in March, 1927, to the investing public had given this bad-debt record of Peru which is embodied in the various memoranda read into the record from your files, that the American investing public would have subscribed at 96½ to those bonds?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. If he saw sufficient income from this tobacco monopoly to support the loan, I think, yes; he would have taken the issue.

Mr. PECORA. Despite the fact that much of that information showed the unsatisfactory agricultural condition, not only of tobacco but of cotton and sugar in Peru?

Mr. BAKER. Well, of course, I can not answer what the public's opinion might have been. I do not know.

Mr. PECORA. Under all the circumstances was not this a very highly speculative and risky loan to make? Tell us frankly, Mr. Baker.

Mr. BAKER. Well, I can not answer that question, because, as I say, we have to get into the question of the support of this loan through this tobacco monopoly and just what those revenues were and what we expected them to be. There are so many elements that enter into that I can not answer that question in——

Mr. PECORA. Who was responsible for this printed inscription at the bottom of the first page of the printed circular which accompanied this offering:

> The above statements are based on information received partly by cable from official and other sources. While not guaranteed, we believe them to be reliable, but they are in no event to be construed as representations by us.

Mr. BAKER. What was your question, please?

Mr. PECORA. Who was responsible for the inclusion of that statement in the circular?

Mr. BAKER. That is a statement that I think, through general practice over a long period of years, as far as I know, is on all circulars.

Mr. PECORA. In other words, the National City Co. in putting out this circular was absolutely unwilling to hold itself responsible for the information embodied in it, and yet upon that information it was asking the public to subscribe for the bonds at 96½; is that right?

Mr. BAKER. That statement that appears on this circulars is merely stating a fact that we have to the best of our judgment and ability determined these to be the facts.

Mr. PECORA. And yet you serve notice on the public that you are not responsible for the statements?

Mr. BAKER. That is right. That is what it does.

Mr. PECORA. And you ask the public to be guided by these statements, for which you disavow responsibility, in buying the bonds?

Mr. BAKER. But which we do say to the best of our ability and judgment are correct.

Mr. PECORA. Well, now, it did not take very long to sell the bonds of this $15,000,000 tobacco loan, did it?

Mr. BAKER. I do not think so. I think it was a very quick issue.

Mr. PECORA. Quick issue. Quickly subscribed for?

Mr. BAKER. Quickly sold.

Mr. PECORA. Was there a second Peruvian loan?

Mr. BAKER. Yes, sir.

Mr. PECORA. That was floated by the National City Co. in participation with others in December, 1927?

Mr. BAKER. There was a—yes; there was another issue December 21, 1927, again under the leadership of J. & W. Seligman & Co.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. When you say "under the leadership of J. & W. Seligman & Co", you do not mean to imply that the National City Co. participated in this issue merely because J. & W. Seligman took the leadership in it, do you?

Mr. BAKER. No. No; because of our own study, of course.

Mr. PECORA. In other words, the participation of the National City Co. in this loan flotation was the result of its own independent judgment?

Mr. BAKER. That is right.

Mr. PECORA. What was the amount of that issue in December, 1927?

Mr. BAKER. $50,000,000.

Mr. PECORA. $50,000,000. And at what price were those bonds offered to the public?

Mr. BAKER. Ninety-one and one-half.

Mr. PECORA. What was the spread to the National City Co. in that underwriting?

Mr. BAKER. The total spread in the issue you are speaking of?

Mr. PECORA. Yes; gross spread.

Mr. BAKER. Five points.

Mr. PECORA. The issue of March 1927, nine months earlier, was made at 96½, wasn't it?

Mr. BAKER. Yes.

Mr. PECORA. And this one of December, 1927, was made at 91½?

Mr. BAKER. Yes.

Mr. PECORA. A difference of 5 points?

Mr. BAKER. The issue of March 16, 1927, was a 7 per cent coupon, and this one is a 6.

Mr. PECORA. Now, do you recall the discussion among the officers, the executive officers, of the National City Co., in the course of which they reached the judgment that this $50,000,000 Peruvian loan was a sound issue to offer to the investing public here?

Mr. BAKER. I recall that we discussed it; yes, sir.

Mr. PECORA. Do you recall the general nature of the discussion and what facts were presented in that discussion?

Mr. BAKER. Not particularly.

Mr. PECORA. Which persuaded the judgment of the executives that this was a sound loan?

Mr. BAKER. Not particularly. I would have to go back through the files altogether and study that, which I have not. That again was under the negotiation of Mr. Schoepperle.

Mr. PECORA. Have you produced from your files a letter dated July 27, 1927, addressed to Mr. Charles E. Mitchell by J. H. Durrell, vice president and overseas manager of the National City Bank, formerly in charge of South America?

Mr. BAKER. Yes; I have that.

Mr. PECORA. Now, let me read that letter into the record and you follow me from the original. That is, I will read the following extracts from it:

As I see it, there are two factors that will long retard the economic importance of Peru.

Mr. BAKER. Just a minute. I have got to find that. Oh, yes; all right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. The letter is dated July 27, 1927, is it not?

Mr. BAKER. Yes.

Mr. PECORA. I will repeat:

As I see it, there are two factors that will long retard the economic importance of Peru. First, its population of 5,500,000 is largely Indian, two-thirds of whom reside east of the Andes, and a majority consume almost no manufactured products. Second, its principal sources of wealth, the mines and oil wells, are nearly all foreign-owned, and excepting for wages and taxes, no part of the value of their production remains in the country. Added to this, the sugar plantations are in the hands of a few families, a majority of whom reside and invest their profits abroad. Also, for political reasons, the present Government has deported some 400 prominent wealthy conservative families, but allows them to continue to receive and to make use of abroad the income from their Peruvian properties. As a whole, I have no great faith in any material betterment of Peru's economic condition in the near future.

The country's political situation is equally uncertain. President Leguia, while not having the absolute power possessed by General Gomez in Venezuela, is the last word in all things political, and usually the first word as well. He is a forceful character, reputed to be absolutely honest, though surrounded by a group of rascals, and is highly intelligent and well educated. He has the army and police well in hand, and it would probably be within his power to continue himself in office when his present term expires in 1929. Unfortunately, his health is bad, and it is reported that he must undergo a serious operation soon.

I discussed political possibilities in the event of his death or retirement with many business and professional men during my stay in Lima. While some, including the United States ambassador, were optimistic, the majority, even the President's political opponents and ill-wishers, believe a revolution or worse would result. Added to this uncertainty, the Tacna-Arica squabble is giving most of the business men no little concern, though they believe at last analysis the United States will refuse to permit open hostilities to break between Peru and Chile. Incidentally, there is a pronounced pro-American feeling in Peru, and officers of the American Navy are engaged in training that of Peru.

Our business is a peanut proposition. While profits have steadily increased each year since the branch was established, the volume of its business is not much greater to-day than it was five years ago, and deposits at June 30 of this year were actually less than those of the corresponding date in 1922.

Now, President Leguia's administration did terminate a few years ago, didn't it?

Mr. BAKER. Yes. I don't know the exact date.

Mr. PECORA. Do you recall the political conditions that followed?

Mr. BAKER. They were considerably disturbed, yes.

Mr. PECORA. Just as Mr. Durrell in July, 1927, reported that they probably would be?

Mr. BAKER. Yes.

Mr. PECORA. Now, these advices contained in this letter from Mr. Durrell, dated July 27, 1927, came some four months after the March, 1927, loan was floated, did they not?

Mr. BAKER. Yes.

Mr. PECORA. Were they not out of harmony with any advices you say had been received for the year prior to March, 1927, and which you say probably actuated the judgment of the company in putting out the March, 1927, loan?

Mr. BAKER. There were certainly questions raised there on the question of exactly what procedure was followed by Mr. Schoepperle in charge of these studies in analyzing those questions and getting the answers to them. Of course, I can not answer that, and Mr. Schoepperle is here, who handled all those negotiations and all that study, and he can answer that.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Mr. Schoepperle was not one of the executives of the company in March, 1927, was he?

Mr. BAKER. Oh, yes; he was. He and Mr. Byrnes. You were vice president [addressing Mr. Schoepperle]?

Mr. SCHOEPPERLE. I became a vice president in April or May, 1927, according to my recollection.

Mr. BAKER. And Mr. Byrnes.

Mr. PECORA. But you are putting emphasis on Mr. Schoepperle. Was Mr. Schoepperle a vice president at the time your company approved this loan in March, 1927?

Mr. BAKER. I do not know whether he was or not, or an assistant vice president, but Mr. Byrnes was there in charge of that negotiation and those studies, and he is prepared to discuss these things.

Mr. PECORA. But these advices embodied in this letter of July 27, 1927, from Mr. Durrell to Mr. Mitchell would be seriously at variance with any reports that your company might have had between March, 1926, and March, 1927, which prompted you to float this loan?

Mr. BAKER. And they would raise a very big question in our minds, I have no doubt, on those questions, and they would be gone into immediately by those men in that department.

Mr. PECORA. Do you recall that they were gone into and discussed with you as one of the executives at that time?

Mr. BAKER. I do not recall this specific letter.

Mr. PECORA. Do you recall the advices contained in that letter?

Mr. BAKER. Well, Mr. Pecora, what I recall are general discussions of Peru led by the officers in charge of those studies.

Mr. PECORA. Do you recall the information embodied in Mr. Durrell's letter being discussed at any time during the year 1927?

Mr. BAKER. Personally I do not remember the exact particular letter shown to me.

Mr. PECORA. Well, now, some five months after that letter was sent by Mr. Durrell, the vice president and overseas manager of the National City Bank at that time, your company participated in the flotation of the $50,000,000 Peruvian loan, did it not?

Mr. BAKER. Yes, sir.

Mr. PECORA. Do you recall upon what information or advices it concluded that the $50,000,000 loan in December, 1927, was a good risk to offer to the American investing public?

Mr. BAKER. No, I do not; but our officers in charge of that can answer that question.

Mr. PECORA. You can not answer it?

Mr. BAKER. No; I can not.

Mr. PECORA. Do you recall any advices at variance with what Mr. Durrell wrote in July, 1927, which prompted the company to get behind a $50,000,000 loan in December, 1927?

Mr. BAKER. I do not recall the specific discussions on those, Mr. Pecora; no.

Mr. PECORA. Now, that December loan of $50,000,000 was the loan with respect to which it was testified that a bribe of four hundred-odd thousand dollars was paid to the son of President Leguia? Do you recall that, Mr. Baker?

Mr. BAKER. I do not recall any such word as that used in connection with it.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Well, what word do you recall was used in connection with it? Gift, gratuity?

Mr. BAKER. Again that is a question that I knew absolutely nothing about at the time. I was not the president of the company, and it is a question with which Mr. Schoepperle is familiar and has testified before a committee here in Washington on.

Mr. PECORA. Testified about a year ago?

Mr. BAKER. And I think he can answer.

Mr. PECORA. That it was a bribe, didn't he?

Mr. BAKER. I do not think he said that, but I am not sure what he said, but he can answer that question, because he knows about it. I do not.

Mr. PECORA. Mr. Schoepperle testified that at the time of the payment of that sum of money, whether it was a bribe, a gift, a gratuity, whatever it was, he did not know of it?

Mr. BAKER. I think that is correct; yes.

Mr. PECORA. But he also testified that he found out about it about 10 days before this $50,000,000 loan was floated?

Mr. BAKER. Yes.

Mr. PECORA. Do you recall his reporting to the executives of your company about the payment of that sum of money to the son of the then President of Peru?

Mr. BAKER. I do not recall just when he mentioned it in an officers' meeting; no. I do not remember the date that he mentioned it. I do remember there was a discussion about it led by Mr. Schoepperle.

Mr. PECORA. If any such sum of money was paid to that particular individual for no apparent reason, that would not be a circumstance which would make the loan sound, would it? It would not contribute to the soundness of the loan or the risk, would it?

Mr. BAKER. Why, no; of course not.

Mr. SCHOEPPERLE. May I make an observation on that point?

Mr. PECORA. I am going to put you on the stand later and you can testify about that.

The testimony that Mr. Schoepperle gave, Mr. Baker, was not given before this committee, you know that, don't you?

Mr. BAKER. Yes.

Mr. PECORA. It was given before a subcommittee of the Senate Finance Committee?

Mr. BAKER. Yes; I know that. That is all right.

Mr. PECORA. That held its hearings under Senator Hiram Johnson's resolution authorizing the committee to make certain investigation?

Mr. BAKER. Yes; all right.

Mr. PECORA. Upon the sale of foreign bonds and securities.

In the course of your discussions with the other executive officers of the National City Co. concerning these Peruvian loans in 1927, did you have any conversation with a Mr. Dennis, connected with J. & W. Seligman & Co.?

Mr. BAKER. I did not.

Mr. PECORA. Do you recall having seen any correspondence or written communications of any kind with Mr. Dennis on the subject of these Peruvian loans?

Mr. BAKER. I do not.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Haven't you in your file a letter dated May 27, 1927, written from the Peru branch of J. & W. Seligman to Earl Bailie and J. & W. Seligman & Co.?

Mr. BAKER. Yes; here it is.

Mr. PECORA. Discussing conditions in Peru?

Mr. BAKER. May 27, 1927; yes, sir.

Mr. PECORA. Do you find anything in that report or letter which indicates a Peruvian loan at that time to have been a sound investment?

Mr. BAKER. I have not studied this. I would like to read this over completely. [Examining document.] I would have to study that completely, except——

Mr. PECORA. Well, it is not so very long. Suppose you look at it

Mr. BAKER. All right.

Mr. PECORA. Let me first ask you: Is this the first time that letter has been brought to your attention?

Mr. BAKER. It is the first time that I recall it. It undoubtedly was——

Mr. PECORA (interposing). You found it bound up in the files of your company relating to its study of the Peruvian loans, did you not?

Mr. BAKER. Yes.

Mr. PECORA. Go ahead and read it.

Mr. BAKER (perusing documents). That seems to be a general study of the situation, Mr. Pecora, in which he is expressing his views. He raises various questions, and then he speaks about the currency system, which seems to be sound, he says.

Mr. PECORA. He does not express any optimistic or enthusiastic views about Peruvian finances, does he?

Mr. BAKER. Not particularly, no.

Mr. PECORA. Now, I believe you said that this $50,000,000 loan was floated in December 1927 at 91½?

Mr. BAKER. 91½.

Mr. PECORA. What was the market value? What is the market value of those bonds at the present time, do you know?

Mr. BAKER. Five or six, I suppose—seven. Very low, almost nothing.

Mr. PECORA. Do you know that they were quoted last week—that is, on February 18, at 5½?

Mr. BAKER. I assume so.

Mr. PECORA. And that the low for this year was 4½?

(There was no response.)

Mr. PECORA. Now, have you before you a copy of the circular or prospectus that was put out by your company and the other participants or underwriters in this loan in offering these $50,000,000 worth of bonds to the American investing public?

Mr. BAKER. Yes, sir.

Mr. PECORA. Is there a statement anywhere in that circular concerning the bad-debt record of Peru for years past?

Mr. BAKER. I have not read this. I would have to read it entirely to answer that. But I do not know that there is anything.

Mr. PECORA. Just look at it so that the record will have your answer based upon an actual examination of the circular which is

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

before you. See if you find any such reference to the Peru debt record.

Mr. BAKER (perusing documents). Well, there is a complete story of the total amount of debts and all that, if you want to——

Mr. PECORA. The total amount of debts without any statement that Peru was ever in default——

Mr. BAKER (interposing). No.

Mr. PECORA. Was not informing the public of the bad-debt record of Peru, was it?

Mr. BAKER. No; it is not.

Mr. PECORA. As a matter of fact, it might mislead the public into believing that it had always met its obligations in the past, might it not?

Mr. BAKER. I don't think so.

Mr. PECORA. What was the purpose of mentioning its outstanding indebtedness without also mentioning its debt record?

Mr. BAKER. I can not answer that.

Mr. PECORA. Do you know anybody that can?

Mr. BAKER. I think my associate who did this negotiating and this study can answer it, as I said awhile ago.

Mr. PECORA. Well, now, none of your associates could have gone into this thing without unanimous approval of all the executives, including yourself, could they?

Mr. BAKER. Of course, his studies were made in his department, as I said this morning, at great length, and spending a great deal of time in detailed study, of which a synopsis was given to all of us and discussed fully in our meetings.

Mr. PECORA. In the circular that accompanied the offering of the $50,000,000 bond issue of December, 1927, there is the following statement, is there not, under the caption "General":

The Republic of Peru is the third largest country in South America, with an area of approximately 550,000 square miles——

Mr. BAKER. Just a minute.

Mr. PECORA. "It has a population estimated at 6,000,000."

Mr. BAKER. Just a minute, Mr. Pecora. I have a different circular there Oh, here is a paragraph on that. All right.

Mr. PECORA. Do you see it?

Mr. BAKER. Yes.

Mr. PECORA. "It has a population estimated at 6,000,000."

Now, as a matter of fact, when that circular was put out your company had in its files the letter dated July 27, 1927, from Mr. Durrell, its vice president and overseas manager, to Mr. Mitchell, in which, discussing the population of Peru, he said:

As I see it, there are two factors that will long retard the economic importance of Peru: First, its population of 5,500,000 is largely Indian, two-thirds of whom reside east of the Andes, and a majority consume almost no manufactured products.

Why wasn't that detailed information given in this circular along with the statement that the population of Peru was 6,000,000?

Mr. BAKER. I can not answer that.

Mr. PECORA. Did you think it would have had a bad effect on the flotation of these bonds if the advices contained in Mr. Durrell's

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

letter of July 27, 1927, had been given to the investing public through the medium of a circular?

Mr. BAKER. It might have; yes.

Mr. PECORA. You feel pretty sure it would have, don't you?

Mr. BAKER. Depending upon the character of the remainder of that population.

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

Mr. BAKER. You say, Would the public have subscribed with that statement?

Mr. PECORA. Yes.

Mr. BAKER. I doubt if they would.

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

Mr. BAKER. I doubt if they would.

Mr. PECORA. Do you know why that information was not embodied in this circular?

Mr. BAKER. I do not. We did not write the circular, but evidently we did not altogether agree with some of the things.

Mr. PECORA. You say you did not write the circular—but your name appears on it.

Mr. BAKER. Yes; it was approved by us.

Mr. PECORA. And it was approved by your company?

Mr. BAKER. That is right.

Mr. PECORA. Which makes your company just as responsible as though it had itself prepared the text of that circular?

Mr. BAKER. We were responsible for those statements, subject to those conditions; yes. We believed them to be correct.

Mr. PECORA. Do you know why this information was not given to the investing public in the circular?

Mr. BAKER. No, sir.

Mr. PECORA. Do you know upon whose judgment it was withheld from the investing public?

Mr. BAKER. No, sir.

Mr. PECORA. Do you think that it was fair to the investing public to withhold this information that your company had about Peru?

Mr. BAKER. Well, I think it is fair to present the facts in reference to Peru, as we tried to do. I do not see any occasion to go into—going over all of these long studies that have been made in which the people were not altogether in accord, and in which generally there were changes taking place, and, as some of them said, the economic trend was improving and all that. You could write, of course, a whole book on the subject, giving various people's opinions, but when we arrive at a conclusion it seems to me that a statement of the important facts connected with it is what is necessary and proper.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And that statement of important facts should have included the statement of your vice president and overseas manager in July, 1927, to the effect that "there are two factors that will long retard the economic importance of Peru. As a whole, I have no great faith in any material betterment in Peru's economic condition in the near future," and "the country's political situation is equally uncertain?" That would have been fair, would it not, to include that information?

Mr. BAKER. If further study of that convinced those in the department that that was correct.

Mr. PECORA. Have you any evidence before you that convinced you or any other official of your company at that time that Mr. Durrell's information was not correct?

Mr. BAKER. I haven't it, but as I say—said before—those in charge of this negotiation can probably answer that question.

Mr. PECORA. Were you exercising your judgment when you gave your approval to this issue, or were you just simply signing on the dotted line pursuant to somebody else's judgment—some subordinate?

Mr. BAKER. As I undertsood the facts given us by those in charge of those negotiations, I favored it.

Mr. PECORA. You do not recall what the facts were that prompted you to favor it, do you?

Mr. BAKER. No.

Mr. PECORA. You do not recall any facts that overthrow all the presumptions and implications of the written information and advices that you had in your files?

Mr. BAKER. No.

Mr. PECORA. As you sit there now, can you recall specifically why you approved this bond issue?

Mr. BAKER. Why, no, Mr. Pecora. These were discussions had over days and days. I don't remember the specific things that led up to that.

Mr. SCHOEFFERLE. If you will permit me, I think I could answer that question in a general way.

Mr. PECORA. You will be put on the stand, Mr. Schoepperle, I will examine you about this. [Laughter.]

Now, there was a third Peruvian loan floated by your company in October, 1928, was there not?

Mr. BAKER. Yes, sir.

Mr. PECORA. And what was the amount of that?

Mr. BAKER. $25,000,000.

Mr. PECORA. $25,000,000. Do you recall the facts and circumstances that persuaded you to approve the offering of those bonds to the American investing public?

Mr. BAKER. Same general discussion as we had on the others.

Mr. PECORA. You do not recall what they were?

Mr. BAKER. Not specifically.

Mr. PECORA. You do not recall now the specific information?

Mr. BAKER. No.

Mr. PECORA. Given to you that prompted you to——

Mr. BAKER. No.

Mr. PECORA. Approve the offering of those $25,000,000——

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. I do not.
Mr. PECORA. Worth of bonds?
Mr. BAKER. No; I do not.
Mr. PECORA. In October, 1928?
Mr. BAKER. No.
Mr. PECORA. What were those bonds offered at?
Mr. BAKER. Ninety-one.
Mr. PECORA. And what was the gross spread to your company under the underwriting agreement?
Mr. BAKER. Five points. That is the total, gross.
Mr. PECORA. Have you produced from the files of your company copy of a report forwarded under date of January 12, 1928, by Ralph Dalton, vice president of the Foundation Co., to Victor Schoepperle, vice president of the National City Co? [After a pause.] Have you got that?
Mr. BAKER. Yes; I have it.
Mr. PECORA. That is a photostatic copy of a report entitled "Penny Report of 1926," is it not?
Mr. BAKER. Yes; that is right.
Mr. PECORA. Does that report contain the following statement?

The present low value of Peruvian money is due primarily to the fact that the balance of international payments is unfavorable to Peru, although the commercial scales show a favorable balance, and this is apparent at a glance when one considers that metals and minerals, oils, bring into the country only a part of the real value as shown by the customhouse statistics, for the reason that the production of these articles is largely in the hands of foreign companies which sell exchange only sufficient to cover their operating costs, and many other articles leave a part of their value abroad.

Mr. BAKER. Yes, sir.
Mr. PECORA. That statement found its way into the possession and information of the National City Co. on January 12, 1928, did it not?
Mr. BAKER. Yes, sir; evidently.
Mr. PECORA. Who is Ralph Dalton, the vice president of the Foundation Co.?
Mr. BAKER. That is all I know about him.
Mr. PECORA. Did you ever hear of him before?
Mr. BAKER. I don't know him.
Mr. PECORA. There is nothing in that statement which makes Peruvian loans a good investment, is there?
Mr. BAKER. There is nothing in that statement that is particularly damaging either way or that is favorable. It is a general discussion of the situation as he sees it.
Mr. PECORA. Don't you think that a statement that—assuming the statement to be based upon facts—the "present low value of Peruvian money is due primarily to the fact that the balance of international payments is unfavorable to Peru," and that "metals and minerals, oils, bring into the country only a part of the real value as shown by the customhouse statistics, for the reason that the production of these articles is largely in the hands of foreign companies which sell exchange only sufficient to cover their operation costs, and many other articles leave a part of their value abroad"—don't you think that is an unfavorable comment on the soundness of a Peruvian loan?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. That would require a study of the whole situation that produces those conditions, which of course was done, and as to the details of that particular discussion I do not recall.

Mr. PECORA. Was a circular put out by your company and other underwriters of this loan, to the American investing public in connection with their offering of these bonds?

Mr. BAKER. Yes.

Mr. PECORA. Does the circular contain this unfavorable comment by Mr. Ralph Dalton?

Mr. BAKER. I don't know.

Mr. PECORA. Well, look at it, will you? You have a copy of it before you, haven't you?

Mr. BAKER (after examining document). I do not see anything here that relates to it particularly.

Mr. PECORA. Do you see any references in that circular to the previous bad debt record of Peru?

Mr. BAKER. No.

Mr. PECORA. Do you see anything in that circular, any references to the factors that were mentioned by Mr. Dalton in his letter to your company of July 27, 1927?

Mr. BAKER. No; I do not.

Mr. PECORA. Which caused him to feel and to say that "There are two factors that will long retard the economic importance of Peru," and "I have no great faith in any material betterment of Peru's economic condition in the near future," and that " the country's political situation is equally uncertain "? Do you?

Mr. BAKER. No.

Mr. PECORA. Do you know why those things were left out?

Mr. BAKER. No, sir.

Mr. PECORA. You would not say that the omission of these statements or that information from the circular was purely accidental, would you?

Mr. BAKER. I don't know why they were not in.

Mr. PECORA. Now, you say these bonds were sold at 91?

Mr. BAKER. Yes, sir.

Mr. PECORA. And a half—no; 91, I think.

Mr. BAKER. 91.

Mr. PECORA. Do you know what their market value is today?

Mr. BAKER. Seven or eight, I think.

Mr. PECORA. Don't you know that on February 18 of this year they were quoted at 5½, or rather at 5¼, and that the year's low has been 4⅝?

Mr. BAKER. That is no doubt correct if you have those figures.

Mr. PECORA. Is there any explanation you care to make other than you have already made, Mr. Baker, concerning the offering of these bonds to the American investing public in 1927 and 1928?

Mr. BAKER. Not if I understand you are going to ask Mr. Schoepperle about the technicalities and details of this.

Mr. PECORA. No; I am asking you now.

Mr. BAKER. No.

Mr. PECORA. If there is any explanation you would like to make.

Mr. BAKER. No, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Other than you have already made in your testimony here this morning.

Mr. BAKER. No, sir.

Mr. PECORA. Is there any other information that you can give us concerning the making of these loans to the Peruvian Government and the selling of its bonds to the American public?

Mr. BAKER. No, sir.

Mr. PECORA. I suggest we take a recess until 2.30.

The CHAIRMAN. The committee will take a recess until 2.30, when we will again meet in this room. Witnesses will appear at that time.

(Accordingly, at 12.45 o'clock p. m., a recess was taken until 2.30 o'clock p. m. of the same day.)

AFTER RECESS

The subcommittee resumed at 2 o'clock p. m. on the expiration of the recess.

The CHAIRMAN. The subcommittee will come to order. Who will you have first, Mr. Pecora?

Mr. PECORA. Mr. Baker will take the stand again, please.

The CHAIRMAN. He has already been sworn.

TESTIMONY OF HUGH B. BAKER, PRESIDENT THE NATIONAL CITY CO., NEW YORK CITY—Resumed

Mr. PECORA. Mr. Baker, do you know an organization called the Investment Bankers' Association of America?

Mr. BAKER. Yes, sir.

Mr. PECORA. Is the National City Co. a member of that organization?

Mr. BAKER. Yes, sir.

Mr. PECORA. Of whom does that organization consist, generally speaking?

Mr. BAKER. Of investment banks and dealers of the United States.

Mr. PECORA. How long has the National City Co. been a member of it?

Mr. BAKER. We were members a good many years ago for a considerable time, and then withdrew, and became members again about a year ago, perhaps, or a year and a half ago.

Mr. PECORA. When did the National City Co. withdraw?

Mr. BAKER. Three or four years previous to that.

Mr. PECORA. Do you recall the circumstances of the withdrawal?

Mr. BAKER. Yes.

Mr. PECORA. What were they?

Mr. BAKER. Principally these: Our objection was based upon the fact that the Investment Bankers' Association of America as a national association divided itself up into so-called groups. In other words, there would be a branch located in various cities of the United States, and those groups had authority to determine certain plans and programs of operation, and for us to have a representative member of that group meant that we had to give him authority to vote on the question of policy of the company as a whole, which we were unwilling to do.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Wasn't some question or issue raised at that time with regard to the unwillingness of the National City Co. to subscribe to certain obligations that the association sought to insist upon from its members?

Mr. BAKER. I think not.

Mr. PECORA. Are you sure of that?

Mr. BAKER. There were occasionally disputes, not only with us but with other members of the association, as to questions of plan of procedure, and so forth, in the offering of securities. But that was not the determining factor.

Mr. PECORA. Was any issue involving a question of ethics raised at that time which had to do with the withdrawal of the National City Co. from the association?

Mr. BAKER. I do not recall that that was the case.

Mr. PECORA. Would you say you are sure that that was not the case?

Mr. BAKER. Well, I would say I am sure that that was not the case, except that there were, as I said, discussions in reference to matters of plan of procedure at various times, not only with us but with others of the association.

Mr. PECORA. What do you understand by the expression "beating the gun" as applied to investment bankers' transactions?

Mr. BAKER. That, as I understand it, is an expression used to mean that offerings would be made prior to some stipulated time set for the offering.

Mr. PECORA. Was the ethical question of indulging in the practice known as "beating the gun" raised at the time of the withdrawal of the National City Co. from this association?

Mr. BAKER. I do not think so. I am not positive on that.

Mr. PECORA. You are not positive about it?

Mr. BAKER. No.

Mr. PECORA. Do you know who would be positive about it?

Mr. BAKER. No; I do not. I would have to check that up.

Mr. PECORA. Do you recall whether or not the National City Co. was formally accused at that time of having been guilty of this practice colloquially called "beating the gun"?

Mr. BAKER. I do not know that there was any formal accusation. I think it is fairly general among distributing houses to question the time of offering by the other.

Mr. PECORA. Do you mean by that answer that the practice of "beating the gun" was one that was generally indulged in?

Mr. BAKER. No; I do not think so.

Mr. PECORA. How was that?

Mr. BAKER. No; I do not think so. But I think where one house failed to get an order because some other house had offered it prior, would lead to the statement sometimes, frequently, that the other house had offered the issue prior to the regular time for offering.

Mr. PECORA. Was the withdrawal of your company from membership in that association 3 or 4 years ago, brought about after a conference and discussion of the matter on the part of the executive officers of the company?

Mr. BAKER. I think it was discussed. I don't remember that there was any particularly formal discussion.

Mr. PECORA. Did you take part in the discussion?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BAKER. Yes.

Mr. PECORA. Whether formal or informal?

Mr. BAKER. Yes; I took part. In fact, I think I recommended that we withdraw.

Mr. PECORA. Due to the fact that you now believe you recommended the withdrawal, can you tell us whether or not the issue of "beating the gun" was raised against your company by other members of the association?

Mr. BAKER. I think not in any specific way that I recall.

Mr. PECORA. Well, was it done in any general way?

Mr. BAKER. I have just said, Mr. Pecora, that general statements of that kind were made from time to time. But I do not know that there was any specific case brought out or mentioned.

Mr. PECORA. Do you know an organization calling itself the Institute of International Finance?

Mr. BAKER. I just know that there is such an organization, yes.

Mr. PECORA. What kind of organization is that?

Mr. BAKER. I think it is an organization principally for the study of securities generally.

Mr. PECORA. Of foreign issues?

Mr. BAKER. Foreign issues, I think, specifically.

Mr. PECORA. Principally that?

Mr. BAKER. Yes.

Mr. PECORA. When was that so-called Institute of International Finance organized?

Mr. BAKER. I don't know.

Mr. PECORA. How long has it been in existence?

Mr. BAKER. I don't know.

Mr. PECORA. Is the National City Co. a member of it or a contributor to it?

Mr. BAKER. May I ask Mr. Schoepperle? I think we are, but he is more familiar with that than I am.

Mr. PECORA. All right.

Mr. SCHOEPPERLE. As members of the I. B. A., out of whose budget there is appropriated a sum of money which supports the institute, which is supposed to be a joint organization, under the auspices of New York University and the I. B. A.

Mr. BAKER. In that way we contribute to the institute, through an appropriation made by the Investment Bankers Association of America.

Mr. PECORA. What are the methods by which the Institute of International Finance functions?

Mr. BAKER. I would have to refer that to Mr. Schoepperle.

Mr. PECORA. Don't you know?

Mr. BAKER. He is in direct touch with it all the time.

Mr. PECORA. Who is the director of that institute?

Mr. BAKER. Dean Madden, Mr. Schoepperle tells me.

Mr. PECORA. He is the dean of what institution of learning?

Mr. BAKER. Of New York University.

Mr. PECORA. How is that institute supported—by the Investment Bankers' Association of America?

Mr. BAKER. Well, there is a contribution made to its support by the Investment Bankers' Association of America. There may be other sources of income that I am not familiar with.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Are you individually a member of the executive committee of the Investment Bankers' Association of America?

Mr. BAKER. No, sir; I am not.

Mr. PECORA. Are you familiar with the operations of the Institute of International Finance at all?

Mr. BAKER. Not at all, really.

Mr. PECORA. Do you know of any instances where persons connected with the institute have passed judgments or expressed opinions on foreign issues?

Mr. BAKER. Well, I am not sufficiently familiar with that, Mr. Pecora, to answer. I think Mr. Schoepperle, who is in direct contact with it, knows about that.

Mr. PECORA. Are you a member of the executive committee or foreign securities committee of the Investment Bankers' Association of America?

Mr. BAKER. Yes; I am a member of that committee.

Mr. PECORA. Were you a member of that committee during the year 1932?

Mr. BAKER. Yes; I think so. I am not sure whether I was during the entire year or not, but certainly for a portion of that year.

Mr. PECORA. Does the National City Co. subscribe to their service?

Mr. BAKER. I think so, yes.

Mr. PECORA. To what extent?

Mr. BAKER. I don't know.

Mr. PECORA. Do you know of instances where opinions that have been prepared after examination and survey of the facts by members of the Institute of International Finance, have been given to the Investment Bankers' Association of America, or to any of its members, and have thereafter been revised by banking houses or investment bankers who are members of the association?

Mr. BAKER. No; I don't know.

Mr. PECORA. By the way, Mr. Baker, have you here the so-called prospectus file of your company with regard to Peruvian loans? Perhaps Mr. Schoepperle can help you answer that.

Mr. SCHOEPPERLE. I do not think we have anything called a prospectus file, although we may. Are you referring to a file of our prospectuses on Peru?

Mr. PECORA. Yes, exactly.

Mr. SCHOEPPERLE. Well, I can readily make one up for you.

Mr. PECORA. Have you a file that contains them?

Mr. SCHOEPPERLE. I think I have the whole business here. I have not a file that contains them, or I do not believe so.

Mr. BAKER. Is this what you want, Mr. Pecora?

Mr. SCHOEPPERLE. If you have such a file, Mr. Pecora, I will be glad to identify it for the purposes of the inquiry.

Mr. PECORA. You have a file, as I understand, containing all prospectuses in connection with Peruvian loans, and in that file are contained letters submitting the prospectuses for the consideration of the company.

Mr. SCHOEPPERLE. If you will permit me I will be very glad to have my assistant go back and look in the case of files and see if he can find anything which corresponds to that description.

Mr. PECORA. Ask him to look for a letter from some member of the Institute of International Finance with respect to one of three

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Peruvian loans that were the subject of testimony at this morning's hearing, and a reply or replies to that letter from officers of your company.

Mr. SCHOEPPERLE. All right.

Mr. PECORA. Now, Mr. Baker, among other purposes of the Institute of International Finance, do you recall that there was included the work of preparing articles to be published in magazines and other periodicals?

Mr. BAKER. I have understood so, but I am not familiar with any of the details of it.

Mr. PECORA. And also the preparation of speeches to be broadcast over the radio?

Mr. BAKER. I have heard that mentioned, but I do not know the fact.

Mr. PECORA. Did you ever see the report made to the members of the executive committee—the annual report of the director of the Institute of International Finance—in which, among other things, he stated as follows:

> It is obvious that the director and the assistant director, under the customs of academic freedom, can express themselves more completely as individuals than they may in their official capacities as representatives of the institute.

Mr. BAKER. No; I don't remember having seen that. If I had seen it I would have sent it directly to the department in charge.

Mr. PECORA. What would that language convey to you concerning the freedom of action of the director and the assistant director of the Institute of International Finance?

Mr. BAKER. May I read it again?

Mr. PECORA. Yes; the portion I have underlined.

Mr. BAKER. Well, I hardly know, Mr. Pecora, what he has in mind in that statement, unless they were stating that they could do so in expressing their own views aside from the institute, without consulting statistics, and so forth, that might be in the Institute.

The CHAIRMAN. Speak a little louder, please.

Mr. BAKER. I beg pardon, Mr. Chairman. I have not seen that statement before, Mr. Pecora, and I do not know just what they meant by that.

Mr. PECORA. Well, I understand this is taken from their annual report to the executive committee for the past year.

Mr. BAKER. Yes.

Mr. PECORA. Wasn't that ever brought to your notice or attention?

Mr. BAKER. It may have been given to me, and if so I would have immediately passed it over, as I say, to the department in our organization in direct charge, or directly interested in that matter.

Mr. PECORA. Does it indicate to you that the director and the assistant director of this institute felt that their freedom to express their opinions publicly in their capacities as director and assistant director, respectively, of this institute, was more or less trammeled?

Mr. BAKER. I do not think so. I can not imagine so, because, certainly, they would not have retained those positions if they felt that they could not express their conclusions as they arrived at them.

Mr. PECORA. Well, what other meaning could possibly be attached to those words?

Mr. BAKER. I do not know.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. They say here:

It is obvious that the director and the assistant director, under the customs of academic freedom, can express themselves more completely as individuals than they may in their official capacities as representatives of the institute.

Do you mean that they were free to express their opinions without reserve in academic cloisters, while they were not as the official representatives of the institute?

Mr. BAKER. I am sure that I don't know what they had in mind in making that statement. I have not the slightest idea, and have never seen the statement before, that I can recall.

Mr. PECORA. Were not the pronouncements of this institute of interest to you as head of the National City Co., which was one of the members of the Investment Bankers' Association of America, which in turn helped to support this institute?

Mr. BAKER. They were; but, as I say, if they came to me directly they would go to the department having that in charge for analysis.

Mr. PECORA. That is, without any perusal of their reports by you?

Mr. BAKER. Very likely; yes.

Mr. PECORA. Well, in that way, how did you think you could exercise a well-informed judgment on matters of policy for your company in the putting out of foreign issues?

Mr. BAKER. If that message, or any other statement which they made, contained any information that should be called to my attention it would have been done by the department that studied it.

Mr. PECORA. Then, it was left to the judgment of the subordinate officers of the company to call these things to your attention, although in the first instance the communication was presented to you.

Mr. BAKER. It would have been left to the vice president in charge of that department.

Mr. PECORA. And this particular portion of the report was never called to your attention so far as you can recall?

Mr. BAKER. Not that I recall. I have never seen it, so far as I can recall.

Mr. PECORA. Would you approve of the implications of this statement?

Mr. BAKER. Well, that depends upon what they are.

Mr. PECORA. Is there any doubt in your mind as to what they are?

Mr. BAKER. I say again, I haven't any idea what the professor had in mind, and I should think the only way I could determine that would be to ask him. I don't know what it was.

Mr. PECORA. He has already expressed himself in the words I have called to your attention. Suppose you read them again and see what meaning you attach to them.

Mr. BAKER. I read it, and I told you I don't know what he meant.

Mr. PECORA. You don't know what that language means?

Mr. BAKER. I don't know what he meant.

Mr. PECORA. Is there any word in that extract the meaning of which you do not understand?

Mr. BAKER. I think not.

Mr. PECORA. The words are all simple enough?

Mr. BAKER. Yes.

Mr. PECORA. The meaning is obvious, isn't it?

Mr. BAKER. Yes; I suppose so.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Why are you unable to understand what is meant by that phraseology then?

Mr. BAKER. Well, I don't know what the gentleman had in mind when he wrote that particular statement.

Mr. PECORA. Well, he had in mind exactly what he has publicly charged in that statement, hadn't he?

Mr. BAKER. I assume he had.

Mr. PECORA. And those words are meaningless to you?

Mr. BAKER. Well, they are meaningless if you ask me to interpret what was in his mind when he wrote it. I can not do that.

Mr. PECORA. Do you think the English used there is so involved that the author did not make himself clear?

Mr. BAKER. Well, I don't understand just what you are trying to get me to answer.

Mr. PECORA. I am trying to find out if you attach any meaning at all to that sentence, or if those words are merely a meaningless jumble to you.

Mr. BAKER. Well, they do not seem to particularly convey anything to me. I don't know what they meant.

Mr. PECORA. Didn't this statement mean specifically that the director and the assistant director of the institute felt that they had less freedom to express themselves in their official capacities as representatives of the institute, than they had as professors in their institution of learning?

Mr. BAKER. That might be implied, but I can not imagine those gentlemen retaining those positions if they felt they were not free to express their views.

Mr. PECORA. Now, the institute is supposed to function as an independent fact-finding body, with respect to foreign issues, is it not?

Mr. BAKER. I think so; yes, sir.

Mr. PECORA. And yet wasn't it the custom of the director or the assistant director of the institute to send in advance of publication a draft of its views to the banking houses interested in the particular issue in order that they might express their views about it?

Mr. BAKER. I am not sure about that. But I think that is probably correct. If it is correct our vice president in charge of foreign issues would know about that and can answer that question. Personally, I have never seen a suggested article that is to appear prior to its appearance.

Mr. PECORA. You would not say, though, that the practice alluded to in my former question was not the practice?

Mr. BAKER. Not at all. It probably is.

Mr. PECORA. Did the Investment Bankers' Association of America by that process seek to trammel and fetter or qualify the otherwise independent judgment of the members of the institute?

Mr. BAKER. That is not my understanding of it at all. I think it was merely to assist in the presentation of the facts, that if there were additional facts, information, or figures, to supply them. That is my idea. I think that is what it was.

Mr. PECORA. Now, from the file that I called for a few minutes ago and which has just been turned over to me by Mr. Schoepperle of your company, I find the following letter on the letterhead of the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Institute of International Finance, conducted by the Investment Bankers' Association of America in cooperation with New York University, dated August 11, 1928, reading as follows:

Mr. VICTOR SCHOEPPERLE,
New York City.

DEAR MR. SCHOEPPERLE: We are inclosing a preliminary draft of the proposed bulletin on the credit position of Peru. We shall greatly appreciate it if you will be good enough to review this draft and return it at your convenience. As soon as we receive the draft with your suggestions the bulletin will be sent to press.

Sincerely yours,

JOHN T. MADDEN, *Director.*

Does that letter indicate that the director was following the practice I alluded to a moment ago, and that it was the general practice?

Mr. BAKER. Of conferring with houses generally interested in those issues?

Mr. PECORA. Of submitting their independent views before publication to the investment banking house interested in the issue.

Mr. BAKER. Yes; I think that would.

Mr. PECORA. And of not presenting them to the public until after they had been revised by the house of issue or the offering house.

Mr. BAKER. Well, I do not know that it means at all that it has been revised. It has been looked over I suppose to see if there are any errors or suggestions that could be made. I do not know that it necessarily means that it has been revised.

Mr. PECORA. Well, for instance, the concluding paragraph says:

"As soon as we receive the draft with your suggestions the bulletin will be sent to the press."

Mr. BAKER. Yes; that is all right.

Mr. PECORA. In this same file appears a copy of the following letter, which apparently is a reply to Dean Madden's letter of August 11, 1928, that I have just read. I will read this letter into the record:

AUGUST 15, 1928.

DEAN JOHN T. MADDEN,
New York.

DEAR DOCTOR MADDEN: We have read over with great interest the preliminary draft of the proposed bulletin on the credit position of Peru which you sent us with your letter of August 11. We are returning this draft, together with memorandum which we trust may be of some help to you.

Very truly yours,

VICTOR SCHOEPPERLE, *Vice President.*

Does that letter also indicate that that was the practice?

Mr. BAKER. That we made suggestions?

Mr. PECORA. Yes.

Mr. BAKER. Yes.

Mr. PECORA. And that no bulletins were issued by the institute to the public until after they had been submitted for approval and suggestions or revision to the issuing house or the offering house.

Mr. BAKER. Well, I cannot assume that. I do not know. As far as I know it may be the universal practice that it is submitted to the house interested, but I do not know about that.

Mr. PECORA. That is all for this witness, Mr. Chairman. Mr. Baker, you will remain subject to further call.

The CHAIRMAN. All right, Mr. Baker.

Mr. PECORA. Mr. Schoepperle, will you resume the stand, please?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

TESTIMONY OF VICTOR SCHOEPPERLE, SHORT HILLS, MELBURN TOWNSHIP, ESSEX COUNTY, N. J., VICE PRESIDENT NATIONAL CITY CO.—Resumed

Mr. PECORA. Mr. Schoepperle, have you before you copies of the prospectus of the National City Co. and other underwriters offering the $15,000,000 bond issue of the Republic of Peru in March, 1927, that was referred to in the examination of Mr. Baker today?

Mr. SCHOEPPERLE. I have.

Mr. PECORA. Have you also the prospectus issued by your company and the other underwriters offering to the public in December, 1927, the $50,000,000 bond issue of the Republic of Peru?

Mr. SCHOEPPERLE. I have.

Mr. PECORA. And also the circular relating to the issue in October 1928 of the $25,000,000 bond issue of the Republic of Peru?

Mr. SCHOEPPERLE. I have.

Mr. PECORA. Now, take those three prospectuses in their chronological order: The first prospectus purports to set forth the revenues of the Government of Peru for the year 1924, does it not?

Mr. SCHOEPPERLE. 1924 to 1926 inclusive; yes, sir.

Mr. PECORA. I am confining myself first to the year 1924.

Mr. SCHOEPPERLE. All right.

Mr. PECORA. What is the statement in that first prospectus as to what the revenues were in the year 1924 of the Government of Peru?

Mr. SCHOEPPERLE. This statement in this prospectus, signed by the Minister of Finance of the Republic of Peru, reads as follows: The revenue of the——

Mr. PECORA (interposing). Just give the figure for the revenue in the year 1924.

Mr. SCHOEPPERLE. It is $3,931,594.

Mr. PECORA. $3,000,000, did you say?

Mr. SCHOEPPERLE. It is $3,931,594.

Mr. PECORA. No. You are reading the revenues from the pledged securities only, aren't you?

Mr. SCHOEPPERLE. That is right.

Mr. PECORA. Under the caption "Currency and Finances" what were the revenues set forth in that prospectus, as the entire revenues of the Government of Peru for the year 1924?

Mr. SCHOEPPERLE. For 1924—let me see——

Mr. PECORA. It is right there.

Mr. SCHOEPPERLE. The thing is put in doubled, 1924 and 1925 together.

Mr. PECORA. Give us first the year 1924.

Mr. SCHOEPPERLE. It is $33,905,805.

Mr. PECORA. Now, will you take up the second prospectus, the one relating to the $50,000,000 loan. Have you that?

Mr. SCHOEPPERLE. Yes.

Mr. PECORA. Now, under the caption "Revenues and Expenditures" what statement is contained there as to the total revenues of the Government of Peru for the year 1924?

Mr. SCHOEPPERLE. The statement here is $38,655,800.

Mr. PECORA. That is a difference of over $5,000,000, isn't it?

Mr. SCHOEPPERLE. That is true.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Now, will you look at the third prospectus, the one relating to the $25,000,000 bond issue, of October, 1928. Have you that there?

Mr. SCHOEPPERLE. Yes, sir; here it is.

Mr. PECORA. What is stated there to be the total revenues of the Government of Peru for the year 1924?

Mr. SCHOEPPERLE. It is $37,691,325.

Mr. PECORA. Now, you have three different amounts, haven't you?

Mr. SCHOEPPERLE. That is right.

Mr. PECORA. Was that noticed by anybody in the foreign department of the National City Co.?

Mr. SCHOEPPERLE. It did not need to be noticed. There was a perfectly clear explanation in the face of the prospectus, in relation to those discrepancies.

Mr. PECORA. Isn't it a fact that in each of those three prospectuses a different sum is stated as the total revenues of the Government of Peru for the year 1924?

Mr. SCHOEPPERLE. It is a fact, but you must remember that the revenues of the Government of Peru are received by the Government in Peruvian pounds, and the Peruvian pound has a fluctuating value when transferred into dollars, which depends upon the value of the currency at the time the calculation is made.

Mr. PECORA. Is that explanation included in any one or all of the prospectuses?

Mr. SCHOEPPERLE. Yes, sir; in all three of these prospectuses.

Mr. PECORA. Where?

Mr. SCHOEPPERLE. In the first prospectus, last paragraph, it says "All conversions herein are made at $3.68 to the Peruvian pound." In the second prospectus it says "All conversions are made at the rate of $3.94 per Peruvian pound." And the last prospectus says "All conversions are made at the rate of $3.83 per Peruvian pound." And it points out that the present value of the Peruvian pound is $4. I think, Mr. Pecora, if you will sharpen up a pencil we can determine that that is about the explanation.

Mr. PECORA. That is about the explanation?

Mr. SCHOEPPERLE. Yes, sir.

Mr. PECORA. Now, Mr. Schoepperle, you were present this morning at the examination of Mr. Baker with respect to those three loans, weren't you?

Mr. SCHOEPPERLE. That is true.

Mr. PECORA. And you heard all his testimony?

Mr. SCHOEPPERLE. Yes, sir.

Mr. PECORA. You were for a number of years the so-called South American expert of the National City Co., weren't you?

Mr. SCHOEPPERLE. I never qualified myself as an expert, although possibly some people may have considered me an expert.

Mr. PECORA. Now, Mr. Schoepperle, before I come to that I am going back to those three different figures set forth in those three prospectuses. Don't those fluctuations in the value of the Peruvian pound indicate the instability of their currency?

Mr. SCHOEPPERLE. They do. They represent instability in the Peruvian currency, and I should like to point out, in connection with those Peruvian negotiations and the work which we did as one of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the bankers in connection with the Peruvian loans, that one of the chief points for correction in the program for the reconstitution of Peruvian finance, was to get the Peruvian pound stabilized so that it would not be fluctuating from month to month and from year to year.

Mr. PECORA. So that one of the chief points that actuated the National City Co. in putting out these three loans aggregating $90,000,000 was just that, was it?

Mr. SCHOEPPERLE. It was not the chief point.

Mr. PECORA. I mean in the years 1927 and 1928?

Mr. SCHOEPPERLE. It was not the chief point.

Mr. PECORA. Well, was it one of them?

Mr. SCHOEPPERLE. It was a collateral point, and a point of very, very great importance.

Mr. PECORA. Was that one of the important collateral points at least, to stabilize the currency of Peru?

Mr. SCHOEPPERLE. In our efforts to get Peru straightened out, that certainly was one of the collateral objectives.

Mr. PECORA. And in your efforts to get Peru straightened out you sold $90,000,000 of Peruvian bonds to the American public?

Mr. SCHOEPPERLE. I should like, if you will permit me——

Mr. PECORA (interposing). Is that right? You can answer that yes or no.

Mr. SCHOEPPERLE. I would say in the process of getting the Peruvian financial situation straightened out we sold those bonds; yes.

Mr. PECORA. Now, let us go to the first loan, of $15,000,000, in March of 1927.

Mr. SCHOEPPERLE. All right.

Mr. PECORA. Was not a portion of the proceeds of that loan devoted to the retirement of existing indebtedness?

Mr. SCHOEPPERLE. I believe it was; yes, sir. That was one of them.

Mr. PECORA. Who held that indebtedness?

Mr. SCHOEPPERLE. Well, you understand, Mr. Pecora, that there were five issues of Peruvian bonds outstanding in the American market, which had been sold in the market during the period 1921 to 1923 by investment houses other than ourselves.

Mr. PECORA. Did the National City Co. have anything to do with those five issues between 1921 and 1923?

Mr. SCHOEPPERLE. No, sir.

Mr. PECORA. You know from the records and files of your company with regard to the Peruvian studies made during those years, or the greater part of those specific years, that the advices given to the company by its agents and officers, including yourself, were unfavorable to Peruvian loans, do you not?

Mr. SCHOEPPERLE. I most decidedly do.

Mr. PECORA. And then in 1927, knowing that one of the objects of the $15,000,000 flotation was to retire some indebtedness that had been put out during those years, did you sanction this loan or issue of $15,000,000 of bonds to the American public?

Mr. SCHOEPPERLE. We joined the firm of J. & W. Seligman & Co., who had arranged the negotiations for this loan, knowing what the proceedings were; yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Did you advise your company to participate in that offering?

Mr. SCHOEPPERLE. I personally?

Mr. PECORA. Yes.

Mr. SCHOEPPERLE. You can see from——

Mr. PECORA (interposing). No. Did you? Answer yes or no.

Mr. SCHOEPPERLE. I want to put in the record——

Mr. PECORA (interposing). Well, first, put in your answer to that question.

Mr. SCHOEPPERLE. Yes, sir; I did.

Mr. PECORA. All right.

Mr. SCHOEPPERLE. I should like in that connection to make a collateral statement.

Mr. PECORA. Do you want to explain why you did it?

Mr. SCHOEPPERLE. I certainly do. I think we all want to know how that happened.

Mr. PECORA. But first, you specifically advised the company to do it?

Mr. SCHOEPPERLE. I most certainly did.

Mr. PECORA. In what form were your advices to the company submitted, in writing or orally?

Mr. SCHOEPPERLE. Orally.

Mr. PECORA. To whom?

Mr. SCHOEPPERLE. I just mentioned the fact that there is a memorandum in the files, which is the only thing I can find that in any way indicates the position I took at that time. And I have asked, or suggested, that I might refer to that memorandum, and one paragraph thereof.

Mr. PECORA. To whom did you make your suggestions or recommendations, was my question.

Mr. SCHOEPPERLE. I concurred in the action that was being taken at the time when the subject was under discussion between Mr. Byrnes and the firm J. and W. Seligman & Co. I will take the responsibility for having reported my views to the executives, although I do not remember the occasion on which I may have made such a report.

Mr. PECORA. Do you recall when you made that oral report about the issue?

Mr. SCHOEPPERLE. I should say that was about February 11, 1927, or a little before that.

Mr. PECORA. That was about a month or so before the actual offering to the public of those $15,000,000 of bonds, wasn't it?

Mr. SCHOEPPERLE. Yes.

Mr. PECORA. And you were the author of the memorandum spread upon the record from the files of your company this morning, reading as follows:

> Peru: Bad debt record, adverse moral and political risk, bad internal debt situation, trade situation about as satisfactory as that of Chile in the past three years. Natural resources more varied. On economic showing Peru should go ahead rapidly within the next 10 years.

Mr. SCHOEPPERLE. That is perfectly true.

Mr. PECORA. What information did you have subsequent to the filing by you of that memorandum regarding Peru as having a bad

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

debt record and as being an adverse moral and political risk, with a bad internal debt situation, which caused you in February of 1927 or thereabouts to recommend to your company participation in this $15,000,000 loan?

Mr. SCHOEPPERLE. A great many things had happened in the meantime.

Mr. PECORA. When did they begin to happen?

Mr. SCHOEPPERLE. They began to happen in February, 1925, which is the date of a memorandum from which you quoted in part this morning, signed by Mr. E. A. Kercher.

Mr. PECORA. Yes. What happened then and thereafter?

Mr. SCHOEPPERLE. I am merely pointing out that in that memorandum there were—I would like to quote that if you are interested—some aspects of the Peruvian situation which were in some measure favorable to the progress that was being made by the Republic of Peru at that time.

Mr. PECORA. What are they?

Mr. SCHOEPPERLE. I will have to read them.

Mr. PECORA. Go ahead.

Mr. SCHOEPPERLE. This is from the same memorandum quoted this morning, February 16, 1925, E. A. Kercher. It states, in part:

Under the competent leadership of President Leguia the Republic has made remarkable progress and appears to have entered upon an era of unusual and permanent prosperity.

Mr. PECORA. "Unusual and permanent prosperity," did you say?

Mr. SCHOEPPERLE. That is what it says.

Mr. PECORA. All right.

Mr. SCHOEPPERLE (reading):

The more important achievements of the Leguia administration during the last five years include—

1. Establishment of a central reserve bank.
2. Revision and improvement of the budget system.
3. Reorganization of customs department with American assistance.
4. Reorganization of educational system.
5. Placing experts from foreign nations in charge of several administrative departments.
6. Placing sanitation services under direction of American experts.
7. Contracting with American firms for construction of extensive sanitary works, modern roads, etc.
8. Marked progress in solving vital problems of irrigation, colonization, railroad construction, road building, and the development of water power, agriculture, and the mining and cattle industries.

Under President Leguia progress has been made in settling disputes with neighboring States. A treaty has been signed with Ecuador, while the Tacna-Arica dispute is now being arbitrated under American supervision. The trouble with Colombia is also well along toward an amicable solution.

FOREIGN CAPITAL INVESTMENTS

Because of its vast natural wealth, developed and undeveloped, the improvement in its national finances and the present policy of developing natural resources with the aid of foreign capital, Peru is rapidly assuming increasing interest in the eyes of American investors. For generations the country has been a favorite field for the investment of European capital.

And so on, and so forth.

Mr. PECORA. So on and so forth. Did that overcome the implication of this statement in the report——

Mr. SCHOEPPERLE (interposing). You notice there——

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Wait a minute. How did you know what statement I was going to read?

Mr. SCHOEPPERLE. Excuse me.

Mr. PECORA. You were ready to say it overcame any implication, weren't you?

Mr. SCHOEPPERLE. I was ready to say that that had not influenced my previous judgment on the Peruvian situation.

Mr. PECORA. What was your previous judgment on the Peruvian situation?

Mr. SCHOEPPERLE. It is in the record.

Mr. PECORA. What was it? Tell us now.

Mr. SCHOEPPERLE. My previous judgment on the Peru situation was that Peru was an unsatisfactory political and moral risk, with a bad debt record, as you have alread quoted from my statement.

Mr. PECORA. And what caused you to revise your opinion to that effect and to recommend in Febrnary, 1927, to your company its participation in this $15,000,000 loan?

Mr. SCHOEPPERLE. I have stated that a number of things did happen in that period, and I have only been able to cite one thus far.

Mr. PECORA. Is that the one you have cited, the one you have just read from?

Mr. SCHOEPPERLE. That I just cited I said did not influence my judgment particularly.

Mr. PECORA. Well, then, give us something that did influence your judgment.

Mr. SCHOEPPERLE. Here is something that I believe must have influenced my judgment: This morning I think you read from a letter dated December 3, 1925, from the manager of the——

Mr. PECORA (interposing). From Mr. Calvin to Mr. Byrnes; yes. What was it in that letter or memorandum of Mr. Calvin to Mr. Byrnes that influenced your prior judgment, that Peru was a bad moral and political risk?

Mr. SCHOEPPERLE. You put that letter in the record this morning, and without going back to it I simply refer to it to say that the general terms of that letter were not altogether adverse to Peruvian credit. Nevertheless, I do not think it——

Mr. PECORA (interposing). Was it favorable to Peruvian credit altogether?

Mr. SCHOEPPERLE. Not altogether. Only in part.

Mr. PECORA. Now, tell us what caused you to revise the judgment that you had had about Peru being a bad moral and political risk.

Mr. SCHOEPPERLE. I just want to state that I do not think even that had any material influence on my judgment.

Mr. PECORA. Then why did you mention it?

Mr. SCHOEPPERLE. Because I think nevertheless it is a fact that should be taken into account, that in these excerpts that were put into the record this morning we ought to have perhaps the full record rather than that part of it that you had.

Mr. PECORA. I am trying to get now from you the things——

Mr. SCHOEPPERLE. All right.

Mr. PECORA. That influenced your judgment, and so far you have given us the things that did not influence your prior judgment that Peru was a bad moral and political risk.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SCHOEPPERLE. All right. Now, I come to the things that did influence my judgment, and I remember very distinctly that on July 13, 1927, Mr. Calvin wrote a letter to Mr. R. M. Byrnes in which he says that "the tobacco loans under way"—that "the Rothschild people in London are after this tobacco loan"——

Mr. PECORA. Now, just a moment. You expressed your recommendation in favor of the March 1927 loan. You certainly could not have based any recommendation in favor of that loan upon something that developed in July 1927, could you?

Mr. SCHOEPPERLE. Quite right.

Mr. PECORA. Well, now, please answer the question with respect to the things that caused you, prior to March 1927, to recommend to your company participation in that $15,000,000 loan, in view of your prior opinion that Peru was a bad moral and political risk.

Mr. SCHOEPPERLE. We have already referred to a memorandum written and signed by me as assistant vice president, dated February 14, 1927. That memorandum details arrangements which were made in conversations with J. and W. Seligman & Co. between officers of the City Co. and members of that firm concerning this tobacco loan. I remember distinctly that I came back from Europe on or about February 11, 1927. This is the first time my name appears in the files of the City Co. for that year.

Evidently I sat in a discussion of this whole question, those being present being Mr. Byrnes and Messrs. Strauss, senior partner of J. and W. Seligman & Co., Mr. White, and Mr. Breck. The last paragraph of that memorandum:

> Lastly, it is understood that the fundamental consideration underlying our decision to appear in this business is the expectation that we eventually shall take an active interest in Peruvian financing on a major scale, anticipating, as we do, some large-scale operations which will be necessary for refunding as well as other government purposes.

Mr. PECORA. Please do not put that away. I want to see the entire memorandum.

Mr. SCHOEPPERLE. Yes, sir; with pleasure [handing document to Mr. Pecora]. Now, let me tell you what happened at that time .

(There was a pause.)

Mr. PECORA. Is the concluding paragraph of this memorandum signed by you under date of February 11, 1927, the most important consideration that was pointed out by you in this memorandum?

Mr. SCHOEPPERLE. By no means.

Mr. PECORA. The reason I asked that is because it is the only portion of the memorandum which you quoted in full.

Mr. SCHOEPPERLE. That is right.

Mr. PECORA. And I thought you quoted from it because you considered it the most important element.

Mr. SCHOEPPERLE. By no means. But it is important for the purposes of this discussion, very important for the purposes of this discussion, because it refreshes my memory on the situation that existed at that time.

Mr. PECORA. Yes. Now go ahead.

Mr. SCHOEPPERLE. I knew and my associates knew that Peru had an unsatisfactory debt record. We felt that Peru was not a good moral risk. There was evidence, however, that under the administration of President Leguia from 1918 or 1919 to 1927 there had

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

been great progress made in the constructive development of the Republic, its economics, its financial arrangements, and we had the information from Mr. Calvin that he thought that the position warranted our serious consideration of this business.

Now, we never would have considered that business for one minute except as we were promised and assured that the President in his wish to complete his financial and economic reconstruction of the country, which had been in process for a period of 10 years, wished to cooperate with some major banking interests with a view to consolidation of his entire external debt, which had been, as said this morning, issued piecemeal; wished to effect a stabilization of his currency, which he felt sure he could do, because the Reserve Bank of Peru had a gold reserve then of about 88 per cent as against its outstanding currency; wished to effect the stabilization of the Budget; wished to embark upon a public works program which had been in process for a period of four or five years, and which had been financed by these various five issues of bonds which had previously, during 1921 to 1927, been floated in the New York market.

The President was pointing out to the bankers that in his desire to complete this financial program it would be necessary to work in very close cooperation with the banking group and that with their assistance he was prepared to complete the work that he had been engaged in for the past 10 years. He felt that a constructive piece of work could be done. He was willing to leave this piecemeal financing that he had formerly been in. He wanted to effect the consolidation. And it was only, as we thought, that we could embark on a program that would clear the financial position in Peru, stabilize the currency, establish a balanced condition in his budget, help him carry out the public works program already under way, which was showing increased taxing power and increased public revenues—it was only in that way that we were willing to embark upon the financing of Peru, and it was on the President's assurance that we be given such an opportuinty that we went into that business.

Mr. PECORA. So that your judgment, reached in February, 1927, or thereabouts, that Peru, theretofore regarded by you as a bad risk, was a good one, was more or less dependent upon the continuance in office of President Leguia, wasnt' it?

Mr. SCHOEPPERLE. No, I don't think so, Mr. Pecora. I think that consideration was very important, that Leguia, the strong man of Peru—and by the way, he was constitutionally elected and was holding his office upon a constitutional basis—the continuance of Leguia and his program—and he assured us when the question came up about his—the question of his continuance in office, that there were other constructive elements in that community that could be depended on to carry out a constructive program; that it did not hinge entirely on his existence. But it did have an important bearing, of course, on our hope for getting, with the cooperation of the President of the Republic, a proper program that would put Peru's financing on a sound basis.

Mr. PECORA. And it was largely on the basis of those considerations that you recommended offering to the public this loan of $15,000,000?

Mr. SCHOEPPERLE. The loan of $15,000,000 was a secured loan, secured on the tobacco monopoly of Peru.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. It is a loan that has not been paid.

Mr. SCHOEPPERLE. That is perfectly true.

Mr. PECORA. That shows how well it was secured, does it not?

Mr. SCHOEPPERLE. The loan went into default subsequently.

Mr. PECORA. I believe you said this morning it was some time between December 5, 1925, and March, 1927, that you wrote that memorandum?

Mr. SCHOEPPERLE. That is right.

Mr. PECORA. It refers to Peru as having a bad debt record and as being an adverse moral and political risk and as having a bad internal debt situation?

Mr. SCHOEPPERLE. Yes, sir. That was sometime between 1925 and 1927.

Mr. PECORA. Did this hope and expectation, based more or less on the continuation of President Leguia's health, life, and government, remove the bad-debt record which Peru had?

Mr. SCHOEPPERLE. It certainly did not.

Mr. PECORA. Did it remove the adverse moral and political risk that Peru had been, between December, 1925, and February, 1927?

Mr. SCHOEPPERLE. I don't think so.

Mr. PECORA. Did it make the bad internal debt situation any better?

Mr. SCHOEPPERLE. Well, this program that we embarked on made the bad internal debt situation very much better; yes, sir.

Mr. PECORA. But as it turned out, it has made it much worse, has it not?

Mr. SCHOEPPERLE. I beg your pardon?

Mr. PECORA. As it turned out, it is much worse than it was even then, is it not?

Mr. SCHOEPPERLE. I can not go along with you on that.

Mr. PECORA. Do you think it was better then than it is now, or do you think it was worse then than it is now? Which is it?

Mr. SCHOEPPERLE. I am simply saying this, that what was done in Peru improved the situation for the Peruvian Government very considerably. And the position in Peru now is bad and worse than it was when Leguia was president, because the present government is a revolutionary government.

Mr. PECORA. Give us some definite data or official records or figures, will you, Mr. Schoepperle, which show the extent of improvement that you say took place? That is, between December, 1925, and February, 1927?

Mr. SCHOEPPERLE. I have already testified the basis on which I joined in the undertaking to do the tobacco loan under the leadership of Seligman.

Mr. PECORA. Why do you continue to say "under the leadership of Seligman"? Were you following in their wake or were you parallel with them?

Mr. SCHOEPPERLE. Well, unfortunately, in the case of the tobacco loan we were following in their wake; yes, sir.

Mr. PECORA. Do you mean that you adopted their judgment instead of your own independent judgment in participating the loan?

Mr. SCHOEPPERLE. No; I don't mean that. I am referring to a technical term that is used in Wall Street when we speak of the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

"leadership of a house" in a given piece of business. We mean by that that they carry the negotiations.

Mr. PECORA. But your company made itself fully cognizant of all the internal conditions in Peru before it participated, did it not?

Mr. SCHOEPPERLE. That is true. You can see from our files that we have a great deal of information.

Mr. PECORA. You had a great deal of adverse information, didn't you?

Mr. SCHOEPPERLE. That is true.

Mr. PECORA. Mr. Schoepperle, did you recommend to your company its participation in the flotation of the $50,000,000 loan in December, 1927?

Mr. SCHOEPPERLE. I was in accord with the judgment of the institution on that point.

Mr. PECORA. What institution do you mean now?

Mr. SCHOEPPERLE. The judgment of the officers of the National City Co. on that point. And their reasons——

Mr. PECORA (interposing). Mr. Baker this morning apparently had no judgment. He said he followed yours. Now which is it?

Mr. SCHOEPPERLE. Well, I say this, that Mr. Baker had judgment all right, Mr. Baker——

Mr. PECORA (interposing). He has apparently forgotten about it, Mr. Schoepperle, and he referred to your judgment as having influenced his.

Mr. SCHOEPPERLE. I regret to say that, while his memory may have failed him on this point, he did, as well as the other officers of the company, sit in or at the officers' meetings where this matter was discussed.

Mr. PECORA. He said that much, but he also said that he was guided by the judgment of the experts, and he mentioned you as one of them. You recall his testimony this forenoon to that effect, do you not?

Mr. SCHOEPPERLE. Yes; I recall it perfectly.

Mr. PECORA. Do you think he was mistaken when he said that?

Mr. SCHOEPPERLE. No; I don't think he was.

Mr. PECORA. Then he was guided by your judgment, was he not?

Mr. SCHOEPPERLE. If you will permit, I have a little difficulty in my mind and I will tell you what it is. You have the record there showing that in April or May of this year I went down to Chile.

Mr. PECORA. In April or May of 1927?

Mr. SCHOEPPERLE. That is right.

Mr. PECORA. Yes.

Mr. SCHOEPPERLE. In April or May of 1927.

Mr. PECORA. Yes. Were you back in December?

Mr. SCHOEPPERLE. Yes, I was.

Mr. PECORA. Then was your judgment consulted by the officers of your company with respect to your company's participation in the $50,000,000 loan that month?

Mr. SCHOEPPERLE. Yes, it was consulted.

Mr. PECORA. And did you recommend participation in that loan?

Mr. SCHOEPPERLE. Yes, I definitely went along in the decision to participate in that loan.

Mr. PECORA. You say you "definitely went along." Did you definitely recommend it and was it your recommendation that was

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

adopted and caused the officers of your company to participate in this loan?

Mr. SCHOEPPERLE. I will answer that by saying that I recommended that we go into that business; yes, sir.

Mr. PECORA. When you made that recommendation, did you feel that you had fully acquainted yourself with the situation in Peru up to date?

Mr. SCHOEPPERLE. I had visited Lima, the capital of Peru, on my way down to Chile.

Mr. PECORA. Is that the answer to the question? My question was, whether you felt that you had fully informed yourself concerning conditions in Peru up to that time. Your answer was that you had gone to Lima, Peru, in May or June of 1927.

Mr. SCHOEPPERLE. Yes. I stopped in Lima, Peru. I had a talk with the President. I went over with him the project which he had in his mind, which has been previously related in my testimony. He informed me of his desire to effect a relationship with bankers that could carry out a constructive program for the reconstruction of Peru's finances and her economic situation. He related to me the experience that he had had in the investment of the proceeds of these five loans to which I have previously referred in various public works; the fact that the taxing revenues of Peru had been greatly increased, the taxing resources of Peru had been increased; that public works were a profitable investment from his point of view. He cited the progress they had made up to that time. He cited me the figures. I can not remember them exactly, but they were impressive, as to what revenues had been expended upon the public works enterprises that had been up to that time completed.

Mr. PECORA. Did you bring back those figures with you?

Mr. SCHOEPPERLE. No.

Mr. PECORA. You say they were very impressive?

Mr. SCHOEPPERLE. I did not bring back any figures. But I was there with him and talked the situation over, and was very definitely convinced that we were embarked on a program, on a constructive program for Peru, which would, and did, consolidate the Peruvian national debt and reduced the total amount of interest charges which the Peruvian Government was then paying on these five issues of bonds which were redeemed out of the proceeds of these issues which we made. Sixty-eight per cent of the proceeds of the loans which we made went to refund other outstanding external loans of Peru.

Mr. PECORA. Who held those loans?

Mr. SCHOEPPERLE. Public held the loans.

Mr. PECORA. What public?

Mr. SCHOEPPERLE. The investing public.

Mr. PECORA. The American public?

Mr. SCHOEPPERLE. In the United States——

Mr. PECORA (interposing). The American public?

Mr. SCHOEPPERLE. Yes; for the most part.

Mr. PECORA. Or foreign investors?

Mr. SCHOEPPERLE. Well, both.

Mr. PECORA. How much of them were held abroad?

Mr. SCHOEPPERLE. Well, now, I am sorry to say that is for me a difficult question. There were certain investments abroad——

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. What were you doing, then—asking the American public to subscribe to a large bond issue, among other reasons, in order that bondholders of prior issues might be paid?

Mr. SCHOEPPERLE. No.

Mr. PECORA. That is what you are mentioning, are you not, as a circumstance?

Mr. SCHOEPPERLE. No; that was not the objective in itself, that we were making a loan so that bondholders of prior issues should be paid. The objective in this program was to reconstruct the finances of Peru and to consolidate its external debt, which is exactly what we are going to do here in the United States some day with a funding operation.

Mr. PECORA. Let us confine ourselves to what was done in Peru and not what is going to be done here in the future. We do not know that.

Mr. SCHOEPPERLE. The consideration was to put the finances of Peru into some kind of order and to get rid of these piecemeal transactions that characterized the Peruvian financial effort from 1921 to 1927.

Mr. PECORA. Put them in some kind of order so that prior bondholders could be paid?

Mr. SCHOEPPERLE. That was the effect; that was not the motivating reason.

Mr. PECORA. That was not a negligible effect, was it?

Mr. SCHOEPPERLE. Not at all.

Mr. PECORA. You do not know how many of those prior bonds were held abroad, do you?

Mr. SCHOEPPERLE. Outside of the United States?

Mr. PECORA. Yes.

Mr. SCHOEPPERLE. Well, I have not very much idea as to how much of those external debts of Peru were foreign debts. I know that there were three of them, and I know that part of these Peruvian loans which we issued were sold as sterling bonds in the London market. So that I should say that about squared itself off in any case.

Mr. PECORA. You say you went to Chile in May, 1927?

Mr. SCHOEPPERLE. That is true; yes, sir.

Mr. PECORA. How much time did you spend in Peru on that trip?

Mr. SCHOEPPERLE. Well, I only stopped over there two or three days. I had a talk with the president.

Mr. PECORA. While you were there those two or three days did you have any conversation with Mr. Durrell, the vice president of the Lima, Peru, branch of the National City Bank?

Mr. SCHOEPPERLE. He was not there at that time.

Mr. PECORA. Then you did not see him, did you?

Mr. SCHOEPPERLE. No, sir.

Mr. PECORA. Did you discuss business conditions with whoever was in charge of the bank at that time?

Mr. SCHOEPPERLE. I did.

Mr. PECORA. Did he tell you that the deposits in the bank at that time were less than they were on the corresponding date five years previous?

Mr. SCHOEPPERLE. If he did, I would not remember it. I don't think it concerned me any.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Would that not have been some indication of the prosperity of the country?

Mr. SCHOEPPERLE. No; I should say not.

Mr. PECORA. Oh, bank deposits do not reflect such a thing?

Mr. SCHOEPPERLE. That is all very true as a general statement, Mr. Pecora; but the question is, Does the fact that over a period of years the City Bank had in its branch fewer deposits than it had five years previous by any means reflect a reduction in general economic activity of Peru? By no means.

Mr. PECORA. It certainly would not imply a radical improvement in those things, would it?

Mr. SCHOEPPERLE. It would not indicate anything one way or the other.

Mr. PECORA. Did you discuss the internal situation economically and politically in Peru with whoever was in charge of the branch of your bank at that time?

Mr. SCHOEPPERLE. Yes.

Mr. PECORA. With whom?

Mr. SCHOEPPERLE. Mr. Calvin.

Mr. PECORA. When did you return to the head office in New York from that trip?

Mr. SCHOEPPERLE. I think it was August or September, 1927.

Mr. PECORA. Meanwhile did you know that under date of July 27, 1927, Mr. Durrell, the vice president in charge of the Lima, Peru, branch, had written the communication that was read into the record this morning?

Mr. SCHOEPPERLE. I did not; no, sir.

Mr. PECORA. When you recommended participation to your company in this $50,000,000 loan in December, 1927, did you not have any knowledge of this letter which Mr. Durrell had written to your company on July 27?

Mr. SCHOEPPERLE. I did not. I first saw that letter this morning when you produced it.

Mr. PECORA. It was produced from among the files of your company, was it not?

Mr. SCHOEPPERLE. That is true; yes, sir.

Mr. PECORA. It has been in the possession of the company ever since its receipt, has it not?

Mr. SCHOEPPERLE. It was; yes, sir.

Mr. PECORA. Did you not make a study of whatever matter was in the files of your company before you recommended participation in the $50,000,000 loan?

Mr. SCHOEPPERLE. I knew what was in there, but I never saw that letter.

Mr. PECORA. The letter must have been there, must it not?

Mr. SCHOEPPERLE. I suppose it was.

Mr. PECORA. Why did you say you knew what was in there if you did not know of this letter and did not hear about it until this morning when I put it in evidence out of your own files?

Mr. SCHOEPPERLE. I mean by that statement in a general way I knew what was in our files.

Mr. PECORA. But you did not know about this letter until this morning, did you?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SCHOEPPERLE. I did not know about that letter until this morning.

Mr. PECORA. You consider Mr. Durrell, who is resident manager of the branch of the bank in Lima, Peru, exceptionally qualified to express an opinion and a judgment about the hazards of a Peruvian loan, do you not?

Mr. SCHOEPPERLE. I considered the resident manager in Peru very well qualified to express an opinion about the hazards of a Peruvian loan, and he had expressed those opinions by mail and orally to us.

Mr. PECORA. Favorably?

Mr. SCHOEPPERLE. Favorably.

Mr. PECORA. Do you consider that this was a favorable expression of opinion when he said on July 27, 1927, "As I see it "——

Mr. SCHOEPPERLE (interposing). Mr. Pecora——

Mr. PECORA (reading):

there are two factors that will long retard the economic importance of Peru: First, its population of five and a half million is largely Indians, two-thirds of whom reside east of the Andes, and a majority consume almost no manufactured products. Secondly, its principal sources of wealth, the mines and oil wells, are nearly all foreign owned, and excepting for wages and taxes, no part of the value of their production remains in the country. Added to this, the sugar plantations are in the hands of a few families, a majority of whom reside and invest their profits abroad. Also, for political reasons the present Government has deported some 400 prominent wealthy conservative families, but allows them to continue to receive and to make us of abroad the income from their Peruvian properties. As a whole, I have no great faith in any material betterment of Peru's economic condition in the near future. The country's political situation is equally uncertain.

From that statement of Mr. Durrell, made under date of July 27, 1927, do you find any recommendation for participation in a $50,000,000 Peruvian loan?

Mr. SCHOEPPERLE. I do not.

Mr. PECORA. Five months later?

Mr. SCHOEPPERLE. I do not. Let me point out that the resident manager to whom you referred and to whom I referred was Mr. Calvin, who had been resident there for 11 years, and who had expressed in 1926 and 1927 favorable opinions. He had been there 11 years. Mr. Durrell, who wrote that letter, probably had not been there 11 days. He was traveling about from one branch to another inspecting branch banks. Whatever gossip he happened to pick up that he thought was interesting he sent along to Mr. Mitchell for what it was worth, but that does not profess to be a seriously considered report on the Peruvian situation. The seriously considered report is the report of Mr. Calvin, who was there for 11 years. He was there for 11 days.

Mr. PECORA. Bring out what Mr. Calvin wrote at about that time which presented a different picture.

Mr. SCHOEPPERLE. July 13, 1926, see if you can find something on that (addressing Mr. Accola). I will give you a letter dated July 13, 1926, which shows that Calvin, after 10 or 11 years on the ground 9 or 10 years, I don't remember exactly how many, expressed a favorable opinion, after having held quite a pessimistic attitude for a number of years.

Mr. PECORA. Is Mr. Calvin's opinion in 1926 at variance with Mr. Durrell's in July 1927?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SCHOEPPERLE. I think this letter of July 13, 1926, is at variance with Mr. Durrell's letter.

Mr. PECORA. And Mr. Calvin's advices of July 1926 were likewise at variance with all the information and advices which you previously had had since 1921, were they not?

Mr. SCHOEPPERLE. It was at variance with my earlier opinion on the whole subject, certainly was.

Mr PECORA. Now, let us see the things that Mr. Calvin said that caused you to reverse your opinion and to ignore Mr. Durrell's statement and advices of July, 1927.

Mr. SCHOEPPERLE. Well, I beg your pardon. But, of course, I have said that the major consideration in my mind, and especially after talking with President Leguia, was that we were embarking on a program, a constructive and comprehensive program, to reorganize the debt, to stabilize the currency, to put the government's finances on equilibrium, and generally to reconstruct that country on a clean basis.

Mr. PECORA. That was all based on this confidence in President Leguia's retaining office, was it not?

Mr. SCHOEPPERLE. I certainly can not admit that there was anything said in confidence about his retaining office, certainly not.

Mr. PECORA. I did not say anything said in confidence. It was all based upon your——

Mr. SCHOEPPERLE (interposing). Oh, I beg your pardon.

Mr. PECORA. Upon your confidence, or Mr. Calvin's confidence, whosesoever confidence it was, in the wisdom of President Leguia?

Mr SCHOEPPERLE. Leguia's remaining in office was a very important consideration to the carrying out of this program on which we were embarked, but we very definitely had the impression that there were enough other constructive elements in Peru to warrant our belief that the program could be carried out.

Mr. PECORA. By the way, do you notice that in this communication from Mr. Durrell in July, 1927, referring to President Leguia, he says:

> Unfortunately, his health is bad, and it is reported that he must undergo a serious operation soon.

Did you notice that in Mr. Durrell's communication?

Mr. SCHOEPPERLE. I see it now, but, as I have stated, I do not for one minute admit that the question of whether Leguia stayed alive was the governing consideration or the main consideration in our believing that a constructive program could be carried out in Peru. There were other intelligent and able people in the country who were in sympathy with Leguia's program.

Mr. PECORA. These bonds were long-term bonds, were they not?

Mr. SCHOEPPERLE. That is true.

Mr. PECORA. They were floated in 1927 and 28?

Mr. SCHOEPPERLE. That is true.

Mr. PECORA. They were 40 and 50 year issues, were they not?

Mr. SCHOEPPERLE. That is true.

Mr. PECORA. You did not expect Leguia's influence to continue that length of time, did you?

Mr. SCHOEPPERLE. I certainly did not expect President Leguia to live all that time; no, sir. We had that fact very much in mind,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

that before these bonds matured we would have to depend on other constructive and intelligent and able statesmen in Peru to carry out the program that was designed to set that country on its financial feet.

Mr. PECORA. You were taking a chance to that extent, were you not?

Mr. SCHOEPPERLE. No matter what investment you buy you are taking some kind of a risk. No debt record is perfect. No government debt record is perfect.

Mr. PECORA. Do you know any which was as bad as Peru's and whose securities your company helped to sell to the public here?

Mr. SCHOEPPERLE. No; I do not.

Mr. PECORA. Now let us go back to Mr. Calvin's views: You find among your files a communication or report or memorandum or letter dated December 3, 1925, do you not?

Mr. SCHOEPPERLE. December 23, 1925 [examining documents].

Mr. PECORA. While you are looking for that let me ask this——

Mr. SCHOEPPERLE (interposing). Yes; I would like to see that memorandum go into the record.

Mr. PECORA. I have put into the record portions of it.

Mr. SCHOEPPERLE. I would like to see the whole thing go into the record.

Mr. PECORA. Put it all into the record.

Mr. SCHOEPPERLE. Thank you.

Senator TOWNSEND (presiding). Unless there is objection, let it go into the record.

Mr. PECORA. Just mark the place there so that the reporter can copy it.

(The memorandum is as follows:)

MEMORANDUM FOR RONALD M. BYRNES, VICE PRESIDENT, NATIONAL CITY CO., RE: PERUVIAN GOVERNMENT FINANCING

DECEMBER 3, 1925.

The general situation of the Peruvian Government has improved during the past two years to the extent that I feel renewed consideration should be given to the advisability of the National City organization interesting itself in Peruvian financing. The budget of the Peruvian Government for the year 1923 was practically balanced except for a nominal deficit of Lp. 10,000, and the budget report for the calendar year 1924 showed a surplus from ordinary revenues and expenditures of over Lp. 600,000, equivalent to about $2,500,000 United States currency, aside from the foreign-loan operations effected for specific purposes mostly connected with public improvements. The country has enjoyed five years of stable government under President Leguia, and the public improvement program now being carried out by the Foundation Co. of New York is beginning to change and modernize the whole aspect of things.

The poor credit standing of the Peruvian Government has been due, in my opinion, in a considerable measure to causes which by many are not fully understood. Speaking generally, practically all of the Spanish colonies in South America, on achieving their independence from Spain, for the first 50 or 60 years of their independent life passed through a period of political and economic unsettlement. During the past 30 or 40 years there has been an increasing tendency toward stabilization in both respects. The principal reason for Peru's delay in showing a like improvement was the war with Chile in 1879–1883, which left the country prostrate, with currency depreciated to nothing, many of its wealthy families ruined and the treasury empty, and made it impossible for the country to attend to the service of its foreign indebtedness contracted prior thereto largely for public improvements. Under such conditions a turbulent political condition logically continued until the election of President Leguia in 1919.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Leguia had served a previous term ending in 1909, and after completing his term had been forced to go to England, where he had resided for a number of years. Upon his election in 1919 he announced his firm intention to rehabilitate his country, establish a stable government, educate the lower classes, encourage the entrance of foreign capital and immigration, and generally bring about the development, which had been so long deferred, of the country's great natural resources.

On his way to Peru from England, Leguia stopped in New York in the spring of 1919 and called on President Vanderlip, of our institution. He stated that he desired to consolidate the various government agencies and monopolies operating in Peru, eliminate all unnecessary overhead and put the entire government machine upon an economic and efficient basis. To do this would require the refunding of various loans secured by such monopolies. Mr. Vanderlip indicated some interest in the matter and promised to send a man to Peru to investigate after Mr. Leguia had been inducted into office.

When I arrived in Lima in October, 1919, to install the branch of the National City Bank, President Leguia thought I was the man sent by our institution pursuant to his conversation with Mr. Vanderlip, and was much disappointed to learn that my visit had no such significance. He repeated his program to me, stating that he desired to tie up the Peruvian Government with one of what he regarded the then three leading financial institutions in New York—the National City Bank, J. P. Morgan & Co., and the Guaranty Trust Co.—remarking that he would prefer our institution, particularly in view of its decision to establish a branch in his country. It was his idea to make us the approved bankers of his government, which would take care of all of his financing and advise and assist him in his program of improving and building up the country, which advice and assistance would be at all times most welcome.

Upon learning that our institution was not disposed to enter into the matter, he sent his minister of finance, Mr. Fernando C. Fuchs, to New York to endeavor to arrange the matter elsewhere. Mr. Fuchs is a very affable and pleasant gentleman, who is a good friend of mine, but he is a mining engineer and not a financier in any sense of the word, and his presentation of the case in New York was such as to injure rather than help President Leguia's plan. Nothing was accomplished, and the Peruvian Government has gotten along since as best it could by "hand to mouth" financing through smaller financial institutions, with the exception of a loan of $2,500,000 arranged three years ago with the Guaranty Trust Co., which was the cause of a quarrel between that institution and President Leguia.

I endeavored to get the exact cause of this at the time from my friend, Dr. W. W. Cumberland, then manager of the Peruvian Reserve Bank, but Doctor Cumberland did not feel that he could give me a full explanation without violating confidences imposed in him. He did remark, however, that there was considerable "horse play" on both sides, which he gave me to understand had been started by the Guaranty Trust Co. in taking advantage of certain clauses in the loan contract to effect commissions never discussed or agreed upon. This aroused President Leguia's anger and in reprisal he failed to carry out certain other clauses of the contract, in taking which action he was, of course, at fault. He made a vow that he would never again do business with the Guaranty Trust Co. The differences were finally patched up, but the President insisted that subsequent operations should not be handled in the name of the Guaranty Trust Co. Firms allied therewith have, therefore, handled the business.

Despite the unsatisfactory situation of his country's finances and the continued hostility of most of the old aristocracy of the country which has not been interested in building up and educating the lower classes, Leguia has made such progress that I feel the whole Peruvian situation merits renewed consideration by our institution. The country's natural resources are unquestioned and are more diversified in character than any other South American country. The petroleum production along the Northern Litoral is steadily increasing and is now between 8,000,000 and 10,000,000 barrels per annum.

Peruvian cotton is of a high grade and commands a price 50 per cent higher than American cotton. Her sugar production amounts to about 400,000 tons per annum. She is a considerable exporter of sheep and llama wool from the Arequipa region, and is the world's only source of supply of alpaca. Her mining wealth has been long famous, and development is steadily increasing. She has an extensive and very fertile area of cultivable land east of the Andes

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

which is now almost wholly undeveloped and uninhabited. Last but not least, the high prices obtained by Peru for her export products during the World War greatly increased the country's general wealth with the result that the losses suffered during the war with Chile have now been probably more than recouped.

The Cerro de Pasco Corporation's investment of about $50,000,000 and that of the Vanadium Co. of America is now being substantially augmented by development work of the American Smelting & Refining Co. and other interests. Peru's mineral wealth consists of gold, silver, copper, vanadium, lead, zinc, marble, and others. A distinctive characteristic is the guano industry, although this product is now used almost exclusively by the local agricultural interests. What the country does lack is an enterprising, energetic population to develop these resources. The Peruvian, as a rule, is not possessed of much initiative or business ability. He is not, in general, a success as an executive in administering an enterprise of magnitude with the single exception of agriculture, in which line the Peruvian planter usually seems to produce better results than the foreigner.

President Leguia appreciates the defects of his people and hopes to improve the situation by encouraging immigration, particularly the northern Italians and Spanish, which he feels will assimilate better than any other races. He is keenly desirous of constructing a railroad into the large fertile area of eastern Peru in the upper Amazon basin which is capable of supporting several million people and is now practically uninhabited. Leguia has his defects, but the manner in which he has surmounted difficulties and steadfastly adhered to his program has aroused no little admiration for him. He has ruled with a firm hand, but the progress achieved during the past five years has been greater than that attained during the preceding 30 or 40 years.

At this writing the Peruvian Government is in the midst of the attempt to settle its long-standing Tacna-Arica controversy with Chile. President Coolidge's decision that a plebiscite should be held to determine the sovereignty of these two provinces was at first received with considerable hostility in Peru on account of the feeling that a fair vote would be impossible with Chile in charge of the territory. However, the American head of the Plebiscitary Commission, General Pershing, has made rulings calculated to protect the Peruvians and insure a fair vote so that at the present it is Chile that is up in arms while Peru is now exceedingly cordial and friendly. If the thing comes to a vote, I believe Peru will win it by a substantial margin.

If Chile withdraws and refuses to proceed, the feeling toward American interests in Peru will nevertheless continue cordial. At the same time I would be inclined to wait the outcome of this affair before definitely deciding to go into the Peruvian business. This decision should be forthcoming, however, within the next few months. If the Tacna-Arica territory is assigned to Peru as a result of Leguia's diplomacy and management, his hold on the Peruvian public will, in my opinion, be so firmly entrenched that he will serve out his present term of office less hampered than in the past and will be able to shape matters up so as to bring about a continuance of his policies. In other words, the winning of these two provinces, in themselves unimportant economically, will mean increased political and economic stability in Peru. Leguia was reelected last year for another term of five years, of which there are nearly four years yet to run.

In the meantime, in view of the improved situation as above outlined, increasing interest is being shown in Peru from several sources. Messrs. E. H. Rollins & Sons have indicated their desire to consider a Peruvian Government loan upon a properly guaranteed basis. They had one of their best representatives visit Peru two years ago, and although nothing was done then, they have been keeping in touch with the situation. In the absence of interest by the National City Co., the Lima branch offered to render them banking services for any operation which they might effect there. I had lunch several days ago with Mr. Green, of the Rollins firm, who appeared somewhat chagrinned that the recent $7,500,000 Peruvian loan handled by White, Weld & Co., Blyth, Winter & Co., and others got away from them. He remarked that if they had had a good man down there he was satisfied they could have gotten the operation. He asked me to see him again before I sail, and I am inclined to believe he has in mind asking if we will put them in touch with any future business offered. I would, therefore, be glad to receive an indication of what attitude I should adopt in connection with such an inquiry if made of him.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In conclusion, attention is invited to the fact that the recent loan handled by White, Weld & Co. was put out at 7½ per cent as against the previous rate of 8 per cent, which is a straw indicating the trend of affairs. I do not and would not suggest the consideration at this time of making loans to Peru upon the unsecured obligation of the Government, but with designated revenues specifically set aside to guarantee the service of loans effected and provisions whereby such revenues would be paid direct to the Lima branch of our institution by the collecting agencies. I feel that a Peruvian Government bond would offer no greater, if as much, risk as that involved in other issues which have been floated by the National City Co. I also feel that when possible within the limits of safe and conservative financing and without effecting unsound loans, effort should be made to cooperate as much as possible in furthering the progress of the branches established abroad by the bank.

C. W. CALVIN.

Mr. PECORA. The number of Indians who constituted two-thirds of the population of Peru, according to Mr. Durrell in July, 1927, had not changed between July and December, 1927, had they?

Mr. SCHOEPPERLE. I imagine it had increased. [Laughter.]

Mr. PECORA. I hope no personal consideration enters into that.

Mr. SCHOEPPERLE. No, I hope you'll admit I had nothing to do with that.

Mr. PECORA. Now, Mr. Schoepperle, their habits of consumption [Laughter]——

Senator TOWNSEND (presiding). Let us have quiet.

Mr. PECORA. I say their habits of consumption had not improved any, had they, so far as you know?

Mr. SCHOEPPERLE. That all depended on their state of prosperity, Mr. Pecora.

Mr. PECORA. According to Mr. Durrell their state of prosperity was rather low at that time?

Mr. SCHOEPPERLE. Yes. The state of prosperity of any Indian population is always rather low, because, as you know, they do not hang onto anything very long.

Mr. PECORA. Why do you say I know? I am not an Indian. [Laughter.]

Mr. SCHOEPPERLE. But whatever prosperity there was they would participate in it, and it would be over that very day, of course. Their habits of consumption are notorious.

Mr. PECORA. And do you think that is the kind of population which could sustain a $90,000,000 loan made over a period of a year and three quarters?

Mr. SCHOEPPERLE. Well now, of course, you will remember that they did not get $90,000,000 over a year and three quarters clean. About 68 per cent of it went into the refunding of their previously outstanding debts. The balance of it went into public-works program. So that the population did not actually consume this sum of money.

Mr. PECORA. Did it give greater security for the repayment of the $90,000,000, that $68,000,000 of that loan went to pay an existing and prior indebtedness?

Mr. SCHOEPPERLE. No; but a very large part of it went to build this great irrigation works which was being constructed by American engineers. I regret to say they have never been completed.

Mr. PECORA. I was just going to ask you about that.

Mr. SCHOEPPERLE. Also to proceed with the completion of the Callao docks, which, as you know, are the greatest public——

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA (interposing). I don't know anything about it, Mr. Schoepperle. I have never been down there.

Mr. SCHOEPPERLE. That is the great piece of work that Leguia did. It is called to Leguia Tunnel. You know, on the Pacific the vessels can not come in; they have to stay outside, and Leguia built these magnificent Callao docks, and an American contractor built it out of the proceeds of these loans, and there you have the harbor of Callao docks, the finest harbor on the western coast of South America, the harbor of Callao, Peru. So that the Indians did not exactly consume it.

Now, to answer your question—and I fear that I have not answered exactly as you put it—it was because of this Indian population that I had always felt that Peru was not particularly a good moral risk. There were some very fine elements, and are to-day, in Peruvian population, but, taken as a whole, I concede to your point that a population of that sort is not an especially good moral risk, looking at it from a broad point of view.

Senator TOWNSEND. Did you stress your view to your company along that line?

Mr. SCHOEPPERLE. I had in previous years expressed my views, as shown by the records, very definitely.

Mr. PECORA. But your views in previous years were contrary to the views that you say led to the recommendation?

Mr. SCHOEPPERLE. That is so.

Mr. PECORA. And the adoption of such a recommendation for participation in these loans?

Mr. SCHOEPPERLE. That is so.

Mr. PECORA. Between December, 1927, and October, 1928, there was a further loan of $25,000,000 to the Peruvian Government, participated in by your company?

Mr. SCHOEPPERLE. That is true.

Mr. PECORA. Did you recommend to your company participation in that loan?

Mr. SCHOEPPERLE. Yes; because once embarked on our program, it was our business to try to go through it, and we had, owing to the bondholders, the engagement undertaken in the representations made in the first project that we were embarked on such a constructive program.

Mr. PECORA. In other words, your recommendation was based principally upon the fact that in December, 1927, the company had participated in the $50,000,000 loan?

Mr. SCHOEPPERLE. No, no.

Mr. PECORA. That is what you just said in substance, isn't it?

Mr. SCHOEPPERLE. I am very glad you called my attention to the fact that I may have given such an impression. Because in the meantime some very fine independent investigations had been made by Frederick R. Kent, a director of the Bankers Trust Co. of New York, and an acknowledged expert on currency stabilization and on finance, and he had made very exhaustive inquiries, investigations, and reports, not only to the bankers but also to President Leguia.

So that, during that period between these two loans, a great many things were accomplished, including the stabilization of the Peruvian currency.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Now, let us see about the recommendations or report of Mr. Kent.

Mr. SCHOEPPERLE. Yes.

Mr. PECORA. Look in your files, will you please, and see if you do not find there, under date of March 4, 1928, a communication from Mr. Kent to Albert Strauss of the Guaranty Co.—no; he was with J. & W. Seligman Co.

Mr. SCHOEPPERLE. Yes; he was senior partner in J. & W. Seligman & Co.

Mr. PECORA. Have you his communication before you?

Mr. SCHOEPPERLE. That is what date, Mr. Pecora?

Mr. PECORA. March 4, 1928. That is the report you have just characterized as a fine summary by an expert, is it not?

Mr. SCHOEPPERLE (examining document). That is a report, I should judge, of about 50 or 60 pages. Wouldn't you?

Mr. PECORA. Well, you have it, haven't you?

Mr. SCHOEPPERLE. Yes.

Mr. PECORA. Do you find that he says—look at page 3—among other things, "Export surpluses are far in excess of the true balance of payments"?

Mr. SCHOEPPERLE. Yes, of course.

Mr. PECORA. "Export surpluses during the last few years have been turned into import surpluses by invisible items, which, of course, include foreign interest and activities, such as production of copper, petroleum, sugar, et cetera."

Mr. SCHOEPPERLE. I do not find it, but I am glad to have you read it to me.

Mr. PECORA. Will you look at it, No. 2 on page 3?

Mr. SCHOEPPERLE (examining document). I am sorry. Yes; I will accept it, of course.

Mr. PECORA. See if you don't find it there.

Mr. SCHOEPPERLE. Oh, yes; I see it. That is on page 13. Let us see; where are we now?

Mr. PECORA. In the hearing.

Mr. SCHOEPPERLE. It is, of course, true that there are invisible transactions the other way, representing new foreign money coming into the country.

Mr. PECORA. Do you find under item 9 this statement by Mr. Kent? (There was a pause.)

Mr. SCHOEPPERLE (after examining files). I do not like to waste your time. I wish you would read it, because I am sure it is here.

Mr. PECORA. I will read it:

That the taxable income of the Peruvian people, including foreign organizations, is not sufficient to warrant an increase in public works, of sanitation, irrigation, highway building, nor railroad building, except in those cases where an immediate return will arise from an increased income and where foreign loans are used for the purpose of foreign exchange in sufficient sums to meet the debt charge.

Mr. SCHOEPPERLE. Yes. I do not have it here, but I will accept that.

Mr. PECORA. Do you find also on page 7 of his report that he says as follows:

As I had the feeling that the whole taxation system is a hodgepodge, I asked Mr. Larranaga of the Caja whether he could have prepared for me in the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Caja, statements showing what form of taxes were too costly to collect to make them worth while, which were merely hit-or-miss forms of taxation, and what recommendations would seem to be advisable based on the actual experience of collection. He told me that it was impossible to answer such a question and that he could not do it and that no one in the government could do it and that possibly at the end of two years, if an expert were brought down from the States who could go over the books of the Caja in connection with its collections, that they might get the answer.

Do you find that statement there?

Mr. SCHOEPPERLE. I do not find it there, but I will accept that.

Mr. PECORA. Let us make sure that it is there.

Mr. SCHOEPPERLE. What page do you figure that on, Mr. Pecora?

Mr. PECORA. Page 7.

Mr. SCHOEPPERLE. Well, I am very sorry; I do not find it.

Mr. PECORA (addressing Mr. Accola). Help him find it, will you?

Mr. SCHOEPPERLE. I would like, in order to assist the inquiry, to read the conclusions of the report, which I think might interest the Senators.

Mr. PECORA. First let us find that. Then you can read them.

Mr. SCHOEPPERLE. Let me make sure that is in there. I am sure it is. But I think the conclusions of the report would be interesting to the Senators.

And I might say, if you are interested in connection with this Caja that is referred to here——

Mr. PECORA (interposing). Some government agency, is it not, down there?

Mr. SCHOEPPERLE. Yes. And there was in 1915 approximately I think, established a government agency called the Caja de Depositos y Consignaciones, which means a bureau for the receipt and deposit of revenues, government revenues. This Caja had been in existence since 1915 and had collected certain revenues of the Republic year by year. When we went into this Peru business we suggested, and the President adopted the suggestion, that the activities and the scope of the Caja's activities be expanded so that the Caja should receive all the governmental revenues other than the customs, which of course no sovereign power is willing to pledge in any case, and other than those revenues which were given as liens for these four or five bond issues that I have referred to on several occasions.

This Caja was to receive and did receive under an irrevocable agreement between the fiscal agents, that is to say, the banks that acted as fiscal agents, the Seligman people and the National City Bank, did receive all these revenues except those which I have referred to, and by an irrevocable arrangement paid first in order out of the receipts that were collected by that Caja, paid them to the fiscal agents each month for the service of these Peruvian loans, these national loans which I have referred to, not the tobacco loan. That was secured by a separate set of revenues on which the bonds had a specific lien. But month by month the first money that came into this Caja was turned over to the banks, the fiscal agents for the service of these loans, until that monthly installment of one-twelfth had been completed.

So that it just occurs to me to make that explanation, since you have referred to this Caja, and I might say that the Caja was not a government agency; it is owned by the banks in Peru. So that we

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

felt that we had adequately secured this loan by every possible and reasonable device; that we thought we had the loan thoroughly well protected before we issued it.

Mr. PECORA. Now, do you find in your files a communication under date of August 25, 1928, from the Lima, Peru, branch of the bank?

Mr. SCHOEPPERLE. While I am looking that up you promised to let me read the conclusion of Kent's report.

Mr. PECORA. We will let you read it. We are looking for extracts from it.

Mr. SCHOEPPERLE. Let us get that straight, please.

Mr. PECORA. August 25.

Mr. SCHOEPPERLE. August 25 what year?

Mr. PECORA. I have it here 1928.

Mr. SCHOEPPERLE. I am afraid it may be that you have the file that contains that.

Mr. PECORA. Look at your own file. Who wrote that letter to your company?

Mr. SCHOEPPERLE (referring to file). Extract of letter from Lima, Peru, branch dated August 25, presumably 1928.

Mr. PECORA. Who wrote it?

Mr. SCHOEPPERLE. I take it that it was written either by Mr. Calvin or by his assistant, Mr. Dewey.

Mr. PECORA. Were they connected with the National City Bank or company down in Lima, Peru, at that time?

Mr. SCOEPPERLE. Mr. Calvin is in the room. He says that he was not. I take it that must have been Mr. Dewey.

Mr. PECORA. Was he connected with the company?

Mr. SCHOEPPERLE. He was the manager of the National City Bank, I believe, the branch in Lima.

Mr. PECORA. Among the extracts from that letter do you find the following statement:

Economic conditions: Business continues to be extremely dull. Although there has been more activity in the cotton market during the past month, important growers estimate that the crop will be 25 per cent below normal and probably a bit more. Our collection department report that collections are becoming increasingly difficult. At every hand one hears complaints regarding slow sales and scarcity of money. Prices of securities and real estate are at extremely low levels, and new building operations have naturally been curtailed considerably.

Mr. SCHOEPPERLE. Yes.

Mr. PECORA. You had better keep it before you. Do you find also this statement in that letter:

Government conditions: Financial condition of Government. Continues very tight. We understand that practically all of the Government dependencies are in arrears as regards salaries paid to employees. One of the members of the American Naval Mission informs us that for the first time in years they have been unable to secure their daily allowance of some Lp 4/500. from the Treasury. Although the Treasury has called upon a number of the banks to effect the discount of some of its paper, we have received no such requests of late.

Do you find those extracts there?

Mr. SCHOEPPERLE. Yes, sir. This is a monthly letter from the manager of the branch, which from month to month reports the immediate position, but very often those positions, of course, are transitory.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Was there anything in those advices, dated August 25, 1928, that made this Peruvian loan which was put out in October, 1928, in the sum of $25,000,000, an attractive one?

Mr. SCHOEPPERLE. That report indicates to me that at that time, as my notes indicate, the bankers were making every endeavor to get the Government to contract as far as possible its expenditures, and naturally there was a squeeze on in the local money market, because the negotiations between the bankers and President Leguia at that time were dealing with these questions of stabilization, the clearing up of the floating debt, getting the budget in to balance, and the bankers took this position that the local floating debt, the payment of Peruvian pounds to the people in government in Lima, should be financed locally by the local banks.

Mr. PECORA. Does it not also indicate what economic conditions at that time were in Peru and indicate them to be extremely dull?

Mr. SCHOEPPERLE. Indicates them to be dull; yes, sir.

Mr. PECORA. "Securities and real estate are at extremely low levels."

Mr. SCHOEPPERLE. It indicates that the business position was dull, just as it says, and that the whole position was——

Mr. PECORA (interposing). And this economic condition is reported to your company, to have prevailed in August, 1928, and that was months after the flotation of $65,000,000 worth of loans for Peru?

Mr. SCHOEPPERLE. Yes. Most of which were used for the purposes of refunding external debts.

Mr. PECORA. Which did not help the internal condition of Peru any, did it, nor give greater security to the holders of those bonds that were issued to retire an existing indebtedness?

Mr. SCHOEPPERLE. Well, I beg your pardon; that was part of the proceeds of the amount you mentioned should be—well, we will say $65,000,00—you are quite right. Part of those proceeds were used to clear up some of the internal floating debt.

Mr. PECORA. A good part of them?

Mr. SCHOEPPERLE. No; no; not——

Mr. PECORA (interposing). You said 68,000,000.

Mr. SCHOEPPERLE. Well, I say——

Mr. PECORA (interposing). We will use that figure for that purpose—or 68 per cent rather.

Mr. SCHOEPPERLE. Yes.

Mr. PECORA. Sixty-eight per cent.

Mr. SCHOEPPERLE. I am saying 68 per cent of the total issues of $85,000,000 of the national loan were used to redeem previously outstanding external debt.

Mr. PECORA. Did you recommend your company's participation in October, 1928, in the $25,000,000 loan?

Mr. SCHOEPPERLE. Yes.

Mr. PECORA. When you recommended it did you have any knowledge of this letter from the Lima (Peru) branch of your company, dated August 25, 1928?

Mr. SCHOEPPERLE. I did. I had knowledge of all the monthly letters that were being sent up by the Lima branch, and I knew the position, and I knew that at that time assurances had been given

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

by the President of Peru to the bankers that he would clean up this internal floating debt position, and the bankers were taking the position that the local banks and the local market ought to clean up the local floating debt. And again I ask that——

Mr. PECORA (interposing). And in the hope that they would clean up the local situation these bonds were offered to the public upon the recommendation of your company?

Mr. SCHOEPPERLE. No, no; that was not the sole consideration, but the basic consideration.

Mr. PECORA. That is what you are mentioning.

Mr. SCHOEPPERLE. I am referring to it because you asked me about the particular point.

Mr. PECORA. No; I asked you if that helped to influence your judgment in recommending the participation by your company in the flotation of the $25,000,000 loan in October, 1928.

Mr. SCHOEPPERLE. The fact that the local banks would clean up the local situation?

Mr. PECORA. Yes.

Mr. SCHOEPPERLE. It was subsequently and finally cleaned up——

Mr. PECORA. And the loan is in default?

Mr. SCHOEPPERLE (interposing). With an internal loan.

Mr. PECORA. The loan is in default?

Mr. SCHOEPPERLE. I do not think so.

Mr. PECORA. The price is around $5?

Mr. SCHOEPPERLE. I am talking about the internal loan.

Mr. PECORA. I am talking about the loan that your company sold the bonds for.

Mr. SCHOEPPERLE. That loan is in default, not the internal one.

Mr. PECORA. Did you have before you when you recommended to your company its participation, in October, 1928, in the $25,000,000 loan, the cablegram that was received by your company at its New York office from its branch in Lima, Peru, under date of September 14, 1928?

Mr. SCHOEPPERLE. Will you kindly tell me what that was?

Mr. PECORA. Haven't you got it in your files there?

Mr. SCHOEPPERLE. Yes; that is a cablegram concerning this internal floating debt position that we have just been discussing. That refers to the internal position of the floating debt of the government. That was cleaned up in 1929 by the flotation of an internal loan by the local banks; and that is all it refers to.

Mr. PECORA. Do you find in your files a letter dated October 8, 1928, passing between Mr. H. E. Henneman, assistant vice president, and Mr. Durrell of the Lima branch?

Mr. SCHOEPPERLE. Yes. I know that is here. That deals with the same internal floating debt.

Mr. PECORA. Let us go back to this cablegram of September 14, 1928. That states, among other things, as follows (does it not)—

> We have assumed (*a*) no further national loan can be safely issued and (*b*) integrity Republic's finances threatened until floating debt problem solved. Stop.

Mr. SCHOEPPERLE. Until it is solved; yes.

Mr. PECORA. Was it solved between September 14, 1928, and October, 1928, when the $25,000,000 issue was put out?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SCHOEPPERLE. No; but one of the partners had an interview with Leguia and had very definite assurances that steps would be taken to solve the problem, and they were, and the problem was solved.

Mr. PECORA. So that when the $25,000,000 loan was put out, the only thing that justified it were those assurances by President Leguia that the local banking situation would be cleared up; is that right?

Mr. SCHOEPPERLE. Yes, sir; those assurances were perfectly good. May I put into the record——

Mr. PECORA. Just a moment; I will give you a chance to put in everything that Mr. Kent said in that regard, if you want to put it in.

On October 8, 1928, there was a communication that passed between Mr. Henneman and Mr. Durrell, both connected with the bank?

Mr. SCHOEPPERLE. I have it before me.

Mr. PECORA. What is the date of it?

Mr. SCHOEPPERLE. October 8, 1928.

Mr. PECORA. To whom was the memorandum addressed?

Mr. SCHOEPPERLE. It is addressed to Mr. Durrell concerning the Lima branch of the bank.

Mr. PECORA. By whom?

Mr. SCHOEPPERLE. By Mr. H. E. Henneman, assistant vice president.

Mr. PECORA. Among other things that memorandum states as follows:

> Economic conditions in the country leave considerable to be desired. The last cotton crop was a short one on account of lack of water for proper irrigation——

Mr. SCHOEPPERLE. And some crops were good—excuse me.

Mr. PECORA. I will repeat:

> The last cotton crop was a short one on account of lack of water for proper irrigation, and recently the fall in prices has discouraged picking and marketing to such an extent that a very considerable part of the crop is still in the fields in the southern valleys, especially in the Ica district. The important hacienda "Hoja Redonda" owned by the Coloma interests has well over 50 per cent of its cotton still in the fields unpicked. The financing of cotton growers is something which we must approach with the greatest precaution. At the present time a large percentage of the estates are mortgaged to the limit, and the hazards of financing the crops of these estates are, generally speaking, too great to be justified. Some of the British financing concerns, such as Graham Rowe and Duncan Fox, are into these estates up to their necks and are using all their diplomacy to get some of the banks to bail them out.
>
> * * * * * * *
>
> A very large volume of new construction work is still being carried on both by the Government and by private capital, and although the representative of J. and W. Seligman & Co. is endeavoring in a diplomatic manner to induce the president to cut down very materially his public-works program, there is as yet no evidence to show that such step has been or will be taken. A number of prominent Peruvians with whom I talked seemed to be of the opinion that the President does not dare to reduce his public-works expenditures for fear of the effect upon his political fortunes and throwing any large number of men out of work. My own impression, however, is that he is doing very little worrying about the political effect of such a move. Having a well paid and loyal army behind him, it is difficult to see what he has to fear. It seems clear, however, that only the most drastic necessity will induce him to reduce materially his expenditures for public work purposes.
>
> It is apparent that the local banks are still badly over extended, this referring particularly to the Peru y Londres and the Banco Italiano.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Under the caption of "Government Finance" in this letter or memorandum, it states as follows:

The budget is not balanced and in fact the floating debt is larger than ever. Just recently the figures were compiled as of June 30, 1928, showing a floating debt of more than 3,600,000 Peruvian pounds or more than double what it was at the beginning of 1927. It seems a fair guess that it is now very close to 4,000,000 Peruvian pounds. When asked about the matter, the President stated as his opinion that the floating debt was not over 2,000,000 Peruvian pounds, and appeared disinclined to examine the details when the compiled figures were shown to him.

Mr. SCHOEPPERLE. That was a report made by a supervising officer of the branches who visited Peru for the purpose of ascertaining what the position of the commercial outstandings were and what the risks of commercial business were at that time. I will admit that it is a picture of the general situation, but I do not say that there are not some extenuating statistics that can be cited to show that he was rather unduly pessimistic at that time.

Mr. PECORA. Who was?

Mr. SCHOEPPERLE. This man, Henneman.

Mr. PECORA. He was connected with your company, was he not?

Mr. SCHOEPPERLE. Yes; he was connected with the bank.

Mr. PECORA. In the light of subsequent events Mr. Henneman's judgment appeared to be pretty sound, did it not?

Mr. SCHOEPPERLE. Yes; but in 1928 the foreign trade exports in terms of thousands of dollars were higher than they had been at any time since 1924. I do not have a record farther back—and higher again in 1929.

Mr. PECORA. But those exports were owned principally by persons living abroad and the profits were invested abroad, were they not, and not in Peru?

Mr. SCHOEPPERLE. That was one of the difficulties which Kent's report cited, as you have pointed out, and we felt that by the restoration of confidence and the establishment of a balanced position in Peru that that state of circumstances which you have referred to would come into a position where the continued seeping of capital out of Peru would cease. If the program of stabilization and the whole plan of reorganization of finances had been carried out, it is a fair assumption that capital would have stayed in Peru rather than having taken flight out of Peru.

Mr. PECORA. And that all means, does it not, that there were flotations of these loans in 1927 and 1928 and the investing public in America was asked something like $90,000,000 for those bonds in order to restore some sort of order out of the economic and political chaos that, to your knowledge, had existed in Peru for many years prior to 1927? Does it not simmer down to that, Mr. Schoepperle? Is not that a true statement?

Mr. SCHOEPPERLE. I feel that that conclusion is impressed with an interpretation which at the time and under the then existing circumstances I would not have accepted. Under the conditions which exist to-day I feel bound to accept it.

Mr. PECORA. The conditions which exist to-day bear out the opinion that you had expressed for years prior to 1927——

Mr. SCHOEPPERLE. I regret to say——

Mr. PECORA. Wait a moment—that Peru was a bad moral, economic, and political risk?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SCHOEPPERLE. I regret to say that in the light of subsequent developments after 1927 and 1928, the opinion that I had previously expressed earlier, in 1921, 1922, and 1925, was borne out. I thought, like a great many others, that I was in a new era, and I made an honest mistake of judgment; and I think that the most that can be said and the only construction that can be put upon the state of facts that has been under review here to-day is that the City Co. made an honest mistake in connection with Peruvian finances.

Mr. PECORA. And it made that mistake in the face of advice from Mr. Durrell, Mr. Henneman, and other experts, including yourself, who were studying the situation and had reported their conclusions; is that right?

Mr. SCHOEPPERLE. I have pointed out that Mr. Durrell and Mr. Henneman were commercial banking men who were interested in making observations in Peru for the purpose of determining the position of their commercial loans and commercial branch banking operations.

Mr. PECORA. The observations they made were not mistaken or false observations, were they?

Mr. SCHOEPPERLE. I do not think they were mistaken or false observations. At the same time, I submit that they were not considered opinions based on a long and continuing study of the Peruvian situation. Those were letters which those managers write occasionally when they happen to be inspecting any branch. A branch manager writes you one letter a month telling what conditions are there. Mr. Durrell would visit branches all around the world, as I remember it, stay a few days, and write an opinion to Mr. Mitchell, including a good bit of the gossip of the town, which was purely of an ephemeral nature.

Mr. PECORA. Was he sent around the world to pick up opinions of an ephemeral nature for your guidance?

Mr. SCHOEPPERLE. Certainly not. His opinions of an ephemeral character were gratituous. He was sent around the world for the purpose of looking after the operating arrangements of the bank, and not for expressing any opinions on the financing that was being done by the National City Co.

Mr. PECORA. Was it for that reason that his statements with regard to the economic and political situation in Peru appear to have been ignored?

Mr. SCHOEPPERLE. It was not for that reason that they were ignored. You will find from an examination of our files that we received great masses of information on every conceivable point. We examined a great number of details with the most meticulous care. We found pros and cons on every one of those questions, and at various times we made a mistake in the appraisal of the facts presented, and we made errors in judgment, just as everybody made errors of judgments in 1927 and 1928.

Mr. PECORA. But in this case you had just as many cons as you had pros, did you not?

Mr. SCHOEPPERLE. Yes; I would say we did, Mr. Pecora. That was an optimistic era in which optimistic interpretations were put on any situation where the pros were about equal to the cons.

Mr. PECORA. And most of the cons came from you?

Mr. SCHOEPPERLE. From me personally?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. As a result of years of study?

Mr. SCHOEPPERLE. They came from me in the early period, most certainly.

Mr. PECORA. And none of the pros came from you in writing, did they?

Mr. SCHOEPPERLE. No, sir; there were no pros that came from me as far as I can judge. But my intellectual judgment was convinced in this project that we embarked on——

Mr. PECORA. Convinced in favor of embarking on it?

Mr. SCHOEPPERLE. That was an honest judgment. I thought we were going to accomplish for Peru something that was very badly needed in that country, and I felt that we could accomplish it. I was honestly convinced on the point.

Mr. PECORA. Was it in the same way that the National City Bank was advised to undertake other South American bond flotations?

Mr. SCHOEPPERLE. I would say not.

Mr. PECORA. You think the others were based upon a sounder judgment?

Mr. SCHOEPPERLE. I think they were.

Mr. PECORA. We will go into some of them to-morrow.

Senator FLETCHER. Do you still hold that an investment company is justified in extending credit on a basis that would be unsound as to commercial banks?

Mr. SCHOEPPERLE. No; I do not hold that. I would not say that I have held that; but I was offering some explanations in extenuation of the ephemeral reports and judgments that came from men who were not studying this whole problem from a long point of view.

The learned counsel offered me the opportunity of putting into this record the following paragraphs of Mr. Kent's report——

Mr. PECORA. Yes; go ahead.

Mr. SCHOEPPERLE. Let me read you two of them. One of the last paragraphs says:

> Based upon the actual experience of many other countries with whose developments since the war I have been closely familiar and whose problems have been somewhat similar in character I am positively convinced that the recommendations herein contained are carried out in their entirety, that barring unseen disaster that might come from abnormal developments, the Peruvian pound can be stabilized and maintained at $4 American money"—

And it was stabilized; it was not maintained there.

> and that the progress of Peru can continue in growing proportion as the years go on.
>
> Further, if the program recommended is carried out there is no reason why the Government and the business interests of the country cooperating together can not so strengthen the economic position of Peru that it will be able to meet successfully all of the emergencies which naturally arise now and again from years of crop failures or overproduction or from reduced foreign markets due to degrees of world prosperity.

It is almost prophetic, is it not?

Mr. PECORA. So were the Durrell advices almost prophetic, were they not?

Mr. SCHOEPPERLE. Yes.

Mr. PECORA. Now, Mr. Schoepperle, according to present figures, who turned out to be the false prophet as between the two—Mr. Kent or Mr. Durrell?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SCHOEPPERLE. Well, you have heard the concluding paragraphs of Mr. Kents' report.

Mr. PECORA. Just answer. Was it Mr. Kent or Mr. Durrell?

Mr. SCHOEPPERLE. I say Mr. Durrell was nearer right. Kent, of course, hedged his concluding recommendations with a great many conditions.

Mr. PECORA. The National City Co.'s profits from its participation in these three Peruvian loans were what?

Mr. SCHOEPPERLE. I think Mr. Baker has testified to that; I can not tell you. They were large.

Mr. PECORA. They were large?

Mr. SCHOEPPERLE. That is my recollection of Mr. Baker's figures.

Mr. PECORA. I understand that from its participation in the first loan of $15,000,000, made in March, 1927, its gross profit was $252,000, in round numbers, and its net profit, $211,000, and that from its participation in the $50,000,000 loan of December, 1927, its gross profit was $382,000 and its net profit, $318,000, and from its participation in the $25,000,000 loan of October, 1928, its gross profit was $221,000 and its net profit, $152,000. Does that accord with your recollection?

Mr. SCHOEPPERLE. Well, you must understand that in my capacity of an officer in charge of the foreign buying department I would not have any direct recollection or knowledge of those profits. If I wanted to know them I would be able to ascertain them; if I heard them I would forget them. But I take it that that is absolutely right, of course.

Mr. PECORA. Did you participate in the distribution of the management fund of the National City Co. for the years 1927, 1928, and 1929?

Mr. SCHOEPPERLE. I did.

Mr. PECORA. To what extent, in those three years?

Mr. SCHOEPPERLE. Wait a minute. You said three years, did you not?

Mr. PECORA. 1927, 1928, and 1929.

Mr. SCHOEPPERLE. In 1927 I was an assistant vice president, as far as the management fund was concerned, and I participated as a junior officer.

Mr. PECORA. To what extent were you a participant?

Mr. SCHOEPPERLE. I can not tell you, because I do not just remember. If you have a record there I will accept it, I think.

Mr. PECORA. Do you recall the extent of your participation in the management fund in 1928?

Mr. SCHOEPPERLE. I do.

Mr. PECORA. You were then a vice president?

Mr. SCHOEPPERLE. I was then a vice president and participated in the management fund as a senior officer; and my recollection is that I must have received about $15,000 along toward the 1st of June or July, and I received about $55,000 in December or January.

Mr. PECORA. A total of about $70,000 for that year?

Mr. SCHOEPPERLE. I think so.

Mr. PECORA. That was in addition to your salary, of course?

Mr. SCHOEPPERLE. That was in addition to my salary, which probably was about $20,000 a year then.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. For the year 1929 to what extent, if any, did you participate in the distribution of the management fund?

Mr. SCHOEPPERLE. I was off on a sabbatical year in 1929 and I did not participate in any of the 1929 management fund.

Mr. PECORA. Did you participate in any management fund distribution for the first six months of 1930?

Mr. SCHOEPPERLE. The first six months of 1930, I think I participated to the extent of about $4,000 in some management fund.

Mr. PECORA. Prior to 1927 you had no participation in the management fund, did you?

Mr. SCHOEPPERLE. Yes, I did.

Mr. PECORA. Did you as a junior officer?

Mr. SCHOEPPERLE. I had some participation in management funds prior to 1927. I can not remember what. I should say that when I was a junior officer my participation was relatively smaller than the participation I received as a senior officer.

Mr. PECORA. Did you have anything to do with the preparation of the three prospectuses issued in connection with those three loans or bond issues?

Mr. SCHOEPPERLE. Those prospectuses were prepared in the office of J. & W. Seligman & Co. who were leaders in the business and who were managing it. I do not recall that we had anything to do with the preparation of the prospectus, but I think it is a perfectly fair assumption that it was referred to us and shown us for our approval before our name was put on it.

Mr. PECORA. So it must have been approved by your company before you permitted the company's name to go on it?

Mr. SCHOEPPERLE. I should say that it had been.

Mr. PECORA. Were the prospectuses submitted to you individually?

Mr. SCHOEPPERLE. I have no recollection of it.

Mr. PECORA. Do you know to whom they were submitted?

Mr. SCHOEPPERLE. I should think they would have been submitted to me, but I do not recall that they were.

Senator FLETCHER. The committee will take a recess until tomorrow morning at 10 o'clock.

(Whereupon, at 5 o'clock p. m., a recess was taken until tomorrow, Tuesday, February 28, 1933, at 10 o'clock a. m.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

STOCK EXCHANGE PRACTICES

TUESDAY, FEBRUARY 28, 1933

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

The subcommittee met, pursuant to adjournment on yesterday, at 10 o'clock a.m. in room 301, Senate Office Building, Senator Peter Norbeck presiding.

Present: Senators Norbeck (chairman), Couzens, Townsend, Fletcher, and Costigan.

Present also: Senator Brookhart.

Further present: Ferdinand Pecora, special counsel to the committee; Julius Silver and David Saperstein, associate counsel to the committee.

The CHAIRMAN. The committee will be in order.

Mr. PECORA. Is Mr. Ronald Byrnes here?

TESTIMONY OF RONALD M. BYRNES, WATCH HILL, R.I.

The CHAIRMAN. Do you solemnly swear the testimony you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

Mr. BYRNES. I do.

Mr. PECORA. Mr. Byrnes, will you give the reporter your full name, address, and business or occupation?

Mr. BYRNES. Ronald M. Byrnes; no business; unemployed.

Mr. PECORA. Are you retired from business?

Mr. BYRNES. You may call it that. I am not in business now.

Mr. PECORA. What was your last business or occupation?

Mr. BYRNES. Vice president of the National City Co.

Mr. PECORA. For what period of time were you connected with that company as vice president?

Mr. BYRNES. I was elected as vice president of the National City Co., I think, in the summer of 1917.

Mr. PECORA. And continued to hold that office until when?

Mr. BYRNES. Until June, 1931.

Mr. PECORA. Were you assigned to any particular branch or department of that company's business as a vice president?

Mr. BYRNES. Shall I explain or just answer these specific questions?

Mr. PECORA. Yes.

Mr. BYRNES. I had been previously employed with the bond department of the National City Bank before 1917. The bond department of the bank became a part of the National City Co. in the summer, I think, of 1916.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Shortly after that, however, I was detached from active service in the institution to go to England in connection with a group of the important houses in the street in connection with allied financing. I returned from Europe I think in the spring of 1917, May or June, and thereafter became identified first with Mr. Vanderlip in setting up the war savings certificate scheme and then in the scheme that was worked out by me for the Liberty Loan allotments. So that during that period I was sort of not appointed or applied to any particular department.

When I was elected vice president of the National City Co. the field that was allotted to me was the development of the analytical and buying organization of the National City Co., which as you realize from the testimony, is not a banker; it is a merchant, and its business naturally divides into the two aspects of selling and buying, or buying and selling. My job was to develop the analytical and buying organization of the City Co., which, as has been explained to you, was departmentized at that time, and subsequently the men in charge of those departments were one by one I think made vice presidents.

Is that sufficient?

Mr. PECORA. Yes. Was there a department connected with the company that confined its buying and selling or analyses to foreign issues?

Mr. BYRNES. Yes.

Mr. PECORA. Were you at any time connected with that department, Mr. Byrnes?

Mr. BYRNES. That was the last department that I kept under my direct personal supervision.

Mr. PECORA. And in what years did you have supervision of that department particularly?

Mr. BYRNES. All years from 1917 to the date of my resignation.

Mr. PECORA. You heard the testimony that was given here yesterday by Mr. Baker and Mr. Schoepperle of the company with respect to the issuance and flotation of the Peruvian bonds?

Mr. BYRNES. I did, mostly. I would not guarantee that I heard every word of it.

Mr. PECORA. In the course of that testimony reference was made to President Leguia. * * *

Mr. BYRNES. Yes.

Mr. PECORA. As being the head of the Peruvian Government at the time of the issuance of those bonds. Do you recall that?

Mr. BYRNES. Yes.

Mr. PECORA. And some testimony was given to the effect that among the circumstances which induced the National City Co. to lend itself to the flotation of those bonds were the plan of President Leguia for internal improvement of that country. Do you recall that testimony?

Mr. BYRNES. Yes.

Mr. PECORA. As a matter of fact, was not Leguia president of Peru from 1919 on until about 1931?

Mr. BYRNES. I would not trust my memory on dates. He had been President of Peru in either a constitutional or perhaps extra constitutional capacity. He had been head of Peru for quite some

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

period, and it was under his leadership that Peru showed such extraordinary progress in its economic and financial affairs.

Mr. PECORA. He was at the head of the Government between 1921 and 1926, that is, during the period of time in which unfavorable reports were made to the National City Co. by its representatives and South American experts, was he not?

Mr. BYRNES. Your question implies a characterization of various men as experts that perhaps we would not entirely agree on as being experts, Mr. Pecora.

Mr. PECORA. Well, they have been alluded to here as experts, and I am perfectly willing to acknowledge their expertness.

Mr. BYRNES. If I take your definition of their expertness, I am quite willing to admit that apparently the record shows here that various of them at various times expressed an unfavorable point of view as to one phase or another of Peruvian credit.

I will add that during that same period, and in fact even earlier, I myself had refused to consider Peru as having yet reached a point of development that warranted the National City Co., with the standards of conservatism that I had insisted upon, as being a fit subject for National City Co. distribution.

But during that period, even granting the unfavorable opinions, I will add my own opinion that very substantial progress was being made in the economic condition of the country throughout the period of Leguia's regime.

Mr. PECORA. Was that progress reflected in the report or advices contained in the letter which Mr. Durrell sent to the National City Co. from Lima, Peru, under date of July 27, 1927?

Mr. BYRNES. I heard that letter yesterday for the first time.

Mr. PECORA. You mean to say that you learned of the existence of that letter for the first time when it was read in evidence at the hearing here yesterday?

Mr. BYRNES. Yes. And at the time I wondered whether I had seen the letter and had completely forgotten it, and I was going to ask, if I was asked about the letter, whether my initials appear upon it. Do you know?

Mr. PECORA. The original letter is undoubtedly still in the files of the company, which are now before Mr. Train. Perhaps he will show you.

Mr. BYRNES. Is it of any interest that I should check this, whether my recollection is at fault?

Mr. PECORA. While we are on the subject I think it might be worth while, Mr. Byrnes. July 27, 1927, a letter of Mr. Durrell addressed to Mr. Charles E. Mitchell.

(Mr Byrnes conferred with Mr. Train.)

Mr. BYRNES. No. The reason I asked is that it is a practice of mine generally to initial any letter or document that I saw, and my initials are not on that, and I had not seen it before.

Mr. PECORA. That is a clear indication, because of your practice and custom of initialing letters and documents submitted to you, that that letter was never submitted to you, is it?

Mr. BYRNES. It is evidence, but not proof.

Mr. PECORA. Do you know of any reason why the information contained in that letter should have been withheld from you in 1927?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. I haven't the slightest idea. I was in this country during the summer of 1927, but I may not have been at the office. I may have been away on vacation when that letter arrived. That is the only explanation I can think of.

Mr. PECORA. Now, in December of 1927 you will probably recall that the National City Co. participated in the underwriting of $50,000,000 Peruvian loans for which the bonds were issued that month. Was your judgment consulted with respect to the National City Co. taking a participation in that issue?

Mr. BYRNES. That was December, 1927?

Mr. PECORA. Yes, sir.

Mr. BYRNES. You understand that I came down here, of course, without any information as to what I was to be questioned on, and I have not checked, but I think it is a reasonable assumption that I was present when that loan was up for consideration. Mr. Schoepperle was in active charge of it, but I think that I was fully au courant at that time.

Mr. PECORA. Do you recall whether or not you recommended participation in that loan to your company?

Mr. BYRNES. I think the general question of the policy of the National City Co. in regard to Peru had been more or less settled and recommended by myself earlier, and that the $50,000,000 loan that you now mention was a subsequent operation that was in accord with the policy that I had been in entire agreement with.

Mr. PECORA. Apparently that policy had been adopted some time prior to March, 1927, in view of the fact that in that month the National City Co. participated in the offering of a $15,000,000 bond issue, being the so-called tobacco loan to Peru?

Mr. BYRNES. That is my recollection, because the policy was first established and then the individual operations followed that. I have a clearer recollection of my shift in viewpoint in regard to Peru which preceded our active participation in the tobacco loan, than I have in any details of the subsequent operations.

Mr. PECORA. If your judgment was specifically consulted with respect to participation in the $50,000,000 issue of December 1927, it is clear to you now that that letter of Mr. Durrell dated July 27, 1927, had never been called to your attention?

Mr. BYRNES. I never saw it.

Mr. PECORA. Do you know whether its contents were made a subject of discussion between July and December?

Mr. BYRNES. With me?

Mr. PECORA. Yes, sir.

Mr. BYRNES. Not with me.

Mr. PECORA. Between July and December 1927.

Mr. BYRNES. Not with me. That does not preclude it may have been considered by those who may have seen the letter.

Mr. PECORA. But as to any such discussion you know nothing, because you did not participate in it?

Mr. BYRNES. I can not recall anything on that letter.

Mr. PECORA. Mr. Byrnes, do you recall an issue of $8,500,000 6½ per cent bonds due 1958 issued by the State of Minas Geraes?

Mr. BYRNES. Yes; in general.

Mr. PECORA. What do you recall about that issue in general?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. That the National City Co. handled it; that we introduced that credit in this market; that we had perviously over a period of years considered the various South American credits; had more or less ranked them as to those that we were willing to immediately handle; and set aside others that we would reconsider, and that we would keep an eye on, and see how the countries progressed, and specifically in regard to Brazil that we had studied the taxation system of the country and had decided that certain States were at least equally good credits with the National Government, and had considered which of those States were most likely then or later to measure up to our requirements, and in that ranking Minas had been ranked as the third State. My recollection is the State of Sao Paulo was ranked first, Rio Grande do Sul second, Minas Geraes third.

Mr. PECORA. Was that the first time the National City Co. had participated in any financing operations for the State of Minas Geraes?

Mr. BYRNES. It was the first time that the State of Minas had come to this market, to the American market.

Mr. PECORA. Just to digress for the moment, Mr. Byrnes, and going back to the first Peruvian loan of $15,000,000 in March, 1927, which was referred to yesterday, as I now recall it, part of the proceeds of that loan was used to pay off an existing funded indebtedness. Do you recall that circumstance?

Mr. BYRNES. I would have to refresh my recollection on that. May I explain why? I do not want to claim a miraculous memory, but I have rather a good one. The determination of the shift in policy which decided us to go into Peru, I think I was responsible for in the end of 1926 or the beginning of 1927. At the beginning of 1927, I think in February, I left New York and went to Japan on rather a leisurely trip, so that I did not get out there for some time.

It just happens, I think at that time, Mr. Schoepperle, as he explained yesterday, was abroad, and between the time he arrived in New York and I left New York there was a very brief interval, and I think I communicated to him orally my views, and the principles established, and those were subsequently enacted. I think that may have been his embarrassment yesterday at one point where you were asking him whether he had decided or whether he had recommended. At that time he was assistant vice president directly under me, and I take responsibility primarily for the change in the point of view, which was a change in my point of view, which was reflected in the change of the point of view of the National City Co.

Mr. PECORA. Now let us go back to the circumstances that part of the proceeds of that first loan was used to pay off an existing indebtedness.

Mr. BYRNES. Yes.

Mr. PECORA. Who held the bonds representing that existing indebtedness which was paid off by part of the proceeds of that $15,000,000 loan?

Mr. BYRNES. May I appeal to the gentlemen who have the files?

Mr. PECORA. Surely. You may utilize any records available.

Mr. BYRNES (addressing Mr. Train). Do you have the information on that?

Mr. TRAIN. I did not hear the question.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. The question is, Who held—may the reporter read the question?

The SHORTHAND REPORTER. "Who held the bonds that represented that existing indebtedness which was paid off by part of the proceeds of that $15,000,000 loan?"

Mr. TRAIN. Discussing Peru?

Mr. BYRNES. Peru, the tobacco loan, as it was called, the $15,000,000 loan; apparently in the circular somewhere information is given that part of the proceeds were used to pay off existing indebtedness. The question is, What is the character of that indebtedness and by whom was it held?

Mr. TRAIN. My recollection is that it was indebtedness held internally in Peru.

Mr. PECORA. Mr. Train has not been sworn.

Mr. BYRNES. Shall he tell me and shall I tell you?

Mr. PECORA. He can refresh your recollection and you may testify

Mr. BYRNES. It will be his information and not mine.

Mr. PECORA. We had better not get into that, then. We are going to swear Mr Train subsequently, anyway

Now, you say it was shortly prior to March, 1928, that the Brazilian State of Minas Geraes first came into the American market for credits or loans?

Mr. BYRNES. That is my recollection.

Mr. PECORA. And prior to that where had its financing been done?

Mr. BYRNES. At home in Brazil and abroad in the Paris market, and I am not sure but there was some in the London market.

Mr. PECORA. Was not most of it in the Paris market?

Mr. BYRNES. I think the principal State loan floated abroad was in the Paris market.

Mr. PECORA. Do you recall the amount of the outstanding loans which the State of Minas Geraes had floated principally in the Paris market prior to March 1, 1928?

Mr. BYRNES. No. I could not give that without going to the records.

Mr. PECORA. Perhaps the gentlemen from the National City Co. have those records here. Have you those records here, Mr. Train?

Mr. TRAIN. Yes, sir.

Mr. PECORA. The two Minas Geraes loans.

Mr. TRAIN. In Paris?

Mr. PECORA. No, the two Minas Geraes loans here.

Mr. TRAIN. Yes.

Mr. PECORA. And your file on the subject of those loans?

Mr. TRAIN. We have a number of files.

Mr. PECORA. Do they also show the prior loans that were handled in Paris?

Mr. TRAIN. Yes, they do.

Mr. PECORA. Will you make those records available to Mr. Byrnes, please?

(Mr. Train handed documents to Mr. Byrnes.)

Senator COUZENS. While that is being looked up I would like to ask if you have received any complaints with respect to the Chase Bank and Chase Securities Co.

Mr. PECORA. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator COUZENS. Have you started any inquiry along those lines?

Mr. PECORA. Not in any intensive way, because time has not been available for that purpose.

Senator COUZENS. I will submit some information that came to me for you to look into.

Mr. PECORA. Very well, sir.

Mr. BYRNES. This appears to be a photostatic résumé of the details of direct issues as of December 31, 1925, of the State of Minas Geraes, Brazil. At that time there had been issued direct State loans, four different ones. The currency in which they had been issued was francs. Whether they were Belgian, Swiss, of French francs is not specified. I assume French francs. There was the 5 per cent loan of 1927 of 25,000,000 francs with a final maturity at 1948.

Mr. PECORA. Is that 1927?

Mr. BYRNES. 1907.

Mr. PECORA. I thought you said 1927.

Mr. BYRNES. If it was, it was a slip of the tongue. Nineteeen hundred and seven.

Senator BROOKHART. How many dollars would that be?

Mr. BYRNES. Possibly $5,000,000, at that time. With the depreciation of the franc and restabilized value, it is only a million dollars.

Senator COUZENS. Are they in default?

Mr. BYRNES. I would have to look up the records, Senator Couzens.

Senator COUZENS. Do you know whether all the Peruvian securities are in default?

Mr. BYRNES. This is Minas.

Mr. PECORA. This is Minas, a Brazilian State.

Senator COUZENS. Are any of those in default anywhere?

Mr. PECORA. Yes, that was testified to yesterday; they are all in default.

Senator COUZENS. I mean this loan that you are speaking about now, are they in default, any of them?

Mr. BYRNES. I have been out of active business for two years.

Mr. PECORA. These other loans?

Senator COUZENS. Any of the loans that you are now discussing, are any of those in default?

Mr. PECORA. Yes, sir.

Mr. BYRNES. All of these four loans apparently were issued by a French banking firm, so I think that confirms to the fact, Mr. Chairman, that they were issued in French francs, and that we divide roughly any of these figures by 5 and we have the dollar equivalent.

Then there was a 4½ per cent loan of 1910 for 120,000,000 francs. There was the so-called 4½ per cent municipal loan of 1911. That was a direct State loan. I suppose the title "municipal loan" indicates that it was reloaned by the State to its municipalities, because on account of the bad division of taxing power in Brazil the State credits are good and the municipal credits are bad, relatively.

That is rather typical of the taxing situation now in most any Latin country; the States are apt to have the taxing powers and the municipalities not, rather different from our system in this country.

Then there is a 5½ per cent funded loan of 1916 for 16,000,000, and there was one of 4½ in 1911 of 50,000,000, which I skipped.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. 50,000,000 francs?

Mr. BYRNES. 50,000,000 francs. These are all stated in francs. A total of the four loans roughly 210,000,000 francs, or $42,000,000.

Mr. PECORA. When the State of Minas Geraes came into the American market for a loan in the latter part of 1927 or the early part of 1928 the National City Co. became interested in the project, did it not?

Mr. BYRNES. It did.

Mr. PECORA. Who conducted the negotiations on behalf of the National City Co. that led to that company underwriting the issue of $8,500,000 on March 1, 1928?

Mr. BYRNES. My recollection is not clear, Mr. Pecora, on that. I think the files would show very clearly what was done.

Mr. PECORA. Mr. Train, I think, will make the files available to you.

Mr. BYRNES. My recollection is that I sent Mr. Train to Brazil and that the negotiations on the ground were in the first instance initiated by Mr. Train, assisted, I think, by one of the staff of the City Bank down there, who of course had command of the Portuguese language. Mr. Train speaks Spanish, but Portuguese is not quite the same. So I think that those two gentlemen initiated the discussions, but if my recollection is correct, they did not eventuate in actual business then, and Mr. Train actually left Brazil before the business came up again and it was pursued to a conclusion.

May I ask if that is correct?

Mr. TRAIN. Yes, Mr. Byrnes.

Mr. PECORA. Who is Mr. D. C. Baldwin?

Mr. BYRNES. Mr. Baldwin was one of the research and analytical men in the foreign department.

Mr. PECORA. Of the National City Co.?

Mr. BYRNES. Of the National City Co.

Mr. PECORA. Under you?

Mr. BYRNES. Under me. Directly under Mr. Schoepperle, but indirectly under me.

Mr. PECORA. Have you before you the files of the National City Co. with respect to this loan of $8,500,000 which was floated by the National City Co. for the State of Minas Geraes?

Mr. BYRNES. The answer to the question is no, but I suppose they may be gotten.

Mr. PECORA. I understand the file is right before you, is it not?

Mr. BYRNES. Is it? All I have is this [exhibiting photostat].

Mr. PECORA. I think that bound set of papers probably constitutes the file.

Mr. TRAIN. No; that is a Peruvian study, Mr. Pecora.

Mr. PECORA. Where is the Minas Geraes file?

Mr. TRAIN. Here they are, Mr. Pecora.

Mr. PECORA. The Minas Geraes finances file?

Mr. TRAIN. I have been having difficulty in locating the various memoranda and letters asked for by your assistants. I am having considerable difficulty in finding them, I may say, because we have a number of files here and they do not follow in order in any way. We have identified and found a number of the things asked for.

Mr. PECORA. Can you locate the letter, or a copy of the letter, dated June 11, 1927, addressed to Mr. Hynson——

Mr. BYRNES. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. By D. C. Baldwin, of the foreign department of the National City Co. to Mr. Hynson, manager of the Washington office of the National City Co.?

Mr. BYRNES. I will answer just as fast as I can. You understand my difficulties?

Mr. PECORA. Yes; I know that.

Mr. BYRNES. I think I have the letter. Letter of June 11, 1927, addressed to Mr. Hynson.

Mr. PECORA. And signed by Mr. D. C. Baldwin.

Mr. BYRNES. There is no signature on it, but the initials are D. C. B., which I assume is Mr. Baldwin.

Mr. PECORA. Which indicated Mr. Baldwin?

Mr. BYRNES. I should say so.

Mr. PECORA. I ask that that letter be read into the record. I shall read from my copy:

STATE OF FINANCES, FOREIGN DEPARTMENT,
Minas Geraes, June 11, 1927.

To R. W. Hynson, Manager Washington Office.

DEAR MR. HYNSON: We are interested in possible financing for the State of Minas Geraes, Brazil. In this connection we wish to investigate further certain outstanding foreign loans of the State which were issued in Paris, and Mr. Byrnes is very anxious if possible to obtain copies of the loan contracts.

The first three loans, with the respective dates of issuance, are as follows: State of Minas Geraes——

Mr. BYRNES. That is apparently excerpts. It is not the entire letter.

(Mr. Byrnes handed document to Mr. Pecora.)

Mr. PECORA. Oh, yes. Well, that is immaterial matter.

Mr. BYRNES. I do not know, but you were asking for the letter.

Mr. PECORA. I will just read the portions of the letter that I think pertain to the examination, and then if you want to refer to any other portions of the letter, Mr. Byrnes, in answer to any questions, you are at liberty to do so.

The first three loans, with the respective dates of issuance, are as follows:
5 per cent loan of 1907 issued in Paris in October, 1907, by J. Loste & Cie.
4½ per cent loan in 1910, issued in Paris June 15, 1910, by Perier & Co.
4½ per cent loan of 1911, issued in Paris April 11, 1911, by Perier & Co.

There is also outstanding a fourth external loan known as the 5½ per cent funding loan of 1916.

Owing to financial difficulties which the State experienced during the first years of the World War, the State was unable to maintain the service on the three loans mentioned above, and this funding loan was used for the purpose of funding the matured and unpaid coupons of the three preceding loans.

We are unable to ascertain the date of issuance of this loan, and probably, owing to its nature as a funding loan, it was never offered publicly. The various reference books state that the plan in regard to this loan was published in October, 1916, and that the plan was not actually put into execution until June, 1920. So that the location of this contract would probably require going through several years of the files. We do not wish you to take any undue trouble in this connection, but would like to have you make an attempt and report to us.

Very truly yours,

Now, as a result of the inquiries made by the National City Co. and the information it received, the National City Co. finally agreed, to float this loan of $8,500,000 in March, 1928, for the State of Minas Geraes did it not?

Mr. BYRNES. Yes, after very considerable consideration and study.

Mr. PECORA. In connection with that study and consideration did you learn that there had been any default within a few years prior to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

1928 on the part of the State of Minas Geraes in meeting its outstanding obligations on loans which had been floated abroad?

Mr. BYRNES. I do not know as I can accept the word "default" without definition, Mr. Pecora. There are all shades of failure to meet a given obligation. My recollection in the case of Minas Geraes is that they had some agreement, they had an agreement with a French banking house, to which they had supplied funds for a more or less specified purpose. This is rather delicate, but my recollection and impression is that, due more or less to the failure of that French banking house, which was located in Paris but was in some way involved I think also in Russia, the funds provided by the State were not available, and that because of that failure of the banking house to keep its commitment the State either refused or was unable to keep its part.

Now that is a general recollection which can undoubtedly be more accurately stated from the files.

Mr. PECORA. Was the banking house that you have referred to the fiscal agent in Paris of the State of Minas Geraes at that time?

Mr. BYRNES. I think so.

Mr. PECORA. These prior existing loans which had been floated in Paris by the State of Minas Geraes were payable in gold francs, were they not?

Mr. BYRNES. I think that that is doubtful. There was some clause in the contract that had to be adjudicated, and I am not familiar as to how it was finally adjudicated.

Mr. PECORA. An adjudication of that question had been made prior to March, 1928, had it not?

Mr. BYRNES. I would have to testify——

Mr. PECORA. Well, won't you kindly refresh your recollection by whatever records have been produced here?

Mr. BYRNES. They have not been produced to me, Mr. Pecora.

Mr. PECORA. They are all here, Mr. Byrnes. They are right here on the table before you. You might look at them. They are here for all purposes.

Mr. BYRNES. Yes, but they are not available to me. I must ask them each time.

Mr. PECORA. Mr. Train, would you be good enough to make those records of your company available to Mr. Byrnes?

Mr. TRAIN. Of course, Mr. Pecora.

Mr. PECORA. You have to refresh your recollection, do you not, in order to answer these questions?

Mr. BYRNES. Why, certainly. Of course I do.

Mr. PECORA. And do you feel that the records and the files of the National City Co. with respect to these loans would serve to refresh your recollection?

Mr. BYRNES. I should certainly say so.

Mr. PECORA. Now will you kindly consult those records to refresh your recollection?

Mr. TRAIN. What was the question?

Mr. RANDOLPH (the shorthand reporter). "An adjudication of that question had been made prior to March 1928, had it not?"

Mr. TRAIN. Yes.

(Mr. Byrnes conferred with Mr. Train off the record.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. I am informed that the settlement was by agreement between the State, and I assume the French—was it a bondholders' committee?

Mr. TRAIN. Association.

Mr. BYRNES. Association, the French official association, a French official association, Associacion Nationale Porteurs des Français de Valeurs Mobiliers who apparently represents the French bondholders in the settlement. I have here a statement apparently of that association in regard to these loans, in French.

Mr. PECORA. Mr. Byrnes, did you have personal knowledge of these elements back in March, 1928, when you were still a vice president——

Mr. BYRNES. Oh, why, certainly.

Mr. PECORA. Connected with the National City Co.?

Mr. BYRNES. Certainly.

Mr. PECORA. You gave your time, study, and consideration to the question of the advisability of the National City Co. underwriting this $8,500,000 loan in March, 1928, did you not?

Mr. BYRNES. Oh, yes.

Mr. PECORA. Have you now no recollection of the circumstances surrounding the flotation of this loan by the National City Co.?

Mr. BYRNES. I have a general recollection, but your questions are specific, and I can not answer those questions except by refreshing my recollection.

Mr. PECORA. Well now, won't you please——

Mr. BYRNES (interposing). And I have no right to ask for those records except as you request these gentlemen to assist me.

Mr. PECORA. Well, let us settle that now. Mr. Train, is there any objection to Mr. Byrnes' having those records on the Minas Geraes loan placed before him so that he may readily consult them from time to time to refresh his recollection?

Mr. TRAIN. I know of no objection, Mr. Pecora.

Mr. PECORA. Then will somebody be good enough to put the file before Mr. Byrnes, so that it will be readily available to him?

(Mr. Train complied with request of Mr. Pecora.)

Mr. BYRNES. Well now, in this case, answering your question, there was an agreement between the State and this official association of French bondholders.

Mr. PECORA. Before that agreement there was litigation, was there not?

(Mr. Byrnes conferred with M. Train.)

Mr. TRAIN. Mr. Pecora, I am working under considerable handicap, since I have been handed a 3-page memorandum asking for various papers to be located in various files, and I am trying to do that simultaneously with Mr. Byrnes' testimony, which makes it extremely difficult for me to pay attention. If somebody could be allowed to come to the table and locate this material while I sit here and listen to your questions and Mr. Byrnes' answers, it would help me considerably.

Mr. PECORA. I suppose in the long run we would be saving time if we did that. I am sorry that it is necessary.

Mr. BYRNES. I am sorry too, but I am just not able to answer these questions.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. You feel unable, Mr. Byrnes, to answer these questions upon your mere recollection?

Mr. BYRNES. I think it would be a mistake to attempt to answer such questions when the facts are undoubtedly available in the City Co.'s files.

Mr. PECORA. I want the fullest possible answers, and I know those are what you want to make.

Mr. BYRNES. I certainly will be glad to answer anything exactly and accurately that I know.

Mr. TRAIN. I might explain parenthetically that there is some difficulty here because some of the material listed in this memorandum is contained in files which your associate, Mr. Saperstein, did not specifically ask be brought to Washington. It created a little confusion here.

Mr. PECORA. Have you the files here?

Mr. TRAIN. We have a number of the files, such files as Mr. Saperstein asked for.

Mr. BYRNES. You see, the very volume of the files and consideration it was given makes it a little difficult to recall the things in detail. It was pretty complicated.

Mr. PECORA. Do you recall whether or not a dispute had arisen between the French holders of the bonds of the State of Minas Geraes prior to March, 1928, in which the issue was whether or not the State should pay those bondholders in gold or in paper.

Mr. BYRNES. My recollection is that there was a dispute between the State and the bondholders in regard to a currency clause in either the bonds or the loan contracts.

Mr. PECORA. That dispute was taken into the French courts by the bondholders, for determination was it not?

Mr. BYRNES. My recollection is yes.

Mr. PECORA. And the French court handed down a decree in favor of the contention of the bondholders substantially to the effect that the bonds were payable in French gold francs. Do you recall that?

Mr. BYRNES. I do not, no. It may be so. At that time there were a great many of these cases before the French courts on currency clauses, and naturally the French courts in every case where they could would hold in favor of their own citizens.

Mr. PECORA. You do not mean to say that naturally the French courts would ignore the specific terms and provisions of the indenture agreements——

Mr. BYRNES. No, but naturally——

Mr. PECORA (interposing). And make decisions in favor of bondholders merely because they were French, do you?

Mr. BYRNES. No, no. A decision, I suppose, in any court of any country would have to be justified by the evidence, but if there were any possibility of the weight of evidence perhaps just teetering one way or the other, naturally it would be resolved in favor of their own citizens.

Mr. PECORA. Don't you know that the State of Minas Geraes did not even raise a defense to the contention of the French bondholders that the bonds were payable in gold francs?

Mr. BYRNES. Yes, but you know that the question of the bondholders against a sovereign State and the right to sue, a decision of a French court is not necessarily binding upon the United States Government or upon the Government of the State of Minas?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. But the State of Minas Geraes accepted the decision of the French courts in that respect, did it not?

Mr. BYRNES. I would like to be as positive as I feel, but my recollection is that the State of Minas did not accept the decision of the French court.

Mr. PECORA. Did not the State of Minas Geraes——

Mr. BYRNES (interposing). May I check it, Mr. Pecora, with Mr. Train?

Mr. PECORA. Let me see if I can refresh your recollection by my question: Did not the State of Minas Geraes take an appeal to a higher judicial tribunal, which appeal was based solely on the ground that the original court or tribunal had no jurisdiction? Do you recall that?

Mr. BYRNES. I do not. I am sorry, but I do not. If that is so, it has slipped my memory.

Mr. SCHOEPPERLE. Do you mind if I hand Mr. Byrnes a memorandum covering that point?

Mr. PECORA. Hand Mr. BYRNES anything from your records which will enable him to refresh his recollection. We want these questions answered.

(Mr. Schoepperle handed Mr. Byrnes the documents.)

Mr. PECORA. Have you completely forgotten all these details, Mr. Byrnes?

Mr. BYRNES. Completely? I would not say that; no.

Mr. PECORA. Or to the extent that——

Mr. BRYNES (interposing). I have forgotten them to the extent that I am telling you. May I read from this?

Mr. PECORA. What are you reading from?

Mr. BRYNES. This is a memorandum or extract from a letter from Mr. Train to myself dated June 12, 1927. (Addressing Mr. Train:) I assume that this letter was written after you had studied the situation either in New York and Minas——

Mr. TRAIN. And Bello Horizonte.

Mr. BRYNES. And the State's capital.

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

Mr. BYRNES. June 12. It is an extract from a letter of that date, June 12, 1927. It is not very long.

Mr. PECORA. All right; go ahead.

Mr. BYRNES (reads):

The State authorities contend that they received no complaints regarding the payment of the service of the three loans of 1910, 1911, and 1916 in paper francs up to 1924. Apparently this refers to the action taken by the bondholders committee through diplomatic channels. The State contends that it furnished explanation of its position in this respect, and that the coupons of that year and of 1925 were paid without protest from the bondholders.

Late in 1925 it was informed by Bauer, Marchal & Co. that a suit was pending in the French courts, and shortly thereafter judgment had been rendered against the State by default.

Parenthetically may I assume that that means that the State did not appear?

Mr. PECORA. The State did not put in a defense?

Mr. BYRNES. Yes. [Continues reading:]

The State authorities received no formal summons to appear to defend the suit or any official notification thereof. In accordance with French law, the summons was served on the proctor of the French Republic. The State contends

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

that immediately it was placed in cognizance of the facts, it engaged French counsel, and caused an appeal to be filed. The grounds for the appeal were chosen with a view to any subsequent action the State might have against Bauer, Marchal & Co.

Mr. PECORA. What was the outcome of that appeal taken by the State?

Mr. BYRNES (addressing Mr. Train). Is the decision of the court here in the files?

Mr. TRAIN. I do not know.

Mr. PECORA. Well, let us see if you recall that during the pendency of the appeal the State of Minas Geraes made a settlement with the French bondholders and paid them in gold. Do you recall that?

Mr. BYRNES. I am reminded that a settlement was entered into between the State and the bondholders or their representatives. The exact terms of that settlement are not clear in my mind.

Mr. PECORA. Eventually the National City Co., with your concurrence and approval or recommendation, decided to float this $8,500,000 issue of bonds for the State of Minas Geraes, did it not?

Mr. BYRNES. Yes.

Mr. PECORA. Do you recall at what price those bonds were offered to the public?

Mr. BYRNES. No; I do not.

Mr. PECORA. Can you refresh your recollection on that point by the records?

Mr. BYRNES. I have before me an advertisement apparently appearing in the papers of Monday, March 19, 1928, showing an offering of the $8,500,000 State of Minas 6½ per cent bonds, in 1928, at the price of 97½ and interest, made by the National City Co., Kissel, Kinnicutt & Co., and the J. Henry Schroeder Banking Corporation.

Mr. PECORA. What was the spread to the National City Co. on this flotation?

Mr. BYRNES (after conferring with others). Apparently the net cost was 93.167 percent, a spread of somewhat over 4 points.

Mr. TRAIN. 4.333.

Mr. PECORA. What do you mean when you say the "net cost"? At what price were these bonds underwritten?

Mr. BYRNES. You see, we bought the bonds on a flat basis.

Mr. PECORA. What was that flat basis?

Mr. BYRNES. We bought the bonds at 95 flat, and deducting from that price the accrued interest to date made the price.

Mr. PECORA. 93.167?

Mr. BYRNES. Yes. We deal in this market, in the American market, generally on an "and interest" basis. Most foreign markets deal in bonds flat, and I assume this arrangement was probably due to the fact that the State officials were accustomed to thinking in terms of flat prices, and at the same time the London banking house, you see, J. Henry Schroeder & Co., were with us, and I think their practice a little bit dictated.

Mr. PECORA. Subsequent to that was another bond issue floated by the National City Co. on behalf of the State of Minas Geraes, in the sum of $8,000,000?

Mr. BYRNES. Yes. In the file before me I see an advertisement over the same names of 8,000,000.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. They were also 6½-percent bonds?

Mr. BYRNES. They were 6½-percent bonds. The series of 1929, series A of 1929.

Mr. PECORA. When were they issued in 1929? Was it about September 1?

Mr. BYRNES. The date of this advertisement is September 16. That would more or less fix the date of public offering.

Mr. PECORA. Yes. The National City Co. took part in that offering, did it not?

Mr. BYRNES. Yes.

Mr. PECORA. At what price were they offered to the public?

Mr. BYRNES. 87 and interest.

Mr. PECORA. 87 and interest?

Mr. BYRNES. Yes.

Mr. PECORA. A year and a half before the $8,500,000 issue bearing the same rate of interest was offered at 97½. How do you account for a depreciation of 10 points in the similar issue offered a year and a half later?

Mr. BYRNES. By the general conditions of the market. A year and a half lapse of time there, you see, from——

Mr. PECORA (interposing). From March 1928 to September 1929.

Mr. BYRNES. There was a substantial change in the market of practically all bonds of this type in the interim.

Mr. PECORA. What was the spread to the National City Co. on that issue of September 1929?

Mr. BYRNES. Again the bonds were bought at a flat price of 84¾ and with the allowance for the interest deduction, the net price to The National City Co. appears to have been 82.33, a spread of 4.67 points.

Mr. PECORA. Have you before you a copy of the circular or prospectus that accompanied this offering in September 1929?

Mr. BYRNES. Yes.

Mr. PECORA. Will you produce it, please?

(Mr. Byrnes handed Mr. Pecora documents.)

Mr. PECORA. Do you find in this circular the following statement with regard to the use to be made of the proceeds of this loan, "The proceeds of this loan will be utilized for purposes designed to increase the economic productivity of the State"?

Mr. BYRNES. That statement is contained in the summary on the outside page of the circular. In the letter which constitutes the actual body of the prospectus from the President of the State, that purpose was stated a little bit more fully.

Mr. PECORA. How was it stated in that portion of the circular to which you have just referred? Will you just read it into the record?

Mr. BYRNES. It says:

The proceeds of the loan will be utilized as provided in law No. 1061 of August 16, 1929, for all or some of the following mentioned purposes: Purchase of additional equipment for the South Minas Railway and the Paracatu Railway, the further development of the Electric Light & Power system of Bello Horizonte, the State capital, advances to the Banco do Credito Real of Minas Geraes—

the land credit bank—

for the purpose of increasing its facilities for making agricultural and mortgage loans, for loans to the municipality of the capital, and to other municipal cor-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

porations of the State, and for a[illegible] other productive undertakings duly authorized by law.

Mr. PECORA. As a matter of fact, do you know whether or not the proceeds of this second loan of $8,000,000 were used for those purposes entirely?

Mr. BYRNES. Of my own knowledge?

Mr. PECORA. Your own knowledge.

Mr. BYRNES. No.

Mr. PECORA. Do you recall that, as a matter of fact, around $4,000,000 of the proceeds of this second loan of $8,000,000 were used to pay off existing short-term obligations held by the National City Co.?

Mr. BYRNES. I have no such recollection.

Mr. PECORA. And by Schroeder?

Mr. BYRNES. I have no such recollection, no. It may be so. I do not recall it. I would rely upon the fiscal officers of the State of Minas to apply the funds in accordance with their statement of the purposes.

Mr. PECORA. Will you see if you have among the files of the National City Co. before you, a copy of the contract?

Mr. BYRNES (after examining documents). Mr. Pecora, may I speak to you off the record?

Mr. PECORA. Yes.

(Discussion off the record.)

Mr. BYRNES. Well, Mr. Pecora, that was four years ago, and I certainly was not being paid, nor anybody else, either undistributed profits or otherwise, for handling any of the legal details, and this appears to have been a question of legal details. And in the end they were interested in seeing that the issue was legally made, and we got from our counsel in New York, supported by high legal opinion in Brazil, an absolute opinion as to the legality of the issue.

Mr. PECORA. Now, Mr. Byrnes, what I want to find out essentially is this: Is it not a fact that when the National City Co. put out this circular offering the second loan of $8,000,000 to the American investing public, which circular contained the statement that the proceeds of the loan were to be utilized for purposes designed to increase the economic productivity of the State of Minas Geraes, the National City Co. knew that approximately half of this loan was to be used to pay off short-term obligations which it held. That is what I want to know.

Mr. BYRNES. That very law, Mr. Pecora, under which the authority was granted contains a paragraph to this effect:

> The Government is also authorized to make, within the country or abroad, in national or other coin short-term loans or other credit operations within the limits above mentioned—

And referring to the present authorization—

> For all and any of the purposes declared in letters a, b, c, d, and e of this law, and such loans and transactions for short terms shall be paid and redeemed with the proceeds of the credit operations authorized by this law.

Mr. PECORA. Exactly. And you find that among the records of the National City Co., don't you?

Mr. BYRNES. Yes. And that is apparently a transaction within the law.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. When did the National City Co. receive the information embodied in the records from which you have just read?

Mr. BYRNES. This is a photostatic copy of the translation. And I am informed here that our counsel wrote the law, so to speak, so that I am assuming that would give me greater confidence that it was legally issued.

Mr. PECORA. You mean that Shearman and Sterling wrote the law for the State of Minas Geraes?

Mr. BYRNES. No; I would hardly say that. I think rather that Momsen and Torres, who were our counsel down there, that they drafted the law, which would be a better way of putting it, than that they wrote the law.

Mr. PECORA. And you might be right in both instances.

Mr. BYRNES. Well, that would be rather extraordinary to say the least.

Mr. PECORA. All right. But, Mr. Byrnes, does it now appear to you that between the flotation of the first loan of $8,500,000, in March of 1928, and the flotation of this second loan of $8,000,000 in September of 1929, some short term loans or advances had been made to the State of Minas Geraes? Does that appear to you to be a fact now?

Mr. BYRNES. I assume that would be the fact.

Mr. PECORA. What was the amount of these short term loans or advances?

Mr. BYRNES. Well, now, let me see——

Mr. PECORA (interposing). Just approximately will do.

Mr. TRAIN. In what period, Mr. Pecora?

Mr. PECORA. Those that were paid out of this $8,000,000 loan.

Mr. TRAIN. Well, there were £650,000 and, let me see, $800,000.

Mr. BYRNES. Apparently the loan was split between——

Mr. PECORA (interposing). Give us the aggregate amount in terms of dollars.

Mr. BYRNES. Well, I would say $750,000, and the equivalent of £650,000, which at that time would have been, roughly—well, let me see——

Mr. PECORA (interposing). So that between $3,000,000 and $4,000,000 of the proceeds of this $8,000,000 loan, instead of having been used for the purposes designed, to increase the economic productivity of the State of Minas Geraes, were actually used to pay back those who had made short-term loans or advances to the State.

Mr. BYRNES. No, I think the language here is correct. It says the proceeds will be utilized, or if you will change that, were utilized as provided in law No. 1061.

Mr. PECORA. Now, the statement on the face of the prospectus is specifically as follows, isn't it:

> The proceeds of this loan will be utilized for purposes designed to increase the economic productivity of the State.

Mr. BYRNES. Yes, but that is preceded by a statement that the following summary is based upon the accompanying letter signed by His Excellency Antonio Carlos Ribeiro de Andrada, President of the State of Minas Geraes.

Mr. PECORA. And in the summary of the letter placed in this prospectus that statement is made concerning the utilization to be made of the proceeds of this loan, is it not?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. Yes.

Mr. PECORA. That statement is couched in the words I have just read.

Mr. BYRNES. Yes.

Mr. PECORA. That the proceeds of this loan will be utilized for purposes designed to increase the economic productivity of the State, is that correct?

Mr. BYRNES. Yes; and I think it is quite correct.

Mr. PECORA. When, as a matter of fact——

Mr. BYRNES (interposing). Have you that——

Mr. PECORA (continuing). One minute. When as a matter of fact between $3,000,000 and $4,000,000 of the proceeds of this $8,000,000 loan, were actually used to pay back to the lenders between $3,000,000 and $4,000,000 of short term advances or loans, is that right?

Mr. BYRNES. Yes; but those advances had been made for those purposes, you must remember.

Mr. PECORA. Those advances had been made for those purposes, but why was the public told that the proceeds of this particular loan represented by this bond issue were going to be utilized, not to pay back those existing short-term obligations but directly for purposes designed to increase the economic productivity of the State?

Mr. BYRNES. Because the buyer of a bond is interested in the essential facts rather than the machinery.

Mr. PECORA. The essential fact in this case was that those short-term loans were to be paid back out of the proceeds of this loan, isn't that so?

Mr. BYRNES. Yes; but——

Mr. PECORA (interposing). And the public was not told that fact in this circular, was it?

Mr. BYRNES. Yes.

Mr. PECORA. Where?

Mr. BYRNES. Right in the back, under law no. 1061.

Mr. PECORA. Read it.

Mr. BYRNES. It says:

The proceeds of this loan——

Mr. PECORA (interposing). Read the information that you say is contained in that circular, which informs the public that a substantial part of the proceeds of that loan was to be used to pay back those short-term advances.

Mr. BYRNES. That is inherent in the first phrase, that the proceeds of the loan will be utilized as provided in law 1061.

Mr. PECORA. Is that the information given to the public to inform it that the proceeds, or a substantial part of the proceeds, were to be used to pay back those short-term advances?

Mr. BYRNES. Yes, sir.

Mr. PECORA. Is that what you claim served notice on the public that nearly half of the proceeds of this loan was to be used to pay back those short-term loans?

Mr. BYRNES. Mr. Pecora——

Mr. PECORA (interposing). Won't you answer that question?

Mr. BYRNES. Well, excuse me. Of course, I will answer your question, but——

Mr. PECORA (interposing). Please do so then.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. But you want my opinion. If you ask me: Does this paragraph contain the direct statement that certain short-term advances incurred for these purposes were to be refunded by this loan, I must answer no, it does not state in here that short-term advances incurred for those purposes are going to be paid back. But that machinery was provided in the law.

Mr. PECORA. Well, Mr. Byrnes, why was not the simple statement embodied in this circular issued to the American investing public, that between $3,000,000 and $4,000,000 of the proceeds of this loan were to be applied to the payment of the short term loans? Why. was not that simple statement put in the circular?

Mr. BYRNES. Because it was more important to state the real purposes for which the borrowing was made, rather than the machinery through which it was to be applied.

Mr. PECORA. It was the purpose of the circular to give the investing public here, who were asked to buy those $8,000,000 worth of bonds, a full and complete picture of the purposes behind this loan, wasn't it?

Mr. BYRNES. Yes.

Mr. PECORA. And if it was understood and known to the National City Co. at the time of this flotation that between $3,000,000 and $4,000,000 of the proceeds of this loan were to be used to pay back short term loans or advances, then held either wholly or in part by the National City Co., why was not that simple statement made in this circular instead of the statement reading as follows:

> The proceeds of this loan will be utilized for purposes designed to increase the economic productivity of the State.

Mr. BYRNES. Do you wish me to answer by giving my opinion?

Mr. PECORA. I have asked the question and am now awaiting your answer.

Mr. BYRNES. In my opinion there is no investor that I know of who would have had the slightest interest, or whose judgment would have been in the least affected, by the fact that the moneys from this loan were to be used to pay advances which were made for these purposes. But such investor is interested in the real expenditures of the State, and for what purpose the State is really borrowing. And that is the essential information which is given. Now, to have quoted the law in full, to have embodied in the prospectus the full legal opinion of our Brazilian counsel and our New York counsel on this thing, would have made such prospectus so inordinately long that there would have been no chance that the investor would have read it, in my opinion.

Mr. PECORA. Is that your statement now?

Mr. BYRNES. Yes.

Senator BROOKHART. That proposition would not have taken much space, just to set out the interest of the National City Co. and say that the company itself was going to have in this money, would it?

Mr. BYRNES. It is assumed in all financial practice in every market I know that the fiscal agents and bankers for the Government carry it with short-term advances, just as the Federal Reserve bank carries the United States Government pending the funding operation.

Mr. PECORA. Why do you say it is assumed by everybody? What do you know as to what is in the minds of the general mass of the investing public when they receive circulars offering bonds for their subscription?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. Well, I do not know much that is in the mind of the investing public, perhaps, but I have had a certain amount of contact with that public over a period of a good many years.

Mr. PECORA. The elements which you refer to may be known to the trained and sophisticated bond buyer, but you certainly do not mean to tell this committee, do you, Mr. Byrnes, that the mass of the investieg public here in America know the elements to which you have just referred?.

Mr. BYRNES. Naturally, they depend upon the bankers to see that the issue is properly made, and the bankers in turn must depend on counsel to see that the necessary legal formalities are set up.

Mr. PECORA. The average investor, the average bond buyer, does not look into those things, does he?

Mr. BYRNES. He depends, first, upon the banker, and they in turn must depend upon their counsel as to the matter of legality.

Mr. PECORA. And the bond buyer relies considerably upon the prestige of the offering and distributing house, doesn't he?

Mr. BYRNES. Why, certainly he does, not only here but anywhere else that I know of.

Mr. PECORA. Exactly, anywhere.

Mr. BYRNES. Yes, sir.

Mr. PECORA. The National City Co. considered that it not only had the prestige which it had developed since its incorporation in1911, but that it also had the prestige represented in the name of the National City Bank, didn't it?

Mr. BYRNES. I do not think the prestige of the National City Bank had anything to do with the prestige achieved by the National City Co. in the course of a careful and conservative development of its business over the years.

Mr. PECORA. Don't you know that the National City Co. put out literature for general distribution among the investment public connecting it specifically with the National City Bank, calling attention to the history of the National City Bank, and referring to the bank as having been chartered way back in the early days of the Republic and as having had as its first president a member of the cabinet of George Washington? Don't you know that?

Mr. BYRNES. Do you mean that the National City Co. put out such literature?

Mr. PECORA. Yes. Don't you know that such literature was put out either by the National City Co. or the National City Bank?

Mr. BYRNES. I do not know. You asked me about the National City Co., and I do not know that any such literature was put out by the City Co.

Mr. PECORA. If you will come here this afternoon, Mr. Byrnes, I will show you some of it.

Mr. BYRNES. That is all right. I am perfectly willing to be shown if you can do so. But you asked me the question about the National City Co., and I do not know any such thing.

Mr. PECORA. Mr. Byrnes, you did not have charge of putting out literature on behalf of the National City Co., did you?

Mr. BYRNES. I did not.

Mr. PECORA. Do you know who did have charge of that?

Mr. BYRNES. No; I do not.

Mr. PECORA. It had a publicity department, didn't it?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. Yes, and a different man at different times.

Mr. PECORA. Who was at the head of it in 1927, 1928, and 1929?

Mr. BYRNES. I think Mr. McNamee.

Mr. PECORA. Is he still connected with the company, do you know?

Mr. BYRNES. I do not know. I do not think he is though.

Mr. TRAIN. That is, at any rate he headed a department, and over him was someone else.

Mr. PECORA. Is Mr. Baker in the room?

Mr. TRAIN. I believe not.

Mr. BYRNES. I had nothing to do with that, Mr. Pecora.

Mr. PECORA. You never saw such literature as I have referred to?

Mrl BYRNES. No; I did not. That is, I do not recall it.

Mr. PECORA. Mr. Byrnes, are both of these bond issues of the State of Minas Geraes which we have been referring to in the course of your examination, now in default?

Mr. BYRNES. I overheard your statement that they were, made by you to Senator Brookhart, otherwise I would not attempt to state.

Mr. PECORA. Can you confirm that?

Mr. BYRNES. I have talked with Mr. Train, and he confirms that the last two coupons have not been paid.

Mr. PECORA. Well, the default was made in September of 1931, wasn't it?

Mr. BYRNES. No; in 1932, I am informed. The March, 1932, coupons were not paid, I believe.

Mr. PECORA. Wasn't that in September of 1931?

Mr. TRAIN. The September, 1931, coupons were paid out of the service reserve fund impounded with the bank.

Mr. PECORA. What is the first issue of those bonds quoted at now?

Mr. BYRNES. Around 21 or 22, Mr. Train tells me.

Mr. PECORA. What is the second issue quoted at?

Mr. BYRNES. I assume at about the same price but I don't know.

Mr. PECORA. Now, Mr. Chairman, that concludes the questioning of this witness. But I do want to examine Mr. Train on the subject of these two foreign issues.

The CHAIRMAN. Mr. Train, please stand, hold up your 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 this committee, so help you God?

Mr. TRAIN. I do.

TESTIMONY OF GEORGE F. TRAIN, SCARSDALE, N. Y.

Mr. PECORA. Mr. Train, give your full name, address, and occupation, please, to the committee reporter.

Mr. TRAIN. My name is George F. Train, 12 Colvin Road, Scarsdale, N. Y., a member of the foreign buying department, National City Co.

Mr. PECORA. What is your business or occupation?

Mr. TRAIN. I am a member of the foreign department, National City Co.

Mr. PECORA. What position do you hold there?

Mr. TRAIN. I have no official position.

119852—33—PT 6——25

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. How long have you been connected with the foreign department of the National City Co. in any capacity?

Mr. TRAIN. Since February of 1926.

Mr. PECORA. Do you recall the negotiations, facts and circumstances of the underwriting and offering of the $8,500,000 of Minas Geraes bonds by the National City Co. in March of 1928?

Mr. TRAIN. I recall particularly the negotiations and investigations which I made in Brazil in the year 1927. However, at the time of the 1928 loan, when it was finally issued in March of that year, and for several months prior thereto, I was again in South America. I was not in New York.

Mr. PECORA. Did you express any judgment, opinion, or recommendation to the executive officers of the National City Co. with respect to the underwriting of this loan of March, 1928?

Mr. TRAIN. I did.

Mr. PECORA. Were any of your expressions submitted in writing?

Mr. TRAIN. They were.

Mr. PECORA. Have you copies of them here, or the originals, if possible?

Mr. TRAIN. Mr. Pecora, the State of Minas Geraes No. 1 file, the negotiation file, which contains practically all of my letters——

Mr. PECORA (interposing). I do not hear you. Please speak up louder.

Mr. TRAIN. The No. 1 State of Minas Geraes file, which contains the most of my letters, does not appear to be here. I am told that one of your associates subpœnaed the specific files that he wanted brought to Washington, and apparently that was not one of them. That file is in New York and can be produced later if desired. We can have it here by to-morrow morning the first thing.

Mr. PECORA. Were not all the files referring to the Minas Geraes loans asked for by subpœna?

Mr. TRAIN. I do not know, Mr. Pecora. Mr. Law handled that.

Mr. PECORA. Senator, if you will take a recess at this time, we will go over the files and find out what the situation is.

Mr. TRAIN. Mr. Pecora, if you have extracts from those files, I am prepared to accept anything that you have.

Mr. PECORA. I am suggesting to the chairman of the committee that a recess be taken now, instead of within half an hour, to enable us to do that very thing, and we will probably save time in the long run, by that process, Mr. Chairman.

The CHAIRMAN. The subcommittee will stand in recess until 2 o'clock p. m.

(Thereupon, at 11.45 a. m. the committee recessed until 2 o'clock p. m. the same day.)

AFTER RECESS

The subcommittee resumed at 2 o'clock p. m. on the expiration of the recess.

The CHAIRMAN. The subcommittee will resume. Who will you have first, Mr. Pecora?

Mr. PECORA. Mr. Chairman, there is some evidence I want to present about a matter wholly unrelated to the Minas Geraes bond issues, which are the subject of inquiry in connection with the examination of Mr. Train who is now on the stand. So, with your per-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

mission, I should like to suspend my examination of Mr. Train at this point, but having him remain in the room, and ask that Mr. Baldwin be called to the stand.

The CHAIRMAN. It is so ordered. Please stand, hold up your 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 this subcommittee, so help you God?

Mr. BALDWIN. I do.

TESTIMONY OF SAMUEL W. BALDWIN, MAPLEWOOD, N. J., TREASURER NATIONAL CITY CO.

Mr. PECORA. Mr. Baldwin, will you give your full name to the committee reporter?

Mr. BALDWIN. Samuel W. Baldwin.

Mr. PECORA. And your residence.

Mr. BALDWIN. Maplewood, N. J.

Mr. PECORA. And your business or occupation.

Mr. BALDWIN. National City Co.

Mr. PECORA. What position do you hold with the National City Co.?

Mr. BALDWIN. Treasurer.

Mr. PECORA. How long have you been its treasurer?

Mr. BALDWIN. Since June 1, 1929.

Mr. PECORA. Prior to that time were you connected in any other capacity with that company?

Mr. BALDWIN. Yes.

Mr. PECORA. Will you give briefly a history of your connection with that company, when it commenced, the various positions you may have held up to the time when you became treasurer in 1929?

Mr. BALDWIN. Well, I came to the National City Co. from N. W. Halsey & Co. in August of 1916. At first I was a clerk, and I was later made chief clerk, and later assistant treasurer. I can not give you the dates as I do not remember them.

Mr. PECORA. All right.

Mr. BALDWIN. And then I remained assistant treasurer until I was made treasurer of the company.

Mr. PECORA. Do you recall a transaction in which the National City Co. in 1931 underwrote an issue of 4¼ per cent serial bonds issued by the Port of New York Authority, and having various maturities?

Mr. BALDWIN. I do.

Mr. PECORA. Can you tell the committee the general purpose of the loan represented by those bonds?

Mr. BALDWIN. I have nothing to do with that and I would not know.

Mr. PECORA. Was the entire issue underwritten by the National City Co., or did it do so in combination with others?

Mr. BALDWIN. With others.

Mr. PECORA. In combination with others?

Mr. BALDWIN. Yes, sir. It was a joint account.

Mr. PECORA. You say it was a joint account?

Mr. BALDWIN. Yes, sir.

Mr. PECORA. Who were the other participants in the joint account?

Mr. BALDWIN. Well, that is a matter of record in the municipal department. I do not keep that data.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Do you happen to recall?

Mr. BALDWIN. No, sir.

Mr. PECORA. As treasurer of the National City Co. have you general supervision over its financial accounts?

Mr. BALDWIN. No.

Mr. PECORA. Well, what generally are your duties as treasurer?

Mr. BALDWIN. Well, just to pay in and pay out, the custody of securities or cash belonging to the company or to customers who may leave them there for safe-keeping, service, and so forth.

Mr. PECORA. You have supervision of its finances and securities?

Mr. BALDWIN. Yes, sir.

Mr. PECORA. What was the total amount of this Port of New York Authority bond issue in 1931?

Mr. BALDWIN. It was $66,000,000.

Mr. PECORA. Did you say $66,000,000?

Mr. BALDWIN. Yes.

Mr. PECORA. Do you recall the transaction in connection with the handling of that bond issue which was had on or about the 2d day of June 1931, in connection with which a cash ticket for $10,020 was made out and the cash given to you?

Mr. BALDWIN. I do.

Mr. PECORA. Have you the book of record, the book of account containing the record of that withdrawal of cash?

Mr. BALDWIN. Well, it is here. That is, the ledger record is here.

Mr. PECORA. Have you with you the syndicate expense book in connection with that issue?

Mr. BALDWIN. Yes.

Mr. PECORA. Will you produce it, please?

Mr. BALDWIN. Yes, sir. Here it is.

Mr. PECORA. May I look at that book, please?

Mr. BALDWIN. Yes, sir.

Mr. PECORA. This is the ledger account of the syndicate expenses in connection with this bond issue, that you have just handed to me, is it not?

Mr. BALDWIN. It is; yes, sir.

Mr. PECORA. Now, I call your attention to the entry on sheet 2 of this ledger account, reading as follows:

1931, June 2, Ticket No. 642546, check to S. W. Baldwin, treasurer, $10,020.

Do you know what that transaction refers to?

Mr. BALDWIN. I do.

Mr. PECORA. Will you please state it to the subcommittee?

Mr. BALDWIN. Why, I received a telephone call from the vice president telling me he needed $10,020 in cash.

Mr. PECORA. Who was the vice president from whom you received that telephone call?

Mr. BALDWIN. Mr. Sylvester.

Mr. PECORA. And was he the senior vice president of the company, or did he hold any other title?

Mr. BALDWIN. Well, he is vice president in charge of municipal financing.

Mr. PECORA. And this issue I have referred to was an issue of that kind, was it?

Mr. BALDWIN. Yes, a municipal issue.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And in response to that telephone call did you cause that cash ticket to be drawn to your order as treasurer?

Mr. BALDWIN. I did.

Mr. PECORA. And the cash procured thereon?

Mr. BALDWIN. I did.

Mr. PECORA. What did you do with that cash?

Mr. BALDWIN. I gave it to Mr. Sylvester.

Mr. PECORA. Did Mr. Sylvester say anything to you either at that time, I mean at the time of that telephone call, or at the time when you gave him the cash, as to the purpose of drawing that cash and giving it to him?

Mr. BALDWIN. He did not. He simply signed the receipt.

Mr. PECORA. Were you told to have this cash ticket drawn to your order as treasurer?

Mr. BALDWIN. I do not know that I was actually told that, but that was the natural way to do it.

Mr. PECORA. Has any statement or explanation ever been made to you in any way, shape, or form by anybody in the company concerning the purpose of drawing out that cash?

Mr. BALDWIN. There has not.

Mr. PECORA. Is there anything in the books of account of the company anywhere that would serve to show the purposes for which that cash was drawn out and turned over by you to Mr. Sylvester?

Mr. BALDWIN. Well, not that I know of. The books are not under my supervision, but I do not know of anything.

Mr. PECORA. Is it usual to pay expenses of any kind incurred by the company in connection with its business operations, in cash?

Mr. BALDWIN. No; I should not say that it was.

Mr. PECORA. Do you know of any other instance of a similar character where a sum of money amounting to several thousand dollars or more was drawn out in cash and charged to expenses?

Mr. BALDWIN. Not during my term as treasurer.

Mr. PECORA. Did you ever have any conversation with Mr. Sylvester at any time in connection with this particular withdrawal of $10,020 that served to enlighten you as to the purpose for which that cash was drawn out or to which it was devoted?

Mr. BALDWIN. No; I did not.

Mr. PECORA. Mr. Sylvester is not present here in the room at this time, is he?

Mr. BALDWIN. I do not think so.

Mr. PECORA. I understand, Mr. Chairman, that Mr. Sylvester has been subpœnaed and will probably be in attendance before the committee to-morrow morning.

The CHAIRMAN. All right.

Mr. PECORA. Mr. Baldwin, is there anything that you can tell us about this cash transaction other than what you have already told us?

Mr. BALDWIN. Absolutely nothing.

Mr. PECORA. You have exhausted your entire and complete knowledge of his transaction in the testimony that you have given here this afternoon about it?

Mr. BALDWIN. When I handed over the cash to Mr. Sylvester and took his receipt I forgot all about it, and never gave it another thought until just to-day.

Mr. PECORA. How was it charged on the books of the company?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BALDWIN. Charged to syndicate expense.

Mr. PECORA. Charged to syndicate expense?

Mr. BALDWIN. Yes, sir; as shown right there.

Mr. PECORA. Have you any idea as to the nature of the syndicate expense which was paid by that cash?

Mr. BALDWIN. None whatever.

Mr. PECORA. As a rule what was the nature of the expenses that attended a syndicate account of this character?

Mr. BALDWIN. Well, various needs, advertising, and sometimes—well, I don't know that that would apply to municipal bonds, but sometimes the preparation of temporary bonds, that is charged into the syndicate expense, the use of a signature company for signing the bonds.

Mr. PECORA. Those expenses are paid by check, aren't they?

Mr. BALDWIN. Mostly, yes.

Mr. PECORA. Specifically drawn to the person who receives the money?

Mr. BALDWIN. Usually.

Mr. PECORA. That was not done in the present case, that is, with regard to the item of $10,020?

Mr. BALDWIN. It was not.

Mr. PECORA. Now, will you look at that ledger account before you and tell us if it is not a fact that there is a specific item amounting to $12,478 charged to advertising in connection with this syndicate account?

Mr. BALDWIN. Well, there may be $12,478 made up of various items. I see one item of $11,918, which I happen to know is an advertising concern, and another one for $560.

Mr. PECORA. And that makes up the $12,478, doesn't it?

Mr. BALDWIN. Yes, that is right.

Mr. PECORA. There is an item in that expense account of $15,000, is there not?

Mr. BALDWIN. I do not see any, no.

Mr. PECORA. Now, when were those bonds acquired by the National City Co.?

Mr. BALDWIN. Well, do you mean the date that we made payment for them?

Mr. PECORA. Yes.

Mr. BALDWIN. I think it was some time in March, but I can not give you the exact date.

Mr. PECORA. As a rule when are the expenses accrued? When do the expenses accrue in the maintenance of a syndicate account of that character?

Mr. BALDWIN. Well, do you mean when they are settled or paid?

Mr. PECORA. Yes.

Mr. BALDWIN. Well, it varies probably with the issue, after the issue has been received and deliveries to purchasers made.

Mr. PECORA. When in the present instance had those expenses fully accrued?

Mr. BALDWIN. Well, I do not understand what you mean by "accrued."

Mr. PECORA. When had they accrued and been paid?

Mr. BALDWIN. Well, they were paid on these respective dates that appear here.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. What is the range of time covered by those dates?
Mr. BALDWIN. From March 13 to June 30.
Mr. PECORA. Of what year, 1931?
Mr. BALDWIN. Yes; 1931.
Mr. PECORA. All in the year 1931?
Mr. BALDWIN. Yes.
Mr. PECORA. May I look at that ledger?
Mr. BALDWIN. Certainly.
Mr. PECORA. The last entry appearing on this ledger record of this syndicate account, is dated June 30, 1931, and is represented by Ticket No. 43781, and is described as "Reserve for general investigations," and the amount thereof is $4,980. Do you know the nature of that item?
Mr. BALDWIN. I believe that means——
Mr. PECORA (interposing). Or, what are the supporting data for that item?
Mr. BALDWIN. Well, I believe it means that it was reserved for any unforeseen expenses during the life of the expense account.
Mr. PECORA. Do you recall that a reserve of $15,000 for some purpose or other was set up in connection with this syndicate account?
Mr. BALDWIN. I do not.
Mr. PECORA. Did you receive instructions of any kind that you now recall about the writing off of $10,020 from the reserve of $15,000, which would leave a balance of $4,980?
Mr. BALDWIN. I never received any such instructions.
Mr. PECORA. Do you know of any written memorandum of any kind in existence containing instructions to write down that reserve from $15,000 to $4,980?
Mr. BALDWIN. I do not.
Mr. PECORA. Didn't you present or produce a written memorandum this morning to one of the associate counsel for the committee, or exhibit it to him?
Mr. BALDWIN. There was a memorandum in the municipal files, yes.
Mr. PECORA. Have you that with you?
Mr. BALDWIN. I think so.
Mr. PECORA. Will you produce it now?
Mr. BALDWIN. There is a memorandum addressed by the municipal department to the accountant.
Mr. PECORA. How does it read?
Mr. BALDWIN. It reads:

We attach hereto a statement of joint-account expenses in connection with the issue of $66,000,000 of Port of New York Authority 4¼ per cent bonds, dated March 15, 1931. Kindly set up as a reserve for sundries, $15,000.

Mr. PECORA. Was that reserve set up in pursuance of the instructions embodied in this memorandum?
Mr. BALDWIN. Well, I presume it was, but of course that did not pass through me.
Mr. PECORA. Well, does that reserve appear anywhere in the ledger record of that syndicate account?
Mr. BALDWIN. I see no entry of $15,000 in this account.
Mr. PECORA. Attached to the memorandum that you have just produced, which is dated April 21, 1931, is a printed sheet entitled:

Expenses syndicate joint account,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

And so forth,

Issue of $66,000,000 Port of New York Authority 4½ per cent bonds, dated March 1, 1931.

Do you notice an entry on that sheet entitled "Reserve for sundries, $15,000?"

Mr. BALDWIN. I do.

Mr. PECORA. Does that memorandum which you have read relate to that item?

Mr. BALDWIN. I can not answer that, because that does not pass through me.

Mr. PECORA. Whom did that pass through?

Mr. BALDWIN. I assume it is the municipal department.

Mr. PECORA. Who is in charge of that department?

Mr. BALDWIN. Mr. Sylvester.

Mr. PECORA. Did you say Mr. Sylvester?

Mr. BALDWIN. Well, he is the vice president in charge.

Mr. PECORA. Do you now say that you have exhausted all the knowledge you have concerning this transaction?

Mr. BALDWIN. Yes. But I should like to point out that the treasury department, in our organization, maintains no record. I mean the books of records are not under the supervision of the treasurer.

Mr. PECORA. Do you recall when you gave that $10,020 in cash to Mr. Sylvester, asking him how it was to be entered or to what it was to be charged?

Mr. BALDWIN. I will answer that in this way if I may: When I received the telephone request I dictated a memorandum to myself, a combination memorandum and acting as a receipt and instructions to charge it to this account, which I presented with the currency to be signed.

Mr. PECORA. And was it signed?

Mr. BALDWIN. Yes, sir.

Mr. PECORA. Where is it?

Mr. BALDWIN. In New York.

Mr. PECORA. It is now in New York?

Mr. BALDWIN. Yes, in the files.

Mr. PECORA. Well, in addition to doing that did you ask Mr. Sylvester how that specific sum should be treated and entered on the books and to what it should be charged?

Mr. BALDWIN. It said so on the memorandum, to be charged to syndicate expense. That was written right into the memorandum.

Mr. PECORA. Have you any idea whatsoever of the nature of the expense charged to the syndicate account in the transaction which that $10,020 represents?

Mr. BALDWIN. None whatever.

Mr. PECORA. May I ask, Mr. Chairman, whether there is any gentleman connected with the National City Co. now in the room, who can enlighten the committee with regard to this item? [After a pause.] If there is I should like to have him indicate that and take the stand. [After a pause.] Do you know about that, Mr. Law?

Mr. LAW. I can explain the mechanical entries. But I do not know anything more about it.

Mr. PECORA. I think we may now excuse Mr. Baldwin. Will you leave those records here, please?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BALDWIN. All right.

(Thereupon Mr. Baldwin left the stand.)

The CHAIRMAN. Mr. Law, will you resume the stand?

TESTIMONY RESUMED OF HARRY S. LAW, SECRETARY THE NATIONAL CITY CO., NEW YORK CITY

Mr. PECORA. Mr. Law, you have heretofore been sworn, I believe?

Mr. LAW. Yes, sir.

Mr. PECORA. Mr. Law, have you heard completely the testimony given by the last witness, Mr. Samuel W. Baldwin?

Mr. LAW. I have.

Mr. PECORA. Do you know of your own personal knowledge anything with respect to the matters that he was interrogated about?

Mr. LAW. No; except the explanation of their method of setting up the expense, and probably the clearance of what a reserve means.

Mr. PECORA. You say "probably." Do you know definitely as applied to the specific transaction now under consideration?

Mr. LAW. As to the entries, yes; they were under my direction.

Mr. PECORA. Did you make any of the entries concerning this particular transaction?

Mr. LAW. No, sir. I never have made any entries.

Mr. PECORA. What expenses are included in a syndicate account of the nature referred to in Mr. Baldwin's testimony with respect to the expenses or reserve for expenses?

Mr. LAW. Any expense necessary to investigate and negotiate a deal. And by "any" is meant what may be necessary for legal fees, printing, postage, insurance, traveling expense, and other things of that kind which are necessary in the preparation and issuance of a security of any kind. They vary according to the deal, of course.

Mr. PECORA. Yes. Now, will you look at the ledger account produced here by Mr. Baldwin, with respect to which he was examined. Look at the entire account, and see whether you can tell this committee from any entries you find, anything about the cash ticket for $10,020 that appears there under date of June 2, 1931.

Mr. LAW. It indicates that a payment was made in the form of cash by Mr. Baldwin as treasurer of the company and charged to this account on June 2, 1931.

Mr. PECORA. Is it customary or usual to make payment of expenses in large sums by cash?

Mr. LAW. I can not tell you how large other cash transactions have been. There are always some cash transactions in connection with practically every deal. It depends entirely upon the nature of the transaction.

Mr. PECORA. Do you know of any other cash payments of that amount, $10,020?

Mr. LAW. I can not recall any right now; no.

Mr. PECORA. Have you any explanation to offer, either on the basis of your personal knowledge or an assumption on your part, with respect to this cash item?

Mr. LAW. Not that particular item; no.

Mr. PECORA. You set up and supervised the system of accounting that is kept by the National City Co., did you not?

Mr. LAW. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And this is the only transaction you know of, involving a cash item of that amount or anything like that amount?

Mr. LAW. Without reference to the books, I should say yes. But there have been thousands of transactions that have passed over our ledgers since I have been the comptroller of the company, and without referring to the books I would not care to make a definite answer.

Mr. PECORA. Within your recollection, as long as you have been the secretary of the company, have there been any other instances where a sum of money anything as large as $10,000 has been drawn out of the company's fund and paid out to some one in cash?

Mr. LAW. I have not the slightest idea, Mr. Pecora.

Mr. PECORA. That is not in accordance with any system of accountancy or bookkeeping which you have set up, is it?

Mr. LAW. The system of accountancy and bookkeeping that I have set up is to record the position of the company, its progress and its status at a given moment. This is strictly——

Mr. PECORA (interposing). That would include payments on behalf of the company——

Mr. LAW. Yes.

Mr. PECORA. Of its obligations or indebtedness?

Mr. LAW. Exactly. As I have testified, there are thousands of syndicate and joint account transactions that have gone over our ledgers during the period of my authority over the accounting department, as a part of the daily routine, and it would be a physical impossibility for one man to watch all the entries that pass over the National City Co.'s books.

Mr. PECORA. We do not expect you to be able to do that, of course. But would a cash transaction involving a sum like $10,020 be an unusual thing for your company so far as you know, as its secretary?

Mr. LAW. It might be unusual, but not over the period of time I have mentioned.

Mr. PECORA. You said a few moments ago that you did not know of any other cash transaction.

Mr. LAW. I say I have no recollection of such.

Mr. PECORA. You have no recollection of any?

Mr. LAW. No.

Mr. PECORA. That means that you have no knowledge, doesn't it? No knowledge which you could give expression to at this time?

Mr. LAW. Recollection and knowledge are two entirely different words.

Mr. PECORA. I will put it in this way: Have you now any knowledge of any other cash transaction where payment was made in cash and not by check or other written voucher, of any item nearly as great as $10,000?

Mr. LAW. I can not recall it.

Mr. PECORA. When you say you can not recall it, do you mean that at this moment you have no knowledge of any other such transaction?

Mr. LAW. That means that without an analysis of the records I would not care to commit myself.

Mr. PECORA. You would not care to commit yourself?

Mr. LAW. No, sir.

Mr. PECORA. Have you ever given instructions to any of the bookkeepers or accountants, or other employees of the company coming directly under your supervision, to record cash transactions of any

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

amount nearly as great as $10,000 in the way that this item has been recorded?

Mr. LAW. Specific instructions for recording any articular transaction are not given. The system is so set up that it records automatically all the items that are passed by the treasurer or by the accounting department according to a particular ticket.

Mr. PECORA. Well, the system that you set up for this accountancy would not include the making of a payment of as much as $10,000 by cash would it?

Mr. LAW. That, Mr. Pecora, would be purely up to the vice president in charge of the department negotiating the loan. His instructions would be obeyed by the treasurer of the company, and the transaction from that point on would be purely mechanical from the standpoint of recording the payment made and entering it in the proper account.

Mr. PECORA. Do you think it is good business practice to do that?

Mr. LAW. I should say yes.

Mr. PECORA. Do you think it is good business practice to make payments of as much cash as $10,000 to an officer of the company?

Mr. LAW. It would depend upon the officer and his authority. This particular man had the authority to receive that cash.

Mr. PECORA. Do you think it is good bookkeeping practice?

Mr. LAW. Good bookkeeping practice, yes; because bookkeeping is merely a recording of items in a particular form for future reference.

Mr. PECORA. Do you know of any reason why a cash payment of as much as $10,000 should be set up on the books of the company or entered on the books of the company in a manner which would not indicate the ultimate receiver of that cash and the purposes for which it was paid?

Mr. LAW. There is no reason why it should not be, I suppose.

Mr. PECORA. In this particular instance does the entry which appears in the ledger account relative to that item, give you any information such as I have suggested?

Mr. LAW. Not at all.

Mr. PECORA. As that entry appears does it convey to you any information or intimation as to the purpose for which that sum of money was drawn and disbursed?

Mr. LAW. Merely an expense in connection with the negotiation or handling of the Port of New York Authority account.

Mr. PECORA. Well, other expenses are itemized and designated and identified in the books, are they not?

Mr. LAW. No. You have referred to the matter of general investigations $4,980, which is not itemized.

Mr. PECORA. Do you know what the supporting data for that item might be?

Mr. LAW. At the time each deal is handled an estimate is made of the expense necessary to handle it. All the expenses that are connected with the negotiation and the handling of a loan are buried in the general expenses of the National City Co.

Mr. PECORA. Buried there, what do you mean?

Mr. LAW. Naturally, because those negotiations are conducted over a period of time. We haven't any idea when we start them whether they will be successful or unsuccessful. Therefore they are left in our expense account until the loan is signed or we think it is

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

going to be signed, and then we estimate the expense necessary, or that has been incurred in connection with it, plus what we think may be incurred in the company until the deal is completed.

Mr. PECORA. This deal was completed entirely by June 30, 1931, wasn't it? That is the date of the last entry appearing on that ledger account.

Mr. LAW. So the records show; yes. But often expenses are or may have been incurred long prior to that.

Mr. PECORA. Is there anything on the printed sheet which Mr. Baldwin presented here, and I refer particularly to the sheet entitled "Expense of Syndicate Joint Account and so forth, reserve for sundries $15,000", which would enlighten you in any way as to the purposes for which the sum of $10,020 was used?

Mr. LAW. I can explain the $15,000 very clearly. The expenses which are itemized in the two columns, aside from this $15,000, are definite expenses that were known at the date this sheet was set up, April 21, 1931. And we knew that there were other expenses that had to be incurred, or that would likely be incurred, in connection with the negotiation and handling of this syndicate, that had to be included with them, and this $15,000 reserve is to take care of the additional expense. That is done in every syndicate and joint account handled in connection with any issue.

Mr. PECORA. Does the data before you indicate that the reserve of $15,000 for expenses for sundries was fully disbursed?

Mr. LAW. It indicates that $10,020 was drawn by Mr. Baldwin in the form of cash, and that $4,980 was used as a general investigation item, which represents an expenditure of the National City Co. because of expenses previously incurred in connection with this syndicate. In other words, it was returned to the expense account of the National City Co. as a reduction to offset the previous expense.

Mr. PECORA. This $4,980 was not used.

Mr. LAW. That was not used.

Mr. PECORA. But the $10,020 was used.

Mr. LAW. Yes; that is correct.

Mr. PECORA. Now, look over the detailed and itemized expenses that appear in the ledger account in regard to this syndicate account and see if they cover all the conceivable expenses incurred in an enterprise of that character.

Mr. LAW. Without knowing the nature of the expense of $10,020 I could not say. That might have been an expense incurred by someone outside for our account which Mr. Sylvester settled personally. I have not the slightest idea.

Mr. PECORA. It might be some expense incurred outside for your account?

Mr. LAW. Yes, sir. I have not the slightest idea because I did not handle the deal.

Mr. PECORA. You are familiar with the general nature and kind of expenses incurred in these operations by the company, aren't you?

Mr. LAW. To some extent, yes; but each deal differs. In other words, the expense in connection with a large deal of this kind, which takes a long period to handle and negotiate, is not at all comparable with a foreign deal or even with a small municipal deal.

Mr. PECORA. This was not a foreign deal.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. LAW. I say, they are not comparable. I am trying to bring out the comparison. It is not comparable with a small municipal deal, which is bought and sold in one day.

Mr. PECORA. Can you think of any expense which this sum of $10,020 might have been devoted to other than the items of expense enumerated in that ledger account?

Mr. LAW. No, sir. I am sorry to say I can not.

Mr. PECORA. How often are the accounts audited?

Mr. LAW. The accounts are under a continual audit. The National City Co. maintains its own auditing department, and the accounts are audited in sections each day, so that once a month practically all accounts have been audited.

Mr. PECORA. They are not audited by any independent accountants?

Mr. LAW. No, sir.

Mr. PECORA. And never have been?

Mr. LAW. Never have been.

Mr. PECORA. That is all with this witness on this subject.

Mr. LAW. Do you want to keep those records that you have in your hand?

Mr. PECORA. If you please.

Mr. BALDWIN. Mr. Chairman, am I to keep those records?

Mr. PECORA. Until Mr. Sylvester gets here tomorrow.

Mr. LAW. I will guarantee to have them produced tomorrow.

Mr. PECORA. I should like to have our accountants look at them.

Mr. LAW. And if they will return them to me I will keep them for production tomorrow.

Mr. PECORA. All right.

Senator FLETCHER (presiding). The witness is excused for the present.

Mr. PECORA. Mr. Train will please resume the stand.

TESTIMONY RESUMED OF GEORGE F. TRAIN, SCARSDALE, N. Y.

Mr. PECORA. Now, Mr. Train, referring to the second loan of $8,000,000 for the State of Minas Geraes, which was underwritten in part by the National City Co. in September of 1929: Are you familiar with the short-term notes or advances, or loans, which had been made prior to that time by the National City Co. and other creditors of the State of Minas Geraes?

Mr. TRAIN. In 1929, Mr. Pecora, I was in Buenos Aires from the beginning of the year until December of that year. I am only familiar in a general way with the details of those transactions by reason of familiarity with the files of the National City Co. concerning Minas Geraes.

Mr. PECORA. Have you in the files a letter dated April 27, 1928, written by you to Mr. M. E. Squires, acting manager of The National City Bank of New York at Rio de Janeiro?

Mr. TRAIN. Apparently that file is one which was not produced here through a misunderstanding, but if you have a copy I am prepared to accept your extracting on that subject, and think I can identify it.

Mr. PECORA. Have you prior to this time seen what purport to be copies or extracts from your files concerning those Minas Geraes loans?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. TRAIN. I have not.

Mr. PECORA. I show you this paper, and I ask you to look it over, please, and then tell us if you are prepared to say that in so far as it contains an extract or extracts from your letter of April 27, 1928, it correctly quotes those extracts.

Mr. TRAIN. I would accept it as having been written by me; yes, Mr. Pecora. I do not want to delay you by taking the time to read it through.

Mr. PECORA. Let me call your attention to the following extract therefrom:

> I regret to say that the reaction here in regard to how the State has handled the details of this transaction is generally unfavorable, and there is a considerable degree of uneasiness on the part of all concerned over the question of the State's willingness to meet its obligations.

Do you find that there?

Mr. TRAIN. I do.

Mr. PECORA. You were writing this letter from Rio de Janeiro, in the Republic of Brazil, weren't you?

Mr. TRAIN. No. This letter is addressed from me in New York to Mr. M. E. Squires, acting manager of the National City Bank of New York at Rio de Janeiro.

Mr. PECORA. You were referring to the reaction in the offices of the company in New York City?

Mr. TRAIN. Exactly.

Mr. PECORA. To the matter of whether the State of Minas Geraes had handled certain of its financial transactions satisfactorily, is that it?

Mr. TRAIN. I recall perfectly well that at that time I was in New York, and I should like to observe that as a result of several months in Brazil I had become convinced that Minas Geraes was the best State credit in Brazil. While I was there many proposals, many propositions for external financing by Brazilian States, were brought to me, and, considered in the light of statistical factors that one takes into consideration, I rejected them all with the exception of Minas Geraes. And——

Mr. PECORA (interposing). Now——

Mr. TRAIN (continuing). I am trying to explain the point I wish to make, Mr. Pecora, if you will permit me.

Mr. PECORA. Well, no, you are trying to explain something that I have not asked you about.

Mr. TRAIN. That is quite true, but——

Mr. PECORA (interposing). I am asking you about the reaction referred to in your letter of April 27, 1928, in which you say:

> I regret to say that the reaction here in regard to how the State has handled the details of this transaction is generally unfavorable, and there is a considerable degree of uneasiness on the part of all concerned over the question of the State's willingness to meet its obligations,

That is what I am questioning you about.

Mr. TRAIN. I think, Mr. Pecora, if you will permit me, it is quite pertinent to my reply in order to explain the background in my mind with respect to the soundness of the Minas Geraes credit.

Mr. PECORA. No. First tell us why you wrote on April 27, 1928, from the main office in New York to the manager in Rio de Janeiro that there was uneasiness in the New York office about the willingness

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of the State of Minas Geraes to meet its obligations. Why did you say that?

Mr. TRAIN. Because certain of my superiors in the New York office did not fully concur in my feeling that in any event the State of Minas Geraes was good for its obligations. There is reference in this letter, and I should like with your permission, Senator, to note for the record that immediately following the extract which Mr. Pecora read, comes this statement:

> It is freely stated here in New York that had it not been for the insistence of Schroeder, the loan contract would never have met with our approval, without the concession of the escrow clause, and certainly subsequent events would seem to justify our contention in this respect. I am naturally reassuring our executives here as to the good faith of the State officials in meeting their obligations, but it would have left a much better taste in everybody's mouths had the matter gone through in the usual orderly manner, to say nothing of the saving of cable and other expenses.

Mr. PECORA. Who were the higher officials of the company that had expressed to you their uneasiness over the willingness of the Minas Geraes State to meet its obligations?

Mr. TRAIN. You will appreciate, Mr. Pecora, that in these matters at times a somewhat narrow and legalistic interpretation is taken. My recollection is that the officials in New York felt it would have been safer for the bondholders to have escrowed the proceeds of this loan for the specific purpose of redeeming the franc bonds. But I felt from my experience in Brazil that the State was perfectly able to redeem them and would do so, and it has since so proved to be the case.

Mr. PECORA. The question was: Who were the higher officials in your company who had expressed to you their uneasiness over the willingness of the State of Minas Geraes to meet its obligations. Please answer that question.

Mr. TRAIN. I will be very glad to do so.

Mr. PECORA. All right. Please do so.

Mr. TRAIN. As I recall it, it was Mr. Schoepperle.

Mr. PECORA. Anyone else?

Mr. TRAIN. I do not recall. I might add that I have had a friendly difference of opinion with Mr. Schoepperle from time to time with respect to this State's credit in Brazil. I had spent considerable time in Brazil, and was thoroughly convinced in my own mind that the credit was perfectly sound, and that there was no necessity for these technicalities. Mr. Schoepperle felt, from his longer experience and no doubt better experience in this business that it would have been better to have escrowed these funds for the specific purpose of redeeming those franc bonds.

Mr. PECORA. Do you know that it has been testified here by the executive officers of your company that before the company undertook to sponsor any issue of domestic or foreign bonds there had to be a unanimity of opinion on their part?

Mr. TRAIN. I think I heard it so testified; yes.

Mr. PECORA. Was there any unanimity of opinion with respect to the wisdom of offering these Minas Geraes loans?

Mr. TRAIN. Of that I have no knowledge since I did not attend any of the executive meetings of the National City Co.

Mr. PECORA. But you detected an uneasiness in April of 1928 on the part of the higher officials in the company here in New York,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

concerning the willingness of the issuing State to meet its obligations, didn't you?

Mr. TRAIN. Since you have pursued this line of questioning I now recall that subsequent to the issuance of the bonds there were various mechanical details in connection with the listing of the bonds, issuance of definitive bonds, and things of that nature——

Mr. PECORA (interposing). Oh, now, my question concerned any uneasiness with regard to the willingness of the issuing State to meet its obligations. That has nothing to do with the mechanical details, has it?

Mr. TRAIN. If you will permit me to proceed I will——

Mr. PECORA (interposing). Please answer the question and do not talk about collateral matters that are really not responsive to the question.

Mr. TRAIN. I am endeavoring to respond to the question, but——

Mr. PECORA (interposing). Please answer the question.

Mr. TRAIN. You asked me to explain, and I am trying——

Mr. PECORA (interposing). No; I have not asked you to explain. You are wanting to explain.

Mr. TRAIN. Well, can't I——

Mr. PECORA (interposing). Did you say that you detected in April of 1928 a state of uneasiness on the part of the higher officials of your company here in New York with regard to the willingness of the State of Minas Geraes to meet its obligations, or did you not?

Mr. TRAIN. I am endeavoring to give you an explanation of why——

Mr. PECORA (interposing). Can't you first answer the question either yes or no, either affirmatively or negatively. Did you or did you not detect a state of uneasiness here in New York.

Mr. TRAIN. I would say that Mr. Schoepperle was not fully satisfied that the State of Minas Geraes would live up to its obligations to redeem the franc bonds, if the redemption of the bonds were left wholly to its disposal.

Mr. PECORA. And you communicated that to the manager of the company down in the capital of the Republic of Brazil, didn't you?

Mr. TRAIN. To the manager or acting manager of the National City Bank in Rio de Janeiro. The National City Co. has no branch in Brazil.

Mr. PECORA. So in view of the absence of a branch of the company in Brazil, the branch of the bank acted for the company, didn't it?

Mr. TRAIN. The manager of the branch of the bank did so, yes, which would be a perfectly natural thing to do.

Mr. PECORA. Now, in September of 1929 this second $8,000,000 loan was floated by the National City Co. and others, for the State of Minas Geraes.

Mr. TRAIN. That is correct.

Mr. PECORA. Have you before you the correspondence that passed between the various persons connected with the National City Co. in connection with that floatation?

Mr. TRAIN. I believe they have been produced here under subpoena.

Mr. PECORA. Now, let me show you a copy of the prospectus that accompanied the offering of the $8,000,000 issue in September, 1929, to the investment public, or have you a copy before you?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. TRAIN. Of the 8½ million dollar loan?

Mr. PECORA. No; the second one, of $8,000,000 in September of 1929.

Mr. TRAIN. All right. I have that one now.

Mr. PECORA. Do you notice on the front page the following statement, along about the middle of the page:

Prudent and careful management of the State's finances has been characteristic of successive administrations in Minas Geraes.

Mr. TRAIN. I do.

Mr. PECORA. Do you know who drew up this circular or prospectus?

Mr. TRAIN. I do not.

Mr. PECORA. Does that statement conform with what was your own knowledge of the management of the finances of the State of Minas Geraes up to that time?

Mr. TRAIN. May I have that question repeated? (Which was done by the committee reporter.) It does.

Mr. PECORA. I think you said before that in the month of June, 1927, you were in Rio de Janeiro, is that right?

Mr. TRAIN. Yes; as nearly as I can now recall. I was in Brazil at any rate.

Mr. PECORA. Were you then the manager of the National City Bank branch in that State?

Mr. TRAIN. I was not.

Mr. PECORA. You made that branch of the bank in that State your headquarters while there, didn't you?

Mr. TRAIN. The manager of the branch gave me office room in the building which they owned.

Mr. PECORA. Do you recall a letter written by you from Rio de Janeiro, under date of June 12, 1927, to Mr. R. M. Byrnes, in New York City, then a vice president of the National City Co., in which, regarding the financial management of the State of Minas Geraes, among other things you said:

The 1911 contract was concluded in Brazil, and apparently the same thing happened. I am unable to confirm this as I have as yet no photostats of the bonds, but the laxness of the State authorities borders on the fantastic. The 1916 bonds were admittedly signed by the then Secretary of Finance in Paris, who carelessly overlooked the wording not being in accordance with the contract. It would be hard to find anywhere a sadder confession of inefficiency and ineptitude than that displayed by the various State officials on the several occasions.

And also the following in that letter, among other things:

The foregoing recital serves to show the complete ignorance, carelessness and negligence of the former State officials in respect to external long-term borrowing. It is hard to believe that there was not some collusion between the officials and Perier & Co., but whether that was the case or not, the latter seem to me to have given sufficient evidence of their bad faith.

Mr. TRAIN. Now that you read me the extracts from that letter, I recall it, yes; Mr. Pecora. And I should like to observe that I particularly referred to the laxity and carelessness of the officials with respect to the details concerning the external loans contracted in 1907 and 1911.

Mr. PECORA. And subsequent dates, 1916.

Mr. TRAIN. And 1916, yes.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Now, the statement in the circular or prospectus to which I call your attention, is as follows:

Prudent and careful management of the State's finances has been characteristic of successive administrations in Minas Geraes.

Keep that in mind when you answer.

Mr. TRAIN. I will be very glad to do it. I recall this particular sentence, because it has been taken from the first circular written with respect to Minas Geraes, a part of which I prepared in Brazil in 1927 as a result of my careful investigations there, and I referred in that sentence, although——

Mr. PECORA (interposing). You said taken from the first circular, is that right?

Mr. TRAIN. I think so.

Mr. PECORA. Aren't you mistaken about that?

Mr. TRAIN. I think it will be found in the first circular. May I quote?

Mr. PECORA. Yes. Under revenues and expenditures.

Mr. TRAIN. It says:

Prudent and careful management of the State's finances has been characteristic of successive administrations in Minas Geraes.

That is quoted from the first circular. What I meant by that, and I think it is fully borne out by the fact, is that it refers only to the management of the State's budget; that they had shown an extremely careful and prudent administration, especially in comparison with the policies followed by other Brazilian States. I might add that the inhabitants of the State of Minas Geraes are generally known in Brazil as the Scotsmen of Brazil. They have given an exhibition of that by a succession of budget surpluses, with one or two minor exceptions, which practically continued from 1916 to 1929. And—well, I have nothing to add to that.

Mr. PECORA. Do you mean to say then that that statement referred only to the management and administration of the State's internal finances?

Mr. TRAIN. On which the security for the loan rested; yes.

Mr. PECORA. And was not intended to relate to its external finances; is that right?

Mr. TRAIN. To the handling of its external financing in previous periods.

Mr. PECORA. In previous periods?

Mr. TRAIN. Yes.

Mr. PECORA. What were the successive administrations referred to in this circular?

Mr. TRAIN. Well, the administration of the State, as I recall it, changes every four years. The president is elected, and other officials are elected. So that there would have been in a period of 14 years—let me be accurate and say from 1916 to 1928 there would have been 12 years or three administrations.

Senator FLETCHER (presiding). Has that kind of administration continued up to date?

Mr. TRAIN. In the State of Minas Geraes?

Senator FLETCHER. Yes.

Mr. TRAIN. Yes.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator FLETCHER. Do you think that is the character of administration that they have now?

Mr. TRAIN. The character of administration they have now. They have a very excellent internal administration and management of their finances.

Mr. PECORA. Mr. Train, did you prepare that first prospectus?

Mr. TRAIN. In part.

Mr. PECORA. Are you responsible for that particular language I have quoted from it?

Mr. TRAIN. As to prudence and careful administration?

Mr. PECORA. Yes.

Mr. TRAIN. I accept responsibility for that. Yes, sir; I recall that I wrote that.

Mr. PECORA. Do you recall having received any criticism of that portion of your prospectus from a Mr. Baldwin connected with the company here in New York?

Mr. TRAIN. I have had many discussions with Mr. Baldwin, who was in New York during this period, respecting Minas Geraes finances.

Mr. PECORA. Let me see if you recall receiving a letter from Mr. Baldwin of the foreign department of the National City Co. here in New York, dated September 14, 1927, addressed to you down in Rio de Janeiro, containing the following statement, among other things, and this refers to the draft of this prospectus that had been submitted to Mr. Baldwin for his suggestions.

Mr. TRAIN. Not by me.

Mr. PECORA. I am quoting now from Mr. Baldwin's letter to you, of September 14, 1927, under the heading of "Revenues and expenditures":

> Prudent and careful administration of the State's finances has been axiomatic with successive administrations in Minas Geraes. I am not trying to criticise, and no doubt I am too much saturated with material dealing with the French issues of the State, but in view of the extremely loose way in which the external debt of the State was managed, do you think the statement quoted above would be subjected to criticism?

Now, do you recall that?

Mr. TRAIN. You have recalled that to my memory. I would not recall that specific letter, but I would say it represented a difference of opinion, a difference of interpretation between Mr. Baldwin and myself. I was in Brazil and perhaps became, as one often does in that country, a little overenthusiastic with respect to the merits of the particular credit I was investigating.

Mr. PECORA. Do you recall that criticism of that portion of the prospectus made by Mr. Baldwin in this letter to you of September 14, 1927?

Mr. TRAIN. Not specifically, except as you read it to me I recall that there was some difference of opinion.

Mr. PECORA. Do you want the help of Mr. Schoepperle in making your answer?

Mr. TRAIN. I do not think I need any help.

Mr. PECORA. Well, please tell that to Mr. Schoepperle, who seems to think you do.

Mr. TRAIN. Well, perhaps he does.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. You notice in this letter of Mr. Baldwin's to you that he apparently was familiar with what he terms the extremely loose way in which the external debt of the State was managed.

Mr. TRAIN. I have already explained I think clearly for the record that there was a difference of opinion between myself, who had been in Brazil and was thoroughly acquainted with and familiar with the Minas Geraes situation, and those who sat up in New York at a distance of several thousand miles and looked at it through long-distance spectacles.

Mr. PECORA. Didn't Mr. Baldwin in New York have access to the files of the company which contained this letter of yours of April, 1928?

Mr. TRAIN. I would assume so.

Mr. PECORA. Wherein you referred to the inefficient and inept manner in which prior administrations had handled certain loans?

Mr. TRAIN. I would point out that I was referring to the handling of the external debt of the State.

Mr. PECORA. And apparently that is what Mr. Baldwin pointed out, because in his letter of September 14, 1927, he says expressly, "In view of the extremely loose way in which the external debt of the State was managed," do you think the statement quoted above would be subjected to criticism? You want to tell us now, do you, that when you incorporated in the prospectus of not only the first issue in March, 1928, but of the second one in September, 1929, the statement that "Prudent and careful management of the State's finances has been characteristic of successive administrations in Minas Geraes," you simply had in mind what you conceived to be the efficient manner in which the Government had conducted its internal finances; is that right?

Mr. TRAIN. I would like to make a small correction to that statement. I believe you stated that I had this statement incorporated in the second prospectus.

Mr. PECORA. You said a few minutes ago that you assumed the responsibility for it, did you not?

Mr. TRAIN. I said that I had put it in the first prospectus, but I was not there at the time the second prospectus was issued.

Mr. PECORA. Do you repudiate it as it appears in the second prospectus?

Mr. TRAIN. I most certainly do not.

Mr. PECORA. Then why make the point about it?

Mr. TRAIN. Well, because I thought it was a slight inaccuracy on your part. [Laughter.] Will you repeat the question? I lost the trend of it. I am sorry.

Mr. PECORA. When I asked you that question which led you to believe there was a slight inaccuracy I was not referring to any particular prospectus.

Mr. TRAIN. May I have that question read?

Mr. RANDOLPH (shorthand reporter). "You want to tell us now, do you, that when you incorporated in the prospectus of not only the first issue in March, 1928, but of the second one in September, 1929, the statement"——

Mr. TRAIN. That is sufficient. I see you referred to the prospectuses.

Mr. PECORA. I referred to both of them.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. TRAIN. You did, Mr. Pecora.

Mr. PECORA. And you are not disavowing responsibliity for the statement in the second prospectus, are you?

Mr. TRAIN. Most certainly not.

Mr. PECORA. All right now; do you want to tell this committee that the statement "prudent and careful management of the State's finances has been characteristic of successive administrations in Minas Geraes", which appears in both the first and the second prospectuses of these two loans, that you merely had in mind the State's internal finances?

Mr. TRAIN. Mr. Pecora, I am here under oath, and I am here to state that is exactly what I meant.

Mr. PECORA. But you knew at the time you made that statement for its inclusion in either the first or the second prospectus that the State's management of its external finances had been "extremely loose, inefficient, and inept and careless"?

Mr. TRAIN. I did.

Mr. PECORA. Don't you consider that when you speak of the management of a State's finances you speak of its finances generally and as including both internal and external finances?

Mr. TRAIN. I think it is a question as to where you want to put the emphasis. I was a banker, and I was putting emphasis on what I regarded as a fundamental security for the Minas bonds, which was the question of their internal revenues and their budgetary surpluses.

Mr. PECORA. That may have been where you were putting emphasis in your mind, but as you placed the emphasis on paper you simply made reference to the management of the State's finances without drawing any distinction between internal and external finances; isn't that right?

Mr. TRAIN. Well, you have quoted from a single letter. If my letters were all taken together I do not think that they would sustain that thesis.

Mr. PECORA. Was it your intention merely to refer to the management of the internal finances when you had this statement incorporated in the prospectus?

Mr. TRAIN. That was my intention.

Mr. PECORA. Why didn't you say so in the prospectus then?

Mr. TRAIN. Well, of course, it would rest on an interpretation of the word "finances." It would have been more accurate had I said the "State's budget" or "budgetary position."

Mr. PECORA. But if you wanted to make a favorable comment on the administration of the internal finances of the State, would it not have been extremely simple to have inserted the word "internal" before the word "finances"?

Mr. TRAIN. I think it would have been more accurate.

Mr. PECORA. And if you wanted to convey to the investing public through the medium of this prospectus what you had learned concerning the "careless, inefficient, and inept and loose way of the State's management of its external finances," you would have said so too, would you not, in the prospectus?

Mr. TRAIN. Let me have that again?

Mr. RANDOLPH (shorthand reporter). And if you wanted to convey to the investing public through the medium of this prospectus what you had learned concerning the "careless, inefficient, and inept and

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

loose way of the State's management of its external finances," you would have said so too, would you not, in the prospectus?

Mr. TRAIN. These people in Minas were back-country people, and they had shown, as I stated in my letter, ineptitude in handling——

Mr. PECORA (interposing). Will you answer my question now?

Mr. TRAIN (continuing). In the handling of their external finances.

Mr. PECORA. Are you answering my question now?

Mr. TRAIN. I am endeavoring to.

Mr. PECORA. Let me put it again to you in another way: Let us assume that in the prospectus you wanted to give the American investing public your observations or your knowledge concerning the inept, careless, and inefficient way in which the Government of the State of Minas Geraes had administered its external finances, you could very easily have done it by including a sentence conveying that knowledge in the prospectus, could you not?

Mr. TRAIN. That was a question of past administrations, and I was very favorably impressed with the officials of the State whom I met in Bello Horizonte. I felt that that was an incident of the past.

Mr. PECORA. You were referring to successive administrations in this prospectus, were your not, and that means the past?

Mr. TRAIN. That means the past in a very general sense. Perhaps I did not go back far enough.

Mr. PECORA. You did not go back to the point where the administration was loose and inefficient in its handling of its external finances, did you?

Mr. TRAIN. I think my phraseology in that respect might be modified by other statements which are made concerning the French bankers with whom the State of Minas Geraes had contracted for the franc bonds. The French bankers in that case were banking firms which I subsequently found, upon investigation, to have been somewhat sharp in their dealings, and it was my feeling that the State officials of that day, while admittedly careless and lax and lacking in knowledge of the technical details of external financing, had nevertheless been misled in many respects by the French banking houses with whom they had done business.

Mr. PECORA. Have you completed your answer?

Mr. TRAIN. I have.

Mr. PECORA. I am going to ask the reporter to read the question to which you made that answer, and see if you have answered the question. Will you be good enough to read the question, Mr. Reporter?

Mr. RANDOLPH (shorthand reporter). "You did not go back to the point where the administration was loose and inefficient in its handling of its external finances, did you?"

Mr. PECORA. Now, Mr. Schoepperle, he said he did not need your help.

That is the question. Now, what is the answer to that question?

Mr. TRAIN. In this prospectus?

Mr. PECORA. Of course, in the prospectus.

Mr. TRAIN. No; we did not go back to that point. I did not go back to that point.

Mr. PECORA. All right. Mr. Train—when you are through quarreling with Mr. Schoepperle, I will ask you a question—Mr. Train, do you know anything about the short-term loans or advances which

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

were made by the National City Co. and Schroeder to the State of Minas Geraes between the floating of the first loan in March, 1928, and the second loan in March, 1929?

Mr. TRAIN. I think my testimony will show that I said that I was in Buenos Aires during that period and that my only knowledge of those transactions is by reason of familiarity with the files in reference thereto.

Mr. PECORA. On the basis of the familiarity which you have thereby acquired with the subject, you know, do you not, that those short-term loans or advances were made within that period of time?

Mr. TRAIN. I do.

Mr. PECORA. To the State of Minas?

Mr. TRAIN. I do. Quite true.

Mr. PECORA. Do you know the circumstances which induced the making of those short-term advances or loans, either from your own personal knowledge or from your familiarity with the files?

Mr. TRAIN. Are you referring to all of them or part of them? Because the question must be answered in part.

Mr. PECORA. To all of them, all the short-term advances made in the period between these two long-term loans.

Mr. TRAIN. My answer to that question, based on my recollection of the files, would be that with respect to £500,000 advanced by the three leading London banking houses, Baring, Schroeder and Rothschilds, I would have no knowledge concerning the considerations that governed or lead up to that advance. With respect—I will continue if you care to have this.

Mr. PECORA. Yes; go ahead.

Mr. TRAIN. With respect to an advance of $750,000 by the National City Bank of New York and with respect to an additional advance of £150,000 by the same London banking houses that I referred to, I would say that the files would show that the consideration for those advances, or in connection with which those advances were made, was an agreement between the President of the State and the bankers whereby certain arrangements were made for long-term financing.

The president of the state, I might observe, was requiring, as I recall it, at that time some funds to meet maturities for public works expenditures, and there was a question as to the existing legal authority for the issuance of long-term bonds. Counsel for the National City Co. apparently were not satisfied with the existing legal authorization, although Brazilian counsel expressed themselves as being perfectly satisfied. Therefore, to bridge over the gap until the long-term bond issue could be duly authorized and issued, this advance of $750,000 and £150,000 was made.

Senator FLETCHER. How were those advances secured?

Mr. TRAIN. Those advances were not secured, Senator Fletcher.

Mr. PECORA. I was going to ask you—those short-term advances were all unsecured, were they not?

Mr. TRAIN. So far as I know.

Mr. PECORA. And they were all paid out of the proceeds of the second loan of $8,000,000 which was floated in September, 1929, were they not?

Mr. TRAIN. Yes; I believe that is right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And one of the purposes of that second loan was to enable the State of Minas Geraes to pay those short-term unsecured loans, was it not?

Mr. TRAIN. I would say that it was to refund the advances made in anticipation of those loans.

Mr. PECORA. That is your way of putting it, but does it not mean the same thing as that which I said in my question?

Mr. TRAIN. I do not think quite the same.

Mr. PECORA. Does it mean generally the same thing? You see, I do not speak the banker's language. You will pardon me, Mr. Train?

Mr. TRAIN. No; I know you do not. I do not speak your language either, the legal language.

But in response to a question from you, with the courtesy of the chairman, I should like to reply to it in my own language.

Mr. PECORA. Certainly. Is it or is it not the fact that one of the purposes of the second loan was to enable the State of Minas Geraes to repay those short-term unsecured loans which had been made to it between the first and second issues?

Mr. TRAIN. I should like to let my previous answer stand.

Mr. PECORA. Will you answer that question?

Mr. TRAIN. I think my previous answer answers it.

Mr. PECORA. Answer it again. I have forgotten the answer.

Mr. TRAIN. One of the purposes of the loan was to refund the short-term advances that had been made in anticipation of long-term financing.

Mr. PECORA. My question was as to whether one of the purposes was to enable the State to repay, and you say that one of the purposes was to refund. That is the difference between your language and mine, is it?

Mr. TRAIN. The advances were made in anticipation of the financing. I think you left that out.

Mr. PECORA. Yes; all right. As a matter of fact, in whatever language you choose to put it——

Mr. TRAIN. I am perfectly willing to agree with whatever——

Mr. PECORA. A substantial part of the proceeds of the second loan went to repay or refund those short-term unsecured advances or loans?

Mr. TRAIN. We can meet on that, of course.

Mr. PECORA. All right. And is it not the fact that there were no other funds available with which to repay those unsecured short-term loans?

Mr. TRAIN. The State of Minas for a number of years had been borrowing at short term from London banking houses, and also from the National City Bank of New York, unsecured. They were advances either in anticipation of revenues or for extraordinary public works expenditures. The credit of the State was so considered at that time both in New York and in London that no specific security was asked.

Mr. PECORA. Who is Mr. H. R. Jolles?

Mr. TRAIN. At the present time Mr. Jolles is vice president of the National City Co. in the foreign department.

Mr. PECORA. And Mr. Squires was connected with the National City Bank at Rio de Janeiro in 1929, was he not?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. TRAIN. Mr. Squires, I believe, in 1929 was the manager of the National City Bank there.

Mr. PECORA. In your familiarity with the files and records of the National City Co. with respect to these loans did you come across a cablegram from Mr. Jolles to Squires dated July 5, 1929, in which he says among other things the following:

In view of State's urgent need for credit, we are inclined to question their ability to meet short-term advances at maturity if issuance first tranche should for any unforeseen reason be delayed?

Mr. TRAIN. That is an expression of opinion from Mr. Jolles, is it not?

Mr. PECORA. I am simply asking you, did you become familiar with that cablegram and that portion of it?

Mr. TRAIN. I recall it now that you read it to me.

Mr. PECORA. The J. Henry Schroeder Banking Corporation was one of the underwriters with the National City Co. of both these Minas Geraes loans, was it not?

Mr. TRAIN. That is correct.

Mr. PECORA. And where was its office?

Mr. TRAIN. In New York City. I don't recall the address.

Mr. PECORA. Who was Andrade?

Mr. TRAIN. Doctor Monteiro de Andrade was the president of the Banco do Credito Real of the State of Minas Geraes. It might briefly be referred to as the State credit bank.

Mr. PECORA. Did you become familiar with a cablegram sent by Schroeder under date of April 12, 1929, to Andrade down in Rio de Janeiro in which he said as follows:

At a group meeting consisting of representatives Baring, Rothschild, National City Bank, and ourselves, held here this morning, your cable re new Government loan to take place of Credito Real was fully discussed. We are all of the opinion that the present moment is most unfavorable for any bond issues in London or New York. The monetary outlook is so obscure that the public are most unwilling to invest in bonds of any kind, and we fear that a new loan would not prove a success, even if issued below the price which you and we have had in mind. The present price of the last loan representa a loss to the subscribers, and we think it essential in the interests of Minas that the next loan should prove quickly profitable. We shall be happy to prepare contracts and all details for a new Government loan in sterling and/or dollars, amount equivalent to £2,000,000 to be issued. When we are able advise that the outlook is favorable, and we shall be greatly obliged if you will send us particulars of the taxes which are to be hypothecated to the new loan. On receipt we will mail new draft contracts.

Mr. TRAIN. What was the question?

Mr. PECORA. The date of this cablegram is April 12, 1929. Are you familiar with that cable?

Mr. TRAIN. I have listened very attentively and recall it in general as you read it to me.

Mr. PECORA. Now, is it not a fact that between March 1928, and September, 1929, the banking firm of Kuhn, Loeb & Co. were seeking an opportunity from the State of Minas Geraes to do its future external financing?

Mr. TRAIN. My recollection of the files would lead me to believe that Kuhn, Loeb & Co. were interested in doing a loan for the State of Minas Geraes, a long-term loan.

Mr. PECORA. Well, that is in the nature of external financing, is it not? You see, I am trying now to use the banker's language.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. TRAIN. Yes; Mr. Pecora, but I understood you to say all future financing, or something like that.

Mr. PECORA. External financing for the future.

Mr. TRAIN. I think it was with respect to a specific loan.

Mr. PECORA. Oh. And that came to the notice of the National City Co., did it not?

Mr. TRAIN. I would assume so.

Mr. PECORA. And the National City Co. as a consequence was naturally desirous of shutting out Kuhn, Loeb & Co. as a competitor for this financing, was it not?

Mr. TRAIN. The National City Co. felt that it had established, together with the London house of J. Henry Schroeder & Co., with whom it was in joint account for Minas business, a continuing relationship, a satisfactory and continuing banking relationship with this State.

Mr. PECORA. The knowledge that Kuhn, Loeb & Co. and Lee, Higginson & Co. were endeavoring in May or April, 1929, to negotiate arrangements to float a long-term loan for the State of Minas Geraes caused a good deal of correspondence to pass between New York, London, and Brazil in which the National City Co. was interested, did it not?

Mr. TRAIN. I would say that it caused a good deal of correspondence to pass; yes, and a good deal of surprise.

Mr. PECORA. Surprise—that is, perturbation?

Mr. TRAIN. Perturbation would be a——

Mr. PECORA (interposing). After the prospective entry of Kuhn, Loeb & Co. and Lee Higginson into that particular field of financing—is that right?

Mr. TRAIN. Well, as I have stated, the City Co. and J. Henry Schroeder Co. hoped to establish the general relationship, and it was naturally, I would characterize it, as rather disconcerting to find that, after having sponsored a loan for the State in the New York market in 1928, that someone else whould come in and have some of the future financing.

Mr. PECORA. Come in and do the future financing?

Mr. TRAIN. Should come in and endeavor to "chisel in."

Mr. PECORA. "Chisel in"—that is not a banker's term, is it?

Mr. TRAIN. That is just an expression. [Laughter.]

Mr. PECORA. Naturally the National City Co. and its co-underwriters in that first loan were unwilling to have these other banking houses "chisel in", were they not?

Mr. TRAIN. I would say that they did not like the idea.

Mr. PECORA. Was it not in order to retain the good will and the favor of the authorities of the State of Minas Geraes that these short-term unsecured advances were made?

Mr. TRAIN. I think my testimony has already explained these short-term advances to the best of my ability.

Mr. PECORA. Your testimony did not explain that possible feature of them, did it?

Mr. TRAIN. I have no present recollection of that consideration of which you speak having entered in.

Mr. PECORA. It is not a violent assumption, is it, that that entered into the consideration of the National City Co. in making these unsecured shortterm advances?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. TRAIN. May I have that question again?

(The shorthand reporter read Mr. Pecora's question as above recorded.)

Mr. TRAIN. My recollection of the files is that those advances were made some time after negotiations with Kuhn, Loeb and the Lee Higginson had been broken off. So that in that case you see——

Mr. PECORA. Were those negotiations broken off because the State authorities down in Brazil had been given to understand that through the National City Co. and its associates these short-term loans could be made?

Mr. TRAIN. My recollection is that the negotiations between the State and Kuhn, Loeb & Co. and Lee, Higginson & Co. were broken off by reason of representations made to the State Government by a representative of the J. Henry Schroeder Banking Corporation who happened to arrive in Brazil and discovered that this negotiation was proceeding.

Senator FLETCHER. How were they broken off?

Mr. TRAIN. How were they broken off?

Senator FLETCHER. Yes.

Mr. TRAIN. Why, my recollection is that they were broken off by, let us say, a cable addressed to these other two banking houses stating that the President of the State had no desire to continue further to negotiate with those particular houses. They would be put on notice that their intervention was not wanted.

Mr. PECORA. From the files of the company have you become familiar with a cablegram dated June 22, 1929, which was sent by Squires, the National City Bank's branch manager in Rio de Janeiro, to Mr. Jolles, the vice president here in New York, in which, among other things, Squires said as follows:

> As regards authority for redemption of short-term advances out of proceeds, Government assures us that such advances served purposes covered by said two laws, and counsel therefore holds that you can obtain necessary protection by including in purpose clause statement such as "part of proceeds will be applied to reimburse Government for expenditures already made in connection with works covered by said laws."?

Mr. TRAIN. I have listened attentively to what you have read, Mr. Pecora, and I have no doubt that that is in the files.

Mr. PECORA. The reference to the purpose clause which is made in that part of this cablegram is in the prospectus that was to be issued in connection with the flotation of the second or subsequent loan out of which these short-term advances were to be paid, is it not?

Mr. TRAIN. Yes.

Mr. PECORA. Now, instead of any such statement being included in the prospectus issued in connection with that second loan, as was specifically suggested by Squires in this cablegram, the statement in the prospectus was to the effect that the proceeds of this loan will be utilized for purposes designed to increase the economic productivity of the State, was it not?

Mr. TRAIN. Will you repeat that question?

(The shorthand reporter read the last question of Mr. Pecora as above recorded.)

Mr. PECORA. Do you know why that suggestion of Mr. Squires was disregarded in the preparation of the prospectus accompanying the second issue?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. TRAIN. I assume because the prospectus clearly stated the purposes as provided by law no. 1061 for which the loan was issued, and the borrowings had been made in anticipation.

Mr. PECORA. How would a recipient of that prospectus know what those laws alluded to?

Mr. TRAIN. I do not think I understand your question. How would a recipient——

Mr. PECORA. How would a person receiving that prospectus and reading it acquire any knowledge from the prospectus itself as to the provisions of the laws referred to there.

Mr. TRAIN. They are very generally summarized here under the purposes of the loan.

Mr. PECORA. Are they summarized in a fashion which would be certain to convey to the average reader of the circular or prospectus the information or knowledge that a substantial part of the proceeds of this second loan was to be used to pay these short-term unsecured advances?

Mr. TRAIN. No.

Mr. PECORA. Now, did you also, for the purpose of familiarizing yourself with the records of the company in connection with these two loans, read a letter from D. C. Baldwin to Mr. Squires dated July 12, 1929, on the subject of the prospectus to be issued in connection with the second loan of September, 1929?

Mr. TRAIN. If you will read me that letter, no doubt I will recall it.

Mr. PECORA. Let me read this portion of it to you:

> We would like to have favorable information from any angle of the State's activities, even in addition to the specific requests that we have made, for use in a prospectus letter, for, while the amount of material that we can use in a prospectus is limited on account of space, there is no limit to the material that we can use in our daily sales letter, and as far as our own organization is concerned, this can be put to just as effective use as the contents of the prospectus letter. We realize that these bonds will be hard to sell, especially in this market, and we are willing to make every effort to put on an "educational campaign" among our sales force if the State authorities will cooperate in trying to give us as much material as possible.

Mr. TRAIN. I have listened attentively to what you have read.

Mr. PECORA. And let me read another extract of the letter:

> Such a statement constitutes the best kind of selling argument, and as you are no doubt well aware, we need some selling arguments for the new loan, as the credit of Minas is not properly apprecitaed in this market.

Do you recall that?

Mr. TRAIN. I do.

Mr. PECORA. Do you know whether those selling arguments were furnished by anybody?

Mr. TRAIN. I do not; no, sir.

Mr. PECORA. Do you know when the State of Minas Geraes defaulted on the first issue, the one of $8,500,000 of March, 1928?

Mr. TRAIN. March 1, 1932.

Mr. PECORA. Was there a provision in the contract between the National City Co. and other underwriters of that loan and the State of Minas Geraes relating to the setting up of a reserve to be deposited with the National City Bank for the payment of interest on these bonds?

Mr. TRAIN. There was set up in connection with each of the two Minas Geraes loans, 1928 and 1929, a service reserve fund.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Yes.

Mr. TRAIN. The presence of that service reserve fund may, I think, be explained by the fact that in the first loan we were in association with J. Henry Schroeder & Co., London, who offered a similar amount of bonds in London simultaneously with our offering in New York. The contract of the first loan, I think the files would disclose, was mainly drafted and signed in London, and many London practices crept into the contract with respect to the issuance of bonds. In the London market it is very common in the case of these South American issues for a service reserve fund to be set up.

Mr. PECORA. When the September, 1931, interest was paid on these bonds was it paid out of funds, apart from this reserve which were required under the contract, to be sent to the National City Bank as the agent?

Mr. TRAIN. It was not.

Mr. PECORA. It was paid out of the reserve, was it not?

Mr. TRAIN. It was.

Mr. PECORA. Did not that indicate financial instability on the part of the State of Minas?

Mr. TRAIN. At that time, it would indicate an inability of the State to transfer funds from Brazil. It was a fact that at that time the foreign exchange question in Brazil became a very difficult one, and the State informed us that it had repeatedly endeavored to secure the necessary foreign exchange to remit to New York, but was unable to do so. My recollection is that it thereupon requested the fiscal agent for the loan, the National City Bank of New York, to use the service reserve fund that it was holding for just such purposes, of a transitory nature.

Mr. PECORA. That did not prove to be of a transitory nature, did it?

Mr. TRAIN. It did not, because——

Mr. PECORA (interposing). It proved to be of a permanent nature?

Mr. TRAIN. The situation grew successively worse until in October 1931 the Federal Government of Brazil imposed a very severe exchange restriction, a restriction on exchange by which the Bank of Brazil, the Government bank, was given the control of all foreign exchange transactions in Brazil, substantially along the lines these exchange controls have grown up in many countries and exist at this time.

Mr. PECORA. In addition to this reserve fund, the agreement between the underwriters and the State of Minas Geraes with regard to both these loans contained a provision under which the State of Minas Geraes was to send monthly to the National City Bank as the paying agent in New York the sums necessary to meet the next interest payment, did it not?

Mr. TRAIN. Monthly?

Mr. PECORA. Monthly.

Mr. TRAIN. No, sir. Semiannually.

Mr. PECORA. Semiannually. Was not such an agreement made after the reserve fund was utilized in September 1931 to meet the interest falling due then?

Mr. TRAIN. In connection with the use by the National City Bank of the reserve fund the State of Minas Geraes agreed to make a deposit

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in Brazil in the local currency of an amount roughly corresponding to the amount of dollars needed and to reconstruct or replace this reserve fund in six equal monthly installments.

Mr. PECORA. That is what I am referring to.

Mr. TRAIN. Yes.

Mr. PECORA. Did the State of Minas Geraes do that after the reserve fund was used to pay the interest coupons that fell due in September, 1931?

Mr. TRAIN. The State made one monthly payment.

Mr. PECORA. Only one?

Mr. TRAIN. One monthly payment.

Mr. PECORA. And that served notice on the National City Co. of serious financial difficulties in the State of Minas Geraes that would probably render it unable to pay the next interest charge, did it not?

Mr. TRAIN. I would say rather that it indicated serious exchange difficulties in Brazil. Brazil money was payable——

Mr. PECORA (interposing). Was any such information given to the bondholders here in this country by the National City Co.?

Mr. TRAIN. By the National City Co.?

Mr. PECORA. Yes.

Mr. TRAIN. I do not recall.

Mr. PECORA. The company kept that information to itself, did it not?

Mr. TRAIN. What information?

Mr. PECORA. That the State of Minas Geraes had failed to make more than one monthly installment payment on account of the interest that would be due and payable in March, 1932, after the reserve fund was drawn upon in September, 1931, to meet the interest payment which then fell due?

Mr. TRAIN. That would be quite true, except that there was an amount in Brazil in local currency quite sufficient to purchase the necessary exchange to pay the March 1 coupon, and the exchange restrictions to which I have referred imposed by the Bank of Brazil in October, 1931, might at any time have been removed prior to March 1, 1932.

Mr. PECORA. The restriction might have continued until long after March, 1932, might it not?

Mr. TRAIN. And has so continued.

Mr. PECORA. And has actually so continued?

Mr. TRAIN. Granted.

Mr. PECORA. But did the National City Co. inform any of the holders of these Minas Geraes bonds that that condition had arisen?

Mr. TRAIN. I would like to answer that question by saying that it is always a very difficult thing to decide whether or not to do it.

Mr. PECORA. Well, did it? Did it do so?

Mr. TRAIN. I am under the impression that it did not.

Mr. PECORA. Did not?

Mr. TRAIN. But I would like to observe that had the City Co. so informed holders of Minas Geraes bonds, undoubtedly the bonds would thereupon have declined in price, thereby causing losses to existing holders, and if subsequently the bonds had recovered in price many of the innocent holders of those bonds would have sold them out.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. But the public who had already purchased those bonds from the National City Co. were, by the silence of the National City Co., deprived of the opportunity to get rid of their bonds, were they not?

Mr. TRAIN. May I be permitted to correct my previous testimony? I recall that, I think, some time prior to September 1, 1931, the National City Co. notified its organization that the September 1, 1932, coupon was being paid out of the service reserve funds. That is my recollection, and it is subject to verification. It may be incorrect, but that is my distinct recollection.

Mr. PECORA. Has any bondholder's protective committee been organized with regard to these bonds?

Mr. TRAIN. Not that I know of.

Senator FLETCHER. How many of those bonds of the $8,500,000, first issue, and $8,000,000, second issue, were sold to the public in the United States?

Mr. TRAIN. I am very glad that you asked me that question, Senator, because I would like to point out that out of the proceeds of the second series bonds, with which there were some short-term credits in Europe repaid, something like $3,000,000 principal amount of those bonds were offered and sold in Europe.

I would say generally, if I might be permitted, that with respect to all our foreign issues, anywhere from 10 to 35 per cent of the original bonds issued were originally sold in Europe at the time the offering was made, thereby, if I may draw an assumption, confirming to some extent the opinion of experienced European bankers and investors, because these bonds were sold through European bankers, as to the merit of the particular security offered. Had they not thought that the security or the bond offered was a reasonable investment, presumably they would not have subscribed.

Senator FLETCHER. Out of the two issues how much was disposed of in the United States?

Mr. TRAIN. In the United States? Well, I would fear that it would be a guess, but I would say that of the sixteen million five approximately 12,000,000 were sold in the United States. That is just a guess. Perhaps 4,000,000 were sold in Europe.

Senator FLETCHER. At what price?

Mr. TRAIN. To the American investor?

Senator FLETCHER. Yes.

Mr. TRAIN. The first issue 97½, 6½ per cent bonds at 97½; and the second issue 6½ per cent bonds at 87.

Senator FLETCHER. When did the default occur on the second issue?

Mr. TRAIN. On both issues the default occurred at the same time and for the same reason, on March 1, 1932. May I observe——

Senator FLETCHER. That default has continued up to date?

Mr. TRAIN. That default has continued to date, although at the present time, if you are interested in this general question, the Federal Government of Brazil is considering arrangements whereby the coupons on these bonds may be optionally collected in internal currency in Brazil. In other words, the holders of these bonds could optionally take Brazilian milreis, since the exchange situation is such that it appears to be impossible to transfer the amounts into dollars. You will appreciate that the foreign trade of Brazil, just as the foreign

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

trade of every country, has shrunk tremendously, and the balance of exports has not been sufficient to provide exchange.

Senator FLETCHER. About what price to-day are those bonds?

Mr. TRAIN. Senator, they are selling, my latest recollection of that, though I have not checked in the last few days, was around 21 or 22.

Mr. PECORA. I think that is all of this witness. Now Mr. Chairman, there is a gentleman here whom I have invited, and, whose testimony I would like to have presented at this time as a matter of convenience to him, since he has been in attendance here for two days and can not afford to spare the time. The gentleman is Mr. Edgar Brown. Will you take the stand, Mr. Brown?

TESTIMONY OF EDGAR D. BROWN, POTTSVILLE, PA.

The CHAIRMAN. Do you solemnly swear the testimony you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

Mr. BROWN. I do.

Mr. PECORA. Your full name, Mr. Brown?

Mr. BROWN. Edgar D. Brown.

Mr. PECORA. And where do you live?

Mr. BROWN. In Pottsville, Pa.

Mr. PECORA. What is your business or occupation?

Mr. BROWN. I have none. Oh, yes; I am clerking for the poor board.

Mr. PECORA. What was your business or occupation?

Mr. BROWN. I was a theatrical manager, owner, and producer.

Mr. PECORA. In the early part of the year 1928 were you a resident of Pottsville, Pa.?

Mr. BROWN. Yes, sir.

Mr. PECORA. And at that time were you contemplating making a trip for your health to the State of California?

Mr. BROWN. I was.

Mr. PECORA. About the time that you had arranged to leave your home for California did you have any business transactions with the National City Co.?

Mr. BROWN. Yes, sir.

Mr. PECORA. How did the transactions originate?

Mr. BROWN. I saw an ad in a national magazine that fitted my particular dilemma.

Mr. PECORA. What was the substance of this ad, as you recall it?

Mr. BROWN. It said—I can not quote verbatim.

Mr. PECORA. No; the substance of it.

Mr. BROWN (reading):

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

Mr. PECORA. Whose name was signed to that advertisement? Was it the National City Bank or the National City Co.?

Mr. BROWN. National City Bank.

Mr. PECORA. What did you do, if anything, when you read that advertisement?

Mr. BROWN. Why, it struck me, Mr. Pecora, as suiting my needs, and I answered the advertisement.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Did you receive a reply?
Mr. BROWN. A man called that I had never seen before.
Mr. PECORA. Do you know his name?
Mr. BROWN. Yes.
Mr. PECORA. What was his name?
Mr. BROWN. Fred Rummel.
Mr. PECORA. Did he tell you whom he represented?
Mr. BROWN. He told me he represented the National City Co. and that they had received a letter from me.
Mr. PECORA. Your letter was addressed to the National City Bank?
Mr. BROWN. I think so.
Mr. PECORA. And a Mr. Rummel of the National City Co. called to see you in response to your letter?
Mr. BROWN. Yes, sir.
Mr. PECORA. Now tell the committee briefly the substance of the conversation you had at that time with Mr. Rummel.
Mr. BROWN. I told Mr. Rummel that I had just sold my chain of theaters to different individuals and that the proceeds were becoming due and that I would need to invest them and that I was contemplating leaving for the West Coast and that I was glad he had called in response to my letter. I wanted his guidance in investing those funds.
Mr. PECORA. Did you tell him how much money you had available for investment at that time?
Mr. BROWN. Yes, sir.
Mr. PECORA. What did you say to him about that?
Mr. BROWN. I told him that I would have approximately $100,000 to invest.
Mr. PECORA. What did Mr. Rummel say to you about that?
Mr. BROWN. He told me that he would make—I had some bonds as well as some cash. The cash was becoming due, Mr. Pecora.
Mr. PECORA. That is, the cash from the proceeds of the sale of your theaters?
Mr. BROWN. Yes, sir.
Mr. PECORA. It was about to be paid by the purchasers?
Mr. BROWN. Yes, sir.
Mr. PECORA. And you told that to Mr. Rummel?
Mr. BROWN. Yes, sir.
Mr. PECORA. You said that cash would amount to about $100,000?
Mr. BROWN. Together with bonds that I had at the time.
Mr. PECORA. What kind of bonds had you at the time?
Mr. BROWN. I had Government bonds.
Mr. PECORA. United States Government bonds?
Mr. BROWN. Yes, sir; and some Italian Government bonds. About $25,000 all told.
Mr. PECORA. Yes. Now, did Mr. Rummel give you any advice concerning the investment you should make with your resources?
Mr. BROWN. He said that he would take that up with his company and would advise me.
Mr. PECORA. What happened thereafter?
Mr. BROWN. He came back with certain recommendations for the sale of all of the securities I had.
Mr. PECORA. That included the United States Government bonds?
Mr. BROWN. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Yes. Go ahead.

Mr. BROWN. And the purchase of other bonds through his company.

Mr. PECORA. Were there any specific issues that he recommended you to buy with the proceeds of the sale of the Government bonds?

Mr. BROWN. I don't remember.

Mr. PECORA. Tell the committee from that point on in your own way——

Mr. BROWN (interposing). Oh, I can remember some, Mr. Pecora. One was that issue of Peru that we spoke about.

Mr. PECORA. You mean the Peruvian bonds that were the subject of testimony here yesterday?

Mr. BROWN. Yes, sir.

Mr. PECORA. Tell the committee in your own way, Mr. Brown, if you will, just what transactions and negotiations led to the making of investments by you with representatives of the National City Co. from that point on. Just tell the committee in your own narrative.

Mr. BROWN. My attention was called to the fact that all the securities which I then held were all wrong, and certain recommendations were made for the purpose of replacing those securities, and loans were made at banks which I had never been in. The first loan was made at the National City Bank of New York of $75,000.

Mr. PECORA. Who arranged that loan?

Mr. BROWN. Mr. Rummel.

Mr. PECORA. Had you ever before had any dealings or transactions with the National City Bank or the National City Co.?

Mr. BROWN. I had never been in them; no, sir.

Mr. PECORA. Give the committee, please, the general circumstances surrounding the making of the loan, what induced it, what the purpose was, and what you did with the proceeds of the loan.

Mr. BROWN. My attention was called by Mr. Rummel that if I could buy bonds below par that were paying 7½, netting 7½ per cent, and borrow the money at 5 or 5½ per cent, that I could make the difference on the borrowed money and pay off those loans when the bonds came back, as he expected they would go to par.

Mr. PECORA. Did you also invest at that time upon his recommendation any part of the $100,000 approximately, which you had in cash or obtained as a result of the sale of your Government bonds? Did you make any investments through Mr. Rummel of that money?

Mr. BROWN. Yes, sir.

Mr. PECORA. Tell the committee about those investments.

Mr. BROWN. They are substantially the same, Mr. Pecora, as the loan at the National City Bank.

Mr. PECORA. Tell us about that.

Mr. BROWN. We would buy Greek Government 6's and have them sent to a bank in Reading that I had never been in, the Northeastern Trust Co., and a loan approximately 2 or 3 times that amount, the amount of the value of the bonds, would be placed and other bonds equal to that sum would be purchased.

Mr. PECORA. Upon whose judgment were the investments made?

Mr. BROWN. I am presuming upon that of the National City Bank and National City Co. because he was their representative.

Mr. PECORA. You mean Mr. Rummel?

Mr. BROWN. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Had you made any suggestions to him concerning the specific securities that you wanted to invest your moneys in——

Mr. BROWN (interposing). Only that I did not want stock.

Mr. PECORA. —— or did you leave that entirely to his judgment?

Mr. BROWN. I left it entirely to his judgment, except that I specified I did not want stocks.

Mr. PECORA. You wanted fixed interest security?

Mr. BROWN. Yes, sir.

Mr. PECORA. Fixed income security?

Mr. BROWN. Yes, sir.

Mr. PECORA. Such as bonds?

Mr. BROWN. Yes, sir.

Mr. PECORA. What investments were made for you by Mr. Rummel?

Mr. BROWN. I would have to consult my records.

Mr. PECORA. Please do that, will you, if you have your records with you?

(The witness left the witness chair for a few moments and returned with documents.)

Mr. BROWN (handing document to Mr. Pecora). That will give you an idea, Mr. Pecora. It is entirely too lengthy to read. They were bought and sold and traded in to such an extent that I could not follow it.

Mr. PECORA. What was the aggregate amount of investments in dollars and cents that you made under Mr. Rummel's advice and guidance?

Mr. BROWN. I should say $200,000 to $250,000.

Mr. PECORA. You had approximately $100,000 of capital to start with in the early part of 1928 when you first met Mr. Rummel?

Mr. BROWN. Yes, sir. I want to correct that. That is December or November, 1927, instead of the early part of 1928.

Mr. PECORA. All right. Where did you get the funds above that amount——

Mr. BROWN (interposing). They were borrowed.

Mr. PECORA. ——that you invested to the aggregate to $200,000 to $250,000?

Mr. BROWN. They were borrowed at various banks.

Mr. PECORA. Through whose instrumentality were those loans effected?

Mr. BROWN. Only through Mr. Rummel's.

Mr. PECORA. And at what banks were those loans placed?

Mr. BROWN. The Northeastern Trust Co. of Reading, Pa.

Mr. PECORA. Had you ever had any business transactions with that bank before?

Mr. BROWN. No, sir.

Mr. PECORA. Go ahead.

(There was a pause.)

Mr. PECORA. May I read into the record the list produced by the witness as being a list of the securities in which investments were made for him in the manner that he has indicated?

Mr. BROWN (handing other documents to Mr. Pecora). That is the bank in Philadelphia, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Beginning with 14th of December, 1927, $2,000 of Vienna 6 per cent bonds, due 1952; 30th of December, 1927, $15,000 of the same issue of Vienna bonds; 30th of December, 1927, $15,000 German Central Bank 6's due in 1960; December 30, 1927, $15,000 of Saxon Public Works 6 per cent bonds, due 1951; December 30, 1927, $15,000 Remington Rand 5½'s, due 1947.

Well, the list is so lengthy I will ask that it be spread on the record, Mr. Chairman.

The CHAIRMAN. If there is no objection, it is so ordered.

(The list is as follows:)

Edgar Brown, Pottsville, Pa.

Date		Amount	Security	Price
Dec. 14, 1927	Sold to	$2,000	Vienna, Austria, 6's, due November, 1952	90½.
Dec. 30, 1927	do	15,000	do	90½.[1]
Do	do	15,000	German Central Bank 6's, Oct. 15, 1960	91⅜.[1]
Do	do	15,000	Saxon Public Works, ½'s, May, 1951	95.[1]
Do	do	15,000	Remington Rand 5½'s, May, 1947	95.[1]
Do	do	15,000	Kingdom of Italy 7's, December, 1951	99.
Do	do	150 shares.	Willys-Overland 7 per cent preferred stock	92½.
Do	do	$15,000	Rhine Westphalia 6's, May, 1952	92¼.[1]
Jan. 17, 1928	do	10,000	Chicago, Milwaukee, & St. Paul & Pacific R. R. 5's, January, 2000.	65.
Do	do	100 shares.	Belgian National Railways, par. preferred stock	85½.
Jan. 28, 1928	do	150 shares.	Geo. A. Fuller Co. pr. preferred stock	106¾.
Feb. 27, 1928	do	$15,000	Rhine Westphalia Electric 6's, May, 1952	93⅛.
Do	do	15,000	Greek Government 6's, February, 1968	91.[1]
Do	do	15,000	Missouri Pacific Ry. 4's, March, 1975	80¾.
Do	do	150 shares.	Belgian National Ry., par. preferred stock	86.
Do	do	$13,000	Republic of Peru 6's, December, 1960	92¼.
Do	do	15,000	Erie R. R. 5's, May, 1967	98⅛.
Mar. 20, 1928	do	15,000	Irish Free State 5's, November, 1960	97.
July 24, 1928	do	100 shares.	Mohawk Carpet Mills common stock	40.
July 31, 1928	do	150 shares.	Postal Telgraph & Cable 7 per cent preferred stock.	101.
Aug. 1, 1928	do	$10,000	Northern Ohio Power & Light 6½'s, January, 1941.	97.
Aug. 3, 1928	do	5,000.	Saxon State Mortgage 6's, September 1947	91.
Aug. 7, 1928	Bought of	5,000	Erie R. R. 5's, May 1, 1967	1,000 at 93½—$2; 2,000 at 93¾ — $2; 2,000 at 93⅞—$2.
Do	do	150 shares.	Missouri, Kansas & Texas 7 per cent preferred	100 shares 103⅛ — 25 cents; 50 shares, 103¾—24 cents.
Do	do	$2,000	Mortgage Bank of Chile 6½'s, 1957	98½—$2.
Aug. 9, 1928	do	2,000	Republic of Chile 6's, April, 1960	93⅞.
Do	do	4,000	Republic of Chile 6's, February, 1961	93¾—20 cents.
Aug. 17, 1928	do	2,000	Vienna, Austria 6's, November, 1952	98¼—$2.
Do	do	4,000	Italian Credit Consort 7's, 1947	94⅜—$2.
Aug. 18, 1928	do	4,000	Antioquia Col. 7's, 1945	97—$2.
Oct. 2, 1928	Sold to	100 shares.	Rhine Westphalia Electric common stock	51.
Mar. 20, 1928	Bought of	15,000	Erie R.R. 5's, May, 1967	99¼.
Mar. 22, 1928	Sold to	10,000	Budapest, Hungary 6's, June, 1962	87¾.
Mar. 23, 1928	do	5,000	do	87¾.
Apr. 3, 1928	Bought of	15,000	Missouri Pacific Ry. 4's, March, 1975	81–$2.
Apr. 11, 1928	Sold to	10,000	Fiat S. F. 7's, July, 1946	106.
Apr. 18, 1928	do	100 shares.	U. S. Realty & Improvement common stock	87.
Do	do	15,000	Erie R. R. 5's, May, 1967	98⅛.
Apr. 25, 1928	do	150 shares.	Missouri, Kansas & Texas 7 per cent preferred	105½.
May 2, 1928	do	15,000	German Central Bank for Agriculture 6's, Apr. 15, 1938.	95½.
Do	Bought of	150 shares.	Geo. A. Fuller Co. prior preferred stock	109.
May 8, 1928	Sold to	15,000	German Central Bank for Agriculture 6's, Apr. 15, 1938.	95½.
May 14, 1928	do	100 shares.	American Power & Light 5 per cent preferred	95.
Do	Bought of	10,000	Erie Railroad 5's, May 1, 1967	98¼.
May 21, 1928	Sold to	15,000	Greek Government 6's, February, 1968	89.
Do	Bought of	15,000	Kingdom of Italy 7's, December, 1951	100.
May 31, 1928	do	10,000	Fiat S. F. 7's, July, 1946	118–$2.
Do	Sold to	10,000	Norwegian Hydro 5½'s, due November, 1957	93.
June 5, 1928	do	10,000	Remington Rand 5½'s, May, 1947	95⅝.
June 7, 1928	do	10,000	German General Electric 6's, April, 1948	95.

[1] These are being held by the National City Bank against your loans.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Edgar Brown, Pottsville, Pa.—Continued

Date		Amount	Security	Price
June 13, 1928	Bought of	150 shares.	Willys Overland 7 per cent preferred	100.
July 10, 1928	do	$10,000	German General Electric 6's, April, 1948	95.
July 11, 1928	Sold to	10,000	State of Rio Grande do Sul, June, 1968	94¼.
July 12, 1928	do	100 shares.	Cannon Mills common stock	48.
Oct. 16, 1928	do	275 shares.	Andes Copper Mining common stock	37½.
Do	do	12 shares.	do	37½.[1]
Oct. 2, 1928	Bought of	50 shares.	Postel Tel. & Cable 7 percent preferred stock	103¾—25 cents.
Oct. 16, 1928	do	100 shares.	do	102¾—25 cents.
Do	Sold to	288 shares.	Andes Copper Mining common stock	37.[1]
Oct. 18, 1928	Bought of	$10,000	Northern Ohio Power & Light 6½'s, Jan. 1941	96.
Oct. 19, 1928	Sold to	100 shares.	Pennsylvania Dixie Cement 7 percent preferred stock.	85.
Oct. 24, 1928	do	$14,000	Remington Rand 5½'s, May 1947	94½—20cents.
Oct. 25, 1928	Bought of	$1,000	do	93⅜—20cents.
Nov. 20, 1928	Sold to	425 shares.	Andes Copper Mining common stock	47¾—15cents.
Nov. 27, 1928	Bought of	50 shares.	Cannon Mills Co. common stock	47⅜—15cents.
Do	do	$10,000	Norwegian Hydro 5½'s November 1957	92.
Do	do	100 shares.	Cannon Mills common stock	47½—15cents.
Do	do	100 shares.	Mohawk Carpet Mills common stock	56—17½.
Dec. 3, 1928	Sold to	100 shares.	Baltimore & Ohio R. R. common stock	121.
Dec. 5, 1928	do	50 shares.	Cannon Mills Co. common stock	45⅞—15cents.

[1] These are being held by the National City Bank against your loans.

Mr. PECORA. The last transaction shown on this list is dated December 5, 1928, a transaction in the shares of the common stock of Cannon Mills Co. What other bank loans were arranged to enable you to make these investments?

Mr. BROWN. North American Trust Co., of Philadelphia.

Mr. PECORA. How much of a loan did you get there?

Mr. BROWN. I do not remember definitely.

Mr. PECORA. What other bank loans were negotiated for your accommodation by Mr. Rummel?

Mr. BROWN. The Pennsylvania National Bank in Pottsville.

Mr. PECORA. Had you ever done business with that bank?

Mr. BROWN. Yes, sir; I had.

Mr. PECORA. How much of a loan did you get there?

Mr. BROWN. I think it was $5,000.

Mr. PECORA. What other bank loans?

Mr. BROWN. The Safe Deposit Bank, possibly. I think that loan was $20,000.

Mr. PECORA. Go ahead.

Mr. BROWN. And the National City Bank in New York City.

Mr. PECORA. How much of a loan did you get there?

Mr. BROWN. $75,000.

Mr. PECORA. Anywhere else; any other bank loans?

Mr. BROWN. Yes, sir. One at the Northeastern Trust Co., of Reading, for about $80,000. I think with my original collateral that would about make it.

Mr. PECORA. In the investments that were made by you, that were made for you—Oh, do you recall a loan that was obtained for you from a bank in Los Angeles by Mr. Rummel?

Mr. BROWN. Oh, yes.

Mr. PECORA. What was the name of that bank?

Mr. BROWN. That was not obtained by Mr. Rummel. That was obtained by a Mr. Anderson of the Los Angeles branch bank?

Mr. PECORA. Of what Los Angeles branch bank?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BROWN. Of the Los Angeles branch of the National City Bank.

Mr. PECORA. I see. Now what collateral was that loan secured by?

Mr. BROWN. Oh, I think an important thing has been missed which will have to be brought out.

Mr. PECORA. Go ahead and tell us about it.

Mr. BROWN. These bonds which I bought instead of accruing in value declined steadily in value, and I complained.

Mr. PECORA. You complained to whom?

Mr. BROWN. Mr. Rummel.

Mr. PECORA. Yes?

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

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

Mr. PECORA. Did you tell him what stocks to buy?

Mr. BROWN. Never.

Mr. PECORA. Did he buy stocks then for your account?

Mr. BROWN. Might I answer that facetiously—Did he buy stocks? (Great and prolonged laughter.)

Mr. PECORA. The witness produces a large batch of confirmations of purchases of various stocks. They are so numerous, Mr. Chairman, that I do not think it necessary to spread them all on the record.

Now, go ahead and tell the committee of the investments that were made for your account, if not benefit.

Mr. BROWN. In early 1929 I went to New York City, without telling anyone connected with the National City Co. that I was going there, on an irregularity in the purchase of Andes Copper Stock and also to complain to the officers of that company that I feared that I was being a shorn lamb, and I went and asked to see one of the officials of the company. I was introduced to a Mr. H. W. Beebe. I laid my complaint before him that my original sum of money, notwithstanding a rising market and the violence with which I had been traded in, was, so near as I could determine, less in value—I say so near as I could determine, Mr. Pecora, because I could not tell where I stood.

I present telegrams to show that I tried to get my accounts balanced at these various banks that I was being traded in, in order to balance my books, to find out where I was.

And Mr. Beebe said that he would make some recommendations to a Mr. —— "the manager of our Philadelphia office." I went away feeling that that would be done. I told him that I disliked the violent trading, and he said a recommendation would be made. I told him that I was fearful that a reaction in the market might wipe me out, and that I had no income and he said that he would confer with the manager of the Philadelphia office

Following that I was called upon by their agent.

Mr. PECORA. Can you give his name? Can you give the agent's name?

Mr. BROWN. The same man, Mr. Rummel.

Mr. PECORA. Go ahead.

Mr. BROWN. With the recommendation that we trade the remaining securities that we had for 200 shares of National City Bank, the 1,000 shares of Andes, which became 450 Anaconda, 250 shares of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Oliver Farm, and 100 shares of Cannon Mills stock, and sit still on that and see what would happen. [Laughter.]

About that time I went to Los Angeles. When I got there——

Mr. PECORA (interposing). What time was this that you are speaking of?

Mr. BROWN. In August of 1929.

Mr. PECORA. Go ahead.

Mr. BROWN. The eastern banks wanted my loans moved, because I was moving out of the territory and out of touch with them and a Mr. Anderson of the Los Angeles office arranged with a bank I had never been in, the Farmers & Merchants Bank, to loan me on those securities which I have just read into the record, $105,000, $95,000 of which was used to reduce the $100,000 they had borrowed for me in the East, and $10,000 to be kept on hand in the bank, a banking custom I have since learned. That was in August.

In September, from data that I have made, I noticed that the prices of those stocks were declining, and I concluded that at the first opportunity I would clean out the whole business.

And about October the 4th I went into the National City Bank and asked them to sell out everything.

Mr. PECORA. That is the branch in Los Angeles you are speaking of?

Mr. BROWN. Yes, sir.

Mr. PECORA. Go ahead.

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

Mr. PECORA. That is, to sell your stocks?

Mr. BROWN. Especially to sell the National City Bank stocks.

Mr. PECORA. What was the quotation at that time for the National City Bank stock, if you recall?

Mr. BROWN. About $490—$500. $500. I then received an unsolicited wire from their agent in the East, who did not know where I was from any knowledge that I had given him, a telegram.

Mr. PECORA. Have you got it with you?

Mr. BROWN. A short one. I have got it.

Mr. PECORA. Read the telegram into the record, will you?

Mr. BROWN (reading):

OCTOBER 8.

Edgar Brown,
Beverly Hills, California—

This was the day following my conference in the Los Angeles bank. It reads:

National City Bank now 525. Sit tight.

I had had no connection with Mr. Rummel for 4 months. I did not see how he knew where I was.

Mr. PECORA. Is that Mr. Rummel's name signed to that telegram? F. C. Rummel?

Mr. BROWN. Yes.

Mr. PECORA. Proceed.

Mr. BROWN. I still continued my endeavors to get that stock. I realize that this testimony sounds rather foolish, to think that a man can not go in and say, "Sell that stock" and walk out. But it was not as easy as it sounds, because each time I would go to sell it they

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

would call my attention to the fact that it had gone up a couple of points.

But on October the 29th they sold the 200 shares of National City Bank stock and the 450 shares of Anaconda, and so on—they sold that without my specific command, stating that the Farmers Bank was calling my loan at that time, which I afterward found out was not the case.

Now in connection with that let me say that that was a Tuesday. The price of that stock when it closed on Monday was $460 a share. And at 7 o'clock on Tuesday morning, which was the equivalent of 10 in New York, I was told that the stock was crashing, and I either had to get out or be sold out by the bank. I was helpless. They got $320 for it. But instead of selling it they bought it themselves for $320.

Mr. PECORA. The witness produces a confirmation.

Mr. BROWN. In the Wall Street Journal the stock was quoted at $360.

Mr. PECORA. The witness produced a confirmation from the National City Co. of California, Los Angeles, dated October 29, 1929, reading as follows:

DEAR SIR: In accordance with instructions we are pleased to confirm purchase from you of 200 shares National City Bank of New York stock at $320 flat, and

We have sold for your account 400 shares Anaconda Copper Mining Co. common stock at 79¾ flat less 20 cents a share commission of our broker.

Fifty shares of Anaconda Copper Mining Co. common stock at 79⅝ flat.

100 shares Eastman Kodak stock at 170 flat, less 25 cents a share commission to our broker.

Settlement and disposition will be made in accordance with your instructions.

Very truly yours,

THE NATIONAL CITY CO. OF CALIFORNIA,
(Signed) R. R. HODGE, *District Sales Manager.*

What did you say was the quotation for the National City Bank stock on October 29, 1929?

Mr. BROWN. $450.

Mr. PECORA. What was the quotation on Tuesday, October 30?

Mr. BROWN. $360. That is when I gave the order.

Mr. PECORA. And they confirmed a purchase from you at $320?

Mr. BROWN. Yes, sir. This will prove that I knew nothing about the letters. The second paragraph.

Mr. PECORA. We will come back to this later on. Just finish your narrative of your transactions with the National City Co.

Mr. BROWN. I felt that I had been very badly used, and protested.

Mr. PECORA. Well, in what way did you protest?

Mr. BROWN. Personally, to the New York office. I wrote to Mr. Beebe. I believe you have a copy of that letter there. I have got it. Do you want me to read it?

Mr. PECORA. Yes.

Mr. BROWN (reading):

BEVERLY HILLS, CALIF.,
October 31, 1929

Mr. W. W. BEEBE,
Assistant Vice President, National City Co., New York City.

MY DEAR MR. BEEBE—

Shall I omit any personal parts of the letter?

Mr. PECORA. Yes. Just read the portion relating to the stock transaction.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BROWN (reading):

I am the chap from Pottsville, Pa. * * * who with my wife called on you some months ago concerning an irregularity in the purchase of Andes copper through your Fred Rummel in Pottsville, and complained about being sold too much stock and traded in too rapidly * * * this I relate only to identify myself.

I told you, if you will recall, that I would like you to take my funds in to the New York bank and trade in them there where you personally could watch them, but this you said you were unable to do, but appreciated this show of faith on my part in the National City Co., and added that I was perfectly safe in following the advice of the company right where I lived.

Almost immediately after I left you I developed tuberculosis and was advised to come out here for my health.

As soon as I arrived I went to your offices * * * and met Mr. Arthur Anderson, and told him that I would like to have my banking facilities moved out here; that I naturally wanted the National City Co. to look after my financial affairs.

He arranged to have my stock moved to the Los Angeles Farmers & Merchants Bank, and after it was out here recommended one or two minor changes which, as always, I complied with.

My collateral list at that time amounted to $170,000 face value, comprised of National City stock, Anaconda Copper, Cannon Mills, and Oliver Farm. The loan was for $105,000—the loan actually really was only $95,000, but they loaned me $105,000 and asked me to let $10,000 lie in the bank and use the remaining $95,000 to lift the draft * * *.

All was well. My collateral grew until it was approximately worth its original $200,000. * * * At this point I begged Anderson to sanction my selling, but he insisted that City Bank would go to $750 at the very least.

Now I have made it a rule since the day I first came with the National City with the proceeds of my first theater sale for them to invest—that I would never buy or sell anything without their sanction and would always act upon any suggestions which they might make, and to this day I have never once departed from that rule. * * *

I bought thousands of shares of stock on their suggestion which I did not know whether the companies they represented made cake, candy, or automobiles. I just stuck to that rule feeling that it was the only safe thing to do, but it was really the only way in which I could be safe. But, alas, I am apparently wrong in placing my faith so.

If you can find a single transaction in the thousands of shares I have bought and sold through your company where I have made any personal suggestion or acted on my own initiative without some one in the National City Co. saying, yes, that is the proper thing to do, or if you can find a single suggestion, just one, concerning a transaction, which I have made up until this time regarding the sale of your stock I will be pleased to withdraw that plea for help which I am about to make.

On Monday night of this week Anderson called me on the phone and said, "Brown, things are looking terrible."

At that time the stock was 450 (continuing reading):

"I think the market might bust wide open tomorrow morning and let you out. You'd better come down and watch it. If they move off you get out from under." I had really never been in a board room. This morning I got up at 6 o'clock and was in the board room next to the National City Bank before the exchange opened, which it did at 7. Anaconda closed, so Anderson said, at 96 the night before and the first opening was for 45,000 shares at 80. Anderson said to myself and to Mrs. Brown, "Now, if this thing strengthens up the first hour everything will be all right, but if it does not, look out." He watched the proceedings, moving nervously about for approximately an hour, and I said, "What do you think about it?" Anaconda was above its opening all this while. He replied, "I don't know. The ticker is late out here and I can't tell. I'll walk over to our office and see what news is coming in direct."

Marie and I—my wife—remained until after another hour had passed. I was about as blue as a poker chip. Everybody was groaning and my godding until I said, "Come on, let's go out into the air. This stuff will be all right. These

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

folks are just getting panicky." We began to think of places where we might go to scrape a little cash together to buy some more Anaconda and make our lot an even 500. As I went in the door of your offices here I noticed that they were deserted save Mr. Anderson. I said, "Wait a minute, I'll see if he has any news." Just as I got to him he hung up the telephone as I reached his desk, and he said, "My God, Brown, City Bank is crashing. The banks are in on this thing and the market is actually way under what it is quoted out here."

Which was not true.

"My advice to you is to get out. Bank stock is well down under 350."

Well, now, I ask you in all earnestness, having taken the National City Co.'s advice, which you can readily prove, in every other case, what was I to do in this instance? Where was I to turn? Who did I know? I said, "Let's ask Kane."

Mr. Kane was the Los Angeles manager.

He said, "He is in Frisco." I said, "Well, where is Judge Ryan?"

He was the head of the Los Angeles Branch Bank.

He said, "Oh, I would not be surprised if he has gone out and cut his throat." I said, "Well, Andy, this thing is serious—now, I don't have to sell, but if you think it is the right thing to do I suppose I'll have to ride along—I presume that even somewhat below the prices quoted on the board I'll have at least $25,000 left."

I walked to the door where my wife was waiting and told her what I had done, and she was furious. She being an even-tempered soul felt that I had made a mistake—and, brother, I had. She said, "You go back in there and tell him not to sell that stock. We were just talking about other people getting panicky; now why get hysterical?"

So back in I went. Anderson stood his ground. He said, "The only thing to do is to get out." Besides, he said, "The order has gone in and I can not stop it." (I have a witness for this.)

"Anyway," he said, "the way they are busting this thing open you'll be able to buy back all the Anaconda you want at 65, and anyhow, the bank is calling your loan."

So I went over to the Farmers & Merchants Bank to report not only what I had done * * * and they just gave me hell. They said they were not even thinking of calling me. That my cash account and my stock value even at the last low was such that they were not even putting out letters or phone calls for me.

Well, I was nearly crazy. Naturally they could not loan me any more money.

since my security was all sold, so

I hurried to Anderson and I asked him to try to get me some from City Bank and to buy a thousand Anaconda, using my cash in my account. Whether he actually wired or not I don't know, but he called a little while later and he said, "They won't loan you a cent on a thousand Anaconda."

The next morning when I woke up I discovered that instead of 350 for my City Bank I got 320 and so on down the line, so that my calculated $25,000 was in reality $6,000 * * *.

Now for my request.

Three years ago I came with your company with the profit on some real estate sales amounting to approximately $100,000. I'll pay you anything I now own if in these three years you can find a single instance where I did not first call up your office before making a sale or a purchase or complying with any suggestions you ever made. This statement is totally and wholly true. In all that time I never bought a single share of stock through any person or company except your company.

Now get this picture.

I am now 40 years of age—tubercular—almost totally deaf—my wife and family are depending on me solely and alone and because of my abiding faith in the advice of your company I am to-day a pauper.

I am absolutely certain that if your man Anderson had sought the advice of any of his superiors, or any of them had been within consulting distance they would have stopped him from innocently, but none the less thoroughly, ruining me by his rattleheadedness. And I am equally certain that if before you ask

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

him whether or not this is true, you assure him that he will not lose his job if he confesses the truth, he will admit every word as I have written it. I believe, however, tnat he would rightly fear that he would be fired and will therefore change the coloring of it. But if you ask him to answer yes or no whether he advised me to get out while I still had something and assure him that no matter how he answers he will still be working for you—he'll say, "yes," I told him to get out.

Everybody out here says * * * that I am only wasting stamps by writing to you, but I can not help feel that your character—something in your eye as we saw you makes us feel that you'll do more than say, "That's too bad."

Now what I ask him to do is to loan me enough money to buy a thousand shares of Anaconda stock by my putting up $25,000 in cash, and their bank loaning me the balance.

I sent him a subsequent telegram following that letter, along the same line, and in reply to that he says this:

While we believe Anaconda is an attractive security for long-terminvestment we do not feel it advisable to make security purchases with borrowed funds except in cases where the purchaser has an earning power which will enable him within a reasonable time to pay off his loan and lock his securities in a safe-deposit box.

And this point I want to make clear to the examiner is that my status at that time was exactly the same as when I went in originally. I had no earning power and he knew it.

I wired again the second time, and again I got a second telegram in reply. My wire to him is as follows:

Mr. W. W. BEEBE,
Vice president, National City Co.,
No. 55 Wall Street, New York City:

Why do you object to my borrowing funds with which to purchase securities now when conditions concerning my income were no different when Rummel was doing that very thing much against my wishes and concerning which I complained to you personally? The only way in which I can possibly recover any appreciable portion of the fortune I lost through following implicitly the advice of the representatives of your company is to adopt the same purchasing methods they used and then sell out at a point where they formerly induced me to stay in. For example, I have ample witness that I wanted to sell City Bank stock after it crossed five hundred but was urged not to do so by Anderson here saying that it would sell over fifteen hundred before it would drop below five hundred and simultaneously I received this telegram from Rummel in Pennsylvania whose opinion I had not even asked and with whom I had not communicated for months. "City Bank stock now crossing five hundred twenty-five. Sit tight." Why was this permitted when Rummel knew all about my income or lack of it but borrowed in order to sell me three times as much stock as I should have been sold and in the face of this induced me to stay in against my wish and now you refuse to help me in buying some of these same securities under conditions exactly the same as when it was sold me in the first place, or perhaps I am misinterpreting your telegram and you are not refusing to get the loan for me but are merely advising me against doing it. Will you please wire again.

EDGAR D. BROWN.

In reply to that I got another telegram from Mr. Beebe, a very brief one, as follows:

Re your wire the thirteenth. At the time you first brought to my attention the condition of your account you will recall I asked the manager of your Philadelphia office to review that account and from time to time make recommendations.

No use reading this all.

Unless the borrower has assured earning power and could pay off the loan within six months without resorting to the sale of the collateral we would not make a collateral loan.

Mr. PECORA. But they did make the collateral loan to you back in 1928?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BROWN. Yes. The conditions, Mr. Pecora, were identical. There wasn't anything different about them.

Senator FLETCHER. But if you had bought Anaconda stock at the price then you would have lost just as much, would you not?

Mr. BROWN. Would you mind repeating his question?

Mr. PECORA. The Senator asked you if you had bought Anaconda then, that is at the time you sent that letter to Mr. Beebe, you would have lost just as much anyway?

Mr. BROWN. That is true. Undeniably. That is true. I would have.

Mr. PECORA. So that about covers your narrative?

Mr. BROWN. Yes.

Mr. PECORA. About your transactions with the National City Co.? Is that right?

Mr. BROWN. That is correct.

Mr. PECORA. Did you get anything back out of your investments?

Mr. BROWN. Not a cent.

Mr. PECORA. I think that is all to-day, Mr. Chairman.

The CHAIRMAN. The committee will adjourn until 10 o'clock to-morrow morning, and the witnesses under subpoena will be present at that time.

(Thereupon, at 4.55 p. m. Tuesday, February 28, 1933, an adjournment was taken until 10 o'clock a. m. the next day, Wednesday, March 1, 1933.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

STOCK EXCHANGE PRACTICES

WEDNESDAY, MARCH 1, 1933

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

The subcommittee met, pursuant to adjournment on yesterday, at 10 a. m. in room 301 Senate Office Building, Senator Peter Norbeck presiding.

Present: Senators Norbeck (chairman), Townsend, Fletcher, and Costigan.

Present also: Senator Brookhart.

Further present: Ferdinand Pecora, special counsel to the committee; Julius Silver and David Saperstein, associate counsel to the committee.

The CHAIRMAN. The subcommittee will come to order. Mr. Horace Sylvester will come forward if he is in the room.

Mr. SYLVESTER. All right.

The CHAIRMAN. You will come forward to the committee table and after being sworn take a seat in front of the committee reporter.

Now, please stand, hold up your right hand, and be sworn: You solemly swear that you will tell the truth, the whole truth, and nothing but the truth regarding the matters under investigation by this subcommittee, so help you God?

Mr. SYLVESTER. I do, sir.

TESTIMONY OF HORACE C. SYLVESTER, JR., CALDWELL, N. J., VICE PRESIDENT OF THE NATIONAL CITY CO., NEW YORK CITY

Mr. PECORA. Mr. Sylvester, will you give your full name to the committee reporter, your residence, and your business or occupation?

Mr. SYLVESTER. Horace C. Sylvester, jr. My residence is Caldwell, N. J. I am a vice president of the National City Co., with offices at 55 Wall Street, New York City.

Mr. PECORA. How long have you been connected with the National City Co. as a vice president?

Mr. SYLVESTER. I think, Mr. Pecora, although I am not exactly sure of the date, but I believe it is around 1910.

Mr. PECORA. Prior to that time were you connected with that company in any other capacity?

Mr. SYLVESTER. I came with the company in its early formation, in charge of the municipal bond department of the company.

Mr. PECORA. As a vice president since 1910 have you been in charge of the municipal bond department of that company?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SYLVESTER. Yes, sir.

Mr. PECORA. And are to-day?

Mr. SYLVESTER. Yes, sir.

Mr. PECORA. Mr. Sylvester, I want to call your attention to an issue of municipal bonds, specifically those issued by the Port of New York Authority in 1931. Do you know the issue I refer to?

Mr. SYLVESTER. An issue of $66,000,000?

Mr. PECORA. Yes.

Mr. SYLVESTER. Yes, sir; of 4¼ per cent bonds.

Mr. PECORA. That issue was underwritten by the National City Co., was it not?

Mr. SYLVESTER. The National City Co. and associates; yes, sir.

Mr. PECORA. Did you have charge of the negotiations on behalf of the National City Co. which led to that Company's acquiring the issue?

Mr. SYLVESTER. Yes, sir.

Mr. PECORA. Are you familiar with the expenses incurred by the company in connection with those negotiations?

Mr. SYLVESTER. In a general sort of way; yes, sir.

Mr. PECORA. There appeared in the ledger account of the syndicate handling that issue, produced here by your company, an entry under date of June 2, 1931, regarding the withdrawal by means of a cash ticket to the order of S. W. Baldwin, treasurer of the National City Co., of the sum of $10,020. Are you familiar with that transaction?

Mr. SYLVESTER. Yes, sir.

Mr. PECORA. Mr. Baldwin testified, in substance, that he drew that cash under your direction or instructions and turned the cash over to you, and that he knows nothing more than that concerning the uses or purposes to which that money was put. Can you tell us about it?

Mr. SYLVESTER. Yes; Mr. Pecora.

Mr. PECORA. I wish you would.

Mr. SYLVESTER. The bonds were bought on March 9. The syndicate was wound up and the checks for the profits sent to the syndicate managers on April 22.

Senator FLETCHER. Of what year?

Mr. SYLVESTER. 1931.

Mr. PECORA. Go ahead with your answer.

Mr. SYLVESTER. We have always set up a reserve for contingent expenses, which was held over for miscellaneous bills that come in; and after that has been held over, that is the National City Co.'s, not the syndicate's profit, because the checks had already gone out on that, and that goes into the company's income. From that amount of money I gave Mr. Baldwin an order to send me $10,020 in cash, which cash I gave to Mr. Edward F. Barrett, on the understanding that he was going to make a loan to Mr. John Ramsey, general manager of the Port of New York Authority.

Mr. PECORA. Did you say to Mr. John Ramsey?

Mr. SYLVESTER. Yes, sir. And that was on June 2, two months after the syndicate was closed.

Mr. PECORA. Do you know who Mr. John Ramsey is?

Mr. SYLVESTER. Yes, sir.

Mr. PECORA. Who is he?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SYLVESTER. Mr. John Ramsey is the general manager of the Port of New York Authority.

Mr. PECORA. Do you know anything besides that about him, I mean about his identity?

Mr. SYLVESTER. Well, I have known Mr. Ramsey in a business way since 1926.

Mr. PECORA. Who is Mr. Edward F. Barrett?

Mr. SYLVESTER. He is an officer of the City Bank.

Mr. PECORA. Of the National City Bank?

Mr. SYLVESTER. Yes, sir.

Mr. PECORA. What office?

Mr. SYLVESTER. A vice president.

Mr. PECORA. Do you know why that particular sum of money was taken out of the expense account set aside as a reserve, for this particular bond issue that was made by the Port of New York Authority?

Mr. SYLVESTER. Mr. Barrett came to me and said that Mr. Ramsey was in need of money and that he would like very much to make him a loan.

Mr. PECORA. Did he make him the loan, do you know?

Mr. SYLVESTER. The bank could not make him a loan, and Mr. Barrett asked me if there was a way to make him a loan in the National City Co. After thinking the matter over I decided that Mr. John Ramsey being a good moral risk it would be perfectly proper to make him a loan of $10,020, and I advanced that sum of money to Mr. Barrett, and I understand that Mr. Barrett made that loan. I had no negotiations with the loan matter at all.

Mr. PECORA. Was the loan made to Mr. Ramsey on behalf of the National City Co.?

Mr. SYLVESTER. I presume it was, Mr. Pecora; yes. I let Mr. Barrett attend to the details of the loan. I had no negotiations in connection with the loan. I had no conversation with Mr. Ramsey. I knew nothing whatsoever about that side of the picture.

Mr. PECORA. What written evidence of indebtedness does the National City Co. hold or has it ever held with respect to this loan?

Mr. SYLVESTER. Mr. Pecora, you will have to get that information from Mr. Barrett, because I had no more connection with the loan after I passed the money on to Mr. Edward Barrett.

Mr. PECORA. Mr. Barrett is not an officer of the National City Co., is he?

Mr. SYLVESTER. No; he is not an officer of the National City Co., but he is a vice president of the bank.

Mr. PECORA. Well, you regard the two as separate institutions with regard to this loan, do you not?

Mr. SYLVESTER. Absolutely. And I understand that he has a note; that there was a note given for it.

Mr. PECORA. When did you understand that? When did you first understand that, Mr. Sylvester?

Mr. SYLVESTER. Mr. Pecora, it is pretty hard for me to pin down to the day, but I always looked on this thing as in the nature of a loan to be repaid, and that a note would be given for it.

Mr. PECORA. If it was a loan made by the National City Co., to Mr. Ramsey because he was considered by you to be a good moral risk, will you please tell this committee why that loan was not set up

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

on the books of the company, and why, instead of being set up as a loan it is charged to expenses in connection with this bond issue of the Port of New York Authority?

Mr. SYLVESTER. Mr. Pecora, the only way I could answer that question is to tell you that I looked on this as an accommodation to Mr. John Ramsey for a short period of time, and that the loan would be repaid, and we carried it in the reserve fund pending that repayment.

Mr. PECORA. Is it customary to carry loans in the reserve fund set up for expenses?

Mr. SYLVESTER. No, sir; it is not.

Mr. PECORA. Do you know of any other instance where that was done by your company?

Mr. SYLVESTER. Mr. Pecora, I have handled $4,500,000,000 worth of municipal, Government, and State bonds in 10 years, and I know of no other instance of this character on the books of the National City Co.

Mr. PECORA. Have you ever seen any note given by Mr. Ramsey for this so-called loan?

Mr. SYLVESTER. No, sir.

Mr. PECORA. Do you distinctly recall Mr. Barrett actually telling you that he had a note as evidence of the loan?

Mr. SYLVESTER. No; I do not.

Mr. PECORA. Do you recall anybody ever telling you that?

Mr. SYLVESTER. No. It was just an understanding that I had, that there was a note given.

Mr. PECORA. Do you mean it is an assumption on your part.

Mr. SYLVESTER. It is an assumption on my part.

Mr. PECORA. It is not an understanding that you had with anyone else, is it?

Mr. SYLVESTER. I presumed, Mr. Pecora, when Mr. Barrett made the loan that he took the proper evidence of that loan, because I expected, and I fully expect, Mr. Ramsey to repay the loan.

Mr. PECORA. Has any interest been paid on account of this loan, do you know?

Mr. SYLVESTER. That I can not tell you, Mr. Pecora.

Mr. PECORA. Who would know about that?

Mr. SYLVESTER. Mr. Barrett.

Mr. PECORA. Well, Mr. Barrett seems to be an officer of the bank and not of the company, and this, you say, was a loan made by the company.

Mr. SYLVESTER. He handled this loan matter, Mr. Pecora, and I had nothing whatsoever to do with the loan. Mr. Ramsey and I have never discussed the loan.

Mr. PECORA. Did you have any contact with Mr. Ramsey in connection with the negotiations that led to the National City Co.'s acquiring $66,000,000 issue of Port of New York Authority bonds?

Mr. SYLVESTER. The Port of New York Authority bonds, Mr. Pecora, were sold by the finance committee of the Port of New York Authority, and confirmed by the board, and my negotiations on this $66,000,000 issue were in open meeting before the whole board. Mr. Ramsey sits in that meeting, but he has no voice and no vote.

Mr. PECORA. Did you have any contact of any kind with him in connection with the negotiations on the loan?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SYLVESTER. My negotiations on this loan, Mr. Pecora, were had with Mr. Ferguson, the chairman of the finance committee.

Mr. PECORA. And that means that you had no contact of any kind with Mr. Ramsey in connection with those negotiations?

Mr. SYLVESTER. A contact possibly as far as information is concerned, and terms, and things of that kind. But as far as negotiations in connection with price and the award of the bonds, no, because Mr. Ramsey has no power along that line.

Mr. PECORA. Was there any competitive bidding for this bond issue?

Mr. SYLVESTER. I understand there was.

Mr. PECORA. I don't suppose the advance information that you got from Mr. Ramsey had anything to do with guiding your company in submitting its bid?

Mr. SYLVESTER. None whatsoever. Oh, none whatsoever.

Mr. PECORA. What kind of advance information did you get from him?

Mr. SYLVESTER. The only information that I got that there was competitive bidding was from Mr. Ferguson, that another group was going to bid on the issue of bonds.

Mr. PECORA. Who was the other group that bid on the issue?

Mr. SYLVESTER. That I can not tell you, because those details have never been made public.

Mr. PECORA. Was there more than one other group that submitted a bid for those bonds?

Mr. SYLVESTER. I can not tell you. I do not know. We make our bids and sometimes there is competition and at other times there is not. May I——

Mr. PECORA (interposing). Were not the bids open, and——

Mr. SYLVESTER (continuing). May I go into that?

Mr. PECORA. Yes.

Mr. SYLVESTER. We bought from the Port Authority over a period $130,000,000 worth of bonds. On the first sale there was an invitation sent out to bid, and we were the only bidder and we bought the bonds.

Senator TOWNSEND. At what price?

Mr. SYLVESTER. That was back in 1926, and the bonds were 4½'s at the price of 97¼. The second sale we bought the bonds, $20,000,000 4's at the price of 95.63. And I understand there were invitations sent out, but due to conditions at that time there were no other bids. The third block of bonds, in 1928, were bought by the Guaranty group, $12,000,000, 4's. The fourth issue of bonds, $30,000,000 4½'s——.

Senator TOWNSEND (interposing). At what price were those bonds sold?

Mr. SYLVESTER. The 4's were sold at 99.73. Those bonds enjoyed a certain special tax exemption in New York State that made them a little more valuable than the others.

Senator TOWNSEND. All right, go ahead.

Mr. SYLVESTER. The fourth issue was $30,000,000 4½'s, Hudson River Bridge bonds, that we bought at 92.85. And this fifth and last issue was the $66,000,000 of 4¼'s that we bought.

Senator TOWNSEND. At what price?

Mr. SYLVESTER. We paid the price of 98.75 for the bonds.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator TOWNSEND. That was the last lot, sold in 1931.

Mr. SYLVESTER. Yes; in 1931, and they were the 4¼'s.

Mr. PECORA. Did Mr. Barrett, as a vice president of the National City Bank, have any authority over the disposition of the funds of the National City Co. for loaning purposes?

Mr. SYLVESTER. Not except as I gave it to him. I took the full authority for it.

Mr. PECORA. When this $10,020 was given to you by the treasurer of your company, Mr. Baldwin, you knew that you were going to turn it over to Mr. Barrett to be given to Mr. Ramsey as a personal loan, did you not?

Mr. SYLVESTER. Yes, sir; that was the understanding.

Mr. PECORA. Then why didn't you have it set up on the books of the company in that way, Mr. Sylvester?

Mr. SYLVESTER. Mr. Pecora, as I told you before, the only reason it was not set up on the books in that way was due to the fact that we expected to have the loan repaid, and we had this $15,000 reserve belonging to the National City Co., and we charged it against that.

Mr. PECORA. You expected the entire loan to be repaid, didn't you?

Mr. SYLVESTER. Yes.

Mr. PECORA. Has any part of it been repaid?

Mr. SYLVESTER. I don't know. I haven't had any negotiations or connection with the loan at all with Mr. Ramsey, and I can not tell you those details.

Mr. PECORA. Do we understand that this transaction which you have described as a loan could not have been made possible without your approval or direction?

Mr. SYLVESTER. I took the responsibility, Mr. Pecora, and made it myself as vice president in charge of the municipal department of the National City Co.

Mr. PECORA. And without that approval on your part this loan could not have been made?

Mr. SYLVESTER. I do not think it could have been made; no, sir. I do not see how it could have been made.

Mr. PECORA. And you say this is the only transaction of the sort of which you have any recollection or knowledge since you have been a vice president of the National City Co.?

Mr. SYLVESTER. That is the only one I have any knowledge of in the Government, State, and municipal business over which I have control. We have never made——

Mr. PECORA (interposing). In view of the fact that you approved the making of the loan by your company to Mr. Ramsey, did you make it your business to see that the loan was properly set up and that it was repaid?

Mr. SYLVESTER. I saw that it was charged to this reserve fund, and I stopped there, Mr. Pecora.

Mr. PECORA. Then was it because of your instructions or directions that this loan was charged against the reserve fund for expenses in connection with that bond issue?

Mr. SYLVESTER. Well, now, whether I actually directed that it should be charged against it or not I can not tell you.

Mr. PECORA. Yesterday Mr. Baldwin testified, in substance, that he drew the cash ticket for this sum of money to his own order as treasurer, turned the cash over to you, and that it was set up as it

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

now appears on the books—as an item against cash for expenses in connection with that loan because of directions given to him to that effect.

Mr. SYLVESTER. By whom?

Mr. PECORA. He stated you were the only person he spoke to in connection with it.

Mr. SYLVESTER. Well, if Mr. Baldwin testified that those are the facts perhaps they are the facts.

Mr. PECORA. Are they facts within your personal recollection now?

Mr. SYLVESTER. If Mr. Baldwin says so; yes.

Mr. PECORA. Are those the facts within your own recollection irrespective of what Mr. Baldwin or anybody else may say about them?

Mr. SYLVESTER. I will have to look into the transaction and see. I do not remember making any memorandum that they should be specifically charged to that account, and I don't remember giving any directions that they should be specifically charged to that account. But if Mr. Baldwin says I did, why, he is the treasurer of the company, and I will say yes to his testimony to that effect.

Mr. PECORA. Do you remember giving any directions of that kind in regard to the manner in which that sum of money should be set up on the books of the company?

Mr. SYLVESTER. Not directly; no.

Mr. PECORA. Did you do so indirectly?

Mr. SYLVESTER. My recollection is hazy on it. I do not want to evade your question, but I don't know whether I did or not, or whether it just came in the routine matters of the treasury department and they set it up. As a rule I do not tell them how to set up items, over in the treasury department.

Mr. PECORA. For how long a period of time was this loan to be made?

Mr. SYLVESTER. It was a demand loan as I understood it.

Mr. PECORA. Is that anything more than your imagination or understanding?

Mr. SYLVESTER. No

Mr. PECORA. Didn't you give any directions concerning that rather important detail?

Mr. SYLVESTER. I authorized Barrett to go ahead and lend John Ramsey the money, on the understanding that it would be repaid to us, and he attended to the details. Now, as to the details of it I can not tell you, because I had nothing whatsoever to do with them. Whether he made it as a demand loan or as a 90-day loan or a 6-month loan, or what, I don't know.

Senator BROOKHART. Was this Mr. Ramsey a member of the New York City government?

Mr. SYLVESTER. The Port of New York Authority is an authority of two States, New York and New Jersey. It is composed of 12 commissioners, 6 appointed by the Governor of the State of New York, and 6 appointed by the Governor of the State of New Jersey. And those commissioners appoint a general manager.

Senator BROOKHART. And this was Mr. Ramsey?

Mr. SYLVESTER. And Mr. Ramsey is that general manager.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Mr. Sylvester, do you know of any other loans made to any other persons connected with the Port of New York Authority either at about that time or at any other time?

Mr. SYLVESTER. Mr. Pecora, as I have said, I know of no other loan of any sort that has ever been made by the National City Co. Certainly none has been made under my supervision or guidance.

Mr. PECORA. Was this loan made on your initiative or on the initiative of Mr. Barrett?

Mr. SYLVESTER. Of Mr. Barrett. He came to me and said that Mr. Ramsey was in dire need of money, and could we find a way to help him out.

Mr. PECORA. And the way was found by the method you have testified to?

Mr. SYLVESTER. Yes, sir.

Mr. PECORA. You do not know whether any part of that loan has been repaid?

Mr. SYLVESTER. I do not.

Mr. PECORA. Do you know whether any interest has been paid on account of it?

Mr. SYLVESTER. No; I can not answer that.

Mr. PECORA. Well, now, is Mr. Bridges in the room? [A pause, without response.] You know Mr. Bridges, don't you, Mr. Sylvester?

Mr. SYLVESTER. Very well.

Mr. PECORA. He is an accountant for the National City Co., the chief accountant, isn't he?

Mr. SYLVESTER. Yes.

Mr. PECORA. Did you give him any instructions or directions with respect to the setting up of this loan on the books of the company?

Mr. SYLVESTER. Mr. Pecora, my mind is hazy on the matter of giving any instructions on the setup of this loan. But my mind is not hazy on making the request for the money.

Mr. PECORA. Which officer or employee of the company would be in the best position to inform this committee whether or not any part of this loan has been repaid, or whether or not any interest on account of this loan has been paid, to the National City Co. by Mr. Ramsey?

Mr. SYLVESTER. I do not believe there is any officer of the company who could give that information. I believe you would have to get that information from Mr. Barrett or from the bank.

Mr. PECORA. You mean that there is nothing of record in the books of the company which made this loan that would disclose any such information?

Mr. SYLVESTER. I think Mr. Bridges will have to answer that question.

Mr. PECORA. Will you consult with Mr. Bridges and then give us the answer to the question?

Mr. SYLVESTER (after talking to a man who came to the table). There is only one charge, Mr. Bridges advises me, and that is against the reserve account.

Mr. PECORA. I now ask for the production of the ledger account of this transaction. It was here yesterday.

Mr. SYLVESTER. Might I consult with Mr. Baldwin on the details that will clear up this thing?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. All right. [Mr. Sylvester talked with Mr. Baldwin.] Now, Mr. Sylvester, will you be good enough to look at the ledger account that Mr. Bridges has just placed before you, and show this committee, please, any entry which indicates or says that this item of $10,020 was charged against the reserve fund?

Mr. SYLVESTER. I see "Port of New York Authority"—and what is this [addressing Mr. Bridges]?

Mr. BRIDGES. It is the syndicate account.

Mr. SYLVESTER. I see "Check, S. W. Baldwin, $10,020, June 2."

Mr. PECORA. What is the entry immediately following the entry which you have read?

Mr. SYLVESTER. "Reserve for general investigations."

Mr. PECORA. What is the amount?

Mr. SYLVESTER. It is $4,980.

Mr. PECORA. Now, the amount of $4,980 plus $10,020 gives us the total of $15,000, does it not?

Mr. SYLVESTER. Yes, sir.

Mr. PECORA. And does that represent the $15,000 reserve fund to which you alluded in the early part of your testimony this morning?

Mr. SYLVESTER. Yes, Mr. Pecora.

Mr. PECORA. Well, now, does that item of $4,980 also represent, perchance, any loans made to some one in distress?

Mr. SYLVESTER. No, sir.

Mr. PECORA. That is a charge specifically for general investigations?

Mr. SYLVESTER. Yes, sir.

Mr. PECORA. To whom was that paid?

Mr. SYLVESTER. That is National City Co. income. The general procedure in municipal syndicates in Wall Street is to set up a general reserve to take care of any expenses that may come in after the closing of the syndicate. And as this expense or these expenses come in they are charged to that account. What is left over goes into the company's income. It is held in the reserve fund for the time being.

Mr. PECORA. Senator Brookhart has indicated to me he would like to know who composed the syndicate that handled this $66,000,000 issue.

Mr. SYLVESTER. The names of the syndicate?

Senator BROOKHART. Yes. And how they operate. What is the purpose of the syndicate?

Mr. PECORA. Mr. Bridges, will you be good enough to let me have that ledger?

Mr. BRIDGES. Certainly.

Mr. PECORA. Now, Mr. Sylvester, will you answer Senator Brookhart's question?

Mr. SYLVESTER. The National City Co. was the manager of the syndicate, with a participation of $12,625,000, and we made sales of $14,472,000 of bonds.

Chase Securities Corporation had the same interest, and had sales of $10,035,000 of bonds.

Kissel, Kinnicut & Co. had an interest of 7½ million dollars.

Brown Bros., Harriman & Co. had an interest of $5,000,000.

Harris Forbes & Co. had an interest of $5,000,000.

Chemical Securities Corporation had an interest of 2½ million dollars.

Chatham Phenix Corporation had an interest of 2½ million dollars.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Eldredge & Co. had an interest of 2½ million dollars.
Kountze Bros. had an interest of $2,000,000.
Barr Bros. & Co. had an interest of $2,000,000.
L. F. Rothschild & Co. had an interest of $1,000,000.
Stone & Webster and Blodget had an interest of $1,000,000.
George B. Gibbons & Co. had an interest of $1,000,000.
First Detroit Co., Inc. had an interest of $1,000,000.
International Manhattan Co. had an interest of $1,000,000.
Do you want the rest of them? There are quite a few small ones here, and I will give them if you wish them.

Senator BROOKHART. Yes. We might as well have all of them.

Mr. SYLVESTER. Kean, Taylor & Co. had an interest of $500,000.

Senator BROOKHART. That sounds pretty big to a farmer.

Mr. SYLVESTER. Phelps, Fenn & Co. had an interest of $500,000.
R. H. Moulton & Co. had an interest of $500,000.
Darby & Co. had an interest of $500,000.
Guardian Detroit Co. had an interest of $500,000.
Ames, Emerich & Co. had an interest of $500,000.
H. L. Allen & Co. had an interest of $500,000.
Hannahs, Ballin & Lee had an interest of $500,000.
Wallace, Sanderson & Co. had an interest of $500,000.
Mercantile Commerce Co. of St. Louis had an interest of $500,000.
Schaumburg, Rebhann & Osborne had an interest of $250,000.
First National Co. of St. Louis had an interest of $250,000.
Batchelder & Co. had an interest of $250,000.
County Trust Co. had an interest of $250,000.
William R. Compton & Co. had an interest of $250,000.
Stern Bros., Kansas City, Mo., had an interest of $250,000.
Dean Witter & Co., San Francisco, had an interest of $250,000.
That makes a total syndicate participation of $66,000,000.

Senator BROOKHART. Who was the manager of this syndicate?

Mr. SYLVESTER. The National City Co.

Senator BROOKHART. Do you know whether any of these other companies made any loans to Mr. Ramsey?

Mr. SYLVESTER. No.

Senator BROOKHART. You don't know whether they did or not?

Mr. SYLVESTER. Oh, no.

Senator BROOKHART. Now, did you operate on the stock exchange?

Mr. SYLVESTER. Oh, no. You buy these bonds from the port authority commissioners in open meeting, and they sell the bonds to you.

Senator BROOKHART. Did you sell them on the stock exchange, any of them?

Mr. SYLVESTER. No. We bought them at a price of 96.675, and then we resold them. They are serial bonds with various maturities, at an average price of par and one-half, with a total profit of around one and three quarters points. And then we go out and sell the bonds through our various sales organizations.

Senator BROOKHART. You all offered them at the same price?

Mr. SYLVESTER. We all offered them at the same price, and with the same concessions, and released them at the same hour.

Senator BROOKHART. And that was understood and agreed to in the beginning?

Mr. SYLVESTER. Oh, absolutely.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. And is so in all these things?

Mr. SYLVESTER. That is the usual form, Senator.

Senator BROOKHART. Regardless of whether it might be in restraint of trade or not.

Mr. SYLVESTER. Well, I cannot answer that. But there are plenty of other groups around here that could sit in and give you competition on a block of that sort, other dealers. And we had competition from other dealers, the Guaranty Co., the Bankers Trust, and plenty of other dealers in the street.

Senator FLETCHER. Did you have to buy all of the bonds, the $66,000,000?

Mr. SYLVESTER. Yes, sir.

Senator FLETCHER. You could not buy a few? For instance, you could not bid for a few million dollars here and a few million dollars there?

Mr. SYLVESTER. They asked for bids on the $66,000,000 of bonds, they asked us to make a bid and we made it on the $66,000,000 of bonds.

Senator FLETCHER. And it is the same way with other bidders, I suppose?

Mr. SYLVESTER. That is the usual procedure in municipal bond sales.

Senator FLETCHER. They do not offer them in broken lots at all?

Mr. SYLVESTER. Oh, yes. When we offer them you can buy 1 bond or 2 bonds or 10 bonds as you may desire.

Senator FLETCHER. You did that, but the Port of New York Authority did not do that?

Mr. SYLVESTER. Oh, no, sir.

Mr. PECORA. Now, Mr. Sylvester, I notice in looking over this ledger account of syndicate expenses that this sum of $10,020 was set up as a part of the expense of this syndicate account; is that correct?

Mr. SYLVESTER. That is what I said.

Mr. PECORA. And it continues to so appear?

Mr. SYLVESTER. Yes, sir.

Mr. PECORA. From the very inception it was treated——

Mr. SYLVESTER (interposing). Mr. Pecora, not the syndicate account, but——

Mr. PECORA (interposing). Well, what account?

Mr. SYLVESTER. We bought the bonds in March, on the 9th, and we sold them. We sent out profit checks on April 22, and here is the fund left over, the general reserve fund, to take up general incidental expenses, and on June 3 this check was drawn, and what is left over in that account belongs to the National City Co. And that is the usual procedure in the Street. It is not a syndicate account, and it is not charged to the syndicate account.

Mr. PECORA. When the distribution of profits was made to the members of the syndicate who participated in this syndicate account, was this sum of $10,020 deducted first from those profits before the distribution?

Mr. SYLVESTER. No, sir.

Mr. PECORA. What is that?

Mr. SYLVESTER. $15,000 was deducted before they were sent out, because that is a reserve that we set up.

Mr. PECORA. Then the sum of $15,000 was deducted?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SYLVESTER. Yes.

Mr. PECORA. As a part of the expenses of that syndicate?

Mr. SYLVESTER. Yes; that is the usual procedure.

Mr. PECORA. And the National City Co. was the manager of this syndicate?

Mr. SYLVESTER. Yes, sir.

Mr. PECORA. In making the distribution of profits to the other members of the syndicate, before those profits were estimated and distributed, the sum of $15,000 was deducted from the profits?

Mr. SYLVESTER. It was.

Mr. PECORA. And the checks given to the members participating in the syndicate for their respective shares of the profits were drawn in amounts which took into account this $15,000 reserve as a part of the expense?

Mr. SYLVESTER. That is the usual practice in Wall Street.

Mr. PECORA. Whether it is the usual practice or not, was it a fact in this particular instance that the other syndicate members have suffered a pro rata reduction of a portion of that amount and failed to receive this $10,020, which was not actually a syndicate expense?

Mr. SYLVESTER. I would not say that, Mr. Pecora, because in the general set-up of all municipal syndicates you set up a reserve fund. You send out your checks for your profit and that reserve fund is held for a period of 30, 60, or 90 days to take care of incidental bills that come in.

Senator BROOKHART. What is done with it then?

Mr. SYLVESTER. And then the syndicate manager takes that money for his own account. It is part of the compensation that goes for the work that you do in the managing of the account.

Senator TOWNSEND. Do you have in mind what those incidental bills would be, Mr. Sylvester?

Mr. SYLVESTER. Oh, that might be printing bills, circulars. You take this account here: $66,000,000 with a $15,000,000 reserve—a job of that character is a very small reserve.

Senator TOWNSEND. You mean $15,000?

Mr. SYLVESTER. $15,000—is a very small reserve. You might have gotten out your first circulars, your first advertising. Bonds go slow. It might be necessary to get out a booklet, get out some more information, and that is held there for that purpose, paying the expenses.

Senator BROOKHART. When do you determine the amount of this reserve?

Mr. SYLVESTER. Generally when we set up a syndicate, when we buy a block of bonds, we set up so much for advertising, so much for legal expenses, and so much for general reserve.

Senator BROOKHART. Did you fix this before you knew about this loan?

Mr. SYLVESTER. Oh, absolutely. Absolutely. Your loan is not until June the 2d. Your checks for your profit went out on April the 22d, and these bonds were bought on May the 9th.

Mr. PECORA. If this loan is ever repaid to the National City Co., assuming that it has not yet been repaid, under your explanation this repayment would belong entirely to the National City Co., would it not?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SYLVESTER. Yes, sir; that would be National City Co. income.

Mr. PECORA. Although, as a matter of fact, it was deducted as part of the expense and no such expense was actually incurred by the syndicate, was it?

Mr. SYLVESTER. Mr. Pecora, I do not agree with you. It was not deducted from any part of the syndicate expense.

Mr. PECORA. It formed part of the syndicate expense and was deducted from the profits?

Mr. SYLVESTER. $15,000 formed a part of the reserve.

Mr. PECORA. Yes.

Mr. SYLVESTER. And this was taken out——

Mr. PECORA (interposing). Of that $15,000?

Mr. SYLVESTER. Of that $15,000. But the syndicate participants did not suffer in any way on any loan that we made on this account.

Mr. PECORA. If this reserve had not been set up and charged to syndicate expenses, the profits would have been increased by that amount, would they not?

Mr. SYLVESTER. The reserve is a usual item, Mr. Pecora.

Mr. PECORA. All right, but if it had not been set up the profits would have been increased by the amount of this reserve, would they not?

Mr. SYLVESTER. If there were no expenses.

Mr. PECORA. And the only expenses were $4,980 out of that $15,000 reserve, were they not?

Mr. SYLVESTER. And the balance is City Co. income.

Mr. PECORA. Then the balance is City Co. "gravy," is it not?

Mr. SYLVESTER. Yes, City Co. income.

Mr. PECORA. At the expense of the other participants in the syndicate?

Mr. SYLVESTER. I do not agree with you, Mr. Pecora. We set up a $15,000 reserve when we set the account up.

Mr. PECORA. Yes.

Mr. SYLVESTER. For expenses that may come in.

Mr. PECORA. Yes. Do you mean to say——

Mr. SYLVESTER (interposing). And we set up so much for advertising and we set up so much for legal opinions, and the bonds are sold.

Mr. PECORA. Yes.

Mr. SYLVESTER. And it is the policy of Wall Street to hold over the general reserve fund, and if there is anything left over it goes to the syndicate managers for the efforts that they have had in managing the syndicate.

Mr. PECORA. Is there not a fee or commission paid to the syndicate manager for those efforts?

Mr. SYLVESTER. No, sir. Not on municipal bonds. You buy municipal bonds at 98; you sell them at par less a quarter, and you get your profit according to your syndicate interest.

Senator FLETCHER. So if the National City Co. had this $15,000 reserve up they could spend it as they saw fit?

Mr. SYLVESTER. Absolutely. Supposing it was necessary to print a booklet or do something of that sort, and we had some additional advertising expenses and so forth. It would come out of that.

Senator BROOKHART. Supposing it was not necessary to do anything? Wall Street would still get the reserve, would it not?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SYLVESTER. National City Co. would get the reserve, $15,000. If the expenses were over the $15,000, why, that would have to come out of our pocket. Supposing the expenses were $25,000, we would still set up a reserve for $15,000. The $10,000 would come out of the National City Co.'s pocket.

Mr. PECORA. In any municipal issue which the National City Co. underwrote, do you recall any instance where the National City Co. was tripped up that way by not setting up enough of a reserve for contingent expenses?

Mr. SYLVESTER. Mr. Pecora, I would have to go over the records to tell you.

Mr. PECORA. There is no such case within your recollection, is there?

Mr. SYLVESTER. No. Over a 20-year period I could not say there was any—but I probably could find some if I dug into them.

Mr. PECORA. Yes, very likely. Mr. Sylvester, who fixed the amount of this reserve in this particular syndicate at $15,000?

Mr. SYLVESTER. The municipal department, and I approved it.

Mr. PECORA. You mean the National City Co.?

Mr. SYLVESTER. Yes, sir; the municipal department of the National City Co., and I approved it.

Mr. PECORA. What guided you in fixing it at $15,000, can you tell us?

Mr. SYLVESTER. Yes, sir. $66,000,000 worth of port of authority 4½ per cent bonds bought in March, 1931, looked like a tremendous job.

Mr. PECORA. You had other items that were allowed?

Mr. SYLVASTER. No, sir.

Mr. PECORA. For instance, a $45,000 item for legal fees, as part of the expense, didn't you?

Mr. SYLVESTER. Yes. True.

Mr. PECORA. What was the total expense of this syndicate?

Mr. SYLVESTER. My recollection is that is around 60, isn't it? You have the record there.

Mr. PECORA. Here is an entry which shows $66,925.47.

Mr. SYLVESTER. Well, you have the record. I will stand on the record.

Mr. PECORA. Well, that is the record.

Mr. SYLVESTER. $66,000.

Mr. PECORA. Mr. Chairman, I ask that a subpoena be issued for Mr. Edward F. Barrett, returnable to-morrow.

Mr. SYLVESTER. Mr. Pecora, Mr. Barrett is in the room if you would like to see him.

Mr. PECORA. Oh, is he?

Mr. SYLVESTER. Yes, sir.

Mr. PECORA. I ask that he take the stand then. Mr. Barrett.

TESTIMONY OF EDWARD F. BARRETT, OF NEW YORK CITY, VICE PRESIDENT, NATIONAL CITY BANK

The CHAIRMAN. You do solemnly swear the evidence you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

Mr. BARRETT. I do.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

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

Mr. BARRETT. Edward F. Barrett, 55 Wall Street; vice president of the National City Bank.

Mr. PECORA. How long have you been a vice president of the National City Bank?

Mr. BARRETT. Since 1926.

Mr. PECORA. Prior to that time did you have any other connection with the bank?

Mr. BARRETT. Beg your pardon?

Mr. PECORA. Prior to that time did you have any other connection or any employment with this bank?

Mr. BARRETT. Yes, sir. I was with the National City Bank in various capacities since 1921, and prior to that time I was president of the National City Realty Co., and prior to that I was assistant secretary of the National City Co.

Mr. PECORA. You heard the testimony given this morning by Mr. Horace Sylvester, a vice president of the National City Co.?

Mr. BARRETT. Yes, sir.

Mr. PECORA. Did you hear all of his testimony?

Mr. BARRETT. Yes, sir.

Mr. PECORA. How long have you known John Ramsey, the general manager of the Port of New York Authority?

Mr. BARRETT. I would say about 10 years.

Mr. PECORA. Do you know him socially?

Mr. BARRETT. Yes, sir.

Mr. PECORA. Do you recall the transaction on or about June 2, 1931, which was alluded to by Mr. Sylvester in his testimony?

Mr. BARRETT. Yes, sir.

Mr. PECORA. Tell the committee what your knowledge is with respect to that transaction.

Mr. BARRETT. Mr. Ramsey came to me as one of his old friends and told me that he was being sadly pressed, or hardly pressed, for money. He wanted to know if there was any way in which I knew where he could get a loan. I told him it was not a bank loan; we could not make it in the National City Bank, because we did not make loans of that kind. He said he did not expect the National City Bank to make him a loan on account of his association with the port authority. I said, "The only other place I can possibly think would be from some private source or some other way of doing it." I could not tell him right then and there. But I said, "If you let me have this for a day or two and let me think it over I may be able to help you out."

Mr. PECORA. How long before June 2, 1931, did you have that conversation with him?

Mr. BARRETT. I would say two or three days.

Mr. PECORA. At that time did you know that the National City Co. participating with others in a syndicate, had, in March 1931, underwritten an issue of $66,000,000 of bonds issued by the Port of New York Authority?

Mr. BARRETT. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. What conversation did you have with Mr. Sylvester following the one you had with Mr. Ramsey to which you have just testified?

Mr. BARRETT. I went upstairs and I told Mr. Sylvester of Mr. Ramsey's plight, and I said to Mr. Sylvester, "If there is any possible way that you could think of that we could help him out I would like to do it, because I have always found John Ramsey to be a very fine, upstanding, square fellow, and he is in this jam, and if I can help him, I want to do it."

Mr. PECORA. Had Ramsey told you the jam he was in?

Mr. BARRETT. He told me, yes; he was in a financial jam and he had to have approximately $10,000—eight or ten thousand dollars, I forget what it was.

Mr. PECORA. Did he tell you the reason for the jam?

Mr. BARRETT. No, sir.

Mr. PECORA. Is that all he said about it, in substance?

Mr. BARRETT. Well, he told me that he needed, figured, I think, that he needed $10,020 to cover the necessary calls on him for payments.

Mr. PECORA. Payments of what kind, did he say?

Mr. BARRETT. I think loans. He did not go into detail, in definite detail, with me. He told me that he needed this money badly, and I knew the way that he talked that he did need it badly.

Mr. PECORA. What was the reason that the National City Bank could not, in the regular routine of banking business, have made this loan to him?

Mr. BARRETT. Because we do not make loans there on an unsecured basis.

Mr. PECORA. You know that that is not so, don't you, Mr. Barrett?

Mr. BARRETT. Well, I don't know—I mean it is not the kind of a loan that we would make there without any collateral. We have made loans in some of our departments where there is no security on the small loans, but even those loans are secured by endorsements.

Mr. PECORA. Was this loan to Ramsey to be an unsecured loan?

Mr. BARRETT. Well, as far as he was concerned it was to be an unsecured loan, yes; because he did not have any security to put up.

Senator FLETCHER. Couldn't he furnish endorsements?

Mr. BARRETT. I did not ask him for that, sir.

Mr. PECORA. At whose suggestion was this loan made to him in cash?

Mr. BARRETT. I do not think at anybody's suggestion.

Mr. PECORA. Why was it made to him in cash?

Mr. BARRETT. As I understood it, he needed the money that day.

Mr. PECORA. Don't you think a check of the National City Co. for the amount of $10,020 would be honored by anybody at that time?

Mr. BARRETT. It possibly would.

Mr. PECORA. There is not any doubt about that in your mind?

Mr. BARRETT. No, sir.

Mr. PECORA. You do not mean "It possibly would"; you knew it would?

Mr. BARRETT. Yes, sir.

Mr. PECORA. Don't you know that the money would have been available to him if it had been paid in the form of a check of the National City Co.?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BARRETT. It would.

Mr. PECORA. Do you know any reason why it was not given to him by check?

Mr. BARRETT. None except that he wanted the money that day, because that was the day that he had to make the payments, and to facilitate that, why, I asked Mr. Sylvester if he could get the money and he said he could.

Mr. PECORA. You said at the outset of your testimony that Ramsey asked you for this accommodation something like two or three days before June the 2d.

Mr. BARRETT. Yes, that is exactly right; but he needed it on this day.

Mr. PECORA. When did you speak to Mr. Sylvester about it? On the day that Ramsey spoke to you or on June the 2d?

Mr. BARRETT. I think it was over a weekend, Mr. Pecora, when Ramsey first spoke to me about it, and I think the next time I talked to him was the day before he needed the money.

Mr. PECORA. Did you get any written evidence from Mr. Ramsey of the loan having been made to him?

Mr. BARRETT. Yes, sir.

Mr. PECORA. Where is it?

Mr. BARRETT. He gave me a note.

Mr. PECORA. Where is it?

Mr. BARRETT. I have it in New York.

Mr. PECORA. Where in New York?

Mr. BARRETT. In my belongings.

Mr. PECORA. To whose order is the note made?

Mr. BARRETT. I recall the note—I have not looked at it in a long while—I recall the note was made to my order.

Mr. PECORA. In your individual capacity?

Mr. BARRETT. Yes, sir.

Mr. PECORA. Any endorsements on it?

Mr. BARRETT. No, sir.

Mr. PECORA. When did he give you that note?

Mr. BARRETT. Either the day he got the loan or the day after.

Mr. PECORA. Why didn't he give it to you at the time he got the loan?

Mr. BARRETT. He probably did. I am not so sure about that.

Mr. PECORA. Did you ask for the note?

Mr. BARRETT. No, sir; he gave it to me himself.

Mr. PECORA. Did you ever tell anybody connected with the National City Co. that you had received this note as evidence of the loan which that company had made to Ramsey?

Mr. BARRETT. No, sir.

Mr. PECORA. Was there any reason for not telling the officers of the National City Co. anything about that?

Mr. BARRETT. No, sir.

Mr. PECORA. It is not good banking practice or good business custom, is it, to do it that way?

Mr. BARRETT. Nobody asked me about it, and I didn't say anything to anybody about it.

Mr. PECORA. Didn't you consider that this loan was a loan made by the National City Co. to Ramsey?

Mr. BARRETT. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Didn't you think it was the business of the National City Co. to have the written evidence of the indebtedness rather than you?

Mr. BARRETT. Mr. Pecora, when that loan was made it was made on a temporary basis.

Mr. PECORA. How temporary?

Mr. BARRETT. Well, he gave me to understand that he needed this money for a short while until he could get himself straightened out.

Mr. PECORA. Well, how temporary? How long a period is that "short while"?

Mr. BARRETT. Maybe two or three weeks or a month.

Mr. PECORA. Has it been paid?

Mr. BARRETT. No, sir.

Mr. PECORA. Any part of it?

Mr. BARRETT. No, sir.

Mr. PECORA. Have you pressed him for payment?

Mr. BARRETT. No, sir.

Senator FLETCHER. What is the due date on the note?

Mr. BARRETT. It is a demand note, Senator.

Mr. PECORA. Does it bear interest?

Mr. BARRETT. Yes, sir.

Mr. PECORA. Has any interest been paid on account of it?

Mr. BARRETT. No, sir.

Mr. PECORA. Have you ever demanded any payment either of principal or interest or any part thereof?

Mr. BARRETT. No, sir; I have not.

Mr. PECORA. Have you learned whether Mr. Ramsey's condition was such that he might have met the demand for payment of part or all of it?

Mr. BARRETT. Yes, sir; I did. That is the very reason that I did not press him, because I realized Mr. Ramsey's position was going from bad to worse; that the Port Authority had instituted a program of strict retrenchment up there; that his salary had been cut two or three times, and I knew that he could not make any payment, and I did not want to embarrass John Ramsey.

Mr. PECORA. Now, Mr. Barrett, this John Ramsey received this loan because he was a friend of yours of some 10 years' standing, is that right?

Mr. BARRETT. Precisely. The one reason that I went to help him was because he was a friend of mine, and a very good friend of mine for 10 years standing, and I have always found him a very high-standing fellow, and I wanted to help him if I possibly could.

Mr. PECORA. So you helped him with the funds of the National City Co. with which you were not connected, didn't you?

Mr. BARRETT. I went to Mr. Sylvester and I asked him if there was any way in which we could help him.

Mr. PECORA. Did you go to Sylvester because he was in charge of the municipal bond department of the National City Co.?

Mr. BARRETT. Well, Mr. Sylvester is a man that I am very closely associated with in business up there, and I probably know him better than any other man in the place, and I could talk to him.

Mr. PECORA. Well, now, let's see: Mr. Sylvester, since 1920, has been vice president of the National City Co. in charge of its municipal bond department?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BARRETT. Yes, sir.

Mr. PECORA. And you, since 1925 or 1926, have been vice president of the National City Bank?

Mr. BARRETT. Yes, sir.

Mr. PECORA. Your duties as a vice president of the bank in no way effect Mr. Sylvester's duties as vice president of the company in charge of municipal bonds, do they?

Mr. BARRETT. None whatever, except that we work very close on all financial matters relating to New York City, New York State, Port Authority, and other municipal authorities in the city of New York.

Mr. PECORA. Do you ever work with Mr. Sylvester with regard to other municipal issues in a fashion similar to the way you worked with him for the purpose of relieving Mr. Ramsey's distress?

Mr. BARRETT. Just reframe that again.

Mr. PECORA. I won't reframe it, but I will ask the same question again. Will you read it to him, Mr. Reporter?

(The shorthand reporter read the question of Mr. Pecora as above recorded.)

Mr. BARRETT. No, sir.

Senator FLETCHER. Is Ramsey still general manager of the Port Authority?

Mr. BARRETT. Yes, sir.

Mr. PECORA. Did you have any reason for not telling Mr. Sylvester that you had a note from Ramsey made to your individual order?

Mr. BARRETT. No, sir.

Mr. PECORA. How soon can you produce that note?

Mr. BARRETT. I looked for it yesterday afternoon. Mr. Pecora.

Mr. PECORA. Did you find it?

Mr. BARRETT. No, sir; I could not find it.

Mr. PECORA. Where did you look for it?

Mr. BARRETT. I looked through my own desk where I left it.

Mr. PECORA. Have you kept it in your desk since June, 1931?

Mr. BARRETT. Yes, sir.

Mr. PECORA. And could not find it?

Mr. BARRETT. That is the last place I remember having it.

Mr. PECORA. Can you think of any other place where you might have put that note?

Mr. BARRETT. No, sir.

Mr. PECORA. You think, then, a further search would be fruitless?

Mr. BARRETT. I am not so sure.

Mr. PECORA. Where else do you think you might have placed it?

Mr. BARRETT. I haven't any—no place that I can think of.

Mr. PECORA. You did make a thorough search of your desk yesterday for this note?

Mr. BARRETT. I did; yes, sir. I may have filed it in some place or other that I cannot recall.

Mr. PECORA. What prompted you to make this search for the note in your desk yesterday?

Mr. BARRETT. Because I knew I was coming down here.

Mr. PECORA. What did you know you were coming down here about?

Mr. BARRETT. Well, I knew that Mr. Sylvester was coming down here, and I knew that the story would come right here, that you would

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

naturally want me to follow him on this stand, and I wanted to be prepared.

Mr. PECORA. Did Mr. Sylvester tell you that he had been subpœnaed to appear before this committee for to-day?

Mr. BARRETT. I don't think he did, but I know it.

Mr. PECORA. When did you learn that Mr. Sylvester had been subpœnaed to come here today?

Mr. BARRETT. I think yesterday some time.

Mr. PECORA. Who told you?

Mr. BARRETT. I could not tell you definitely. It was all around the shop.

Mr. PECORA. By "shop" do you mean the bank?

Mr. BARRETT. Yes, sir; the institution.

Mr. PECORA. What led you to conclude from that information that Mr. Sylvester was going to be questioned in any way with regard to this sum of $10,020?

Mr. BARRETT. Except that I saw in the newspapers last night this statement that Mr. Baldwin had testified that the money was given to Mr. Sylvester and that Mr. Sylvester was to come down here, and I thought that the thing to do was to come right down with him and tell the whole story to the committee.

Mr. PECORA. When did you learn that last night?

Mr. BARRETT. I saw it in the Sun, I think.

Mr. PECORA. What time?

Mr. BARRETT. On my way home.

Mr. PECORA. Then what did you do, go back to your bank and look in your desk for the note?

Mr. BARRETT. Well, I think I heard it before I left the office.

Mr. PECORA. Why didn't you say that?

Mr. BARRETT. Because I saw it definitely in the Sun. I think I heard that Mr. Sylvester was subpœnaed here quite a while before I left the office.

Mr. PECORA. You proceed on the principle that if you see it in the Sun it is so?

Mr. BARRETT. Yes, sir.

Mr. PECORA. I do not think there are any more questions to ask Mr. Barrett about this.

The CHAIRMAN. All right; you are excused.

Mr. BARRETT. Mr. Ramsey is here in Washington if you want him.

Mr. PECORA. Mr. Richard Whitney.

TESTIMONY OF RICHARD WHITNEY (RESUMED), PRESIDENT NEW YORK STOCK EXCHANGE, NEW YORK CITY

Mr. PECORA. He has been sworn before this committee on a prior occasion.

The CHAIRMAN. He does not have to be sworn again.

Mr. PECORA. Mr. Whitney, you have heretofore been sworn and have testified before this committee, I understand?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. That was some months ago when I was in no way connected with the committee?

Mr. WHITNEY. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Are you still the president of the New York Stock Exchange?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. How long have you been a member of the New York Stock Exchange?

Mr. WHITNEY. Since January 18, 1912.

Mr. PECORA. Do you actively conduct the business of a stock-broker?

Mr. WHITNEY. More particularly, sir, that of a bond broker.

Mr. PECORA. Mr. Whitney, will you tell us generally the form of organization of the New York Stock Exchange?

Mr. WHITNEY. That is a large order, Mr. Pecora. I will try to if you want me to. I think there is in the record here the constitution of the New York Stock Exchange, which specifically and exactly shows the organization in great detail.

Mr. PECORA. Perhaps you could give us the more salient features of it, without the necessity of our reading that constitution in its entirety. Tell us the general form of the organization.

Mr. WHITNEY. As I go along will you advise me as to what you wish me to be specific about?

Mr. PECORA. Very well.

Mr. WHITNEY. I do not know what you want.

Senator FLETCHER. It is not a corporation, as I understand it?

Mr. WHITNEY. No, Senator Fletcher, it is not a corporation. It is an unincorporated body consisting at the present time of 1,375 members, barring those that may be deceased, but there are 1,375 memberships.

The control of the exchange rests with the board of governors, 40 in number, and the treasurer and president ex officio.

There are various standing committees. The more prominent of these is the committee on business conduct, committee on stock list, committee on admissions, committee of arrangements.

There are also various special committees appointed from time to time to undertake certain particular studies that come before the attention of the governing committee.

There are then officers of the exchange who conduct the routine affairs of the exchange under, however, the supervision and control of the president or the chairman of the various committees.

That, simply, Mr. Pecora, is the organization of the Exchange. I will be delighted to amplify if you tell me what you have in mind.

Senator BROOKHART. What connection or association do you have with the Better Business Bureau?

Mr. WHITNEY. What associaion, sir? We ask information of the Better Business Bureau, of any of the Better Business Bureaus, continuously as to matters that come under their jurisdiction and in which they can help us gather information.

Senator BROOKHART. You yourself are a director and on the advisory council of the Investors Section?

Mr. WHITNEY. I believe so.

Senator BROOKHART. And the Better Business Bureau is a sort of a censor of business all over the country, is it not?

Mr. WHITNEY. I do not understand that it is a censor, Senator Brookhart. I understand that it investigates business practices.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. And then it publishes reports against dishonest or fraudulent practices?

Mr. WHITNEY. I believe so.

Senator BROOKHART. And tries to stop them?

Mr. WHITNEY. I believe so.

Senator BROOKHART. But it never has published any report against the New York Stock Exchange, has it?

Mr. WHITNEY. Not that I know of.

Senator BROOKHART. And has never published a report against any syndicate or any pool or any group operating in the New York Stock Exchange?

Mr. WHITNEY. That I do not know.

Senator BROOKHART. If those fraudulent pools are organized to make a market and manipulate the price of issues to put them off on the people, they never tell the people about that, do they?

Mr. WHITNEY. If there were fraudulent pools and they chose to make statements about them, it would be entirely within their province, I presume.

Senator BROOKHART. But they never do it?

Mr. WHITNEY. I don't know whether they have discovered fraudulent pools. If I remember rightly, there were some statements by the Better Business Bureau of New York with regard to the Manhattan Electric Supply Co. operations, which we found to be unethical. It was referred to the Attorney General in the first instance, and in the second instance of a second pool in that stock we suspended a member who merely had his office used through carelessness on his part for certain operations.

Senator BROOKHART. But the Better Business Bureau had nothing to do with that; you were doing that yourselves?

Mr. WHITNEY. I believe, as I stated, the Better Business Bureau made certain statements with regard to those practices.

Senator BROOKHART. Well now, in your testimony before you testified to a transaction, I think, of a $98,000,000 issue of bonds that were sold on the exchange by Morgan & Co.

Mr. WHITNEY. I beg your pardon, Senator Brookhart. I never said they were sold on the Exchange by Morgan & Co. They were not sold on the exchange.

Senator BROOKHART. How were they sold?

Mr. WHITNEY. They were distributed through various syndicate participants and through them by their associates in their organizations throughout the country.

Senator BROOKHART. During that distribution you testified that your company was employed to purchase those bonds for Morgan & Co. at the same time they were selling them?

Mr. WHITNEY. I stated that I had orders to buy those bonds at certain prices for the syndicate; yes, sir.

Senator BROOKHART. And the price, as I recollect it, was 90?

Mr. WHITNEY. A large part of the time 90. At other times lower prices.

Senator BROOKHART. And did you maintain that price during all the time that those bonds were being distributed?

Mr. WHITNEY. I had bids for a considerable length of time; yes, sir.

Senator BROOKHART. And bought in some $10,000,000 of those bonds during that distribution?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. Approximately; yes.

Senator BROOKHART. And then you maintained the price for 18 days after the bonds were all sold?

Mr. WHITNEY. If I remember rightly, the bonds during that time sold at higher prices, Senator Brookhart, than our bid or the price at which we bought them.

Senator BROOKHART. Yes; but you testified that you maintained the price for 18 days.

Mr. WHITNEY. I think that I had bids on the bonds for 18 days thereafter, if that is the fact, and bought bonds at varying prices; yes, sir. I had orders.

Senator BROOKHART. To maintain that price for 18 days?

Mr. WHITNEY. To buy bonds. Sometimes my orders were very limited in volume.

Senator BROOKHART. Then the next day after the 18 was out, why, they dropped from 90 to 86?

Mr. WHITNEY. I can not vouch for that without referring to my testimony.

Senator BROOKHART. And were 32 at the time you were testifying?

Mr. WHITNEY. And have sold up to 60-odd since that time.

Senator BROOKHART. And the Better Business Bureau never reports any of the practices of that kind of the stock exchange to people of the country, does it?

Mr. WHITNEY. I do not claim that that is an unethical practice, Senator Brookhart, as I stated.

Senator BROOKHART. Well, I do. I do. I think that is just about as unethical as you can figure it out.

Mr. PECORA. Mr. Whitney, are any stock brokerage firms holding more than one membership in the exchange?

Mr. WHITNEY. Are there?

Mr. PECORA. Yes.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. That is a rather frequent occurrence, is it not?

Mr. WHITNEY. Yes, Mr. Pecora.

Mr. PECORA. Of the 1,375 members who now constitute the membership of the exchange, how many offices, stock brokerage offices, or firms or companies, do they actually represent?

Mr. WHITNEY. This is largely a guess. I could find it out of course exactly for you. I haven't got it in my mind. But about 613, I think. That may be a little high, but I think about that.

Mr. PECORA. How many different issues are listed and traded in on the exchange to-day?

Mr. WHITNEY. I think approximately 1,547 bond issues, and somewhere in the neighborhood of 1,228 stock issues. That does not mean, sir, of different companies, but issues.

Mr. PECORA. Different issues of securities?

Mr. WHITNEY. There may be four or five issues of the same company.

Mr. PECORA. Will you let me have those figures again, please?

Mr. WHITNEY. Again approximately, please, sir?

Mr. PECORA. Yes.

Mr. WHITNEY. About 1,547 of bonds and about 1,228 of stocks.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Of course, the stock issues include both preferred and common stock?

Mr. WHITNEY. Yes, sir.

Senator BROOKHART. One other question: The stock exchange or members of it put up $100,000 in the beginning to organize this Better Business Bureau, did they not?

Mr. WHITNEY. They put up $100,000 to help organize a Better Business Bureau. Whether it was the national or the—yes, sir, the Better Business Bureau of New York.

Senator BROOKHART. And out of that came the National Better Business Bureau?

Mr. WHITNEY. No, sir. The national was the organization of all the Better Business Bureaus in all the cities.

Senator BROOKHART. The New York Better Business Bureau is a part of it?

Mr. WHITNEY. It was a part. I think it has divorced itself.

Senator BROOKHART. It is yet? When did it get the divorce?

Mr. WHITNEY. I think it got the divorce together with all the other members about a year or two ago. I think almost all of the Better Business Bureaus broke away for some reason from the National some time ago.

Senator BROOKHART. But the New York Better Business Bureau continues its relations with the stock exchange?

Mr. WHITNEY. In so far as I say that we ask them for information frequently; yes, sir. And they ask us for information.

Senator BROOKHART. But never report against you? They have never made a report——

Mr. WHITNEY (interposing). I have not actually gone through their files. I do not know if they have.

Senator BROOKHART. You would hear of it if they did?

Mr. WHITNEY. I hear a great many things about the exchange; yes, sir.

Senator BROOKHART. But you have never heard of a complaint against the stock exchange by the Better Business Bureau?

Mr. WHITNEY. No, sir.

Mr. PECORA. When was the exchange organized, Mr. Whitney?

Mr. WHITNEY. I think in 1791, and counsel tells me in organized written form in 1819.

Mr. PECORA. And when was its membership increased to 1,100?

Mr. WHITNEY. You are asking questions I can not—may I ask counsel? I do not know, sir.

Mr. PECORA. Many years ago, wasn't it?

Mr. WHITNEY. Many years ago, yes.

Mr. PECORA. About 40 or 45 years ago?

Mr. ROLAND L. REDMOND. About 70.

Mr. WHITNEY. 70 years ago.

Mr. PECORA. When was that membership increased to its present number of 1,375 members?

Mr. WHITNEY. In 1929, February, 1929, February 7, 1929. You are now getting down to my period of life, sir.

Mr. PECORA. And my own.

Mr. WHITNEY. Thank you.

Mr. PECORA. What kind of auditing has been made by the exchange of issues, or corporations making issues, which have been listed on the exchange?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. There is in the record, which I presented during some of my previous appearances, a memorandum showing that in detail, Mr. Pecora, and examples of various listing applications made by various companies applying for listing. We make no audit of the company ourselves. We do not pretend to pass upon values of shares that seek listing. We do, however, seek to find out that they have actual plant and earning capacity or both, and when they present their applications for listing they are accompanied by accountants' or auditors' statements from the company itself. Those are reviewed for the facts to be found out, as stated in this memorandum which is in the record.

Mr. PECORA. Then, accompanying the application for listing of a stock there must be a financial statement?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Made by the corporation seeking to have its securities listed?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. That financial statement is analyzed by the members of your stock list committee?

Mr. WHITNEY. By the employees of the stock list committee; yes, sir.

Mr. PECORA. But no independent audit is made by the stock exchange itself?

Mr. WHITNEY. Of the company itself?

Mr. PECORA. Yes.

Mr. WHITNEY. No, sir. We are demanding now——

Mr. PECORA (interposing). That never has been a requirement of the exchange, has it?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. What, to make an independent audit?

Mr. WHITNEY. A requirement of the exchange that an independent audit be made and submitted to us. That has been in force——

Mr. PECORA (interposing). I say it never has been a requirement or rule of the exchange for it to make an independent audit or cause one to be made in its behalf. Is that correct?

Mr. WHITNEY. May I answer?

Mr. PECORA. Yes, sir.

Mr. WHITNEY. It is not a requirement of the exchange that the exchange itself will make an independent audit. It is a requirement of the exchange on all applications for listings from April 1, 1932, that they have to be accompanied by independent audits.

Mr. PECORA. But the independent audits are not made at the instance of or by or for the exchange?

Mr. WHITNEY. Not made by the exchange.

Mr. PECORA. And the auditor making one is the auditor of the corporation which is making the listing application?

Mr. WHITNEY. Except in so far as we demand independent audits; yes, sir.

Mr. PECORA. But the auditors who make a so-called independent audit are chosen or selected by the corporation making the listing application; is that correct?

Mr. WHITNEY. That is correct. If I may add, I think the standing of the auditors or accountants who made such an independent audit would naturally be taken into account in the investigation and review of the application by the exchange.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Does the stock exchange prescribe as an essential to the listing of securities that any particular form of accounting or auditing be made and submitted by the corporation making the listing application?

Mr. WHITNEY. Yes, sir; in certain instances.

Mr. PECORA. In what instances?

Mr. WHITNEY. You are getting rather above my head there, Mr. Pecora, in the details. I can only refer you again to the memorandum that is here in this record.

Mr. PECORA. How long have you been the president of the exchange, Mr. Whitney?

Mr. WHITNEY. Since May, 1930.

Mr. PECORA. That is for nearly three years?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. And these questions are over your head?

Mr. WHITNEY. Yes, sir. I must grant it, because they are very detailed in their ramifications, and although in general I am acquainted with the subject, I can not tell you the actual forms of accounting that are set forth except in certain specific cases that have come to my attention.

Mr. PECORA. Well, tell us of those specific cases, or give us an illustration of the nature of them.

Mr. WHITNEY. With regard to the management investment trusts. There we have demanded the following specifically; if I may quote from the memorandum I have here:

"The very rigid requirements adopted in regard to the listing of management type investment trusts, created the public demand for full publicity in regard to not only the earnings but also the investments held by organizations of this character."

Mr. PECORA. Is that statement one that was prepared by you?

Mr. WHITNEY. Yes, sir. I never prepare any statements or speeches of any kind without consultation. It was prepared in consultation with my associates.

Senator FLETCHER. Do you require, Mr. Whitney, any investigation to satisfy you regarding the integrity of the people who are making application for listing their stocks?

Mr. WHITNEY. Yes, sir.

Senator FLETCHER. As to their standing, their honesty, their good faith?

Mr. WHITNEY. Absolutely, Senator Fletcher.

Mr. PECORA. Does the exchange continue that sort of inquiry with respect to the integrity of men constituting the officers in control or in management of a corporation whose security is listed, after the listing has been effected?

Mr. WHITNEY. I am not quite sure, Mr. Pecora, that that is done. It may be done incidentally. We do, however, demand that, when application is made, in the future the statements made by that corporation shall be along the same lines—and that is a contract with that company—as were the statements made by the company when applying for listing.

Mr. PECORA. What is the purpose of the exchange in making the kind of inquiry which Senator Fletcher has alluded to?

Mr. WHITNEY. To see that the background of the company making application for listing is proper in as many ways as we can cover.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And don't you think it would be just as advisable to exercise that same kind of supervision by inquiry even after a corporation has succeeded in having its securities listed?

Mr. WHITNEY. I think it would be advisable, and I do not say it is not done, Mr. Pecora, but please bear this in mind, that after a company is listed on the exchange, or even before it was listed on the exchange, the shares of that company are available for purchase to anybody in this wide world, and so the officers or the directors or whoever they might be, are entirely beyond our control thereafter.

Mr. PECORA. If it is considered of importance to the public for the exchange to make some inquiry so that it may satisfy itself of the integrity of the persons in control of the corporation at the time the corporation makes its listing application, is it not just as important to continue after the listing has been effected?

Mr. WHITNEY. I think it is important.

Mr. PECORA. That same sort of inquiry and supervision?

Mr. WHITNEY. I think it is important, sir, yes. But I am trying to answer you by calling to your attention that there is nothing that we can do about it after the company is once listed, unless such transgressions with regard to conduct or with regard to their agreement with the exchange take place as to force us to take penalizing action.

Mr. PECORA. What circumstance or condition renders the stock exchange impotent to continue that sort of inquiry?

Mr. WHITNEY. I have not granted, sir, or meant to infer that anything, any condition—I do not say that we do not follow up who are the officers. Of course, that is presented to us.

Mr. PECORA. You said you can do nothing about it. What were you referring to then?

Mr. WHITNEY. We cannot remove those officers.

Mr. PECORA. I know you cannot remove the officers, but can't you exercise your influence in the proper conduct and administration of a corporation whose securities are traded in through the facilities offered by the exchange?

Mr. WHITNEY. I did not understand that you had signified that improper conduct had taken place, and I did try to point out that if there was improper conduct in the administration of that corporation or in any relevant affairs of that corporation, then the exchange could try to take certain action to rectify the situation.

Mr. PECORA. Along what lines could it take such kind of action?

Mr. WHITNEY. Our final power, sir, is to strike from the list.

Mr. PECORA. Has that power ever been exercised by the exchange, to your knowledge, because the exchange officials had reached a conclusion that those in control of a corporation listed on the exchange did not possess that degree of business integrity which would protect the public?

Mr. WHITNEY. To all intents and purposes, yes. In the case of the second manipulation of Manhattan Electrical Supply Co.'s stock. They were in a position to desire additional listing of stock. We refused to list—I think it would have jeopardized the company in its corporate existence—we refused to list unless the officers of that company, the prior company, be removed and a new name given to the new company and new officers put in.

Mr. PECORA. That is, you refused to list additional issues?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Put out by that company?

Mr. WHITNEY. Which would——

Mr. PECORA (interposing). But the original listing continued in effect?

Mr. WHITNEY. I think the company would have broken up and gone to pieces.

Mr. PECORA. I say that original listing under those circumstances would continue in effect, would it not?

Mr. WHITNEY. It would have, but not in this particular instance, sir.

Mr. PECORA. In this particular instance it worked out the other way?

Mr. WHITNEY. It worked the way that we wanted it to work; yes.

Mr. PECORA. The exchange had no control over that; it just developed that way, didn't it?

Mr. WHITNEY. It did develop that way, giving us a control.

Senator BROOKHART. Mr. Whitney, I do not believe I quite understood this German bond deal, so I want to refer back to your testimony.

Mr. WHITNEY. What page, please, Senator Brookhart?

Senator BROOKHART. I am going to start quoting to you on page 245. I will start down near the bottom of the page. I think from there on it contains all the ideas I want to bring out (reading):

Mr. GRAY. You mean that all had been disposed of that the syndicate desired to dispose of; is that the answer?

Mr. WHITNEY. All so far as I know had been disposed of by the syndicate.

Mr. GRAY. Yes.

Mr. WHITNEY. And during that time purchases were made at the syndicate price until the price restriction was taken off, so that for a period of 18 to 20 days all those who had purchased those bonds could have sold them at the purchase price or for more. And during that time we purchased for the account of the syndicate approximately $9,200,000, slightly in excess of $9,200,000 bonds.

Mr. GRAY. When was that that the syndicate put that out, last year you mean?

Mr. WHITNEY. No, sir.

Mr. GRAY. I do not know the year.

Mr. WHITNEY. June 12, 1930. I beg your pardon.

Mr. GRAY. Not blaming it on you, of course, but what are those bonds selling for now?

Mr. WHITNEY. They are selling for around 35½. They have sold at 23 in spite of the fact that they and the 7 per cent German bonds have at all times paid interest, the latter having paid on April 15 last; and I have every reason to believe that the 5½'s will pay interest on June 1. That is the fluctuation in the world situation.

Mr. GRAY. Your firm, now, acting for Morgan & Co., and if I am wrong about this, correct me; I so understood your statement the other day—acted for this syndicate in maintaining that price during the time that the syndicate's operations were in effect; is that correct?

Mr. WHITNEY. Yes, sir; under order.

Mr. GRAY. Under order, of course.

Mr. WHITNEY. Yes.

Mr. GRAY. That means that your brokerage house executed such orders as were given to you by the syndicate; that is correct, is it not?

Mr. WHITNEY. Through J. P. Morgan & Co.

Mr. GRAY. And the purpose of the execution of those orders was to maintain—and I was going to use the word "artificial", but I know you would not agree with me—to maintain a fixed valuation for those bonds; that is correct, is it not?

Mr. WHITNEY. To maintain a price, sir. So that at any time, as I have stated, during some 18 or 20 days any purchasers who did not want to hold the bonds that they had bought could have sold them at the selling price or higher. That is an absolutely usual and customary method of merchandising and distributing securities.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

That last statement is the one I particularly want to call your attention to. [Continuing reading:]

Senator BROOKHART. In that connection did you tell them that you were only going to maintain that price for 18 or 20 days?
Mr. WHITNEY. Tell whom?
Senator BROOKHART. These purchasers?
Mr. WHITNEY. Tell the purchasers—I did not have anything to do with the purchasers, if you mean the persons to whom the bonds were sold.
Senator BROOKHART. You maintained the price 18 or 20 days, so that they could sell and get their money back?
Mr WHITNEY. No; I said if they wanted to sell.
Senator BROOKHART. If they wanted to sell.
Mr. GRAY. I think Mr. Whitney will admit that no such information was conveyed to those who actually conducted the deals with the purchasers.
Mr. WHITNEY. As to how long the bid would be named?
Mr. GRAY. Yes.
Mr. WHITNEY. No, sir.
Mr. GRAY. He will admit that.
Senator FLETCHER. Were those bonds sold to the public generally?
Mr. WHITNEY. That is to be presumed, Senator Fletcher, inasmuch as there were 1,011 participants in that syndicate.
Senator FLETCHER. How much was the total?
Mr. WHITNEY. A little in excess of 98,000,000.

And then I skip down to the bottom of the page. [Continuing reading:]

Mr. GRAY. The point I want to develop, Mr. Whitney, is this: During that period of time your firm, acting under orders from this syndicate or from J. P. Morgan & Co. in connection with those bonds, were maintaining a price on the market. That is correct, is it not?
Mr. WHITNEY. We were bidding a price at which anybody could sell bonds; yes, sir.
Mr. GRAY. Yes. In other words, what you were doing was executing buying and selling orders for the purpose of maintaining that price?
Mr. WHITNEY. Not selling orders; no, sir.
Mr. GRAY. Only buying orders. In other words, what you had was what in effect you may call either a syndicate and pool, a syndicate for the issuance of the bonds, the underwriting of them, possibly, but a pool for the purpose of maintaining that price at a certain level. Isn't that true, for a certain period of time?
Mr. WHITNEY. Yes, Mr. Gray. The syndicate at all times were selling the bonds.

And then down at the bottom of page 248. [Continuing reading:]

Senator BROOKHART. As I understand this, your firm was selling bonds?
Mr. WHITNEY. No, sir; we were not. We were buying bonds.
Senator BROOKHART. Who were selling them for the syndicate?
Mr. WHITNEY. The syndicate participants, consisting of 1,011 dealers and individuals throughout this country.
Senator BROOKHART. They were selling these German bonds?
Mr. WHITNEY. I presume so.
Senator BROOKHART. And while they were selling they had you employed to maintain the price?
Mr. WHITNEY. My firm had the orders, had some orders, these orders.
Senator BROOKHART. You were buying them for this same syndicate that was selling them to the public?
Mr. WHITNEY. That is right.

And the remark I made was that that was double-crossing the public.

Now Mr. Whitney, you say in there that it is a general practice of the stock exchange when these syndicates are formed to float these securities to maintain the price for them during the period when they are being sold?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITMEY. Senator Brookhart, I do not wish to quibble, but I never said it was a practice of the stock exchange. I said that it was the usual practice of syndicates merchandising securities to maintain a price during the life of the syndicate, and many times long after the life of the syndicate. And that occurs not only on the stock exchange but off the stock exchange where merchandising of securities is taking place.

Senator BROOKHART. We have had some very pointed evidence off the stock exchange, and I want to get it now on the stock exchange.

Mr. WHITMEY. I grant that it is done by orders placed on the stock exchange. I do not grant that the stock exchange does it.

Senator BROOKHART. Well, you knew, for instance, when Morgan & Co. gave you this order to bid at this price of 90 or thereabouts—you knew that was being done for the purpose of keeping the price up to that level while the syndicate was disposing of the bonds?

Mr. WHITNEY. Yes, sir; and I was advising personally the sale of bonds at higher prices because I felt they were worth it.

Senator BROOKHART. And you also knew that as soon as the bonds were disposed of that those orders would be withdrawn?

Mr. WHITNEY. I did not.

Senator BROOKHART. Well, you knew it was just during the period of disposal that——

Mr. WHITNEY (interposing). I did not.

Senator BROOKHART. How long was the order given in this particular case?

Mr. WHITNEY. Daily.

Senator BROOKHART. Just daily?

Mr. WHITNEY. Day orders.

Senator BROOKHART. Well, you know the syndicate's practice that they will give you these orders daily until they have disposed of their issue.

Mr. WHITNEY. And very often, Senator, they will continue orders in such securities for a period after the syndicate's life.

Senator BROOKHART. And that is for coverup purposes, to make the public think they have been fair with them?

Mr. WHITNEY. No, sir. Because they think the securities are worth buying at that price. Remember, we are speaking of German Government bonds in 1930, and shortly after that period, if you remember, there were very serious happenings on the continent, and for that reason, and that reason alone, as I tried to describe when I was last here, there was a depreciation in the price of those bonds and all other foreign government issues—I mean central-continent government issues. Those bonds went down, as I said——

Senator BROOKHART. We have had a lot of testimony about that. We are quite familiar with it. But the thing I want to bring out is that it is a practice of the stock exchange members with the knowlegde, of course, of the stock exchange management, that brokerage firms will go in during the period of disposal of securities to the public, to the people at large, and they will take orders from the same syndicate that is selling those bonds and maintain the price so they will sell them at this fixed price by the syndicate?

Mr. WHITNEY. They will take such orders. If I am correct in my memory it is an agreement, a public agreement of all the participants in the syndicate that such will be done.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. And you think that is not a violation of the antitrust laws in restraint of trade?

Mr. WHITNEY. Senator, I am no lawyer.

Senator BROOKHART. Well, I think it is, myself.

Senator FLETCHER. Was that interest paid in June which you predicted would be paid?

Mr. WHITNEY. Oh, yes, sir; and since. The interest has been maintained steadily on those two issues, and the 5½'s that we are referring to have sold up recently to around 65. There has also been, I think, a large sinking fund operating on the part of the German Government and purchasing those bonds, which they were under contract to do.

Senator FLETCHER. What were they sold for here?

Mr. WHITNEY. Ninety. They have recently, in the last few days, dropped down again, due to certain conditions abroad.

Senator BROOKHART. Has there been any pool or syndicate operating in them since they were down to 23?

Mr. WHITNEY. That I can not tell you, Senator.

Senator BROOKHART. You do not know whether there is any pool boosting them up again or not?

Mr. WHITNEY. I do not.

Senator BROOKHART. And if there had been and they had asked your firm to buy them at a stated price you would have bought them, of course?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Shall I proceed, Senator?

Senator BROOKHART. Yes; go ahead.

Mr. PECORA. Mr. Whitney, what is the disciplinary power which the exchange authorities exercise over the members?

Mr. WHITNEY. The governing committee has the power to discipline either by suspension or expulsion, depending upon the misconduct.

Mr. PECORA. Under the agreement between the members and the exchange is a decision of the board of governors or other disciplinary board of the exchange, effecting the expulsion or suspension of a member, reviewable by the courts?

Mr. WHITNEY. With apologies to you as a lawyer, because I do not pretend to be a lawyer, and I may be wrong in what I am going to say from a legal point of view—they have been reviewed by the courts at various times, and notably, as I referred when I was last here, the last review by the courts came before Senator Wagner, who handed down a very wonderful decision in its legal elements and otherwise, upholding the absolute power of the governing committee to take such action as it had taken under its constitution, toward the member.

Mr. PECORA. Oh, I know that there have been cases in which members who have been dealt with by the power of discipline of the exchange authorities have sought redress in the courts.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. But do you know of any court decision or review that reversed the decision of the board?

Mr. WHITNEY. No; I do not.

Mr. PECORA. On the ground of lack of merit?

Mr. WHITNEY. I do not know of any; no.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Has it not always been the contention of the exchange in such actions that its decisions are not reviewable by the courts?

Mr. WHITNEY. I do not think so. I do not know any rule of the exchange preventing a member who has been suspended or expelled to seek an injunction, or whatever it might be, from a court.

Mr. PECORA. I have not asked about that. I have asked whether it has not been consistently the contention of the exchange, whenever any member who has been disciplined has sought to review its decision in the courts, that the courts were without power to make such review?

Mr. WHITNEY. Mr. Pecora, I cannot answer that. I would be glad to refer to our counsel, Mr. Redmond, who is right here. He can answer.

Mr. PECORA. That, it strikes me, Mr. Whitney, would be a matter of general policy of the exchange with which you might be familiar not only because you have been president since 1930, but also because you have been a member since 1912, something like 21 years ago.

Mr. WHITNEY. I am not personally acquainted with the argument of counsel when the case that I referred to was brought before Senator Wagner when he was then a judge.

Mr. PECORA. Well, it is the endeavor of counsel for the exchange to seek in all instances to carry out the policies of the exchange?

Mr. WHITNEY. And to uphold the constitution.

Mr. PECORA. Just as an attorney for a private client seeks to carry out the policy of his client, is that not true?

Mr. WHITNEY. If I may say, I think to uphold the constitution of the exchange.

Mr. PECORA. For what infractions or conduct, for instance, may the governing authorities of the exchange discipline a member by expulsion?

Mr. WHITNEY. May I read from the constitution?

Mr. PECORA. Will you tell us in your own language without referring to the formal phraseology of the constitution?

Mr. WHITNEY. Expelled, you said?

Mr. PECORA. Yes.

Mr. WHITNEY. Found guilty of fraud. Making fictitious transactions. Purchasing or selling securities where there is no change of ownership. Misstatements to any committee of the exchange.

Senator BROOKHART. Now on that one about where there is no change of ownership. Where a syndicate is selling bonds and then the brokerage firm is buying them back for the same syndicate, in effect there is no change of ownership in that deal?

Mr. WHITNEY. No, sir; there is a real change of ownership. The bonds are sold by the participants in the syndicate to an individual. Let us say to Mr. Pecora. Mr. Pecora decides that he does not want those bonds, and he sells them through his broker on the New York Stock Exchange to me, who am buying for the syndicate. There is a change of ownership just as exact as I can imagine. Mr. Pecora paid his money and then changed his mind and sells them and he is paid money for his sale.

Senator BROOKHART. Yes, you sell them to Mr. Pecora, or the syndicate does, but he wants to get rid of them right away, and you turn around and buy them back from him for the same syndicate that sold them to him and before night they are in the same hands that they

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

were before. Now there is no substantial change of ownership there?

Mr. WHITNEY. I am sorry, Senator Brookhart, I can not agree.

Mr. PECORA. May the record have it clearly shown that all these are suppositious transactions with me.

Senator BROOKHART. I will agree with that, Mr. Pecora.

Mr. PECORA. What section were you reading from when you were answering my last question, Mr. Whitney?

Mr. WHITNEY. Article 17 of the constitution. And I was trying in my own language, as you requested——

Mr. PECORA. Yes.

Mr. WHITNEY (continuing). To state. The fraud is in section 2; fictitious transactions is in section 3; misstatement to a committee, section 5; and section 4 is any act intended to demoralize the market. And 7, the violation of just and equitable principles of trade or proceeding inconsistent with just and equitable principles of trade, which is left to the discretion of the governing committee.

Mr. PECORA. Let us assume a transaction where a syndicate has been formed to trade in a security listed on the exchange, and the syndicate, we will say, consists of 10 members. It is conceivable, is it not, that a sale might be made by the manager of the syndicate through the specialist to an individual member of the syndicate, and that individual member of the syndicate in turn, might sell back to the syndicate or to some other individual member of the syndicate? Such a thing is easily possible, is it not?

Mr. WHITNEY. It could be possible.

Mr. PECORA. And if all that were done in pursuance of an agreement or understanding on the part of the several members of the syndicate to make those trades for the purposes of the syndicate, do you consider that an actual change or transfer of ownership of the securities so traded in would be effected?

Mr. WHITNEY. No, sir. If I understand you right, no, sir.

Mr. PECORA. That would be a violation of the rules of the exchange?

Mr. WHITNEY. Absolutely.

Mr. PECORA. And would subject any member guilty of that violation to the penalty of explusion?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Now what steps, if any, do you know of that have been taken by the governing authorities of the exchange to detect such collusions?

Mr. WHITNEY. The business conduct committee at all times where it believes there is a pool in operation is in touch with the specialist and requests of the specialist any information that may seem to denote improper transactions. I have every reason to believe that frequently the business conduct committee when such knowledge comes to them will go to the office of the manager of the syndicate and go through the transactions there.

Mr. PECORA. Through what means or channels would the governing authorities of the exchange acquire such knowledge?

Mr. WHITNEY. Through the accountants of the exchange acting, as I have described, for the business conduct committee.

Mr. PECORA. Well, what I mean to inquire about is this: The accountants of the exchange would not function in such a situation unless they were first requested to do so by the governing authorities?

Mr. WHITNEY. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And before the governing authorities would request their accountants to function in that fashion they would first have to have some knowledge or belief that a pool was being operated, would they not?

Mr. WHITNEY. They would have, presumably, to have knowledge that transactions in a stock were such as to cause or render it necessary to investigate.

Mr. PECORA. That is to say they would have to have knowledge or information of the transactions which would suggest that a pool was in operation? Is that what you mean, Mr. Whitney?

Mr. WHITNEY. Yes; the Business Conduct Committee investigates complaints or other matters that indicate there have been irregularities in the conduct of the members.

Mr. PECORA. Would the governing committee act only after it had received specific complaints?

Mr. WHITNEY. Largely, Mr. Pecora. The governing committee, you understand I am talking about the business conduct committee. That is the committee that does it.

Mr. PECORA. Well, I am talking about the governing authorities generally who exercise any powers with regard to disciplining members for infractions of the kind which you have alluded to.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Whether it be the board of governors or the business conduct committee or any other agency of the exchange?

Mr. WHITNEY. It just so happens that the business conduct committee is the only committee to which is delegated the power to go into offices other than the governing committee itself.

Senator BROOKHART. Mr. Pecora, may I interrupt?

Mr. PECORA. Yes, Senator.

Senator BROOKHART. Let me ask you about another transaction or two. Supposing a brokerage firm is selling securities for anybody, are they permitted to buy them for the same party at the same time they are selling, the same day?

Mr. WHITNEY. Do you mean if I sell securities to one individual for the account of a firm, may I buy securities for that same firm from another individual?

Senator BROOKHART. Yes; we will take that first.

Mr. WHITNEY. The answer is yes.

Senator BROOKART. They are permitted to take orders buying and selling for the same firm on the same days at the same time?

Mr. WHITNEY. Certainly. So can I buy hogs the same day for the same individual and sell for him. Absolutely, yes.

Senator BROOKHART. Yes; but we do not do the hog business that way until it gets in the produce exchange. Then we have a simpler transaction. Now what is a wash sale? Let us get an exact definition of that.

Mr. WHITNEY. Where there is no change of ownership. Members being parties to a wash sale would transgress the constitution, which is very specific on that point, and be subject to expulsion.

Senator BROOKHART. Suppose that three people would make an arrangement: Morgan & Co. would make an arrangement to sell to Mr. Pecora, and he would sell it to me, and then I would sell it back to Morgan. Would that be a wash sale?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. If you made an arrangement, you say, on the New York Stock Exchange?

Senator BROOKHART. Yes.

Mr. WHITNEY. I think it would be, without question.

Senator BROOKHART. Well, notwithstanding the fact that it was a different party sold it back from the one that bought it?

Mr. WHITNEY. Just such transactions took place, Senator Brookhart, in the Manhattan Electrical Supply Co.'s stock to which I referred. Various officers of the corporation were selling it around the rosy, and we found it out.

Senator BROOKHART. When Morgan & Co. are selling German bonds and they do not want to buy bonds, but they do buy them for the purpose of maintaining the market, they are conducting just as unethical a proposition as the one I described?

Mr. WHITNEY. No, sir.

Senator BROOKHART. You can not see that at all?

Mr. WHITNEY. No, sir.

Mr. PECORA. You used an expression in answer to one of the Senator's questions just now; as I heard it it was "round the rosy". Is that a colloquialism of the exchange?

Mr. WHITNEY. No, sir. I was referring to a certain game, Mr. Pecora, that I think they used to play once, holding hands and dancing round the rosy.

Mr. PECORA. Are there any transactions on the exchange which suggest that kind of a game to you?

Mr. WHITNEY. Yes, the holding of hands or the agreement by yourself and J. P. Morgan & Co. and Senator Brookhart.

Mr. PECORA. I wish you would leave me out of this, please.

Mr. WHITNEY. But Senator Brookhart said that. The Senator put you in. I did not, Mr. Pecora.

Senator BROOKHART. But so far as Morgan & Co. are concerned, if they are buying back bonds when they do not want them, but for the purpose of maintaining the market, they are defrauding the public then as to the market trend, are they not?

Mr. WHITNEY. I can not agree with you, and I do not know that there has been any evidence presented anywhere that they did not want the bonds. They did want them.

Senator BROOKHART. Well, take these $9,200,000 that you bought back for them, or your firm, they were all resold again right away; they cleared their books of them?

Mr. WHITNEY. That I can not tell you.

Senator BROOKHART. And their theory is to stay liquid and not hold those bonds, pass them on to the public as quick as they can, is it not?

Mr. WHITNEY. I do not know that for a fact at all.

Senator BROOKHART. We will have to have Mr. Morgan down here, I guess, and find out about that.

Mr. PECORA. Did I understand you to say a few minutes ago that disciplinary power is exercised by the exchange through its business conduct committee?

Mr. WHITNEY. The investigation of offices through the business conduct committee, yes.

Mr. PECORA. Well, is not the power of discipline actually exercised and imposed upon its members by the governing committee?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. Yes.

Mr. PECORA. The governing committee acts upon evidence presented to it by the business conduct committee, is that it?

Mr. WHITNEY. Or any other committee of the exchange.

Mr. PECORA. Are there any agencies of the exchange or its governing authorities which, upon their own initiative, seek to ascertain evidence of violations of these trading rules to which you have referred, without waiting specifically for a complaint to be made?

Mr. WHITNEY. If they have knowledge of what they believe is wrongdoing, yes.

Mr. PECORA. It would be possible, would it not, for the governing authorities of the exchange to acquire knowledge, through observation of transactions on the part of its members, which would suggest to those authorities a violation of the rules as, for instance, by the operation of a pool?

Mr. WHITNEY. That might be so. But you have used the word "power", and the power of the governing committee, as delegated to the business conduct committee, is supreme, true. But it is essential that the use of that power shall be based upon a right to go into the personal affairs of a member of the exchange.

Mr. PECORA. I do not think you have answered the question, Mr. Whitney.

Mr. WHITNEY. I am sorry.

Mr. PECORA. Perhaps I have not made it clear to you. Do the governing authorities of the exchange, before they set their disciplinary machinery in motion, wait for the receipt of a complaint?

Mr. WHITNEY. In some instances, and in others where the business conduct committee by its observation or another committee by its observation feels that there has been something going on that is sufficient for investigation. In other words, our committees or the employees of our committees who are sent on such investigations do not go into offices unless they are told to do so for a specific reason.

Mr. PECORA. And who has the power to tell them to do so?

Mr. WHITNEY. The various committees.

Mr. PECORA. Do those committees ever act without first receiving a complaint or do they always wait for a complaint?

Mr. WHITNEY. I have tried to answer that, Mr. Pecora. I said upon complaint, or when it has come to their knowledge in some way or another, or by their observation or otherwise that there has been improper conduct on the part of members in one way or another.

Mr. PECORA. Now, the operation or existence of a pool trading in a certain security might suggest itself through violent fluctuations in prices, might it not?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Were there many occasions during the year 1929, prior to October 29, when issues fluctuated violently in price in the course of a single day's or fraction of a day's trading?

Mr. WHITNEY. Yes. I suppose there were, although if I remember, those days the market as a whole was going in the same general direction at all times, and sometimes violently as a whole.

Mr. PECORA. There were many occasions, were there not, in those days in 1929, when securities jumped as much as 50 points in the course of a single hour's trading?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. If you will tell me specifically I can answer that. I can not of my own personal information, Mr. Pecora.

Mr. PECORA. How violent do you think a fluctuation should be in order to excite a suspicion in the minds of the governing authorities of the Exchange that a pool is operating?

Mr. WHITNEY. Well, that would entirely depend upon the particular security, the price at which it was selling, and so forth. If it was selling in the high hundreds that security might fluctuate very much more than if it were selling in the price range of 50 or thereabouts.

Senator BROOKHART. Are pools against the rules of the exchange?

Mr. WHITNEY. No, sir.

Mr. PECORA. You say pools are not against the rules of the exchange?

Mr. WHITNEY. They are not, Mr. Pecora.

Mr. PECORA. What did you understand by the term "pool" when you answered that question?

Mr. WHITNEY. A group of individuals, or whoever they might be, feel that a stock or a security is selling at a price that is out of line, and they will go and buy that stock or that security up to a price where they think it is in line. And then——

Mr. PECORA. In line with what?

Mr. WHITNEY. With their judgment as to what it should sell at. And then——

Mr. PECORA. That is, in line with their judgment of its intrinsic value?

Mr. WHITNEY. We had a discussion here last spring about intrinsic value, and I am very scared of the word, because I cannot explain it.

Mr. PECORA. Well, it is a very definite term, is it not, Mr. Whitney? Does it not convey a very definite meaning to you?

Mr. WHITNEY. Not after what Senator Bulkley said last year; no.

Senator BROOKHART. Not in stocks and bonds.

Mr. PECORA. Does not the term "intrinsic value" convey a very definite meaning to you whether applied to stocks or merchandise?

Mr. WHITNEY. Not very; no. Because it all depends on what you believe makes up intrinsic value.

Mr. PECORA. Well, I would not know what makes up intrinsic value if I did not know the meaning of the term "intrinsic value", would I? Would you?

Mr. WHITNEY. Well, the term is broad, Mr. Pecora.

Mr. PECORA. What?

Mr. WHITNEY. The term is broad.

Mr. PECORA. What do you understand by the term "intrinsic value?"

Mr. WHITNEY. I used to think that it meant the worth of the fixtures, the plant of a corporation—that they all had a certain intrinsic value. But in these days you do not know whether anything is worth anything that might wipe out what was very important in constituting intrinsic value of a corporation and, therefore, its securities.

Senator BROOKHART. Do you think that values of 1929 on the stock exchange were supported by any substantial intrinsic value?

Mr. WHITNEY. They were supported, Senator Brookhart, in many, many instances, I believe at that time, by tremendous earning capacity.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. But the prices went up above even the tremendous earning value?

Mr. WHITNEY. In some instances; yes. The pendulum always swings too far.

Senator BROOKHART. And that is the purpose of the stock exchange, to help it swing?

Mr. WHITNEY. No, sir. The purpose of the stock exchange is to allow the ready action of the law of supply and demand. Purchasers and sellers.

Senator BROOKHART. Well, in order to follow the law of supply and demand you pay a good deal of attention to this intrinsic value?

Mr. WHITNEY. The purchasers and sellers. Not the New York Stock Exchange; sir. They do nothing in the evolution of securities.

Senator BROOKHART. Nothing whatever?

Mr. WHITNEY. No, sir. The New York Stock Exchange does not.

Senator BROOKHART. It leaves that to the dear public to find out altogether for itself?

Mr. WHITNEY. Yes, sir. We are a market place.

Senator BROOKHART. And you have no responsibility for the quality of the stuff you market?

Mr. WHITNEY. We have a responsibility, a very real one, as to the securities that we list upon the New York Stock Exchange. I have said that today. And we are trying to progress. We do not say that our rules are perfect by any manner of means.

Senator BROOKHART. And under your rules every security you had listed went too high in 1929, did it not?

Mr. WHITNEY. I do not know, Senator Brookhart.

Senator BROOKHART. And they are all down now, are they not?

Mr. WHITNEY. Regrettably. And so is everything else.

Senator BROOKHART. And they are still high, are they not? The chart I had when you were here before showed them still too high. Have they depreciated considerably since that?

Mr. WHITNEY. I could not say. I presume they have. Certainly some of them.

Senator BROOKHART. I will have to get my chart.

Mr. WHITNEY. We have a chart down to date in that connection if you would like to see it.

Senator BROOKHART. Yes. Who made it?

Mr. WHITNEY. Our accountant. Our economist, I should say.

Mr. PECORA. Mr. Whitney, when you testified before this committee last year——

Mr. WHITNEY. May I have the page please, Mr. Pecora?

Mr. PECORA. Page 254. In April of last year——

Mr. WHITNEY. Yes, sir.

Mr. PECORA. You were asked the following questions to which you made the following answers, which I will read.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Most, if not all the questions having then been asked you by Senator Brookhart. [Reading:]

Senator BROOKHART. What are the purposes of pools generally?

Mr. WHITNEY. To distribute that stock or bonds.

Senator BROOKHART. That kind of a pool wants to dispose of them at the highest possible price, does it not?

Mr. WHITNEY. Not necessarily. At a price.

Senator BROOKHART. And at a profit?

Mr. WHITNEY. Not necessarily.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

That is not the whole of that answer, but it is the portion I want to question you about. Did you ever know of a pool that was formed to distribute stocks and bonds definitely at a loss?

Mr. WHITNEY. Yes, sir. If you will read on it will be explained there. At great losses.

Mr. PECORA. You know of pools formed specifically for the purpose of trading in stocks in order to incur a loss?

Mr. WHITNEY. May I ask you to have read the question before this last one?

Mr. PECORA. Yes.

(Thereupon the question was read by the reporter, as above recorded, as follows: Mr. Pecora. * * * Did you ever know of a pool that was formed to distribute stocks and bonds definitely at a loss?)

Mr. WHITNEY. Yes, sir.

Mr. PECORA. That is, the pool was formed for the purpose of making the distribution at a loss?

Mr. WHITNEY. Which would incur a loss to the pool managers or the syndicate participants; yes.

Mr. PECORA. What would be the purpose of pool managers or participants in organizing and conducting a pool specifically to incur a loss?

Mr. WHITNEY. In order to sell securities, sir, at a price at which they could be sold that had cost them higher prices. That has been a very customary act in recent years.

Senator BROOKHART. These securities have depreciated in the meantime, have they not, since they got them?

Mr. WHITNEY. Considerably.

Senator BROOKHART. It is like the bonds they put off on the banks all over the country; they have depreciated so much that they closed several thousand banks. And, of course, the bank or the receiver is forced to sell those at a loss.

Mr. WHITNEY. I do not think the cause of the failure of those banks can be entirely attributed to their security holdings.

Mr. PECORA. Can you tell me of an instance within your knowledge where a pool was formed for the specific purpose of taking a loss?

Mr. WHITNEY. No; not here, Mr. Pecora. But I can inquire of our committee on secondary distribution and point out a great many of them.

Mr. PECORA. You have none now that you can give us from your recollection?

Mr. WHITNEY. No. I am not on that committee, and I would hate to say from memory. But I can get you that information readily.

Mr. PECORA. How were the interests of the members of such a pool advanced by the operation, Mr. Whitney?

Mr. WHITNEY. By selling securities they had on their shelves at prices at which they could be sold properly.

Mr. PECORA. Well, give me an instance of that, or give me an illustration of how it is done, so that we will understand the application of it.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. Well, a group—a syndicate may have purchased, let us say, 25,000 shares of stock thinking that stock at the time of purchase was cheap, that they could sell it at higher prices. I grant—and if that was what you had in mind—that naturally when people go into business they do it for the purpose of making money, and that is the intent naturally. But these specific instances, to go back: they were wrong in their judgment, as so many of us have been in these last few years, as to security values or any other values. And there came a time—there might have been a steadying in the stock market or in the security market and they felt that at a recession of price those securities could be merchandised to whomever wished to buy them, and they then in these particular instances, where they happened to be listed securities, came to our committee on secondary distribution and asked permission to do so, which was granted, and in many, many cases at a considerable loss to those original participants.

Mr. PECORA. In such a case the pool was not originally formed to trade in the stock or security at a loss, was it?

Mr. WHITNEY. Probably not. It might not have been, sir, a pool in the original situation. It may have been one firm or one individual that bought those securities.

Mr. PECORA. That kind of pool then is undertaken, among other things, for the purpose of bailing out those holders?

Mr. WHITNEY. Possibly; yes.

Mr. PECORA. And by that process the loss which otherwise would accrue to those security holders is minimized; is that not true?

Mr. WHITNEY. Not necessarily; no. The price at which they sold those securities in the last instance might be the low price at which those securities sold.

Mr. PECORA. Those are the exceptional circumstances when a pool is organized and operated for the specific purpose of incurring a loss?

Mr. WHITNEY. I think that is one of them; yes, sir.

Mr. PECORA. They are rather exceptional, are they not?

Mr. WHITNEY. Yes. Not in recent years. But I have granted that I think a pool or a syndicate is formed for the purpose of making a profit.

Mr. PECORA. In 1929, prior to the market crash in the latter part of October, do you know of any pool which was organized and operated to take a loss in the fashion you have described?

Mr. WHITNEY. No, sir. But I believe if you wish I can recount to you pools that were operated in that time or approximately that time that did take a loss.

Mr. PECORA. Well, we know that there were pools which did take a loss, but the object of these pools when organized and when their operations commenced was not to incur a loss?

Mr. WHITNEY. No, sir. No one goes into a business deal to lose money intentionally.

Mr. PECORA. That is the point I am trying to make.

Mr. WHITNEY. Except in these connections that we referred to.

Mr. PECORA. That is the point I am trying to make. The general purpose of pools is to distribute securities at a profit to the members; is that not so?

Mr. WHITNEY. Yes, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And in order to distribute at a profit they have to sell at a higher price than that at which they purchased?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Pool operations then are often maintained in a fashion calculated to bring higher prices for the stock accumulated? Is that correct?

Mr. WHITNEY. May that be repeated?

(Mr. Pecora's last question was thereupon read as above recorded.)

Mr. WHITNEY. I do not understand, Mr. Pecora, what you have in mind by the use of the word "maintained."

Mr. PECORA. Would you be good enough to read that question to the witness?

(The question by Mr. Pecora was again read by the shorthand reporter, as above recorded.)

Mr. PECORA. Well, "maintained" there is used as a verb synonymous, we will say, with "conducted."

Mr. WHITNEY. I think that is a fair statement; yes.

Mr. PECORA. And it then becomes the definite object and purpose of the members of the pool to conduct such market operations in the stock as will enable them to dispose of it at a profit? Does it not?

Mr. WHITNEY. If it can be disposed of at a profit.

Mr. PECORA. If it can be disposed of. And it is natural to assume, is it not, that the pool members will do whatever is calculated to bring such a result about?

Mr. WHITNEY. If in connection with members of the New York Stock Exchange so that they do not transgress our rules.

Mr. PECORA. The pool could operate through the medium of fictitious transactions—that is, fictitious beneath the surface—for the purpose of effectuating the result I have referred to?

Mr. WHITNEY. I suppose there is no agency in the world that can prevent crookedness.

Mr. PECORA. Do you mean that in many, many respects the governing authorities of the stock exchange are powerless to detect that kind of crookedness?

Mr. WHITNEY. I do not say in many, many respects. I——

Mr. PECORA. Or in many respects?

Mr. WHITNEY. It is possible that people without our control may effect transactions on the New York Stock Exchange that are fictitious or wrong or improper.

Mr. PECORA. What kind of manifestations would there have to be of the existence of a pool in order to give the exchange authorities knowledge or belief that a pool is operating?

Mr. WHITNEY. As I tried to explain to you, the business conduct committee is in close touch with what goes on in the various stocks through the specialists in those stocks, and if there are any unusual transactions—I do not mean to infer by that improper transactions—but if there are transactions that would denote the operation of a pool that particular stock would be closely scrutinized thereafter.

Mr. PECORA. Were you ever a member of the business conduct committee of the exchange?

Mr. WHITNEY. For many years.

Mr. PECORA. Well, what kind of transactions would strike you as being of such an unusual character as to excite your suspicion of the existence of a pool?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. If the orders to buy in that pool all seemed to come from the same source, the same members of the exchange, and vice versa, or if the orders to both buy and sell seemed to come from the same sources, that would create interest at least.

Mr. PECORA. It is the desire of the authorities of the exchange to maintain a free and open market?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Through the medium of the exchange for the purchase and sale of securities?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. And by a free and open market you do not mean a controlled market, do you?

Mr. WHITNEY. What is a controlled market?

Mr. PECORA. Well, Mr. Whitney, I am trying to use words that are simple in their meaning, but if I am using words that you do not understand I will try to change them.

Mr. WHITNEY. I understand the word "controlled" completely, Mr. Pecora. But the mere fact that a pool may buy large quantities of a stock, if they do not buy them from themselves there is no nefarious transaction, and that, as I see it, is not controlled.

Mr. PECORA. You know what is meant by a controlled market, do you not?

Mr. WHITNEY. I do—what you mean I think I know, but I do not know specifically of controlled markets. If you will give me an example of what you have in mind I will try to answer it.

Mr. PECORA. Well, where the bids and offerings virtually come from the same party or group or groups.

Mr. WHITNEY. But there is nothing to prevent other persons interested in that stock from selling large quantities of that stock or from buying it.

Mr. PECORA. But it is possible under the operation of the exchange for a group so to operate in the market as to more or less control prices for the time being?

Mr. WHITNEY. If their stock and if their money holds out, yes.

Mr. PECORA. And it is that sort of thing which the exchange does not like to have done, is it not?

Mr. WHITNEY. If there are no improper transaction connected with such an operation my answer is that the exchange does not object. The exchange has no objection to a man or a pool bidding 40 for 5,000 shares and offering 5,000 shares at 40⅛. None whatsoever.

Mr. PECORA. Is it easily possible for a group operating through the medium of a pool to exercise temporarily, at least, or for the purposes of the operation, a control of the market price?

Mr. WHITNEY. I will answer yes, sir; on the conditions——

Mr. PECORA. The market price of a given security?

Mr. WHITNEY. As long as the stock and their money hold out, yes.

Mr. PECORA. Yes. And to that extent those persons are enabled to exercise a control, are they not?

Mr. WHITNEY. By bidding and offering; yes.

Mr. PECORA. By bidding and offering. Now, what steps, if any, does the exchange take to prevent that kind of control?

Mr. WHITNEY. I do not know of any, Mr. Pecora.

Mr. PECORA. When such a pool is operating and effecting such a control it is restricting a free and open market where honest values can be obtained, is it not?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. No, sir.

Mr. PECORA. Is it not?

Mr. WHITNEY. No, sir. And there are hundreds of individuals that can do the same thing. A man may bid 40 for 5,000 shares and offer 5,000 shares at 40⅛. I can do it. Any member of the exchange. I do not call that a restricting of a free and open market. The world can take that stock from me or sell that stock to me.

Mr. PECORA. When I said "restricting" I meant restriction to the extent that such an operation would bring about an artificial stimulation of prices.

Mr. WHITNEY. Mr. Pecora, I am afraid I can not agree with what you have in mind, if I understand you correctly. If you will give me a specific instance of where you believe the operation of a pool has been improper I will gladly give you my opinion.

Mr. PECORA. Well, take, for instance, the many pools that by common report were operating on the stock exchange in various securities such as Anaconda Copper and Radio in 1929. You heard those common rumors or reports, did you not, Mr. Whitney, at the time?

Mr. WHITNEY. Yes, sir; and I have investigated them.

Mr. PECORA. What investigation was made?

Mr. WHITNEY. Well, it is quite long. If you care to I would like to put it in the record. I have got it here. I have got the accountants' reports with regard to it.

Mr. PECORA. How many pools did you find had operated in 1929 in the exchange?

Mr. WHITNEY. That I can not tell you. That would be a matter that only the business conduct committee could give you. With relation to the Anaconda pool—the two Anaconda pools, and the radio pool, I went into that at some length and have the facts before me.

Mr. PECORA. Did you find that pools had been operated in those stocks in 1929?

Mr. WHITNEY. We did.

Mr. PECORA. And did you find that as a result of those pool operations artificial prices were for the time being established?

Mr. WHITNEY. We did not, except in one instance.

Mr. PECORA. In which instance?

Mr. WHITNEY. Where there was an incorrect sale or an improper sale by accident purely, made in 35,000 shares of Greene Cananea stock.

Mr. PECORA. An accidental sale, you say?

Mr. WHITNEY. Yes, sir; improper execution of the order given to the broker. The broker made an error.

Mr. PECORA. How long after the making of the error was its commission first noticed in that particular case, Mr. Whitney?

Mr. WHITNEY. That I can not tell you.

Mr. PECORA. Was it not something like a month?

Mr. WHITNEY. I do not truly know. Again I would have to refer to the records of the business conduct committee.

Mr. PECORA. Did you cause that transaction to be fully explored?

Mr. WHITNEY. Did I? Yes; last spring, or last summer.

Mr. PECORA. Is it not a fact that the authorities did not learn of that until something like two or three years after the commission of the operation?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. I just said I can not tell you that without referring to the records of the business conduct committee, sir.

Mr. PECORA. Why was the investigation which you caused to be made delayed until the summer of 1932?

Mr. WHITNEY. Because there were references made to these various pools, sir, in the investigation last spring, and I wished to acquaint myself with the facts and to present them to the members of the New York Stock Exchange.

Mr. PECORA. Did you personally make the investigation?

Mr. WHITNEY. No, sir; the accountants of the exchange did, though.

Mr. PECORA. But they reported their conclusions to you?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. And their conclusions were that in that particular instance there was a mistake? Is that right?

Mr. WHITNEY. An absolute mistake, an accident, yes.

Mr. PECORA. Did they report how long a period of time elapsed before the mistake or accident was discovered by anybody?

Mr. WHITNEY. It was discovered almost momentarily. And if I remember, Mr. Pecora—this is gathering a little momentum in my brain, because if I remember rightly I was chairman of the business conduct committee at that time—I may have been; I am not quite sure——

Mr. PECORA. Are you through?

Mr. WHITNEY. No.

Mr. PECORA. Go ahead.

Mr. WHITNEY. That that transaction was reported, the accident of it, to the business conduct committee within 10 or 15 minutes after it occurred, or shortly thereafter.

Mr. PECORA. Whom did you find to be responsible for that accident or mistake?

Mr. WHITNEY. A broker on the exchange. A misunderstanding of an order given. The order was for immediate execution, and he considered it a day order in error.

Mr. PECORA. Now, if that broker, as you say, discovered the mistake within 15 minutes after he had made it, do you know whether any announcement was made of the commission of that mistake in a transaction involving 35,000 shares?

Mr. WHITNEY. I do not think there was any announcement because no harm had been done in so far as our investigation shows.

Mr. PECORA. Did not the price of that stock go up as the result of that mistake?

Mr. WHITNEY. Not that I know of.

Mr. PECORA. Have you any data which indicates whether it did or not?

Mr. WHITNEY. Just one minute, please [looking over some papers]. My answer to that, Mr. Pecora, is that the stock—I don't know that the stock went up on future days, on subsequent days, but I do know that the pool that was operating in that stock never sold any stock on balance on future days, and were always buyers on balance, and finally distributed their entire holdings in the stock to the participants of the pool. They distributed no stock thereafter on balance.

Mr. PECORA. Did you learn what effect that mistake had on the quotations for that stock at the time of the commission of the mistake?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. Now, I have got to go back to the records of the business conduct committee, which I have not in mind, unless we have them here. Let me see——

Senator TOWNSEND. It is now 10 minutes of 1. It has been suggested that the committee take a recess until 2.30 o'clock this afternoon.

Mr. PECORA. Mr. Whitney, suppose you look at that during the recess and see if you can answer the question.

Mr. WHITNEY. All right. I do not have the records here.

Mr. PECORA. The testimony of the broker who claimed to have made the mistake was that the stock jumped four points as a result of that 35,000-share transaction.

Mr. REDMOND. And it immediately went back, didn't it? I think it was something that went up and down for a minute.

Mr. PECORA. The stock jumped from 192 to 196, he says.

Mr. WHITNEY. What page is that on?

Mr. PECORA. It is on page 810, and Mr. Fayne testified to that effect.

Mr. WHITNEY. It might have been so, but we could not have done anything about it after that.

Senator TOWNSEND. The committee is now in recess until 2.30 o'clock this afternoon.

(Whereupon, at 12.50 p. m. the subcommittee recessed until 2.30 o'clock p. m. the same day.)

AFTER RECESS

The subcommittee resumed at 2.30 o'clock p. m. on the expiration of the recess.

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

TESTIMONY OF RICHARD WHITNEY, PRESIDENT, NEW YORK STOCK EXCHANGE, NEW YORK CITY—Resumed

Mr. PECORA. You recognize, don't you, Mr. Whitney, that the New York Stock Exchange through its facilities for trading in securities probably constitutes the greatest market for securities in this country, if not in the world?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. And that its daily quotations of the trades executed on its floor are accepted as substantial evidence of the value of the securities to which they relate?

Mr. WHITNEY. Yes, sir; at that time.

Mr. PECORA. Yes; at that time.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. And that the securities listed on the exchange which are the subject of its transactions are freely accepted as collateral by banks to support loans?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. And that they are much more readily accepted as collateral because they are listed on your exchange than they would be if they were not so listed, isn't that so?

Mr. WHITNEY. I believe that is true.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. So that the operations, the trades, which take place daily on the stock exchange are of interest to the entire country because of the relationship which those trades bear to the value of securities traded in?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. The stock exchange, as now constituted, is subject to no official regulatory power, is it?

Mr. WHITNEY. Well, it is not an incorporated company if that is what you mean?

Mr. PECORA. No. You know of no public agency that exercises any regulatory power over it, do you?

Mr. WHITNEY. I know of none that has been exercised, yes.

Mr. PECORA. You know of none that has the power of exercising regulation over its affairs, do you?

Mr. WHITNEY. I will grant that there is none, Mr. Pecora. From a legal point of view I perhaps do not follow you, but I will grant it.

Mr. PECORA. The stock exchange has consistently resisted all efforts to subject it to official regulation of some kind or other, has it not?

Mr. WHITNEY. No, sir. They have resisted efforts toward its incorporation, believing that if it were incorporated it would take away the most salutary and most important powers that it now has in controlling the conduct of its members.

Mr. PECORA. Do you think that that power could not be just as well exercised under State or Federal supervision of some kind?

Mr. WHITNEY. By incorporation?

Mr. PECORA. Yes.

Mr. WHITNEY. I do not.

Mr. PECORA. As it now stands the stock exchange has absolutely autocratic power over the discipline of its members.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. And over the conduct of members on its floor?

Mr. WHITNEY. By its members; yes, sir.

Mr. PECORA. By its members I mean.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Now, the course of market values evidenced by trade on the stock exchange has an effect on bank loans, for instance, that are secured by so-called stock exchange collateral, has it not?

Mr. WHITNEY. The prices at which shares sell, certainly, yes, as they fluctuate.

Mr. PECORA. As prices move up or down notice is taken of the movement of prices by banks that have made loans secured by stock exchange collateral.

Mr. WHITNEY. Correct, the same as the movements of shares up and down off the exchange are taken cognizance of.

Mr. PECORA. But most of the securities which are the subject of daily trades are listed on the exchange, aren't they? You would not, for instance, compare the volume of over-the-counter trades with the volume of stock exchange trades, would you?

Mr. WHITNEY. No, perhaps not; and yet I would not know. There is a large volume of trading on the New York Curb Exchange, and there is a large volume of trading at times over-the-counter in securities.

Mr. PECORA. But their volume does not compare with the volume of transactions on the New York Stock Exchange, do they?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. I do not believe that the volume of transactions in bonds, and even in listed bonds is otherwise than greater over-the-counter than on the floor of the exchange.

Mr. PECORA. Is that true with respect to stocks, common and preferred?

Mr. WHITNEY. Not with regard to those that are listed, no, sir.

Mr. PECORA. If prices of listed stocks move downward as a result of manipulation by members of the Stock Exchange, or by customers dealing through members of the Stock Exchange, such a thing would have its echoes in the offices of banks holding collateral for loans, and would frequently constitute a reason for the calling of additional margin from the borrowers. That is true, isn't it?

Mr. WHITNEY. Yes, sir; if such manipulation takes place.

Mr. PECORA. Have you ever heard of any such manipulations taking place?

Mr. WHITNEY. For the downswing?

Mr. PECORA. Either for the downswing or for the upswing.

Mr. WHITNEY. I have known operations to take place, as you referred to this morning, pool operations for the upswing. I do not know of manipulations by groups or syndicates or pools for a downswing. There has been a great deal of rumor to that effect but I do not know of it.

Mr. PECORA. Well, then, let us confine ourselves for the time being to manipulations for the upswing: Those manipulations may be of a character to excite activity on the part of the public, and attract it to those stocks that are subject to that kind of manipulation.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. And to that extent the investing public might be tempted to buy securities at prices which have been made as a result of such manipulation, isn't that so?

Mr. WHITNEY. Possibly, more particularly perhaps the speculating public.

Mr. PECORA. Do you know what proportion of the trades which are made on the floor of the New York Stock Exchange represent speculative buying and what proportion represent investment buying?

Mr. WHITNEY. No, sir. But I would say that in 1927, 1928, 1929, and 1930 the proportion was far greater as to speculative buying as against what has happened since that day, where the ratio has turned very much I believe to investment buying.

Mr. PECORA. How is speculative buying, as it is indulged in through the medium of the stock exchange, to be distinguished from investment buying? What are the earmarks of it?

Mr. WHITNEY. Do you mean between speculation and investment?

Mr. PECORA. Yes, sir.

Mr. WHITNEY. I have always felt that that depended upon the intent of the individual.

Mr. PECORA. But what are the outward and visible evidences, as they would appear to you——

Mr. WHITNEY. When the purchases are made——

Mr. PECORA (continuing). Evidences of whether buying is for speculative account or for investment account?

Mr. WHITNEY. From watching trades on the floor?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Well, I am asking how you would determine what kind of buying is speculative buying and what kind is investment buying. That leaves you free to describe them.

Mr. WHITNEY. One could not determine without knowing what the buying was.

Mr. PECORA. Where the stock of a particular corporation is made the subject of an unusual amount of trading on one day or on a series of days, wouldn't that unusual amount of trading have a strong tendency to indicate that most of it was for speculative account?

Mr. WHITNEY. It is very possible.

Mr. PECORA. You know of many instances where the number of shares of a certain stock dealt in during the course of a few days, would exceed the total number of shares of capital stock that that corporation had do you not?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Surely a case of that sort would indicate that most of the buying was for speculative purposes, wouldn't it?

Mr. WHITNEY. In the particular cases that I do know of the buying and selling were both for speculative purposes.

Mr. PECORA. Yes. Would it be fair to say that investment buying would be evidenced by the actual registration of certificates on the books of the issuing company or with its registrar?

Mr. WHITNEY. Not necessarily, unless it was a dividend-paying stock. Then eventually investment buying would be registered on the books.

Mr. PECORA. Do you know or have you any means of knowing what proportion of the transactions on the floor of the stock exchange result in a change of ownership on the books of the issuing corporation?

Mr. WHITNEY. No, sir; I do not know.

Mr. PECORA. If you were to venture an opinion on that you would say it is a very small percentage, wouldn't you?

Mr. WHITNEY. It would depend very greatly in the particular period you referred to. As I have said to-day, and for the last few years, the ratio or proportion would be far greater than would have been true in 1929, 1928, and 1927. That is my judgment. The investment buying to-day is very tremendous, as shown by the terrific increase in the number of stockholders in our corporations.

Mr. PECORA. The volume of buying and selling to-day is much less than it was in 1928 and 1929.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. What proportion of the transactions to-day—and I am speaking merely of the present period rather than of this calendar day—are transactions in which the change of ownership of the securities dealt in is evidenced by registration or transfer on the books of the company?

Mr. WHITNEY. I have no idea, sir. But to-day, with the few stocks paying dividends, or we will say the many stocks that are not dividend payers, there is not the necessity for such transfer that there was when they were dividend payers.

Mr. PECORA. Do you think that speculative buying and selling are evidenced more in nondividend-paying securities than in dividend-paying securities?

Mr. WHITNEY. No; not necessarily. What I meant to say was, as to finding out the actual facts regarding the question that you previously asked, I do not know how that fact could be determined.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Would you say that, by and large, the greater percentage of the transactions on the floor of the stock exchange are speculative transactions as distinguished from investment transactions?

Mr. WHITNEY. As compared with the case in recent months, and recent years, no. But in 1929, 1928 and 1927, perhaps, yes.

Mr. PECORA. Do you say "perhaps, yes"?

Mr. WHITNEY. Yes.

Mr. PECORA. Aren't you willing to give an unqualified opinion to that effect?

Mr. WHITNEY. Yes; I will give that opinion. I do not know, but I think so. I do not think it is so now.

Mr. PECORA. Speculative transactions as a rule are margin transactions, aren't they?

Mr. WHITNEY. They may very well be.

Mr. PECORA. Aren't they as a rule, to your knowledge?

Mr. WHITNEY. Well, they may be. It depends on how far you wish to extend your understanding of "margin." It may be a speculative transaction and not on margin, but by a collateral loan not made through a brokerage house. The situation to-day is that in the brokerage houses their loans have been steadily coming down and have been fairly dormant at a fairly low level.

Mr. PECORA. The reverse of that situation was true in 1928 and 1929, wasn't it?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. What, if anything, did the authorities of the stock exchange do in those years toward exercising vigilant supervision over or scrutiny of speculative buying?

Mr. WHITNEY. Supervision by the business conduct committee over the financial conditions of their houses, and with respect to margins a demand for a far greater margin on the part of our houses.

Mr. PECORA. How were those demands for far greater margin evidenced?

Mr. WHITNEY. By the frequent, continual contact of the business conduct committee and its representatives and the accountants of the exchange with our houses.

Mr. PECORA. To what extent were the margin demands increased?

Mr. WHITNEY. The margin demands by the business conduct committee?

Mr. PECORA. Yes.

Mr. WHITNEY. The actual margin considered necessary was 25 per cent or more, together with the fact—and all this I have said in the past—together with the fact that the rule was that any account must carry itself. And during that period certain stocks selling at high prices were not accepted as collateral at anywhere near the prevailng market price.

Mr. PECORA. That was due, wasn't it, to a recognition by lending institutions that market prices were way out of line with intrinsic values?

Mr. WHITNEY. That I do not know, Mr. Pecora. It might have been a recognition on their part that the fluctuations in those high-priced stocks were very great, as they were.

Mr. PECORA. I believe you delivered an address yesterday before the Cleveland Chamber of Commerce, did you not?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. I did.

Mr. PECORA. I have not had access to your entire address, but I read some paragraphs from it in one of the newspapers last evening.

Mr. WHITNEY. Here it is.

Mr. PECORA. What I read indicated that, among other subjects, you discussed inflation of prices of securities.

Mr. WHITNEY. Yes, sir; I did.

Mr. PECORA. You were referring to inflation of security values in 1927, 1928 and 1929, weren't you?

Mr. WHITNEY. Particularly to 1929 in what I said, or to 1928 and 1929.

Mr. PECORA. Those two years particularly witnessed a very strong, so-called bull market, did they not?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. In the course of the making of that bull market did you detect an unusual inflation of security values?

Mr. WHITNEY. Did I detect it?

Mr. PECORA. Yes, sir.

Mr. WHITNEY. At that time?

Mr. PECORA. At that time; yes.

Mr. WHITNEY. No, sir.

Mr. PECORA. Well, from the perspective of time since 1929 do you now recognize that an unusual inflation of values was brought about during that bull market?

Mr. WHITNEY. Yes; that has been true, I think.

Senator BROOKHART. Just a minute, on that proposition: Mr. Whitney, neither you nor any other of the financial leaders detected that great inflation at the time, did you?

Mr. WHITNEY. I thank you for the compliment, Senator Brookhart, but I had many times felt that the market was running away with itself, as did many others, and that we were going to pay for it very seriously. But because the market continued to go up I think we were all fooled.

Senator BROOKHART. You made an official report to this committee on that proposition, didn't you, in which you said that neither the financial leaders nor the political leaders detected the inflation of values in the market at that time.

Mr. WHITNEY. I do not think that my statement was quite as comprehensive as that.

Mr. PECORA. Isn't that what you said in substance just a moment ago in answer to a question of mine?

Mr. WHITNEY. In substance; yes, sir.

Senator BROOKHART. Have you a copy of your report as President of the New York Stock Exchange with you?

Mr. WHITNEY. The annual report?

Senator BROOKHART. Yes, the annual report, and, I think, the last one.

Mr. WHITNEY. No, sir; we have not. But we can easily get it for you.

Senator BROOKHART. Well, I have it in my office, but did not bring it with me. I should have brought it along. In that you have stated that political leaders, the last three Presidents and the big financial leaders, none of them saw the great inflation that had taken place until after the collapse.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. I grant it, Senator Brookhart. I do not think the majority of the people did see it or it would not have gone as far as it did. I think there were various warnings by economists and others, but the surge upward continued, and the country, perhaps some leaders, but individuals and everybody, were fooled terribly.

Senator BROOKHART. I know that Senator Shipstead made a speech discussing this question in 1925, in which he analyzed its course quite fully, even that far back, and there were several of us that commented on it in Congress. I know that I wrote an article myself 5 months before the crash in which I said we were headed into the greatest panic in the history of the world. And that is the way it came out, isn't it?

Mr. WHITNEY. I think it was.

Mr. PECORA. Mr. Whitney, can you account either for the failure or the inability of stock-exchange authorities to recognize that inflation while it was in the making during the bull market of 1928 and 1929?

Mr. WHITNEY. The exchange authorities, Mr. Pecora, do not pretend as such to evaluate securities or prices. But I do not doubt that there were various partners in stock exchange firms and members of stock exchange firms who were members of the exchange, who felt that the inflation was getting out of hand. I know of some. But their views were not heard by the public or by the majority of the people throughout the country. The stock exchange does not evaluate prices.

Mr. PECORA. Is there any reason why the stock-exchange authorities should hold themselves detached from that duty or responsibility?

Mr. WHITNEY. I cannot see that it is a duty or a responsibility. We do not control prices. The stock exchange neither buys nor sells any securities.

Mr. PECORA. But the operations of the members of the exchange have the effect of maintaining prices or of establishing prices, do they not?

Mr. WHITNEY. Absolutely; yes.

Mr. PECORA. And those operations have their repercussions throughout the country, have they not?

Mr. WHITNEY. In their buying and selling of shares on the exchange upon order, yes, sir; or if they do it for their own account.

Mr. PECORA. Prices of commodities are often affected by quotations on securities, are they not?

Mr. WHITNEY. It is supposed to be so, and vice versa.

Mr. PECORA. What is your personal opinion on that?

Mr. WHITNEY. I do not believe that it has a tremendous influence one way or the other. I think the trends up or down are apt to be together, but we have seen, in 1929 and 1928, where commodity prices were not going up but were coming down, and yet security prices were going up. So I think there is no real proof of it.

Mr. PECORA. As you look back upon the bull market of 1928 and 1929 you have no difficulty now in realizing and understanding that that market was accompanied by a very considerable inflation of securities values.

Mr. WHITNEY. That has been the result; yes.

Mr. PECORA. You mean that you now can readily see that that was what happened in 1928 and 1929?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. That is what happened. There is no question about it.

Mr. PECORA. Why wasn't it possible to perceive at that time that it was happening?

Mr. WHITNEY. Mr. Pecora, you are talking about judgment of hindsight. We did not have it then, nor did but very few, if any, have it then.

Mr. PECORA. Didn't prices of certain securities that had never paid a dividend go up into the hundreds of dollars a share during that bull market?

Mr. WHITNEY. I believe so. But the New York Stock Exchange did not put them there.

Mr. PECORA. The New York Stock Exchange gave its facilities to operations that resulted in putting those prices there, did it not?

Mr. WHITNEY. The New York Stock Exchange as a market place did. That is, it offered a market place for the exercise of supply and demand.

Mr. PECORA. Mr. Whitney, don't you think that becaue the New York Stock Exchange, through its market place which is open to the public, offers that opportunity, it owes some measure of responsibility to the public to watch those prices and when they get out of line to sound some kind of public warning?

Mr. WHITNEY. If you will tell me, Mr. Pecora, how I, as president of the New York Stock Exchange, might do that I will be glad to have you do so, and will endeavor to act accordingly. But I will say that if the president of the New York Stock Exchange at that time had issued such warnings, in the first place he would have been attempting to evaluate securities, and in such effort he would have been speaking as an individual, and I think he would have been laughed at.

Mr. PECORA. Does the New York Stock Exchange particularly avoid any effort to evaluate securities?

Mr. WHITNEY. We do not think it is our duty in any way to do so.

Mr. PECORA. And you sedulously avoid doing so, don't you?

Mr. WHITNEY. It being not our duty; yes.

Mr. PECORA. Since you consider it is not your duty, you avoid doing it?

Mr. WHITNEY. Because neither our duty nor within our province; yes, sir.

Mr. PECORA. In view of the fact that through the maintenance of those facilities afforded by the New York Stock Exchange it is the most important market place for trading in securities, and in view of the fact that the quotations of security prices on the New York Stock Exchange have a nation-wide effect, don't you think that the stock exchange could very well conclude that it might be its duty, or that it owes some measure of responsibility to the public, to protect it from a feverish or artificially stimulated activity?

Mr. WHITNEY. No, sir. I do not see how it could do it, Mr. Pecora. I do not think that the New York Stock Exchange has either the facility or the ability to be the oracle as to how prices should fluctuate, or to set forth whether a price is too high or too low. If I might illustrate: I have frequently during the last few months averred that the people of this country were trying to sell the United

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

States short. I think security prices are far too low. But it has not done any good.

Senator BROOKHART. Well, you are always on that side of the market on the stock exchange, aren't you?

Mr. WHITNEY. Do you mean that I am?

Senator BROOKHART. Yes.

Mr. WHITNEY. No, sir.

Senator BROOKHART. You are always wanting to draw the public in and to have them buy more. That is the general position of the New York Stock Exchange and of its members, isn't it?

Mr. WHITNEY. Well, I do not know, Senator Brookhart, whether we try to draw the public in to buy more or to sell more. But at the same time the action of the public through stock exchange members has been predominantly on the other side in the last two or three years.

Senator BROOKHART. They have been on the buying side of the market, haven't they?

Mr. WHITNEY. They have sold more than they have bought.

Senator BROOKHART. That is, the professionals?

Mr. WHITNEY. No; I am talking about the real buyers.

Senator BROOKHART. Well, they are the fellows who had to sell because of economic conditions generally?

Mr. WHITNEY. Not necessarily. Again I think many have sold merely because they felt it was best to sell.

Senator BROOKHART. Well, now, if telling them to buy and that this stuff is too low, does not take us out of the depression what do you think will take us out?

Mr. WHITNEY. Restoration of confidence in this country.

Senator BROOKHART. Well, what do you do particularly to restore confidence? Apparently they have not got confidence back in the New York Stock Exchange.

Mr. WHITNEY. Well, that is a very large economic question, Senator Brookhart.

Senator BROOKHART. But you are representing a very large trading institution, the largest the world has ever known, and you ought to be able to answer some pretty large questions.

Mr. WHITNEY. Well, do you wish to have my personal opinion? If so, I will be very glad to give it.

Senator BROOKHART. Well, that is what I want.

Mr. WHITNEY. Well, I think the Government Budget must be balanced. That is No. 1. And next——

Senator BROOKHART (interposing). How would you balance the Budget?

Mr. WHITNEY. By decreasing expenditures throughout the country.

Senator BROOKHART. You would cut out, for instance, the soldiers' compensation in the way of nonservice-connected disabilities, would you?

Mr. WHITNEY. I would.

Senator BROOKHART. You are a member of the National Economy League, are you?

Mr. WHITNEY. I am.

Senator BROOKHART. And you would change, then, the whole 150 years of American history on that proposition, would you?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. I would give to veterans who had been injured or affected by the war every care in the world, and to their dependents.

Senator BROOKHART. But if they had suffered injuries since the war you would tell them to go to the poorhouse, would you?

Mr. WHITNEY. If their injuries were in no way attributable to the war I wouldn't think the Government is called upon to help them.

Senator BROOKHART. Then you think that George Washington, when he recommended land grants to soldiers of the Revolution regardless of disability, was wrong?

Mr. WHITNEY. I think that was for the purpose of colonization.

Senator BROOKHART. Well, we had land in those days, and now we have profits, or at any rate when speculation is going on. And you would think what they did after the War of 1812 was wrong in the way of giving pensions to nonservice-connected disabilities.

Mr. WHITNEY. I do not know the details of that matter.

Senator BROOKHART. And you think the Government did wrong after the Mexican War. There are still some Mexican War pensioners, and evidently they did not get their disability in the war.

Mr. WHITNEY. As to that I do not know.

Senator BROOKHART. And as to the Civil War, that was all wrong, was it?

Mr. WHITNEY. I did not say it was all wrong. I am only expressing myself as to——

Senator BROOKHART (interposing). But it is wrong for Spanish-American veterans and World War veterans, you say that?

Mr. WHITNEY. No; I do not say, because I can not compare one with the other for the reason that I do not know. But I do think that any man who fought in the war, and any dependents of such men as fought in the war and were injured or killed, should have proper care from our Government. On the other hand, that able-bodied men should be given money for having fought in the war, I can not see that in these days of this Government's situation.

Senator BROOKHART. And your theory is that they came out of the war in as good physical condition as when they went in, and therefore they are not entitled to any consideration from the Government?

Mr. WHITNEY. If they did not come out of the war in that condition they should be taken care of. On the other hand, if they did come out of the war in good shape, in as good shape as when they entered, they should not be taken care of by the Government.

Senator BROOKHART. You know that the most of them were drafted into the war at a dollar a day, don't you?

Mr. WHITNEY. Yes, sir; and a great many others were drafted during the war for nothing a day.

Senator BROOKHART. Those dollar-a-year men who made a million or two dollars on the side in the way of profit; do you mean those?

Mr. WHITNEY. I do not know anything about a million dollars on the side in profits.

Senator BROOKHART. Those men that were drafted and paid a dollar a day, suffered economic damage at the hands of the Government, didn't they?

Mr. WHITNEY. That I do not know, Senator Brookhart.

Senator BROOKHART. You know that the most of them did. You know that that was not adequate pay for the most of those men, don't you?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. Well, I think they had a duty toward their country. Some one had to fight.

Senator BROOKHART. Yes; some one had to fight in order to maintain the New York Stock Exchange, for instance.

Mr. WHITNEY. No, sir. The New York Stock Exchange was closed during a part of the Great War.

Senator BROOKHART. And I am sorry it has not stayed closed ever since. [Laughter.] Now then, you would balance the Budget and you would cut off $300,000,000 of expense by means of that item that you mentioned. And I know what it is, because I have been through it recently. But that would not balance the Budget.

Mr. WHITNEY. It would not seem so; no.

Senator BROOKHART. What else would you do in order to balance the Budget?

Mr. WHITNEY. I was trying to tell you. Curtailment of Federal, State, county, municipal expenditures throughout the country.

Senator BROOKHART. Well, in the matter of State governments I can not go into that, but what would you take out there?

Mr. WHITNEY. I am not a lawmaker, sir. But I am sure that expenditures could be curtailed by a great deal.

Senator BROOKHART. Well, what items do you think of that could be curtailed?

Mr. WHITNEY. I must answer there that I am not a lawmaker, sir.

Senator BROOKHART. But you are a financier and you ought to know something about these matters of finance. If you are going to balance the Budget by reducing expenditures you ought to have some bill of particulars to present. It ought not to be all a matter of glittering generalities. I want to know what else you would do besides cutting off the soldiers' compensation.

Mr. WHITNEY. I think that salaries might be reduced. [Laughter in the room.]

Senator BROOKHART. I will agree with you on that. Here was Mr. Mitchell who came before this subcommittee and showed that he had a salary and compensation of $1,200,000 a year. That ought to be reduced in some way.

Mr. WHITNEY. I never knew that Mr. Mitchell was working for the Government.

Senator BROOKHART. Well, he was working for a corporation that the Government chartered. You knew that, didn't you?

Mr. WHITNEY. Yes, sir; but——

Senator BROOKHART (interposing). And you knew that the Government could regulate those salaries, too. By the way, how much salary do you get?

Mr. WHITNEY. As what?

Senator BROOKHART. As president of the New York Stock Exchange?

Mr. WHITNEY. Nothing.

Senator BROOKHART. How much salary do you get with Whitney & Co.?

Mr. WHITNEY. Very little in the last few years.

Senator BROOKHART. Well, how much is that? I want to find out what very little is in your opinion.

Mr. WHITNEY. Do you mean in 1932?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. Yes.

Mr. WHITNEY. I think I received approximately $60,000.

Senator BROOKHART. Well, that would be as much as the salary received by six United States Senators. I think you ought to be reduced. [Laughter in the room.]

Mr. WHITNEY. That is a return on efforts and business and capital and one thing and another, Senator Brookhart. I am not paid as president of the New York Stock Exchange, although I have given practically my entire time to that work for three years.

Senator BROOKHART. Then that is just a labor of love altogether, is it? [Laughter in the room.]

Mr. WHITNEY. I am interested in the institution; yes, sir.

Senator BROOKHART. Well, I know some railroad presidents that draw $125,000 a year.

Mr. WHITNEY. I draw no salary from my firm, if you please.

Senator BROOKHART. In fact, I know of a long string of salaries that I think ought to be reduced that are collected out of the people, out of soldiers and farmers and different people by way of economic taxation if not by governmental taxation, and the most of those are subject to regulation in interstate commerce. So I agree with you that there are a lot of salaries in this country that ought to be reduced. But the $1,600 Government employee I do not think is getting any too much. What do you think about that?

Mr. WHITNEY. If all expenditures of the Government have got to be reduced it seems to me everybody must take his share in it. And I rather think the railroad presidents you refer to are themselves taking reductions in their salaries, and they are also paying very large income taxes.

Senator BROOKHART. But after they reduce them they have left seven or eight times as much as a United States Senator receives.

Mr. WHITNEY. I have known United States Senators to take positions that also had large remuneration.

Senator BROOKHART. Well, they might get to be attorney for the New York Stock Exchange or something of that kind and get big pay. [Laughter in the room.]

Mr. WHITNEY. That is quite an idea.

Senator BROOKHART. Now, let us see: I want to know a little more about balancing the Budget because we have not got very far along that line yet. How much would you cut out of salaries?

Mr. WHITNEY. Senator Brookhart, I am not competent to speak of those detailed affairs with regard to governmental expenditures.

Senator BROOKHART. You do know that when they get down to it they figure $200,000,000 or about that as all they can reduce in the way of Government expenditures. Then the Economy League, of which you are such a prominent member, wanted to reduce the soldiers about three hundred or four hundred million dollars more. Those two items would not balance the Budget, would they?

Mr. WHITNEY. Not from what I hear.

Senator BROOKHART. Where will we get the money needed to balance it, then?

Mr. WHITNEY. I do not know where you can get the money to balance the Budget.

Senator BROOKHART. Are you for a sales tax?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. Yes, sir. I do not see where the additional revenue needed can be got in order to balance the expenditures of the Government, and therefore Government expenditures must be reduced.

Senator BROOKHART. But you think after they are reduced as far as we can, we will still have to have a sales tax in order to balance the Budget, do you?

Mr. WHITNEY. That or some other tax that would bring in revenue, yes.

Senator BROOKHART. Well, a sales tax is the one you advocate first, is it?

Mr. WHITNEY. I have, and——

Senator BROOKHART (interposing). All right. Now let us put that on sales on the stock exchange. What do you say to that?

Mr. WHITNEY. It has been put on.

Senator BROOKHART. What is it now? What is the rate?

Mr. WHITNEY. Now it is 5 cents as a Government tax, and 4 cents to New York State. It is a sales tax.

Senator BROOKHART. Four and five cents on what?

Mr. WHITNEY. Per share.

Senator BROOKHART. On the $100?

Mr. WHITNEY. On $100 par, but they may sell very much below and do.

Senator BROOKHART. Supposing we put the same rate of sales tax on stocks, on speculative sales and all, that you want put on commodities in general, what do you say to that?

Mr. WHITNEY. It is very much higher than any suggested general sales tax that I know of, that is generally suggested by anybody. It is already a sales tax.

Senator BROOKHART. I understand that it is a sales tax, but the rate on it that you have mentioned is only a fraction of what is proposed to be put on commodities.

Mr. WHITNEY. I don't think you will find that it works out that way with present prices of securities.

Senator BROOKHART. Well, then, you would favor putting a sales tax on every speculative sale just the same as on sales of various commodities, five per cent or something like that?

Mr. WHITNEY. We were talking about a general sales tax. There is already a sales tax on stock transactions.

Senator BROOKHART. But it is so light. It is not anything like 5 per cent of those sales.

Mr. WHITNEY. I have never heard it suggested to put a 5 per cent sales tax on.

Senator BROOKHART. Yes, Senator Glass offered a bill to levy 5 per cent sales tax on all resales that are made within 60 days, and I am suggesting now that we extend that to all sales so that the stock exchange will get under this sales tax just the same as other folks.

Mr. WHITNEY. As I understand, taxation is sought in order to collect revenue, and you will not collect revenue by any such tax.

Senator BROOKHART. Why wouldn't we?

Mr. WHITNEY. Because the volume would be stifled and smothered by a prohibitive tax to that extent.

Senator BROOKHART. In other words, it would stop the stock gambling down there and speculation?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. I think there is extremely little stock speculation at the present time.

Senator BROOKHART. You are not in favor of stopping that speculation?

Mr. WHITNEY. I am not, or any speculation in this country.

Senator BROOKHART. I am. That is where we differ on that proposition.

Now, let us see: Balancing the budget you think would bring back prosperity?

Mr. WHITNEY. Yes, sir; it would be a contributing cause. Yes.

Senator BROOKHART. Is there anything else necessary to do?

Mr. WHITNEY. Yes. I think there are a great many things to do to bring back confidence.

Senator BROOKHART. Do you think we can have prosperity as long as agricultural products are down on the present level?

Mr. WHITNEY. I think that is one of the things that need to be rectified, sir, and I think it is by a resumption of international trade, and probably only by a resumption of international trade, that you will get an increase in agricultural prices.

Senator BROOKHART. Of course, you know the industrial prices are protected by special laws of the country, and agriculture is entitled to the same kind of a consideration, is it not?

Mr. WHITNEY. I understand it is protected by certain laws.

Senator BROOKHART. Do you understand that tariff rates protect agriculture now?

Mr. WHITNEY. I believe there is quite a high tariff on wheat, is there not?

Senator BROOKHART. Yes, and wheat is selling for less than the tariff. So it does not protect.

Mr. WHITNEY. There is an oversupply.

Senator BROOKHART. It was a citizen of your own city, your own State, Alexander Hamilton, that said we would have to protect agriculture with bounty; said that when he presented the first tariff bill to the first Congress of the United States. Would you be in favor of doing that?

Mr. WHITNEY. No, sir. I think there are better ways of doing it.

Senator BROOKHART. What is the way?

Mr. WHITNEY. Resuming international trade.

Senator BROOKHART. That can not be done without the other fellow in the other country agrees to it, can it?

Mr. WHITNEY. That is true, I presume.

Senator BROOKHART. And at present they are all putting up barriers against it. Unless we can get new treaties that will not get anywhere, will it?

Mr. WHITNEY. Unless we can get new treaties.

Senator BROOKHART. Yes. Well now, what are you going to do with these 12,000,000 laborers that are unemployed? Can we have prosperity as long as 12,000,000 men are out of jobs and the president of the stock exchange drawing a $60,000 a year salary?

Mr. WHITNEY. I do not draw a salary, sir. I am sorry.

Senator BROOKHART. Not as president of the exchange, but you draw it in the other business.

Mr. WHITNEY. Not as a salary at all. At the risk of the business.

Senator BROOKHART. Did it in speculation, is that the way?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. No, sir.

Senator BROOKHART. But what about these 12,000,000 unemployed? What are you going to do with those?

Mr. WHITNEY. I think the 12,000,000 unemployed are going to be taken care of if prosperity returns, and if you get a basis for a return of prosperity——

Senator BROOKHART (interposing). How are you going to get a return of prosperity? That is what I am trying to find out.

Mr. WHITNEY. I have been trying to explain what my small ideas are in that regard, Senator. One must leave those matters to the lawmakers of the country.

Senator BROOKHART. I may be pretty dumb, but I have not found out yet how you are either going to balance the Budget or bring back the prosperity.

That is all, Mr. Pecora.

Mr. PECORA. Now, Mr. Whitney.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. You said in answer to the last question I put to you that the exchange has pronounced its views publicly with regard to selling America short.

Mr. WHITNEY. I said that I had stated that.

Mr. PECORA. That is, you have stated it in your individual capacity——

Mr. WHITNEY. Entirely.

Mr. PECORA. Or as a representative of the exchange?

Mr. WHITNEY. I have stated it here, and I was here in an official capacity, I presume.

Mr. PECORA. Do the amount of brokers' loans that are carried give any indication of the amount of speculative transactions on the exchange?

Mr. WHITNEY. I think they do; yes.

Mr. PECORA. And you noticed that in 1928 and 1929 broker's loans reached a maximum that was absolutely unprecedented?

Mr. WHITNEY. It was, the largest that it had ever been.

Mr. PECORA. Did the exchange authorities take action of any kind at that time for the purpose of placing some restraint or limitation upon that undue amount of speculative activity in the market?

Mr. WHITNEY. No. I have stated that before, Mr. Pecora. The business conduct committee had constant supervision over our members and what they were doing. But I did not feel, and I do not feel, that the exchange can dictate as to whether individuals shall buy or sell shares. The individual brokers and members of the exchange may suggest, but they can hardly dictate.

Mr. PECORA. I am going to ask again the substance of a question or series of questions that I put to you before recess to-day. Were there not many rumors and reports abroad in 1928 and 1929 about the existence of pool operations on the exchange during those years?

Mr. WHITNEY. I think there was considerable rumor, about that and other things.

Mr. PECORA. Did the exchange officials do anything specifically to ascertain how much basis of fact there might have been with regard to those rumors at that time?

Mr. WHITNEY. I tried to explain to you before the recess about the business conduct committee of the exchange. Its duty is to see

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

that the conduct of its members is not improper and that there were, whenever occasion arose, investigations made to see if any transactions were improper, and constantly were being made, to see whether transactions were improper or proper.

Mr. PECORA. Did they report any conclusions at that time as a result of their investigations?

Mr. WHITNEY. Not that I remember. I am not quite sure when the Manhattan Electrical Supply Co. occurred. That was in 1927 and 1930. They did in those cases.

Mr. PECORA. Are those the only cases in which they reported definite conclusions that pools had been in operation?

Mr. WHITNEY. Again this is a matter that could be definitely stated by reference to the business conduct committee's files. I personally remember they reported with regard to a pool in Devoe & Reynolds stock.

Mr. PECORA. Did they examine into the existence of any pool in radio stock in those years?

Mr. WHITNEY. I believe they did.

Mr. PECORA. What conclusions did they report?

Mr. WHITNEY. They did not find anything that was improper in those transactions.

Mr. PECORA. Did they definitely make such a report?

Mr. WHITNEY. The governing committee? No, sir.

Mr. PECORA. Did they make any report to the governing committee?

Mr. WHITNEY. In the case of the Manhattan Electrical Supply Co. only.

Mr. PECORA. No; I mean in the case of radio.

Mr. WHITNEY. I beg your pardon. I did not understand you. No; not that I know of.

Mr. PECORA. Did they make any investigation that you know of?

Mr. WHITNEY. That I cannot tell you definitely. I have made an investigation since, or had an investigation made.

Mr. PECORA. Do you think it so easy to make an investigation some three years after the alleged event?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Just as easy?

Mr. WHITNEY. I think so.

Mr. PECORA. Is it not a fact that brokers do not maintain records of their transactions after a certain period of time?

Mr. WHITNEY. Complete records were maintained by the brokers.

Mr. PECORA. Haven't you informed this committee in the past that investigations made by committees of the exchange—I withdraw that. Testimony has been given before this committee in the past by members of the exchange, if my recollection is correct, Mr. Whitney, to the effect that they had destroyed their records of transactions in certain stocks with respect to which pools had been reported. Did you find this condition to be so?

Mr. WHITNEY. No, sir; not in the Radio pool. I have stated, in a public document that I sent to the members of the exchange, with regard to certain items of transactions but the fundamentals we got.

Mr. PECORA. I have before me, Mr. Whitney, what purports to be a printed pamphlet entitled "Statement by Richard Whitney,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

president of the New York Stock Exchange, Made to the Governing Committee and to the Membership."

Mr. WHITNEY. Yes, sir.

Mr. PECORA (reading):

With regard to the investigation of Stock Exchange practices by the Banking and Currency Committee of the United States Senate.

This pamphlet bears date August 24, 1932.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. The committee referred to in the title page is this committee, is it not?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Let me call your attention to the statement contained on page 18 of that pamphlet, as follows:

I regret that it is impossible to analyze every transaction which took place in the radio pool accounts. To do so would require the examination of the orders sent through to the floor of the exchange, and the reports sent back when the orders were executed. It is now more than three years since these transactions took place, and many of the orders and reports have been destroyed, as it is not customary for members of the exchange to keep records of this kind for any extended period.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. In view of the statement which you made to the governing committee and the members of your exchange through the medium of this printed pamphlet, do you now say that in the examination which you caused to be made, with respect to whether or not a pool in Radio was operated in the exchange in 1928 and 1929, all the facts were fully investigated?

Mr. WHITNEY. I do think that all the material facts with regard to the operations of that pool are in existence and were determined in our investigations. Orders on the floor and reports from the floor are taken off onto the ledgers if transacted, and those ledgers existed.

Mr. PECORA. What did you mean when you said:

It is now more than three years since these transactions took place, and many of the orders and reports have been destroyed, as it is not customary for members of the exchange to keep records of this kind for any extended period.

Mr. WHITNEY. I mean exactly this, Mr. Pecora: An order goes from the telephone of a member on the floor of the exchange to a broker to be executed, and the report comes from that member on the floor after executing the order to that phone, and is reported to the office, and if there is an execution so reported, that is put on sheets commonly called purchase and sales sheets, and then are entered into permanent ledger records. Those records existed, and all transactions that took place in that Radio pool, it is my belief, we have found on ledger records, and the report of the investigation was made thereon.

Mr. PECORA. Then what did you mean by this portion of your statement:

I regret that it is impossible to analyze every transaction which took place in the radio pool accounts.

Mr. WHITNEY. From the point of view of what I went on to say there as to reports and orders.

Mr. PECORA. Do you feel that you were hampered in any way in making that analysis by the fact that the records referred to by you in this pamphlet were unavailable?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. No, sir; not in the material points.

Mr. PECORA. Or do you now say that the absence of those records in no way hampered or impeded you in making a complete analysis of the transactions?

Mr. WHITNEY. I think the analysis has been complete ,sir, in the material points that we wished to find out and could find out.

Mr. PECORA. Why was it necessary, then, to report that it was impossible to analyze every transaction which took place in the Radio pool accounts and to express your regret at that circumstance?

Mr. WHITNEY. So that no false statement could be made.

Mr. PECORA. The Radio stock in that year was not a dividend-paying stock, was it?

Mr. WHITNEY. I don't think so, no.

Mr. PECORA. It never had been up to that time, had it?

Mr. WHITNEY. I don't think so.

Mr. PECORA. What was the highest price reached on the exchange for that stock prior to October, 1929?

Mr. WHITNEY. During that year 114¾.

Mr. PECORA. 114¾.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. What was the highest during the preceding year?

Mr. WHITNEY. I do not think I have any record of that. Somewhere near $500 a share, and was split, if I remember, 5 to 1.

Mr. PECORA. So that this high of 114 that you have referred to was after the stock had been split 5 for 1?

Mr. WHITNEY. Yes, sir. If I am correct in the amount. I think it was 5 for 1.

Mr. PECORA. And when that stock reached a value of about 500 in 1928 did the exchange make any inquiry for the purpose of ascertaining whether or not that valuation was completely out of line with intrinsic value?

Mr. WHITNEY. We did not, sir.

Mr. PECORA. It has since been ascertained that it was very largely out of line with intrinsic value, has it not?

Mr. WHITNEY. Well, I think, Mr. Pecora, there were a good many other considerations that went into the fact of that stock selling where it did. It was supposed to have a great many elements of business that it was developing. The general radio field, I do not think at that time, had been tremendously entered into by a tremendous amount of competitors, and probably you are quite correct as to intrinsic value. But how one is going to determine what is intrinsic value I do not quite know.

Mr. PECORA. For what purpose does the stock exchange require an applicant for listing of its stock to file a financial statement?

Mr. WHITNEY. To show whether it is solvent.

Mr. PECORA. Solvent. It also gives some information as to value, does it not?

Mr. WHITNEY. That is determined by the company itself. Or rather that can be determined by a deduction of debts and the division of the shares outstanding into what is set down as its assets.

Mr. PECORA. Do you mean to say, Mr. Whitney, that the exchange does not seek to ascertain anything about the intrinsic or other value of a security when application is made for the listing of that security?

Mr. WHITNEY. An audit, as I said, is presented by the applying company.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. And that is the only guidance the exchange has on the question of the value of a security?

Mr. WHITNEY. We are not looking for the value of the security.

Mr. PECORA. Then why do you require that financial report or audit, Mr. Whitney?

Mr. WHITNEY. To see that the company is a solvent company; that it has assets.

Mr. PECORA. That it has assets?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Of a definite value?

Mr. WHITNEY. Of a definite fact.

Mr. PECORA. You mean merely assets as assets, irrespective of the amount of value represented by those assets? Is that what you mean?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. When a new issue is listed how is the market made for it on the exchange?

Mr. WHITNEY. If a new issue is listed the committee on arrangements places that stock at a particular post on the floor of the exchange. Some broker presumably makes a book in that stock; in other words, becomes a specialist, and receives orders to buy and sell shares in that stock. That is all the exchange does toward facilitating a market.

Mr. PECORA. But the stock that is traded in as a rule is owned only by those interested in the promotion of that stock at the outset, is it not?

Mr. WHITNEY. No, sir. The exchange demands a material distribution of that stock before it may be listed.

Mr. PECORA. And the distribution or the terms of distribution are made known to the exchange in connection with the listing application?

Mr. WHITNEY. The terms of distribution?

Mr. PECORA. Yes. Are they or are they not?

Mr. WHITNEY. I believe the number of shareholders are made known to the exchange, and the fact that they are bona fide shareholders, in other words, not holding the stock in one interest, although in different names.

Mr. PECORA. Is an inquiry or investigation made by the exchange through its listing committee or any other agency in order to verify or confirm the statements set forth in the listing application?

Mr. WHITNEY. I do not think so; sir. I think they are certified by the company to be true by an official of the company.

Mr. PECORA. It is easily possible——

Senator BROOKHART (interposing). Mr. Pecora, I have to go. I wanted to ask him about one other thing.

In the Kreuger & Toll listing, that had no value at any time, had it?

Mr. WHITNEY. Well, I do not think I am competent to answer that question, Senator Brookhart. It was thought to have considerable value.

Mr. PECORA. It was thought to have, but in fact it did not have?

Mr. WHITNEY. That I do not know, at one time.

Senator BROOKHART. These oaths you mentioned were fraudulent, were they not?

Mr. WHITNEY. I beg your pardon?

Senator BROOKHART. These oaths that you mentioned about the value were fraudulent, not true?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. That may have been true in that situation.

Senator BROOKHART. Now, what I wanted to ask you about particularly: You do not think the stock exchange caused the inflation in 1928 and 1929?

Mr. WHITNEY. No, sir.

Senator BROOKHART. Supposing the stock exchange had stayed closed when it was closed during the war and had not been opened at all. Could that inflation have occurred?

Mr. WHITNEY. Yes, sir.

Senator BROOKHART. Would it, anything like it did?

Mr. WHITNEY. I can only answer that in years prior to 1928 and 1929 there was greater inflation in agricultural products, farm value, and real estate and in many other things not listed on the New York Stock Exchange at least comparable in their inflation, with any shares of stock listed on the New York Stock Exchange.

Senator BROOKHART. The greatest inflation of land perhaps occurred in my own State, and values never more than doubled in all that time at the highest peak.

The CHAIRMAN. I think the census gives it 102 percent.

Senator BROOKHART. Something like that. And your values increased several hundred percent?

Mr. WHITNEY. Yes, sir; some of them did.

Senator BROOKHART. Well, on an average they did. So that the agricultural inflation is not comparable after all to the stock exchange.

Mr. WHITNEY. I do not think I can agree with you, Senator, because, if I remember rightly, wheat sold at what price? You know better than I, the top.

Senator BROOKHART. We fixed the price of wheat at $2.26 a bushel.

Mr. WHITNEY. Yes, sir. Now it is selling in the 40's.

The CHAIRMAN. When comparative conditions meant that it would have gone considerably above $2 the Government pulled it down and fixed it there.

Mr. WHITNEY. And now it is selling in the 40-cent area, I believe.

Senator BROOKHART. Yes; something like that. And it costs about a dollar and a quarter to produce it.

Mr. WHITNEY. Yes, sir; and it costs a good deal to produce the plants of the companies listed on the exchange.

Senator BROOKHART. Is it not plain to you or to anybody that if this speculative institution had been suppressed that great inflation of 1929 and the bursting of that bubble could not have happened?

Mr. WHITNEY. No, sir; it is not plain to me.

Senator BROOKHART. You do not see that at all?

Mr. WHITNEY. No, sir.

Senator BROOKHART. I believe you are the only fellow in the room that cannot.

Mr. WHITNEY. I am in the vast minority.

Senator BROOKHART. That is all.

Mr. PECORA. The exchange in acting upon a listing application requires that a substantial proportion—and by that I do not necessarily mean a majority of the authorized capital stock—shall have actually been issued, does it not?

Mr. WHITNEY. I do not think I understand your question quite. The stock of a company where application is made to list must, if outstanding, be distributed.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Yes; there must be a substantial portion actually distributed?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. The persons to whom that stock has been issued are required to be set forth in the listing application?

Mr. WHITNEY. Their number, yes.

Mr. PECORA. Their number, and also the amount of shares allocated or issued to them?

Mr. WHITNEY. In some cases, yes; where we specifically wish to find out. I do not think that is the universal rule, that each shareholder has to have his name against it.

Mr. PECORA. What is the purpose of that rule?

Mr. WHITNEY. That there shall be proper distribution of that stock so that no action tending toward a corner could be possible. In other words, that a free market will exist in the stock when listed.

Mr. PECORA. And a free market would not exist if the names shown in the application for listing were unknown to the exchange—were names of mere dummy holders; isn't that so?

Mr. WHITNEY. A free market might not exist, but on the other hand, the company certifies that the distribution is bona fide.

Mr. PECORA. Does the exchange accept without any attempt to confirm or check up the certification of the corporation's officers?

Mr. WHITNEY. That is my understanding; yes.

Mr. PECORA. Now, there was evidence presented before this committee two weeks ago, Mr. Whitney, to the effect that upon the incorporation of one of the so-called Insull companies in the State of Illinois several hundred thousand shares of the common stock had been issued to certain persons whose names were set forth in the listing application.

Mr. WHITNEY. To whom?

Mr. PECORA. The exchange in that case was the Chicago Stock Exchange.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. An employee of Halsey Stuart & Co. was named in that application as the person to whom 999,996 shares of common stock in the corporation had been issued, and it developed that he was merely a dummy for Halsey Stuart & Co., who, as investment bankers and dealers, thereafter sold to the public senior securities issued by that company consisting of debentures. Could such a thing be possible on the New York Stock Exchange?

Mr. WHITNEY. Mr. Pecora, naturally, if people wish to be crooked and to make false statements, they may get away with it with any agency or institution.

Mr. PECORA. But does the New York Stock Exchange take any steps to confirm the statements made by the officers of a corporation seeking to list its securities on your exchange?

Mr. WHITNEY. I would like to refer to the memorandum of the committee on stock lists.

Mr. PECORA. No. Can't you tell me that from your own knowledge, Mr. Whitney?

Mr. WHITNEY. I haven't got that of my own knowledge. I do not serve on the committee on stock list. That is what committees are for. To attend to certain matters.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. My dear sir, you have been a member of the exchange for 21 years. You have been its president for nearly three years.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Can't you tell me, from the wealth of knowledge and experience that must have come to you during those years——

Mr. WHITNEY (interposing). I have told you——

Mr. PECORA. Whether or not the exchange affirmatively takes any action seeking to check up or to confirm the statements made to it by corporation officers seeking to have their securities listed?

Mr. WHITNEY. I do not think, unless a check is made through the transfer agent, that any other check is made except the certified attestation of an official of the company that the facts given are correct. Now, I believe that is all the United States Government asks from any individual in reporting to them or is common in any court of law in a legal paper.

Mr. PECORA. In other words, the exchange proceeds upon the assumption that nobody lies to it, does it?

Mr. WHITNEY. The exchange, I think of necessity, has got to take people at their face value and that they are honest until they are proved otherwise.

Mr. PECORA. The presumption is all in favor of the person who makes applications as to honesty and integrity? Is that what you mean?

Mr. WHITNEY. Yes; if you wish it that way.

Mr. PECORA. In the case that I spoke of—and it was elicited from the testimony of the man who was the head of Halsey Stuart & Co.——

Mr. WHITNEY (interposing). That was not made, Mr. Pecora, to the New York Stock Exchange.

Mr. PECORA. Well, it was made to the Chicago Stock Exchange and I learned that their rules and procedure are similar to yours. Is that so or is it not?

Mr. WHITNEY. No, sir; not that I know of.

Mr. PECORA. They did not make any investigation. They took the statements in the listing application at full face value, and that is exactly what your exchange does.

Mr. WHITNEY. May I call to your attention, sir, that we have not listed any of the Insull securities.

Mr. PECORA. I know, but the procedure of the Chicago Stock Exchange, in the cases that I have cited, was identical with the procedure followed by your exchange, was it not, sir?

Mr. WHITNEY. I do not grant that at all.

Mr. PECORA. Haven't you testified here within the last few minutes that the exchange authorities——

Mr. WHITNEY (interposing). You are talking about people——

Mr. PECORA. Wait a minute—the exchange accepts at full face value the sworn statements embodied in the applications for listing?

Mr. WHITNEY. Yes, sir; unless they are checked with the transfer agents. Yes; I said that. No question about it. But our stock-list committee is not the stock-list committee of the Chicago Stock Exchange and the executive staff of the committee of stock list of the New York Stock Exchange is not the same as that of the Chicago Stock Exchange; and also, sir, we will list certain securities, or we will not list certain securities that perhaps may be listed elsewhere.

Mr. PECORA. The purpose of the exchange in requiring a distribution before listing of the outstanding stock of the corporation making

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

application for listing, is to insure, so far as possible, that there will be a free and open market for that stock when trading in it is opened after listing, is it not?

Mr. WHITNEY. That is correct.

Mr. PECORA. Now, in order to assure itself of that, would it not be necessary for the exchange to make certain that the information contained in the listing application is honest information?

Mr. WHITNEY. Mr. Pecora, that is but one of the many requirements——

Mr. PECORA (interposing). I will come to the others.

Mr. WHITNEY (continuing). Demanded by the stock-list committee.

Mr. PECORA. I will come to that. For the time being let us confine ourselves to that one. With regard to that one requirement, your exchange accepts without question the information contained in the listing application, does it not?

Mr. WHITNEY. From persons that we believe to tell the truth, yes.

Mr. PECORA. Have you ever known of an instance where any effort was made to check up on that particular kind of information embodied in a listing application?

Mr. WHITNEY. Not to my knowledge, but I do not say it has not been done. I know that at various times we have requested the same advice from companies over their attestation, the attestation of some official of the company.

Mr. PECORA. In order to insure that the opening trades in the security after listing will be in a free and open market, does it not now seem necessary to you for the exchange to verify the statements concerning the distribution of the outstanding stock which are embodied in the listing applications made to it?

Mr. WHITNEY. No, sir; because that means the presumption of dishonesty rather than honesty.

Mr. PECORA. In other words, you would rather discover the dishonesty after it has come to light or after its evil effects have been manifested, than prevent the dishonesty beforehand?

Mr. WHITNEY. But that has not happened, Mr. Pecora.

Mr. PECORA. How do you know it has not happened?

Mr. WHITNEY. We have not found reason to believe that there was not a free and open market in the shares of stock that we have listed, or else if we have found it we have taken action upon it.

Mr. PECORA. The stock could be described in a listing application as being distributed, we will say, to A, B, C, D, and E, and it would be conceivable or possible under the stock exchange procedure for B, C, D, and E to be dummies of A, would it not?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Inasmuch as the exchange takes no precautions to ascertain the owner?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. In such an event A would be in a position to dominate the opening of the market, would he not, without the stock exchange knowing any thing about it?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. And you still think that the stock exchange should do nothing affirmatively to prevent that sort of thing but should wait until it happens and then punish those who have been responsible for it?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. It does not happen, Mr. Pecora, that I know of.

Mr. PECORA. Isn't that an assumption on your part?

Mr. WHITNEY. Assumption——

Mr. PECORA (interposing). That it has not happened?

Mr. WHITNEY. You are asking me of my knowledge regarding affairs to do with the New York Stock Exchange, and frankly, sir, I do not know of any misinformation ever having been given in this particular regard.

Mr. PECORA. Has any inquiry been made to ascertain whether or not the information supplied to the exchange was honest information or misinformation?

Mr. WHITNEY. Our basis is for a free and open market.

Mr. PECORA. That does not answer my question, Mr. Whitney. Will you please read the question, Mr. Reporter?

The SHORTHAND REPORTER. Has any inquiry been made to ascertain whether or not the information supplied to the exchange was honest information or misinformation?

Mr. WHITNEY. In what way do you mean "Inquiry?"

Mr. PECORA. In any way, Mr. Whitney, under which the stock exchange could inquire.

Mr. WHITNEY. No, sir; not that I know of. I would not say that it has not been done. I do not know of it. I do not know that there has been occasion to make any such inquiry or that any events occurred subsequent to its being listed, the stock being listed, which warranted such action on our part.

Mr. PECORA. Does the listing application also inform the exchange, Mr. Whitney, of the prices at which the stock shown to have been issued was issued?

Mr. WHITNEY. That I do not know.

Mr. PECORA. Haven't you ever seen a listing application?

Mr. WHITNEY. Yes, sir; but I have not studied it. If I may state what counsel tells me, in some cases they do and in some cases they do not.

Mr. PECORA. There is no requirement of the exchange as to whether that should or should not be set forth?

Mr. WHITNEY. Not that I know of, sir.

Mr. PECORA. Mr. Whitney, do you have to depend upon the information given to you by counsel who is sitting alongside of you in order to answer questions concerning the rules and customs of the stock exchange?

Mr. WHITNEY. With regard to the details of what goes on in certain committees, yes; or to members of that committee.

Mr. PECORA. How long does a man have to be a member of the stock exchange or its president before he can hope to inform himself as to such fundamental things as the information entered in the listing application?

Mr. WHITNEY. I do not know that any man, president of the stock exchange, unless he has been a member of the stock list committee, could ever know. Counsel knows because he has gone over from a legal point of view countless listing applications. I, Mr. Pecora, have not gone over any listing applications. I have never served on that committee. I meet with them on a policy occasionally, but I I have never studied them. Those applications are studied by the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

executives, the employed executives of that committee in certain cases, and then a report is given on the facts as found.

Mr. PECORA. As president since May, 1930, can you tell us now what the requirements of the exchange are with respect to the kind of information that must be given in a listing application?

Mr. WHITNEY. I have it here and it is in the record, sir.

Mr. PECORA. No; can you give it to me from your own knowledge?

Mr. WHITNEY. In all the details; no, sir, certainly not. I question whether anyone except Mr. Hoxsey, who is the executive secretary of the committee on stock lists, could do it.

Mr. PECORA. Are the rules and requirements so complicated in that respect, Mr. Whitney——

Mr. WHITNEY (interposing). They are voluminous.

Mr. PECORA. That the president, who has served nearly three years, can not acquire within that time the information which I have asked for.

Mr. WHITNEY. I believe that the president, if he saw fit to memorize these facts, could do so, Mr. Pecora. If you would look at this requirement for listing, which is a printed pamphlet, you would notice it is some 11 pages long of close print, and the accompanying papers that have to be filed, one of which is the matter that you have been asking about regarding distribution.

Mr. PECORA. Suppose you look at it and see if you find any rule in there which requires a corporation making application to the exchange for the right to list its shares to state the price for which the outstanding stock has been issued.

Mr. WHITNEY. That will take some time, Mr. Pecora. I have no idea that that is a requirement. In that connection may I state that in many, many instances securities are listed long after any sale or attempted sale of those securities has taken place. In other instances they are listed at approximately the time the sale is taking place. But it is rare that we will list the securities of any company where it is just going into organization, although we will list new securities of companies that already have securities listed with us.

Mr. PECORA. I am talking about applications for original listings.

Mr. WHITNEY. With relation to the original listing I find no demand that the information suggested by you is asked for. When a company wishes to make additional listings of securities, of shares, then we ask, among a great many other questions, the purpose of the issue, the application of the proceeds, the amount, description and disposition of the securities exchanged for new issues, and so forth. I do not find that the price at which a stock is sold to the public or offered for sale is demanded by us.

Mr. PECORA. I have not asked about that, Mr. Whitney; I have asked whether or not there is any requirement or rule of the stock exchange in connection with applications for original listings that the price paid for the shares already issued should be shown in the listing application.

Mr. WHITNEY. Are you not speaking about, when you say the shares that are issued, their being offered for sale? That is what I have been going on, Mr. Pecora.

Mr. PECORA. Or being offered for sale. All right; have it that way.

Mr. WHITNEY. That is not asked. I stated that.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. In the case of the company of which I spoke a little while ago, it developed also that nearly 2 million shares of the common stock of the company making the application for original listing on the Chicago Stock Exchange had been issued to a few individuals who caused the company to be incorporated, at a price of $7.54 a share, and that two days after such issuance trading in the stock was opened on the Chicago Stock Exchange at $30 a share, and on the second day's trading the price had gone up to $40 a share. Would such a thing be possible on the New York Stock Exchange under the rules and requirements that it has for listing securities?

Mr. WHITNEY. All things are possible, Mr. Pecora.

Mr. PECORA. Would that be possible, just that?

Mr. WHITNEY. You are using a hypothetical question of an actual company which was not making application to the New York Stock Exchange.

Mr. PECORA. Would that operation have been possible under the rules of the New York Stock Exchange, if that had been the arena of action instead of the Chicago Stock Exchange?

Mr. WHITNEY. As a hypothetical question I presume it might have been possible. I will not grant, however, that that security could have been listed on the New York Stock Exchange, and I have tried to point out to you that our investigation, our requirements, and the fulfillment of those requirements, are more stringent than any other stock exchange in the world.

Mr. PECORA. And yet those requirements do not include an inquiry in some concrete, definite, authenticated way into the real value or intrinsic value, as you please, of its stock?

Mr. WHITENY. I do not see that that advice would change the situation in the hypothetical case that you cited, Mr. Pecora.

Mr. PECORA. Well, would it not change the situation in this respect, that if, from information of that sort given to the exchange in the listing application, it learned, for instance, that the stock was valued by its promoter at $10 a share and that on the opening trades it sold at $40 or $50 a share, there would be evident inflation of value in the public market right at the outset?

Mr. WHITNEY. Such a situation might exist; yes.

Mr. PECORA. And could exist to-day so far as the exchange has taken any precautions against it; could it not?

Mr. WHITNEY. I think that is true. May I point out to you that there were frequently issues brought out in 1928 and 1929 where the stock was offered at a price and entirely subscribed for, and the very day that those particular securieties were made available for trading in the open market they sold at 10, 20, 30, and sometimes 50 points above the issued price, at which price they had all been sold. I do not see where the exchange is going to have a control of what the price of that stock is if the market is made free and open.

Mr. PECORA. It is quite apparent from your testimony to-day, that the exchange assiduously avoids having such a control.

Mr. WHITNEY. We do not have such a control.

Mr. PECORA. And you avoid having such a control, do you not?

Mr. WHITNEY. Of evaluating securities?

Mr. PECORA. Yes.

Mr. WHITNEY. Of course——

Mr. PECORA (interposing). In any way, shape, or form?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. That is in so far as the application for listing is concerned. If transactions on that stock thereafter are improper and contrary to decent conduct and decent methods of doing business, they are taken immediately into consideration and control is exercised.

Mr. PECORA. Now, you admitted in your speech at Cleveland yesterday, and you have indicated the same thing in your testimony to-day, that there was a great inflation of securities values in 1928 and 1929; is that correct?

Mr. WHITNEY. I stated that there was inflation.

Mr. PECORA. You admit that now in this year of 1933, don't you?

Mr. WHITNEY. And I have for a long time past.

Mr. PECORA. For a long time—since 1929?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. And yet you were not able to see the processes of inflation while they were actually in operation in 1928 and 1929; isn't that so?

Mr. WHITNEY. It may be so. I do not think it is fair.

Mr. PECORA. Whether it is fair or not, is it so? If it is a fact it is fair, isn't it?

Mr. WHITNEY. Did you?

Mr. PECORA. I am not a broker and I am not president of the New York Stock Exchange and I have no duties to the public in that regard, because I furnish no facilities for trading in securities to the public. Now will you answer my question?

Mr. WHITNEY. I wish to Heaven that I had had that insight into situations at that time, Mr. Pecora. I did not.

Mr. PECORA. Then the same thing that happened in 1928 and 1929 conceivably could happen in 1936 and 1937?

Mr. WHITNEY. Conceivably.

Mr. PECORA. Yes.

Mr. WHITNEY. And we have made suggestions to prevent it in so far as we see that possibility.

Mr. PECORA. Now tell us just what you have done to prevent that situation from recurring.

Mr. WHITNEY. We have concretely endeavored and been endeavoring for years for more and more complete and more frequent information to be given by corporations to shareholders and made available to them.

Mr. PECORA. Now let me ask you first about that: You have not reached the point of requiring definite information of the price at which the stock of a company seeking to list its shares on your exchange has been issued, have you?

Mr. WHITNEY. Mr. Pecora, if I understand you rightly——

Mr. PECORA (interposing). Well, if you do not, please tell me.

Mr. WHITNEY. If I understand you rightly, that fact is public knowledge in almost every case.

Mr. PECORA. What are the facilities—what are the media through which it becomes public knowledge?

Mr. WHITNEY. The newspapers, the offerings of that stock by bankers and dealers that are merchandising it. We do not take securities on the New York Stock Exchange until they have been distributed.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. I know that, and the price at which they have been distributed would be——

Mr. WHITNEY (interposing). That is public knowledge.

Mr. PECORA (continuing). Some indication to the exchange of their value, would it not?

Mr. WHITNEY. I do not doubt that the executives of the stock list committee have that information. What I am saying to you is that we do not require it in the application.

Mr. PECORA. So that if they have that information they have it by force of some fortuitous circumstance?

Mr. WHITNEY. Yes; and I do not see where that has a bearing upon the application, sir.

Mr. PECORA. It has a bearing in so far as it tends to inform the exchange of the value of the security so that if it was traded in after listing at a price far beyond that figure the exchange officials would thereby gain some knowledge or information that the opening market was maintained as as result of manipulation.

Mr. WHITNEY. Sir, the committee on stock list has no control whatever in that direction. They list a security. They are through with it when they have presented it and recommended its listing to the governing committee. The governing committee either approves or disapproves, and the next day that is put upon the stock exchange. What the stock sells for after that time has no relation to the committee on stock list whatsoever in general.

Mr. PECORA. Has it any relation to anybody in the stock exchange?

Mr. WHITNEY. Absolutely. That is what I was going to say. And then it comes under the other committees in respect to their duties, more particularly probably the business conduct committee.

Mr. PECORA. In 1928 or 1929 when, as you are now able to see, there was inflation of securities values to an unprecendented extent, the exchange officials were unable to see the processes by which that inflation was effected—is that a correct statement?

Mr. WHITNEY. I think it would be unfair for me to presume to state what the opinions were of the officials of the exchange at that time. I tried to give you my own, that I did not have the insight or foresight to see what was going to happen in the calamitous way it has happened.

Mr. PECORA. Do you know anybody in the stock exchange in 1928 and 1929 who perceived the processes of inflation then in operation and made a public pronouncement about it?

Mr. WHITNEY. Not that I know of, public pronouncement; no, sir.

Mr. PECORA. Did they make private pronouncements about it?

Mr. WHITNEY. I believe there have been many men who believed that the inflation had gone to ridiculous lengths; yes, sir.

Mr. PECORA. But the investing public was not given the benefit of that knowledge or belief, was it, through any public pronouncements?

Mr. WHITNEY. Not so far as I know, public pronouncements, no.

Mr. PECORA. So that the investing public continued to rush into the market and buy securities at inflated prices during those two years?

Mr. WHITNEY. As hindsight now shows it.

Mr. PECORA. So far as you can tell us, what has been done to prevent a recurrence of that in the future by the exchange?

Mr. WHITNEY. I started to, Mr. Pecora, and you asked me another question. And that is that we believe and have been working steadily

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

toward the giving of complete, full and adequate information by companies to their shareholders, or the public, I should say.

Mr. PECORA. What have you done along those lines?

Mr. WHITNEY. What have we done?

Mr. PECORA. Yes, sir.

Mr. WHITNEY. We have arrived a long ways toward getting that information.

Mr. PECORA. Now you are stating a conclusion. What have you done? What are the acts which have been undertaken or performed or committed by the exchange, supporting the conclusion you have just expressed?

Mr. WHITNEY. I refer you to our listing requirements which are far more full and complete. I refer you to our——

Mr. PECORA (interposing). Can't you tell us without putting us to the burden of reading a long and complicated document?

Mr. WHITNEY. I think I can tell you a great many of the points.

Mr. PECORA. Will you please do it?

Mr. WHITNEY. That is one. In seeking listing we are far more demanding in the details of answers given us. We have since April 1932 demanded of all companies seeking listing or additional listing independent audits. We have requested and have achieved the publication of quarterly reports, or if not quarterly reports, semi-annual reports, where possible. We have achieved in that way the greatest cooperation from our corporations. They have to move slowly, because great wheels have to be changed in their progress, but we have done, I believe, Mr. Pecora, as much as we can to date to safeguard investors who are interested in securities listed on the New York Stock Exchange.

Mr. PECORA. Along that line, what specifically has been done to indicate to it anything of a tangible character which will enable it to determine that market quotations might be greatly in excess of actual values?

Mr. WHITNEY. Mr. Pecora, if proper information and frequent information is given with relation to the activities of corporations no one in the world can dictate to the individual as to whether or not he will buy or sell those securities. If the information is put before them it is their duty to choose and to study it.

Mr. PECORA. What has been done by the exchange to enable it to ascertain when a quotation might be far in excess of actual value? Anything at all?

Mr. WHITNEY. No, sir; because we do not evaluate securities. We can not do that, sir.

Mr. PECORA. Why can you not do it?

Mr. WHITNEY. Because who can judge?

Mr. PECORA. Do you mean to say that it is impossible for anyone to judge the real value of a security?

Mr. WHITNEY. You are talking about the market value?

Mr. PECORA. I am talking about both market and real values, am I not?

Mr. WHITNEY. I think it is impossible.

Mr. PECORA. You think it is impossible for anyone to ascertain the real value of a security?

Mr. WHITNEY. It depends on what you call real. You may be able to get book worth as of today that may change tomorrow.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Well, what do you call real value?

Mr. WHITNEY. I do not know. The nearest——

Mr. PECORA. What do you call inflated value?

Mr. WHITNEY. When there seems to be no real equation between the price and the earning power or what is said to be the asset value of the corporation.

Mr. PECORA. Then does not earning power indicate to a certain extent real value?

Mr. WHITNEY. I think it has a great deal to do with the proper price at which a security should sell, and it is along that very line that the exchange is seeking to get that information to those that are interested so they can govern themselves accordingly.

Mr. PECORA. If you were contemplating the purchase of stock for investment purposes you would find it possible, would you not, to learn from something outside of mere market quotations what real or asset value was?

Mr. WHITNEY. Yes, sir. And the only way I could do that is, just as I have said, by studying the information given by that particular corporation as to its financial structure.

Mr. PECORA. Does the exchange call for information of that sort from time to time from the corporations whose securities are listed?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Does it make it a rule to call for those reports periodically or at regular intervals?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. And what is done with those reports when they are received by the exchange?

Mr. WHITNEY. They are received by the committee on stock list and, as I understand it, they are compared with the agreement by that company in its application to make such and such reports along such and such lines, to see that it follows that agreement.

Mr. PECORA. I am talking about the obtaining of those reports from a company whose stock is already listed.

Mr. WHITNEY. So am I, sir.

Mr. PECORA. All right. Now, as the result of the procurement of these reports the exchange authorities are enabled to get some definite information bearing upon the real value of the security, are they not? Through the medium of these financial reports that you have referred to?

Mr. WHITNEY. They can determine book worth; yes, I imagine so.

Mr. PECORA. All right. Now, thereafter if the quotations in the stock are far in excess of the book value or asset value or any other value, call it what you will, reflected by the financial statement given to the exchange in response to its call, does the exchange do anything, as a matter of course, or under any rule?

Mr. WHITNEY. About it?

Mr. PECORA. About it?

Mr. WHITNEY. No, sir.

Mr. PECORA. Do you not think the exchange might do something with advantage to the investing public toward preventing the inflation of a security to a price far beyond the values shown by the company's own reports to the exchange?

Mr. WHITNEY. I would be delighted to be advised as to how the exchange could do it, Mr. Pecora. Frankly realizing that between

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

reports tremendous orders may be given to that company, as happened during the war, and as happened during great times of prosperity in 1927, 1928, and 1929, I do not see how, as I said before, the exchange can set itself up as an oracle and dictate that General Electric is worth $15 a share, that United States Steel is worth $25. That might change hour by hour.

Mr. PECORA. Let us take a supposititious case. Let us take the case of a corporation listed on the exchange whose financial reports, submitted periodically to the stock exchange, show an asset value for its stock of $50 a share. Suppose the market quotation should go up to $100 or $150 a share; would the exchange do nothing about it?

Mr. WHITNEY. It would not. Might I call to your attention certain corporations that exist that have practically no asset value whatsoever. They have a plant and they produce a product that is world-wide and known throughout the world. Their asset value in that instance has no relation to the price of that stock. That is based, I would believe, entirely upon its earning capacity. And that may vary with the days, with the weeks. Who is to set himself up as the dictator of what prices should be day by day is beyond me, frankly. If you can suggest how we could help toward that end to give information to that dictator who would make those pronouncements we would be willing to help as much as we could. How the New York Stock Exchange could do it is beyond my conception.

Mr. PECORA. Those prices way above asset values indicated by the company's own financial reports are of no concern to the exchange then, are they?

Mr. WHITNEY. From the point of view of being——

Mr. PECORA. From any point of view?

Mr. WHITNEY. Of being——

Mr. PECORA. From any point of view.

Mr. WHITNEY. Well, yes; from some points of view. Because if there seems to be something going on at a price that together with other facts seems totally out of line, I think the business-conduct committee without fail would look into it to see that there was a free and open market.

Mr. PECORA. Did the business-conduct committee correct any situation in 1928 and 1929 which contributed to the inflation of security values?

Mr. WHITNEY. I think the business-conduct committee sent out various questionnaires on particular stocks that seemed to be acting in an untoward way.

Mr. PECORA. Did the business-conduct committee when it got the answers to those questionnaires give the information to the investing public?

Mr. WHITNEY. The result of those questionnaires that I have any knowledge of is that they almost invariably have corrected the wrong condition of the market, the price, merely by the sending out of the questionnaire.

Mr. PECORA. Well, they did not do it in 1928 and 1929, did they?

Mr. WHITNEY. I believe there were certain instances; yes, sir.

Mr. PECORA. In some instances?

Mr. WHITNEY. Yes.

Mr. PECORA. But in the main it did not have that effect, did it?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. It was only in those cases where there was something going on that should not be and over which we did not ha e control.

Mr. PECORA. And you are unable to suggest after 20 years' experience as a member of the exchange and as its president for nearly three years anything that the exchange might do to protect the investing public against inflated values reflected by market quotations?

Mr. WHITNEY. I did not say that, Mr. Pecora.

Mr. PECORA. Well, you asked——

Mr. WHITNEY. I said that I did not know how the exchange or anybody connected with the exchange could value prices. I tried to say that the exchange was doing everything in its power, from the point of view of information to the public, to any that are interested, so that they would have at hand the facts frequently regarding their corporations or what corporations they wanted to get the facts about. I also advised yesterday that I believed and that we believe in some kind of uniform corporate laws for incorporation of companies.

Mr. PECORA. But you do not believe in any incorporation law for the New York Stock Exchange, do you?

Mr. WHITNEY. I do not. I have explained that before this committee before, and briefly to you this morning. It would take away the power of the governing committee to act.

Mr. PECORA. And would lodge it somewhere else, would it not?

Mr. WHITNEY. There would be the recourse to court action, which would totally prevent the exchange exercising its immediate control of its members.

Mr. PECORA. And that is what the exchange does not want to surrender or have abrogated, limited or qualified in any way?

Mr. WHITNEY. We do not wish that control because we feel the entire essence of the conduct of the exchange would be done away with.

Mr. PECORA. With all that power which the exchange is jealous of and does not want to surrender in any respect to any public authority, the exchange officials were unable to perceive in 1928 and 1929 that a tremendous inflation of security values was going on?

Mr. WHITNEY. I did not say that, Mr. Pecora.

Mr. PECORA. Well, you said you could not see it at the time?

Mr. WHITNEY. I did. I said that I could not see it. But I did not say——

Mr. PECORA. You do not know any one else connected with the exchange who made any public pronouncement of views that he had?

Mr. WHITNEY. Public pronouncement; no, because I do not think it is a part, even if they had them, of exchange officials—and I have tried consistently to say that this afternoon—to make public pronouncement as to what is the proper value of this share of stock or that.

Mr. PECORA. Is it not a fact that pools operating in securities very often operate under options given to them for large blocks of stock in the security in which they desire to operate?

Mr. WHITNEY. That may be so.

Mr. PECORA. Is there any rule or requirement of the exchange that the giving of such options should be reported to the exchange?

Mr. WHITNEY. No, sir.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Do you not think that information derived under such a rule would put the exchange authorities in a position where they could more easily learn of the existence of a pool to artificially affect market values?

Mr. WHITNEY. I do not think that it would give the exchange more easily the information in that regard; no, sir.

Mr. PECORA. Those options are secret options, are they not?

Mr. WHITNEY. You mean in so far as the exchange is concerned or the public is concerned?

Mr. PECORA. Yes.

Mr. WHITNEY. I presume so. Just as any contract between one person and another is secret.

Mr. PECORA. And one of the reasons for their secrecy is to enable the members of the pool or syndicate safely to conduct their operation, is it not?

Mr. WHITNEY. I frankly have never looked upon it in that light.

Mr. PECORA. Suppose you ponder that for a moment.

Mr. WHITNEY. When one makes a contract, Mr. Pecora, you do not make it public to the world.

Mr. PECORA. Are not contracts made public to the world?

Mr. WHITNEY. In some instances.

Mr. PECORA. Do you not know that there are many statutes passed by the several States and by the Government that require that publicity be given to important contracts of certain kinds?

Mr. WHITNEY. Very likely, if you say so. I did not know it. I do not know what the certain kinds are that you refer to.

Mr. PECORA. Your exchange has very able counsel, Mr. Whitney, and I have not any doubt they will inform you of many such instances as I have referred to.

Mr. WHITNEY. I do not doubt it, Mr. Pecora. I am not in any way attempting to take exception. But I do not see anything inherently wrong in having a contract to purchase shares of securities and not giving that to the public.

Mr. PECORA. Where those contracts, as you are pleased to call them, or options, as I will refer to them——

Mr. WHITNEY. The same thing.

Mr. PECORA (continuing). Are given to members of a pool it is the possession of such an option and the rights under it that enable the pool to operate, is it not?

Mr. WHITNEY. That may be; yes.

Mr. PECORA. It gives the pool definite assurance that they can call upon persons giving them the option for a specified number of shares at a specified price, does it not?

Mr. WHITNEY. Yes; that is what options are.

Mr. PECORA. And within a certain specified period of time?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Have you ever worked under such an option?

Mr. WHITNEY. I do not know of any, Mr. Pecora.

Mr. PECORA. Some evidence was given here within the last few days of the giving of an option to the firm of Dominick & Dominick. for some 32,000 shares of the capital stock of the National City Bank, which at the time was an unlisted security. The option was given at prices ranging 10 points below the market. Have you heard of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

similar things being done with regard to securities listed on the exchange?

Mr. WHITNEY. I haven't that in my knowledge in detail. Such options I know are given; yes, sir.

Mr. PECORA. At prices below the market?

Mr. WHITNEY. I would believe that the more common way of giving options is at prices below the market and ranging to prices above the market. The average might be approximately what the market was at that time.

Mr. PECORA. And do you see any objection to the giving of those options secretly?

Mr. WHITNEY. I do not.

Mr. PECORA. Do you think that it is a practice that should not be interfered with in any way?

Mr. WHITNEY. It is the merchandising practice, sir, for the distribution of stock or securities or whatever it may be.

Mr. PECORA. It is a practice often resorted to to enable persons through pool operations to manipulate prices, is it not?

Mr. WHITNEY. You do not refer in this instance to Dominick & Dominick?

Mr. PECORA. I am referring to an abstract case, Mr. Whitney.

Mr. WHITNEY. I will ask to have that question repeated.

(Thereupon the question was read, as above recorded, as follows:)

Mr. PECORA. It is a practice often resorted to to enable persons through pool operations to manipulate prices, is it not?

Mr. WHITNEY. Yes; with the reserve with regard to the word "manipulate."

Mr. PECORA. Is there anything about that word which is harsh or displeasing?

Mr. WHITNEY. I think the word is usually used in the sense that some wrongdoing entails to it.

Mr. PECORA. Have you not heard that pool operations are often conducted for the purpose of pegging prices artificially so as to enable pool members to sell to the investing public the shares which they meanwhile have accumulated? In other words, by exciting or stimulating the demand through their own buying and selling operations do they not often lead the public to pay higher prices in the market than the security is actually worth?

Mr. WHITNEY. I have never known of a pool, Mr. Pecora, that was successful in merchandising or selling its securities unless its operation was in accordance with the trend of the market at that time.

Mr. PECORA. Do you think that the operations of 1928 and 1929 were in accordance with a normal trend of the market? Or do you think that they were in accordance with an artificial trend?

Mr. WHITNEY. I think the market did what it did in 1928 and 1929 largely on its own resources, without any operations as you state. I would refer you to United States Steel. I would refer you to General Electric. To New York Central. To General Motors. To a hundred, two hundred, three hundred others, where I have never heard, sir, that there was a pool in operation.

Mr. PECORA. In those instances, Mr. Whitney, would you say that the peak prices reached on the exchange for those securities, were justified by the earnings' statements?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. Just at that time, yes. I will not say all. Now, let me——

Mr. PECORA. No. Well, you will not say all?

Mr. WHITNEY. But in large measure the earnings of those corporations justified their prices at the time.

Mr. PECORA. Would you say that about Radio in 1928 and 1929?

Mr. WHITNEY. I tried to explain Radio was what is called a mystery stock.

Mr. PECORA. What characteristics must a stock have in order to come within that classification of a mystery stock?

Mr. WHITNEY. I do not quite know, except that people believe or say—there are rumors that the company has undeclared profits, that is has undeclared inventions, patents, contracts, and those are the very things, sir, that we are trying to have adjusted by more complete, more detailed, and more frequent information regarding those corporations that are listed.

Mr. PECORA. And when you get that information you say that even if the quotations went far beyond the prices or values given by those statements the exchange would do nothing about it?

Mr. WHITNEY. I did not think that we had received any values. We received the information upon which anybody interested in the purchase or sale of those securities could base their opinion.

Mr. PECORA. Do you make that information available to the public?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. How?

Mr. WHITNEY. It is available to the public to anybody that wants to apply at the exchange, and we also demand under certain conditions that these reports to us will be made public where there are quarterly reports. It is only, as I understand, that we demand an audited statement once a year, but we call for quarterly or semi-annual reports which shall be published and made available also to the shareholders.

Mr. PECORA. And anyone can go down to your exchange and have ready access to those financial statements?

Mr. WHITNEY. Anybody in the world; yes, sir. We can not give copies of those out indefinitely, because we have not got them, but anybody may come and look at our files at any time.

Mr. PECORA. Has any public pronouncement ever been made of that by the exchange?

Mr. WHITNEY. I think I have said it myself; yes, sir, publicly.

Mr. PECORA. You have referred on various occasions during the day to the Manhattan Electric Supply issue in which the exchange took some action because it found that pools had operated in violation of rules.

Mr. WHITNEY. Individuals, sir.

Mr. PECORA. That is individuals——

Mr. WHITNEY. If my memory serves me.

Mr. PECORA (continuing). Who were members of the pool?

Mr. WHITNEY. If you wish it. I would not call it a pool.

Mr. PECORA. Upon whom was the disciplinary action of the exchange visited?

Mr. WHITNEY. In the first case we found no misconduct on the part of our members. We found a misconduct on the part of in-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

dividuals connected with the company, and I believe a firm that previously had been—or individual that previously had been connected with our exchange. In that the information, or that the facts showed that it was beyond our specific control we turned it all over, everything, to the office of the attorney general of the State of New York. That was in the first instance.

In the second instance I believe some of the same men were operating, washing stock, and because if greater care, greater scrutiny had been used by one of our members who allowed the facilities of his office to be wrongfully used, perhaps these transactions could not have taken place. Certainly not through him. And he was suspended for five years.

Mr. PECORA. Does the exchange enforce a uniform system of accounting upon the corporations whose securities are listed?

Mr. WHITNEY. No, sir. That would be impossible.

Mr. PECORA. Why?

Mr. WHITNEY. Well, I think that is self-evident. That a railroad, an oil company, a manufacturing company, a motor company, can not have the same form of accounting.

Mr. PECORA. Well, might it not devise separate forms of accounting for different classifications like industrial stocks in one class, railroad stocks in another, and so forth?

Mr. WHITNEY. Possibly. Of course the Interstate Commerce Commission dictates as to railroads. The New York Stock Exchange, particularly through Mr. Hoxsey has been in the closest touch with the American Institute of Accountants for some years in this particular regard. And there was appointed by that institute a committee which was entitled "The committee to cooperate with stock exchanges." That subject, if I may briefly add to what I have said, Mr. Pecora, has been having the most extreme care and investigation and attention by that committee and our own representatives. And we have adopted, or there has been adopted the Federal Reserve Board's so-called minimum requirements for corporate accounting by the exchange with relation to corporations that seek listing. That is an evolutionary process.

Mr. PECORA. You said this morning in answer to a question that Senator Brookhart asked you that you do not favor limiting speculation of any kind? Am I correct?

Mr. WHITNEY. I said I did not favor limiting speculation of any kind with reference to his question as to speculation on the exchange, and I had in mind also speculation in its true and proper sense.

Mr. PECORA. What is the true and proper sense of speculation in which you use that term?

Mr. WHITNEY. I think speculation, sir, has built this country.

Mr. PECORA. What is the improper sense in which that term "speculation" is used?

Mr. WHITNEY. Where the word "speculation" is used when denoting gambling.

Mr. PECORA. Would you say that speculative trading of that character in issues listed on the stock exchange is indulged in?

Mr. WHITNEY. In the main, no. The line of distinction I grant is delicate.

Mr. PECORA. Where do you draw it?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. WHITNEY. Personally I draw it: Where a man speculates he buys something for a rise or with a possibility of loss that he can not himself at the time of purchase or sale determine. A gambler gambles for a fixed sum and can not lose more.

Mr. PECORA. Do you not think that a very considerable amount of trading of that kind is indulged in on the stock exchange?

Mr. WHITNEY. Not in a true sense, Mr. Pecora, no. If you will specifically tell me what you have in your mind I will answer it the best I can.

Mr. PECORA. What I have in my mind is the very kind of speculation that you have defined as gambling.

Mr. WHITNEY. That can not be so in the main in stock exchange transactions.

Mr. PECORA. Why can it not be so, Mr. Whitney?

Mr. WHITNEY. Because you buy a hundred shares of stock; you never know what you are going to get out of it, at either up or down.

Mr. PECORA. Well, is that the element that takes it out of the gambling classification of speculation?

Mr. WHITNEY. As I tried this morning to say, the difference between speculation and investment lies in the intent. The investor buys to hold thinking or expecting to have security in his capital and because of the income therefrom. A speculator buys in order to have an appreciation in the capital.

Mr. PECORA. And the gambler buys for what purposes?

Mr. WHITNEY. The gambler—well, I say there is a small distinction. I use the word in so far as the purchase or sale of securities, or commodities, or real estate, or whatnot is concerned, that that is not gambling. It is speculation.

Mr. PECORA. Well, what would constitute speculation of the kind that you would classify as gambling?

Mr. WHITNEY. I do not know what there is. That is what I have said.

Mr. PECORA. You have said that there was a delicate line between——

Mr. WHITNEY. There is a delicate line.

Mr. PECORA (continuing). Between the right kind of speculation and the gambling kind of speculation, so that you must have some idea of what constitutes the kind of speculation you characterize as gambling in order to recognize that there is a delicate line dividing the two classes?

Mr. WHITNEY. Yes, sir; I grant it. I suppose that an individual who bought 100 shares of stock hoping that the market was going to carry up and then immediately tried to sell it, that would hardly be called a speculator in the true sense. Although without his will be may be a speculator in the true sense. But his intent may be merely to gamble. Just as a man may risk a dollar on the flip of a coin.

Mr. PECORA. So that it is all a matter of intent which controls?

Mr. WHITNEY. It seems to me so, yes.

Mr. PECORA. How do you determine the intent of a traders in his market operations?

Mr. WHITNEY. How do I? I do not know what his intent is, sir.

Mr. PECORA. Then how are you able to recognize any line that distinguishes an honest or proper kind of speculative trading from an

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

improper kind or gambling kind, if you have no way of ascertaining the intent?

Mr. WHITNEY. I have not, Mr. Pecora, any more than I know whether a man buys shares—officially I can not know when a man buys shares of stock on the exchange whether he is an investor or a speculator.

Mr. PECORA. Then as far as you know to the contrary the majority of the speculative buying might be of the gambling variety, might it not?

Mr. WHITNEY. I do not think so, sir.

Mr. PECORA. What is your test for determining it? If you say that intent is the test and you are unable to ascertain intent, how could you say whether it is or not?

Mr. WHITNEY. I say I do not think so. I do not say that it is not. I do not think so. The very fact that individuals, particularly in the speculative era of 1926, 1927, 1928, and 1929, in there—with brokers' loans denoting large margin accounts, or a large volume of margin accounts, when they mounted so, that denotes to my mind, and I think to any fair-minded person, a great wave of speculation and not gambling.

Mr. PECORA. Mr. Chairman, I suggest that recess be now taken. I do not want it understood that this concludes my examination of Mr. Whitney. But at some future time I shall resume this with the permission of the committee.

The CHAIRMAN. The committee will adjourn until tomorrow at 10 o'clock. The witnesses will appear at that time. You are excused for the time being. You need not be here, Mr. Whitney.

Mr. WHITNEY. Thank you, Senator.

(Thereupon, at 4.50 p. m., Wednesday, March 1, 1933, an adjournment was taken until 10 o'clock a. m. the next day, Thursday, March 2, 1933.)

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

STOCK EXCHANGE PRACTICES

THURSDAY, MARCH 2, 1933.

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

The subcommittee met, pursuant to adjournment on yesterday, at 10 o'clock a. m. in room 301, Senate Office Building, Senator Peter Norbeck presiding.

Present: Senators Norbeck (chairman), Walcott and Carey.

Present also: Senator Brookhart.

Further present: Ferdinand Pecora, special counsel to the committee; Julius Silver and David Saperstein, associate counsel to the committee.

The CHAIRMAN. The subcommittee will come to order.

Mr. PECORA. Mr. Mitchell.

FURTHER TESTIMONY OF CHARLES E. MITCHELL, NEW YORK CITY

(The witness was sworn on his prior appearance before the committee.)

Senator BROOKHART. Mr. Chairman, I would like to ask Mr. Mitchell a few questions. I have to go in just a few minutes.

The CHAIRMAN. Very well. Proceed, Senator.

Senator BROOKHART. Mr. Mitchell, Mr. George E. Roberts is a vice president of the National City Bank, is he not?

Mr. MITCHELL. That is true.

Senator BROOKHART. Is he still vice president?

Mr. MITCHELL. He is. He has a title of economic advisor in addition to his vice presidency.

Senator BROOKHART. In addition to being vice president. What is his salary?

Mr. MITCHELL. I can not be certain from memory, but I should say offhand that it was $25,000.

Senator BROOKHART. Does he have any bonus then?

Mr. MITCHELL. He has participated in the management fund; yes, sir.

Senator BROOKHART. Do you know what that amounts to?

Mr. MITCHELL. No; I can not tell you, Senator.

Senator BROOKHART. Can you give an approximate idea?

Mr. MITCHELL. No; I really could not.

Senator BROOKHART. Have you records here so you can put it in the record later?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. MITCHELL. I can give it to you; yes, sir. I do not think that we have anything here. I think I will have to introduce it later; I will have to send it to you, Senator.

Senator BROOKHART. Well, his participation would be a good deal more than his salary, would it not?

Mr. MITCHELL. I should judge not.

Senator BROOKHART. It would up to 1929?

Mr. MITCHELL. I should judge not. But it would be a matter of record.

Senator BROOKHART. I will have you put it in the record. Now he controls a big newspaper out at Fort Dodge, Iowa; I believe his son is in charge of it now, or in control of it. And that paper has very strongly advocated the reduction of Government salaries, and I wanted to know something about his own situation.

Mr. MITCHELL. I did not know that he owned, controlled, or in any way managed or had anything to do with a newspaper in Fort Dodge, Iowa.

Senator BROOKHART. I learned from a Fort Dodge man this morning that he still has charge of it through his son. And he has had it, I know, before that for a long time. And I wonder if you have any other vice presidents controlling newspapers over the United States.

Mr. MITCHELL. No, sir. And I would doubt very much indeed if that could be substantiated with respect to Mr. Roberts. I have never heard of it. I never have heard of Mr. Roberts doing any writing or paying any attention whatsoever to any outside interest of that character.

Senator BROOKHART. I heard of it this morning from the most distinguished citizen of his town, so I think it is not a wild rumor. And I have heard of it in former years myself.

Mr. MITCHELL. All I can say is that I never have heard of it.

Senator BROOKHART. Then if you will put those figures in the record, why that is all I will ask at this time.

(Thereafter a letter, supplying certain information desired of the witness, was received by the chairman, which is made a part of the record, as follows:)

NEW YORK, *March 4, 1933.*

Senator PETER NORBECK,
Chairman Subcommittee, Senate Office Building,
Washington, D. C.

MY DEAR SENATOR NORBECK: In compliance with the request that Senator Brookhart made of Mr. Mitchell at the hearing yesterday in Washington, I advise you that the salary of Mr. George E. Roberts as vice president of the National City Bank in 1929 was $30,000 and his share of the management fund for that year was $20,000. Mr. Roberts sold all interest that he had in a newspaper in Fort Dodge, Iowa, over 20 years ago. He now has no interest in any newspaper in Fort Dodge, and no son of his is in charge of a newspaper in Fort Dodge or controls a newspaper in Fort Dodge.

I am writing this letter because my father is out of town at present.

Very truly yours,

GEO. B. ROBERTS.

Mr. PECORA. Mr. Mitchell, when you were examined before this committee last Friday, February the 24th, you were questioned among other things on the subject of the opinion which was submitted by Solicitor General Lehmann to the Attorney General of the United

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

States under date of November 11, 1911. Do you recall the testimony in question?

Mr. MITCHELL. I do.

Mr. PECORA. My recollection is that you then testified that you had seen a copy of that opinion or memorandum several years ago. Do you recall that?

Mr. MITCHELL. Yes.

Mr. PECORA. Did you at that time have in your possession a copy of that opinion or memorandum?

Mr. MITCHELL. Mr. Pecora, my recollection is entirely vague about it. I could not tell you when I saw it. It seemed to me that that was something that Senator Glass had introduced into the record at some time or another. I am uncertain. In general I have known that there was such an opinion, and my recollection is that I had at some time or another seen the opinion. To indicate that I had read that opinion with care at any particular time I could not possibly testify.

Mr. PECORA. Well, you said last Friday that you had seen a copy of the opinion several years ago.

Mr. MITCHELL. Yes.

Mr. PECORA. Where did you see it? In New York or Washington or elsewhere?

Mr. MITCHELL. No; it is something that I have seen somewhere at some time, certainly not in Washington. I never connected Washington in any way with it.

Mr. PECORA. Can you tell the committee how many years ago it was that you saw a copy of that opinion?

Mr. MITCHELL. No, I can not. I would say that very likely I never saw any part of that opinion until, according to my recollection, it was introduced somewhere by Senator Glass at some time. Prior thereto I had understood that when the National City Co. was formed in 1911 there was an adverse opinion that had to do particularly with the holding of bank stocks.

Mr. PECORA. National bank stock?

Mr. MITCHELL. National bank stock. When the City Co. was formed—I am giving this from impression because, of course, I had no connection with it then.

Mr. PECORA. You had no connection with it then.

Mr. MITCHELL. There was a portfolio of bank stocks introduced into that company's assets at its very outset, and I had assumed that the question that was up had to do very largely with the propriety of their holding of such bank stocks. And that as an outcome of the discussion as to the proprieties at that time it was determined that the company should not find its future through a channel that looks as though it might have been in part the raison d'etre of the organization of the National City Co. It did dispose of that portfolio, and at the time I came into the National City Co. it did not own bank stocks. And has not since.

Mr. PECORA. Do you recall who it was that showed you the copy of the opinion in question?

Mr. MITCHELL. I do not, Mr. Pecora.

Mr. PECORA. Was it a typewritten copy or a printed copy?

Mr. MITCHELL. I do not recall that. My recollection about it is perfectly vague, Mr. Pecora. I have simply the knowledge that I

119852—33—PT 6——33

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

have spoken of here with perfect truth and frankness.

Mr. PECORA. Mr. Mitchell, have you any recollection of the identity of the person who showed it to you?

Mr. MITCHELL. No; I have not.

Mr. PECORA. Was it as you now recall some one connected either with the bank or the National City Co.?

Mr. MITCHELL. That I do not recall. As I say, my impression is that at some time or another some record of that opinion was introduced by Senator Glass. Now beyond that I have no recollection of it. Whether it was in a record or whether I may have asked somebody about it and got a copy of that record I truthfully can not say.

Mr. PECORA. Nor do you recall who it was that had a copy of it and showed it to you?

Mr. MITCHELL. I do not.

Mr. PECORA. How long ago, would you say, you saw a copy of it? Last Friday you stated that it was several years ago.

Mr. MITCHELL. Yes; I stated——

Mr. PECORA. I will read to you your testimony on that. The question specifically was: "Did you ever hear of that?" Meaning the opinion. You answer was "I have heard of that, and at one time I read it, but I do not recall it now. It has been many, many years since I saw it."

Mr. MITCHELL. Yes. That was an impression that was in my mind at the time. The existence of that opinion or anything about it had not entered into my mind for so long that it is simply a vague recollection of having heard that there was such an opinion, and at some time or another having seen parts of it, or it may be all of it. I could not say. Whether it was 3 years or 5 years or 10 years ago I simply could not answer, Mr. Pecora.

Mr. PECORA. The incident to which you have alluded this morning, namely, that of Senator Glass having had that opinion incorporated into a record, took place on May 10, 1932, when Senator Glass spread that opinion on the Congressional Record in the course of proceedings on the floor of the Senate. Now, the date of that occurrence is less than a year ago, May 10, 1932. You feel quite certain, do you not, that the copy which you saw was shown you years before May 10, 1932?

Mr. MITCHELL. I would not say so. Now that you say this, I think it very likely it may have been even as late as that that I saw this. I had heard that there was such an opinion many, many years ago.

Mr. PECORA. Do you know whether the bank or the company ever had a copy of the opinion in its files?

Mr. MITCHELL. I can not answer that, Mr. Pecora. I should think it was very doubtful. If in file at all I should think likely it would be in the files of counsel.

Mr. PECORA. Is that Shearman & Sterling?

Mr. MITCHELL. I am prompted by counsel to say that the secretary of our company has looked in the files of the National City Co. for evidence of that opinion and has been unable to locate it.

Mr. PECORA. Did you ever see a copy of the opinion of August 1, 1911, referred to in the opinion of Solicitor General Lehmann, which is dated November 6, 1911?

Mr. MITCHELL. Is this the same opinion that you have been talking about?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. No; the opinion that we have been discussing, Mr. Mitchell, is one dated November 6, 1911, submitted by Mr. Lehmann to the then Attorney General of the United States. And in that opinion he refers to an opinion which he submitted to the Attorney General on August 1, 1911.

Mr. MITCHELL. If I ever have seen it I do not recall. If you would ask me definitely to say yes or not I should say no.

Mr. PECORA. That is all with Mr. Mitchell, Senator.

The CHAIRMAN. You will be excused, then, from any further attendance at this hearing.

Mr. MITCHELL. Thank you.

Mr. PECORA. Mr. Russell, please take the stand.

The CHAIRMAN. You do solemnly swear that the evidence you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

Mr. RUSSELL. I do.

TESTIMONY OF STANLEY A. RUSSELL, VICE PRESIDENT OF THE NATIONAL CITY CO., MONTCLAIR, N. J.

Mr. PECORA. What is your full name, please?

Mr. RUSSELL. Stanley A. Russell.

Mr. PECORA. Your address?

Mr. RUSSELL. Montclair, N. J.

Mr. PECORA. What is your business or occupation?

Mr. RUSSELL. Vice president of the National City Co.

Mr. PECORA. How long have you been a vice president of the National City Co.?

Mr. RUSSELL. Since June, 1922.

Mr. PECORA. Prior to that time did you have any connection with that company in any other office or capacity?

Mr. RUSSELL. Assistant vice president.

Mr. PECORA. When did you first become connected with the National City Co.?

Mr. RUSSELL. In August, 1918.

Mr. PECORA. Since becoming a vice president of that company have you been assigned to any particular department or branch of the company's business?

Mr. RUSSELL. I have been responsible for a part of its industrial financing and its public utility financing.

Mr. PECORA. Have you been in charge of that branch of its work?

Mr. RUSSELL. I have shared the responsibility of the industrial financing with another officer and have been responsible largely for the public utility work.

Mr. PECORA. Tell us generally, will you, Mr. Russell, your duties as a vice president in the fields that you have referred to?

Mr. RUSSELL. How far do you want me to go, Mr. Pecora?

Mr. PECORA. Just far enough to give the committee a comprehensive idea of your duties as a vice president in the industrial and utilities division of the National City Co.'s work.

Mr. RUSSELL. Internally the responsibility embraces the selection and training of a staff of employees and junior officers to the end that they become competent in the analysis of corporation balance sheets,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

income accounts, the judgment upon investment securities, the direction of studies of various corporations by that staff, the contacting of officers of industrial and public utility corporations with whom we have financial relations and of those with whom we would like to have financial relations. I think in general that is about the picture.

Mr. PECORA. When you say that part of your duties consists of establishing contacts with the officers of industrial corporations with whom you would like to have business relations, what do you mean?

Mr. RUSSELL. Well, if our studies in the departments were to disclose a particular corporation which it appeared might require some financing at some future time and the past performance of that corporation was a creditable one we naturally would endeavor to become acquainted with the management of that company.

Mr. PECORA. With a view——

Mr. RUSSELL. With a view to doing the financing if, as, and when it developed.

Mr. PECORA. Did you also make similar studies with a view to bringing about or effecting mergers or combinations——

Mr. RUSSELL. Oh, yes.

Mr. PECORA (continuing). Of industrial corporations?

Mr. RUSSELL. Oh, yes.

Mr. PECORA. And that incidentally brought you the business of financing such a merger?

Mr. RUSSELL. That is right.

Mr. PECORA. That was rather a common practice of the National City Co., was it not, Mr. Russell?

Mr. RUSSELL. The development of a merger is not as common, I should not say, as simply buying an issue of bonds and selling it. It is a rather common occurrence; yes.

Mr. PECORA. Well, the National City Co. devoted itself with some care and particularity to that kind of business, did it not?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. That is to say, it had departments and officers whose business it was to survey a section of an industrial field, see what companies were operating in it, and, where in the opinion of the company a merger could be effected with profit and advantage, efforts were made to bring about such a merger or combination?

Mr. RUSSELL. Those suggestions, Mr. Pecora, usually came to us from the outside.

Mr. PECORA. Oh, you did not look the field over with a view of ascertaining——

Mr. RUSSELL (interposing). Sometimes, sometimes. But generally speaking, the idea of a consolidation will arise from the outside.

Mr. PECORA. Did you at any time during the years 1928 and 1929 get information concerning the business of the manufacture of agricultural machinery and implements?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. Was that information brought to your notice by anyone, or did you ascertain it for yourself?

Mr. RUSSELL. That was brought to my notice.

Mr. PECORA. By whom?

Mr. RUSSELL. Mr. Baker.

Mr. PECORA. Mr. Hugh B. Baker?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RUSSELL. Yes.

Mr. PECORA. He was then a vice president, was he not?

Mr. RUSSELL. Yes.

Mr. PECORA. And subsequently he became president of the National City Co.?

Mr. RUSSELL. That is right.

Mr. PECORA. As a result of having had your attention drawn to the business of manufacturing farm machinery and implements did you endeavor to bring about a merger or combination of any companies engaged in that business?

Mr. RUSSELL. Well, I should like to answer that this way. The suggestion to Mr. Baker was made to him by a personal friend, a business friend, an individual who was then interested financially in one of those companies. And his first suggestion to us was that we interest ourselves in financing his particular company.

Mr. PECORA. Which company was that?

Mr. RUSSELL. Nichols & Shepard Co., Battle Creek, Mich. Do you want me to go on with this?

Mr. PECORA. Yes, sir.

Mr. RUSSELL. Tell it in my own way?

Mr. PECORA. Yes, sir.

Mr. RUSSELL. We did look into the Nichols & Shepard Co., which was then prospering very considerably. But owing to the rather small size of that particular company we did not feel that we wanted to undertake its financing. Whereupon this gentleman made the suggestion that possibly a consolidation of that company with some others, which apparently had been discussed, could be developed. I then said that we would be very much interested in looking at that.

That is the preliminary history of it.

Mr. PECORA. Yes. What was the name of the gentleman connected with the Nichols & Shepard Co. who first discussed that subject with Mr. Baker and then with you?

Mr. RUSSELL. Mason B. Starring.

Mr. PECORA. When did Mr. Starring have a discussion of that subject with you and Mr. Baker?

Mr. RUSSELL. In August, 1928. I think it was August.

Mr. PECORA. Did he suggest the identity or names of the other companies with which a merger might advantageously be affected?

Mr. RUSSELL. He did later.

Mr. PECORA. What companies did he suggest?

Mr. RUSSELL. The Oliver Chilled Plow Works, of South Bend, Ind., and the Hart-Parr Co., of Charles City, Iowa.

Mr. PECORA. Did you then get in touch with the officers of those two corporations with a view to ascertaining whether or not they would be favorably disposed toward such a merger?

Mr. RUSSELL. Well, I first talked with Mr. Brown, the president of Nichols & Shepard, and he in turn talked with the officials of the Oliver Co. and of the Hart-Parr Co. with whom he had previously had some talks.

Mr. PECORA. The Nichols & Shepard Co. at that time was, you say, in a prosperous, flourishing condition?

Mr. RUSSELL. Very.

Mr. PECORA. How about the other two companies?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RUSSELL. The Hart-Parr Co. was likewise prosperous. The Oliver Co. was not so prosperous. But it was in good shape.

Mr. PECORA. The Oliver Co. was the largest of the three, was it not at that time?

Mr. RUSSELL. Somewhat. Somewhat.

Mr. PECORA. Well, from that point on did you have a series of conversations or conduct negotiations with the executive officers of those three companies with a view to merging them into one company?

Mr. RUSSELL. At various times; yes.

Mr. PECORA. Did you personally conduct those negotiations in behalf of the National City Co.?

Mr. RUSSELL. I did.

Mr. PECORA. The interest of the National City Co. in bringing about such a merger was what?

Mr. RUSSELL. The financing.

Mr. PECORA. Well, the three companies, you say, were in pretty good financial condition?

Mr. RUSSELL. Right.

Mr. PECORA. Was it necessary for them to have any financial support outside of their own resources in order to bring about such a combination or merger?

Mr. RUSSELL. It was desirable.

Mr. PECORA. Desirable to whom?

Mr. RUSSELL. To the new company.

Mr. PECORA. And to the National City Co.?

Mr. RUSSELL. Obviously.

Mr. PECORA. Is that not what really animated the National City Co.—a desire to make some money——

Mr. RUSSELL. Sure.

Mr. PECORA (continuing). Out of bringing about this merger through the handling of it?

Mr. RUSSELL. Certainly. That is what we are in business for.

Mr. PECORA. Now such a merger was eventually effected, was it not?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. When?

Mr. RUSSELL. The final consummation of the merger took place I think on April 2, 1929.

Mr. PECORA. April 2. What was the name of the new company?

Mr. RUSSELL. The final name was the Oliver Farm Equipment Co.

Mr. PECORA. What was the name originally of the new company?

Mr. RUSSELL. Oliver Agricultural Equipment Co.

Mr. PECORA. When was that incorporated?

Mr. RUSSELL. I think it was along in February.

Mr. PECORA. Of 1929?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. Under the laws of the State of Delaware?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. And you say the name of that corporation was subsequently changed?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. To the Oliver Farm Equipment Co.?

Mr. RUSSELL. Oliver Farm Equipment Co.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Oliver Farm. Now who were the officers of the Oliver Farm Equipment Co. at the outset?

Mr. RUSSELL. Do you mean before or after it acquired the properties of the predecessor companies?

Mr. PECORA. At the time of the incorporation and at the time it acquired the properties of the constituent companies.

Mr. RUSSELL. Well, Mr. Pecora, it was incorporated a month and a half before it acquired the actual properties.

Mr. PECORA. All right. Who were the officers at the time of incorporation?

Mr. RUSSELL. I think Mr. Winston was president, and I was secretary or vice president—I am not positive.

Mr. PECORA. The Mr. Winston you refer to is Mr. Garrard A. Winston, is it not?

Mr. RUSSELL. Mr. Garrard Winston; yes.

Mr. PECORA. Garrard B. Winston?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. Was he connected with the National City Co. at that time?

Mr. RUSSELL. He was a director and counsel.

Mr. PECORA. Who were the officers of the Oliver Farm Equipment Co. at the time that company acquired the three predecessor companies?

Mr. RUSSELL. Mr. J. D. Oliver was chairman of the board. I think Mr. John T. Nichols was vice chairman. Mr. M. W. Ellis was president. Mr. Brown was executive vice president. Mr. W. A. Weed was a vice president. And I think a Mr. Freeman was secretary.

Mr. PECORA. At the time this merger was effected were any of the predecessor companies indebted in any way to the National City Co.?

Mr. RUSSELL. The Nichols & Shepard Co. during the progress of the negotiations, as I recall it, was building an extension to its plant and needed some funds. They also contemplated retiring an issue of their notes which were convertible into stock. They wanted to get them out of the way. They proposed to go ahead with an additional offering of common stock to their stockholders to raise that money, which they could have done. But in view of the pendency of the negotiations for the consolidation we all thought it would be better if they did not go ahead with the stock offering and that they make a temporary loan to carry them through on the theory that that loan would be paid off out of the proceeds of financing, or if the consolidation did not go through they could then offer stock to their share holders and raise the necessary money. As a consequence for those purposes a temporary loan was made with the National City Bank, a small part of it in the fall of 1928; the greater part of it, approximately $2,000,000, was made I think the latter part of January or February. I am not sure which.

Mr. PECORA. January 31, 1929, was it not, that a loan of $1,939,-144.71 was made by the National City Bank to the Nichols & Shepard Co.?

Mr. RUSSELL. Yes. Prior to that particular circumstance the National City Bank had had no loans and I think no financial relations with any one of these three companies.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Now, what was the financial set-up of the merging corporation, the Oliver Farm Equipment Co.?

Mr. RUSSELL. Do you mean the corporate set-up?

Mr. PECORA. Yes.

Mr. RUSSELL. They had an authorized issue of prior preferred stock. I think it was 300,000 shares. They had had an authorized issue of convertible participating stock. And an authorized issue of common shares.

Mr. PECORA. You said the authorized number of shares of prior preferred stock was 300,000?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. Of any par value?

Mr. RUSSELL. No par value.

Mr. PECORA. And the authorized number of convertible participating stock was 750,000 shares?

Mr. RUSSELL. I think so.

Mr. PECORA. The authorized number of common stock was 2,000,000?

Mr. RUSSELL. I think so.

Mr. PECORA. Both without par value?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. Now did any of those issues carry any rights or warrants?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. Which of them?

Mr. RUSSELL. The prior preferred stock carried a purchase warrant to buy common stock over a period of 10 years.

Mr. PECORA. At what price?

Mr. RUSSELL. The first five years was a right to buy one and one quarter shares of common stock at $80 a share, and the last five years I think it was one share of common stock at $100 a share.

Mr. PECORA. Did the convertible participating stock have any rights or warrants?

Mr. RUSSELL. I think it had only the right to convert into the common stock share for share.

Mr. PECORA. What stock possessed the voting rights?

Mr. RUSSELL. As I recall, the convertible and the common stock both had voting rights, and the prior preferred stock had the usual voting rights of a preferred stock in the event of default. But not otherwise. That is my recollection.

Mr. PECORA. Upon what terms was this merger effected? That is to say, what was paid by the Oliver Farm Equipment Co. to the three predecessor companies for their respective rights and properties?

Mr. RUSSELL. The Oliver Farm Equipment Co. took over all the assets and assumed the liabilities of the Nichols & Shepard Co., the consideration therefor being the delivery by Oliver Farm Equipment Co. of 126,000 shares of convertible participating stock and 126,000 shares of common stock. The Oliver Farm Equipment Co. took over the assets and assumed the liabilities of the Hart-Parr Co., and the consideration therefor was 267,972 shares of convertible participating stock, and 133,986 shares of common stock. The Oliver Farm Equipment Co. took over the assets and assumed the liabilities of the Oliver Chilled Plow Works, the consideration being cash in the amount of $9,325,652, and 75,000 shares each of the convertible and common stock.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Have you a copy of the contract entered into between the National City Co. and the Oliver Agricultural Equipment Co. with respect to this merger?

Mr. RUSSELL. We have brought everything down you asked for. I do not know whether you asked for that or not. Did you?

Mr. PECORA. Yes; we asked for that contract. If you have not the original contract perhaps you have some data or record before you which will enable you to give the committee the essential provisions of that contract. Particularly with respect to the consideration to be paid to the National City Co. for its services in financing this combination or merger.

Mr. RUSSELL. Yes; I can give you that. There were a series of contracts. The National City Co. had a contract with the Oliver Farm Equipment Co. It may have been with the Oliver Agricultural Equipment Co. at that time. I mean the new company. The new company in turn had contracts with the three predecessor companies. All of these contracts were conditioned upon the fulfillment of each.

The National City Co. contract with the new company provided that the City Co. would purchase from the new company 200,000 shares of prior preferred stock, 31,028 shares of convertible participating stock, 15,014 shares of common stock, and options to purchase over a period of time 75,000 shares additional of common stock at varying prices. And the National City Co. paid for that package $20,625,652.

Mr. PECORA. That was paid in cash?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. On what date?

Mr. RUSSELL. I believe April 2, 1929.

Mr. PECORA. Now in arriving at that total purchase price of $20,625,652, was there any allocation of values given to the respective classes of stock that you were contracting to purchase?

Mr. RUSSELL. We did on our books.

Mr. PECORA. Well, did you in the negotiations, or was the allocation made after the purchase?

Mr. RUSSELL. I think, Mr. Pecora, the allocation was made after the purchase.

Mr. PECORA. But in the negotiations the National City Co. simply undertook to purchase this package of securities issued by the new company, for $20,625,652?

Mr. RUSSELL. That is right.

Mr. PECORA. Without any allocation——

Mr. RUSSELL. That is right.

Mr. PECORA (continuing). Or apportionment of value as among the three different classes of stock?

Mr. RUSSELL. That is right.

Mr. PECORA. Now when the allocation or apportionment of value was made by the National City Co. on its books the figures apportioned or allocated to the different classes of stock were arbitrary figures, were they not?

Mr. RUSSELL. Well, they necessarily were arbitrary, but I should express it this way, that we allocated a purchase price to the two senior stocks, and the rest of the cost was applied against the common. It so happened it worked out in pretty even figures.

Mr. PECORA. Who made that allocation or apportionment?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RUSSELL. I think I did.

Mr. PECORA. And what were the figures you ascribed in that fashion to the three classes of stock respectively?

Mr. RUSSELL. $94 a share on the prior preferred stock; $54 a share on the convertible participating stock; and $10 a share on the common stock.

Mr. PECORA. There is no doubt those were arbitrary figures, is there?

Mr. RUSSELL. I do not quite understand what you mean—arbitrary. Obviously the contract did not have them in it.

Mr. PECORA. The contract merely required the payment of a lump sum?

Mr. RUSSELL. That is right.

Mr. PECORA. The sum of $20,000,000 plus?

Mr. RUSSELL. That is right.

Mr. PECORA. In return for these three classes of stock in the amounts that you have stated?

Mr. RUSSELL. That is right.

Mr. PECORA. The apportionment or allocation of value to these three classes of stock was made by you in the exercise of an arbitrary judgment, was it not?

Mr. RUSSELL. Not an allocation of value. An allocation of cost.

Mr. PECORA. Well, that was made in the exercise of an arbitrary judgment, was it not.

Mr. RUSSELL. Yes.

Mr. PECORA. Now, you said that included in this purchase price of $20,625,000 and odd was an option which gave to your company the right to purchase 75,000 shares of the common stock at various prices. What were those prices?

Mr. RUSSELL. One fifth, I think, at the end of 1 year, at $10 a share; one fifth at the end of 2 years, at $20 a share; one fifth at the end of 3 years, at $30 a share; one fifth at the end of 4 years, at $40 a share; one fifth at the end of 5 years, at $50 a share.

Mr. PECORA. This option resided solely in the judgment of the National City Co. to exercise?

Mr. RUSSELL. That is right.

Mr. PECORA. Did the company exercise any of its rights under this option to acquire the common stock at these prices?

Mr. RUSSELL. Well, in the first place, we had partners in the business.

Mr. PECORA. Who were the partners you had?

Mr. RUSSELL. The National Republic Co., of Chicago, and Mason B. Starring, Jr., as an individual.

Mr. PECORA. Now, Mason B. Starring was an officer of the Nichols & Shepard Co.?

Mr. RUSSELL. Oh, no.

Mr. PECORA. I understood you to say that he was.

Mr. RUSSELL. No; he was a member of the firm of Campbell, Starring & Co., New York, and a director of the Nichols & Shepard Co., and interested in it as a stockholder.

Mr. PECORA. Or a director?

Mr. RUSSELL. Yes.

Mr. PECORA. Not an officer?

Mr. RUSSELL. I think he was a director.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Yes. And that is the gentleman who first brought this proposition to the notice of your company?

Mr. RUSSELL. Quite true.

Mr. PECORA. Was it because of that circumstance that he was taken in as a partner?

Mr. RUSSELL. That is right.

Mr. PECORA. What partnership interest was accorded to him?

Mr. RUSSELL. Seven and one-half per cent.

Mr. PECORA. That is a custom quite prevalent in this kind of business, is it not?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. That is, a certain percentage of profits is paid to the person who finds the business, so to speak?

Mr. RUSSELL. I would not say a certain percentage of profits. I would say that a fee, a payment, is made very frequently.

Mr. PECORA. And the payment is usually made on the basis of a percentage of the profits?

Mr. RUSSELL. I know of no common practice, Mr. Pecora.

Mr. PECORA. Well, was that done in the instance you are testifying about?

Mr. RUSSELL. We arrived at this figure. He wanted more, and we traded it out to 7½ per cent.

Mr. PECORA. Of what? The profit of the National City Co.?

Mr. RUSSELL. Seven and one-half per cent interest in the original terms account.

Mr. PECORA. I see. And the National Republic Co., I think you said?

Mr. RUSSELL. Yes.

Mr. PECORA. What interest did it acquire as a participant in the original terms account?

Mr. RUSSELL. Fifteen per cent.

Mr. PECORA. Why was the National Republic Co. taken in as a partner?

Mr. RUSSELL. Because they had been the bankers for the Hart-Parr Co.

Mr. PECORA. In other words, as the bankers for the Hart-Parr Co., one of the constituent companies in this merger, they had expected that would reap them certain profits if they continued as bankers of the company?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. They lost that position because the National City Co. stepped in and undertook upon effecting this merger to take care of the finances of the Hart-Parr Co.? Is that right?

Mr. RUSSELL. The president of the Hart-Parr Co. requested that we take the National Republic Co. into the account. And under the circumstances existing it is a common practice to do so.

Mr. PECORA. And the reason that the National Republic Co. was taken in as a partner was to make up to it for whatever loss of prospective profits would result from its being dislodged as the financier of the Hart-Parr Co.?

Mr. RUSSELL. It was a friendly recognition of their position.

Mr. PECORA. Well, their position was in substance that as financiers of the Hart-Parr Co. they expected to make certain profits if permitted to continue in that position, but on account of this

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

merger they would be dislodged from that position and those potential profits would not accrue to them?

Mr. RUSSELL. That is possible.

Mr. PECORA. That was the basis or consideration for this 15-percent interest, was it not?

Mr. RUSSELL. Sure.

Mr. PECORA. Is that a common practice?

Mr. RUSSELL. Sure.

Mr. PECORA. Was there any banking house which occupied a similar relationship to either of the other two predecessor companies in this merger?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. Who?

Mr. RUSSELL. Nichols & Shepard Co.

Mr. PECORA. Who were their bankers prior to the merger?

Mr. RUSSELL. Eastman, Dillon & Co.

Mr. PECORA. Were they taken care of in the same general fashion as the National Republic Co.?

Mr. RUSSELL. They were not.

Mr. PECORA. Was there any reason for leaving them out of consideration?

Mr. RUSSELL. They were not left out of consideration.

Mr. PECORA. Well, I asked you if they were taken care of and you said they were not.

Mr. RUSSELL. I beg your pardon, you asked if they were taken care of in the same fashion.

Mr. PECORA. They were taken care of for a similar reason?

Mr. RUSSELL. In some fashion.

Mr. PECORA. In some fashion?

Mr. RUSSELL. Yes.

Mr. PECORA. In what fashion?

Mr. RUSSELL. They were given an interest—I have forgotten how much—in the—I think, in the banking group.

Mr. PECORA. Amounting to what?

Mr. RUSSELL. I can not recall that, Mr. Pecora.

Mr. PECORA. Have you your contracts to show?

Mr. RUSSELL. I say they were given an interest in the banking group—I think it was the banking group. They had no interest in the original terms group. None of the parties signed these contracts except the National City Co. so far as the bankers were concerned. Now I have no information on what position Eastman, Dillon were offered.

Mr. PECORA. What is the original terms group that you have referred to so far? Explain why it was organized, who composed it, and the interests conceded or accorded to the members of the original terms group.

Mr. RUSSELL. An original terms group in investment banking practice is the first step above the purchase cost in most pieces of finance. For instance any banking house buys an issue of bonds at, let us say, 95. They may form an original terms group with one point in it.

Mr. PECORA. Do you mean one point profit?

Mr. RUSSELL. Yes; gross spread. Then they may form a banking group.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Yes, but what is the necessity for forming an original terms group? You see we just want a little general education.

Mr. RUSSELL. Primarily to carry the commitment.

Mr. PECORA. Was it necessary for the National City Co. in fulfilling its commitment of twenty million and odd dollars in this merger to have the financial assistance of anyone?

Mr. RUSSELL. Not necessary, no.

Mr. PECORA. Did it receive any financial assistance from anyone else?

Mr. RUSSELL. We had their commitment.

Mr. PECORA. When you say you had their commitment, what do you mean?

Mr. RUSSELL. They were committed to their pro rata portion of the business—namely, 15 per cent and 7½ percent.

Mr. PECORA. The National City Co. did not need any such commitment from them, did it?

Mr. RUSSELL. Did not need it, no.

Mr. PECORA. Who were the participants in the original terms group? Name all of them.

Mr. RUSSELL. The National City Co. 77½ per cent. National Republic Co. 15 per cent. Mason B. Starring, jr. 7½ per cent.

Mr. PECORA. Now outside of the National City Co. none of the participants in this original terms group actually advanced any moneys for the carrying out of this merger?

Mr. RUSSELL. No. Until they paid for the securities which they had sold, if they sold any.

Mr. PECORA. Was it necessary for the original terms group to sell?

Mr. RUSSELL. Well, they naturally followed through into later groups except Starring. He did not. His firm did.

Mr. PECORA. Did the other members of the original terms group follow through?

Mr. RUSSELL. The National Republic Co. did. We did.

Mr. PECORA. The members of the original terms group, by the way, were all let in on the same terms as the National City Co.?

Mr. RUSSELL. Oh, yes. That is what an original terms group is.

Mr. PECORA. They paid $94 a share for the prior preferred stock, $54 a share for the convertible stock, and $10 a share for the common shares, is that right?

Mr. RUSSELL. Well, an account like that, Mr. Pecora, is not parceled out in that way.

Mr. PECORA. How was it parceled out in this case?

Mr. RUSSELL. We handled a syndicate—we headed a syndicate and managed it.

Mr. PECORA. And put up all the money?

Mr. RUSSELL. Yes.

Mr. PECORA. What management fee did the agreement provide that the National City Co. was to receive?

Mr. RUSSELL. Receive from whom?

Mr. PECORA. From whomever was to pay it. From the profits, in other words?

Mr. RUSSELL. There was no fee from the Oliver Farm Equipment Co. We bought something at a price. The bankers made the profit above that price. It is common in syndicate agreements to have a management fee of a certain per cent of the gross profit in the ac-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

count, which fee obviously comes out of the other members of the syndicate for the effort of management. I do not recall whether in this particular one we had such a management fee. We may have. It is generally common practice in the Street to do so.

Mr. PECORA. Well now, after the formation of this original terms group which included the National City Co., Mr. Starring and the National Republic Co., was another group formed for the purpose of floating the stock?

Mr. RUSSELL. There was. I can not remember, Mr. Pecora, whether it was a banking group or a distributing group or what it was.

Mr. PECORA. Perhaps your records will enlighten you.

Mr. RUSSELL. Not here. I haven't them. We formed a distributing group.

Mr. PECORA. How many persons or corporations composed the distributing group.

Mr. RUSSELL. Well, you mean dealers? Thirty-six.

Mr. PECORA. All dealers?

Mr. RUSSELL. All except Starring.

Mr. PECORA. Was Starring also a member of the distributing group?

Mr. RUSSELL. Yes.

Mr. PECORA. Mr. Starring you said was a director of the Nichols & Shepard Co.?

Mr. RUSSELL. I think so.

Mr. PECORA. Was the fact of his interest in the profits first of the original terms group and secondly of the distributing group, made known to the officers and stockholders of the Nichols & Shepard Co., Mr. Russell?

Mr. RUSSELL. It was made known to the officers, yes.

Mr. PECORA. Not to the stockholders?

Mr. RUSSELL. I do not know.

Mr. PECORA. Is that ethical?

Mr. RUSSELL. Well, of course that is not our responsibility.

Mr. PECORA. Well, it was your responsibility to the extent that you took him in as a partner——

Mr. RUSSELL. Yes, sure.

Mr. PECORA (continuing). In the original terms group?

Mr. RUSSELL. Sure.

Mr. PECORA. Do you think it ethical to do that without giving information of that participating interest to the stockholders of the company of which he was a director?

Mr. RUSSELL. We had no responsibility to the stockholders of the Nichols & Shepard Co.

Mr. PECORA. Well, do you think it was an ethical and sound thing to do?

Mr. RUSSELL. Well, I will answer you this way. I think if I had been in Mr. Starring's place I would have disclosed that information. And he may have done so. I do not know.

Mr. PECORA. You know that it is a sound and equitable principle for an officer and director of a corporation not to make any secret profit——

Mr. RUSSELL. Absolutely.

Mr. PECORA (continuing). Out of a transaction involving the corporation?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RUSSELL. Absolutely.

Mr. PECORA. So far as you know the stockholders of the Nichols & Shepard Co. never learned of the secret interest that Mr. Starring had in the profits of the original terms group and the distributing group?

Mr. RUSSELL. I do not know.

Mr. PECORA. Was Mr. Starring's name ever made public in connection with the flotation of the stock of the Oliver Farm Equipment Co.?

Mr. RUSSELL. I do not recall.

Mr. PECORA. I show you this circular and ask you if that is one of the circulars or prospectuses put out by the Oliver Farm Equipment Co. in floating these securities.

Mr. RUSSELL. Yes, sir.

Mr. PECORA. Do you see Mr. Starring's name mentioned anywhere as a participant in either the original terms group or the distributing group?

Mr. RUSSELL. No, sir; I know it is not there.

Mr. PECORA. You know it is not there?

Mr. RUSSELL. It would not be there.

Mr. PECORA. Would it be in any other printed matter generally circulated?

Mr. RUSSELL. I do not know what communications the officers or directors of the Nichols & Shepard Co. may have made to their shareholders.

Mr. PECORA. You know it was necessary for the shareholders of the Nichols & Shepard Co. to agree to this merger?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. And they did agree to it?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. It was part of your business as manager of the negotiations for the merger, in behalf of the National City Co., to see that the merger was duly approved by the stockholders of the constituent companies, was it not?

Mr. RUSSELL. Yes.

Mr. PECORA. In that connection, did you see what notice was sent out to the stockholders of the Nichols & Shepard Co. concerning this proposed merger?

Mr. RUSSELL. I saw one.

Mr. PECORA. Did it state or indicate that Mr. Starring, the director of the company, had a secret interest in profits that would accrue to the managers of the merger?

Mr. RUSSELL. I do not recall.

Mr. PECORA. Do you know whether or not any person who was an officer or director of the National Republic Co. was an officer or director of any of the three constituent companies in this merger?

Mr. RUSSELL. I think Mr. Samuel White, who was an officer of the National Republic Co., was also a director of the Hart-Parr Co.

Mr. PECORA. With respect to him, do you know whether or not the stockholders of the Hart-Parr Co. were told that Mr. White would participate as an officer of the National Republic Co. in a secret profit from this underwriting?

Mr. RUSSELL. He individually did not participate.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. He did as a stockholder of the National Republic Co., did he not?

Mr. RUSSELL. His firm did.

Mr. PECORA. His corporation did?

Mr. RUSSELL. His corporation did.

Mr. PECORA. What officer was he in that company?

Mr. RUSSELL. I think he was president; I am not sure. That was an affiliate of the bank.

Mr. PECORA. Which bank?

Mr. RUSSELL. The National Republic Bank—I have forgotten the name of it.

Mr. PECORA. Was it an investment affiliate?

Mr. RUSSELL. Yes.

Mr. PECORA. Who was president of that bank?

Mr. RUSSELL. I have forgotten.

Mr. PECORA. Is that the bank of which General Dawes was chairman?

Mr. RUSSELL. No; not at that time.

Mr. PECORA. He was subsequently?

Mr. RUSSELL. There was a merger.

Mr. PECORA. That is the bank?

Mr. RUSSELL. That bank merged with General Dawes' bank; but at that time it had no connection with it, as far as I know.

Mr. PECORA. The original terms group took over the prior preferred stock at $94 a share, did it not?

Mr. RUSSELL. Yes.

Mr. PECORA. Two hundred thousand shares?

Mr. RUSSELL. Right.

Mr. PECORA. And the original terms group also had 31,028 shares of the convertible participating stock?

Mr. RUSSELL. No. The convertible and common stock, I think, went into what you would call a joint members' account.

Mr. PECORA. Did any of the members of the original terms group have any interest in the 31,028 shares of convertible participating stock?

Mr. RUSSELL. Oh, yes.

Mr. PECORA. Or the 15,014 shares of the common stock which the National City Co. acquired?

Mr. RUSSELL. The same interest, I think.

Mr. PECORA. What do you mean by "the same interest"?

Mr. RUSSELL. Seventy-seven and a half, 15 and 7½.

Mr. PECORA. Who had that interest—the members of the original terms group?

Mr. RUSSELL. Yes.

Mr. PECORA. The National Republic Co. and Mr. Starring?

Mr. RUSSELL. That is right; that is my recollection.

Mr. PECORA. When the distributing group, composed of 35 dealers and Mr. Starring, was formed, upon what terms did they participate in the distribution of this stock?

Mr. RUSSELL. The distributing group dealt only with the prior preferred stock.

Mr. PECORA. Only with the 200,000 shares of prior preferred stock?

Mr. RUSSELL. Right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. The members of the distributing group had no interest in either the convertible participating stock or the common stock?

Mr. RUSSELL. I am pretty sure that is right.

Mr. PECORA. On what terms were they permitted to participate in the prior preferred stock?

Mr. RUSSELL. Ninety-six.

Mr. PECORA. That is an advance of 2 points over the price at which the original terms group took the stock?

Mr. RUSSELL. That is right.

Mr. PECORA. What was the necessity for organizing this distributing group at an advance of $2 a share for the prior preferred stock?

Mr. RUSSELL. I beg your pardon?

Mr. PECORA. What was the necessity for organizing this distributing group?

Mr. RUSSELL. Mr. Pecora, we were merely following the usual practice in the handling of an operation of this kind, which is to form a distributing or banking group above the original terms group, and to invite into that group a larger list of dealers, the more important and larger dealers. That is done in every operation in Wall Street in financing; and from there on you form a selling syndicate which embraces a great many more dealers who do the distribution.

Mr. PECORA. Did not the National City Co. have its own selling facilities?

Mr. RUSSELL. Sure.

Mr. PECORA. For marketing these securities to the public?

Mr. RUSSELL. Sure.

Mr. PECORA. Why was it necessary, then, to resort to this common practice, as you say, of organizing a distributing group and giving it a 2-point profit?

Mr. RUSSELL. Because we are not the only ones selling securities in this country.

Mr. PECORA. You said that the National City Co. had its own facilities for marketing its stock?

Mr. RUSSELL. Right.

Mr. PECORA. Why did it not market the stock through its own facilities?

Mr. RUSSELL. We did.

Mr. PECORA. But you took in with you other dealers?

Mr. RUSSELL. Sure.

Mr. PECORA. Did the National City Co. always do that?

Mr. RUSSELL. We always do it; it is common practice.

Mr. PECORA. Was there any group after this distributing group, like a wholesale or selling group?

Mr. RUSSELL. There was a selling group.

Mr. PECORA. Before that was there not a wholesale group, so called?

Mr. RUSSELL. According to my records, when you say "wholesale group" you must refer to the distributing group.

Mr. PECORA. No. The original terms group took over the prior preferred stock at $94 a share?

Mr. RUSSELL. Right.

Mr. PECORA. Then it was passed on to a distribution group at $96?

Mr. RUSSELL. Right.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Was it not then passed on to a so-called wholesale group at 97½ a share?

Mr. RUSSELL. My records do not show that, Mr. Pecora.

Mr. PECORA. If you will look among your records, I think you will find that there was a wholesale group formed to take over these 200,000 shares of prior preferred stock at 97½.

Mr. RUSSELL. Well, that is what I have as a selling group.

Mr. PECORA. Oh. You call it a selling group?

Mr. RUSSELL. That is right.

Mr. PECORA. How many participants were in this selling group?

Mr. RUSSELL. A hundred and ninety-four.

Mr. PECORA. Did this group include persons who had been officers or directors of the three predecessor companies?

Mr. RUSSELL. I will have to look over the list, Mr. Pecora. I have a list here.

Mr. PECORA. First see whether Mr. Starring's name is on the selling group list.

Mr. RUSSELL. No.

Mr. PECORA. Do you recognize the names of any other persons who were officers or directors of the predecessor companies?

Mr. RUSSELL (after referring to memoranda). I do not find any, Mr. Pecora.

Mr. PECORA. Now, this selling group was brought into the picture to make the actual distribution to the investing public?

Mr. RUSSELL. Right.

Mr. PECORA. And they took over the prior preferred stock at 97½?

Mr. RUSSELL. That is right.

Mr. PECORA. The convertible participating stock and the common stock remained in the original terms group?

Mr. RUSSELL. That is right.

Mr. PECORA. The National City Co., 77½ per cent; the National Republic Co., 15 per cent; and Mr. Starring 7½ per cent?

Mr. RUSSELL. That is right.

Mr. PECORA. Did the selling group then offer that prior preferred stock to the public?

Mr. RUSSELL. Yes.

Mr. PECORA. Was it all sold?

Mr. RUSSELL. Yes.

Mr. PECORA. At what price?

Mr. RUSSELL. $100 a share. That was the list price.

Mr. PECORA. How was it offered to the public—through what media?

Mr. RUSSELL. The usual method of a syndicate—advertising, through its various dealers; the usual procedure.

Mr. PECORA. In offering it to the public was the public told that the original terms group had acquired the stock at 94, had passed it on to the distributing group at 96, who, in turn, passed it on to the selling group at 97½?

Mr. RUSSELL. No, sir.

Mr. PECORA. What were the profits in cash that accrued to the members of the original terms group from the marketing of the prior preferred stock?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RUSSELL. I will have to do some figuring to get that for you, Mr. Pecora.

Mr. PECORA. Have you not the figures before you?

Mr. RUSSELL. I can give you the profits in the original terms group, yes; but I assumed you wanted the profits—your question indicates that you have asked for the total profits for the original terms members in the whole operation of the prior preferred stock.

Mr. PECORA. No; in the selling of the prior preferred stock.

Mr. RUSSELL. Exactly. I will have to do some calculation to get that.

Mr. PECORA. Mr. Russell, I am simply asking you now for the profits of the original terms group.

Mr. RUSSELL. Just the original terms group?

Mr. PECORA. Yes.

Mr. RUSSELL. You said, members of the original terms group.

Mr. PECORA. I meant, of course, the original terms group; who took the stock at 94 and passed it on to the distributing group at 96.

Mr. RUSSELL. That is different. $400,000.

Mr. PECORA. That does not take into account, does it, whatever value attached to the convertible stock and to the common stock?

Mr. RUSSELL. Oh, no.

Mr. PECORA. Of that sum of $400,000 how much went to the National City Co.?

Mr. RUSSELL. Seventy-seven and a half per cent.

Mr. PECORA. That would be $310,000, would it not?

Mr. RUSSELL. I have not figured it out.

Mr. PECORA. What profits accrued to the distributing group?

Mr. RUSSELL. All members?

Mr. PECORA. Yes.

Mr. RUSSELL. $300,000.

Mr. PECORA. Of which the National City Co. got how much?

Mr. RUSSELL. You say, the distributing group?

Mr. PECORA. Yes, sir.

Mr. RUSSELL. Approximately $129,000.

Mr. PECORA. What profits accrued to the selling group?

Mr. RUSSELL. Approximately $391,000.

Mr. PECORA. How much of that did the National City Co. get?

Mr. RUSSELL. Approximately $249,000.

Mr. PECORA. That is still exclusive of the convertible stock and the common stock which it received in the original transaction?

Mr. RUSSELL. Right.

Mr. PECORA. That makes a total of about $688,000 which the National City Co. got from these three groups?

Mr. RUSSELL. Yes.

Mr. PECORA. Exclusive, again, of the convertible stock and the common stock?

Mr. RUSSELL. Yes; and exclusive, of course, of our own costs and expenses which are not chargeable against the syndicate.

Mr. PECORA. Was any of this stock listed on any exchange at any time?

Mr. RUSSELL. Yes.

Mr. PECORA. Which?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RUSSELL. All three issues were on the New York Curb Exchange, and later on the New York Stock Exchange.

Mr. PECORA. When did the first trading on any exchange take place in any of these shares?

Mr. RUSSELL. I think the first trading occurred on the New York Curb Market on March 1, 1929, although I believe there had been some over-counter trading before that.

Mr. PECORA. In what shares was the trading on March 1—the common?

Mr. RUSSELL. I think it was in all three stocks. I am not positive, but I think so, sir.

Mr. PECORA. At what prices was the common stock traded in on that day?

Mr. RUSSELL. I think it was a range of 42 to 48.

Mr. PECORA. $42 to $48 a share for the common?

Mr. RUSSELL. Yes.

Mr. PECORA. That was stock to which you gave a value originally of $10 a share?

Mr. RUSSELL. The cost value; yes.

Mr. PECORA. In doing that you felt that was what it cost the National City Co.?

Mr. RUSSELL. Yes; what it cost; yes.

Mr. PECORA. On what date was the negotiation concluded with respect to this merger?

Mr. RUSSELL. I think the contract was signed on the 22d of February.

Mr. PECORA. And on the 1st of March the common stock was traded in on the public exchange at $42 to $48 a share?

Mr. RUSSELL. Right.

Mr. PECORA. How many shares of common stock did the National City Co. get from the Oliver Farm Equipment Co.?

Mr. RUSSELL. Fifteen thousand and fourteen shares. That is, the group as a whole got that.

Mr. PECORA. That is, the original terms group got it?

Mr. RUSSELL. Yes.

Mr. PECORA. The National City Co. receiving 77½ per cent of it?

Mr. RUSSELL. It had 77½ per cent interest in it.

Mr. PECORA. On the basis of the quotations of common stock on the first day's trading, what additional profit did the National City Co. and its two participants in the original terms group get from this common stock?

Mr. RUSSELL. Which quotations shall I use?

Mr. PECORA. Take the average, the range between 42 and 48. Let us take 45. That would be the average.

Mr. RUSSELL. Well, there was a paper profit of approximately $425,000.

Mr. PECORA. Is not that $525,000?

Mr. RUSSELL. You are right—$525,000.

Mr. PECORA. At what price did the convertible participating stock sell, on the exchange on March 1, 1929?

Mr. RUSSELL. I think it was about 61 or 62. I think the range was 61 to 62 that day.

Mr. PECORA. And the National City Co., with the other two members of the original terms group, had 31,000 shares of that stock given to it?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RUSSELL. Yes—not given to it.

Mr. PECORA. Well, I meant, allocated to it at $54 a share.

Mr. RUSSELL. Right.

Mr. PECORA. What was the profit of the National City Co. and the other two participants in the original terms group, based upon the market value of the convertible participating stock on the opening day's trading?

Mr. RUSSELL. Approximately $248,000, paper profit.

Mr. PECORA. The National City Co. had 77½ per cent interest in those two classes of paper profits, which made a total of $599,079, approximately, as I have figured it out, Mr. Russell, that the National City Co. made out of this deal, in addition to the cash profits in connection with the distribution of the prior preferred stock. Is that right?

Mr. RUSSELL. How much did you say?

Mr. PECORA. $599,079. That is about right, is it not?

Mr. RUSSELL. That is about right.

Mr. PECORA. And that sum in addition to the cash profit of approximately $688,000 was the profit accruing in cash or on paper to the National City Co. from its conceiving of this merger?

Mr. RUSSELL. That is about right.

Mr. PECORA. That would make a total of $1,288,000; merely for the idea of conceiving the merger?

Mr. RUSSELL. No; I would not say that.

Mr. PECORA. It did not do very much beyond that, did it?

Mr. RUSSELL. Oh, yes; it did.

Mr. PECORA. Outside of conceiving and financing it?

Mr. RUSSELL. Oh, yes; it did.

Mr. PECORA. What else did it do?

Mr. RUSSELL. It persuaded everybody to do it.

Mr. PECORA. The "everybody" were the three constituent companies?

Mr. RUSSELL. Right.

Mr. PECORA. You had the officers of the three companies assisting you in persuading the stockholders to do it?

Mr. RUSSELL. Far from assisting.

Mr. PECORA. Did not the officers of the three predecessor companies persuade their respective stockholders to agree to this merger?

Mr. RUSSELL. They finally did; yes. That was a very difficult negotiation, Mr. Pecora. It repeatedly broke down.

Mr. PECORA. Have you a letter addressed to your company by Eastman, Dillon & Co. in connection with this merger?

Mr. RUSSELL. There was such a letter.

Mr. PECORA. Will you produce it? It is a letter dated March 7, 1929, addressed specifically to you. Have you that letter?

Mr. RUSSELL. My assistant is seeing to it now.

Mr. PECORA. Let me read from what purports to be a copy which we got from the files or records of your company. [Reading.]

Re Oliver Farms Equipment Co.

MARCH 7, 1929.

Mr. STANLEY A. RUSSELL,
The National City Co., New York City.

DEAR STANLEY: Last Friday while lunching with you I tried to leave with you (as pleasantly as possible) the idea that my partners and I feel very strongly that up to date we have not been properly or fairly treated in this Oliver business,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

and that we were looking for you to give us some fair percentage of the origination profits in line with your personal promise to my partner, Bent, and Mr Brown's personal promise to my partners, Bent and Buffington.

I had been hoping to hear from you favorably before now, but inasmuch as it is almost a week since I saw you, I naturally concluded that your present intention is not to do what we want in this matter.

After careful consideration of the points you made concerning your annoyance at our delaying stepping aside from our contract with N. & S., it seems to me that this is a minor point in the whole matter. The big thing is that we did step aside finally (because of your promise and Mr. Brown's promise to take us into the deal with you on a fair basis) and, as a result of our stepping aside, you stand to make a profit of between seven and eight million dollars on this deal, providing your common stock options become as valuable as you told me you felt pretty sure they would during the next two or three years.

You definitely stated to me last Friday that you would not have gone ahead with the business under any conditions if we had not stepped aside—I think this was a wise decision on your part, because we were advised at the time that our position was strong enough to probably prevent your going ahead with the business if we had chosen to take that attitude, which we finally decided not to take because of your promise to take us into the deal with you.

It is quite clear from the above facts that our stepping aside from our contract permitted you to make a profit which looks as if it might run into seven or eight million dollars, and only by our stepping aside was that profit possible.

In thinking over the percentage of this profit which should come to us we have no arbitrary or impossible ideas and we will try very hard to be reasonable, but as matters now stand we are looking to you to carry out your agreement and Mr. Brown's agreement. I hope that you will give the matter your immediate and most serious consideration, because we feel very strongly about this and we consider it a very serious thing for you to consider promptly and settle fairly in line with your agreement.

Sincerely yours,

HERBERT L. DILLON.

Had you, prior to March 7, 1929, which was the date of this letter, told Mr. Dillon that you expected your company to make between seven and eight million dollars from this deal?

Mr. RUSSELL. No, sir.

Mr. PECORA. What reply, if any, did you send Mr. Dillon?

Mr. RUSSELL. I find a letter of March 9, 1929, addressed to Mr. Herbert L. Dillon.

Mr. PECORA. Will you produce the letter, please?

(The witness handed a correspondence file to Mr. Pecora.)

Mr. PECORA. Did you dictate the reply to Mr. Dillon's letter, a copy of which you have just shown me?

Mr. RUSSELL. I think I and counsel conferred on the reply.

Mr. PECORA. You and counsel?

Mr. RUSSELL. I think so.

Mr. PECORA. What counsel?

Mr. RUSSELL. Mr. Winston.

Mr. PECORA. You say you never told Mr. Dillon, prior to March 7, 1929, that you expected your company to make between seven and eight million dollars in this merger?

Mr. RUSSELL. I do not think I did. We may have discussed it as a possibility, if the options turned out well. Possibly we did. I do not recall, Mr. Pecora.

Mr. PECORA. It seemed to you that if the company progressed as you expected, after this merger was effected, your company could make as much as seven or eight million dollars on the deal, in view of the options it had for 75,000 shares of the common stock?

Mr. RUSSELL. I would have to figure it up. But we would make a great deal of money, yes, if the options worked out. These 75,000 shares were not issued, of course; it was solely an option.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. An option over a period of five years?

Mr. RUSSELL. To buy for cash.

Mr. PECORA. May I read into the record the letter which the witness has produced as being his reply to Mr. Dillon's letter? (Reading:)

MARCH 9, 1929.

Mr. HERBERT L. DILLON,
Messrs. Eastman, Dillon & Co., New York City.

MY DEAR HERBERT: I have your letter of March 7 regarding the Oliver financing.

I think possibly that our views differ because we are not entirely in accord on the facts. Your firm were the bankers for the Nichols & Shepard Co. and held a contract with that company giving you a preference on any future financing. When the National City Co. was studying a consolidation of farm-equipment companies, Nichols & Shepard was one of the companies under consideration. It was quite evident, however, that a single banking house must control the negotiations in any large consolidation and we made it one of the prerequisites to Nichols & Shepard participating in the consolidation that they secure a release of any obligation to outside bankers. If such a release could not have been obtained, we would have dropped Nichols & Shepard Co. out of the plans and considered some other company or companies. Your refusal to grant them a release would not necessarily have prevented a farm-equipment consolidation being put through by us, but it would have left Nichols & Shepard out of the picture to the detriment of the stockholders of that company. The distinction between the facts and the impression conveyed in your letter is, as you see, material.

I understand that Mr. Brown took up with your firm the question of release and there was presented to us a release signed by your firm to the effect that you released Nichols & Shepard Co. from its obligation to you upon condition that your firm be accorded a reasonable participation in the financing incident to the consolidation satisfactory to you. This condition was quite unacceptable to us and I so advised Mr. Brown. Thereafter Mr. Brown advised me that he had a release from your firm which eliminated this condition. Since the condition was withdrawn, we had the right to and did assume the release was unconditional and it was on this basis that we continued the negotiations.

Under these circumstances there exists no obligation on the National City Co. to give you any participation in the financing incidental to the consolidation. If Mr. Brown has made any promise to you such as you state, he has not advised me. He has asked me, however, to give you reasonable consideration. This request I believe I have met in giving you participation in the bankers' group to the extent of $1,000,000, which you have accepted.

In your letter to me you say, "We were looking for you to give us some fair percentage of the origination profits in line with your personal promise to my partner, Bent and Mr. Brown's personal promise to my partners, Bent and Buffington." I made no such promise and I have not been advised by Mr. Brown that he has made any such promise. While I felt that the National City Co. was under no formal obligation to you to give you a participation of any kind in this financing, I still felt that since you had prior banking relations with the Nichols & Shepard Co., it was fair you should participate to a certain extent in the offering, and we have evidenced this feeling by granting you the participation mentioned above.

There are two other statements in your letter which I think should be mentioned. You say, "You definitely stated to me last Friday that you would not have gone ahead with the business under any conditions if we had not stepped aside." As I have indicated above, what I did say was that we might not have brought Nichols & Shepard into the consolidation if they could not have obtained a release from their contract with you.

You also say, "You (the National City Co.) stand to make a profit of between $7,000,000 and $8,000,000 on this deal." I gave you no specific figures. The question of profits depends, of course, on the improvement the new company makes in earnings and the increase in the market value of its shares. A similar profit is possible to anyone who would make a large enough investment in the stock of the company.

While I sincerely regret that you do not feel you have had reasonable treatment from us in this business, I personally have endeavored to be entirely equitable in the consideration accorded to your firm as well as to others. We have given you the participation in the bankers' group contrary to the judgment of some of the others interested in this business who have felt there was no reason for granting

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

your firm any participation. I particularly regret the present misunderstanding because of your expressed attitude on a previous piece of business with which I was not familiar. We can not, however, consider that there is either a legal or moral agreement on our part which would entitle your firm to a participation in the business on original terms.

Yours faithfully,

_____,
Vice President.

I presume it was signed by you as vice president?

Mr. RUSSELL. Yes.

Mr. PECORA. Did Eastman, Dillon & Co. get a participation in the bankers' group which netted them a profit of $1,000,000?

Mr. RUSSELL. Oh, no.

Mr. PECORA. That million dollars referred to the extent of their participation in the so-called "bankers' group"?

Mr. RUSSELL. Yes.

Mr. PECORA. It is referred to in this letter as a bankers' group. You referred to it as a distributing group.

Mr. RUSSELL. The terms are sometimes synonymous.

Mr. PECORA. But this alluded to the same group?

Mr. RUSSELL. Yes. They had an interest of 10,000 shares in the distributing group.

Mr. PECORA. When you apportioned the value of $10 a share to the common stock which your company acquired from the Oliver Farm Equipment Co. on or about February 22, 1929, you felt that that was a fair and reasonable value for the common stock, did you not?

Mr. RUSSELL. No, sir.

Mr. PECORA. You thought it was unfair?

Mr. RUSSELL. That was our cost.

Mr. PECORA. It was the cost to you?

Mr. RUSSELL. Right.

Mr. PECORA. Would not the cost be an element to be considered in determining the fair and reasonable value? Is not cost always an element to be considered?

Mr. RUSSELL. Not necessarily.

Mr. PECORA. Do you want to tell us that the consolidation sold you its common stock at a price less than its value?

Mr. RUSSELL. May I answer in my own way that question?

Mr. PECORA. You can only answer in your way.

Mr. RUSSELL. Nobody in this negotiation had any idea what these stocks would sell for when they opened up on the market; these junior stocks. As a matter of fact, the officers, or some of the officers, of the predecessor companies asked me for a guess as to what the common stock would open up for, and I told them as a pure guess that I would say maybe $20 a share. We had nothing to do with the opening of the stock on the curb market, and I was as much amazed as anyone else when the shares sold where they did.

Mr. PECORA. That is, from $42 to $48 a share?

Mr. RUSSELL. Yes. That was a free market. We had nothing to do with it. The public did that.

Mr. PECORA. You said before that the apportionment of value which was made among those three classes of stock that your company took over for some $26,000,000 was an arbitrary one determined by you?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RUSSELL. I think so, as I recall it.

Mr. PECORA. In making that apportionment of value did you not attempt to express what your personal opinion was of the value of these three classes of stock?

Mr. RUSSELL. No, sir; except on the prior preferred.

Mr. PECORA. If the prior preferred was worth, in your judgment, $94 a share, that would leave the convertible and the common stock worth about the sums you fixed upon for them, would it not?

Mr. RUSSELL. Those were our costs.

Mr. PECORA. When you let in the participants in the original terms group, you let them in on the basis of $10 a share for the common stock, did you not?

Mr. RUSSELL. Yes.

Mr. PECORA. And on the basis of $54 a share for the convertible participating preferred?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. You adopted those figures because they represented your honest judgment of the value of those shares, did you not?

Mr. RUSSELL. No, sir.

Mr. PECORA. Well, upon what basis did you reach those figures?

Mr. RUSSELL. Our cost.

Mr. PECORA. The cost, Mr. Russell, was not definitely based on any specific valuation ascribed to any one of these three classes of stocks, was it?

Mr. RUSSELL. We made a trade.

Mr. PECORA. You made a trade whereby your company received a certain number of shares of the prior preferred stock and a certain number of shares of the convertible participating stock, and a certain number of shares of the common stock for a total purchase price of $20,625,652?

Mr. RUSSELL. Right.

Mr. PECORA. And there was no apportionment of values ascribed to any of those three classes of stock in agreeing upon that total purchase price of $20,625,000, was there?

Mr. RUSSELL. In the contract, you mean?

Mr. PECORA. In the contract or anywhere else, except in your mind.

Mr. RUSSELL. That is right.

Senator WALCOTT. Do you mean to say that you spent $20,000,000 of the National City Co.'s money for something that you gave no thought to as to its value?

Mr. RUSSELL. Not at all.

Senator WALCOTT. You just said that you paid no attention to the value, that it was your guess. How did you estimate that it was worth $10 a share if you did not know something about the prospect, or at least estimated the prospects of the earnings of the company?

Mr. RUSSELL. We certainly did.

Senator WALCOTT. Why did you not bring that out, then, in answer to Mr. Pecora's question?

Mr. RUSSELL. I did not say we disregarded values.

Senator WALCOTT. You certainly implied it.

Mr. RUSSELL. I said those figures were not the values; they are cost figures.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Did you think you were getting this stock at less than its real value?

Mr. RUSSELL. What do you mean by "real value"?

Senator WALCOTT. What were the earnings applicable to the stock that was to be issued? You must have had the history of the company.

Mr. RUSSELL. Surely. We had full audits; we had field investigations of all three companies; we had audits by one of the very best firms in America, and we had complete information of every kind and character.

Senator WALCOTT. I assumed you did. That is why I feel that you are trying to dodge Mr. Pecora's question.

Mr. RUSSELL. I am not trying to dodge it at all, Senator.

Senator WALCOTT. Then why don't you help out and show how you estimated the values, starting with your prior preferred, which, let us say, had a fair market value of 94; you convertible, let us say, with a fair market value of $54. Now, you have got a certain amount of common stock to be issued at once for the formation of this new company. What were the earnings or previous earnings 1 year or 2 or 3 or 4 or 5 years, that would be applicable to that common stock per share?

Mr. RUSSELL. The net income for the year ended December 31, 1928, of the consolidated companies as audited by Arthur Anderson & Co. and adjusted to eliminate interest charges on outstanding securities that were paid from the proceeds of the financing, and also adjusted to the then existing Federal income tax basis of 12 per cent, was $3,094,478. There were no bank loans or funded debt of any kind of character; therefore, no interest. This sum was available for dividends of $1,200,000 on the prior preferred stock, which leaves $1,894,478. The convertible participating stock calls for a $3 dividend, and there were 500,000 shares of it at $3, which is a million and a half dollars.

Senator WALCOTT. That leaves you $394,000?

Mr. RUSSELL. $394,478.

Senator WALCOTT. Applicable to how many shares?

Mr. RUSSELL. 350,000 shares.

Mr. PECORA. Was it 350,000 or 375,000?

Mr. RUSSELL. 350,000.

Senator WALCOTT. $1.20?

Mr. RUSSELL. Yes, sir.

Senator WALCOTT. That is the answer. It seemed to be difficult to get that out.

Mr. RUSSELL. Senator, I felt that Mr. Pecora was trying to have me say that that was the value of those stocks, in my opinion. It was not. It was the cost.

Mr. PECORA. Then I ask you if you thought you got the stock at a price lower than its real value.

Mr. RUSSELL. What do you mean when you say "real value"?

Mr. PECORA. Apparently you recognize that there is a distinction between real value and cost price, do you not?

Mr. RUSSELL. Cost price is a definitely determinable thing.

Mr. PECORA. Cost price is an arbitrary thing, is it not?

Mr. RUSSELL. Definitely determinable?

Mr. PECORA. Yes.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RUSSELL. Sure.

Mr. PECORA. The actual value is not quite so definitely determinable? Is that what you mean to say?

Mr. RUSSELL. I do not know what you mean when you say "actual value."

Senator WALCOTT. Let us get at it this way. You show an applicable earning there of $1.20 a share; and you know, of course, that the old rule of thumb was ten times your net for the market value?

Mr. RUSSELL. That is right.

Senator WALCOTT. And you got up in those boom days of 1929 to anywhere from 15 up to 30 times net?

Mr. RUSSELL. And more.

Senator WALCOTT. So that the old rule of thumb was 10, and you have $12 a share?

Mr. RUSSELL. Yes, sir.

Senator WALCOTT. Why not bring that into the testimony? I presume it must have been going through your mind in figuring this out.

Mr. RUSSELL. Senator, I had no idea where these stocks might sell.

Senator WALCOTT. Of course not. Mr. Pecora is not trying to get at what you thought they might sell at. It is what you determined as an approximate value.

Mr. RUSSELL. I was trying to make a good trade. That is what I was trying to do.

Senator WALCOTT. Apparently you did make a good trade.

Mr. RUSSELL. I think I did.

Senator WALCOTT. I think so too; but why take so much time in developing your real point of view.

Mr. RUSSELL. I do not mean to delay it. I am not trying to. But I do not propose to have Mr. Pecora have me say that that is, in my judgment, the value of those stocks.

Mr. PECORA. If it is not the value of the stocks, just simply tell us so, and then tell us what you really thought was the value.

Mr. RUSSELL. We felt that the prior preferred stock, as a 6 per cent preferred stock in this industry, could be sold at approximately par, which it was sold at.

Mr. PECORA. That is, $100.

Mr. RUSSELL. $100.

Mr. PECORA. They had no par value.

Mr. RUSSELL. They had no par value. On the convertible participating stock, it was difficult to determine approximately what that might sell at. As I recall it, at the time I think we had in mind generally around $60 a share as the probable sales value of that stock, which, with a $3 dividend, would be about a 5 per cent basis. The participating feature and the convertible feature in it added some attractiveness. On the common stock, as I say, the best guess I made, as a guess, was around $20 a share, as I told the gentleman, in the negotiations when they asked me that question. But in those days attempting to express an opinion as to what a new stock would sell for on the stock exchange, resulting from a consolidation in the prosperous condition of the farm-implement industry, was purely a guess, and at the time your guess might have been just as good as mine.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. To summarize it, this common stock, which your company got at a cost of $10 a share was sold exactly one week after it concluded that negotiation, on the public exchanges for an average price of four and a half times its cost price to you, and two and a quarter times what you felt, under ordinary circumstances, it ought to sell for or it might sell for on the exchange.

Mr. RUSSELL. That is quite right.

Mr. PECORA. Do you know who made the market for that common stock?

Mr. RUSSELL. I haven't any idea.

Mr. PECORA. Did the National City Co. have anything to do with it?

Mr. RUSSELL. I do not think we had a thing to do with it.

Mr. PECORA. Did the National City Co. hold on to its common stock while the market was being made—that is, hold on to all of it?

Mr. RUSSELL. No; we sold some.

Mr. PECORA. At the opening of the market?

Mr. RUSSELL. I do not know whether we did or not. I can not answer that.

Mr. PECORA. You do not know that?

Mr. RUSSELL. We would have to get into the records.

Mr. PECORA. Who would have charge of that?

Mr. RUSSELL. The records?

Mr. PECORA. No; of releasing your common stock at the opening of the market.

Mr. RUSSELL. I think Mr. Morrison, the head of the trading department.

Mr. PECORA. Is Mr. Morrison still here?

Mr. RUSSELL. No.

The CHAIRMAN. This is too important a point to pass over, I think. If they are not willing to disclose it, we had better take the necessary steps to get the information.

Mr. PECORA. It is important; yes, sir.

Mr. RUSSELL. Of course, we will be glad to get you any information you want on it.

Mr. PECORA. Would you have anything to do with making that decision?

Mr. RUSSELL. I might.

Mr. PECORA. What is your present best recollection as to whether or not the National City Co. participated in any way in the making of the market for that common stock?

Mr. RUSSELL. I do not think we had the slightest thing to do with it. As a matter of fact——

Mr. PECORA. Then who made it—the members of the selling group?

Mr. RUSSELL. No; I do not think so. I think some stock firm probably did.

Mr. PECORA. What stock firm do you think probably did?

Mr. RUSSELL. I haven't any idea. That is usually the way that sort of thing will arise.

Mr. PECORA. That is interesting——

Mr. RUSSELL. We had nothing to do with the making of that market, I am positive.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. How does a stock firm go about making the market for a new issue?

Mr. RUSSELL. I am not in the stock-exchange business, or so-called "stock firm." I really do not know, Mr. Pecora.

Mr. PECORA. It seems to be an exceedingly difficult thing, Mr. Chairman, to find out from any of these financiers how operations are conducted on the market. Men who have been engaged in that business for a score or more years seem to show an abysmal ignorance about the operations of their own kind of business.

Mr. RUSSELL. Bear in mind, Mr. Pecora, that the great majority of the convertible and common shares of this company were issued to the shareholders of the predecessor companies. The stock of the predecessor companies were outstanding, being traded in in the market.

Mr. PECORA. Let me ask you——

Mr. RUSSELL. There was a direct comparison there.

Mr. PECORA. Let me ask you this, Mr. Russell. Who made the listing application to the stock exchange for the listing of these securities?

Mr. RUSSELL. Usually——

Mr. PECORA. No; in this case who did it?

Mr. RUSSELL. I can not recall definitely.

Mr. PECORA. Do you recall, Mr. Winston?

Mr. WINSTON. I do not know who signed it, but I appeared before the committee on stock listing. This trading you are talking about was not on the New York Stock Exchange.

Mr. PECORA. It was on one of the exchanges.

Mr. RUSSELL. The curb market.

Mr. WINSTON. There was a listing application made for that.

Mr. RUSSELL. You do not have a listing application, I do not think, on the curb market, in the same form as you do on the stock exchange.

Mr. WINSTON. You do not have a listing application.

Mr. PECORA. Oh, yes. You have to make application to the curb exchange to list a security on its board.

Mr. RUSSELL. But not like the New York Stock Exchange.

Mr. PECORA. The application might be in different form, but an application must be made, and the application must be granted. You know that, don't you, Mr. Russell?

Mr. RUSSELL. Yes; but I think the brokers can do it. I am not sure, but I think so.

Mr. PECORA. I am trying to find out who did do it.

Mr. RUSSELL. I do not know.

Mr. WINSTON. I can find out for you, Mr. Pecora, whether the National City Co. made any application to list it.

Mr. PECORA. Or any person connected with the National City Co.

Mr. WINSTON. Or any person connected with the National City Co.

Mr. RUSSELL. Mr. Pecora, the common shares of the Nichols-Shepard Co. and the Hart-Parr Co. were being traded in on the market at that very time.

Mr. PECORA. Mr. Russell, referring to the option which was given at the outset by the Oliver Farm Equipment Co. to the National City Co. for 75,000 shares of its common stock, how many shares were drawn down under that option by the National City Co.?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RUSSELL. We split the option and gave the respective proportions to the other members of the original terms group, and we exercised our proportion of the first option, which was 11,625 shares.

Mr. PECORA. Eleven thousand six hundred and twenty-five shares.

Mr. RUSSELL. Yes, sir.

Mr. PECORA. When did you exercise the option to that extent?

Mr. RUSSELL. I think that was in April or May, 1930, a year later.

Mr. PECORA. My information is it was on April 24, 1930.

Mr. RUSSELL. It may well be.

Mr. PECORA. You acquired those 11,625 shares at that time at $10 a share.

Mr. RUSSELL. Right.

Mr. PECORA. What was the market for the stock at that time, do you recall?

Mr. RUSSELL. The market for the week ended April 26, 1930, was a low of 31 and a high of 33⅝, according to my records.

Mr. PECORA. Let us take an average of 32. That would be fair, would it not?

Mr. RUSSELL. Yes, sir.

Mr. PECORA. That was 22 points above the price at which the National City Co. acquired those 11,625 shares. That would add a paper profit of $255,750.

Mr. RUSSELL. If we had sold it; and I think we still have some of it.

Mr. PECORA. All these profits were the result of the labors and services—whether they were monumental in character or not—of the National City Co. in bringing about this merger.

Mr. RISSELL. And the risk of the commitment.

Mr. PECORA. You pretty well explored that risk before you brought about the merger, did you not? You said that the three companies were all in prosperous condition.

Mr. RUSSELL. I am talking of the market risk.

Mr. PECORA. The market risk.

Mr. RUSSELL. Of the banking commitment, which is inherent in any financial operation of this character.

Mr. PECORA. The market risk was represented in part by the fact that the cost of the common stock to your company was $10 a share and the market opened at an average of $45 a week later.

Mr. RUSSELL. There happened to be no risk. That does not always happen.

Mr. PECORA. There happened to be no risk, and it also happened that other bankers—Eastman, Dillon & Co.—had a controversy, more or less friendly in character with you about your company making a profit of between seven and eight million dollars out of this operation.

Mr. RUSSELL. Yes.

Mr. PECORA. In putting out the circular which the National City Co. issued in connection with its sale of the 200,000 shares of prior preferred stock, was anything said to the investing public concerning the entire interest which the National City Co. had in the stock of the Oliver Farm Equipment Co.?

Mr. RUSSELL. Concerning the entire interest?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Concerning the interest which the National City Co. had been accorded by its contracts with the Oliver Farm Equipment Co.

Mr. RUSSELL. No.

Mr. PECORA. You know that under the British Companies Act that information would have to be given to the public, do you not?

Mr. RUSSELL. I am not entirely familiar with British practice, but I understand that under certain methods they do, and under other methods they do not.

Mr. PECORA. That is, when they seek to comply with the letter and the spirit of the law they do, and when they try to evade it they do not.

Mr. RUSSELL. No; that is not my understanding.

Mr. PECORA. Do you, as one who has had years of experience in investment banking and in the accumulation and sale of securities to the public, favor a legal requirement of that kind, that is, one which would require an offering house or a house of issue, to state to the investing public its complete interest?

Mr. RUSSELL. I would like to think that subject over, Mr. Pecora. I do not see any particular objection. I think a great deal more importance is given to it than is warranted.

Mr. PECORA. You would not object to such a statute?

Mr. RUSSELL. Off-hand I do not see any particular objection. I would like to think it over more.

Mr. PECORA. What are these stocks selling for to-day, do you know?

Mr. RUSSELL. Yes. The prior preferred is selling at 3½. The common and convertible have been reclassified into a new common stock, which is selling at about 1¼ to 1½.

Mr. PECORA. That is all for this witness.

Mr. WINSTON. Mr. Pecora, I can have a witness as to that practice of listing if you want to examine him. He advises me that as far as he can recall the National City Co. made no application for the listing. It was done by some broker.

Mr. PECORA. I will take Mr. Winston's statement to that effect, without calling any witness.

Mr. WINSTON. Thank you.

The CHAIRMAN. The committee will adjourn until 2.30. Witnesses under subpoena will appear at that time.

(Whereupon, at 12.45 o'clock p. m., the committee recessed, to reconvene at 2.30 o'clock p. m.)

AFTER RECESS

The committee reconvened at the expiration of the recess, at 2.30 o'clock p. m.

The CHAIRMAN. The committee will come to order.

Mr. PECORA. Mr. Chairman, the evidence in the matter of the Lautaro Nitrate Corporation flotation of bonds by the National City Co. will be presented by Mr. Julius Silver, associate counsel to the committee.

Mr. SILVER. Mr. Byrnes.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

FURTHER TESTIMONY OF RONALD M. BYRNES, WATCH HILL, R. I.

(The witness, having been previously duly sworn, was examined and testified further as follows:)

Mr. SILVER. Mr. Byrnes, are you familiar with the details of the flotation of the $32,000,000 Lautaro Nitrate Co. (Ltd.), first mortgage 6 per cent convertible gold bond issue?

Mr. BYRNES. I was.

Mr. SILVER. Was that issue floated under your supervision?

Mr. BYRNES. Yes.

Mr. SILVER. You were a vice president of the National City Co. at the time?

Mr. BYRNES. Yes.

Mr. SILVER. Will you tell us what the relationship was between the Lautaro Nitrate Corporation and the Lautaro Nitrate Co. (Ltd.)?

Mr. BYRNES. The Lautaro Nitrate Co. (Ltd.) was an English company. It had been in existence for a great many years. My recollection is that it was incorporated in England in, I think, 1889, under the English Companies' Act, and at the time of this financing and when the bond issue for the company was issued, it had been and still was the largest producer of Chilean nitrate, sodium nitrate. The Lautaro Nitrate Corporation was an American corporation organized about that time, in the year 1929, I think under the laws of the State of Delaware, and became the owner of all of the common stock of the English company.

Mr. SILVER. That Delaware corporation was, in effect, a holding company, was it not?

Mr. BYRNES. Yes.

Mr. SILVER. Is it not a fact, Mr. Byrnes, that the Lautaro Nitrate Co. (Ltd.), was controlled by the Guggenheim interests?

Mr. BYRNES. The Lautaro Nitrate Co. (Ltd.), was not, had not been prior to that time, and was not at this time, but as a result of the arrangements made at that time, through control of the Delaware corporation, it is my recollection that the Anglo-Chilean Consolidated Nitrates Co., which, in turn, was controlled by the Guggenheims, did exercise subsequently control over the English company.

Mr. SILVER. The Lautaro Nitrate Corporation, a Delaware company, was formed just prior to the flotation of the bond issue that I have referred to, isn't that so?

Mr. BYRNES. I want to be legally accurate. I am not sure whether it had actually been organized and incorporated at the time this bond issue was offered to the public.

Mr. SILVER. It was at or about the same time, was it not?

Mr. BYRNES. Before the bonds were delivered, this company had been organized and was in existence—the Delaware corporation.

Mr. SILVER. It is a fact, is it not, that as a result of the organization of this holding company, the Guggenheim interests were able to procure control of the Lautaro Nitrate Corporation, and, through it, of the Lautaro Nitrate Co. (Ltd.)?

Mr. BYRNES. That, I think, is a fair statement.

Mr. SILVER. In any event, it represented, at the time of the flotation of this bond issue, the outstanding and chief controlling interest of that Chilean company?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. It was an English company.

Mr. SILVER. But, I mean, operating in Chile.

Mr. BYRNES. If we waive the matter of days or months in the operation, eventually, as a result of the negotiation of which this was a part, they acquired indirect control.

Mr. SILVER. That issue was offered to the public at what price?

Mr. BYRNES. A price of 99 and interest.

Mr. SILVER. Will you tell us how much was paid for this issue by the National City Co.?

Mr. BYRNES. I have before me the contract between the National City Co. and the Lautaro Nitrate Co., and, under that, the National City Co. did buy $32,000,000 of bonds, and paid for those bonds, plus 600,000 shares of stock of the Lautaro Nitrate Corporation, the sum of $30,000,000 plus interest accrued to date of delivery—date of issue of interims, I should say.

Mr. SILVER. Those bonds contained certain warrants, did they not?

Mr. BYRNES. Each $1,000 principal amount of bonds was accompanied by a warrant entitling the holder to receive, on January 1, 1930, without cost, 10 shares of the common stock of the Lautaro Nitrate Corporation.

Mr. SILVER. Of the 600,000 shares of common stock that you have referred to as having been included in the purchase price of $30,000,000, 320,000 shares were reserved for these warrants, is that correct?

Mr. BYRNES. Yes; that would be correct.

Mr. SILVER. There were certain additional conversion privileges attaching to the bonds?

Mr. BYRNES. Yes.

Mr. SILVER. What were they?

Mr. BYRNES. There was a conversion privilege——

Mr. SILVER. With respect to the common stock, please.

Mr. BYRNES. Each $1,000 principal amount of the bonds was to be convertible at the option of the holder at any time on or prior to July 1, 1939, or, in the case of prior redemption, up to the date of redemption, or six days before the date of redemption, into 10 shares of cumulative preferred stock or shares of the Lautaro Nitrate Co. (Ltd.), and 4 shares of common stock of the Lautaro Nitrate Corporation, of no par value, I believe.

Mr. SILVER. Setting up the reserve of 320,000 shares of the common stock for the warrants, and 128,000 shares of the common stock for the conversion privilege to which you have just referred, that left free to the National City Co. 152,000 shares of the common stock, is that correct?

Mr. BYRNES. That is correct.

Mr. SILVER. In other words, the National City Co. paid $30,000,000 and received in return $32,000,000 worth of these first mortgage 6 per cent convertible gold bonds, and in addition, 152,000 shares of the common stock?

Mr. BYRNES. That is a net statement. We received the 600,000——

Mr. SILVER. But it retained for its own purposes——

Mr. BYRNES. The National City Co., out of that 600,000 attached to the bonds the right of conversion plus—I do not like to use the word—a bonus of stock. The warrant form was simply because the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

stock would not be deliverable until a later date on account of organization necessities.

Mr. SILVER. Is it your suggestion, then, Mr. Byrnes, that after providing for the necessities of the contract contained in the bond, that there was provision for 152,000 shares of common stock as a bonus to the National City Co. in conjunction with this purchases of the face amount of the bonds?

Mr. BYRNES. After providing for the necessities of the financing, the National City Co. was left with 152,000 of those shares of stock, in which, however, there was a minor interest that had been ceded, so that its net, if you want that exactly——

Mr. SILVER. We will get to that. What was the spread in connection with this bond issue?

Mr. BYRNES. Our cash cost was $30,000,000, which, applied upon the principal amount of $32,000,000, figures out 93¾ per cent, adjusting the purchase price to the bond issue.

Mr. SILVER. In other words, for purposes of computing the spread, the 152,000 shares of common stock are not counted, and you get a cost of 93¾ for the bonds?

Mr. BYRNES. Correct.

Mr. SILVER. In the original terms group, there were certain other interests in addition to the National City Co., were there not?

Mr. BYRNES. Yes; not parties to the contract, but an interest was ceded by the National City Co.

Mr. SILVER. Is it true that the National City Co. ceded an interest of 10 per cent in the original terms group to the Guggenheim Bros.?

Mr. BYRNES. That is true.

Mr. SILVER. Is it also true that an additional interest of 25 per cent, less a management fee, was ceded to J. P. Morgan & Co.?

Mr. BYRNES. I believe that is also true; a one-quarter interest after the deduction of the 10 per cent interest, was ceded to J. P. Morgan & Co., subject to a management fee.

Mr. SILVER. Will you be good enough to tell us what effort was applied in the flotation of these bonds by Guggenheim Bros.?

Mr. BYRNES. Of course, the firm of Guggenheim Bros. had approached us in the first instance in trying to interest us in financing in previous years—possible financing for their existing operations in the Anglo-Chilean Nitrate. Subsequently, over a period of time, they developed the idea of applying that process to the Lautaro operations, and the Lautaro's assets, the deposits which they controlled. You must bear in mind that there were very few deposits of nitrate in Chile that could be made amenable to the Guggenheim process, because it required a large ore reserve to incur the large capital expenditure that was involved in the Guggenheim process. But just to make that clear, Mr. Silver, and I think, perhaps, to save time, while this interest was ceded to Guggenheim Bros., it was really destined for Lehman Bros., a banking firm, and not to Guggenheim Bros. in themselves.

Mr. SILVER. Why was it not ceded directly to Lehman Bros.?

Mr. BYRNES. Simply because that interest really represented an interest to Lehman Bros. that was involved in the fact that Lehman Bros. had financed the previous operation of the Guggenheim process, the Anglo-Chilean Nitrate Consolidated Corporation, and rather than myself being a party to that, or the National City Co., it was merely a matter of form that it was ceded to Guggen-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

heim Bros.; to be dealt with in their discretion. It was destined, though, and it was revealed to me at the time, that the Guggenheim Bros. wanted it, not for themselves, but for Lehman Bros.

Mr. SILVER. Mr. Byrnes, there was no outstanding contract, was there, between Lehman Bros. and the borrower?

Mr. BYRNES. Borrower?

Mr. SILVER. There was no contract outstanding between Lehman Bros., and the Lautaro Nitrate Co. (Ltd.), for its financing?

Mr. BYRNES. Oh, no.

Mr. SILVER. Or for any exclusive right to its financing?

Mr. BYRNES. They had had nothing to do with the Lautaro. They had had to do with Anglo-Chilean.

Mr. SILVER. What was the reason for ceding this interest to Guggenheim Bros., instead of directly to Lehman Bros.?

Mr. BYRNES. Mr. Silver, you can see, from a certain letter introduced in evidence this morning, that bankers that at one time may have had connection with an enterprise, may, at times, feel that they have rights in a situation that perhaps would not be fully justified at law, and I think Lehman Bros. felt that they had some rights, not, perhaps, as against us, but perhaps as against, at least, the good will of Guggenheim Bros.

Mr. SILVER. Do you know whether Guggenheim Bros. permitted Lehman Bros. to participate in any way in this 10 per cent interest?

Mr. BYRNES. Oh, yes. It is my understanding that they did.

Mr. SILVER. Do you know to what extent?

Mr. BYRNES. Ten per cent. The whole 10 per cent went to Lehman Bros.

Mr. SILVER. Guggenheim Bros. represented the major stock interest in this organization, did they not?

Mr. BYRNES. In the Anglo-Chilean, yes.

Mr. SILVER. And they brought this issue to your attention?

Mr. BYRNES. Yes.

Mr. SILVER. When they brought this matter to your attention were they acting in behalf of the stockholders of the company, or were they appearing personally?

Mr. BYRNES. When this business was first broached, it was, of course, in a formative stage. The Guggenheims felt that it would be a good idea to spread the application of their process to the extent they could; that it would be a benefit to the industry, and also, of course, a benefit to them, because, on account of the long time they had taken to work the process up to a demonstrated commercial success, the capital structure of Anglo-Chilean was such that there was not left an earning power applied only to one plant and to one property, that was adequate to the investment which they had made.

Mr. SILVER. Mr. Byrnes, what part, in the flotation of this loan, did J. P. Morgan & Co. play?

Mr. BYRNES. They took a commitment equal to their interest.

Mr. SILVER. Their names do not appear on the prospectus.

Mr. BYRNES. Oh, no. That is quite customary, as between leading houses that have individual issues. They may spread their financial risk or commitment by taking other houses in on original terms, who may or may not travel along into subsequent steps.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SILVER. What do you mean by taking a commitment as applied to this situation?

Mr. BYRNES. We took a commitment of $30,000,000. Because of their 10 per cent interest on original terms, the firm of Lehman Bros., through the Guggenheims, were committed for $3,000,000 on that. The firm of J. P. Morgan & Co., through their 25 per cent interest in what was left—that would be $27,000,000, one-quarter of that would be, roughly, six and three-fourths million dollars, and J. P. Morgan & Co. had that amount of commitment, so that the National City Co. financial commitment of $30,000,000 had been thereby reduced to approximately $20,000,000.

Mr. SILVER. Is there any written memorandum or contract showing that commitment of J. P. Morgan & Co.?

Mr. BYRNES. Yes. I think probably it is here. [After examining papers.] I have before me a letter of June 19 from J. P. Morgan & Co., addressed to the National City Co., saying:

> We acknowledge receipt of your letter of June 18, offering us a one-quarter interest in your 90 per cent share on original terms in the purchase of—

And so forth.

> We are pleased to accept this offer, subject to the terms mentioned in your letter, and thank you for including us in this business.

Mr. SILVER. Did they have a full 25 per cent participation in the original terms group, to the same extent and in the same manner that the Guggenheim Bros. had a 10 per cent interest in that group?

Mr. BYRNES. I will have to find the letter of the 18th referred to, to see what the terms were that were offered them. Suppose we look through this file, to save time.

Mr. SILVER. Guggenheim Bros. were not in a position, as stockholders and directors of this company, to take a commitment directly of 10 per cent, or of any other amount, were they?

Mr. BYRNES. The firm of Guggenheim Bros. was not a direct stockholding interest in either the Lautaro Nitrate Co.——

Mr. SILVER. They were the controlling interest, in any event.

Mr. BYRNES. They were stockholders, as I understand it—I believe I am correct—in the Anglo-Chilean Nitrate Co.

Mr. SILVER. Which, in turn, owned 50 per cent of the stock of the operating company, isn't that so?

Mr. BYRNES. No, that is not so. The English company was the operating company, and we bought the bonds from the English company. Its common stock was owned by the Lautaro Nitrate Corporation of Delaware, an American company, whose stock, in turn, was, or a substantial portion of it—I think more than a majority—held by the Anglo-Chilean Consolidated Nitrate Corporation, and Guggenheim Bros. interest was in the Anglo-Chilean, and had been right along.

Mr. SILVER. But, as a result of these various holding companies, the effect was that Guggenheim Bros. were the controlling interest of the main operating company, is not that so?

Mr. BYRNES. Through that step, yes, through those stages, but not directly.

Mr. SILVER. Guggenheim Bros., as such, were not in a position to, nor did they accept any direct participation in the original terms

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

group, from the standpoint of making a commitment as to the purchase or distribution of any part of this flotation?

Mr. BYRNES. They accepted the 10 per cent interest, I believe.

Mr. SILVER. And you say that they accepted this 10 per cent interest in behalf of Lehman Bros.?

Mr. BYRNES. Yes. It was asked for and granted to them.

Mr. SILVER. As a result of their participation, they received 10 per cent of the profits, amounting to $32,000, and they received, in addition, 10 per cent of the common stock which we have referred to, amounting to 15,280 shares; is that correct?

Mr. BYRNES. I believe so.

Mr. SILVER. Do you know whether all, or any part of that amount of cash and of stock, was delivered to Lehman Bros.?

Mr. BYRNES. Not of my own knowledge, but I would be willing to give anything but the most solemn oath on it.

Mr. SILVER. Is there any reason you know of for the omission of the name of J. P. Morgan & Co. from the prospectus in connection with the flotation of these bonds?

Mr. BYRNES. The signatures on the prospectus, as a matter of common practice, consist of the names of the principal houses who are in the selling syndicate, rather than, necessarily, in any of the underlying groups. In other words, it is a selling presentation.

Mr. SILVER. Did the addition of the name of J. P. Morgan & Co. to any security of this type at that time have any value in promoting or accelerating the sale of such a security?

Mr. BYRNES. You mean if it had been on the prospectus?

Mr. SILVER. Yes.

Mr. BYRNES. It would certainly not have detracted from it.

Mr. SILVER. Was the commitment made with J. P. Morgan & Co. before the flotation was prepared for public consumption?

Mr. BYRNES. Oh, yes. The letter I have been looking for is supposed to be dated June 18. It is referred to in Morgan's letter. We are not able to find it.

Mr. SILVER. Did you invite the participation of J. P. Morgan & Co. in this issue or did they take the first step in that connection?

Mr. BYRNES. We invited them.

Mr. SILVER. Did you at that time ask them for the right to use their name on the prospectus?

Mr. BYRNES. I do not think so.

Mr. SILVER. Did it occur to anybody in your organization that the use of that name on the prospectus to be issued to the public would substantially enhance the salability of the issue?

Mr. BYRNES. I do not see the bearing of the hypothetical question. I do not recall that it was even discussed.

Mr. SILVER. Now, in connection with the distribution of the profits to the original terms group, 25 per cent of the cash, amounting to $53,100, was delivered to J. P. Morgan & Co., was it not?

Mr. BYRNES. Yes; $53,100, in full and final settlement of their interest and account.

Mr. SILVER. There was a letter written to them, in which it was said that that sum was in full and final settlement of their participation in the original terms group?

Mr. BYRNES. Yes.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SILVER. Was any portion of the common stock delivered to them?

Mr. BYRNES. Now it has come back to me. I remember that, on that phase of it, the fact that it was discussed with them as to whether, under the circumstances—that may be too strong a word. I think it was suggested that in view of the amount of work involved in the thing, and in the presentation and the preparation of this deal, that what we offered them was a one-quarter interest in the bonds less the stock. In other words, they had an original terms position that was not quite as original as either ours or Lehman Bros.

Mr. SILVER. Was any such reservation made, Mr. Byrnes, in the letter in which they were invited to participate in this group?

Mr. BYRNES. That letter, I do not find here. I believe it must be here. May I ask you, did you find it in the files?

Mr. SILVER. No.

Mr. PECORA. We found no letter from them.

Mr. BYRNES. The letter from them is here, but our letter to them, Mr. Pecora——

Mr. SILVER. We have not seen that letter.

Mr. BYRNES. We have not found it. I can not believe it is not here, because they have referred to it. I do have a recollection that the omission of stock from their interest was discussed orally, rather than in the letter, and I think it was discussed subsequently.

Here is the letter to Morgan, of June 18th:

Referring to Mr. Baker's conversation with Mr. Anderson to-day relative to our offering of $32,000,000 the Lautaro Nitrate Company Limited First Mortgage convertible gold bonds due 1954 with some common stock bonus shares, these bonds were bought by us, together with some stock of the Lautaro Nitrate Corporation (an American company).

In determining our cost price as applied to the bonds, we have concluded that 93¾ per cent and interest is the originating base cost from which we start to develop various selling steps.

Then we go on to tell them:

We are forming a bankers distributing group to take this over. We have a 90 per cent interest in this purchase, and we are pleased to offer you a one-quarter interest in our share of the original terms profit, namely, 1 per cent, subject to an origination and management fee of 5 per cent of the gross spread. Kindly advise if you desire to accept.

Mr. SILVER. In that letter——

Mr. BYRNES. I am wrong. It was in the letter, and was not an oral discussion. I thought it was.

Mr. SILVER. Was there any reservation made in that letter with respect to the common stock?

Mr. BYRNES. Oh, yes. It was discussed orally. This letter was meant to cover an interest in the bonds without the stock. It was not clear. There was subsequent oral discussion, which J. P. Morgan & Co. accepted as constituting their understanding of our agreement.

Mr. SILVER. In other words, there is no reference in this letter to your participation in the common stock which you have referred to as a bonus?

Mr. BYRNES. That is true.

Mr. SILVER. And the price fixed, of 93¾, is a price which does not take into cognizance the value of that common stock.

Mr. BYRNES. As against J. P. Morgan & Co.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SILVER. Is there any letter, either written by J. P. Morgan & Co., or by the National City Co., evidencing or confirming any conversation of the nature you have just referred to, in which they release any right or claim to participation in the common stock?

Mr. BYRNES. I have read the letter inclosing the check, I believe. Is that in the record?

Mr. SILVER. Just look at your letters, Mr. Byrnes, and tell us whether there is any letter which makes written reference to that release.

Mr. BYRNES. This is dated October 25. This is our letter addressed to them:

> Referring to our letter of June 18 wherein we ceded you a one-quarter interest in our share, we are pleased to inclose our check to your order for $53,100 in full and final settlement of your interest in this account.

In other words, it was settled with them on the basis of the cash.

Mr. SILVER. That letter, Mr. Byrnes, not only fails to make reference to the common stock, but scrupulously refrains from making any reference to the fact that that common stock was part of the compensation or bonus, as you have put it, which accrued to the National City Co. as a result of the flotation of this issue.

Mr. BYRNES. And their letter of October 26 acknowledges our check, and they add:

> Which we note is in full and final settlement of our one-quarter interest in your share on original terms, in connection with the purchase and sale of $32,000,000 Lautaro Nitrate Co. (Ltd.) first mortgage 6 per cent convertible gold bonds due July 1, 1954.

Again, just for the bonds, you see.

Mr. SILVER. Is there anything in any letter which you wrote to J. P. Morgan & Co., or which they wrote to you, which shows that they knew that part of the compensation you were receiving for the flotation of this issue was a substantial amount of the common stock of the borrowing company?

Mr. BYRNES. I was going to give you the letter to them, which stated what we had bought. I can give you absolute assurance, Mr. Silver, that J. P. Morgan & Co. were fully cognizant of the fact that we bought bonds plus stock, and that their interest was in the bonds at the price of 93¾. There is no question about it.

Mr. SILVER. Referring to the prospectus, Mr. Byrnes, will you tell us whether any mention is made in the prospectus of the fact that the banking group was receiving a substantial amount of common stock of the company?

Mr. BYRNES. In the prospectus, whether there is any statement that the National City Co., or the original group, had received stock?

Mr. SILVER. Yes.

Mr. BYRNES. I am prompted to tell you that there is nothing contained to that effect in the prospectus. I was looking through to see.

Senator BROOKHART. There is nothing there about the price you paid for the bonds, either, is there?

Mr. BYRNES. Oh, no.

Mr. SILVER. Don't you think the public would have been interested in knowing that a substantial amount of the common stock of the company had been delivered to the bankers as partial compensation for the flotation of this loan?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. I think the public might be interested. I do not think that they are necessarily entitled to such information.

Mr. SILVER. Do you think it would have affected the salability of these bonds to have made that statement?

Mr. BYRNES. Not necessarily.

Mr. SILVER. Would it have had any effect, in your opinion, upon the value of the bonds in the eyes of prospective purchasers had they been informed that the compensation paid to the bankers included not only a spread of 5¼ points, but that, in addition, a substantial block of the common stock of the borrowing company had been delivered to the bankers?

Mr. BYRNES. Not necessarily.

Mr. SILVER. This spread of 5¼ points was distributed among how many groups?

Mr. BYRNES. There was, first, the group we have already mentioned. Then there was a subsequent group.

Mr. SILVER. Will you give us the price at which these bonds were allocated to each group?

Mr. BYRNES. The original terms group was formed at 99¾. The next group was formed at 94¾. That was called a banking group.

Mr. SILVER. In other words, there was a 1-point spread?

Mr. BYRNES. One point to the original terms group. The bankers' group consisted of the Bankers Co. of New York; Brown Bros. & Co.; Continental Illinois Co.; Lehman Bros.; and the National City Co.

The next group was called the distributing group, and was formed at a price of 95¾.

Mr. SILVER. That is a rise of 1 point.

Mr. BYRNES. That is another point up. The distributing group, I imagine, is rather a long list. Do you want the names?

Mr. SILVER. No. Do not read the names. Just tell us at what price they received these bonds.

Mr. BYRNES. They received the bonds at 95¾.

Mr. SILVER. That is another point, is it not?

Mr. BYRNES. Yes. Then there was a wholesale group, which was given the privilege of taking bonds down. I guess that group was formed at 96½; two and one-half points off the issue price is the way it is stated here. That would be 96½, and the bonds were sold at 99, so that there was two and one-half points to the last group, and one point each to the first three groups.

Mr. SILVER. Will you refer to the contents of a memorandum dated November 13——

Senator BROOKHART. Just a minute. Were those facts stated in the prospectus?

Mr. BYRNES. Oh, no. The spreads in the later groups were very widely known, Senator, because there was a very large group of dealers in it, and they, of course, had direct knowledge of the spread they were receiving.

Senator BROOKHART. What the public knew, then, was this last figure you have given?

Mr. BYRNES. The public would only know that as, perhaps, it had access to the information that some dealer might give to them.

Senator BROOKHART. They did not know of these different spreads or profits to all these insiders from the beginning?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. No; any more than I know the price the Atlantic & Pacific has paid for the eggs I buy from them.

Senator BROOKHART. I can tell you that is not much of a price. I know about that.

Mr. BYRNES. They make some money, though.

Senator BROOKHART. Of course they do, because they pay the farmers hardly anything for the eggs.

Mr. PECORA. Might it be pertinent to observe here, Mr. Byrnes, that when you buy eggs, you know you are buying eggs, and when you buy bonds, you do not know whether you are buying gold and water mixed.

Mr. BYRNES. It is a different kind of merchandise, I will admit, and a form of merchandise with respect to which, as you have seen from previous discussions here, it is very difficult to set up yardsticks of value agreeable to you and to others.

Mr. PECORA. You bankers are always fond of using the analogy of merchandise, taking commodities like eggs and coffee, where there is no water.

Mr. BYRNES. Even eggs have to be candled.

Mr. PECORA. But they do not pay for that.

Mr. SILVER. Mr. Byrnes, will you be good enough to refer to the memorandum dated November 13, 1929, addressed to Mr. J. E. Clark, of the syndicate department, by W. R. Bridges, head accountant, and tell me whether that statement indicates that the total gross profits of the flotation of this issue amounted to——

Mr. BYRNES. What date is that memorandum?

Mr. SILVER. November 13—amounted to $1,766,138.28; and whether the net profit to the National City Co. in cash amounted to $998,089.19. (Subsequently computed at $995,275.)

Mr. BYRNES. It is not summarized in that form here. I will have to do some figuring. You want the total profit for all groups?

Mr. SILVER. Subject to confirmation, will you have somebody make that computation for us?

Mr. BYRNES. I will accept it for the time being. We will confirm it.

Mr. SILVER. Subject to confirmation. In addition to the amount that I have just stated, the National City Co. received 136,800 shares of the common stock of the Lautaro Corporation.

Mr. BYRNES. 136,800; correct.

Mr. SILVER. That stock, at or about the time the bonds were being floated, had a market value of $10 a share; is that correct?

Mr. BYRNES. No; it had no market.

Mr. SILVER. Did it have a market value immediately after these bonds were floated?

Mr. BYRNES. My recollection is not clear. I should say that there was no market in that stock for some time after the flotation of the bonds.

Mr. SILVER. Were not those stocks traded in on the New York Produce Exchange?

Mr. BYRNES. I accept the information.

Mr. SILVER. Were they not traded in on the New York Produce Exchange at $10 per share?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. That would have to be checked, because I accept the statement that they were. At what price, or when, I can not answer, unless the information is available here.

Mr. SILVER. What was the high reached on April 5, 1930?

Mr. BYRNES. Ten and one-fourth. That was nearly a year later.

Mr. SILVER. Then, at the high figure of 10¼, that would represent a paper value of a sum in excess of $1,400,000, would it not, for the common stock which was received as a bonus by the National City Co.?

Mr. BYRNES. Accepting your premise, I would agree with your conclusion, but in the first place you could not have sold 136,000 shares on the New York Produce Exchange in a year, I believe, so that the idea that you could sell 136,000 shares at the top price reached nine months later than the time at which we received the shares, is no criterion at all of the value of the stock at the time we received it.

Mr. SILVER. Mr. Byrnes, you have heard of distributing operations, as a result of which substantial blocks of stock have been distributed and sold to the public at a time when the entire amount could not have been sold on any one day on any one exchange.

Mr. BYRNES. Yes. But to value the stock which we became entitled to in June, 1929, upon the basis of a peak quotation in April, 1930, of probably only a few shares of stock dealt in on that day, is absolutely an erroneous calculation of the value of the stock that we received, at the time we received it.

Senator BROOKHART. What did you do with the stock?

Mr. BYRNES. Held it.

Senator BROOKHART. Have you got it yet?

Mr. BYRNES. Yes. It could never have been sold, Senator Brookhart, at any time—such a volume of stock. I am speaking from only general acquaintance with dealings on the New York Produce Exchange. I do not like to put it in the record, but it is not a big market. Even on the London Exchange, which I believe also quoted this stock in sterling quotations, you could never sell any substantial amount.

Senator BROOKHART. Is it eligible for listing on the stock exchange?

Mr. BYRNES. No; under the requirements of the New York Stock Exchange this stock could not have been listed on the New York Stock Exchange, in my opinion.

Mr. SILVER. What was the low for that particular stock on the produce exchange?

Mr. BYRNES. The low, in the first six months of 1930, was four and one-eighth on June 25, but we have not yet found what was the first date.

Mr. SILVER. Then, on the basis of an estimate on the low for that stock, the National City Co. would have had a paper profit in excess of $600,000 for that bonus stock received in connection with the same operation?

Mr. BYRNES. I would say that, valuing the holdings of the National City Co. at any figure that you choose, the valuation on the basis on which you choose to value it would be so much; but I would not accept that as a correct method of valuation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SILVER. Mr. Byrnes, you stated a moment ago that you felt that this stock could not be listed on the New York Stock Exchange?

Mr. BYRNES. Because of the requirements of the exchange.

Mr. SILVER. Were not the bonds in the same company?

Mr. BYRNES. No.

Mr. SILVER. The bonds were, of course, in the English company.

Mr. BYRNES. Yes.

Mr. SILVER. Whereas the stocks were in the holding company, which was a Delaware corporation?

Mr. BYRNES. Yes.

Mr. SILVER. Was not the asset position of the holding corporation based upon the earnings and profits of the operating company?

Mr. BYRNES. The holding company, of course, became entitled to any earnings that were declared upon the stock of the operating company.

Mr. SILVER. In other words, they were both based upon the same earnings base?

Mr. BYRNES. Yes. Now, of course, the New York Stock Exchange would not list, I believe, the stock of any company of which the majority was owned by another company, as a general rule. That would not satisfy, I think, their requirements on distribution. Secondly, the Delaware corporation was a new corporation which in and of itself did not have a previous record of successful operation.

Mr. SILVER. What is the market value of these bonds in the present market?

Mr. BYRNES. This morning I believe they are quoted at 2½. Yesterday's close was 2½.

Mr. SILVER. The bonds are in default?

Mr. BYRNES. Yes.

Mr. SILVER. In other words, the present market value of the entire issue is approximately less than one-half of the spread or the profit received in cash by the bankers in the flotation of this issue?

Mr. BYRNES. The present quotation of the bonds is 2½.

Mr. SILVER. In connection with this same issue do you recall a provision in the contract which authorized the National City Co. to make certain purchases of the bonds in the open market after the date of the original flotation?

Mr. BYRNES. Is it the contract between the National City Co. and the Lautaro Nitrate Co. (Ltd.)? Is that it?

Mr. SILVER. Yes.

Mr. BYRNES. Section 10?

Mr. SILVER. Yes.

Mr. BYRNES. Yes.

Mr. SILVER. Will you tell us in your own words, and briefly, what the substance of that provision is?

Mr. BYRNES. I do not believe I can shorten this very much. Suppose I read it. (Reading:)

Lautaro—
which means the Lautaro Nitrate Co. (Ltd.)—
authorizes you from time to time as you may deem expedient in your discretion to purchase, for its account prior to July 1, 1930, any of your interim certificates and/or any of the bonds, accompanied by original warrants entitling holders to receive the stock, which you may be able to purchase at prices not exceeding the original issue price thereof and accrued interest. Lautaro agrees that upon your request it will reimburse you promptly for the purchase price plus accrued

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

interest to date of such reimbursement of any and all interim certificates and/or bonds with warrants so purchased together with the amount of any brokers' commission paid by you in connection therewith provided that the total cash disbursement of Lautaro under this agreement shall not at any one time exceed $1,000,000. You are authorized to resell any interim certificates and/or bonds and warrants so purchased by you provided that the average sales price per $1,000 principal amount equals or exceeds the average purchase price per $1,000 in each case exclusive of accrued interest and in each case of any such resale you shall credit Lautaro with the net sales price realized by you upon such resale. On or after July 1, 1930, any bonds with warrants then held by you for account of Lautaro shall be delivered subject to its order.

Mr. SILVER. Now, these bonds bore the date July 1, 1929, did they not?

Mr. BYRNES. They bore the date of what?

Mr. SILVER. July 1, 1929?

Mr. BYRNES. They were to be dated as of July 1, 1929.

Mr. SILVER. And they were issued and sold in one operation on one day, on or about June 19, 1929?

Mr. BYRNES. I think that is correct.

Mr. SILVER. So that under the terms of section 10 the City Co. was authorized for a period of approximately one full year after the flotation of this issue to purchase these bonds in the market at par or less than par——

Mr. BYRNES. No.

Mr. SILVER. In accordance with the terms of this agreement?

Mr. BYRNES. At or below issue price. That would be 99 or less.

Mr. SILVER. At or below 99?

Mr. BYRNES. Yes.

Mr. SILVER. Provided that the total amount of the purchase of these bonds at any one time should not exceed $1,000,000?

Mr. BYRNES. Yes.

Mr. SILVER. Should not exceed $1,000,000?

Mr. BYRNES. That the cash involved in such purchase should never exceed $1,000,000.

Mr. SILVER. What was the purpose of that provision, Mr. Byrnes?

Mr. BYRNES. To provide a purchasing power on behalf of the company in case the bonds should decline below the issue price. You must remember that this was a bond for the construction of a new plant. All of the cash proceeds of the bonds were impounded for the construction of the plant, roughly. That is rather a technical—escrow provision. And at the time of the issue, or before the time of the issue—at the time of the contract we thought it desirable, and the company did too, that a purchasing power supplied by the company should be available in the event that this new credit, which was not an ordinary type to the American public—much better known in England than in America—should decline below the issue price. The company had substantial working capital and they agreed to such purchasing power.

Mr. SILVER. Now, Mr. Byrnes, what was the purpose of that provision?

Mr. BYRNES. To have an interested purchasing power in the bonds and to purchase at or below the issue price in the event we considered the exercise of such purchasing power desirable, in the interest of the bondholders, of course.

Mr. SILVER. Was not this method or device employed for the purpose of absorbing any slack in the bond market in this issue so as to

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

maintain over that period of approximately one year a price for the bonds at or near the issue price?

Mr. BYRNES. The purchasing power could only be used in case the bonds could be bought below the issue price, as I remember.

Mr. SILVER. In other words, whenever the market sagged below the offering price then this purchasing power which had been set up was used for the purpose of bringing that price back up?

Mr. BYRNES. No; it could be used. Not would be used. It could be used in our discretion.

Mr. SILVER. In any event that was the purpose of the provision?

Mr. BYRNES. What was the purpose?

Mr. SILVER. The purpose was to enable you, if in your discretion it seemed necessary, to use that fund to bring the market value up to the offering price?

Mr. BYRNES. I do not want to quibble, but I think the wording here is exactly accurate, and if we deemed it desirable we could use this purchasing power in our discretion providing we could use it below the offering price.

Senator BROOKHART. Why did you want a purchasing power like that?

Mr. BYRNES. There is always a possibility in a $32,000,000 issue, and particularly in that type of credit, Senator Brookhart, that there may be times when for one reason or other there may be the need of some purchasing power. Very often we supply that ourselves.

Senator BROOKHART. The thing that makes the need is the price dropping down?

Mr. BYRNES. Yes. And if we can find interested——

Senator BEOOKHART. You wanted that, then, for the purpose of maintaining the price while you were disposing of those bonds?

Mr. BYRNES. No, no, no, Senator Brookhart, because those bonds were all disposed of on or about this date, June 19. We could have stepped out of the market and so could the Lautaro Nitrate Co. (Ltd.), and never paid another bit of attention to it. But if so we would not have been maintaining the reputation which we have built up of paying attention to our secondary markets, and of really achieving distribution.

Senator BROOKHART. You wanted the public to believe, then, that you were sustaining them and keeping them up?

Mr. BYRNES. As a matter of fact, no purchasing power was required and none of it was exercised until after the crack in the stock market in October, 1929. From June until October of that year this reserve purchasing power did not need to be used—was not used.

Senator BROOKHART. I understand. Was it used finally?

Mr. BYRNES. It was used in October, 1929.

Senator BROOKHART. To what extent?

Mr. BYRNES. Let me go back. These bonds were immediately disposed of. They went to a premium. They sold in August of that year—I think I am correct; you correct me if I am wrong—as high as 104. Maybe 105.

Senator BROOKHART. That is in August of 1929?

Mr. BYRNES. August of 1929. And they maintained—they stayed at or above their issue price until late in October, when all markets were upset by the conditions that obtained at that time. And we did use this purchasing power I think over a period—not to main-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tain price; we did not peg price; we bought bonds on the decline, not trying to—merely keeping it orderly, and I think that that purchasing power was not exhausted until some time in December of 1929. A few months later we were able to reverse the operation. A demand sprang up for the bonds again, the market advanced, these bonds were taken back from the company and distributed.

Mr. SILVER. In connection with the flotation of any issue, Mr. Byrnes, it is not only necessary to sell the issue but in order to maintain the reputation of the issuing house it is also important that the issue should stay sold, is that not so?

Mr. BYRNES. Highly desirable.

Mr. SILVER. And in that connection there is a practice which is known as the creation of a secondary market in connection with the flotation of any issue, is there not?

Mr. BYRNES. There are various phrases used. Primary distribution, secondary distribution; primary placement, secondary placement. But the idea, of course, is to get bonds placed in a wide enough market so that the amount that comes in from time to time is a reasonable amount so that probably your purchasers and your sellers more or less balance.

Mr. SILVER. In other words, the important thing is to keep out of the market after the original distribution any speculative interests, any floating bonds or any deluge of selling that would affect or depress the market price; is that not so?

Mr. BYRNES. To absorb such selling if necessary.

Mr. SILVER. And it is in order to absorb such selling and to keep the market price orderly that a provision is made of the type referred to in section 10 of this contract between the National City Co. and Lautaro Nitrate Co.?

Mr. BYRNES. That is correct.

Senator BROOKHART. Let me ask you a question about that. I do not understand that. In absorbing selling you just buy back what somebody else sells, do you not?

Mr. BYRNES. Yes; and replace it, Senator Brookhart.

Senator BROOKHART. Do you have to have new stock or new bonds?

Mr. BYRNES. There may be some man in Maine that wants to for some reason sell and some man in California wants to buy.

Senator BROOKHART. But you would not have to buy anything from the nitrate company to absorb that?

Mr. BYRNES. We had bought these bonds for their account. This market fund, or call it what you will here, this purchasing power put in our hands by the company was exercised for their account. They were the owner of these bonds we bought in the market.

Senator BROOKHART. But I can not see what purpose you would have in buying more from them unless it was to maintain the market and keep the price up.

Mr. BYRNES. We did not buy any more from them.

Senator BROOKHART. You did not buy them from them?

Mr. BYRNES. No, sir.

Senator BROOKHART. What you bought was in the market?

Mr. BYRNES. In the market; yes. Bonds that, as I said, had been sold in June.

Senator BROOKHART. And you did that, of course, to maintain the old price at which you had sold them?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. Well, I think the history—if you wish the history of the actual operations of that market fund it could be put in the record.

Senator BROOKHART. Well, the purpose of it is what we are after here. You did not want the bonds yourself as a further investment?

Mr. BYRNES. We buy bonds to sell, Senator Brookhart.

Sentor BROOKHART. Yes; and then when you bought them the second time, why, you bought them to maintain the market price?

Mr. BYRNES. Not to maintain the market, necessarily. That may be an effect of achieving an orderly market at any given moment, yes, it might. It certainly would contribute to that.

Senator BROOKHART. Is that not what you do it for, then, to maintain that market value?

Mr. BYRNES. Well, that is perhaps an incidental effect. The primary thing is to have a purchasing power available in case one of these bondholders wants to sell, and at the moment we have no other purchasing power.

Senator BROOKHART. It seems to me that the main purpose of a deal like that is to maintain the market. I can not see that incidental part of it.

Mr. BYRNES. I would say, sir, from the standpoint of the bondholders themselves and the company it is to maintain the credit rating of the company in the market.

Senator BROOKHART. Well, the credit rating is to make the public believe that the stuff is really worth what you sold it at?

Mr. BYRNES. Yes, but there are always buyers and sellers. This is a particular buyer, the company that is particularly interested in maintaining an orderly market for its securities.

Senator BROOKHART. I think that is all right. They want to maintain the market.

Mr. SILVER. In connection with this operation, Mr. Byrnes, did the Lautaro Co. deposit with the National City Bank the sum of $275,000 to be used in financing such purchases?

Mr. BYRNES. I will accept your statement to that effect if I may, or we will check it and corroborate it. Do you want it technically accurate? If so I must consult.

Mr. SILVER. Yes. Please look at a memorandum from W. P. Meyer of the trading department to S. W. Baldwin, treasurer, dated October 31, 1929.

Now after this advance of $275,000 had been made by the Lautaro Co. in connection with the financing of these purchases, is it not a fact that additional funds of the National City Bank were made available in connection with the same trransaction?

Mr. BYRNES. My recollection is that the Lautaro Nitrate Co. had a line of credit or arranged a line of credit with, naturally, the bank that it had such a line with. And that the actual payment for bonds in excess of that amount was made against that line of credit or borrowed.

Mr. SILVER. Will you refer to your records and tell us whether it is not a fact that between November 11, 1929, and December 28, 1929, $1,000,000 were expended by the National City Co. in the repurchasing of the Lautaro bonds and that a sum approximately 75 per cent of that amount was borrowed from the National City Bank for this purpose?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. We will accept that. The gentleman here from the National City Co. informs me that that is right. Mr. Schoepperle informs me that. We have not seen the bank records on that, but we believe it to be correct.

Mr. SILVER. I show you a memorandum dated February 15, 1933, signed by Mr. Baldwin, and let him check from this computation while we go on with the questioning, and we will let the amount stand subject to correction, if it should be required.

Now it is a fact, is it not, Mr. Byrnes, that in connection with this operation the capital funds and assets of the Lautaro Co. were being used for the purpose of maintaining a market in its own bonds, and that that operation was being carried on with the knowledge and consent of the National City Co.?

Mr. BYRNES. The National City Co. acting as the agent of the Lautaro Nitrate Co. (Ltd.) did buy bonds of the company for account of the company.

Mr. SILVER. In other words, an operating company the purpose of which was to manufacture and sell a nitrate product was permitting a substantial portion of its assets to be used for the purpose of a market operation in the support of its own bonds?

Mr. BYRNES. Yes, Mr. Silver. And in spite of the great praise that we have had of the English Companies act, that company was formed under the British Companies act.

Mr. SILVER. But the disposition, sale, and the market were maintained in America.

Mr. BYRNES. It was the British company that was using its funds and it was acting under its corporate powers.

Mr. SILVER. And the question is whether the market operation in the use of funds of that character would have been authorized if done in England.

Mr. BYRNES. A British company doing something in America under its charter powers that it could not do in England? I do not think so.

Mr. SILVER. Is it not a fact, too, Mr. Byrnes, that the loan advanced by the National City Bank was advanced with specific knowledge that that advance was to be used in connection with this market operation for the maintenance of a market in the bonds?

Mr. BYRNES. I do not know that, but the mere fact that the bonds were delivered into the bank and formed collateral for the loan I should think would be some evidence that the loan was for that purpose.

Mr. SILVER. Well, is not this a sample operation, Mr. Byrnes: The National City Co. would buy the bonds of the Lautaro Co., would deliver them to the bank, would receive payment, and leave those bonds as collateral for the repayment of that indebtedness. Is that not correct?

Mr. BYRNES. Yes. I believe so.

Mr. SILVER. The National City Bank advanced 100 per cent of the purchase price of those bonds, is that not so?

Mr. BYRNES. I think there was a protective margin there of $275,000 worth of the bonds, whatever it may be.

Mr. SILVER. But after that $250,000 margin had been exhausted by the actual purchase of bonds there were additional bonds to the extent of $750,000 that were purchased at the then market and the entire amount was advanced by the National City Bank?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. And the entire amount of bonds, including the $275,000 worth, was pledged as collateral for the loan.

Mr. SILVER. In other words, the only security the National City Bank had for that loan was the difference between the purchase price or the then market value of the bonds and some other price that they may have had at some prior time?

Mr. BYRNES. Plus the credit of the Lautaro Nitrate Co. (Ltd.).

Mr. SILVER. But so far as the specific security was concerned here this was virtually a loan based upon 100 per cent of the then value of the security?

Mr. BYRNES. Oh, no. Oh, no. It was based upon that margin of $275,000, and the borrowing of only $750,000; you had a margin there of I should say at all times 25 per cent or more. Oh, more than that—it is 33⅓, or somewhere around there, margin.

Mr. SILVER. Was not a substantial part of that $275,000 originally desposited, subsequently returned to the company and prior to the completion of this market operation? [Pause] While that is being checked, Mr. Byrnes; is it not a fact that the relationship between the bank and the security company in this instance made it possible for the bank to lend its resources to the National City Co. for the purpose of maintaining a market operation in a security that had been floated and sponsored by the National City Co.?

Mr. BYRNES. That was not the purpose at all. Naturally the Lautaro Nitrate Co. borrowed from the bank with which it had its closest relations as a matter of comity and good relations. They might just as well have borrowed the money from anybody else. It was a perfectly good loan.

Mr. SILVER. Well, whether that was the purpose or not, that certainly was the effect, was it not?

Mr. BYRNES. Yes; but you asked me the purpose, not the effect.

Mr. SILVER. Well, was that the effect?

Mr. BYRNES. No; the effect was that the National City Bank financed the Lautaro Nitrate Co. to buy its bonds. The National City Co. merely acted as the agent of the Lautaro Nitrate Co. to effect the purchase of those bonds, and under directions of the Lautaro Nitrate Co. delivered those bonds to the banking institution which the Lautaro Co. had selected.

Mr. SILVER. But in financing that operation with the Lautaro Co. the National City Bank had knowledge of the fact that the funds advanced were being used by the Lautaro Co. in conjunction with the National City Co. for the specific purpose of maintaining the market in that bond issue?

Mr. BYRNES. I am not sure that they did. But it has no significance to me if they did. It is a perfectly good banking transaction. They were probably very glad to have it.

Mr. SILVER. Is there any question in your mind but that the Nationl City Bank had such knowledge, Mr. Byrnes?

Mr. BYRNES. I think they probably did. I mean the very form of the transaction——

Mr. SILVER. Well, did they not really? Did they not without doubt have knowledge of the purpose of this loan?

Mr. BYRNES. I did not arrange the line of credit with the bank. That was arranged by the Lautaro Nitrate Co. (Ltd.).

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SILVER. Do not your records show that the National City Bank had knowledge of this transaction and the purpose of the loan?

Mr. BYRNES. I am not sure that they did.

Senator BROOKHART. When was this done? What was the date of it?

Mr. BYRNES. From the end of October, 1929, through December, 1929, and the loan was repaid—the bonds were resold in the first half of 1930.

Senator BROOKHART. And were they sold at a loss?

Mr. BYRNES. A loss to whom, Senator?

Senator BROOKHART. Well, the Lautaro Co. bought them?

Mr. BYRNES. Yes; the Lautaro Nitrate Co. bought them.

Senator BROOKHART. Now you had bought them before that under your contract with the Lautaro Co.?

Mr. BYRNES. Yes.

Senator BROOKHART. Now they bought them, and then did you sell them altogether?

Mr. BYRNES. Well, I believe those figures are here, Senator. I offered to put them in the record some time back, and Mr. Silver said we would come to that a little later.

Senator BROOKHART. Yes; I understand. The point I want to know is whether you sold them at a loss.

Mr. BYRNES. I would have to check to find out. And it would be a question of loss to whom? No loss to us, and I think it was not any loss, or certainly any substantial loss to the Lautaro Co. There was no loss to Lautaro. There was no loss to us. In other words, we did not buy them as was intimated before at a fixed price close to the issue price. We bought them on a declining market, and subsequently the market went up again and the bonds were cleared out from Lautaro without a loss to them.

Senator BROOKHART. You bought them for yourselves and also for the Lautaro Co. while the market was down?

Mr. BYRNES. We bought them for the Lautaro Co. as the market was declining.

Senator BROOKHART. Those that you bought under your contract with them?

Mr. BYRNES. That is what I am talking about.

Senator BROOKHART. Was that on a declining market?

Mr. BYRNES. That was on a declining market, after the crack in the stock market in 1929.

Mr. SILVER. In that connection may I read the memorandum submitted to counsel by Mr. H. S. Law, secretary, dated February 20, 1933, reading as follows:

> Referring to the purchase fund on Lautaro Nitrate 6's of 1954:
> The original purchase fund folder which you have reviewed, showed that the total of 1,115 units were purchased for the Lautaro Nitrate Corporation for a total principal of $974,108.25. During March and April, 1930, these were resold for the account of the Lautaro Nitrate Corporation at prices ranging from $875 to $932.90 per unit, producing a profit of $12,978.40 of which $1,516.75 was paid to the Lautaro Nitrate Corporation and the balance retained by the National City Co. for its services. The units consisted of one $1,000 bond and 10 shares of common stock.

That refers, as I understand it, to this secondary market operation that we have been discussing?

Mr. BYRNES. Yes, sir; I think so.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SILVER. Now, in connection, finally, with this deposit that you have referred to of $275,000, may I call your attention, Mr. Byrnes, to a statement from the files of the National City Bank, including a memorandum signed by T. A. Rave as assistant cashier, addressed to—well, it is with respect to the Lautaro Nitrate Corporation, general file, and it contains this excerpt:

The corporation—

Referring to Lautaro Nitrate Corporation—

Has made a cash deposit of $275,000 with the City Co. which was to be used as margin, but as Mr. Edmunds desired to secure the return of part of this cash deposit he felt that the purchase of the bonds could be handled to their better advantage on a loan basis. We agreed to make loans as bonds were purchased against our regular form of borrowing contract with a margin of 10 per cent.

Does that not indicate to you, Mr. Byrnes, that instead of maintaining this margin of 27½ per cent that you have referred to, shortly after the inception of this margin plan, a new arrangement was consummated under the terms of which this secondary market operation was transacted on a 10 per cent margin basis?

Mr. BYRNES. It shows clearly that I had no knowledge of any modification of the arrangement, and that it was made merely as a banking arrangement between Lautaro and the bank.

Mr. SILVER. You know it now?

Mr. BYRNES. I accept your statement; yes.

Mr. SILVER. And you know now, do you not, that this operation involving $1,000,000 was financed at least to the extent of 90 per cent by the National City Bank with full knowledge of the fact that the funds advanced for the account of Lautaro Nitrate Co. were being used to maintain the market of this bond issue?

Mr. BYRNES. No, not to maintain the market. But to purchase bonds in the market.

Mr. PECORA. Mr. Byrnes, at the time of the flotation of this Lautaro Nitrate bond issue there were a number of European nations engaged in the production of a synthetic nitrate, were there not?

Mr. BYRNES. You are getting onto a very technical subject, Mr. Pecora. I will be very glad to explain if you wish to take the time. The fertilizer material is not nitrate. It is nitrogen.

Mr. PECORA. Nitrogen. All right.

Mr. BYRNES. And nitrogen is fixed in various forms. It happens to be fixed in this unusual deposit of caliche down in Chile in the form of sodium nitrate, and that is the chemical form in which it is contained. There is very little sodium nitrate produced by any chemical process anywhere in the world.

Mr. PECORA. Now in connection with the National City Co.'s negotiation to float this bond issue: A Mr. Sterling H. Bunnell, an engineer in the employ of the industrial department of the National City Co. made a study and a survey of that industrial field, did he not?

Mr. BYRNES. Although we had very great confidence in the acumen and the ability of the Guggenheim organization, so-called, in the engineers whom they had then attached to their organization, we did take the final precaution of sending a man to Chile to study the industry on the ground, in order that we might have somebody in our

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

organization that would understand something about the very technical processes involved.

Mr. PECORA. And that answer is another way of saying "Yes" to my question, is it not?

Mr. BYRNES. I think it is.

Mr. PECORA. All right. Now we would save time if you would just confine yourself to simple answers. Mr. Bunnell made a written report to the company under date of May 1, 1929, did he not?

Mr. BYRNES. I am informed that is correct.

Mr. PECORA. And in that report among other things did he not say as follows:

> Sodium nitrate was originally obtained almost exclusively from the caliche rock deposits in Chile, but in recent years has also been produced synthetically. During the great European war Germany and her allies, cut off from Chilean supplies, developed methods for the atmospheric fixation of nitrogen. The bulk of Chilean nitrate is used for fertilizer and for this purpose it acts in competition with the various products of the nitrogen fixation plants and with by-product such as ammonium sulphate produced from coke ovens. The result has been price competition in which the Chilean product was handicapped by the high Chilean export duty of * * * $12.32 per metric ton of 2,205 pounds. Thus the tremendous demand of the war years which after the recession of 1919 reached a peak in 1920 was followed by minimum production in 1922. Since that time the demand has fluctuated irregularly as prices were automatically maintained by the Association of Chilean Nitrate Producers, backed by the Chilean Government.

Do you recall that report made by Mr. Bunnell less than two months before the National City Co. floated this $32,000,000 bond issue?

Mr. BYRNES. That was an office study.

Mr. PECORA. Yes?

Mr. BYRNES. That report was not made after his visit but before he went to Chile.

Mr. PECORA. Well, he made that report under date of May 1, 1929, did he not?

Mr. BYRNES. Yes. That was an office study. That was not his report from the field.

Mr. PECORA. Did you not learn from this report, if you did not already know it, that the synthetic production of nitrate——

Mr. BYRNES. Nitrogen.

Mr. PECORA. Nitrogen had assumed very formidable proportions in various European nations?

Mr. BYRNES. Oh, yes.

Mr. PECORA. And those proportions grew to the point where in competition with the Chilean natural product the Chilean product was handicapped particularly because of a large export tax placed by the Chilean Government on its product?

Mr. BYRNES. That was naturally an addition to their cost.

Mr. PECORA. Yes. Now in putting out a bond issue——

Mr. BYRNES. Which had always existed, as you know.

Mr. PECORA. I know that. Now in putting out a bond issue to the American investing public did the National City Co. always seek to inform itself fully concerning the risks and hazards surrounding such an issue?

Mr. BYRNES. We certainly tried to.

Mr. PECORA. Yes. And in the effort to acquaint itself with all these elements in the nitrate industry in order to reach a determina-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tion as to whether your company should have lent itself to the flotation of these $32,000,000 worth of bonds your company learned of the extent of the production of synthetic nitrate in Europe, did it not?

Mr. BYRNES. We knew it.

Senator BROOKHART. It was also developed in the United States?

Mr. BYRNES. Not very much at that time, Senator.

Senator BROOKHART. There was a plant at Syracuse, N. Y., and there was one other plant in the West.

Mr. BYRNES. The production in this country of synthetic nitrogenous fertilizer was relatively small at that time. Since that time——

Senator BROOKHART. But the process had already developed.

Mr. BYRNES. Oh, yes. There was a German process that was seized.

Senator BROOKHART. And then the same thing was considered in the Muscle Shoals proposition?

Mr. BYRNES. But it had not been proven at that time. I do not know that it is even proven to-day that the unit of nitrogen content can be produced cheaper by the synthetic as against the natural.

Senator BROOKHART. Well, you did not put this engineer's report in your prospectus so as to let all people know what the real facts were, did you?

Mr. BYRNES. Mr. Pecora has the study there.

Senator BROOKHART. Here is the prospectus. I looked it over hastily. I do not find anything like that.

Mr. BYRNES. The study is something over 70 pages long. The report as finally made was eighty-odd pages long. And naturally it was not contained in a prospectus of two pages.

Senator BROOKHART. The short statement that Mr. Pecora read here was not included?

Mr. BYRNES. I do not know whether that was produced or not.

Mr. PECORA. No. That was just an extract from the report which I read. I know the report was a lengthy one. Now, after Mr. Bunnell made that report, which you say was simply an office study and not a report based upon field survey or operation, your company sent an engineer to make a field study or survey, did it not?

Mr. BYRNES. Mr. Bunnell at the time he made the office study had the advantage of the reports and the figures submitted to him by the operating organization, the technical organization of Guggenheims. He went to the field to check back those figures and see the method of operation and satisfy himself.

Mr. PECORA. And when did he go to Chile to make that check-up? Was it before or after the flotation of these bonds by the National City Co.?

Mr. BYRNES. Before.

Mr. PECORA. Before?

Mr. BYRNES. Before.

Mr. PECORA. When did he make his report based upon that field survey?

Mr. BYRNES. His report based on the field study was made by cable in the first instance, and subsequently confirmed in this written report after he reached New York.

Mr. PECORA. What is the date of that written report?

Mr. BYRNES. Do you want the written report or the cabled report?

Mr. PECORA. The date of the written report.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. BYRNES. August 10.

Mr. PECORA. August 10, 1929. When were the bonds actually floated by the National City Co.?

Mr. BYRNES. June, 1929.

Mr. PECORA. So he made his written report some two months after the actual flotation?

Mr. BYRNES. Yes; but made a very full report of conclusions by cable before the bonds were issued.

Mr. PECORA. In his written report of August 10, 1929, did not Mr. Bunnel among other things say as follows, referring to this proposition:

From the banking viewpoint, the proposition is speculative, but if there is adequate value in Caliche land to secure the debentures the addition of a speculative feature, together with the common stock, should make the debentures readily salable.

Do you find that he said that in his report?

Mr. BYRNES. No; that is in the study before he left New York.

Mr. PECORA. In the study before he left. Is that in the study——

Mr. BYRNES. Of May.

Mr. PECORA. A part of which was made May 1, 1929?

Mr. BYRNES. Yes; page 71.

Mr. PECORA. So that the National City Co. actually had in its files a month and a half before it floated these bonds an opinion from its engineer in its industrial department that called attention to the speculative character of this proposition, did it not?

Mr. BYRNES. It had that statement in his office study; yes.

Mr. PECORA. And with that statement in its files the company nevertheless went ahead with the negotiations and put out the bond issue?

Mr. BYRNES. Yes. But it had subsequent statements.

Mr. PECORA. Now, I am coming to the subsequent statements. Did Mr. Bunnell go down to Chile before or after the bond issue was floated by your company?

Mr. BYRNES. Before.

Mr. PECORA. How long before?

Mr. BYRNES. Mr. Bunnell arrived in Chile on May 17.

Mr. PECORA. And when did he send in his cabled report?

Mr. BYRNES. They are in several cables here.

Mr. PECORA. How many of them, and give their respective dates, will you? Well, if you can not find them and give me the dates readily, let me ask you this question——

Mr. BYRNES. There are quite a few. It is just a matter of locating them in the files.

Mr. PECORA. Is it not a fact that when he submitted his final and written report under date of August 10, 1929, Mr. Bunnell concluded that written report with this statement? See if I read it correctly, the last paragraph. Have you got it?

Mr. BYRNES. Start it.

Mr. PECORA [Reading:]

The unknown factor is obsolescence. By the substantial reduction in the cost of producing Chilean nitrate——

Mr. BYRNES. "The unknown factor is obsolescence." That is one sentence. Then start another sentence.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA (reading):

By the substantial reduction in the cost of producing Chilean nitrate the industry is placed in a competitive position——

Mr. BYRNES. "Advantageous competitive position."

Mr. PECORA. "Advantageous." That is left out here. [Continuing reading:]

advantageous competitive position with synthetic and other production of fertilizer chemicals.

Mr. BYRNES. "Fertilizing chemicals."

Mr. PECORA. "Fertilizing"?

Mr. BYRNES. Yes.

Mr. PECORA. All right. [Continuing reading:]

But with the current march of progress, it is impossible to prophesy the conditions which may exist in the Chilean nitrate industry within the 25-year term of new financing. There is, however, every possibility that the Lautaro Anglo-Chilean management will be able to maintain its lead in the Chilean industry and to continue operation at a rate of earnings which will place the security of the debenture beyond reasonable doubt.

Is that correct?

Mr. BYRNES. That is correct now.

Mr. PECORA. What study was made at the same time of the production of synthetic nitrate abroad?

Mr. BYRNES. At the same time?

Mr. PECORA. At any time.

Mr. BYRNES. Every industrial company naturally guards its cost figures. We endeavored—we had endeavored in a number of ways to check the costs, the competitive costs of competitive nitrogenous fertilizers. It was impossible for us to get the same kind of detailed inside information on such things as it was to get on nitrate from the Guggenheims. They were running a sodium nitrate undertaking. They were satisfied themselves that their competitive costs would be at least as low as that of the synthetic competitors, and we could obtain no information that proved them wrong.

Mr. PECORA. Now, Mr. Byrnes, is it not a fact that not long after the flotation of these $32,000,000 worth of Lautaro Nitrate bonds the National City Co. lent itself to the flotation of a bond issue put out by a German company that was manufacturing synthetic nitrate?

Mr. BYRNES. I do not think so. Oh, You mean, the American I. G.?

Mr. PECORA. Yes.

Mr. BYRNES. That was an American company.

Mr. PECORA. An American company, but operating under——

Mr. BYRNES. But not producing, itself, any nitrogenous fertilizers.

Mr. PECORA. Was it producing?

Mr. BYRNES. No. The I. G. Farbenindustrie is the largest producer in Germany of nitrogenous fertilizers.

Mr. PECORA. What was the relationship between the American I. G. Co. and that Germany company?

Mr. BYRNES. The American I. G. was an affiliated company organized by a German company or one of its affiliated subsidiaries. I think it actually may have been their Swiss subsidiary.

Mr. PECORA. Did the American I. G. Co. put out a bond issue?

Mr. BYRNES. Yes; but I think it was before the Lautaro.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. Did the National City Co. have anything to do with that?

Mr. BYRNES. It certainly did. It issued bonds of the American I. G. Chemical Co.

Mr. PECORA. To what amount?

Mr. BYRNES. $30,000,000.

Mr. PECORA. When did it do that?

Mr. BYRNES. I think it was May, 1929, but I do not think we have any figures.

Mr. PECORA. Within a month or two of the time that was put out, the National City Co. put out the $32,000,000 bond issue of the Lautaro Nitrate Co.?

Mr. BYRNES. Quite right.

Mr. PECORA. So that within a space of, we will say, two months, the National City Co. sponsored two bond issues, one for $30,000,000 and the other for $32,000,000; put out, respectively, by competing companies, one a German company manufacturing a synthetic product, and the other a Chilean company, that is, the operating company, putting out a natural product?

Mr. BYRNES. That is not technically correct, and it is not actually correct. We did not put out any bonds for a Germany company producing nitrates.

Mr. PECORA. You put them out for the American I. G. Co.?

Mr. BYRNES. We did.

Mr. PECORA. And the securities underlying these bonds were the earnings of the German company?

Mr. BYRNES. Only through the fact that the German company guaranteed principal and interest; but the assets of the American I. G. were not German assets.

Mr. PECORA. Was the American I. G. Co. a producing company?

Mr. BYRNES. It was a holding company.

Mr. PECORA. And dependent for its earnings upon the producing company in Germany?

Mr. BYRNES. Oh, no; not at all.

Mr. PECORA. Where?

Mr. BYRNES. Here in this country.

Mr. PECORA. So that with that correction, the fact is that within two months' time your company put out a bond issue of $30,000,000 representing obligations of interests engaged in the manufacture of synthetic nitrates and a $32,000,000 issue representing the obligations of interests engaged in the natural production of nitrates; is that right?

Mr. BYRNES. That is correct.

Mr. PECORA. And the two were competing one with the other, were they not?

Mr. BYRNES. The bonds of the American I. G. Co.——

Mr. PECORA. No; I mean the two industries were competing one with the other. Were they or were they not?

Mr. BYRNES. The companies were not competing; no.

Mr. PECORA. The industries were competing industries, were they not?

Mr. BYRNES. But the bonds of the American I. G. were not bonds supported purely or at all, really, directly by the nitrogenous fertilizer industry of the German I. G.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. PECORA. The bonds put out by the American I. G. Co. were bonds put out by corporate interests that were engaged in the production of synthetic nitrate; is that correct, Mr. Byrnes?

Mr. BYRNES. The American I. G. does not produce any nitrogenous fertilizer at all, that I know of—did not at the time and does not to-day.

Mr. PECORA. You said the American I. G. Co. was a holding company?

Mr. BYRNES. Yes.

Mr. PECORA. Well, what operating company supported it?

Mr. BYRNES. I have not the circular, but from my recollection the American I. G. had, among other things, investments in companies here producing pharmaceutics, dyes, photographic materials, and, I think, an interest with the Standard Oil Co. in a subsidiary—or that may have been represented by ownership of Standard Oil of New Jersey stock. I am just trying to recall what that is.

Mr. PECORA. Did it also have an interest in any company producing synthetic nitrate?

Mr. BYRNES. No.

Mr. PECORA. What was this German company you mentioned before?

Mr. BYRNES. That is the I. G. Farbenindustrie, the biggest company in Germany, and I think, or the largest company in Europe; the most important dye and chemical company, perhaps. Comparisons are odious.

Mr. PECORA. Was that company engaged in the manufacture and production of synthetic nitrate?

Mr. BYRNES. It was, in Germany.

Mr. PECORA. Tell us again what the relationship was between the German company and the American I. G. Co.

Mr. BYRNES. The German company owned these various interests in enterprises in this country, some of them in partnership with American enterprises, American companies. Those interests of the German company were put into the American company in exchange, directly or indirectly, for stock of the American company.

Mr. PECORA. Which company—the American I. G. Co.?

Mr. BYRNES. Yes.

Mr. PECORA. So there was that relationship between the American I. G. Co. and this German company that was producing and manufacturing synthetic nitrate?

Mr. BYRNES. Yes; in Germany.

Mr. PECORA. Of course, in Germany; just as the Lautaro Nitrate Co. was producing natural nitrate in Chile. And the National City Co. sponsored the bond issue in the one instance of the American I. G. Co., and within two months thereafter, this issue of $32,000,000 of the Lautaro Nitrate Co.

Mr. BYRNES. Yes.

Mr. PECORA. That is all I wanted to establish.

Mr. Chairman, associate counsel, Mr. David Saperstein, will present evidence to the committee with respect to the operations by the National City Co. in securities of the United Aircraft Co.

(Witness excused.)

Mr. SAPERSTEIN. Mr. Ripley.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

TESTIMONY OF JOSEPH P. RIPLEY, NEW YORK, N. Y.

The CHAIRMAN. Do you solemnly swear the testimony you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

Mr. RIPLEY. I do.

Mr. SAPERSTEIN. Will you be kind enough to state for the record your full name, address, business, or occupation?

Mr. RIPLEY. Joseph P. Ripley; 55 Wall Street, New York City. Residence, 120 Kensington Road, Garden City, Long Island, N. Y. Occupation, vice president National City Co.

Mr. SAPERSTEIN. How long have you been connected with the National City Co.?

Mr. RIPLEY. Since about April, 1925.

Mr. SAPERSTEIN. How long have you been a vice president of that company?

Mr. RIPLEY. Since June 28, 1927.

Mr. SAPERSTEIN. You were a vice president of the National City Co. at the time when a merger, involving three companies engaged in the manufacture of airplanes or in the air-transport business, was effected, resulting in the company known as the Boeing Airplane & Transport Corporation, were you not?

Mr. RIPLEY. I was; but I must correct the way you put your question, because I would not call it a merger operation.

Mr. SAPERSTEIN. You were a vice president of the National City Co. at the time this operation took place, whatever you call it?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. In connection with that business you went to Seattle, Wash., did you not?

Mr. RIPLEY. I did.

Mr. SAPERSTEIN. And you arranged the details of this operation?

Mr. RIPLEY. I did.

Mr. SAPERSTEIN. On behalf of the National City Co.?

Mr. RIPLEY. I did.

Mr. SAPERSTEIN. Will you give us the names of the three companies involved in this operation?

Mr. RIPLEY. Boeing Airplane Co., Boeing Air Transport (Inc.), and Pacific Air Transport.

Mr. SAPERSTEIN. Prior to the time when you went to Seattle, did the National City Co. or the National City Bank have any interest in any of those companies?

Mr. RIPLEY. No.

Mr. SAPERSTEIN. Did the company or the bank have any stock ownership in those companies?

Mr. RIPLEY. None whatever.

Mr. SAPERSTEIN. Did the National City Co. have loans outstanding against any of them?

Mr. RIPLEY. Not a cent.

Mr. SAPERSTEIN. Those three companies were commonly owned and controlled, were they not?

Mr. RIPLEY. That depends, sir, on how you use that expression "commonly owned and controlled." If you will allow me to describe the situation, I think it may suit your purpose.

Mr. SAPERSTEIN. Yes. Will you tell us where the control was?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RIPLEY. I would say that a group of individuals identified with these three companies and active in their management together controlled all three of them through stock ownership—if that answers your question.

Mr. SAPERSTEIN. Who was the head of that group?

Mr. RIPLEY. Mr. William E. Boeing.

Mr. SAPERSTEIN. You said a moment ago that you would not describe this operation as a merger?

Mr. RIPLEY. That is right.

Mr. SAPERSTEIN. Will you tell us what you would describe this operation to be, if it was not a merger?

Mr. RIPLEY. I regard a merger as an operation where two or more corporations merge their affairs either into one of the then existing corporations or into a new corporation owning and operating the properties of the companies that go into the merger. The formation of Boeing Airplane & Transport Corporation I would speak of as the formation of a holding company to acquire all or substantially all of the stock of the three constituent companies.

Mr. SAPERSTEIN. The Boeing Airplane & Transport Corporation was organized at or about the time when these negotiations were going on, was it not?

Mr. RIPLEY. It was organized in the month of October, 1928, which was the time that the negotiations were going on.

Mr. SAPERSTEIN. Did the Boeing Airplane & Transport Corporation succeed in procuring a controlling interest in the three companies which you have named?

Mr. RIPLEY. It did, and it now owns 100 per cent of Boeing Airplane Co., 100 per cent of Boeing Air Transport (Inc.), and practically 100 per cent of Pacific Air Transport.

Mr. SAPERSTEIN. Did you make a thorough study of the condition of each of those—I will call them constituent companies for the purpose of convenience?

Mr. RIPLEY. To the best of my ability; yes.

Mr. SAPERSTEIN. Did you find those companies in a prosperous and flourishing condition?

Mr. RIPLEY. It depends upon how you use the term "prosperous and flourishing." I do not know how to answer that question. They were all earning profits, if that answers the question.

Mr. SAPERSTEIN. What did you consider the prospects for earning increased profits were?

Mr. RIPLEY. I thought they were favorable.

Mr. SAPERSTEIN. You recommended that the National City Co. go into this financing because you thought the prospects were favorable, did you not?

Mr. RIPLEY. I sent a telegram to head office in which I used the exact expression, "I recommend and urge that you authorize me to proceed with these negotiations."

Mr. SAPERSTEIN. What was the business of the Boeing Airplane Co.?

Mr. RIPLEY. The manufacture of airplanes.

Mr. SAPERSTEIN. Have you any idea how many airplanes had been manufactured by that company up to 1928?

Mr. RIPLEY. No. Your question refers to "up to 1928;" and if you will allow me to change it so as to read "up to the end of 1928," the answer is about 1,060.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SAPERSTEIN. What was the business of the Boeing Air Transport (Inc.)?

Mr. RIPLEY. The Boeing Air Transport (Inc.) was engaged in the carrying of United States air mail and passengers and small amounts of express between Chicago and San Francisco.

Mr. SAPERSTEIN. How many planes did it have in operation at that time?

Mr. RIPLEY. At what time, sir?

Mr. SAPERSTEIN. At the time when negotiations for this financing were going on.

Mr. RIPLEY. It had 26 in service and 10 under construction.

Mr. SAPERSTEIN. What was the business of the Pacific Air Transport?

Mr. RIPLEY. The Pacific Air Transport flew the United States air mail between Los Angeles and Seattle and also passengers and moderate amounts of express.

Mr. SAPERSTEIN. Do you recall, Mr. Ripley, that there was considerable discussion within your own organization as to whether this issue of stock which the National City Co. was about to acquire from the Boeing Airplane & Transport Corporation should be publicly or privately offered for sale?

Mr. RIPLEY. I do; yes.

Mr. SAPERSTEIN. Do you recall what the decision was with regard to that issue?

Mr. RIPLEY. The decision was to sell it by what was used as an expressive term, "privately."

Mr. SAPERSTEIN. Did you recommend that the issue be disposed of privately?

Mr. RIPLEY. No.

Mr. SAPERSTEIN. You were in favor of a public offering?

Mr. RIPLEY. I was. The files indicate that clearly. That was what I had in mind when I went to Seattle.

Mr. SAPERSTEIN. How many shares of the stock of the Boeing Airplane & Transport Corporation did the National City Co. acquire?

Mr. RIPLEY. The National City Co. purchased 90,000 shares of preferred stock of $50 par value per share and 45,000 shares of common stock. Please note, however, that another investment firm had an interest in that purchase. You have asked me how much the National City Co. purchased.

Mr. SAPERSTEIN. You had a partner in the original terms group?

Mr. RIPLEY. We did.

Mr. SAPERSTEIN. Who was that?

Mr. RIPLEY. The Pacific National Co. of Seattle.

Mr. SAPERSTEIN. What was the extent of its interests?

Mr. RIPLEY. Ten per cent.

Mr. SAPERSTEIN. Are you aware of the factors which induced the heads of your organization to arrive at the decision that the stock would be offered not publicly put privately?

Mr. RIPLEY. My recollection is that I received a telegram from head office advising me that the matter had been discussed, and my recollection is that such telegram indicated that the head office thought that such an offering was a little bit too speculative to be spread around to the entire American public.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SAPERSTEIN. Was that telegram from Mr. Charles E. Mitchell?

Mr. RIPLEY. My recollection is that it was; but I gather that you have it before you.

Mr. SAPERSTEIN. I will read you what purports to be a copy of the telegram to which you have just referred. It is dated October 22, 1928, from Mr. Charles E. Mitchell, National City Co., to you at Seattle, Wash. [reading]:

Have had luncheon meeting to-day with Messrs. Swenson, Rockefeller, Ryan, Brady, Deeds, and Russell for purpose of discussing Boeing matter. All heartily approve purchase, but urge that instead of a public offering and general distribution through sales organization the distribution be limited as far as possible to our own officers, key men, directors and special friends, the principal reasons being that smaller group stockholders would enable us to more easily handle further desirable mergers and to some extent, at least, would take away the heavy speculation that would accompany in general a public offering on our part. At the same time I would hope that the distribution could be sufficiently broad to justify in due course a listing. Under these circumstances I see no need for hasty distribution and believe we can await any early date that you will suggest. We strongly approve the suggestion that you should join the board of directors. We see no objection to a public announcement by Boeing along the line of your suggestion. Russell left this afternoon for Chicago, and Baker will not return until to-morrow. Therefore, please address me on any vital questions.

Mr. Ripley, does Mr. Mitchell's statement that "a smaller group of stockholders would enable us to more easily handle further desirable mergers" accord with your own idea as to the reason for not offering this issue publicly?

Mr. RIPLEY. You mean, the reason that moved the head office to arrive at that conclusion?

Mr. SAPERSTEIN. Yes.

Mr. RIPLEY. No; I think the real reason was that the National City Co. had not at that time come to the point where it felt justified in sponsoring the aviation industry to the investing public of this country.

Mr. SAPERSTEIN. But it had come to the point where it felt that it could safely and with profit offer an aviation issue to its own officers, directors, and special friends; is not that a fact?

Mr. RIPLEY. I want to give you two answers. In the first place, the motive, or the implied motive—implied by you—that the main purpose was put to through additional mergers or what not, does not hold water, because the great bulk of the stock, the common stock—and that was the voting stock—of Boeing Airplane & Transport Corporation was owned by Mr. W. E. Boeing and his associates. In other words, that group, quite regardless of any votes from this little amount or relatively little amount of common stock we sold, could have easily determined the course of action of Boeing Airplane & Transport and coming into any further mergers, or what not.

Next, I want to point out that in your question to me you have left out an important expression in Mr. Mitchell's telegram to me, namely, the expression "key men"—meaning, I believe, key men in the Boeing organization.

Mr. SAPERSTEIN. Mr. Ripley, I call your attention to the fact that I was not quibbling about anything; I was asking you whether your idea as to the reason that this issue was not publicly offered accorded with the ideas expressed by Mr. Mitchell in this telegram.

Mr. RIPLEY. I feel quite certain that the reason for adopting the so-called "private sale" method is outlined in this telegram, but it is twofold and includes the element of the speculative nature of the offering.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. Also it includes the prospect of mergers, too, does it not?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. In addition to the 90,000 shares of 6 per cent cumulative preferred stock, the National City Co. received 45,000 shares of the common stock of the Boeing Airplane & Transport Corporation and rights to purchase an additional 45,000 shares at $30 per share, is that right?

Mr. RIPLEY. Yes; I previously recited the 45,000 shares of common stock which we purchased.

Mr. SAPERSTEIN. The total purchase price paid by the National City Co. was how much?

Mr. RIPLEY. $5,013,500.

Mr. SAPERSTEIN. You said, as I understood you, that the National City Co. did not want to put itself in the position of sponsoring aircraft stock because it regarded that type of stock as still in the speculative class. Don't you know, that on November 1, 1928, within a few days after this telegram was sent, newspaper advertisements appeared in several large cities in the United States announcing that the National City Co. was sponsoring the issue of 90,000 shares of preferred stock and 27,000 shares of common stock of the Boeing Airplane & Transport Corporation?

Mr. RIPLEY. I do.

Mr. SAPERSTEIN. Those advertisements also contained the statement that none of those shares would be available to the general public at that time because of the fact that they had been privately subscribed for. Am I correct in that?

Mr. RIPLEY. I must look at the files. [After examining files.] Will you read that question, Mr. Reporter?

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

Mr. RIPLEY. Not exactly. The advertisement reads as follows, at the top: "These units have been sold privately", and so forth.

Mr. SAPERSTEIN. That is substantially what I said, is it not, Mr. Ripley?

Mr. RIPLEY. Yes, substantially.

Mr. SAPERSTEIN. Each share of preferred stock had a warrant entitling the holder to one half share of common stock at $30 a share, did it not?

Mr. RIPLEY. Entitling the holder thereof to purchase one half share of common stock at $30 per share during a certain period of time.

Mr. SAPERSTEIN. In other words, for every 2 shares of preferred stock he held, the holder was entitled to purchase 1 share of common stock at $30 a share.

Mr. RIPLEY. During a certain period of time; yes.

Mr. SAPERSTEIN. The National City Co. allotted, out of the shares of stock acquired by it, only 90,000 shares of the preferred and 27,000 shares of the common stock, according to the circular which I have before me.

Mr. RIPLEY. That is right.

Mr. SAPERSTEIN. Retaining in its possession some 18,000 shares of the common stock which it had acquired on the occasion of the original purchase?

Mr. RIPLEY. Less the amount that it had to give to the Pacific National Co., of Seattle.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SAPERSTEIN. Less 10 per cent which the Pacific National Co. was entitled to. Do you know at what price the stock was offered to these private individuals—"officers, key men, directors, and special friends"?

Mr. RIPLEY. Yes; it was offered in units of 10 shares of preferred stock of $50 par value per share plus 3 shares of common stock at a price of $590 flat per unit.

Mr. SAPERSTEIN. Do you know what the profit of the National City Co. was in that transaction?

Mr. RIPLEY. In previous testimony before this committee, I believe there has been a differentiation drawn between the term "profit" and the term "spread." As a matter of fact, in the investment banking business I know of no accounting system by which profit can be ascertained in respect to any one transaction, because from any figures that any of us give you there is not deducted the expense of operating the National City organization.

Mr. SAPERSTEIN. You mean the portion of the overhead of the entire organization which is attributable to a particular issue?

Mr. RIPLEY. I know of no accounting system in this business that splits up that expense as between the different transactions we handle.

Mr. SAPERSTEIN. Suppose you tell me the profit which the National City Co. received, according to its syndicate records.

Mr. RIPLEY. $244,366.67 plus 16,200 shares of common stock plus 40,500 stock-purchase warrants.

Mr. SAPERSTEIN. That 40,500 figure you have given us, is after deducting the share received by the Pacific National Co.?

Mr. RIPLEY. Quite so; as is the dollar spread as between the dollars which I gave.

Mr. SAPERSTEIN. And the figures you have given represent the net profit after deducting the expenses which are directly attribut ble to the flotation of this issue?

Mr. RIPLEY. I would like to have that question read. I do not wish to quibble, but I want to have it read.

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

Mr. RIPLEY. Yes; after deducting the charges made to the floating of this issue.

Mr. SAPERSTEIN. What did your company do with the 16,200 shares which it had left after this entire issue of preferred stock was disposed of?

Mr. RIPLEY. It kept them, so far as I know.

Mr. SAPERSTEIN. It traded in them, did it not?

Mr. RIPLEY. Not to my knowledge. Let me make clear that I have nothing to do with the trading department of the National City Co.

Mr. SAPERSTEIN. Have you any records indicating whether or not those 16,200 shares which you described a moment ago as part of the profits on the transaction, were disposed of subsequently?

Mr. RIPLEY. I have before me a memorandum from the secretary of the National City Co. indicating that the 16,200 shares of common stock to which I have just referred were sold during the 5-month period succeeding the offering in the latter part of October, 1928.

Mr. SAPERSTEIN. Does that memorandum show what the profit was in connection with those 16,200 shares?

Mr. RIPLEY. The memorandum shows a profit of $1,414,884.50.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SAPERSTEIN. That sum must be added to the figure of $244,366 which you gave us before as the net profit in the syndicate account, in order to determine what the entire profit of the company was; is that right?

Mr. RIPLEY. Yes; again, with the use of the term "profit" as I use it.

Mr. SAPERSTEIN. Subject only to the deduction which, at best, would be only guesswork, of such portion of the overhead as may be attributable to this particular issue?

Mr. RIPLEY. Quite so; guesswork in the same sense as it is impossible on a railroad to ascertain the cost of hauling this versus that, versus that, and so on.

Mr. SAPERSTEIN. In addition to the stock you have just related as having been disposed of, the company exercised its option to acquire additional shares of stock under the warrants to the extent of 28,000 shares, did it not?

Mr. RIPLEY. I have before me a memorandum showing that it did; and I believe the memorandum. I can not answer from personal knowledge.

Mr. SAPERSTEIN. You believe 28,000 shares to be correct?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. Do you know the minimum price at which this Boeing Airplane & Transport Corporation stock sold, during the first few months of its existence?

Mr. RIPLEY. My distinct recollection is that I was in Seattle when it first went on the New York curb market, and that the first transactions were about 34, on the common stock.

Mr. SAPERSTEIN. About 34. Are you sure of that, Mr. Ripley?

Mr. RIPLEY. I am not sure of it. It is my recollection; and in order to be fair with you I hand you a chart prepared by my staff which shows that it started higher, but my distinct recollection is that it started at about 34.

Mr. SAPERSTEIN. We have here the curb records, and perhaps in a moment or two we will be able to tell you the opening prices for that stock. Our records show that the stock opened at $60 per share.

Mr. RIPLEY. I have merely stated my recollection, and I may be quite wrong.

Mr. SAPERSTEIN. You acquired this additional stock in the exercise of these warrants at $30 per share; is that correct?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. And if the opening were $60 per share—we will assume that to be so, for the moment, until we check it—you would have had an additional profit of $30 per share for each of those 28,000 shares?

Mr. RIPLEY. If they were all sold at that price.

Mr. SAPERSTEIN. You would at least have had a paper profit of $30 per share, would you not?

Mr. RIPLEY. Yes; quite so.

Mr. SAPERSTEIN. And that would have aggregated an additional $840,000 profit?

Mr. RIPLEY. Right.

Mr. SAPERSTEIN. Now, that sum would have to be added to the profits which we have heretofore aggregated at about $1,600,000.

Mr. RIPLEY. Yes.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SAPERSTEIN. If we are to arrive at a figure indicating the total profit made by the National City Co. in this one transaction?

Mr. RIPLEY. The profit made or to be made, depending on whether the stock from the warrants was sold.

Mr. SAPERSTEIN. You know, of course, from Mr. Law's memorandum that the 16,200 shares were sold?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. Mr. Ripley, I call your attention to the fact that the report of sales on the New York curb market for Saturday, November 3, 1928, which appears to be the opening day of trading, indicates that the Boeing Airplane & Transport Corporation stock opened at 57 and closed at 63.

Mr. RIPLEY. May I see that sheet, please?

Mr. SAPERSTEIN. Yes [handing paper to the witness].

Senator BROOKHART. Is that the date when the first of the stock was sold?

Mr. SAPERSTEIN. Yes, sir.

Senator BROOKHART. Did it go higher or lower than that?

Mr. SAPERSTEIN. It went much higher.

Mr. RIPLEY. May I hear your question again?

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

Mr. RIPLEY. That is not a question, is it?

Mr. SAPERSTEIN. Have you examined that report and ascertained that statement to be correct?

Mr. RIPLEY. Yes. My memory certainly must be wrong.

Mr. SAPERSTEIN. Your recollection must be wrong in that connection?

Mr. RIPLEY. It would certainly seem so. I accept that.

Mr. SAPERSTEIN. A hasty calculation of the profits that the National City Co. made in connection with the Boeing Airplane & Transport Co., indicated that the grand total is about $1,842,866, subject, only to the deduction, which you have several times adverted to, of the amount of overhead attributable to this one issue. Am I correct?

Mr. RIPLEY. May I ask you to read off the component items? I did not follow them.

Mr. SAPERSTEIN. $244,666, $1,414,884, and $840,000.

Mr. RIPLEY. What is your total, sir?

Mr. SAPERSTEIN. My total is about $1,842,000.

Mr. RIPLEY. I accept it.

Mr. SAPERSTEIN. You accept it because the total is a little bit more than that, don't you?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. It is over $2,400,000.

Mr. RIPLEY. But you must bear in mind that part of that is, as you said, a paper profit.

Mr. SAPERSTEIN. If we leave out of consideration the warrants, we still have a profit on the original transaction of over $1,600,000, do we not?

Mr. RIPLEY. On the first two items I have mentioned, $1,659,000.

Mr. SAPERSTEIN. And that was the return of the National City Co. on its original investment of $5,000,000?

Mr. RIPLEY. Of $5,013,500.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. SAPERSTEIN. Do you know, Mr. Ripley, that your company made an application to list this stock on the New York Curb Exchange on or about October 31, 1928?

Mr. RIPLEY. I do not know of my company making an application. My recollection is that Boeing Airplane & Transport made the application; but I grant that the National City Co. cooperated in the making of it.

Mr. SAPERSTEIN. I show you a letter dated October 31, 1928, which purports to bear the signature of H. B. Baker, vice president of the National City Co., to the committee on listing and securities, New York curb market, and I ask you whether that letter does not indicate that the National City Co. made application for listing the stock on the New York curb market.

Mr. RIPLEY. No; it does not.

Mr. SAPERSTEIN. What does it indicate?

Mr. RIPLEY. It indicates that the National City Co. addressed the committee on listing and securities of the New York curb market transmitting to it an application of Boeing Airplane & Transport Corporation for a listing.

Mr. SAPERSTEIN. Do you know who prepared that application?

Mr. RIPLEY. I do not know, but I can make a good guess.

Mr. SAPERSTEIN. What is your guess?

Mr. RIPLEY. W. C. Cross, with the assistance of Messrs. Hilcken and Reuter.

Mr. SAPERSTEIN. Are they connected with the National City Co.?

Mr. RIPLEY. No. Messrs. Hilcken & Reuter are a professional firm in New York City specializing in the business of preparing listing applications on the two main stock exchanges.

Mr. SAPERSTEIN. Who is Mr. Cross?

Mr. RIPLEY. Mr. Cross was a member of the staff of the National City Co. and is now a junior officer, and he was also a vice president of Boeing Airplane & Transport Corporation.

Mr. SAPERSTEIN. If it was not the intention or desire of the National City Co. to sponsor an aircraft stock because of the fact that it was too speculative, why was an application made for listing this stock upon the New York Curb Exchange?

Mr. RIPLEY. Because one of the conditions of my negotiations with Mr. W. E. Boeing, starting in the early part of October, 1928, approximately a month before I received this telegram from Mr. Charles E. Mitchell—one of the conditions of the said negotiations, was that the stocks of the Boeing Airplane & Transport should be listed in New York City on the New York Stock Exchange, if possible, and the New York curb market, if not possible, on the big board, as we call it.

Mr. SAPERSTEIN. Does that answer the question, Mr. Ripley?

Mr. RIPLEY. I am not through.

Mr. SAPERSTEIN. I beg your pardon.

Mr. RIPLEY. In addition to that, the desirability of having a quoted market on the stock was doubtless a consideration.

Mr. SAPERSTEIN. Why did you want a quoted market on the stock, if you were confining its sale to the officers and the key men, and those other persons who are mentioned in Mr. Mitchell's telegram?

Mr. RIPLEY. Are you asking why I wanted it?

Mr. SAPERSTEIN. Why did the National City Co. want it listed?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RIPLEY. I could not tell you what was in the minds of people at head office. I was obligated to Mr. Boeing to get it listed.

Mr. SAPERSTEIN. Did you know that an application was actually made for the listing of the stock?

Mr. RIPLEY. Yes, indeed.

Mr. SAPERSTEIN. You had arranged that?

Mr. RIPLEY. Certainly.

Mr. SAPERSTEIN. When you arranged it, you knew that the stock was going to be offered in private only, and not to the public, did you not?

Mr. RIPLEY. My work in connection with making an application to list started before receiving any telegram from Mr. Mitchell to the effect that the offering was to be private.

Mr. SAPERSTEIN. When you received that telegram, you were made cognizant of the fact that it was to be private, and yet you went right ahead with your plans to have the stock listed, didn't you?

Mr. RIPLEY. Yes; having obligated myself to Mr. Boeing to do so.

Mr. SAPERSTEIN. Mr. Ripley, are you familiar with a flash that was sent out to the various dealers by Mr. Baker on November 1, 1928, flash No. 3225? Have you seen that?

Mr. RIPLEY. I have it.

Mr. SAPERSTEIN. I want to read that into the record. The flash is as follows:

November 1, 1928. Advertisement on Boeing Airplane & Transport Corporation units of 6 per cent preferred with common stock is being published to-day only in following cities: New York, Chicago, San Francisco, and Seattle, with the statement that units have all been sold privately and the advertisement appears as a matter of record only. The statement we are making to customers regarding our inability to consider orders from them is substantially as follows: We have purchased an interest in this company, and on account of the fact this industry is still somewhat unseasoned, even though we regard this particular company as sound and having a very bright future, we were not quite ready to make a general offering to our customers. It would have been next to impossible to avoid taking orders from the type of investor who should not buy this stock. Therefore, our own family and certain officers and employees of the Boeing Co. and affiliations have taken the entire issue.

Have you ever seen that flash before, Mr. Ripley?

Mr. RIPLEY. Yes, I have.

Mr. SAPERSTEIN. When that flash was sent out, it certainly was in the minds of the officers of the National City Co. that in the near future the stock would be offered to the public, was it not?

Mr. RIPLEY. In the near future after the sending of this flash?

Mr. SAPERSTEIN. Yes.

Mr. RIPLEY. Certainly not that I know of, using the term "public" as I take it you use it.

Mr. SAPERSTEIN. Does this not indicate an intention that very shortly it would be offered to the members of the general public, when Mr. Baker says:

We have purchased an interest in this company, and, on account of the fact this industry is still somewhat unseasoned, even though we regard this particular company as sound, and having a very bright future, we were not quite ready to make a general offering to our customers.

What do you suppose that language means, if it does not indicate that you were getting ready to make a general offering to your customers?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RIPLEY. I can not interpret Mr. Baker's use of words. He might have had in mind the formation of a larger company at a later date. I do not know.

Mr. SAPERSTEIN. Have you before you the records indicating at what price and to whom these shares were offered or allotted?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. At what price were they allotted?

Mr. RIPLEY. $590 flat for each unit consisting of 10 shares of $50 par value stock and 3 shares of common stock.

Mr. SAPERSTEIN. I will not ask you to read the entire list, but I will ask you to state, for the purposes of the record, how many units were allotted to the persons I am going to name. How many units were allotted to Mr. Charles E. Mitchell?

Mr. RIPLEY. 200.

Mr. SAPERSTEIN. Are not those in alphabetical order, Mr. Ripley?

Mr. RIPLEY. Not entirely. May I show you? [Exhibiting paper to Mr. Saperstein.]

Mr. WINSTON. If you will give the names, they can check them.

Mr. RIPLEY. It is not alphabetical.

Mr. SAPERSTEIN. I see by the list which you have just handed to me that Mr. E. P. Swenson was allotted 185 units. Who is Mr. Swenson?

Mr. RIPLEY. Mr. Swenson was then chairman of the board of the National City Bank, I believe.

Mr. SAPERSTEIN. The list further shows that Col. Sosthenes Behn received 100 units. Who is Colonel Behn?

Mr. RIPLEY. I believe that he was chairman of the International Telephone & Telegraph at that time.

Mr. SAPERSTEIN. Mr. Guy Cary received 150 units. Mr. Cary is a member of the firm of Shearman & Sterling, is he not?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. Mr. John A. Garver received 100 units. He is also a member of the firm of Shearman & Sterling?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. And Shearman & Sterling are attorneys for the National City Co., the National City Bank, and the City Farmers Trust?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. Mr. Gordon S. Rentschler received 100 units. He is president of the National City Bank, is he not?

Mr. RIPLEY. He is now, but was not then.

Mr. SAPERSTEIN. What was he then?

Mr. RIPLEY. Assistant to the president.

Mr. SAPERSTEIN. Mr. Percy Rockefeller received 400 units. Did he then have a connection with the National City Co. or bank?

Mr. RIPLEY. I believe he was a director of the bank at that time.

Mr. SAPERSTEIN. Col. R. W. Stewart received 100 units. Who is he?

Mr. RIPLEY. I believe he was a director of the bank at that time.

Mr. SAPERSTEIN. Mr. James A. Stillman received 150 units. What was his position?

Mr. RIPLEY. A director of the National City Bank.

Mr. SAPERSTEIN. Mr. Garrard B. Winston received 100 units. Mr. Winston is also a member of the firm of Shearman & Sterling?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. I note that the largest single allotment was made to Francis Bartow, 645 units. Who was Mr. Bartow?

Mr. RIPLEY. Mr. Bartow is and was then a partner in the firm of J. P. Morgan & Co., but I think it is no more than fair to point out that I am quite certain that that was not all for him.

Mr. SAPERSTEIN. Do you mean that the allotment in his name was for the various members of the firm of J. P. Morgan & Co.?

Mr. RIPLEY. I do not know for whom it was, but certainly for somebody in addition to Mr. Bartow.

Mr. SAPERSTEIN. You have no basis for the statement you have just made, have you, other than your guess that it was not all taken by him?

Mr. RIPLEY. I have no exact facts, but I believe it.

Mr. SAPERSTEIN. I see also that Col. E. A. Deeds received 220 units. He is connected with the National City Co., is he not?

Mr. RIPLEY. No. Colonel Deeds is a director of the National City Bank. I do not believe he is connected with the National City Co.

Mr. SAPERSTEIN. According to the records which we have just exhibited to you, Mr. Ripley, of the first day's trading on the New York curb market, on November 2, 1928, the preferred opened at $60 a share, and the common at $57 a share. The units, as you have described them, were 10 shares of preferred, and 3 shares of common. How much would that be for each unit?

Mr. RIPLEY. It would be $771 for each unit.

Mr. SAPERSTEIN. And the cost to each of these persons I have mentioned, and to the others who appear on your list, was $590, I think you said?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. That would leave them a profit of how much on each unit?

Mr. RIPLEY. A paper profit of $181 per unit.

Mr. SAPERSTEIN. And if you multiply that profit by the number of units outstanding in their hands, what total do you get?

Mr. RIPLEY. $1,629,000.

Mr. SAPERSTEIN. You refer to this as a paper profit.

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. I assume that you mean by that that some of the participants may not have sold their shares at the opening price?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. Don't you know, Mr. Ripley, that the price of this stock went up, and continued to go up, until it sold for more than $100 a share?

Mr. RIPLEY. I certainly do.

Mr. SAPERSTEIN. So that the figure I have just given you as the profit, the figure you have just designated as the "paper profit," is the minimum profit which those persons would have made had they cashed in on the first day of trading, is it not?

Mr. RIPLEY. I do not think so, because I do not believe that all of them could have cashed in on the first day of trading at those levels. It is what I would call a thin market.

Mr. SAPERSTEIN. The level continued to rise from that point on until the stock was priced at over $100 a share?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RIPLEY. Which surprised me more than anything in my life yet.

Mr. SAPERSTEIN. Whether it surprised you or not, that increase in price increased the amount of profit which was available to any member of that comparatively small group at any time that he desired to cash in on his investment, isn't that right?

Mr. RIPLEY. I will have to have that read. It is too long.

(The reporter read the pending question.)

Mr. RIPLEY. Up to a certain time, and within the limits of their ability to sell it, yes.

Senator BROOKHART. How long did the price rise?

Mr. RIPLEY. Senator Brookhart, the price rose until some time in January, 1929. Then it declined, not very much.

Senator BROOKHART. When did this thing start, this first quotation?

Mr. RIPLEY. November 2, 1928.

Senator BROOKHART. November; and the price continued to rise until——

Mr. RIPLEY. Some time in January, 1929.

Senator BROOKHART. The purpose of these allotments was to enable those persons to make a little easy money there while this market was being boomed, was it not?

Mr. RIPLEY. I do not think so, Senator Brookhart. I have testified that I was in Seattle conducting all the negotiations to purchase this stock.

Senator BROOKHART. But was not the intention all the time to finally sell this whole thing to the public, and these allotments were made so that these persons would have an advantage when it was sold to the public?

Mr. RIPLEY. I do not think that was the intention. Senator Brookhart, there was grave doubt, at the time we bought these stocks from the Boeing Airplane & Transport Corporation as to how the market would receive them.

Senator BROOKHART. You thought you could sell them all right at an advance. You did not have any doubt about that.

Mr. RIPLEY. I certainly thought that we could sell them at a profit, but I never expected any rise in the market such as took place.

Senator BROOKHART. Then what happened to them afterwards?

Mr. RIPLEY. After when, Senator Brookhart?

Senator BROOKHART. After the stock was mostly all sold. This was all sold within five months, according to that letter, as I recall it—these allotments.

Mr. RIPLEY. These units were all sold in one operation.

Senator BROOKHART. They were to these individuals, but the individuals sold them, did they not?

Mr. RIPLEY. I do not know.

Senator BROOKHART. You don't know about that?

Mr. RIPLEY. These individuals involve a list of over 300 people, and I have no knowledge——

Senator BROOKHART. But these people that got the allotments were mostly connected with your company.

Mr. RIPLEY. Some of them were.

Senator BROOKHART. And they were the ones that were wise about the situation. They would sell while it was going up.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RIPLEY. I do not know who is the wisest in regard to the market movements of United Aircraft, as this has later become.

Mr. SAPERSTEIN. Mr. Ripley, you yourself received some share of these allotments, did you not?

Mr. RIPLEY. Yes, indeed.

Mr. SAPERSTEIN. You got 175 units?

Mr. RIPLEY. I purchased 175 units for cash; yes.

Mr. SAPERSTEIN. Did you sell those out?

Mr. RIPLEY. I have sold them out at some time. I do not remember when.

Mr. SAPERSTEIN. How long after the trading began on the market would you say you sold yours out?

Mr. RIPLEY. I will get you that information. [After examining papers.] My records indicate December 7, 1928.

Mr. SAPERSTEIN. So that within five weeks from the time when trading began on the curb market, you had sold out your allotment?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. Have you the record to show the prices at which you sold out?

Mr. RIPLEY. The question can not be answered, because I transferred some of my preferred stock into common stock in the interim.

Mr. SAPERSTEIN. Haven't you a statement there indicating what this stock cost you, and what you ultimately received for it?

Mr. RIPLEY. Yes. If you will tell me what you are driving at.

Mr. SAPERSTEIN. What was the amount of your profit in connection with these 175 units?

Mr. RIPLEY. $67,501.88.

Senator BROOKHART. You were one of the wise ones, then, all right.

Mr. RIPLEY. I thought the price was too high, Senator Brookhart, but if I had waited another several months, it would have been twice as high.

Senator BROOKHART. Did not all of these men that you have mentioned specially sell theirs out, too? They did not wait, either, did they? They were like you, were they not?

Mr. RIPLEY. I do not know. I never asked a one of them.

Mr. SAPERSTEIN. Will you, by reference to this curb chart, Mr. Ripley, state what the high was on this stock, and on what date that high was achieved?

Mr. RIPLEY. The high was about 160, and achieved in May, 1929, but please note that that was United Aircraft stock.

Mr. SAPERSTEIN. When did the Boeing Airplane & Transport Corporation become the United Aircraft & Transport (Inc.)?

Mr. RIPLEY. Some time in the early part of February, 1929.

Mr. SAPERSTEIN. There were several other units included in that company when it was organized, in addition to the Boeing units, were there not?

Mr. RIPLEY. Please do not use the term "when it was organized." The United Aircraft & Transport Corporation is the same corporate entity that Boeing Airplanes & Transport was.

Mr. SAPERSTEIN. I see. The name was simply changed?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. There were several additional units added to the Boeing group at or about the time when the name was changed to United Aircraft & Transport (Inc.)?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. Do you recall that in January, 1929, the National City Co. entered into a contract with the Boeing Airplane & Transport Corporation—I believe the name was changed a day or two after that—to acquire 150,000 shares of the preferred stock of the company, with warrants attached? Are you familiar with that transaction?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. Do you know the price at which it acquired that stock?

Mr. RIPLEY. The National City Co. bought from the Boeing Airplane & Transport Corporation, 150,000 shares of $50 par preferred stock, plus 100,000 stock purchase warrants, at an aggregate price of about $8,800,000.

Mr. SAPERSTEIN. That purchase did not carry with it any common stock, did it?

Mr. RIPLEY. No.

Mr. SAPERSTEIN. Are you aware of the fact that the company, shortly before that date, had purchased from Mr. Frederick B. Rentschler 65,000 shares of the common stock of the Boeing Airplane & Transport Corporation?

Mr. RIPLEY. The National City Co. bought——

Mr. SAPERSTEIN. Do you know at what price that common stock was acquired?

Mr. RIPLEY. $70.

Mr. SAPERSTEIN. And the Pacific National Co. was granted 10 per cent in that purchase, was it not?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. When the name was changed to United Aircraft & Transport Corporation, that stock was offered to the public, was it not?

Mr. RIPLEY. Some of it.

Mr. SAPERSTEIN. How much of it was offered to the public?

Mr. RIPLEY. Sixty thousand shares, I believe.

Mr. SAPERSTEIN. The 60,000 shares you refer to were the common stock offering?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. That stock was offered together with preferred stock, was it not?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. What were the units, and what was the price of each unit?

Mr. RIPLEY. The units consisted of 10 shares of preferred stock and 4 shares of common stock, and the price was $1,000.

Senator BROOKHART. That is what you paid for them?

Mr. RIPLEY. No. He asked me the offering price.

Senator BROOKHART. At what price were they offered to the public?

Mr. RIPLEY. Do you want to know——

Senator BROOKHART. Yes. What did you pay for it? I was talking to the chairman, and did not catch that connection.

Mr. RIPLEY. Senator Brookhart is asking what we paid for the units. According to my rapid arithmetic, I figure it at about $13,000,000.

Senator BROOKHART. Not $13,000,000 per unit.

Mr. RIPLEY. No; for the total.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Senator BROOKHART. What would that be for each unit? I want to get what you paid, and then what you offered them at.

Mr. RIPLEY. I am advised by Mr. Law that the cost was $867.50 per unit.

Senator BROOKHART. Then you offered them to the public at a thousand dollars?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. Have you a copy of the prospectus for this United Aircraft & Transport Corporation offer to the public?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. You will note that the prospectus states that there is being offered 150,000 shares of 6 per cent cumulative preferred stock, series A, and 60,000 shares of common stock. Do you know, Mr. Ripley, that when that prospectus was issued, the National City Co. had made a contract with William E. Boeing to sell him 20,000 shares out of this 150,000 preferred stock issue, for $58.75 per share?

Mr. RIPLEY. I do not know that the National City Co. had so contracted prior to the issuance of this prospectus.

Mr. SAPERSTEIN. Have you any records there that would indicate when that contract was entered into?

Mr. RIPLEY. I have not, and I must add that I was in California at the time of this offering.

Mr. SAPERSTEIN. Do you know the date when this prospectus was issued?

Mr. RIPLEY. The president's letter is dated January 31, 1929.

Mr. SAPERSTEIN. Then it could not have been issued before that date, could it?

Mr. RIPLEY. No.

Mr. SAPERSTEIN. I call your attention to a memorandum in your syndicate files dated January 21, 1929, which is some 9 or 10 days before the date of the prospectus, prepared by the manager of the syndicate department, to Mr. Bradley, in which the following statement appears:

> We have purchased from the United Aircraft & Transport Corporation 150,000 shares of its 6 per cent cumulative preferred stock, series A, with warrants attached, to subscribe for 75,000 shares of common stock, and additional warrants for 25,000 shares of common stock, the cost of which figures $55.75 per share of preferred.

Mr. RIPLEY. $58.75.

Mr. SAPERSTEIN. Is it $58.75?

Mr. RIPLEY. You read it $55.75. Here it is [exhibiting paper to Mr. Saperstein].

Mr. SAPERSTEIN. $58.75.

> We have sold out of the original terms account 20,000 shares of preferred stock with warrants attached to Mr. William E. Boeing at $58.75 per share.

That memorandum indicates that some time before the prospectus was issued, your company had sold to Mr. Boeing 20,000 of these preferred shares at the same price at which it had acquired them, does it not?

Mr. RIPLEY. No; not the same price at which we acquired it, because you would have to make a deduction for the value of the 25,000 warrants.

Senator BROOKHART. You had the warrants left?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. You had the warrants left.

Mr. RIPLEY. So, the true cost of that preferred stock is less than $58.75.

Mr. SAPERSTEIN. Don't you think, Mr. Ripley, that the public was entitled to know, when that prospectus was issued, that not 150,000 shares of preferred stock were being offered for public sale, but only 130,000 shares?

Mr. RIPLEY. I would rather have it do so.

Mr. SAPERSTEIN. You think that the prospectus should have said 130,000 shares?

Mr. RIPLEY. I would rather have it say so.

Mr. SAPERSTEIN. Do you know who prepared that prospectus?

Mr. RIPLEY. I do not. I repeat that I was in California, and add that I left New York on January 4, 1929, and did not get back until February 15, 1929.

Senator BROOKHART. I am obliged to go, and I would like to ask a question or two. With respect to these units we mentioned a while ago, that you offered at $1,000 per unit, were they all sold at that price to the public?

Mr. RIPLEY. Yes.

Senator BROOKHART. What are they worth now?

Mr. RIPLEY. My arithmetic, and the last market quotations I have seen bring it out to $598 per unit, which indicates distinctly less decline than the general run of securities.

Senator BROOKHART. Do you think that indicates less water in this stock than in most of the stocks you sold, then?

Mr. RIPLEY. I do not know how you use the term "water," Senator Brookhart.

Senator BROOKHART. Perhaps I ought not to use the term "water." That is too thick. I expect I should have said "wind"

Mr. SAPERSTEIN. Your company offered to the public 60,000 shares of common stock. It had previously acquired 65,000 shares of the common stock from Mr. Frederick B. Rentschler, had it not?

Mr. RIPLEY. Correct.

Mr. SAPERSTEIN. That left you with 5,000 shares in your possession, besides which, when Mr. Boeing acquired his preferred stock, he did not purchase any common stock, and that left you with an additional 8,000 shares in your possession, making a total of 13,000 shares of common stock, which the National City Co. had left after this public offer was made. Am I correct in that?

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. Do you know what became of those 13,000 shares?

Mr. RIPLEY. They were sold, as I recall it, at a price of $80 a share.

Mr. SAPERSTEIN. Making a total of what?

Mr. RIPLEY. Do you mean the total realization from the sale of the 13,000 shares?

Mr. SAPERSTEIN. Yes.

Mr. RIPLEY. $1,040,000.

Mr. SAPERSTEIN. To whom were those shares sold? Look at this memorandum furnished to us by Mr. Henry S. Law, and tell me whether this is a list of the persons to whom those shares were sold [exhibiting paper to Mr. Ripley].

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RIPLEY. Yes; it is.

Mr. SAPERSTEIN. That list contains the names of all the principal officers, or nearly all the principal officers of the National City Co., the National City Bank, and persons connected with the bank or the company, in one way or another, is that right?

Mr. RIPLEY. No; because you have asked me whether it includes all the principal officers, and I happen to have been omitted, and I think I was one of the principal officers.

Mr. SAPERSTEIN. I modified that statement. I said nearly all principal officers, Mr. Ripley. Mr. Charles Mitchell, for example, was allotted 1,000 shares on that list, was he not?

Mr. RIPLEY. That is correct.

Mr. SAPERSTEIN. R. M. Byrnes was allotted a thousand shares, was he not?

Mr. RIPLEY. That is correct.

Mr. SAPERSTEIN. Mr. Hugh Baker was allotted 500 shares?

Mr. RIPLEY. Yes; that is correct.

Mr. SAPERSTEIN. The other officers received graduated amounts, apparently according to the importance of the individual, to his respective institutions; is that correct?

Mr. RIPLEY. There are many officers of the bank and company not on this list.

Mr. SAPERSTEIN. They did not all participate in this offering?

Mr. RIPLEY. No.

Mr. SAPERSTEIN. Nevertheless, the entire 13,000 shares were allotted to the persons on that list?

Mr. RIPLEY. To the persons on that list; yes.

Mr. SAPERSTEIN. And that allotment was made at a price of $80 a share?

Mr. RIPLEY. At a price of $80 a share.

Mr. SAPERSTEIN. Do you know what the market price of the stock was on the day when those allotments were made?

Mr. RIPLEY. I think about $88.

Mr. SAPERSTEIN. About how much?

Mr. RIPLEY. $88.

Mr. SAPERSTEIN. What record are you referring to, Mr. Ripley?

Mr. RIPLEY. A digest of my files.

Mr. SAPERSTEIN. Do you know the date when these allotments were made, and these sales took place?

Mr. RIPLEY. I think January 31.

Mr. LAW. January 29.

Mr. RIPLEY. Mr. Law says January 29. My records show it as January 31.

Mr. SAPERSTEIN. Let me call your attention to a flash bearing No. 3752, from "General Sales" to your various dealers, dated January 31, 1929, which reads as follows:

> For your information, United Aircraft & Transport Corporation preferred and common being dealt in in over-the-counter market separately now quoted, common, 95 to 96; preferred, 77 to 78. We expect to have it listed on curb during day. Therefore, your customers can now buy this stock through other channels, but, as we would like to center this market in our own organization, will be glad to have you place buying orders with us to be executed in the market.

That flash indicates that the price on January 31, 1929, on the common was 95 to 96, does it not, Mr. Ripley?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. LAW. What is the number of that?

Mr. SAPERSTEIN. Thirty-seven hundred and fifty-two.

Mr. RIPLEY. Yes; but I gave you a quotation of 88 on January 30, and this flash was dated January 31.

Mr. SAPERSTEIN. I thought you said your recollection was that the sales were made on January 31.

Mr. RIPLEY. My recollection is that January 31 was the date of the offering of the units.

Mr. SAPERSTEIN. That is what I am talking about, the date of the offering of the units.

Mr. RIPLEY. Then, what is the question before me?

Mr. SAPERSTEIN. Read the question.

(The reporter read the pending question.)

Mr. RIPLEY. Yes; but I wish to point out that you have used the expression "flash to dealers," whereas this flash is a flash only to our branch offices.

Mr. SAPERSTEIN. I am not discussing that.

Mr. RIPLEY. No; but I wish to correct you.

Mr. SAPERSTEIN. One of the papers which appears among your own records indicates that the price of this common stock on January 31, 1929, was 95 to 96. That was the same day or the day following the day upon which these members of your organization received their allotments of this common stock, at the price of $80 per share, isn't that true?

Mr. RIPLEY. I am advised that that 13,000-share offering was on the 29th.

Mr. SAPERSTEIN. Then, it would be two days later that the price was 95 to 96.

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. Do you know what the price was on January 29?

Mr. RIPLEY. I am advised that there was no quotation, because it opened on the 30th.

Mr. SAPERSTEIN. All right. What was the price on the 30th?

Mr. RIPLEY. From 88 to 89½, I am advised.

Mr. SAPERSTEIN. Then, on the 30th, the participants had 8 or 9 points profit on this allotment. On the 31st, they had 15 or 16 points profit on each share allotted to them.

Mr. RIPLEY. Paper profits, yes.

Mr. SAPERSTEIN. Paper profits. Do you know what the gross profit of the National City Co. was in this United Aircraft offering?

Mr. RIPLEY. The original terms spread was $1,002,251, and the selling profit, $442,482, and then a small additional profit of $2,338.

Mr. SAPERSTEIN. What is the total of those items?

Mr. RIPLEY. $1,558,430.

Mr. SAPERSTEIN. That figure you have just given us represents the profit which the National City Co. made for itself after deducting the amount which the Pacific National Co. made on this transaction, is that right?

Mr. RIPLEY. My addition was wrong. The total is $1,447,820.

Mr. SAPERSTEIN. Does that figure represent the National City Co.'s share after paying the 10 per cent to the Pacific National Co.?

Mr. RIPLEY. It does.

Mr. SAPERSTEIN. And the Pacific National Co. received an amount approximately equivalent to 10 per cent of the amount which the National City Co. received as its share of the profit?

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. RIPLEY. Yes.

Mr. SAPERSTEIN. I think that is all, Mr. Chairman.

(Witness excused.)

Mr. PECORA. Call Mr. Meehan.

The CHAIRMAN. Please stand, hold up your 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 this subcommittee, so help you God?

Mr. MEEHAN. I do.

TESTIMONY OF MICHAEL JOSEPH MEEHAN, OF M. J. MEEHAN & CO., STOCKBROKERS, NEW YORK CITY

Mr. PECORA. Mr. Meehan, please give your full name, address, and business or occupation.

Mr. MEEHAN. Michael Joseph Meehan.

Mr. PECORA. And what is your address?

Mr. MEEHAN. 2 East Sixty-seventh Street.

Mr. PECORA. What is your business or occupation?

Mr. MEEHAN. Broker.

Mr. PECORA. Are you a member of the New York Stock Exchange?

Mr. MEEHAN. Yes, sir.

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

Mr. MEEHAN. Twelve years.

Mr. PECORA. Are you in the brokerage business by yourself or are you a member of a firm?

Mr. MEEHAN. I am the senior partner of M. J. Meehan & Co.

Mr. PECORA. Where is the office of that firm?

Mr. MEEHAN. No. 30 Broad Street.

Mr. PECORA. Has it any branch offices?

Mr. MEEHAN. We did have a considerable number of branch offices, but have not any more.

Mr. PECORA. Mr. Meehan, you communicated to me that you had some statement you desired to make to the committee concerning your unavailablity some time last year when it was sought to subpœna you to appear before this committee.

Mr. MEEHAN. Well, Mr. Pecora, I was never subpœnaed. There was a misunderstanding last year. Mr. Gray or Mr. Watson came to my home when I was ill. And then I waited three weeks on them and understood they had excused me. We had furnished all our records, turned over all our books, and all the information that they wanted, my partners did. And I understood that I had been excused; that they were going to be able to use my partners. There seems to have been some misunderstanding about the matter of my not being permanently excused. And I have been waiting ever since to be called.

Mr. PECORA. You were subpœnaed in the early part of this month to attend before this committee on February 21, were you not?

Mr. MEEHAN. Yes, sir; and I have been here since that time.

Mr. PECORA. Have you been here in attendance on the committee since that time?

Mr. MEEHAN. Yes, sir.

Mr. PECORA. Now, Mr. Meehan, are you willing to make available to the committee or its present counsel whatever records, in-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

formation, or data may be in your possession and which may be called for?

Mr. MEEHAN. Yes, sir.

Mr. PECORA. Concerning certain stock market operations?

Mr. MEEHAN. Yes, sir. And I think that the committee have all of our records of any kind, of any size at all now. Mr. Watson and his men were in our office for about three weeks.

Mr. PECORA. I will examine whatever records are in the files——

Mr. MEEHAN (interposing). You may have anything we have.

Mr. PECORA (continuing). And I mean by that any records that came from your office. And I may want you to supplement the information contained in those records.

Mr. MEEHAN. All right.

Mr. PECORA. That you are willing to do at any time, are you?

Mr. MEEHAN. Yes, sir.

Mr. PECORA. Will you hold yourself subject to the call of this committee for attendance at any future hearing?

Mr. MEEHAN. Yes, sir. And I have been very anxious to get down and get that misunderstanding straightened out, because my partner told me I was permanently excused. I might explain that I suffered an automobile accident on March 24, which was very serious for one of my partners and myself, and left me in very bad shape, and the doctors insisted on my going away. When Mr. Gray told Mr. McConchie that I had been excused I took it for granted I had been permanently excused, because they knew I wanted to go abroad the 1st of May, and I waited until the 19th or 20th or somewhere along in there before going.

Mr. PECORA. You do not now contemplate making any trip out of the country, do you?

Mr. MEEHAN. No, sir.

Mr. PECORA. On event that you should decide to change your plans you will notify me first, will you?

Mr. MEEHAN. Yes, sir.

Mr. PECORA. Mr. Chairman, in view of the lateness of the hour, and the fact that I will require perhaps additional written data from Mr. Meehan or his office in connection with various stock-market transactions, with which I understand he or his firm were connected, I will ask that the examination of Mr. Meehan at this time be suspended, and that it be considered that he is still under subpœna to attend before this committee upon call.

Mr. MEEHAN. That is agreeable to me.

The CHAIRMAN. All right. It is so ordered.

Mr. PECORA. Mr. Chairman, may I make a statement now, before you recess?

The CHAIRMAN. Certainly.

Mr. PECORA. May I say, Mr. Chairman, that it was either January 24 or 25 that I was asked to serve as counsel to this committee for the purpose of conducting the inquiry that had been in existence since some time during the early part of last year. I accepted the engagement with a high appreciation of the privilege and the honor, which appreciation has been enhanced by the service that I have been permitted to render. I want to say that I have received the utmost cooperation from you, Mr. Chairman, and from all the mem-

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

bers of your committee, in the work that I have been called upon to do, and to say that that considerably eased my labors.

I think it also would be fair to say on the record and announce to the public, because, after all, this is in the nature of the discharge of a public service, that in the discharge of the duties of counsel to this committee I have enjoyed their valued cooperation and assistance in a professional way from Mr. Julius Silver of the New York Bar, Mr. David Saperstein of the New Jersey Bar, and Mr. James B. McDonough, jr., also of the New York Bar, who have acted as associate counsel to this committee.

I have also enjoyed the cooperation of and have very highly valued the assistance given by Mr. Frank J. Meehan as statistician, and also Mr. Joseph F. O'Hanlen as accountant. These gentlemen have served with me, and have spared no labor or exertion. We have sat until late into the night practically ever since the date of our appointment, and I want to say for my associates that whatever results have been attained represent in very large proportion the result of their labors.

And I do not want to overlook the valuable assistance of Mr. John A. Marrinan, and all that I have said in behalf of the other gentlemen I want to say for him. He has been most untiring and devoted in his zeal and industry, and his work has been of a character that has made a very genuine contribution to our progress.

I want the record to show my personal appreciation and thanks for their devotion, loyalty, industry and integrity, each and every one of them, to the work in hand.

The CHAIRMAN. Speaking for the committee, I wish to say that we are well pleased with the progress you have made, Mr. Pecora, in the remarkably short time that you have had a chance to work. The Senate has ordered the committee to continue its work, and there is no doubt in my mind that it will be vigorously prosecuted. I shall not be chairman of the committee very long, but whoever takes charge of the work will go ahead with it I feel certain.

Mr. PECORA. I thank you, Mr. Chairman.

Now do you wish to adjourn subject to the call of the Chair?

The CHAIRMAN. Yes; the committee will now stand adjourned subject to the call of the Chair.

(Thereupon, at 5.50 p. m., Thursday, March 2, 1933, the committee was adjourned subject to the call of the Chair.)

×

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis