

F. J. Lisman Replies to Louis Seibold on St. Paul Receivership

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The subjoined article is by F. J. Lisman, head of F. J. Lisman & Co., members of the New York Stock Exchange, and is a reply to a series on the Chicago, Milwaukee & St. Paul Railway receivership which appeared recently in the EVENING POST.

The POST detailed Louis Seibold to make a study of the failure, and his articles in this paper were the result. Mr. Lisman has long been a student of railroad bonds and takes exception to some phases of the Seibold articles.

Boiled down to a final analysis, Louis Seibold's recent articles on the Chicago, Milwaukee & St. Paul situation set forth these possibilities:

(1) That the receivership of the road coming within a few days after the adjournment of Congress was timed to avoid any investigation by Congress;

(2) That the Government might have helped the company to avoid bankruptcy and that the company did not fully avail of this possibility;

(3) That besides bad judgment there were extravagance and corruption in the construction of the Puget Sound extension.

(1) Time of receivership after adjournment of Congress—The maturity of \$48,000,000 of bonds on June 1 has been a menace to the company's credit for several years. It had been hoped by the directors of the company that with improved earnings a syndicate could be formed to underwrite a new issue of bonds or notes to take care of the maturing issue, and if no syndicate could be arranged for the full amount that the holders of the bulk of the maturing issue would be willing to extend their bonds at a higher rate of interest, and that it might be possible to create a smaller syndicate to furnish the necessary cash to take up the comparatively small amount from those who might not be willing to take the new extended bonds.

Practicability is Discussed

Whether this could be done or not depended—

(A) On the gross and net earnings for the first few months of 1925 and outlook for business during the remainder of the current year.

(B) On the reduction in interest charges on the \$55,000,000 Government loan to 4½ per cent, which would have made a saving of \$825,000 per annum.

A bill providing for this reduction in interest was introduced in Congress, but failed of final passage, and simultaneously with this failure and the adjournment of Congress there came the collapse in the grain markets, with shrinkage in the price of wheat of about 60 cents a bushel and a consequent more uncertain business outlook; all of which meant that the chances for forming any kind of a syndicate for the extension of the bonds were hopeless.

Furthermore, the company had coming due on April 1 an interest payment on general and refunding 4½s to an amount of nearly \$1,100,000. The withdrawal of this substantial amount of cash from the treasury would probably have involved the deferring of payment on current vouchers and would have injured the company's credit locally.

To put the case differently, the outlook for business

becoming worse and the chance for reduction in interest of the Government's loan gone and the company's treasury low in cash, the provision for the payment of the bonds maturing on June 1 was impossible. The directors, therefore, could do nothing else but seek the protection of the court by asking for the appointment of receivers.

Obstacles Facing Company

(2) The possibility of Government aid—The company was not only confronted with the payment of the principal of its bonds and the raising of the necessary amount of money to provide for interest charges, but also with the impossibility of raising on reasonable terms additional money for capital needs for expansion.

The Interstate Commerce Commission might have surrendered to the company the \$18,000,000 of underlying general mortgage bonds which it held as collateral for its loan and which were marketable, and accepted in exchange therefor a much greater amount of the less well-secured general and refunding bonds. These \$18,000,000 of general mortgage bonds could have been sold at a price between 85 and 90, which would have provided from \$16,000,000 to \$16,500,000.

This sum would not have sufficed to take care of bonds maturing on June 1. The Interstate Commerce Commission, even if it had had funds available, under the law, which it did not have, would probably not have been justified in lending to the company \$30,000,000 additional to enable it to pay off the bonds maturing on the 1st of June.

Even if the commission had been willing to do this, the St. Paul company would not have had any funds available for additional capital needs for equipment and to make good a certain amount of deferred maintenance which unquestionably exists. No doubt this fact will be brought out in the engineers' report, which is expected in due time.

To have thrashed out these problems between the company's officials and the Interstate Commerce Commission would have taken at least several weeks and could not have remedied the situation. The company's directors, therefore, were compelled to face the unpleasant situation that they had reached the jumping-off place.

The Puget Sound Extension

(3) Extravagance and corruption in connection with the Puget Sound extension—The original and preliminary estimate for the cost of the extension of \$70,000,000 provided only for the construction of the main line, without branches and equipment necessary to handle the business. If the cost of the extension, with branches, etc., was over twice that, this is merely a repetition of what happens in nine cases out of ten in projects of this type.

There is the old, well-known story of the man who was asked whether he had accumulated sufficient funds to build the \$5000 house he had been talking about. His reply was he had \$8000 in bank for the \$5000 house and that at the end of the year he hoped to have \$10,000, when he thought he might take the chance of starting to build.

This conversation happened long before the war. Now this same man would probably want to accumu-

late \$25,000 to bank before he would be willing to take the chance to commence a \$10,000 house.

The allegation that the company paid \$16,000,000 for terminals which a few days or weeks previously could have been bought for \$10,000,000 can have no substantial basis of fact, because the entire expenditure for terminal lands in the three Pacific Coast cities certainly did not involve \$10,000,000. Regarding extravagance and corruption in connection with contracts under the management of the late President Earling rumors were freely current at the time.

I am not in a position to know what basis there was for these statements, but at any rate if favoritism has involved the sum of as much as \$10,000,000, which I do not believe was the case, it would have meant no real difference in the present status of the Chicago, Milwaukee & St. Paul property.

Hindsight Versus Foresight

The construction of the Puget Sound branch by the light of hindsight may have been bad judgment, but until the experts' report is on hand it would be best to suspend judgment.

Twenty years ago, when this project was first conceived, we all had great faith in the rapid development of the Northwest, which had been growing continuously since the days of the Lewis and Clark expedition, nearly 100 years previous. The cessation of the growth of the communities, checking of immigration, income taxes and rate regulations were not conceived of at that time.

If the then directors of the Chicago, Milwaukee & St. Paul could have foreseen all these contingencies they certainly would not have embarked on a program of extension, nor would others have ventured on development enterprises. Quite likely the effect of the Panama Canal might have been foreseen to some extent, but the present low vessel rates brought about by the overbuilding of ships during the World War could not have been foreshadowed.

The company, besides the through freight business, expected to carry a rapidly increasing local business. The profitable local passenger business on the old part of the road has practically been extinguished through the unforeseeable development of the automobile and the building of thousands of miles of hard roads, largely at the railroad company's expense.

Hopes for Congress Inquiry

Investigation by Congress of the conditions surrounding the collapse of the Chicago, Milwaukee & St. Paul is very desirable indeed and I hope an investigation of this kind by competent men will be ordered. This will demonstrate the fact that not only the C. M. & St. P. but every road in the Northwest needs more revenue if the transportation system of that section is to be extended and developed.

The burden of the Chicago, Milwaukee & St. Paul in the way of interest charges was disproportionate to that of most of its competitors and therefore this road had to go into bankruptcy, while its competitors reduced dividends and showed an enormous shrinkage in the value of their shares. The St. Paul, unfortunately, was so located that it had no share in the only profitable business in the Northwest—that is, in the carrying of iron ore.

If the Chicago North Western had not had a share of this profitable business it would unquestionably have ceased entirely to pay dividends by this time. The same remarks apply to a lesser extent to the Great Northern and Northern Pacific.

I hope this investigation will be ordered by Congress and carried out by the Interstate Commerce Commission or by some commission of experts who will bring out the facts, because a Congressional committee is sure to contain some mealy-mouthed member who will try to bring out only certain phases of the situation for the purpose of getting into the limelight to get votes in his district.

A non-political investigation is exactly what is wanted. Its sequence should be some constructive action by which the roads in the Northwest will be allowed to earn a fair return on their capital, as was intended by the Transportation act of 1920.

Roads Not Needing Advances

The roads running from Chicago and St. Louis westerly and southwesterly are now moderately profitable and do not need a rate advance. It is difficult to advance the rates to the various gateways in the Northwest without advancing the rates to competing gateways further South.

Some method may be devised by which the rate structure as a whole in the West may be slightly advanced and the benefit of this increase returned by the roads which do not need it to those which do. I advocated this in the case of the New England roads, when I stated that the rate advance which had been granted to all the trunk lines was not necessary for the Norfolk & Western, Chesapeake & Ohio and Virginian Railway, the three coal roads terminating at Hampton Roads, and that they should be compelled to give up some of their excess for the benefit of the New England roads.

The Interstate Commerce Commission at that time felt uncertain about its power to force these roads to surrender some of this surplus. I believe the Commission will have to give this matter some thought in connection with the Western situation.

From Stockholders' Standpoint

Stockholders Position—I have received approximately 3000 letters from security holders of the Chicago, Milwaukee & St. Paul, many of which contain statements that a receivership could have been avoided. The writers of these letters undoubtedly merely thought of their own position and did not realize the problem which confronted the directors, which I would sum up as follows:

(A) The attempt to avoid receivership would have meant slow payment of the company's bills.

(B) To secure additional working capital at reasonable rates.

(C) Judgments against the company on part of bondholders, many of whom would not be willing to consent to a voluntary extension. This would have amounted to many million dollars and made it impossible to give the public good transportation service.

(D) No likelihood of help from the Government in the reduction of the interest rates on its loan.

Advantages of Receivership

The receivership enables the company to treat all the security holders alike; according to their respective rights to give the public good service; demonstrate to the public at large the dangerous position of railroads in the Northwest brought about by the present low rate structure, and the necessity of some kind of an advance in rates which should result in an income on their investment to all holders of the company's securities, in accordance with their legal status.

Human nature is nowhere near perfection, not even in Wisconsin, where the company's headquarters is

located. There was undoubtedly some bad judgment exercised in the management of the company's affairs. Quite likely there was some dishonesty, but not enough to make a real difference in the situation of this road; but, anyway, let the ax fall on whom it may.

There is probably no large enterprise where there has not been some bad judgment and some dishonesty. We have progressed and are doing substantially better in this respect in this generation than formerly. By all means let us have a fair and thorough investigation.