CHAPTER VI

THE BOARD OF DIRECTORS AT WORK

THE St. Paul directors had receivership staring them in the face for years. It was not merely a danger to be reckoned with if things went wrong, but an impending reality unless things could be set right. President Byram "always hoped we could avoid a receivership from the beginning, ever since I came to the property [in 1917] and found that its financial affairs were involved and that it needed to be extricated." Mr. Field, one of the directors, testified: "I think back in 1918 I remember telling Mr. Earling [then chairman of the board] the thing that worried me about the St. Paul road was how they were going to get by 1925," when about $47,000,000 of bonds were going to fall due. The reserves of the company were low. Director McRoberts, who had been in the meat-packing business before he became a banker, testified that the St. Paul "did not have the bacon in the cellar that the other roads had." According to President Byram, the road always had, from the time he came to the company, three to eight millions of unpaid bills, and it had to resort to large temporary loans from its bankers.

Director Mason's answer to the question: "When did the condition of the St. Paul become serious, from a financial point of view?" was this: "What do you mean serious? It was always serious." The directors could not help knowing what was known in financial circles outside the company. As Mr. Percy Rocke-

feller said, possible receivership "had been discussed for three or four years in the public prints, wondering if the St. Paul would pull through." If ever a board of directors knew that its company was in trouble, and had years in which to bestir itself, it was the St. Paul board.

The underlying difficulty was that expenses of operation, and interest charges on the bonds, exceeded the income of the road. Mr. Hanauer felt that the 1925 maturities could have been refinanced if the earnings had been sufficient to give investors confidence in the bonds of the company. He said that "there wasn't any bond market in years equal to the bond market in 1925 . . . if the St. Paul had had the necessary earnings, there would have been no difficulty at all of refinancing the St. Paul. In other words, the inability to refund was the result of their trouble, and not the trouble itself. The trouble itself was the fact that their earnings did not for a number of years meet their fixed charges." Mr. Mitchell, president of the National City Company, the other of the St. Paul company's bankers, said that "without earnings you were robbed of any possibility of doing anything. That was the sum and substance of it; . . . you could not get people to renew" [bonds which fell due].

The problem was therefore one of increasing the gross revenues of the road, or decreasing its expenses, so that the net profit would be ample to pay all interest charges. The company would then be freed from deficits, continuance of which would sooner or later exhaust its resources. It would also be able to refinance maturing indebtedness, or at the worst to arrange with the holders of maturing bonds to extend their maturity date.

Increase of gross income could be effected by adding to the St. Paul's volume of traffic, which was difficult, or securing higher rates on such traffic as it could get. The latter necessitated joint action of the various roads in that territory. The St. Paul board would have had to engage in extraordinary effort to secure joint action with its competitors. But there is no evidence in the record that the board adequately tried to obtain co-operation from its competitors to this end. Instead, one of the directors tried to effect a consolidation of the St. Paul with some other road. He testified that "nobody wanted to consolidate with us. . . . Nobody wanted to come and play with us."

Far greater possibilities lay in the direction of retrenchment, as demonstrated by economies effected since that time by the railroad industry. But the St. Paul board did not take the aggressive in this respect either. Director McRoberts put it that "you could not make twice two come out five, and that was all there was to it." Subtraction played a negligible part in the arithmetic of the directors.

The testimony of Mr. Colpitts on this point was testimony from an important source. He was the consulting engineer who made a study of the property, and submitted a voluminous report. He was asked in the Interstate Commerce Commission investigation what important instances of retrenchment in the previous five years he had reported, and failed to point out one instance.

The nonchalance and inattention of various board members when the company took on the burdens of the Terre Haute and Gary deals, and when the operating officers made company fuel purchases and issued free transportation through subsidiary-company directorships, were matched by inactivity with respect even to the more obvious of possible savings. Two of the straws in the wind may be mentioned.

Large salaries provided the board with one area for pruning. Temporary cuts, pending rehabilitation of the property, would have been appropriate, since the officers were desirous of continued employment. But instead of reductions the board provided increases above the rates paid by the war-time government administration of the property, and made these increases retroactive for the period of government control. The president's salary was increased from $60,000 to $75,000. Mr. Rockefeller justified this on the ground that the cost of living had gone up, and that "an employer has to maintain the ruling rate for services." He acknowledged that he did not know whether the president was proposing to leave the company at the time his salary was

increased, and agreed that if salary increases had been dependent upon the degree of success attained, the salaries of higher executives would not have been raised.

Another of the obvious subjects of a campaign of economy was the arrangement with Mr. Ryan's power companies. Even as a temporary measure, to tide the St. Paul company over its difficulties, it would have been appropriate to press for an amelioration of some of the burdensome provisions of the power contracts. At worst, the board could have indicated to the power people that there was ground for a lawsuit by reason of the character of the interlocking directorate and other circumstances which prevailed at the time the power contracts were made. But in the long record of the Commission proceedings there is no evidence of adequate activity by the St. Paul board to such an end.

The condition of the company was such that it could probably not be saved unless the board did pioneer work on the St. Paul, to get at some of the less accessible wastes then burdening the railroad industry. This pioneering was not, however, for a board whose achievements Mr. Percy Rockefeller was able to praise only in general, without enumeration of any specific contribution. The testimony follows:

Mr. Grady: Now, Mr. Rockefeller, after fifteen years as a director of this railroad, what do you now recall as being the most beneficial thing that was ever accomplished during your period of service in behalf of the stockholders of this company?

Mr. Rockefeller: I don't know as I ever thought of it.

Mr. Grady: Can you think of a single thing that was accomplished, that was really for the benefit of the stockholders?

Mr. Rockefeller: Everything that I did was in my judgment for the benefit of the stockholders.

Mr. Grady: But now looking back over fifteen years, can you recall a single achievement of the board of directors that was to the real benefit of the stockholders?

Mr. Rockefeller: If it were to be done over, I do not know how it would be done differently.

Mr. Grady: I am not asking you that. I am asking you a question. Just read the question again. (Question repeated by the Reporter.)

Mr. Rockefeller: They always used their best judgment, and I think that their judgment, if it had not been as good as it was, the situation might have been worse.

Mr. Grady: That is the only answer you would care to make to that question, is it? I will have it read again if you care to answer it. (Question repeated by the Reporter.)

Mr. Rockefeller: They always in my judgment acted in the best interests of the stockholders.

Mr. Grady: Is that the only answer you care to make to that question?

Mr. Rockefeller: That is the answer I think.

Mr. Grady: But you cannot recall a single thing that has proven to be of benefit to the stockholders, can you?

Mr. Rockefeller: The situation has been unfortunate.

The key to the mystery of a board which did not measure up to the company's needs is to be found in part in its make-up. The standard set in selecting men for the directorate was stated by Mr. Percy Rockefeller: "They always tried to select directors who would be the most useful in handling the affairs of the company. . . . Discussions were always along the line of trying to secure directors who would be the most helpful to the property." But most of the directors had no substantial investment in the company. All of them were barred by law from profiting through interlocking directorate arrangements. Self-interest sufficient to command adequate service was thus apparently lacking. "The twenty-dollar gold pieces that a railroad director gets for attending a meeting," said Mr. Ryan, "is not going to attract the kind of men that are going to make the railroads of this country successful." What was left, to evoke service responsive to the company's plight, was either sentiment or sense of duty. Few of the directors had, as Mr. Percy Rockefeller said his father had, "a great

affection for that property in some way or other. I don't know why." Mr. William Rockefeller served on the board over forty years; a majority of the directors who voted the St. Paul into receivership had not been on the board as long as five years.

The thirteen board members included the president and three categories of directors—four western directors, four New York banker directors, and a miscellaneous group of four others. Four men from the middle west had been selected because, as Mr. Percy Rockefeller explained, "it had always been the policy of the St. Paul company to have a number of western directors." Thus it was, as one of the New York directors testified, that "Mr. Byram suggested Mr. McNider as a good man. . . . I myself suggested Mr. Crosby as a good man." But only the annual meetings were held in the middle west, and one of these men attended four board meetings in twenty-two months, the other only four meetings in three years. The other two westerners did little better, one being at five meetings in sixteen months, and the other at five meetings in four years. In effect, they exchanged the use of their names as prominent business men in the territory served by the railroad for the honor of being its directors and for the passes over its lines.

Four of the New York directors were important bankers, three being principal officers of large banks. Whether it was due to the preoccupation of such busy men with other matters, or some other circumstance, they apparently did not have the time which the St. Paul road's problems required. An example was provided by the testimony of one of these bankers, Mr. McHugh, president of the Mechanics and Metals National Bank. His accession to the board was thus described by one of his banker colleagues who was also a St. Paul director: "I think Mr. McHugh came on about that time. . . . Mr. McHugh was president of one of the strongest and largest banks in New York, an outstanding man here in New York City, and they did not have to sell McHugh to me. . . . I always thought he was a representative of the Rockefeller interests." Mr. McHugh, examined in the Interstate Commerce Commission investigation, did not know whether anyone had placed in his name the shares which the law required all directors to have; he did not know the period of time for which he was elected to serve on the board; and when his knowledge of the affairs of the road was tested by questions about the Gary line, the following appeared:

Mr. Fisher: . . . You know what that road is in general, do you?
Mr. McHugh: No.
Mr. Fisher: Do you know what they mean when they talk about the Gary road?
Mr. McHugh: No.
Mr. Fisher: You have no idea where it is located?
Mr. McHugh: Well, it is in the vicinity of Chicago, but that is about all I know about it.
Mr. Fisher: You deduce that from the fact that it is called the Gary road, do you?
Mr. McHugh: Yes.
Mr. Fisher: I mean all you know about it is that it is called the Gary road, and you assume it must be somewhere in the vicinity of Chicago?
Mr. McHugh: Yes.
Mr. Fisher: What kind of a road is it, do you know?
Mr. McHugh: I do not know.
Mr. Fisher: Ever hear?
Mr. McHugh: No.

Mr. McHugh was on the St. Paul board for more than two years and attended most of its meetings during that period.

The third group of directors was made up of four men, two selected to represent interests which sold out their St. Paul holdings, and two to represent the Harkness interest. The latter were representing an investment which was part of an inherited Standard Oil fortune, and they went on the board at the request of the Rockefellers, with whom there had been a long business association in the first generation and an association from college times in the second generation. They leaned heavily on Mr. Percy Rockefeller, without knowing that he had quietly disposed of his family's St. Paul stock while the Harkness family continued to hold all of theirs.

Those of the St. Paul directors who were active on the board were not accorded the information necessary to the discharge of their duties, and did not peer beneath the surface of such reports as were made to them. The book-keeping on which the directors relied was such that Mr. Colpitts, the consulting engineer, testified in the Commission investigation: "I perhaps would shock you if I told you just the figure that I felt the depreciation fund was in arrears."

The legally constituted government of the St. Paul society began to fall into disuse, particularly after the death in 1922 of Mr. William Rockefeller, the last of the strong personalities which had dominated the company. The number of board meetings, instead of increasing as the company's affairs approached a climax, fell off. In the two twelvemonths beginning with March 1920, while the octogenarian William Rockefeller was still a cohesive force in the company's board, its meetings averaged more than one a month. In the next three twelvemonths the number of meetings declined from year to year, until in the last of them only eight meetings were held. Finally (as was disclosed in the Interstate Commerce Commission investigation), in June 1924, without vote of the board, and without any record of its creation being noted in the board's minutes, a special committee began to function and really took over such direction of affairs as still remained to this body. The situation thus developing may not have been a far cry from that which moved Mr. Roswell Miller, chairman of the St. Paul board, to resign his directorship in the Union Pacific twenty-odd years before. He explained his resignation to the head of that road, Mr. Harriman, saying "that the only duties of the office were to meet once in two or three months, and ratify what had been done by the Executive Committee; that he could just as well have this done by a wooden man, and I did not feel like occupying that position."

The board of the St. Paul had displayed a compound of fatalism and Micawber-like hope. One of the directors who resigned in 1922 "always felt that from 1918 on, it [receivership] was inevitable . . . it had to occur. . . . Absolutely inevitable, it had to occur." Another testified that "we, I think most of us, felt, and perhaps I did in October . . . 1924, that a readjustment was inevitable." A number of the directors testified that they had all been hoping that things would get better. "We were always very hopeful," said one, "that there would be a change in the tide." Director McRoberts "made a careful study . . . during the summer of 1923, and I felt . . . unless we should have a development of earnings, that I then saw no reason for assuming we would have, the road was in trouble. . . . We have seen remarkable turnovers, you know, in different situations, and it was—from that time on I was simply anxiously looking for the benefit that was going to come to the road, that would carry it over a difficult place, recognizing that 1925 would be probably the difficult point."

The propensity to delay and hope became marked in the last year before the receivership, when delay was almost certain to be fatal. "Much to our surprise and disgust," said one of the directors, "April 1924 went into red. . . . It then seemed to us that it was very doubtful if in the year 1924 we would earn our fixed charges. . . . It was felt by the bankers, and we agreed with them, that it would be advisable to postpone any definite planning until we knew how the year was coming out in regard to our earnings." Another director added that "it was a very uncertain and unhappy position to be in, to wait and watch the business develop or fail to develop over that fall."

The special committee and the bankers conferred on the desirability of asking for an extension of time at the hands of the owners of the bonds falling due in 1925. Such a process would take considerable time, as the bondholders were scattered in France and the United States and to some extent were resident all over the world. But the special committee decided to wait

until the year 1924 was over, in the hope that earnings might be better. This was virtually a resignation to fate and not a hope which had any likelihood of realization. As one of the directors acknowledged, the best earnings which could reasonably be expected would not have changed the situation.

Faced with pressing problems which could not be given adequate consideration without some estimate of probable future earnings, the board did not address itself to this question until the end of 1924 or the beginning of 1925, two or three months before the receivership. The directors then secured from the company's officers a forecast of the probable earnings of ensuing years. "It was the first time," said one of the directors, "we had clearly a definite conclusion drawn from the situation." This forecast was not communicated to the company's bankers. "I think it was probably too bad to show me," was Mr. Hanauer's comment. Ignorant of this study, he suggested that one be made by independent consultants. This was done, consuming two months' valuable time on the eve of the 1925 maturities, and resulting in a forecast substantially similar to that which the board had previously received from its officers. In the interim the board was marking time, and the special committee was trying to evolve some plan.

The special committee had met several times in the latter half of 1924, and considered the question of offering a ten per cent cash payment to the holders of the bonds due in 1925, provided they would agree to defer the balance. One of the members of the committee, Mr. McHugh, when asked whether there was any discussion of the feasibility of such a plan, said: "I do not think any definite conclusion was reached." Asked whether there was any discussion of its advisability, he answered: "Well, as I say, there was no definite conclusion." The questioning continued, as follows:

Mr. Fisher: Still I do not get an answer—what was the expression of opinion?

Mr. McHugh: I could not say that there was any conclusion reached.

.....

Commissioner Cox: What was the proposition that was expected to be put up to the holders of the securities . . . ?

Mr. McHugh: We had not reached that conclusion up to the time I went away.

.....

Commissioner Cox: The suggestion that you mentioned a moment ago, that is to have a new security with a larger rate of interest for the full amount . . . were the people, the St. Paul Company, in a position to have financed a situation of that character? . . .

Mr. McHugh: Well, I don't know that any conclusion was reached.

Mr. McHugh's description of the special committee's work included the following: "We were quite at sea as to what to do. We . . . realized the impracticability of dealing with the holders of those securities because they were scattered all over the globe . . . and no definite conclusion was reached" before the committee met with the road's bankers. At that meeting "no conclusion was reached . . . As I say, no definite conclusion was reached—nothing done before I went away. . . . I doubt if it had reached the stage where there was any definite conclusion at that time." Mr. McHugh left New York for a trip round the world in November 1924, and thereafter the special committee functioned without his aid.

Mr. Buckner, another of the directors, himself head of New York Trust Company, said of the special committee that "there was not much to report, except lack of progress. They were very unhappy that they could not get ahead faster. They always had something to say about it. . . . I think the problem that that committee had was trying to get something definite out of the

bankers." Finally, the committee evolved various plans, and of the best of them Mr. Hanauer, the principal figure among the St. Paul company's bankers, said that it "was an absolute absurdity, proposed by inexperienced gentlemen."

It was the attorney for the St. Paul company who said, in the course of the investigation by the Interstate Commerce Commission: "This property . . . had drifted into a receivership."