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BY JOHN T. FLYNN

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FOREWORD

This book is addressed not to citizens but to people; not to government but to society; not to law-makers but to business men. It is not an indictment; it is a remonstrance. It is not an assault by a foe; but the warning of a friend. It deals with a phase of business which is, in some measure, a fruit of this new age; not a new form of dishonesty, but an old one—as old as faith itself and the betrayal of faith; a sin which springs not from man's native dishonesty but from his weakness, whenever that weakness is exposed to the lure of easy gain.

The book deals primarily with graft in business, not with dishonesty in business at all, save only as dishonesty is a by-product of graft. For graft is in its essence a profit drawn off from some perfectly legitimate business enterprise for some unnecessary service, perhaps for some service forced upon it. It is a device by which men tap the ordinary processes of production and distribution to drain away for themselves some portion of the product without giving anything in return. It is a parasitic growth which devours the substance of business. Because of the appalling cost, business recoils from old-age pensions, unemployment insurance, other just demands upon its fruits by those who really serve business, yet submits tamely to a tax upon its earnings through the medium of graft large enough to cover several times the requirements of these essential reforms.

This is not a book of revelations. It makes no pretension to bringing to light hitherto unknown facts. It aims merely to assemble the fragmentary and known facts into a complete picture. Whatever value it may have must be derived from the light it throws upon the volume and weight of graft which it exhibits by massing the evidence.

I have not included racketeering among the forms of graft treated here. It has been omitted partly because of the too specious objection that it is something for which business is not responsible. It is supposed to be a form of violence by

which men not in business levy tribute upon men in business. But this is far from the whole truth. There is excellent authority for including racketeering among the established forms of business graft. "Racketeering," said Mr. Robert Isham Randolph, president of the Chicago Association of Commerce recently, "is a philosophy of economics widely seized upon by business men and labor leaders as a quick solution of the problems of competitive conditions and labor organization control. It is by no means an invasion of alien criminal hordes." Mr. Randolph added that "racketeering is an inside job for which business itself is responsible." I have omitted it, however, because it has had plenty of attention in recent months and is generally reprobated by the public. I preferred to turn all the light upon those more insidious, subtle and secret forms of graft against which the public conscience is not so much roused, some of them, indeed, enjoying a kind of respectability.

I do not believe this vice will be cured by law, though I think the law should withdraw from the hands of the grafter some of the implements with which it now endows him. Something will have to be done by business in its organized agencies, by society in its cultural development to eradicate this curse of graft which poisons it and which is responsible not only for a bad estimate of values, but for a bad distribution of rewards and a bad classification of men. The extent to which business is capable of evolving a spiritual energy strong enough to combat the disease diagnosed in this volume will be its measure as a civilizing force. If this book, therefore, is received as just a piece of muckraking, just a snarl at men who are successful, just an angry broadside against our present system, I will be profoundly disappointed.

In printing the story which I have to tell—a sorry tale enough—I shall try to avoid grumbling in general terms. I shall offer definite evidence and will stick to the record.

JOHN T. FLYNN

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THE UNJUST STEWARD

I

"And he said unto his disciples, There was a certain rich man, which had a steward; and the same was accused unto him that he had wasted his goods.

"And he called him and said unto him, How is it that I hear this of thee? give an account of thy stewardship; for thou mayest be no longer steward.

"Then the steward said within himself, What shall I do? for my lord taketh away from me the stewardship: I cannot dig; to beg I am ashamed.

"I am resolved what to do, that, when I am put out of the stewardship, they may receive me into their house.

"So he called every one of his lord's debtors into him and said unto the first, How much owest thou unto my lord?

"And he said, An hundred measures of oil. And he said unto him, Take thy bill and sit down quickly, and write fifty.

"Then he said to another, And how much owest thou? And he said, An hundred measures of wheat. And he said unto him, Take thy bill and write fourscore.

"And the lord commended the unjust steward because he had done wisely; for the children of this world are in their generation wiser than the children of light.

"And I say unto you, Make to yourselves friends of the mammon of unrighteousness; that when ye fail, they may receive you into everlasting habitations.

"He that is faithful in that which is least is faithful also in much: and he that is unjust in the least is unjust also in much.

"If therefore ye have not been faithful in the unrighteous mammon, who will commit to your trust the true riches?

"And if ye have not been faithful in that which is another man's, who shall give you that which is your own?

"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. Ye cannot serve God and mammon."

2

Judge Elbert H. Gary, late Chairman of the Board of the United States Steel Corporation, had a Methodist's hard-shelled conscience. He was far from being a brilliant man, but he was a thoroughly honest man, who carried his old-fashioned notions of personal honesty into his business affairs. The fee of a director of the great steel concern for attending a directors' meeting was a twenty-dollar gold piece. Always there were several directors who failed to put in an appearance at meetings. Of course, they were not entitled to their gold pieces. But the directors who did attend—all men of vast wealth—did not hesitate to claim the fees of their absent fellows. They merely divided the gold pieces amongst themselves. Judge Gary did not like this. Ida Tarbell, in telling this story in her authorized biography of the Judge, omits what I once heard him say—that he felt they had as much right to the cash in the corporation's safe as they had to these twenty-dollar pieces. At all events, not wishing to appear pharisaical, he accepted his share at first. But when Henry H. Rogers, a born gambler if there ever was one, suggested that the directors match for them, the Judge's Methodist conscience rose in rebellion against the sin of petty graft thus made atrocious by the curse of gambling. He protested against the whole business and put an end to it. Rogers and Frick came around to agreeing with the Judge, "but," he told Ida Tarbell, "I don't think the rest ever did."

These were very distinguished leaders of American business. But they refused to be persuaded that they had no more right to the twenty-dollar gold coins which their fellow directors failed to earn than they had to the money in the safe. Small as the offense was—those little twenty-dollar drops in the great ocean of the Steel Corporation's millions—it was graft.

Gary introduced another reform into corporate finance. He refused to permit the directors

of the corporation to see the report of the company before the stockholders.

"To prevent this," says Miss Tarbell, "he had issued an order that the comptroller give the figures to no one, not even to himself, until the day of the directors' meeting. They were not to be placed before the board until three o'clock—the time at which the market closed—and they were turned over to the public at the same time they were given to the directors. That is, he had devised a scheme by which a director had no better opportunity in the market than the public at large. The inveterate gamblers were at first very angry.

"'As a matter of fact,' insists Judge Gary, 'I always thought this use of inside information by directors—very common at the time—*was akin to robbery of their own stockholders,* and I had no hesitation in making my disapproval of it so clear that everybody on the board would understand. They finally gave up trying to get information from me, though in one case one of our directors went to our treasurer or comptroller to get it. But I was able to stop that. But it was wrong in principle and it set a bad example.' "

Judge Gary called this robbery. That is a strong word, particularly when we realize it is applied to a practice which was being followed by the leaders of American business in the greatest corporation in the country at the time. The measures he adopted to hold back the company's report were taken to prevent the directors—American business leaders—from robbing their stockholders. Judge Gary thought the practice was "common at that time". It was. And, while today there are many corporation leaders who would not think of indulging in it, the practice, unhappily, is still common. This, too, is a form of graft in business—profits derived not from some authorized and open mode of compensation granted to directors for their services, but secret, carefully concealed, derived from a betrayal of the interest of stockholders by the men they select to protect them.

A great oil corporation needs oil. The head of the corporation, charged with the duty of buying oil for it at the lowest price, finds a supply. Instead of buying it for his corporation directly, he

buys the oil himself and sells it to his corporation at a profit of 25 cents a barrel. He accomplishes this secretly and through the medium of a dummy corporation. That is graft—a corporation official using his position to make an extra profit out of his company by taxing it for his benefit 25 cents a barrel on the oil it buys.

Another corporation executive—a whole group of them—vote themselves, in addition to their salaries, exorbitant bonuses at a time when the corporation pays no dividends to its stockholders and in a year when all business is suffering from the effects of a disastrous depression. There is nothing illegal about it. It is what is called honest graft. Graft is not necessarily illegal. It is not necessarily dishonest, according to current standards.

The director of a bank, charged with protecting the interests of the bank, borrows money in large sums from the bank and upon inadequate collateral, makes a loan he could not make in any other bank, uses his position to get easy money and hence easy profits—that is graft.

The owner of a business—a coal concern, an insurance company, an equipment company—takes a post as director of a railroad. As such he is charged with protecting the interest of the railroad. But he appears on both sides of a business transaction. He sells goods to the railroad. He gets for himself or his company a preferential position with the railroad in selling it goods. He does not act as the trustee of the railroad's stockholders. He acts for himself, to make a profit out of the stockholders. That is graft. There is plenty of it in all sorts of corporations.

The purchasing agent of a corporation uses his position to exact or at least to collect gratuities from those who sell goods to his corporation. That is graft.

All these are forms of graft—graft in business. We think of graft as a form of dishonesty peculiar to political life. It is far more common, far more extensive, in business. It is one of the most serious and disturbing weaknesses in our business life, common among those who are charged with "faithfulness in the least" as well as those who are expected to be "faithful in much".

3

I have no doubt that this may be answered with the outburst of the over-zealous paid apologist of business who will proclaim that business is more honest than it has ever been in its history; that it continues to improve in honesty and that what I have said is a libel upon the good name of American business.

"Business," exclaims the Dean of the Chicago University Divinity School, in an almost ecstatic prostration before the throne of Mammon, "Business! Maker of morals!" Then, like a true priest, eager to set up a monopoly for his particular god, he cries out: "What else than business could make morality?"

The late Dr. Frank Crane once lifted up his soul to an exalted level in an incantation of such poetic and religious fervor that he rose almost to a chant about the National Cash Register Company. There upon a hill in Dayton the good doctor catches a glimpse of Paradise and he calls his little apocalyptic saga Heaven and Kingdom Come.

Glenn Frank glorifies the American salesman. He tells how salesmanship is the essence of almost every human effort, including the great drama of the Atonement, which was in reality just a big plan to merchandise salvation to the human race by the Greatest of all Salesmen.

The muck-rakers of the last generation are in exile or are writing biographical eulogies of the Captains of Industry they once denounced. Business has become such a spiritually beautiful thing that it confers upon its devotees a kind of holiness and on its leaders a kind of apostleship. We have recalled the old free-booters from the deserts of odium to which we whipped them twenty years ago and are preparing niches for them in our American Valhalla. A few of them wait only for death to be admitted to full sainthood. And Business, the great system of barter and bargain and gain by which they climbed, is become, not just a maker of morals, but the only maker of morals in the world.

No good purpose is to be served by this incessant fawning and laudation of business and business men which is indulged in, not so much by busi-

ness men themselves, as by those parasitic gentlemen of the quill and cloth and the academy who have invented a form of graft of their own, and who, not having the talent for making money themselves, find a way to feather their nests by fawning on the able and practical men who do know how to make it. Most of the silly adulation of modern business honesty has come from writers and preachers and professors. The intelligent leaders of big business are aware of the profound difficulties which gather in the path of any business man who attempts to interfere with the established grafts peculiar to different industries. Slowly these men are recognizing that the way to deal with this disease is to turn upon it the spotlight of publicity, to drag it out into the open and expose it to public view. Some years ago, for instance, the amazingly extensive system of commercial bribery, which seemed to permeate all business and which made it impossible for men in certain lines to be honest even if they wished to be, was a subject which business men were reluctant to discuss. To have talked about it in the newspapers or actually to have catalogued and published the various kinds of commercial bribery would have been looked upon as an unspeakable libel upon business. But that is no longer so. The subject has gotten now no end of publicity and scores of business leaders have frankly declared that the best way to deal with it is to give it full and pitiless publicity.

Unhappily any effort to discuss any form of dishonesty in business serves to furnish the parasitic apologist with another opportunity to reveal his devotion to his patron. It is quite possible, therefore, that whatever indignant snarls may be uttered about the criticisms in this volume will come, not from hard-headed, practical business men themselves, but from their over-zealous pensioners. Some years ago I wrote an article for *Harper's Magazine* in which I attempted to picture certain security abuses which had grown up even among some of our responsible industrial corporations. Shortly after its publication I found on my desk one day a pile of letters sent to the editor, expressing various views about the article. One of them was from a subordinate chieftain, a kind of petty officer in what might be

called the Department of Apologetics, denouncing me in the most unmeasured terms for what he called my indefensible and libellous strictures upon the great corporation with which he was connected. As I read through the batch of letters I came rather unexpectedly upon one from the president of that same company. I may add that he is one of the leaders of American industry and his company one of the very largest in the country. He too had read the article. But he was not in the least alarmed about it. He informed me that the facts set out in my article, so far as his company was concerned, while quite true at one time, were no longer so. His company had recognized and corrected the condition and he added that he was glad to see the whole subject aired in so important a magazine and expressed the hope that the article would be reprinted and published for wider circulation.

4

In view of all this I deem it important to disclaim any intention of making a blanket attack upon the honesty of American business. Above all, I do not intend to be put in the position of denying to business full credit for the advances it has made. I have no tears to shed over the passage of a better day and of the old-fashioned business man. He certainly was not hampered by the niceties of ethics. The moral standards of a group must be measured by the things it tolerates. And the old merchant and manufacturer tolerated many practices which would be universally frowned upon today. Then "business was business" and a man had fairly exhausted the resources of apologetics when he explained that he was not in business for his health. Of course, the trader of the last generation suffered somewhat because he did his own talking. There was an engaging if damning quality about his freebootery. The modern business man knows how to keep his mouth shut or, better still, commit his talking to more adroit tongues. The fraternity of business apologists had not yet grown up around the captains. Chancellor Day of Syracuse University was thundering about Standard Oil, but his was a lonely voice. Orison Swett Marsden was just beginning

to pipe about the glorious philosophy of success. William James was putting together his philosophy of Pragmatism, in which he had truly caught the spirit of American morals and furnished it with a philosophical basis. But that famous book was not yet thoroughly circulated.*

The old-fashioned business man had his code, even though it was not engrossed on illuminated parchment and hung on his wall. It was simple if not easy to express. There seemed to be two laws —one for the people he knew and another for the stranger. He must be honest with anyone he supposed would call again or, if the sacrifice was not too great, with anyone he might have to face. He must deal scrupulously, or nearly so, with the members of his lodge for sweet fraternity's sake and with his regular customers for sweet common sense. A regular customer, aware of being short-weighted or over-charged, might go to a rival. And a rival was hated above all evils. But apparently it was defensible to squeeze the last

* See "Business and Ethics" by John T. Flynn, in *The Forum*, October, 1928.

penny from the outlander and the passer-by.

J. C. Penney, that amazing merchant whose vast chain has expanded to a thousand stores, tells about the code he met with when as a young man he clerked in an old-fashioned dry goods store. He found on a shelf two stacks of socks seemingly alike in all things save prices. One stack was marked 25 cents a pair; the other, two for 25 cents. The merchant instructed young Penney that he was to offer a customer the socks marked 25 cents a pair first and if the prospective buyer demurred then the "Two for 25" socks were to be brought out. But the socks were the same. There are such merchants left, but the tribe grows steadily less and they are not characteristic of modern traders. In place of that system we now have the one-price store which is the chief triumph of modern business.

Merchants now operate on the one-price plan, not because they are fundamentally more moral but because they are more intelligent. The cost system and the mark-up have succeeded the old hit-and-miss method and it produces better dividends. The old merchant felt he had a right to

charge what he pleased. Society taught him, and his minister re-enforced the lesson on Sunday, that property was a God-given institute. The goods upon his shelves were his. He could sell them for much or little. He could give them away or hold fast to them as his own. If he chose to sell to one man at a low price and exact a high price from the next man, that was his right. And he exercised it, sometimes as freely as the Egyptian merchant who asks forty piastres for a string of beads and ends by selling them for five. This has now come to be immoral in American business. The old order has passed where the merchant bargained with his customer and lied ignobly in the process. He asked a big price and came down if he had to. Now he asks a big price and sticks to it. Instead of charging one man a dollar and another two dollars for a fifty cent razor he asks five dollars from all and the light of heaven shines upon the transaction.

What could be expected of the rank and file of business men when the leaders were so bad? At the top were men like Jay Gould and Jim Fisk, Jr., Commodore Vanderbilt and that astonishing and picturesque old rascal, Daniel Drew. The foremost financiers counted our railroads and our industries as just so many tools in their kits to use in their speculative battles. The most unrestrained corruption was revealed in the management of insurance companies entrusted with the most sacred of all trusts. The promoter ruled our financial and industrial life. Public utilities were juggled in stock promotion schemes from which many of them to this day have not fully recovered. Railroads were primarily instruments in Wall Street gambling; transportation was just a by-product. In the oil industry a competition so savage prevailed that the nation was aghast at its lawlessness. Beginning with the close of the Civil War business began to sink into a state of corruption so noisome that the people revolted against it in self-defense.

With the opening of this century came a revival of morals. But while business had its share in initiating the reforms, they were not wholly the work of business. It was the muck-rakers who first stirred the public conscience. Of course, the muck-rakers, like the business eulogists today,

went too far—made the mistake of putting down every man who followed these practices as a villain, without understanding that the whole business world was just running along in a rut in which by easy stages all had come to travel. In the same way the modern business panegyrist chronicling these events makes the mistake of supposing that organized business rose en masse to correct these old abuses. A few business leaders gave their voice on the side of decency, but organized business as a whole seemed, for a long time, to be well content with its wallow. The states set up public utility commissions, health commissions, food commissions. Laws were introduced to curb wrong-doers. The nation established the Interstate Commerce Commission and the Federal Trade Commission. The pure food and drug act was passed. All this required almost super-human struggle; incessant, tireless, thankless, even heroic efforts. And all the time, against nearly every movement forward where the attack was made upon its own practices organized business blocked the way. It was driven from its bad habits with a whip and it contested every inch of its regeneration. Now an obsequious preacher lifts his hands and cries out: "Business! Maker of Morals!"

It would be equally far from the truth, however, not to recognize that after awhile certain forces in business itself began to stir. Business began to move in the direction of better trading ethics. After all, the business man is not only a purveyor of goods; he is a purchaser as well. When the noodle man became more intelligent he began to notice that while he was loading his cartons with poor noodles he in turn was being made the victim of the egg man, the flour man and the machinery man from whom he bought goods. Very soon the noodle makers began to form themselves into trade groups to protect themselves against the egg men and the flour men who in turn began to consider similar measures to guard against those with whom they dealt. A famous advertising man has written the story of his life. In one chapter he tells with great gusto of his part as a pioneer in patent medicine advertising in the early days when it flourished in all its glory. In another chapter he tells with swelling pride of the

part he took against dishonest newspaper publishers who lied about their circulation to advertisers. One can imagine the pious chagrin of a patent medicine advertiser who supposed he had been lying to 100,000 readers when he was lying to only half that number because the publisher was lying to him.

This force is operating now with greater effectiveness than ever. The new competition has put every business into competition with every other business for a share of the consumer's dollar. If one business group can drive another business group out of the race it will have a better chance for a larger share of that dollar. Hence we see the investment bankers realizing with a sickening sense the fact that fake stock swindlers are taking away from American investors several billion dollars a year. Billions, mind you, available for investment and which the legitimate bankers can get if they can drive the fraudulent competitors out of the market place. And so the investment banker gets solemnly and severely ethical, raises the hue and cry against the stock swindler and the campaign to purify business goes merrily on.

Of course, along with this the modern business man's greater intelligence is pointing the way to sounder, safer, surer profits in better business. Aside from the chicanery of the knave, a good deal of the badness in business may be traced to ignorance. Today, perhaps, no trade surpasses the women's ready-to-wear industry in the extent and intensity of its bad manners and its bad ethics. And no trade surpasses it in ignorance.

In all this we have been examining the long and painfully slow movement forward in what might be called the personal relations of business—elementary problems of honesty and price, quality and delivery. I have given this much space to it because I want to be sure the criticisms I have to make of some other phases of business will not be answered by pointing out the advances made in what we may call our trading ethics. I have no hesitation in saying that the trading ethics of American business men are not only immensely better than they were but that they are better than the trading ethics of any other people in the world.

Of course, there is plenty of dishonesty left

even in trading. Not long ago many drug store windows seemed to break out with an extensive display of "etchings" offered at $1 each. Numerous stores were not satisfied with calling the pictures "etchings"; "genuine etchings" seemed more effective. Of course, they were not etchings but just imitations. About the same time numerous hat stores appeared with ladies' "Panama hats" at $5 apiece. Some of these hats were actually Japanese paper hats, some were made of straw; but none were "Panama". A chain of shoe stores advertised its wares as "Hand-Turned Footwear" though none of its shoes were of that variety. A Brooklyn department store advertised a "new pattern in peach China", though none of it was of china. Another Brooklyn department store advertised a well-known brand of hosiery for sale at low prices, but amongst the advertised brand were other and inferior hose all mixed up on the same counter. All examples were found about the same time, in the same section and in fairly well-known stores. What redeems this unpleasant phenomenon and illustrates strikingly the great improvement is the fact that an organization—formed by business men and supported by them to keep its eyes open for just such performances—had the energy to bring these cases to light, protest them to the proprietors of the stores in question and put an end to the dishonesties, in some cases obtaining public acknowledgment of the "inaccuracies".

5

But there is another region of ethics where the same improvement has not been made. Business men have always delighted in sneers at the morals of politics. I have mixed more or less intimately with business men and politicians for many years and I think it must be said in all fairness that the latter do not suffer by comparison with their brothers in trade. In one particular at least—in respect for the trust relationship—political life, I firmly believe, exacts a higher standard of honesty than business. If an elected public official were known to be connected with a concern engaged in selling goods to the city of which he was an official or in performing contract services for it, he would be disgraced. But no one thinks of

condemning a corporation official who, while he is, perhaps, a director of one corporation, is also the owner of another which supplies it with goods or enjoys a preference in performing for it certain services. In the past the dishonesties of business and those of politics have been quite different. But now most of the bad practices of political life begin to make their appearance in the business world.

A moment's reflection reveals how like the political organization the business concern is becoming. All important business is coming into the hands of great corporations owned by tens of thousands of stockholders. The management of these corporations is in the hands of elected officials just as the management of our cities and states are. These corporation officials are elected officials, salaried, and bear the same relation to their corporations that public officials bear to the communities they serve. We still talk of private business, persisting in the illusion which survives from the old days, that business belongs to the private individuals who operate it. The term "private business" is misleading. If we use it to distinguish business from the affairs of the political community the term may stand. But if we use it to describe business units in which the men who rule them ought to be privileged to enjoy the "privacy" which we once attached to a man's personal affairs, the term can be very easily perverted to produce confusion.

Most business is no longer private. It is public in the same way as our political affairs are public. Water works belonging to the 20,000 citizens of the town grouped together in their capacity of citizens are no more public than gas works that belong to 20,000 persons grouped together as stockholders. The officials who manage the town's water works are no more public officials than the officials who manage its gas works. They differ merely in the group of owners or the constituency to which they are answerable. Both institutions belong to corporations—one to a political corporation, the other to a business corporation. But neither one is privately owned.

Because of this resemblance it is easy to see how our modern business corporation may develop a collection of vices not unlike those found in polit-

ical corporations. There are managers of corporations who do not scruple to exploit the corporations they direct and the stockholders whose trust they hold. The executive of one large corporation, perhaps, finds in that post an opportunity to own and promote other corporations which deal with it and fatten on its favor. He feels he has a right to fill the departments with his relatives and dependents as if he owned the business. Exorbitant salaries may be paid to officials which never would be tolerated if the interests of the stockholders controlled. Not long ago directors of numerous companies lifted their eyebrows in astonishment at the proposal that they owe their stockholders full and complete and detailed statements of their operations.

Much of this grows, not out of actual dishonesty, but out of the failure of the business men who direct these companies to orient themselves correctly in the new economic order, their failure to perceive the newly recognized character of their positions and to feel thoroughly imbued with the nature of the trust which they hold.

The net result is that the characteristic vice of business today is graft. After making full acknowledgment of the great improvement which has taken place in our trading morals—the square dealing between business on one side and its customers on the other—there still remains this other area of ethics which covers the relations between the employer on one side and his agents on the other—his employees, if you will. For almost all business men are employees now, though many of them fail to understand that fact, and the crowning moral weakness of business in its new corporate form is that which arises from the infidelities of these employees great and small—violations of trust, sins against the fiduciary relationship.

Now again let me insist that I do not intend to be put in the position of making a blanket indictment against all business men; of denouncing all business men as grafters. No one knows better than I do that this is not so. There are many business men whose relations with their stockholders are governed by the most scrupulous regard for the latter's rights. There are many more who look with growing alarm upon the necessity

which seems at times to compel them to wink at practices which they condemn. My chief hope in presenting the facts which are assembled in this volume lies in the aid it may give the better element in business to correct the abuses catalogued. Such abuses I group in this book under the name of Graft.

6

It is quite important that there be no vagueness about the meaning which is attached to the word graft in this book. The word is, I believe, comparatively recent as a term for describing a certain form of parasitic profit. I have seen it written that in that sense it was first used in the latter days of the last century. As to that I have not attempted to follow the matter. But certainly it came into wide use at that time to describe certain kinds of profits which were being made in politics.

I am told that the word was first used in circus circles to describe the business plied by various gentlemen who followed the circus—including perhaps the side shows—and who flourished on the crowds drawn by the circus. Most of these business men were engaged in thoroughly respectable pursuits, at least according to circus standards. But they had no basis for existence, no independent reason for existence, save as parasites upon the circus. These gentry referred to their special callings as "grafts". A man's graft was his special and peculiar device for making a living on the fringes of the great show.

That is very close to the natural and normal meaning of the word. A shoot inserted in the original stock—thus the dictionaries describe it when applied to trees or flowers. That is what it is when applied to business. It is by no means essential that the profit involved shall be a dishonest profit. It is essential that the profit be one which is derived from an operation not necessary to or inherent in the life of some business, but which is made possible through its attachment to that business.

Because it is possible for an employee to carry on a parasitic operation grafted upon the employer's business, much graft is found among em-

ployees; and hence it involves to so great an extent a violation of the trust relationship. And because so much of it involves a breach of the fiduciary relationship graft includes very often an act that is unlawful. But it need not be necessarily unlawful or criminal or even immoral.

The phrase "indirect profits" may, perhaps, describe some of those forms of profit to which I object in this volume. Indirect profits—profits which are not regularly authorized by the people who must pay them, but which arise, indirectly, perhaps secretly, in the course of the agent's dealings with the concern. Thus, for instance, a banker receives a commission for underwriting and distributing an issue of stock. This is fixed and may be quite moderate. However, when the whole transaction is complete, if you could see all of its parts, you would learn that the banker has made twice as much, maybe ten times as much by dealing in the stock of the company, manipulating it, buying and selling it, as he has through his direct commission. The director of a corporation, having access to the intimate and secret affairs of the concern, knows in advance facts which will depress or enhance the price of the stock of his corporation. As a director he gets practically no pay—twenty dollars a meeting—but with his secret information about the corporation, he can go into the market and buy its shares or sell them short and make large sums of money.

These are what I mean by "indirect profits". I think we may safely call profits like these graft. They are not unlawful. They are not even considered, actually, to be wrong. Many business men think they have a perfect right to enjoy them.

Indeed, the term graft covers a wide range of operations. It may refer merely to one's work, whatever that may be; but there goes with it in this sense an implication that the profits derived from the work are easy, large, with the suggestion that they are indeed excessive and almost always parasitic. "A good graft" is a phrase frequently applied to some job or some business, which, to put it mildly, can hardly be included among the basic industries and which borders a little on the smart or slick variety of occupations.

While many forms of graft, therefore, involve the elements of downright dishonesty or swindling, this is not true of all. The word may be used to describe profits which are wholly legitimate but which suffer a little in the scale of respectability through a certain secrecy, particularly if that secrecy be employed against those who have a right to know about such profits.

7

It will not do to dismiss this important matter by saying that it is not sufficiently widespread to be called a major problem of business. Graft of one kind or another permeates every level of business. It is found practiced in its cruder and more vulgar forms, and in its more refined, delicate and respectable technique. It may be used by employees in all departments from the porter at the door to the chairman of the board.

"It is a festering sore in the commercial body of the nation; its extinction calls for a drastic use of the knife. If allowed to proceed unchecked and uncontrolled, it destroys legitimate competition, and cancels the reward of merit; it frustrates the rightful development of true progress. . . . . So long as this practice continues, the hope of honest conditions of trade remains a chimerical dream.

"We have been too ready to ascribe the prevalence of this practice to foreign influences; it is perilously near a national fault with us. *There are few branches of American business which are not honey-combed by its corroding influence.*"

The paragraphs just quoted are not so much muck dripping from the pen of some irresponsible radical critic of American institutions. They are taken from a document denouncing commercial bribery and bearing the signatures of representatives of the National Association of Purchasing Agents, the Association of National Advertisers, the National Association of Credit Men, the Associated Advertising Clubs of the World, the American Society of Sales Executives and a number of other national business organizations.

Joseph H. Choate, Jr., speaking as counsel for the American Chemical Foundation, describing the bribery of textile mill employees by chemical

manufacturers called it "the most extraordinary corruption that, I think, the world has ever seen."

"Graft giving and receiving exists in the nursery business," says the report of the American Association of Nurserymen for 1922; "just as it does in most if not all other business."

"That this question of commercial bribery constitutes a serious problem to many business men cannot be denied. There is no use claiming, ostrich-like, that graft in business is a thing of the past."

This frank avowal is taken from an article in no less a champion of business than The Rotarian. It was printed just one year ago.

These expressions and these activities of business men to correct their own crafty weaknesses represent business at its best. It is at its worst when its stupid paid apologists are trying to hide the need for reform behind a curtain of cheap adulation. We saw a serious phenomenon of this kind in the silence with which business regarded the now famous oil scandals. All of the political offenders in that celebrated episode, though most of them were involved only on the fringes of the scandal, were promptly driven from public life; while the large number of business men involved continued to hold their high posts and for several years not a single voice in business was raised in criticism of their acts. There were many business men who condemned these things, particularly the performances of that group of corporation executives who were involved with Colonel Robert Stewart in the Continental Trading Company affair. But it seemed to be the understood role of business to keep its mouth shut about such matters. This was a little too much for some men and finally Judge Edwin B. Parker, Chairman of the Board of Directors of the United States Chamber of Commerce, in a notable address at the annual meeting of that body, boldly declared that the times demanded "straight thinking and straight talking".

"They demand," he said; "that we consider the disturbing evidences of a business atavism, a throw-back to a day of unrestrained individualism; a day of 'public be damned', when men of great business ability with an eye single to their own selfish interest and immediate returns and

without regard to the future, ruthlessly pursued their predatory lusts in a spirit of 'after me the deluge'.

"We are here concerned," he concluded, "in awakening the seemingly dormant business consciences of many of the stockholders of corporations who, through non-action, impliedly place the seal of their approval on the acts of their offending agents. All such owe it to themselves, to the profession of business, to the government publicly to repudiate those who misrepresent them. They cannot accept the profits flowing from corruption and escape the moral stigma which adheres to such profits. Neither can they permit those who act for them personally to profit through corrupt corporate transactions or shield others who do."

8

How can this be remedied? Before I bring this volume to an end I shall attempt to indicate some measures which may tend to eradicate this abuse, or at least reduce it. But there is no remedy which can be expected to take it out of our lives swiftly. There are no means which will satisfy the appetite for cure of that type of reformer who finds a social abuse one day and is impatient to see it ripped violently out of society the next.

This thing is as old as history. The earliest chronicles we have, vague though they be, reaching back into the very dawn of history, reveal to us the priests of Amen who had already learned how to commercialize a spurious diety and fatten even upon the Pharaoh. The earliest known code, that of Hammurabi, king of Babylon, recognized the existence of graft and contained provisions punishing the sale of a man's property by his servant or son. It recognized, too, and provided punishments for that age-old social crime, the bribing of judges. In Judea men had already learned something of the trust which attaches to agency and from that land we get the parable of the Unjust Steward—the chamberlain who called in his master's debtors and remitted half of the debt of each in order to ingratiate himself with them when he discovered that his master was

about to give him the sack. And it is interesting to be told that the master, when he discovered his steward's faithlessness, commended him and declared that he had acted wisely, "for the children of this world are in their generation wiser than the children of light". This seems to be a very antique denial of that famous copy-book maxim that honesty is the best policy. The position of the unjust steward is not yet wholly reprobated in society. Men do not despise the men who make their money by more or less devious means. The names of many able men who have amassed great fortunes, whose methods are known to all the world, continue to be held in the highest esteem. I have already observed that the ethics of a people are to be measured, not by the things they condemn in the abstract but by the things they tolerate in practice. And who can deny that the most extreme cases of graft are tolerated in almost all quarters? A distinguished business man who, after public opinion is aroused against him and various political agitators seeking his scalp precipitate a movement against him, is removed from the leadership of a great corporation in a hotly contested election, nevertheless receives an overwhelming majority of the votes of the individual stockholders and is still carried on the rolls of the corporation for a pension of many thousands dollars a year. The men who are guilty of this vice are not essentially wicked men. The causes of the practice must lie somewhere in our social system itself, not wholly in the breasts of the guilty ones.

In the following pages I shall attempt to set forth the extent and kinds of graft which flourish in our business society. This is not intended to be a catalogue of business dishonesty or of commercial crimes. I will not include those kinds of offenses which come under the head of palpable dishonesty—theft, robbery and such like. I intend to describe that group of performances which enjoy a kind of toleration among business men in general, though there are many business men who decry or even denounce them. I shall picture, if I can, the performances, not of the crook or the criminal or the thief or the gunman but the sins

of the gentleman, the shortcomings of the Unjust Steward, who, though he may extract a little of his lord's substance, nevertheless enjoys a kind of commendation from that gentleman, who knows how to admire, with a certain restraint of course, the astuteness of "the children of this world".

PART ONE

COMMERCIAL BRIBERY

CHAPTER ONE

THE MENACE OF BRIBERY

I

THE average politician is the merest amateur in the gentle art of graft compared with his brother in the field of business. I have already observed that there is more graft in business than there is in political life. That statement will be received as a preposterous exaggeration by those who are deceived by the eternal chanting of the praises of honesty in business which has been so popular ever since the high profession of public relations counsel came into its own. Before we are done with this matter we will see that there is at least very considerable ground for making this statement. I shall ask the reader at the very threshold of the subject to remember that the performances of public officials are subject to incessant and pitiless publicity; to ceaseless scrutiny by the dispossessed minority; that higher officials must submit themselves to endless questioning and cross-questioning by representatives of the press; that hostile newspapers literally hound the leaders they oppose and mercilessly exploit all their shortcomings; and that more or less full reports of all the public business must be made at intervals and are open to the inspection of all. On the other hand the activities of those in business, managers and subordinates, are carried on behind a screen of privacy. Newspapers and magazines very naturally shrink from criticising individual business concerns; no one has the right to question managers; the law affords to their cherished secrecy a kind of protection. Even stockholders of corporations cannot learn very much about what goes on in many of the institutions they help to finance. Perhaps this is as it should be. But it offers an explanation of why we hear so much about the sins and graft in politics and so little about the sins and graft in business.

Graft in business as carried on by subordinates

is known by the name of commercial bribery. It is, however, nothing else than graft. Commercial bribery has been defined by Garland S. Ferguson, former Chairman of the Federal Trade Commission, as "the giving by the seller to the employee or agent of the real buyer and without the buyer's consent, of a commission or gratuity for the purpose of influencing the sale of goods. The commission may be paid outright or concealed in a variety of manners. The gratuities may range from gifts to entertainment or other favors."

The definition is, I think, not wholly adequate. It leaves out a good many operations which belong in the category of commercial bribery. Here are some examples:

A mechanic demonstrating a new machine for use in a factory fails in his test because the manufacturer of the old machine bribes the factory engineer to spoil the test.

One concern, through its agents, gets hold of the trade secrets of other concerns—the names of its customers, the ingredients of its product. This may be accomplished by giving money to the employee of the victimized rival. That is commercial bribery.

One concern induces the employees of another to violate their contracts or to leave their employment in such numbers as to embarrass their employers. This may be done by the use of money payments. This is commercial bribery.

Hospital employees receive bribes from undertakers to notify them of deaths and hence of prospective burials. Doctors may receive from surgeons commissions based on the fees collected by the latter for operations on patients recommended to them by the former. Men charged with the hiring of laborers may exact from the laborers gratuities for putting them on the payroll. The practice of commercial bribery ranges over a wide field.

A better definition is found in the bill aimed at the practice in the last Congress. Stripped of its verbiage and circumlocution it classifies as commercial bribery the act of any person or corporation who gives or offers the employee of another or to a member of his family, directly or indirectly, any valuable thing as an inducement

for doing or omitting to do any act in relation to the affairs of his employer.

There are some other things included in the offense hit by that act. The act is not aimed precisely at commercial bribery. It is directed rather at certain forms of unfair competition. The law proposes to make the whole practice of bribery unlawful, not because it is morally wrong but because it interferes with open, free and fair competition.

All graft is not commercial bribery. And all unfair competition is not necessarily either graft or commercial bribery.

For instance, there is the Spiff—that curiously named device for stirring up trade. The manufacturer, having sold his goods to the merchant, is not altogether done with his job. He wants to be sure that the merchant will in his turn sell those goods so that he will order more. So the manufacturer offers to the merchant's sales-person a little gratuity, a small commission as an inducement to push those goods. This might seem to be a favor to the merchant who is thus enabled to dispose of the merchandise he has bought through the energy of the salesman stimulated by the gratuity or spiff of the manufacturer. But it happens that the merchant has other goods to sell, goods in competition with those which his clerk has been induced to push on the customers. The merchant's reputation with his customers, his claim upon his customer's continued trade, may be seriously impaired by this pushing of the favored line. The merchant has no right to complain of this, however, if he knows of the spiff and permits it which sometimes happens among short-sighted merchants. But if he does not know about it, if the whole operation is carried on behind his back, as is most frequently the case, then the thing given the sales-person is nothing less than a bribe. But in any case the judgment of business is that the practice is unfair competition since there is also involved the right of the competitor whose product suffers in the process and of the customer who is usually deceived by the clerk in order to make the sale. And so the latest models of laws offered against commercial bribery tend to include this little practice in the list.

Then there are forms of graft which are not

bribery. Thus the owner of a private school pays the pupils' bills and passes on the charge to the parents, neglecting to deduct the discount which he receives. Here is a form of graft not, indeed, found in all private schools, but not unknown to some.

In the case of commercial bribery, however, which comprises by far the major portion of commercial graft, it is of the essence of the offense that the reward received is hidden from the principal. It is a violation of a trust. It must be made, therefore, to a trustee, an agent, someone acting in a fiduciary capacity, someone whose judgment and honesty is relied upon by the employer. This is overlooked by some of the too zealous enemies of the vice. Thus the gentlemen who manufacture for the hog world a serum and virus for hog cholera were swept by a tidal wave of commercial purity. They adopted a code condemning commercial bribery and along with it the practice prevalent in the trade of bribing customers by giving them special discounts. There is a good deal of that sort of thing. In the drug trade, for instance, wholesale druggists have been known literally to buy a man's trade by granting him handsome subsidies. "You are about to start in business," the wholesaler in effect says to the newly arrived druggist. "For the first year you will know great travail. You will probably lose money. Therefore we will pay your rent for the first year, $50 a month say. Or we will provide the salary of one clerk, $25 a week." In return, of course, the wholesaler expects the whole business of the retailer. This little stratagem is not unknown to the hardware trade and some others.

In that special commercial world occupied by the hog-cholera serum makers it was rampant. There it took the form of very generous special discounts to users of serum. So the hog-cholera men called it anathema—damned it with a bad name; they called it bribery. But the Federal Trade Commission was not deceived by this outburst of probity. "They would condemn," said the Commission, "the granting by one company of better discounts than those granted by a competitor. So-called rebates, refunds or unearned discounts allowed to a purchaser simply mean

giving a better price. Instead of the granting of such discounts being unlawful, as the minority of the Commission contends, the fact is that an agreement by the trade not to give them amounts to an agreement as to price which is in violation of the Sherman anti-trust law." You cannot make a thing a bribe by calling it so.

Give the discount to the employee without the knowledge of the employer and it would be bribery. But if the employer gets it, or knows about it and countenances it, it is not bribery. There are certain trades in which the practice is well-known to the employer, and is not only permitted but encouraged by him. He expects his employees to get most of their pay in that way. This is akin to tipping. Waiters in restaurants, stewards on ships, employees in hotels are usually paid very small sums by their employers, who expect them to make up their wages from their tips. This tipping system is an abominable thing; but it is not to be put down as bribery where the employer knows of it and actually trades on it in fixing the wages of his staff.

2

And now the critical reader asks why all this pother about a practice in business which is comparatively rare; which is engaged in by very few. Why smear all business with the odium which should attach to exceptional sinners?

Rare! Exceptional! Ah well, let us see if this is so.

"The crime of commercial bribery is one of the greatest evils in American business today." This is the verdict of the Managing Director of the National Council of the Traveling Salesmen's Association, Mr. W. G. Adams, who made this statement in a letter to the Judiciary Committee of the House of Representatives in 1926.

"Under the present inadequate laws," continued Mr. Adams, "its growth is a very serious menace. There is an increasing disrespect of personal and business honesty on the part of our younger generation and a deplorable let-down of ethics on the part of a considerable number of our older generation. The unscrupulousness of the successful and the success of the unscrupulous

engender a philosophy that the end justifies the means."

The head of the traveling salesmen of America, who are on the firing line of selling, ought to know something about this matter and these are very strong words. Mr. Adams declared that his "members, 912,000 traveling salesmen, the advance army of American commerce", were united in favor of the passage of the Graham Bill to make commercial bribery a crime.

The *New York Times* is not a radical grumbler about business. "American business," it declared in an editorial note last year, "even that part which has nothing to do with official or political contracts, *is full of this kind of bribery*. It is found in estates and in banks as well as breweries."

The *Commercial and Financial Chronicle*, a very staid and conservative recorder of solemn business facts for business men, decried an attempt to end this practice by law and made a curious defense of its position which amounted to a rather sweeping indictment of business.

"More or less this vice runs through business. It works between retailers and domestic servants.

It is almost as universal as the tip. It has its lurkings and its large development under government itself."

Then comes the strange defense:

"It is wrong, but so is all sin. There is no reason for assuming that the evil is relatively much greater than formerly or that any new statutes are required or could cure the evil."

The argument is further elaborated, taking this peculiarly damning turn; that statutes would be useless against a practice *which is so universal*.

From *Commerce and Finance* comes the following:

"Federal investigations have shown the prevalence of commercial bribery which has been allowed to flourish unchecked because of a lack of adequate laws to put a stop to it. The secret giving of commissions or other things to employees of customers to induce them to buy or recommend the purchase of certain supplies *has become a nation-wide system*. It infests not only the ordinary lines of business but also the professions, even the surgical profession. . . . . .

"Waiving the moral issues involved—a fact few

will dispute—a practice authoritatively estimated to take a BILLION DOLLARS A YEAR OUT OF THE CASH DRAWER OF BUSINESS Should Be Stamped Out For Strictly Business Reasons."

The General Manager of the New York Better Business Bureau confirms this estimate of a billion dollar a year cost to business and to business in New York City alone, at least a hundred million.

These are credible witnesses—the *New York Times*, *Commerce and Finance*, the *Commercial and Financial Chronicle*, the head of the Traveling Salesmen's Association, the Better Business Bureau. Hearing these characterizations one asks himself if the evil is so rare, so exceptional, after all.

CHAPTER TWO

CUMSHAW

I

THERE is a notion that commercial bribery is more or less limited to traveling salesmen on one side and purchasing agents on the other. We have seen the protest of the National Association of Traveling Salesmen, which means simply, of course, that there is an influential group among these men who oppose the practice and chafe under the odium it casts upon all. On behalf of the purchasing agents Mr. L. F. Boffey, Secretary of the National Association of Purchasing Agents, appeared before the House Committee and urged the passage of the Sims bill levelled at commercial bribery. He protested against the reputation imputed to purchasing agents as the bribe-receiving class. The records showed, he said, "that men most sus-

ceptible to bribes were minor plant officials, department foremen, stationery engineers and the like."

The simple truth is that the practice is found among salesmen, purchasing agents, plant officials, foremen and any other classes whose judgment is relied on to make or influence decisions in which sellers are interested. The facts which follow and which relate to a single business will reveal the extent of this vice:

Purchases for ships are made by various officers. Repairs for ships are contracted for sometimes by captains, sometimes by agents. But by whomever made, the men who go down to the sea in ships not only know the ancient art of grafting as well as the most skillful landlubber but they have a name for it all their own. "Cumshaw", we are informed by shipping men, is almost as old as the sea itself.

The bribing of ships' officers takes all known forms—entertainment, gifts, cash. Of course, the salt sea rover home from the deep after a long voyage is a mark for entertainment. And so dinners, theatre tickets, "seeing the town" go down very well with the pleasure-thirsty sea-faring man.

Glancing through the records of the Federal Trade Commission for 1921 one finds 40 ship chandlery and dry dock concerns hauled up before the Commission charged with bribing captains and stewards. And of the 40 cases, in all but one were the charges proved to be true. Of course, no cases come before the Commission save those involving foreign or interstate commerce and, moreover, only a small fraction of the cases of commercial bribery ever come to light.

H. C. Donaldson, President of the Association of Ship Store Dealers at New Orleans, testified before a congressional committee that "conditions in the ships' supply business are particularly deplorable so far as the masters of foreign vessels are concerned. In many cases they exact their commission before they will do business."

In a hearing before the Judiciary Committee of the House on a bill to declare this practice unlawful, many shipping men appeared and revealed the shameful conditions in the business, not only

as respects foreign officers but American shipping men as well.

The representative of a packing house swore that if he had not given gratuities to captains and stewards his concern would have been out of the marine supply business.

A sailmaker testified that his firm had paid $4,500 in gratuities in 20 months.

A dry dock and ship-building company's books revealed the following payments under the heading of gratuities in four years: 1917, $19,229; 1918, $31,067; 1919, $29,985; 1920 (three months) $19,066. And another dry dock concern admitted that it had paid out in bribes to captains $8,800 in 15 months.

Dealer after dealer swore that they had given bribes to captains and stewards ranging as a rule around 5 per cent; that the practice was a long-established custom in the business; that without it you could not do business, because ships' officers, if you refused to pay them, took their business to other concerns or even to other ports.

One supply man declared that his firm had attempted to do away with the practice of bribing in their dealings but that captains just passed them by. As a side-light on the comparative honesty of foreign and American captains, this man said that while the practice was common abroad he had never seen bribes paid to such an extent as in this country.

Still another marine supply man testified that these bribes might run to a single captain anywhere from $50 to $7,000; that his firm usually gave the captains from $100 to $200 and charged it as a trade discount. Others declared that the captain might get his 5 per cent on as high a repair bill as $100,000.

Five per cent, however, is not the maximum. That is the usual amount but it runs higher. An examination of the books of 225 supply and repair and chandlery houses by investigators showed bribes in cases running as high as 25 per cent. Indeed such commissions were not uncommon, while some went to 30 per cent and 100 per cent bribes were not unknown. In a single year one concern paid out 8 per cent of its entire business volume in bribes to ships' officers.

When the United States Government, as a

result of the war, found itself in the shipping business, it found itself also up against this practice—a network of graft which must have made some of the old government veterans, not wholly unaccustomed to the practice, rub their eyes. The United States Emergency Fleet Corporation's vessels were run in some cases by private operators proceeding under contracts with the corporation. In 1919 a select committee of the House made an inquiry into the affairs of the Emergency Fleet Corporation and later reported "many instances of over-charges, defective work, and inferior materials in connection with repairs of ships, particularly in the New York district, had been brought to the attention of the committee, particularly with reference to the payment of gratuities and commissions to officers. This practice has been common in marine circles for many years and there is no question that it is a vicious practice."

One dealer admitted to the agent and traveling auditor of the Shipping Board that he overcharged the Board about 60 per cent on $400,000 by reason of the necessity, as he claimed, of giving gratuities in the shape of automobiles, whiskey, entertainment, etc., to the captains and stewards. This auditor testified that the New York office of the Shipping Board had on file the records of 2,000 cases where stewards had confessed to being paid 10 per cent on bills. He testified that Richardson Bros. carried on their books a total of $11,000 on account of gratuities given to ships' masters, stewards and engineers. John T. Meehan, Deputy Chief of the Board's Division of Investigation, said that he believed "cumshaw", the marine term for graft, had been common in marine circles for hundreds of years. Walden Fawcett, writing in *Marine Engineering*, May, 1921, spoke of the orgy of graft in connection with repairs and outfitting of ships which has been for these many years a reproach to all concerned. "Some 60 ships' chandler, repair and supply firms," he said, "have already received black marks from the business umpire and the end is not yet."

Of course, a practice which had endured so long and been followed so long by so many men, so that it permeated a whole business and was in practically universal use, was bound to have, if not

defenders, at least many apologists. Why all the pother? said many, when investigations started. The custom is as old as the life of the sea, it has always been so. What is the use of getting excited about it at this late day, particularly when there is nothing you can do about it? Others said the practice was in a way excusable because of the low wages and small salaries paid on ships. This might be some reason for the practice on foreign ships but was not considered a valid excuse on American ships. Owners felt themselves helpless. They realized that the practice was against their interests, inasmuch as the masters would seek the biggest bribes, would accept inferior supplies and would even let a ship run down in order to increase the amount of necessary repairs. The attempt to pass a federal act providing penalties for acts of bribery in the shipping business met with little support and the bill finally died in committee.

In the shipping business, as in all others, are men who find themselves compelled to conform to this vicious practice without giving it their approval, who, indeed, smart under the payment of these dishonest gratuities, who, in short, do not relish the roles of bribe givers. Accordingly, some 48 representatives of ship supply and service concerns located at points from Norfolk to Galveston organized themselves into the American Ship Service Corporation of Washington. Each member signed a pledge not to engage in the usual graft and this organization urged Congress to pass the anti-bribery law recommended by the Federal Trade Commission. But the law of graft was more deeply rooted in the sea and along its shores than these men supposed. It was a custom buttressed by age and moral weakness and far too powerful to fall before this first assault. In the end graft won. The members found they were not strong enough to crush the practice and that all they were achieving was martyrdom. They lost so much business that one by one they dropped out and the organization ceased to function.

In the face of this record will anyone assert that graft does not permeate at least this one branch of business and that at least as relates to the business of shipping I am not so far at sea in my statement that graft in business is more widespread than it is in politics?

CHAPTER THREE

ANCIENT CUSTOMS

A LOT of glue is used by the makers of Victor Talking Machines—some 350,000 pounds a year. The contract to supply that glue is a very desirable one. Some years ago this large company bought its glue from Milligan and Higgins. Another company—Baeder-Adamson—looked with hungry eyes upon this juicy contract. One day the general sales manager of the Baeder-Adamson Company communicated to his partners the interesting morsel of information that by the discreet expenditure of a commission of 5 per cent he could land that contract. The necessary authorization was forthcoming and the sales manager went to work.

The superintendent of the Victor factory was the man who specified what glue should be used.

And though at his suggestion Milligan and Higgins glue had been used for a number of years, he finally reported to the purchasing department that the glue of the Milligan and Higgins people was no longer good, that it had gone bad and failed to give proper results. He urged a change in glues. "What glue would you recommend?" asked the purchasing department. "Baeder-Adamson," was his reply. Apparently that sales manager had lost no time.

Of course, when the Milligan & Higgins Company heard that their glue was held to be no longer satisfactory they promptly sent one of their salesmen to the Victor plant. He took samples of the discarded glue and found them in every way equal to the glue previously supplied. Backed by his company and by the Victor purchasing department, which was impressed with the report, the Milligan and Higgins representative asked permission to make tests with his glue in the Victor factory. But the superintendent refused in language so discourteous that the Milligan and Higgins agent refused to have any further dealings with him. But the whole proceeding finally came to

the attention of the Federal Trade Commission, which found that the shift from one glue to another had been accomplished by the placing of that five per cent commission with the factory superintendent. He had been bribed. This story might be duplicated endlessly.

It is in these finishing industries that commercial bribery seems to flourish most. It is so simple a matter for a foreman or superintendent to mar the good results of any finishing process by deliberate sabotage and the bad finish thus resulting is so obvious that there is little room for argument. It is for this reason that the existence of graft has been found so largely in the paint and varnish and the chemical and dye industries.

I have already referred to the declaration of the counsel for the American Dyes Institute who asserted that in that industry was found "the most extraordinary system of commercial corruption that the world has ever seen." "There is not," he added, "a textile mill whose dye operations were not corrupted." Can it be that here is another industry where graft has flourished as it has in the shipping industry?

Mr. H. J. Kenner, the General Manager of the Better Business Bureau in New York, an institution supported by the Associated Advertising Clubs of the World, describes the little comedy thus:

"A chemical company wishing to sell dyes to a textile plant goes to the foreman of the dye department and promises him a commission on the total purchases of the factory if he will induce the firm to buy its products. The foreman goes to the purchasing agent and complains about the dyes in use and recommends the new brand. If the purchasing agent attempts a check up, the foreman may resort to sabotage to gain his end. He may, for instance, drop acid into the textile soap or in some other way spoil the articles treated with the old dyes."

The activities of at least one chemical and dye company in Massachusetts got well aired before the Federal Trade Commission. The sales manager had a neat little trick of depositing money in a savings bank in the names of superintendents of the textile mills he wished to reach and then sending them the deposit books—a rather delicate and

gracious way of passing the money without soiling the palm with the tainted cash. In Tennessee two woolen mill employees were found accepting bribes from a fulling soap company. The Federal government managed to reach the guilty parties through the postal laws and prosecuted the employees of the textile mill and the textile soap company. The soap company was fined $5,000 and the two textile mill employees $500 each. For good measure the textile mill men were sent to jail for three months each. One wonders why the guilty parties in the bribing concern were not also given a touch of prison.

Indeed one witness testified before the Federal Trade Commission that the commission or bribe paid for accepting inferior fulling soap in woolen mills was one cent a pound. It was customary to put one barrel of good soap in the lot, carefully identified so that the bribed employees could set it aside for inspection. Another witness said that dyers and finishers were paid $10 to $12 a barrel for accepting inferior soap. It was brought out in a legal proceeding in Tennessee that one employee collected $16,570 from various concerns from whom he had bought material and that the loss to his firm because of inferior materials accepted amounted to nearly $54,000.

Another company paid out from $30,000 to $40,000 in bribes to employees of their customers and these bribes amounted to between 8 and 10 per cent of the amount of all their sales.

Still another concern, according to one of its former officers who testified in a court proceeding, paid out enormous sums every year ranging from $110,000 in 1914 to $172,000 in 1916.

The Alien Property Custodian said that bribery of dyers in the United States had been carried on almost universally. "So extensive was the corruption," said this report, "that I came across only one American consumer who had escaped its ill effects."

The German trader is an especially unscrupulous briber and in the chemical industry he had been very active before the war. It might be claimed that he had introduced bribery into the industry. Whatever the origin, bribery had certainly settled itself in this branch of business.

In the paint and varnish industry bribe giving

was one of the major problems of the business. It became, indeed, so widespread that the decent men in this industry rose in revolt against it and organized a movement to crush it out. In a single year's report of the Federal Trade Commission can be found reports on a very large number of manufacturers of varnish—some 32 in number—charging them with various forms of commercial bribery, and in all the cases the Commission found the charges proved. Some of these reports included the charge that the varnish concerns paid employees of prospective customers to adulterate and spoil the product sold them by rivals. As one glances through the long roll call of companies thus haled before the Commission he is amazed to find there some of the best known business concerns in America.

H. W. Cole of New York, representing the Insecticide and Disinfectant Manufacturers' Association, said, "graft has been quite rampant throughout our industry for years." In this case it appears that among the largest customers of disinfectant makers are public institutions. Hence it is not surprising to find several companies brought before the Federal Trade Commission charged with giving goods as premiums to officials in charge of government departments, boards and administrative offices. It was shown that in a surprisingly large number of cases persons charged with the duty of making purchases of disinfectant ordered them in quantities so large as to be out of proportion to the needs of the institutions. The gratuities were cash as well as gifts. One concern was enabled to add $1,000 to its usual charge for the quantity of disinfectant ordered and sent to the proper officer as a prize a piano which cost only $130.

In the butter and egg business there was a practice of giving money to the employees of common carriers to divert shipments of goods. Indeed, the butter and egg business, as well as the creamery and poultry business, has been shot through with commercial bribery. As a matter of fact, in the large cities the poultry business has become infected with a kind of lawless graft which is nothing less than a criminal racket. In New York City the chronicles of the poultrymen read like a chapter out of the trading annals of some semi-barba-

rous oriental trade—bribery of every nature and description, violence, even murder.

As for the bribery of train crews to get preferences in the routing of cars this breaks out in various places. If half a dozen car lots arrive at the same time consigned to men in the same industry there are spots where bribes from $10 to $50 will get one's car unloaded ahead of the others.

I do not go into the garment and ready-to-wear industry here. The amazing system of bribery in vogue in this trade, under the dominion of a backward ignorance, is almost past belief. The trade is honeycombed with dishonesty and bribery of every kind on which it will take years, perhaps, to make any impression.

The *New York Times*, July, 1928, referred to the complaints of the Silk Travelers' Association and the Silk Club against commercial bribery and the fact that salesmen were compelled to pay to buyers or suffer discrimination. "Most of the buyers complained of are under thirty and of the sheik type. Their salaries are usually $40 or $50 a week. They get the rest of their large incomes by making salesmen pay tribute on every yard of goods the buyers accept, so that $10,000 a year on the side is said not to be exceptional and in one case the buyer's cut ran between $30,000 and $35,000 a year."

Chauffeurs do not pay for their own uniforms. This bit of display and haberdashery is paid for by the boss. However, the chauffeur buys the suit where he chooses and the bill goes to his master. Sometime ago the Better Business Bureau found the practice to be general of giving the chauffeur a cash premium as a bribe for bringing business. It is very simple. The chauffeur orders his suit. The dealer gives him 10 per cent in cash, based on the purchase price, then adds that to the price of the suit and collects if from the boss. At the request of the Better Business Bureau the dealers promised to discontinue the practice.

Mr. James J. Wilson, Assistant District-Attorney of New York, at a conference of three hundred business men, declared that in New York City alone chauffeurs collected not less than $2,500,000 a year in this graft from dealers. "In one field," said Mr. H. J. Kenner, of the Better Business Bureau, "that of garages where private cars

are stored and serviced, three kinds of bribery have been practiced: First, the so-called 'pull-in' payment, ranging from $10 to $100 and given to a private chauffeur for bestowing his custom on that particular garage; second, the percentage payment, a gift to the chauffeur of 5 to 10 per cent of the month's bill paid by his employer to the garage; third, the so-called 'put-over' payment, a lump sum in cash given to the chauffeur and later collected from the car's owner by padding one or more garage bills."

The records of the Federal Trade Commission reek with the accounts of bribery practiced on an extensive scale in innumerable lines of business. When this impressive and disturbing record of graft is supplemented by the accounts which have been given by business men themselves before various congressional committees there is left little ground for further questioning the assertion with which I began this discussion, namely that business is even more intensively affected by the vice of graft than public life. Indeed it is upon this substructure of business graft that the much more advertised edifice of political dishonesty is reared.

It is not to be expected that a society thus infected by the practice of bribery will exhibit many symptoms of horror at a similar condition in its public affairs.

Nowhere is the complacence of the public toward this vice more perfectly exemplified than in the matter of published testimonials for tobacco, beauty preparations and other products given by well-known persons. The indecency which distinguishes this futile and tawdry exhibition of dishonesty lies in the fact that it seems to be taken for granted that nobody believes the bulk of these statements; many of those highly publicized, transient celebrities who give the endorsements have a feeling that the statements are not taken seriously, yet they have no objection to occupying a rather public position, if not among the masses, at least among their friends and the more knowing members of the community of having been bought. This form of bribery lacks the element of secrecy. The bribee does not shrink from a public exhibition of dishonesty.

That distinguished knight of the gridiron, the heroic ice-man, Red Grange, when he reached the

zenith of his fame and signed up as a professional, surveying with satisfaction the rosy prospect which stretched ahead, announced that he expected to make several hundred thousand dollars endorsing a host of products.

On the other hand, another amateur who entered the professional ranks, Miss Gertrude Ederle, said:

"I was an honest amateur and I intend to remain an honest professional at any cost. I'm not going to endorse things that I don't know anything about. I'm not going to say for a few thousand dollars that I trained on some malted product when I didn't or that I like Punko cigarettes when I never smoke."

When this practice was at its height, Famous Names, Inc., a Chicago concern, was reported by Hygeia, the journal of the American Medical Association, as having sent out to advertisers a letter offering to supply "names, pictures and endorsements of celebrities for advertising". The letter named thirteen movie actresses and actors and quoted the fee each required. "If desired," the letter added, "the endorsement signed by the star may be of your own dictation." A New York company announced that it was ready to supply endorsements signed by Queen Marie of Rumania, who was just then visiting us.

The subject was considered in another connection in 1924 by the Federal Trade Commission: It had been the custom among manufacturers of band instruments to promote the sale of their goods by giving instruments free to professional musicians. We are all familiar with the picture of Professor Whoosis gracefully posed with the silver cornet of the manufacturer or a glittering saxophone, indicating that the Professor uses no other weapon. Testimonials from professional musicians about the instruments they prefer were common. In return, of course, they got their instruments free, the lesser lights merely getting discounts on the instruments they bought. In the case, however, of the greater luminaries, the star performers, not only were very fine instruments given them free but some of them were kept on salary.

This, of course, was commercial bribery. The Federal Trade Commission apparently has no jurisdiction over commercial bribery as such, but

under the statute can deal with it in certain cases as a violation of the law against unfair competition. This was manifestly unfair competition. The leaders in the industry were therefore brought together and finally made an agreement to discontinue the use of salaries, fees or gratuities.

This illustrates a form of commercial bribery somewhat different from that offered to purchasing agents—bribery in which the bribe is given not to a buyer, but to some person whose recommendation is considered valuable in order to induce him to recommend the briber's product.

Strangely enough, in the field of sport, where common honesty is supposed to be an indispensable requisite, these secret payments are widely practiced. Professional golf players have been known to receive large salaries for using or recommending certain golf balls. Baseball and football players in colleges and elsewhere are also paid by manufacturers of athletic and sports goods. Domestic science teachers and authorities receive payment from manufacturers to use special equipment and food products.

Judge Jean Norris received $1,000 for recommending a brand of yeast. Some years ago I was the director of a newspaper syndicate and among the features syndicated was a daily diet article. At that time there was a craze for reducing and many thousands of letters flowed in to the writer of the feature asking for advice about reducing. Not one, but a number of manufacturers of nostrums for reducing wrote to the syndicate asking me to name a price either to give the names of persons writing in or to recommend their preparations to such persons. These letters were always just simple, formal business propositions made as openly and directly as if they were asking for a price on any legitimate article. It is the simple truth to say that the writer of this feature, had she not been honest and conscientious, could have made a fortune endorsing various kinds of reducing and food and beauty nostrums in her articles, recommending them in personal letters and supplying the names of thousands of trusting readers to these business men.

In 1924, when the band instrument manufacturers' agreement was signed by twenty-three of the best-known manufacturers it was believed

that a great blow had been delivered to the practice of secret subsidies. Immediately thereafter, the golf ball industry in 1927 attempted to do something of the same kind at a trade practice conference in Cleveland. Rules were adopted by the delegates under the auspices of the Federal Trade Commission against the following:

1. The paying secretly of yearly salaries to professional golf players in order to have them use the golf ball of a particular manufacturer or marketing company.

2. The paying secretly of special prize money to professional golfers who win matches or tournaments by a company whose ball has been used by the winning player.

But the endorsement racket is still a long way from extinction.

The whole subject of commercial bribery includes the giving of gifts, particularly at Christmas and the subject of entertainment. Here the question gets away at points from the purely ethical considerations involved and becomes largely a matter of wise trade practice and fair competition, though, of course, when the gifts and entertainment go to unreasonable lengths they amount to a form of bribery. The golf course and the luncheon table have become a more or less standardized arena for the discussion of trades. Business generally seems to feel there is nothing wrong in lubricating a business conference with a little pleasant social intercourse. This, however, is different from the elaborate use of entertainment, particularly in certain questionable forms which is in vogue in some lines of business.

Some years ago (1913) three piano manufacturers were arrested for violating a state law against bribing. They were accused of "making it worth while" for the manager of the piano department of a local department store to buy the manufacturers' products. When the matter was investigated it was surprising how little interest was shown by wholesalers and salesmen. The opinion held generally was that the practice was more general among the buyers of stores in small towns, who were usually satisfied with entertainment and petty presents, while in the large towns, though the grafting was less common, the preference was for cash. Presents given, however, were not always

petty. Thus, for instance, the *New York Times* reported the case of a diamond ring belonging to a prominent importer of lace—a three-stone diamond ring. A buyer admired the ring, asked to be permitted to try it on and then appeared offended when requested to return the ring after he had given an order. He did return the ring, but suggested that he would like to have one like it. The importer ignored his hint. Later all the goods ordered were returned. A Pacific Coast buyer wrote his New York connections that he was soon to be married. Then he came East and was showered with many costly presents. He was now confronted with the problem of freight and complained to several salesmen that the freight on some presents would be very large, whereupon the salesmen had his presents shipped freight-free to his home.

Who is to blame for this? It is difficult to say. Does it originate with the buyer or with the seller? It is probable that entertainment originates with the seller. It is common for some houses to maintain what might be considered a substitute for the old-time puller-in—a sparkling, personable gentleman who drives a handsome car and has a large expense account and whose business it is to corral buyers, wine them and dine them and turn them over to the actual salesmen later for the shearing. There are buyers as well as employers who object to this kind of entertainment. On the other hand, there are buyers who are out for cash and will not do business with the concern which does not give them cash.

Entertaining visiting buyers began many years ago when their visits were infrequent, perhaps annual. Of course, firms began to vie with each other in the elaborateness of their entertainments and finally, when the visits of the buyers became semi-annual and even monthly, the expense of this entertainment expanded out of all bounds. In Chicago the president of one concern kept an account for "perfumery". He told the Federal Trade Commission it was for Christmas presents. But he couldn't explain how so much of it was spent in February. The Commission found that one concern had spent $1,400,000 in secret commissions in two years, all paid to their own customers and to the customers of competing concerns. Another

method of bribing a buyer is to lose to him in a poker game. Eleven salesmen are employed by one novelty jewelry concern in New England. The eleven spent $6,000 at Christmas for gifts to buyers. On the other side the buyer for a syndicate of department stores received last year $500 in cigars alone and other gifts valued at $1,700. Gifts are frequently sent to the wives and children of buyers. Somehow many men will receive gifts and entertainment who will not accept cash bribes.

A salesman of the New Jersey Asbestos Company testified before the Federal Trade Commission that his company's item for entertainment amounted to 5 per cent of gross sales and made one of the largest items of annual expense. The complacent attitude of honest men towards this thing is well illustrated in the case of the Appellate Court of the Second District. The Federal Trade Commission ordered the New Jersey Asbestos Company to cease and desist from its lavish entertainment policy and the Appeals Court set this aside saying "it had been an incident of business from time immemorial."

CHAPTER FOUR

CAUSES AND REMEDIES

THE roots of this practice of commercial bribery go rather deep into the character of the human beings who make up our society. Of course, various causes are assigned for the practice. A favorite one with social reformers is that the practice is forced upon many men by reason of the inadequacy of their wages. Of course, there are cases, perhaps a good many, where poor pay is at the bottom of the trouble. Commercial bribery is found very largely among that class of employees who are known as white collar workers. This is explained by the fact that they constitute the most poorly paid class of workers in proportion to the type of work they do and the responsibility with which they are entrusted. On the other hand, by reason of their condition in life they are called

upon to live on a somewhat more expensive scale than laborers. They associate with men who receive much larger salaries and are therefore keenly aware of the eternal deficit in their incomes. This straining after better living conditions, therefore, renders them peculiarly susceptible to the opportunity for making a little extra money via the commercial bribery route. It is probably true that a correction of the pay given to such employees would stiffen the resistance of these men, a little at least, to the temptations which fall in their way.

It would not be true to say, however, that this is the only cause or the chief cause or even an important cause, because a great deal of commercial bribery is found amongst men whose salaries are far from inadequate. This leads us to seek for the major causes in other quarters. I suggest two: One of them is the extent to which one small focus of infection of this sort will spread to a whole industry. Of course it goes without saying that in any industry or business there will be some dishonest men. The moment these dishonest ones begin to practice commercial bribery the way of all the others who compete with them is made difficult. Where a few men who can influence purchases demand bribes from a seller who is willing to pay them every other seller is compelled to pay the bribe or abandon the business. Some are willing to forego much business where the practice is localized to a few buyers, but when those sellers who readily accept the practice find it successful with a few buyers they do not lose very much time in trying the same methods on others. Of course they will not fail to find other buyers willing to do business with them. The road of those sellers who have refrained from the practice becomes increasingly difficult and hence before long almost all sellers in that industry find they must either pay the bribes or go out of business. In the end the whole industry becomes thoroughly infected with the practice. Describing something like this, the *Harvard Business Review* said: "The almost invariable results of such situations is that bribery rapidly becomes the practice of an entire industry. Whatever the quality of his goods, whatever his price, a producer will find it very difficult, if not impossible, to compete with rivals who bribe. 'From an experience of thirty years,' writes one

manufacturer, 'I believe that *there's not a house in the industry which has not had to pay bribes* to hold old business or to get new business.'

"Another manufacturer writes, 'Very few companies will refuse to resort to bribery, for the alternative is loss of the business, and no considerable part of the industry can resist such pressure, except with outside aid.

" 'We ourselves, like the others, have the choice of doing as others do—in which case one feels like a crook; or of losing the business—when one feels like a sucker. I've tried both plans.' "

Underlying all this is the prevailing level of honesty in business, or rather in our society itself. That level is not as high as we suppose. I do not say this in criticism but rather in an effort to diagnose the true causes which produce the situation we have been discussing. I speak of the level of honesty, not the ideal of honesty; the gauge of honesty by which men are judged in the ordinary course of affairs. The standard which the more meticulously honest among us hold out for ourselves is not the standard of the general run of people. Still less is it characteristic of the level along which they travel.

We are a commercial people whose business civilization is founded upon credit and property. The virtues which may be called the commercial virtues derive their vigor and sanction from the needs of such a society. The respect for property and the sanctity of contracts are, in a measure, quite indispensable in our orderly life. Respect for contracts is rooted in a far more natural spiritual operation than respect for property. Property, after all, is a wholly artificial invention. The most natural relation of man to things is one nearer to a state in which free appropriation would be recognized. He is sufficiently removed from that natural state to feel the existence of property rights when his neighbor's possession is visible, obvious, present. When it is not he is more apt to be influenced by a natural desire to lay hold of those things he desires. Here again he is sufficiently advanced along the trail of commercial civilization to be restrained from doing this if the operation involves violence or even an implied force. And many are still further held back when satisfaction

of the urge involves an obvious violation of the law, which, in itself, implies a kind of violence. But if the operation of taking what he wants can be concealed under the forms of law, if it can be covered over with certain fictions, if indeed it can be sufficiently complicated so that it is no longer just simple taking but rather a kind of tolerated acquisition, if the whole operation can be so dramatized that instead of just grabbing what he wants, he can have it delivered over peaceably and even willingly by another, it will not be difficult for most men to quiet the low mutterings of their partially civilized consciences. This, perhaps, is why the average man recoils from violent infractions of property rights, such as burglary, theft, highway robbery, yet slides more or less easily into acquiring the goods of others by the less offensive and more intricate ways of graft.

Our quarrel in this case must be with the present spiritual constitution of man, not with particular offenders. The old muck-rakers made the mistake of dramatizing public grafters as scoundrels. Perhaps this was the best way to inflame public indignation. But the old grafters were not scoundrels. Neither are our present day business grafters scoundrels. Most of them are pretty much like other men, differing only in the conditions in which they have been placed. Many of them are charming gentlemen, excellent fathers, neighbors and friends. A great many of them are good citizens, after a fashion, and in not a few cases are animated in their business relations by good social principles. Some of my very good friends are grafters. They would hesitate to label themselves as such and would doubtless resent the intimation. Yet it is quite true. I do not love them less. Certainly I do not despise them. I think it would be better for society if they were not grafters. But I do not make the mistake of calling them scoundrels or looking upon their occasional forays into the fields of graft as exhibitions of villainy. It is for this reason that we get nowhere with laws to suppress commercial bribery which denounce severe jail penalties against offenders. It would be difficult to get a jury of twelve men together which did not include at least one gentle, lovable, perhaps more or less honest grafter. Such jurors will of course refuse to

consign to jail a fellow worker who, they will think, has done nothing more than manage for himself a little rake-off of some sort.

If this is all true one can understand the complacence of many business houses toward the practice and see, perhaps, a little logic at least in the objection of the financial journal to further laws on the subject because "the practice was so universal" that they could not be enforced.

It is probable that human pity rather than respect for property rights exercises a far more powerful influence upon men for honesty. Most men will be honest, that is, will refuse to perpetrate a wrong against a person if the injury inflicted is obvious and the suffering visible. Many a man who would shrink from that classic example of mean-spirited dishonesty, the taking of candy from a baby, that is, snatching the candy directly from the baby's hand to the accompaniment of its sobs and tears, would feel no such compunction in taking some of the baby's money from the child's guardian in exchange for worthless bonds. It is easy to get aid from men if you can stimulate their pity. You can impress them and stir their pity with a present spectacle of suffering in the case of a small infirmity when you could not get a penny out of them with a mere account of a vast disaster occurring at a remote distance. A man might hesitate to swindle his neighbor whom he knows, whose family he knows, whose sufferings he can visualize and whose injuries will be always present to him, though he might not hesitate to take part in an operation in which the dishonest elements were kept carefully out of sight under an intricate stage management and in which the victims are unknown and far removed so that their cries would never reach his ears.

I say all this so that, in concerting remedies, we will not make the mistake of treating the evil we are aiming at as a heinous crime of the most atrocious dye.

One observation must be made here and that is that all movements against commercial bribery will be seriously impaired until we make a drive at that kind of graft which flourishes at the top of business as commercial bribery flourishes below. It is no use preaching to the subordinates about

shying away from graft when they know that their betters, as Mr. Mencken would call them, enjoy a form of graft of their own. I should think that the movement against commercial bribery has begun with the second step instead of the first. The first should be a movement against management graft—particularly graft which is found at the very top in corporation management. This is something we will consider in its place.

With this said, however, we must in all fairness point to another side of this picture, and that is the vigorous movement which some business men and groups have made to rid their own particular areas of business of the vice.

It cannot be said that business as a whole has risen up against the use of graft. But it can be said that in a very large number of industries groups of men have appeared who have set in motion more or less lively movements to mitigate the evil. Certainly it is bad ethics. But more and more business men are learning that it is also bad business. Some twenty-nine different industries, through their trade associations, have condemned the practice of commercial bribery.

Others have taken more or less vigorous measures to end it. The paint, varnish and lacquer industry has brought into existence the Unfair Competition Bureau to fight commercial bribery in that business actively, to receive and investigate specific complaints and carry on an incessant agitation against it. In the shipping business, as already pointed out, some forty-eight supply and service houses in the South formed the American Ship Service Corporation to carry on a battle against bribery in the shipping business and while the association did not last long its very formation represented a positive assertion of protest, which is the beginning of reform.

The Better Business Bureau in various cities organized under the auspices of the Advertising Clubs of the World, has kept up a ceaseless warfare on this form of commercial graft and more recently the Commercial Standards Council, representing a large group of organized industries, has been created for the special purpose of stamping out bribery. These are only some of the activities through which business leaders have expressed their opposition to this vice.

Of course, this is only a beginning. In the meantime the rank and file of business men in numerous industries go right along in the old ways, bribing buyers, plant foremen, purchasing agents and petty officials of all grades. It is not a simple matter to bring an abuse of such antiquity to an end. As already shown it is almost impossible even for an honest manufacturer or merchant to give up the practice as long as his competitor insists on employing it. Moreover the moral perceptions of a whole industry are more or less blunted and the unethical elements in the practice are hardly perceived because of long usage.

Because of the difficulties in the way of the honest business man who earnestly wishes to quit the use of secret bribery a movement has grown up for laws which will compel the dishonest one to stop it. For this reason laws have been passed in sixteen states aimed at commercial bribery, either in general or in some particular business. Most of these laws, however, are dead letters. The reasons for this are twofold. First of all until recently all the state laws pronounced both parties to the bribing process, the giver and the receiver, equally guilty and afforded no immunity to either party who was disposed to reveal the facts either through repentance or a desire to escape punishment. At least this has been almost universally held to be an obstacle to successful prosecution. Secondly, state laws reach only offenses committed wholly in the state. Prosecutors, as well as trade associations have felt a reluctance to bring the heavy hand of the law down on concerns inside the state when their competitors outside the state could use bribery against them with impunity. Business flows over state lines now; in some industries almost all such business is carried on across state lines. It would be manifestly unfair to press an anti-bribe law against only one part of an industry, the domestic group, while the outside group was left unmolested.

To meet this situation various business groups, among them the Better Business Bureau, the Commercial Standards Council, the Paint and Varnish National Association and several others have been working for the passage of more effective state laws to provide immunity for the party to the bribing operation who first divulges the secret

and for a federal law which will apply to cases in interstate commerce.

As to the improvement of state laws some success has been gained. New York State last year (1930) passed a new anti-bribery law which grants immunity to the giver or receiver of the bribe who reports the fact to a prosecutor within one year from the commission of the offense. Michigan, New Jersey and Louisiana have also adopted similar laws.

Not much success has been met so far in the field of federal legislation. A bill to punish masters and other officers of vessels who receive bribes died in committee, though it was urged by a large section of shipping men. In 1919 a measure called the Sims bill was introduced by Representative T. W. Sims of Tennessee and another by Senator Cummins of Iowa was pressed in the Senate. Both got no further than committee hearings.

In the 67th Congress another bill was offered by Representative Volstead which was passed by the House after an extensive committee hearing which at least had the effect of airing the practice and shocking a little the public conscience. But it was suffered to die in the Senate committee.

Later another bill was introduced by Representative George S. Graham of Pennsylvania which was practically the same as the Volstead bill. This bill too slumbered undisturbed in the Judiciary Committee. In 1930 another Graham bill was introduced which was still pending in committee when the last Congress came to an end, March, 1931. Thus the matter stands. These various bills were urged by many organizations of business men; but something, apparently a lethargy in Congress about matters which have no special political appeal and due, in some sense, to that fatal complacence about graft in business to which I have already alluded, has kept from them sufficient support to ensure passage.

The Graham bill as it now stands is looked upon as a model measure. The definition of commercial bribery is quite comprehensive. It applies to gifts of money or things of value or loans. It reaches the principal or his agent or attorney. It applies to the corrupt solicitation of a bribe as well as the receipt of one. It includes in the offense the

giving of false receipts or invoices to cover or facilitate hidden bribes. And it further provides that any person guilty of the offense who shall report the facts under oath within six months to any United States District Attorney may be granted immunity.

Violation of the act subjects the guilty person to a fine of not more than $2,000 or imprisonment for not more than two years or both.

The act, perhaps, could be improved by making the penalty less and by including the provision which has been used in the Louisiana law which sets out that it will be no defense to the charge of bribery that the gift or commission is customary in the business or trade.

PART TWO

CORPORATION GRAFT

CHAPTER FIVE

A RAILROAD STEWARDSHIP

I

WE NOW come to a form of profit which men charged with the rule of large corporations find it possible to make without actually drawing their rewards directly from the corporations they serve. These profits are almost always secret and often devious. For the most part they are quite in accordance with the prevailing ethical standard governing corporation management.

I have been very particular to point out that the word "graft" is drawn out a little from its true meaning when the element of swindling is imported into it as an essential. Graft may indeed involve a swindle, if I may be permitted to repeat my definition of the word, but it is not necessarily so. The most essential element of it is that it is a profit or reward or collection or levy which someone, frequently a trusted agent, but not necessarily so, is able to draw out of his connection with some person or interest. This collection may not be enforced directly from the person served, but it is made possible by that relation. Specifically the graft is precisely that, a stem inserted into some other living shoot with the design of drawing its sustaining nourishment from that shoot.

In this way we find directors or those connected with them drawing certain vague nourishment from the corporations which they serve, not always money, perhaps only opportunity. We see directors who hold little or no stock in the corporations of which they are directors and who receive no salaries for their services. Ostensibly there is no practical reason why they should serve as directors. Yet they are almost always practical men. One is entitled to ask why they sit as directors when they are not paid and when they have no investment interest, either direct or indirect, in the companies they control.

The answer must be found in those secret, undisclosed rewards which they seek or at least hope

to derive from their directorship. It is a common thing to hear directors referred to as representing certain interests on their boards. In business you will hear the director of some railroad or some bank or some utility company classified and characterized in this way. He represents the steel crowd; he represents the bank crowd; he represents the oil crowd, men will say. And the steel crowd, the bank crowd, the oil crowd may very well all be groups which have no interest in the road save the business which they do with it. "He represents the short interest," said one railroad director to me describing a certain director on another road. These things are taken for granted in business. A classic instance of what results from this sort of thing is the failure of the St. Paul Railroad—actually the Chicago, Milwaukee and St. Paul Railway Company.

2

The business world was startled in March, 1925, by the application for a receiver for the St. Paul Railroad. Two and one half months before, December 31, 1924, its financial statement revealed a company operating approximately 11,000 miles of road, with a total capitalization of more than $700,000,000 and with operating revenues in 1924 of $160,000,000. Twenty years before the common stock of the St. Paul sold at a high of 199, the preferred stock at 218. Now on May 19, the day after the receivership was applied for, the common stockholders saw their shares go down to 5, the preferred to 8½. This was the greatest failure in the history of American railroads.

What caused this failure? The public and even shareholders know very little, as a rule, of what goes on behind the scenes in the management of their corporate properties. Had the St. Paul not figured in this sensational failure it would not be possible to say what took place in its affairs. Indeed had the receivership been a mere device, as so many are, for re-establishing the credit and reorganizing the financial structure of the road, we perhaps would never have known. It fell out, however, that the bondholders, or at least a large interest among them, felt themselves aggrieved by the form of reorganization proposed and in

the litigation which ensued and in the investigations of the Interstate Commerce Commission which followed, many of the details of the company's management came to the surface and we were given an opportunity to see the board of directors of a great railroad at work.

3

First, who were the directors? What did they do? How did they direct? And why were they directors?

The directors of the road were formed, more or less, into four main groups, representing four chief interests. The first of these groups might be called the Rockefeller group. For many years the late William Rockefeller, brother of John D., had large interests in the road and exercised a dominating influence over its affairs. Indeed one might say, since we have pointed to the resemblance between business and political corporations, that William Rockefeller was the Boss of the St. Paul. At one time he had 150,000 shares. Later his son, Percy Rockefeller, was a director.

However, in 1921 Percy Rockefeller resigned from the board and immediately thereafter the Rockefellers began to unload their holdings. By 1924 all of these holdings were disposed of. Percy Rockefeller himself never had very large stock interests in the corporation. As a matter of fact, after January, 1921, the Rockefellers ceased to be members of the board and a little later they began the liquidation of their investment interests. But in spite of this Percy Rockefeller continued to attend meetings of the board; he continued to receive all the statements and reports sent to directors and he continued to be consulted by the officials of the road about important matters. In truth he merely resigned in order to comply with Section 10 of the Clayton Act, after it was passed. This section prohibits a common carrier corporation from having any large dealings with other corporations if any of the first company's directors or purchasing officials is also a director or manager or substantial investor in such other corporation.

A second group was known as the Armour group. Philip D. Armour had been a director at

one time. Later his son, J. Ogden Armour, succeeded him. The Armours held 125,000 shares for a while, but they also began liquidating in 1921 and after that they held only sufficient shares to qualify as directors.

Then there were the George Smith interests. These at one time amounted to $20,000,000. The Smith interests were English and they were represented on the board first by Peter Geddes and then by his son, Donald G. Geddes. But the Smith interests were sold out during the war and after 1917 they disappeared. Nevertheless Geddes, with only the necessary qualifying shares, continued to function as a director. One of the Smith heirs, George G. Mason, with merely the qualifying shares, was made a director in 1920.

The fourth holding was that of the Harkness family. This amounted to 100,000 shares at the time of the receivership. E. S. Harkness was one of the several Harkness directors. Besides its shares his family had substantial holdings of bonds. It will be readily seen, therefore, that this was the only group on the board which had precisely the same interest as the corporation and its stockholders.

The various members of the board were grouped around these several interests. With the exception of the Harkness members, none of the other directors represented any substantial ownership in the stock or bonds of the road, nor had they any other interest that was apparent to explain why they should be sitting as directors of the company. "It is significant," says the Interstate Commerce Commission, "that during the months immediately prior to the receivership, directors like Buckner and Fisher, who represented a real interest in the property (the Harkness interest) were the most active in trying to find some way out of the trouble. And it is apparent from the record that Harkness was the only one really pressing for a plan which would avert receivership, and had indicated his willingness, if such a plan could be evolved, to stand back of it in a large way by putting up cash to pay dissenting stockholders."

The record of most of the other directors was severely criticised by the Commission as a record

of inattention, incompetency, inertia and even worse. Again one asks what are these directors doing on these boards? The answer is that frequently these great railroad and industrial properties cut across the field of such directors' personal interests, traverse areas of business in which they are profoundly concerned. One finds them, therefore, on these boards to guard their other interests. The management of the railroad itself is a secondary consideration. What these St. Paul directors did and permitted to be done is ample evidence that this is so.

4

The first great electrification of a steam railroad was undertaken by the St. Paul. Three divisions of the Puget Sound extension of the road were electrified—the Rocky Mountain, the Missoula and the Coast divisions—with a total mileage of 648 miles. In 1909 William Rockefeller, then a director of the road, also had a large interest in the Anaconda Mining Company and was a director of that company. Rockefeller had Ryan, the President of the Anaconda Mining Company made a director of the St. Paul. Ryan had large interests in Montana besides his copper holdings and was also interested in water power. He and his associates had acquired control of the Great Falls Water Power and Town Site Company from the Hill interests and he was developing the water power in Montana when he became a director of the St. Paul.

At this time Ryan was deeply interested in the general subject of railway electrification. He admitted as much. Railway electrification would result in extensive new uses for copper. Moreover, if the St. Paul were electrified it would become a large potential user of water power controlled by him and his associates. As President of the Anaconda Mining Company with large investments therein he was deeply, profoundly interested in copper and in power. As a director of the St. Paul Railway with only sufficient shares to qualify, his interest was slight.

After much discussion the St. Paul proceeded to electrify certain sections of its Puget Sound branch. All the copper was bought from the

United Metals Selling Company, the selling agency of the Anaconda, both headed by Ryan, and the copper bill was $4,000,000. Then the railroad proceeded to make contracts for obtaining power from the Great Falls Power Company and the Thompson Falls Power Company. These two companies were subsidiaries of the Montana Power Company. What they were and who controlled them is brought out fully in the report of the Interstate Commerce Commission already referred to. All these companies were controlled by Ryan.

The Great Falls Power Company, through which Ryan had developed his Great Falls water power holdings, sold about 10 per cent of its power to the St. Paul, the greater part of the balance going to the Anaconda. The Thompson Falls Company built a plant at Thompson Falls, Montana, primarily for the purpose of furnishing power to operate the Missoula division of the St. Paul, and the St. Paul took somewhere around 50 per cent of the power generated.

Here is a bit of history about the Thompson Falls site. Ryan and an associate owned a half interest in the site which they sold to the St. Paul. Later, Earling, president of the St. Paul, asked Ryan to get the other half interest for the railroad, which Ryan did and sold it to the St. Paul, the total cost to the railroad being about $300,000. Sometime later Ryan bought the whole site back from the St. Paul. Ryan testified that Earling requested him to do this and also requested that he make a contract for furnishing power to operate the Missoula division. Ryan believed that the railroad could not develop its own power economically and Earling said he had become convinced of the same thing. So Ryan took the Thompson Falls power site from the St. Paul at a price equal to double the amount which the rights had cost the St. Paul with interest at 5 per cent per annum since the railroad had acquired the title. Here then is the sequence of incidents in this transaction:

Ryan, a director of the St. Paul railroad, buys the Thompson Falls site from the St. Paul February 11, 1913, the total cost being about $600,000 plus accumulated interest.

The same day the Thompson Falls Power Com-

pany, organized only a little while before, makes a contract with the St. Paul to furnish it with power.

The next day Ryan transfers the site to the Thompson Falls Power Company for $5,000,000 par value of the stock of the power company.

He immediately exchanged the $5,000,000 of Thompson Falls stock for an equal amount of stock of the Montana Power Company, which he controlled.

"The record indicates," says the Interstate Commerce Commission, "that Ryan and his associates did not expend over $925,000 for the property for which they received $5,000,000 nominal par value in stock of the Montana Power Company. The principal thing that gave value to the stock of the Thompson Falls Company was its contract with the St. Paul. The stock of the Montana Power Company given to Ryan did not become entitled to dividends, according to the agreement, until 1917, when one-half became entitled to dividends after power had been furnished to the St. Paul for six months, and the other half became entitled to dividends one year later. In the meantime the stock had been held by voting trustees. Ryan stated that the stock paid to him for the Thompson Falls stock was worth when received about $19 per share, as at that time the market price of the Montana Power stock was about $37. Inasmuch as the stock issued to Ryan and his associates was not to receive dividends except under the provisions outlined above, it was of course not worth the market price of the stock receiving dividends. The Montana Power stock has since sold on the New York Stock Exchange as high as $114 a share. It is obvious that this transaction has been of great profit to Ryan and his associates. In return for an investment of less than $1,000,000 they received $5,000,000 par value in stock of what has since become one of the strongest power companies in the country. Ryan and his family have held large blocks of stock in the company and have received dividends of over $1,600,000 since 1913, the great bulk of which was received after 1917, when the stock he received in the Thompson Falls deal started to receive dividends. With the exception of Ryan, the stock records of the Montana Power Company

indicate that no director, trustee, or officer of the St. Paul, the Chicago, Milwaukee and Puget Sound, or the Milwaukee Land Company has ever received, directly or indirectly, any portion of the $5,000,000 block of Montana Power stock referred to. As stated before, the principal element of value in the Thompson Falls project which Ryan turned over to the Montana Power Company was the 99-year contract of the St. Paul with the Thompson Falls Power Company which was executed at the same time that the railway turned its rights over to Ryan, because as Ryan says the railway was obligated to pay for enough power to warrant development of the site. The St. Paul continues to be the principal customer of the Thompson Falls Company, the road's payments under the contract being about 40 per cent of the total revenue of the power company."

The other contract for power was with the Great Falls Power Company. Ryan and his associates controlled a half interest in the Great Falls Power Company. When the contract with the St. Paul was made they promptly turned over this interest to the Montana Power Company in return for $5,000,000 of preferred and $17,500,000 of common stock of the Montana Power Company with the understanding that dividends were not payable until the St. Paul started to pay for power under the contract.

"Here again," says the Commission, "a large element of value to the interest of Ryan and his associates was the contract negotiated by Ryan with the St. Paul."

All this time Ryan was a director of the railroad. Obviously as a director he could not represent the road or honestly advise the road and he admitted that his interests in power and copper were such that he ought not to be an active party representing the railroad in the negotiations. Although he was a director of the road, he said there was never any doubt as to the capacity in which he was acting. Everyone knew he was acting for the power companies and he was very careful not to take part in the discussions of the board as to the electrification and in fact he avoided meetings with the board when the question was to come up. In framing the contracts he was the active negotiator for the power companies and

Earling, then President and Goodnow, his assistant, represented the railroad. Ryan depended principally on the railroad officials to protect the carrier's interests.

An example of how this railroad failed to receive at the hands of its directors the protection it required because of their adverse interests, is to be seen in the following additional power incident:

Power for the Coast division was furnished under a contract with the Intermountain Power Company made March 13, 1917. It is for a term of 98 years. In 1915 the Washington Water Power Company had a plant at Long Lake near Spokane, Washington at which it was developing more power than it could use. Ryan knew about this. Moreover, the St. Paul then needed just such power and Earling, the President and Goodnow, the Vice-President, were anxious to buy power. The St. Paul could have bought it directly from the Washington Power Company. Ryan, a director of the St. Paul, had he been thinking about the interests of the St. Paul Railroad, could have put it in touch with that source of power. What did he do? He started negotiations with the St.

Paul officials to furnish the railroad with the power it needed at that point and the railway entered into a contract with Ryan and his associates directly to obtain the power from them. Thereupon Ryan organized the Intermountain Power Company, incorporated October 30, 1916. Meantime the Intermountain Power Company bought this excess power from the Washington Power Company under an agreement for $10 per horse power per year, a very low price and resold it to the St. Paul at the same price as in the other two contracts. The St. Paul was the only customer of the Intermountain Power Company. Various contracts were made with the Intermountain. Summing up this whole transaction the Commission said:

"On June 20, 1922, all of the stock of the Intermountain was sold to the Washington Company under an agreement dated April 18, 1922. Up to that time the former had paid no dividends. In fact, as the St. Paul did not take any power under its contract until late in 1919 the Intermountain showed deficits in 1919 and 1920 on account of the payments it was making. It had

$745,000 capital stock outstanding and had something over $700,000 invested in transmission lines. Yet the consideration agreed upon was $1,900,000, $501,000 in cash and $798,400 in stock of the Washington Company. If the gross receipts of the Intermountain for any 12-month period up to and including December 31, 1939, exceeded a certain amount, $600,000 in stock or cash additional was to be paid. Up to December 31, 1925, no part of this amount had been paid. During the years 1922 to 1925, inclusive, dividends of 8 per cent per annum were paid on the stock so exchanged. Of the cash received, $50 a share was paid to the stockholders and $127,300 was reserved to pay indebtedness of the company. Of the 7,454 shares of Intermountain, Ryan held 1,500 shares and he received 1,608 shares of the Washington Company.

"In the Washington Company's annual report to its stockholders for 1922, the following comment was made on the purchase of the Intermountain:

> The purchase of the company brought to the Washington Water Power Company useful physical assets, and con-

tracts of considerable importance in connection with the Chicago, Milwaukee and St. Paul Railway Company's present and future electrification.

"It is obvious that those contracts were the elements which gave such a high value to the stock of the Intermountain.

"There does not appear to have been any good reason for interjecting the Intermountain into this situation. The only purpose it has served has been as a vehicle for profits to Ryan and his associates. The railway was prospectively a heavy user of power; the surplus power of the Washington Company was or should have been known to St. Paul officials. It was known to Ryan, who was a member of the board of directors and of the executive committee, and as a result the railway should have been in a position to secure power just as reasonably as did Ryan. Likewise the railroad could have contracted for power on the west end on the same basis as did the Intermountain.

"As stated before, William Rockefeller, long one of the dominant men in St. Paul affairs, was interested in the power companies and the Anaconda Copper Company. His son, Percy, testified

that in 1915 his father bought about 20,000 shares of Montana Power stock and later bought several thousand shares of Intermountain stock. William Rockefeller was also heavily interested in the Anaconda Mining Company and was a director of that company when the St. Paul's electrification was undertaken."

The price which the St. Paul was charged for electric power under the contract made with the corporation by one of its own directors was severely criticised by the Interstate Commerce Commission as unfair. Under the contract the railway got its power for .00536 per kilowatt hour but there was a limitation that "the minimum payment shall be for 60 per cent of the number of kilowatt hours which would have been taken if the fixed amount of power which from time to time the railway company was obligated to receive and the power company to furnish had been taken continuously." This fixed amount of power was 10,000 kilowatts for each of the two electrified divisions and has been increased from time to time until in 1925 it was 16,000 kilowatts for each division. As a matter of fact, in 1923 and 1924, for instance, the load factor never approached the 60 per cent named in the contracts in any month. In many months it was more nearly half that. As a result the price per kilowatt hour to the St. Paul was forced up to .727 in 1923, and .818 in 1924 on the Rocky Mountain division and as high as .939 in 1923 and 1924 on the Missoula division. There were some consumers who bought power at times for little more than half that. The I. C. C. observed that in the years from 1921 to 1924 inclusive, the St. Paul paid $1,500,000 for power which it was unable to use.

All this resulted from a contract made by the railroad with companies in which two of its own directors were largely interested and from which they profited heavily.

It may be said that this would not be possible now since the adoption of Section 10 of the Clayton Act already referred to. There is no doubt that this act in some measure mitigates this abuse in the case of railroads. But of course it does not reach the case of industrial corporations. Besides it is quite possible for men to avoid the effect of

that act by remaining off the directorate and being represented there by mere dummies.

5

We now are treated to a look at the profits which bankers can make out of their railroad clients. I have no wish here to discuss the practice of employing bankers to finance railroads. We may assume that a good banking house enjoying the business of the railroad and deeply concerned in its financial welfare can render important services for which it is entitled to be well paid. It comes down to a question whether the bankers have a right to look upon their railroad client as a fruitful source of miscellaneous profits.

In 1910 the bankers of the road—Kuhn, Loeb and Company—sold some $48,000,000 of bonds of the St. Paul to investors in France. They received a commission of $770,000 for this service plus an additional $113,000 as their share of the profits of the syndicate which distributed the bonds.

Five years later Kuhn, Loeb and Company went to the railroad to say that the French bankers would like to have the St. Paul re-acquire these bonds. The inference was that the French investors with the war on their hands would perhaps like to get out of the investment and that this would be a good time for the railroad to buy back its bonds at a considerable discount and thus save some money. Of course, there was the further inference that the American bankers would have to accumulate the bonds, would have to engage in certain careful negotiations and would be entitled to compensation for their work. The railroad did not seem interested, as indeed it might well not be. For these old bonds were payable in francs or sterling and these two units were, as a result of the war, likely to depreciate very much. What would the road gain by buying these bonds even at a discount and then substituting bonds payable in dollars, particularly when this would involve putting out another issue of bonds to take up the old ones? Nevertheless after a time Mr. Percy Rockefeller, a director, was drawn into the negotiations and a contract was made with the bankers authorizing them to buy up all the French bonds they

could accumulate. The money was to be provided by the St. Paul through a new issue of 4 per cent bonds. It was up to the bankers to buy in the old French bonds as cheaply as possible and whatever profits would accrue would be divided equally between the bankers and their railroad client. As a matter of fact, very little accumulation was needed. That had already been accomplished by other hands. The bankers knew precisely where they could lay their hands on $29,000,000 of these bonds. Some $26,000,000 of them reposed in the vaults of another banking house. Kuhn, Loeb and Company had merely to walk across the street and buy them. The total amount finally "accumulated" was $34,000,000. The profit of the bankers was $1,813,000. It is important to note that the profit of the bankers was for some reason split with the National City Company. Why? The Interstate Commerce Commission expresses its views rather tartly in the following excerpt from its report:

"The transaction in view of all the circumstances is obviously inconsistent with any theory of the relationship which is supposed to exist between a railroad and its regular bankers. The St. Paul issued about $35,000,000 of 4 per cent gold bonds maturing in 1925 to acquire the French bonds, and the bankers' profits amounted to over 5 per cent of that amount. Under the relation which Hanauer says should exist between a railroad and its bankers, the railroad was entitled to profits; the bankers, to fair compensation for their services. In view of commissions received on other loans 2 per cent would have been generous. The transaction is defended on the ground that in it Kuhn, Loeb and Company were not acting as the bankers for the St. Paul. That is exactly the point. They had acted as bankers for the St. Paul as far back as 1880; since 1909 they and the National City Bank had exclusively handled vast sums for the St. Paul; and yet at this opportunity to render to the St. Paul an important banking service the banker-railroad relation was suspended and profits greater than regular banking compensation were received. Hanauer testified that the profits were greater than expected when the agreement was entered into, as the spread between the purchase price of the French bonds and the

selling price of the dollar bonds increased rapidly.

"The only director of the St. Paul who seems to have been directly or indirectly interested in the transaction was Percy Rockefeller. His family, long one of the dominant factors in St. Paul affairs, was largely interested in the National City Bank. The other directors when questioned could remember little or nothing of the transaction. One director, himself a banker, admitted that it might be considered that 'it was a pretty juicy piece of business for the bankers.' Again, John D. Ryan, although a member of the board, could remember nothing of that important transaction except that there was 'some kind of a change of securities.'

"Roswell Miller, long Chairman of the Board of the St. Paul, died on January 21, 1913. Since that time the road has been without an executive officer of long experience or recognized standing in financial circles. Byram was selected solely on his operating experience. On the whole since Miller's death the executive management appears to have been uninformed, inexperienced, and incompetent to handle large financial transactions, or to determine large financial policies. Percy Rockefeller and other directors recognized this as one of the weak spots of the company, and Hanauer also recognized that the St. Paul had no one after Miller who was a financial representative in the large sense.

"The directors do not seem to have exercised any responsibility for the financial structure. The record fails to disclose any consideration by them of the possible effect of the successive bond maturities which they were creating, or any comprehensive forecast of the future of the company, while this financial structure was being built up."

6

Next we come to the purchase of the Terre Haute Railroad by the St. Paul, which was handled by the President of the road, Mr. Byram. Byram believed that it would be a good thing for the St. Paul railroad to have more coal-producing properties on its lines, so that it would haul more of its own coal. To do this he decided that the best way was to buy the Chicago, Terre Haute and

Southeastern Railroad, on which there were a number of coal producing companies. This company was originally a promotion of the late John R. Walsh, which collapsed in 1905 and brought several Chicago banks down in the wreck with it. The Chicago Clearing House banks took over the banks involved and with them, of course, got a large number of Walsh's securities. Among them were the securities of the Terre Haute Railroad. These the banks were unable to dispose of. The properties of the railroad were therefore foreclosed on and were acquired by the Chicago, Terre Haute and Southeastern Railroad Company of Indiana which was chartered for that purpose. Thus this line then operated a road extending from Chicago Heights, Illinois to Westport, Indiana, a distance of nearly 300 miles. The Chicago banks turned in their holdings—the securities of the old railroad—and received from the Terre Haute 40 per cent of its income bonds and 40 per cent of its stock. The banks, therefore, still had on their hands these new securities which they had to sell in order to liquidate their holdings. Byram therefore went into negotiations with the bankers to get control of the Terre Haute road for the St. Paul. He made an agreement to lease the Terre Haute on the following terms:

1. The St. Paul agreed to pay the principal and interest of the income bonds amounting to $11,981,000.

2. The St. Paul agreed to pay a floating indebtedness of the road of $837,000 due the Chicago banks.

3. The St. Paul guaranteed the full principal and interest at 5 per cent of bonds amounting to $6,336,000.

4. It agreed to buy 43,000 shares of the capital stock held by the banks at $10 a share.

Now let us see what the St. Paul got for its money from this transaction. First of all, this railroad was in a state of great distress. The cars were obsolete, its locomotives in poor shape; it was hard up for working capital. Nobody wanted the road. It was of no use to anybody but the St. Paul. Now let us examine each one of the items in the transaction.

1. The St. Paul guaranteed the full principal and interest at 5 per cent of all the income bonds.

That is to say, it agreed to pay 100 cents on the dollar and all back interest. Just before this one of these banks had sold some of these same income bonds to one of its directors for 20 cents on the dollar. The bank was inclined to sell them for less than 10 cents on the dollar but the director paid $8,000 more than the highest outside bidder in order to avoid the suggestion that they were being sold to a director for less than they were worth.

2. The St. Paul agreed to pay $10 a share for the stock of the Terre Haute. What was the real value of the stock of this road which could not pay the interest on its bonds? When Byram was negotiating with the banks to buy this stock at $10 a share the President of the Terre Haute sent to the stockholders a circular with reference to the proposed lease in which he said that the stock "had during the past five years a *merely nominal* market value of *only one or two dollars per share.*"

7

Here is another incident: In January, 1922, Byram arranged to purchase the Chicago, Milwaukee and Gary, a 140-mile road, by agreeing to guarantee the principal and interest from January 1st, 1924 of $3,000,000 of the Gary's first mortgage bonds. The control of this road was acquired from the St. Louis Trust Company and the sale was negotiated by S. B. Pryor, who had formerly been a director of the trust company. The company had been for ten years attempting to dispose of that property. Pryor was a close business associate of Percy Rockefeller and Rockefeller brought Pryor and Byram together. Pryor had an arrangement with the St. Louis Trust Company for 10 per cent commission if he sold the road to the St. Paul. While Pryor was negotiating with Byram he found out that another gentleman was engaged on the same job so he joined forces with him and they agreed to split the commission. When the sale was completed Pryor got as his share of the commission $150,000 of the 5 per cent bonds guaranteed by the St. Paul. As soon as he received these bonds Pryor contributed them to the Owen Oak Corporation, a personal investment corporation of Rockefeller, Pryor and another. There is no intention here to intimate

that Byram profited by this transaction. He was then purely an operating railroad man, not a financial expert, though he was dealing with financial experts and there were several men of large financial experience on his board who sanctioned this transaction.

"Rockefeller," said the Interstate Commerce Commission, "denied that he attempted to influence Byram. He testified that he acted merely as a channel of communication between Byram and Pryor, and that he had no knowledge of the fact that Pryor was to receive a commission. But the net result of the transaction was that Rockefeller, a former member of the board, became the owner of an undivided third interest in $150,000 of the Gary bonds received by Pryor for putting the deal through.

"In addition after the acquisition Byram made Rockefeller a member of the board of the Gary so that he could receive free transportation, including a general Pullman pass, on the theory, as Rockefeller expresses it, that 'one never gets all one wants'. John D. Ryan, too, was made a member of the Gary's board by Byram so that he could receive free transportation. As a result he may ride over the St. Paul and other northwestern roads in a private car without cost to him. Neither Rockefeller nor Ryan up to the time of our hearings had ever attended a meeting of the Gary board. Aside from this phase of the matter there is the much more serious question of their resigning from the board of the St. Paul admittedly on account of the provisions of Section 10 of the Clayton Act and almost immediately becoming members of the board of a subsidiary controlled by the St. Paul. It would not seem possible that the spirit of Section 10, if indeed the letter, could be so easily circumvented."

8

This peep into the affairs of a great railroad would seem to indicate pretty clearly that the directors of the road had some purpose in serving as directors other than the wise management of the road. "Many of these directors had no special qualifications for the duties of the board and took little or no interest in the company's affairs." Thus the Interstate Commerce Commission described

them. "They had no substantial interest in the property, and did not represent any such interest except that of Harkness." They drew no dividends from the corporation. They got no salaries. They were for the most part very rich and very busy men whose time was valuable. Why did they find themselves upon this board of directors? Why did they permit the various performances which I have described? They were not wicked men. No business man, after surveying the whole record, would pronounce them dishonest men. They were then, and most of them still are, leaders among American business men and anyone of them, notwithstanding the record of the St. Paul, would be welcomed into almost any directorate in the land. Does not the explanation lie in this—that it is considered not amiss for men to enter the directorates of large corporations for the purpose, primarily, of advancing some interest which they cherish and which they feel they can advance by reason of the position which their membership on the board gives them, very often some interest which may well be in conflict with the interests of the corporation? At least the Interstate Commerce Commission thinks so. "Many of the men," it says of railroad directors, "have no substantial interest in the property which they are directing, and not infrequently they seem to have little appreciation of the great responsibility of their office and of *the degree of trusteeship which they owe to the stockholders.* The investigation has shown that many of the directors of the St. Paul knew comparatively little of the affairs of the company, that many of them did not even attend the meetings of the board with any regularity and that some of them were affiliated with interests which conflicted in one way or another with the interests of the railroad company."

Is this characteristic of all railroads? Perhaps this is an extreme case. We do not know just what goes on behind directors' doors. We would never have known of this case if the St. Paul had not failed. And I venture to suggest this without denying that our railroad corporations today, in the matter of business honesty, are better managed than most large industrial corporations and are freer from what we have been referring to as graft.

It may be insisted that the passage of the Clayton Act and especially of Section 10 which prohibits railroads from having dealings with corporations in which their own directors or officials are interested, has put an end to such things as I have been criticising.

It is quite possible that this law has in some measure mitigated this practice. The passage of the section is a recognition by Congress that the condition I have been describing existed. If the railroads are better it is due to this and many other laws, which in spite of the popular sneer at laws, have tended to make certain kinds of business graft difficult. The greatly improved behavior of the railroads is due in greatest measure to the incessant scrutiny they are under from the Interstate Commerce Commission and chiefly to the courage of some of the members of that Commission. But after all the law does not apply to industrial and financial corporations and I think it may be fairly said that what went on in the St. Paul management is characteristic of corporations in the industrial and mercantile and financial field.

CHAPTER SIX

OTHER RAILROAD TRUSTEES

I

THERE is some danger in the multiplication of accounts of these railroad abuses. Lifted out of the whole picture of railroad management and recited by themselves, apart from all other phases of railroad management, they are apt to carry the impression that the direction of our carriers is just an orgy of mismanagement and graft. This, of course, is not the case today. Elsewhere I have tried to make a picture of the extraordinary record of railroad management in the last ten years.* Vast economies have been introduced. Great improvements in service have been developed. The

* "Battle by Rail" by John T. Flynn, *Collier's*, April 4, 1931.

financial structures of most roads have been amazingly straightened out and corrected. The employee relations and the public relations of the roads have been tremendously bettered. But in this volume I am dealing with only one phase of business. Hence, I elaborate the facts which refer to that phase only. It is no part of the purpose of this book to discuss other phases of railroad or business management, whether good or bad. Moreover the incidents described here are intended to be illustrative of what goes on in corporate management, whether railroad or industrial, for the same men control both.

The St. Louis and San Francisco Railroad, better known as the Frisco, went into the hands of a receiver largely because of misfortunes resulting from floods and the general state of railroad credit at the time. These were the immediate causes. And when the receivership was announced, the press, both railroad and lay, was quick to absolve the management from all blame for the disaster. So little does the public know of what goes on in the carefully guarded privacy of business finance.

However, receiverships at least produce publicity; lights get turned on hitherto hidden corners of management. And so as the Frisco case got more and more public attention the public came to realize that its woes did not proceed wholly from floods and hard times. Management had had something to do with it. Finally a stockholders' suit was instituted against the officers of the road for restitution of profits of $3,975,000 said to have been made in the sale of subsidiary lines to the company. The receivers also petitioned the court for leave to sue former directors and officers for restitution, the application being based on the performances of a syndicate which sold to the Frisco the St. Louis, Brownsville and Mexico line.

As a result of all this, an investigation was made at the request of the United States Senate and by the Interstate Commerce Commission. One of the most disturbed critics of those who had at first attacked the road's management for the failure was the very ably edited Railway Age. But after the investigation that journal printed the following criticism of the management, which also

makes an excellent summary of what went on in this road:

"The evidence which has been introduced in the investigation by the I. C. C. into the condition causing the appointment of a receiver for the St. Louis and San Francisco is not of a character to hearten those who are engaged in efforts to improve the relations between the railways and the public.

"The evidence indicates that B. F. Yoakum, Chairman of the Frisco, and others influential in its affairs acquired railway properties in the Southwest and then sold them at a profit to the St. Louis and San Francisco Company.

"It may be that those against whom these charges are made can successfully defend themselves. If, however, they have done what is alleged, they have violated sound principles of morals, if not also of law. Those employed by a corporation in an official or fiduciary capacity have no right, while continuing in that capacity, to acquire outside property and then use their official or fiduciary positions as means for selling the outside property to the corporation at a profit to themselves. They are employed to make money for the corporation, not from it. And the moral obligations of directors and officers of railroads are especially high.

"Mr. Yoakum was, for a long time, one of the most popular and highly respected railway officials in America. It is, therefore, especially unfortunate that he has put himself in a position where such charges can be made against him and still more unfortunate if these charges are true. Not only are such transactions wrong; the disclosure of them reflects discredit on every railway officer and excites public hostility against every railway company in the country. It has been repeatedly said, and it is literally true, *that most of the troubles of the railways have been brought on them by the indiscretions or the downright offenses of their own managers.* It would seem that the experience of the past ten years should be sufficient to teach railway directors and officers the danger of betraying their trusts or even committing acts that may be construed as betrayal of them. But the desire for selfish or improper, or even dishonest, gain continues to be in the railways

as in every other business, a motive which, in the cases of many men, overwhelms the dictates of discretion, good sense and even honor."

Then came the investigation. A. T. Perkins, Vice-President of the St. Louis, Brownsville and Mexico, testified before the Interstate Commerce Commission that a syndicate made up of 99 persons sold the Brownsville road to the Frisco at a profit of $3,000,000 or 75 per cent on their investment. The St. Louis Union Trust Company made public the names of the syndicate members, which included many directors and officers of the Frisco; and disclosed other records from which it was calculated that Yoakum and his associates had made a profit of over $7,000,000 in the sale of properties to the Frisco.

All this time before the receivership the financial condition of the road was at low ebb. Some of its securities were sold at a discount of 37½ per cent, no dividends were earned on common stock and dividends had to be paid on first preferred stock without being earned. D. E. Brown, examiner for the I. C. C., testified that records showed that large profits had been made by the syndicate for the sale of subsidiary roads to the parent company; and that during the same years the Frisco sold securities for $32,000,000 less than their par value. The up-shot of this was that the receivers brought suit against Yoakum and other directors, or former directors of the road to recover $14,409,000, of which more than $13,000,000 had been paid directly by the Frisco to the St. Louis Union Trust Company as manager of the syndicate which sold the Brownsville and Mexico road. The receivers alleged that Chairman B. F. Yoakum, Vice-President James Campbell and Director W. K. Bixby acted as both buyers and sellers to their individual profit in the Brownsville deal.

The suits against Yoakum and others were withdrawn and the attorneys for the receivers made a statement: "We found that in the so-called Brownsville and Iberia deals, for the latter of which settlement has been made, there was in our opinion an excessive exercise of authority by the directors for the results of which, in the Brownsville case, the directors probably could be held accountable. Also that certain directors

might be held accountable for profits made out of the deal, if the courts should decide that the Frisco is liable at all on account of the New Orleans, Texas and Mexico division bonds. We fail, however, to find, and judging from the information we have, we do not believe that any of the directors of the St. Louis and San Francisco have been guilty of any actual, wilful or intentional fraud in the administration of the affairs of the company."

Yoakum did not feel that he had done anything calling for criticism, for when the road was about to be reorganized in 1915 he asked that in the reorganization he should get his former position as Chairman of the Board, but the bankers and bondholders refused.

2

One of the most recent subjects of inquiry in railroad management is that group of trading phenomena which is included under the head of reciprocal buying. An immense amount of criticism of this practice in the case of the railroads had been coming to the surface for a number of years, a good deal of it bearing a striking resemblance to one of the oldest of railroad troubles, the eternal battle between the large and the small shipper.

Reciprocal buying refers to the practice of some roads of purchasing their supplies from those shippers who give freight business to the buying roads. It is just another form of a very old business practice which has often been described in the pithy phrase—You scratch my back and I will scratch yours. Ordinarily it is difficult to see what objection there can be to a form of doing business which makes so powerful an appeal to the most primary instincts of the trader. There is perhaps not a business man who is not disposed, and with a good deal of justice, to buy his materials from those persons who deal with him.

In the case of the railroads, however, several other considerations got mixed up in the matter which tended to complicate its economic, if not its moral, character. At any rate, in 1929 the Interstate Commerce Commission began an investi-

gation of the practice. Many railroad presidents frankly avowed that they followed the practice of buying their supplies, equipment, coal, lumber, ties and other things from merchants who gave their freight to the roads. In other cases they made it a point to give their orders, where possible, to shippers located along their own lines. In the latter case they justified their policy on the ground that it was to the interest of the roads to build up the territory they served in every way possible. It would be difficult to quarrel with this if the matter went no further.

However, the investigation developed that many large shippers who had goods to sell to the road used their freight business as a means of forcing the roads to buy from them. Of course no small shipper could compete with a rival who had a large amount of freight to offer. As a result the small shippers complained bitterly that the practice of reciprocal buying was being used as just one more weapon to drive them out of business. An immense amount of testimony was taken on this point, most of which can have no significance for the inquiry we are making here, which has to do only with graft. However, a phase of it did develop at least the possibility that the practice could easily be managed in such a way as to grant to big shippers preferential freight rates. In other words, while the railroad ostensibly charged all the shippers the same rates, as required by law, they could easily give a favored shipper a rebate by buying materials from him and paying a price which would include not merely compensation for the goods bought but also a rebate on his freight. It would be unfair to say that any evidence was developed which could be used as a basis for proving this charge.

However, testimony was developed which had to do directly with the subject we are pursuing. Here is an example: Railroads use, among other things, a certain form of equipment which is known as draft gears. A number of companies manufacture these gears. Among others is one known as the Durable Draft Gear manufactured by the Mechanical Manufacturing Company. This company wishes quite naturally to sell its

gears to the railroads. A great many people are willing to concede that there would be nothing improper in the Mechanical Manufacturing Company going to the roads and suggesting that they would give a preference in the shipment of their goods over those roads which bought from them. This, however, is not what was done. When the Federal Trade Commission investigated this matter it found that the Mechanical Manufacturing Company belonged to the Swift family and the directors and officers of Swift and Company. Mr. George A. Hood, Secretary of the Mechanical Manufacturing Company and manager of the bureau looking after the affairs of the Swift family, produced records to show that 52,000 common shares of that Mechanical Manufacturing Company out of a total of 75,000 belonged to members of the Swift family and the officers of the Swift Company, and that 4,300 out of 5,000 shares of the preferred were also so held.

Now the Swift family and the directors of the Swift Company do not by any means own Swift and Company. It belongs to a large number of stockholders whose interests are supposed to be represented by the directors. Nevertheless we find the officers of Swift and Company sending a letter to various railroads and stating that "*our people*" have decided to take on the Durable Draft Gear and Durable Centering device; and "we expect our railroad friends to use these devices on a reciprocity basis, with the understanding that they are competitively priced and their quality is second to none."

The traffic manager of Swift and Company wrote the Santa Fe Railroad complaining that "for the past six months the Mechanical Manufacturing Company has sold you only five posts" another product of the Mechanical Company and "I should like to have you, in view of the large amount of competitive traffic that we are favoring you with, take whatever action is necessary to see that we secure your bumping post business in the future. Please reply."

Letters were written to other railroads. In the letters the interest of the Swift family was stressed, though the interests of the directors of the Mechanical Manufacturing Company were

left out. The *Railway Age*, March 1, 1930 said: "Swift and Company had no right in the Mechanical Manufacturing Company. Its ownership is controlled by officers of Swift and Company and members of the Swift family. Swift and Company give the railways a large amount of traffic; but have a right to demand only that the railways reciprocate by giving Swift and Company good service at reasonable rates." But here the freight traffic which Swift and Company could control was used to secure business for a company which belonged not to Swift and Company but to the officers of that company and some of its stockholders, the Swift family.

There was evidence that the freight traffic of other large companies was used in the same way, to get business for concerns controlled by the officers or directors of those companies. It all illustrated in the most perfect manner those indirect benefits, those devious rewards, those profits which directors are enabled to make by reason of the opportunities they enjoy as directors. They are not paid by the corporations they serve. They do not always have an important stock interest. But their position as directors and officers enables them to draw nourishment for other concerns in which they are largely interested. And this instance of so-called but spurious reciprocal buying in the case of Swift and Company is a perfect instance of this sort of graft.

CHAPTER SEVEN

RUBBER STOCKS AND RUBBER FEES

I

THE great secret of corporation management is secrecy. Behind closed doors—doors closed so tight that not even stockholders can peer into the directors' rooms—indeed behind other doors and series of doors that shut out from view even some of the less important and favored directors—the business of the corporation is transacted. And now, since the flowering of the holding company the number of doors—even secret panels and mysterious passages through the impenetrable maze of which corporation affairs move—has become so numerous that it is possible for the managers who sit on the very interior of the penetralia to hide the operations of their cluster of corporations from the eyes of everyone but themselves.

A small town is of course a political corporation. It is run by officers and directors, only differently named. Most of their meetings are in public. Full public reports must be made. The newspapers feel at liberty to ask the most pertinent and penetrating questions. The president of the corporation—the mayor, the treasurers and directors—the aldermen—are regularly called on by reporters and must submit to questioning about all sorts of matters. Even the President of our great corporate body, the United States Government, does not escape this. But the publicity which the directors of a public corporation with 20,000 stockholders (citizens) must undergo, is escaped by the president of a large business corporation with 100,000 stockholders quite as profoundly interested in its affairs.

It is only when these corporations get into trouble that we begin to hear something of the strange performances which go on behind those closed doors—only when a sudden receivership perhaps throws open the doors. Then the erstwhile

rulers begin to quarrel among themselves, the dirty linen of the company is brought out into the open for a public washing, and stockholders and the public begin to hear what these trusted gentlemen have been doing with their trust.

2

In 1920 when the spurious prosperity built on the war and the conditions following the war began to fall apart, the Goodyear Tire and Rubber Company proceeded to fall apart along with a great many other large properties. Earlier in the year the Goodyear company declared a stock dividend. Then, as rumors began to gather about the condition of the great corporation, on December 10, 1920, Francis A. Seiberling, President of the company, wrote its stockholders that sales for the year had fallen $45,000,000 below the $250,000,000 expected; that it was loaded with raw materials which had fallen heavily in price, that the company was seriously in need of cash but that bank credit had been curtailed, that it could not pay its merchandising creditors, could not meet its banking obligations and the stockholders were called to meet December 24 to pass on a plan for issuing eight per cent bonds to the extent of $50,-000,000.

The company faced bankruptcy. Here was a huge hulk floating about helpless, like an immense ship at sea, loaded with valuable cargo—a perfectly good ship with perfectly good freight—but utterly helpless for the lack of one thing, fuel to proceed on its journey. Here was that magnificent opportunity which business seems to deal with under the old laws of the sea; when the salvage crews begin to put out from shore for the crippled vessel and when it seems to be understood that the rescuers shall be permitted to help themselves upon the most generous scale to the assets of the thing they save—a good law enough in the days of sailing ships and crippling storms, when rescue meant the risk of life. It's not a good law in industrial finance, yet the influence of the old sea custom survives. The record of receiverships in American courts on the part of lawyers, financiers and all the parasites who gather about the sinking corporation is a disgraceful one.

Francis A. Seiberling, the President of the company, struggled very valiantly to save the great rubber concern which he had organized. A man of extraordinary ability, of vast experience in the rubber industry and in industrial management, he had built up the Goodyear Tire and Rubber Company until it was the largest manufacturer of tires in the world.

Looking back over the event the plight of that corporation may well be laid to the accumulation of unexpected conditions which followed the orgy of 1918 and 1919. Business men seemed to lose their wits, certainly their sense of proportion. Rich, juicy profits seemed to paralyze their intelligence. When the natural order began to assert itself they were almost all caught unprepared and defenseless. One might denounce Seiberling for his management were it not for the fact that he did what most other business men did.

Other charges were made against him by the bankers who later took his company for a little while out of his hands. They said he had used the funds of the company for his own enrichment. He had borrowed great sums from a company of which he was president on insufficient collateral. This he admitted but pleaded that he had always returned the money in time to have the transaction disappear from the annual statements—a curious defense which illustrates and confirms in an interesting way some of the things I have been pressing in this book. But after all this is admitted, the fact remains that the threatened disaster of the company was due first to the excessive speed which the industry attained in the inflation of 1919, secondly to the accumulation of vast stores of raw materials at high prices, thirdly to the sudden falling off of business due to the drastic deflation to which the country was exposed, finally to the lack of cash and credit when capital took flight at the critical moment. In spite of all this, however, the one thing which the company needed to weather the storm was cash. The necessary management brains were present in the company in abundance. P. W. Litchfield, the Vice-President, now President of the company, had been operating manager for years and still is. Seiberling is easily one of the outstanding figures in the rubber industry. He had built up the Good-

year to its great proportions and he has since organized another great rubber company—The Seiberling Rubber Company. What neither Litchfield nor Seiberling could get was cash, or credit if you will.

Seiberling engaged a law firm to get new financing. One Chicago banker tried to get aid in Chicago, St. Louis, San Francisco and New York. The National City Bank and the Guaranty Trust Company agreed to investigate, sent experts to Akron, but the reports from them were so gloomy that neither bank would undertake the rescue job. Goldman, Sachs and Company, the New York bankers, provided either $18,000,000 or $25,000,000—the testimony is conflicting—but this was insufficient and they advised a receivership. I relate these facts to show that the situation of the company was quite desperate and that if help could be gotten it was worth a good deal. At this stage young Mr. Clarence Dillon, of Dillon, Read and Company, was called in. He was practically a newcomer to Wall Street. He was recognized as a banker of ability. It was believed the saving of Goodyear would appeal to his imagination. It offered him an extraordinary opportunity to show what he could do. And thereupon Dillon proceeded to the work of finding credit for the foundering rubber corporation. Here is the plan he evolved.

First he proposed to eliminate the old management, chiefly Seiberling. Seiberling exercised control over the company through a voting trust. Dillon now, in a complete reorganization of the company, provided for 10,000 shares of management stock at $1 a share which should have the complete voting power. Thus the whole stockholder interest was at a blow disfranchised and the power of management put into the hands of the management shares held by three persons, one being Dillon, none of whom invested anything whatever in the company.

Second, under this plan Seiberling and his immediate followers were removed from the Board of Directors and Dillon and his immediate associates substituted in their place; and Edward G. Wilmer was made president of the company at a salary of $50,000 a year, certainly not an exorbitant sum.

Third, the financial structure of the company was made over to provide for the raising of new capital. It is not necessary to follow the complicated maze of security issues here save to say that the common stock was all reduced to a new issue of more or less nominal value—$1 a share—and the new funds were raised by means of new preferred stock and debentures.

The necessary funds were provided and in the course of a few years the company was put back on its feet. On the surface of the event the credit for this must be given to the bankers. But the inevitable shirt stuffer has not been missing from the scene and has not failed to describe the achievement as if it were some gigantic and almost miraculous performance in management. The piloting of the company back to health was not a difficult thing once the necessary cash was provided. The bankers did provide the cash. That is all they did. For this service, the shirt stuffer trumpets how they did it for the modest sum of $200,000, an extraordinarily pitiful wage, as the compensation of bankers goes.

Let us see what the bankers did and what they got out of this transaction. I do not for one moment propose to charge them with anything wrong. What they did may perhaps have the seal of approval from their profession. It all seems in perfect accordance with the methods in vogue in high finance for making profits out of large corporations. It supplies a perfect example of those kinds of indirect profits which I have been talking about which are possible under present conditions and which are made possible by the secrecy with which corporate affairs are managed.

3

When bankers embark on a major financing operation like this one, it is customary for them to require representation on the board of directors. This is quite understandable. They recognize the necessity of having a seat on the very inside where they can see what is being done with the funds and have some voice in the matter. In this case, however, the bankers went a good deal further than that. They demanded, first, that the stockholders surrender all their voting privileges

and commit them irrevocably to a committee of three on which the bankers controlled two votes. They took over outright the entire voting powers of the corporation. Then they literally filled the board with their representatives. But most important of all they put forward something new in the field of management. Hitherto the company had been managed by a president elected by the board and paid by the company. This system was abandoned and instead of a president and treasurer the bankers devised a plan by which the direct management of the company would be turned over to another company. A contract was made with Leonard Kennedy and Company of New York, and the management of the Goodyear Tire and Rubber Company was put in its hands. The Kennedy Company was to provide a president and a treasurer, and these officers were to be responsible to it and be paid by it and not by the rubber corporation. This was, to say the least, an extraordinary arrangement.

It was defended by the bankers on the theory that the company was in a very serious jam and needed management of the most extraordinary ability. From this one might infer that the Kennedy company was a management concern of such ability. As a matter of fact it had never before undertaken such a job. It had a single small office in which the personnel was Mr. Kennedy and a secretary. The bankers had tried to induce two or three outstanding industrial leaders to accept the job of president of Goodyear at salaries of from $200,000 to $250,000 a year but they had refused. It was after this they turned to the Kennedy Company.

The contract made with the Kennedy concern was, however, far more liberal than the offers made to these great industrial leaders. That contract agreed to pay Kennedy and Company $250,000 a year and 5 per cent on any earnings in excess of $10,000,000 a year and not above $20,000,000 a year. As it fell out, with that extra 5 per cent in the course of two years (25 months to be exact) Kennedy company, for the services of a president and a treasurer, was paid $926,540. At the end of that time the contract was terminated by the board. But if it had continued for the full five years the Kennedy company

would have collected nearly one million dollars a year. And for what? For the services of a president and treasurer. What did the Kennedy company pay the president? Edward G. Wilmer was the company's selection for president and he was paid $50,000 a year. What the treasurer got I do not know.

What was the extraordinary managerial ability which the Kennedy company could bring to the Goodyear company which would justify such a contract? It named Mr. Wilmer President. He was, as it turned out, a young man of ability. But he had no record as an industrialist which would justify such a salary. As a matter of fact, the Kennedy company put an estimate on his value when they paid him $50,000 a year. Who was Mr. Kennedy? He gave an account of himself in one of the law suits growing out of all this. Up to 1917, he said, he had been employed by Wm. A. Read and Company, predecessors of Dillon, Read and Company. Then he became First Vice-President of the Ludlum Steel Company, which in his thirty-third year paid him $100,000 a year salary and commission (more, by the way, than was being paid to

James A. Farrell as President of the giant United States Steel Corporation). After the war he originated, he testified, the idea of a "cracker-jack management concern" which could run any large corporation whose heads didn't know how to do it. However, when the Goodyear contract came along it was not Kennedy who assumed the role of manager, but Wilmer, who was apparently employed for the job.

However, according to the banker himself it was, apparently, neither Kennedy nor Wilmer who justified the expensive contract at the start but a gentleman named Schlesinger of Milwaukee. Schlesinger had an organization which it was alleged could take an anæmic industrial corporation and fill it full of blood and nerves. As a matter of fact, Schlesinger's skill in industrial medicine had been revealed in the management of the Milwaukee Coal and Gas Company, the Newport Company and its subsidiaries. These were comparatively small concerns and hardly qualified Schlesinger for the role of savior of the Goodyear Company at such a huge compensation. In any case if it was Schlesinger why was the contract

not made with his company? And when Wilmer was selected, what further did the Kennedy Company supply, and what did Schlesinger supply? We learn that Wilmer took with him about twenty young men from the Schlesinger organization. And now who was the Kennedy company? Who owned it? Well, the facts came out in one of the numerous trials which grew out of this case. Forty-five per cent of the stock of the Kennedy Company belonged to the Nassau Company. And who was the Nassau Company? It was a private corporation, the stock of which belonged to the family of Mr. Dillon. So the contract for the management of the Goodyear company at a price which yielded nearly a million dollars for two years' work was made with a company which belonged to the extent of one-half to the bankers employed by the Goodyear company to put it on its feet. Shortly after the contract was made the stock of the Nassau company was transferred to certain other persons, dummy stockholders, mostly minor employees of the bankers. When they were called as witnesses some of them couldn't remember very much about their shareholdings though one of them, a bookkeeper, held 22,500 shares.

One of the bankers, when he testified about this episode, insisted that there was no secret about his interest in it. As a matter of fact, he declared, his connection with it was a thing which the Kennedy company was eager to advertise. Nevertheless one of the directors of the Goodyear company, friendly to the bankers, testified under oath that when he voted for the Kennedy company contract he did not know that the bankers had any interest in it, that one of them had talked to him before the meeting of the board and told him that it was a good thing for the company but did not disclose his interest in it.

Now I do not say that there is anything wrong in all this. I am calling attention, however, to the fact that the bankers believed that it was quite within the bounds of propriety, when they were called on to salvage this great company, to have it make a contract with another company, in which one of the bankers was interested, to manage the Goodyear concern. This becomes all the more surprising when they stipulate an enormous price,

many times what Judge Gary, for instance, was paid by the U. S. Steel Corporation.

This contract was terminated when it was attacked in a law suit by one of the stockholders. Mr. Wilmer, however, continued as President until the same bankers undertook the job of reorganizing the automobile production business of the Dodge Brothers. Then Mr. Wilmer, who had now become a member of the banking firm, was transferred to Dodge Brothers as President of that company. This did not terminate his connection with the Goodyear company, however. He was made Chairman of the Board and Mr. P. W. Litchfield, the Vice-President, was made President. However, as President of Dodge Brothers, a huge concern, and as a member of the banking firm of Dillon, Read and Company, Mr. Wilmer had his hands full. The chairmanship of the board of the Goodyear company became a mere part-time job. Nevertheless at the moment when he gave up the job of being President which consumed his whole time and became Chairman of the Board on a purely part-time basis, his salary was raised from $50,000 a year to $125,000 a year.

4

How much can bankers make out of a deal like this Goodyear reorganization? The subject must be of interest to any young man who has an ambition to be a banker. Of course, one can only guess at the profits in this business. In 1922 a suit was filed against various persons, including the bankers, by one of the stockholders of the Goodyear company—a Mrs. Laura A. Weiss—attacking the reorganization plan. In that suit many allegations were made. One of them was that when the bankers underwrote an issue of $27,500,000 of debentures they received a bonus of 275,000 shares of common stock. It was also alleged that the Goodyear company paid a premium of $20 a bond, plus the 8 per cent interest on a $30,000,000 issue, which would be $6,000,000.

Later another suit was filed by other stockholders against the bankers and others in which the following allegations were made: It was pointed out that the refunding operations had brought to the company $51,000,000 in cash, but that the company assumed $11,000,000 in premiums and had

given bonuses of $9,000,000. The Goodyear company assigned $27,000,000 of its debentures to the bankers to whom it was indebted at 90 and 170,000 shares of common stock at one dollar a share. The bankers later sold these bonds at $98 and the stock as high as $48 a share. What they paid for the stock is not known. There was much dealing in Goodyear securities. For instance, one creditor had a bill of $213,875 against the Goodyear company. They were given stock which they sold soon after to the bankers at a price which produced a loss of $31,000. The bankers later sold it at a good profit.

Some 326,013 shares of Goodyear prior preference stock were purchased by the bankers from the merchandise creditors of the company to whom it had been assigned. The price was fixed by the syndicate managers committee at $85.60 a share. Shortly after a $10 dividend was declared on this stock and the bankers sold it to the public at $98, making a profit of $3,450,000. These were a part of the various transactions by which the bankers were alleged to have made $15,000,000 or more.

These are the indirect profits which are made out of corporations and stockholders, which never come to the surface, which constitute extravagant and wasteful expenditures and which add an enormous burden to the cost of industry. It seems to me the disinterested business man will readily concede this. There is no question here of men with executive ability being well paid for their brains. There can be no quarrel with that by anyone who is willing to accept the present system of control in industry. What is proper and adequate compensation is a subject about which honest men may well disagree—whether an executive head of a great corporation ought to have $50,000 a year or $100,000 or $250,000. There can be little question that if the brains in industry are to be paid the money ought to go to those who furnish them, the managers, executives and their associates. Here, however, is a group of bankers who collect, according to the bankers' own computation some $815,000 in open and obvious pay for their services and then, through the opportunity which their employment gave them, made millions more out of the company and the stockhold-

ers. And what is worse, there is no way of keeping track or checking up on these profits. They are secret, carefully concealed and come out only in unusual cases when a receivership or a law suit or some sort of investigation results.

All this results in a carelessness with reference to funds which belong to the corporation and the stockholders. For instance, we find one very well-known business man admitting on the stand in this Goodyear case that he was named a member of the finance committee of the corporation; that he never attended a meeting, yet he drew a salary of $5,000 a year.

All the time we find other corporations organized and controlled by the same bankers, dealing in the stocks of the Goodyear company—corporations the funds of which are supplied by investors. Around it all clusters an intricate webb of corporate investment which it is almost impossible to follow.

The intricate character of the financial structure built around these things may be seen as follows. In 1927 the United States and Foreign Securities Corporation, a Dillon, Read investment trust, bought 2,000 of Goodyear preferred and 20,800 shares of common in the open market. Then the West States Corporation had 91,057 common and 8,439 preferred. This company is owned by the Oakmont Company, Inc., the stock of which belongs to Dillon, Read, partners or former partners and the Oakmont had in its own name 30,500 shares of common and 8,100 of preferred. Also when Goodyear bonds were sold in 1921 the Nassau Company participated in the banking group to the extent of $150,000 and to the extent of $100,000 in the distributing group. In the debenture issue the Nassau Company took $150,000 each in the purchasing group and the distributing group.

This whole reorganization episode was marked by an incessant war between the bankers on one side and Francis A. Seiberling, the organizer and deposed President of Goodyear, on the other. Seiberling kept up a ceaseless attack and through the suits of various persons and finally the suit by nine stockholders dragged the whole operation into court. After all sorts of charges and counter-charges the case was finally settled out of court.

When this happened there were nine law suits pending, with fifteen leading law firms of New York and Cleveland on either side. All charges and counter-charges were dropped. The parties declared they all recognized the constructive character of the reorganization. About that there could be little doubt. Much of the quarrel was about the manner in which the bankers got themselves paid for that. It was decided that the bankers should continue as bankers for the company and that the management stock should continue in force until the various bonds and debentures were paid off. All voting trusts were to be abolished and a new issue of bonds was to be put out at five per cent instead of eight. This was all a temporary arrangement, however, for when the new bonds were put out and the old debts cancelled the management trust was abolished, Seiberling and the directors who fought the bankers were put back on the board and the connections of the bankers with the company were brought to an end.

CHAPTER EIGHT

ST. GEORGE AND THE BONUS

ONE of the most extraordinary episodes in business during the last year grew out of the effort of the Bethlehem Steel Corporation to absorb the Youngstown Sheet and Tube Company. In that proposed merger the plans of Mr. Charles Schwab and Mr. Eugene Grace, rulers of the Bethlehem organization, were thwarted by Mr. Cyrus S. Eaton, the Cleveland banker, who carried his opposition to the merger into the courts and succeeded in bringing to the surface some very extraordinary facts which kept the battle on the first pages of the newspapers for many weeks. Mr. Eaton won his fight and during the course of the proceedings he seemed to occupy in the public mind the role of the crusader, a plumed knight charging at the abuses of corporate wealth. Mr.

Eaton rendered a service to the study of corporate management through the revelations which he brought out, but Eaton's own actions, though not so widely advertised at the time, were no less open to censure than that of Bethlehem officials.

One of the crying weaknesses in our modern corporate structure is the tendency of managers to regard themselves as the owners; to forget that they are trustees, that they are employees, and that they owe to the stockholders who own the corporation a fiduciary obligation as clear and as binding as that which applies to public officials. They are in every sense public officials representing not political constituents, it is true, but large numbers of industrial constituents who are their stockholders. Many of the apparently indefensible performances of directors of corporations are more easily understood if we keep in mind the manner in which corporate rulers come to look upon the corporations as their special instruments. This is particularly true where there remains in the corporation the man who has built it from its early stages and who, perhaps, gives it his name, as in the case of the various Fox Film Corporations.

And so it was not surprising to find Messrs. Schwab and Grace on one side and Messrs. Campbell, Dalton and others on the other side, getting together and arranging for the sale of the Youngstown Sheet and Tube to the Bethlehem Steel Corporation, without consulting all of the directors and then putting the matter through the Board of Directors without affording all the directors anything more than the most rudimentary information about their plans. "Without going into details," said Judge Jenkins in deciding the Eaton injunction against the Bethlehem-Youngstown merger, "the evidence conclusively, irrefutably to the court's mind, shows that several members of the board who voted affirmatively either had no reasonable opportunity or sufficient facts for the necessary investigation and formation of any full and formed judgment at the meeting, as required by the statute, or having such opportunity made no individual investigation, were not supplied with adequate information, but acted on the opinion or advice of other directors.

"The director voting 'no', frankly said he didn't have sufficient knowledge to judge of the merits of

the proposal . . . . this lack of information and of opportunity for obtaining it was well known to all and is a shocking and outstanding feature of this case."

This is quoted to illustrate the attitude of directors towards their corporations and to explain the doing of acts which would never be done by men keenly alive to their duties as trustees pure and simple.

The sensational and most damaging fact brought out by Eaton was the bonus system which was in effect in the Bethlehem Steel Corporation. It is accepted almost without question in our capitalistic society that managers receive large salaries for their services. Salaries of $50,000 and $100,000 a year are reasonably common in American business. Judge Gary, who started at $100,000 with the United States Steel Corporation as its Chairman, had his salary increased until he got $250,000. Various railroad presidents are reported to receive $50,000, $75,000 and $100,000. The head of a great insurance company is said to receive $200,000 a year. The largest known salary was that paid to George Gordon Crawford, president of the Jones-Laughlin Steel Company, a former United States Steel executive, who now gets $350,000 on a three-year contract. Judge Gary is said to have received one year $425,000, including his salary and a bonus paid at that time. These are large sums and they are fairly well-known. Eaton brought out, however, that the board of directors of the Bethlehem Steel Corporation voted to various officials of the corporation, many of whom were members of the board of directors, bonuses which ran to enormous sums and which shocked even money-mad America when they were revealed. These bonuses began in 1917 and were paid first to eight or ten of the officers and finally to about twenty-one. Mr. Grace, President of the corporation, in 1929, got a bonus of $1,623,753, presumably for his genius in managing the corporation. From 1925 to 1928 no dividends were paid by the Bethlehem Steel Corporation, but Grace received his bonuses just the same. The stockholders got nothing, but Grace got $3,200,000 in bonuses during those years. In the single year 1929 these twenty-one officials divided among themselves $3,425,306 in bonuses. One

vice-president got $378,678, another got $375,664 and still another $216,729. For thirteen years, from 1918 to 1930, Grace's bonuses averaged $814,933 a year.

Nothing was ever said to the stockholders about these bonuses and when Grace took the witness stand in the Bethlehem case it required a good deal of persistence to get him to admit these payments. What the effect of these secret payments was on the public mind may be gathered from the comments of the *Wall Street Journal*, certainly not a radical newspaper, which remarked that if such payments as the Bethlehem company made are to be paid, stockholders ought to be told of it. A search of the annual reports of the company, it declared "fails to reveal any other reference to the bonus system" than that contained in the year 1917, the year that Mr. Schwab wrote his letter and it is twelve years since the stockholders in 1918 approved the system, but nothing to indicate what the payments were to be was shown then. Schwab has insisted that he was the sponsor of the system in the Bethlehem company and he pointed to the fact that he got more than a million dollars a year from Andrew Carnegie in the days of the old Carnegie Steel Company; and that, he observed, was when a million dollars was worth a good deal more than it is now. That is true and when the United States Steel Corporation was organized and Schwab became its first President he permitted it to be known that he was getting a salary of one million dollars a year, a fact which received a good deal of publicity at the time. When the newspaper story came to the attention of Judge Gary the judge sent for Mr. Schwab and informed him that if he expected to get a million dollars a year he would have to look to Carnegie for it and not to the United States Steel Corporation, and Mr. Schwab's salary was fixed at $100,000. When Corey succeeded Schwab, Corey also got $100,000 and when Farrell became President of U. S. Steel he got $50,000, although it is probable he gets more than that now.

Mr. Schwab has vigorously defended his bonus system. "America's door of opportunity must be kept open," he says, "if we are to continue our commercial leadership we must continue to reward men of productive genius so that they will

put their best efforts to work for us. I hope never to see the day when a poor boy is prevented from making a million dollars if he is worth it. When that day comes we shall have shackled ambition and become a *nation of job holders*." Here again is an example of a corporation executive's failure to observe that he, as well as Mr. Grace and the exalted vice-presidents, is a job holder. They are employees of the stockholders of the Bethlehem Steel Corporation, just as the President of the United States is an employee of the people of the United States. Then Mr. Schwab told a story: "Thousands of our employees are on piece work," he said. "An instance that happened at one of our plants many years ago taught me that you must give reward for effort and I have never forgotten that incident. I saw Bill, one of the men, shoveling fire clay, and it didn't seem to me that he was putting the best possible effort into it.

" 'Bill,' I said, 'how many tons of clay are you shoveling a day?'

" 'About twelve tons, Mr. Schwab,' he replied.

"I asked him what he could do if I gave him a bonus for every shovelful above that amount. He said he couldn't possibly do any more, as he was worn out at the end of the day now. I told him that we would give him the bonus and see what happened.

"For several weeks after that I didn't see Bill, and finally realized that he was dodging me. Finally one day I ran across him and asked him what was the matter. He said:

" 'I guess you know, Mr. Schwab.'

" 'No I don't know,' I answered. 'What is the trouble?'

"He hesitated a minute and then said:

" 'Well, I told you I couldn't shovel more than twelve tons a day, and now I am doing almost thirty, and don't feel as tired as I did before. You see,' he added, 'every time I put up a shovelful now I says to myself, "There's a shovelful for Bill." ' "

But there is a big difference between Bill's shovelful and the shovelful for Eugene. This bonus was defended by Schwab as the modern substitute for proprietorship. It is certainly a delightful substitute from the point of view of the beneficiary. If Mr. Grace had been an owner, to have collected a dividend of $1,600,000 he would have

had to invest $22,000,000 in the stock. As it was he collected that amount without investing anything. Moreover, as an owner he would have gotten it if the company had earned it. If the company earned nothing he would have gotten nothing. In 1926, however, he collected $852,000 in bonus but the stockholders collected nothing in that year.

No question is here raised about the soundness of the bonus system. It is a question of the abuses of the bonus system—abuses in which the directors of the corporation secretly vote to themselves millions of dollars of the stockholders' money. A group of stockholders of the Bethlehem Steel Corporation have protested against this and summed it up as follows:

"The amount of the bonuses is most unseemly and improper. The President, Mr. Grace, it now appears, received in the year 1929 a bonus of $1,623,753 and in the year 1930 a bonus of $1,015,591. During the period in which these bonuses for executive officers have been in force, and up to the close of 1928, there has been taken out of the corporate treasury for this purpose

$31,878,255 as against $40,886,996 paid to common stockholders. In other words, 80 per cent of the amount distributed as common dividends to the owners of the equity of the property. In the four years 1925-1928 inclusive, during which not a dollar of dividends was paid to the common stockholders, $6,800,524 in bonuses was paid to these few favored directors and other executives. The President alone took $3,105,963 as bonuses during these years. Although the company in 1930 failed to earn its dividends, it nevertheless paid a bonus of $1,015,591 in that year to its President."

This bonus figured as a strong reason in the mind of the court in enjoining the proposed merger of the Bethlehem and Youngstown companies. Even the directors of the company didn't know all the particulars of this bonus system and the court censured those directors who knew in a general way of the bonus system but failed to investigate its full character. Judge Jenkins held that not only the directors but all the stockholders had a right to know of this bonus.

Many corporations give bonuses. For instance,

the United States Steel Corporation in 1930 paid $3,122,168 in bonuses. This was about what the Bethlehem paid out. The Bethlehem bonus was paid to twenty-one men. The U. S. Steel bonus was paid to 2,574 executive officers and others. The largest bonus paid by U. S. Steel to any one individual was $70,000. The largest paid by Bethlehem was $1,015,591. The bonuses paid by the Bethlehem officials to themselves were paid irrespective of earnings—were paid in spite of the fact that earnings in 1930 were practically cut in half and were not sufficient to cover interest and dividends. The U. S. Steel Corporation bonus is paid only when net income, after all charges, taxes and depreciation reaches $100,000,000 for the year. A more important difference, however, is that the Steel Corporation reported its bonuses in full to its stockholders, while the bonuses of the Bethlehem Steel Corporation were kept a profound secret even from some of the directors and were revealed only when Mr. Grace was put on the witness stand and grilled mercilessly by Mr. Eaton's lawyers. And when stockholders, learning of it, bring suit to end the practice, it melts away without a trial. Mr. Schwab moaned that the suit had taken ten years off his life. This remains to be seen, but it has happily taken millions off the pickings of "his boys."

It must not be supposed that Mr. Eaton, who appeared as the St. George brandishing his sword against the Bethlehem dragon, was so very much of a St. George after all. He fought Schwab and Grace because they thwarted his plans for getting the Youngstown Sheet and Tube Company for his own interests. And what were Mr. Eaton's interests? He is a banker—an investment banker. He has been dabbling in iron and steel for six or seven years, just as he has been dabbling in rubber and other things which happened to get themselves into his gigantic schemes. As a matter of fact, Cyrus S. Eaton's financial operations offer a perfect example of the manner in which an investment banker, using other people's money, can pile up huge profits for himself by all kinds of indirect means.

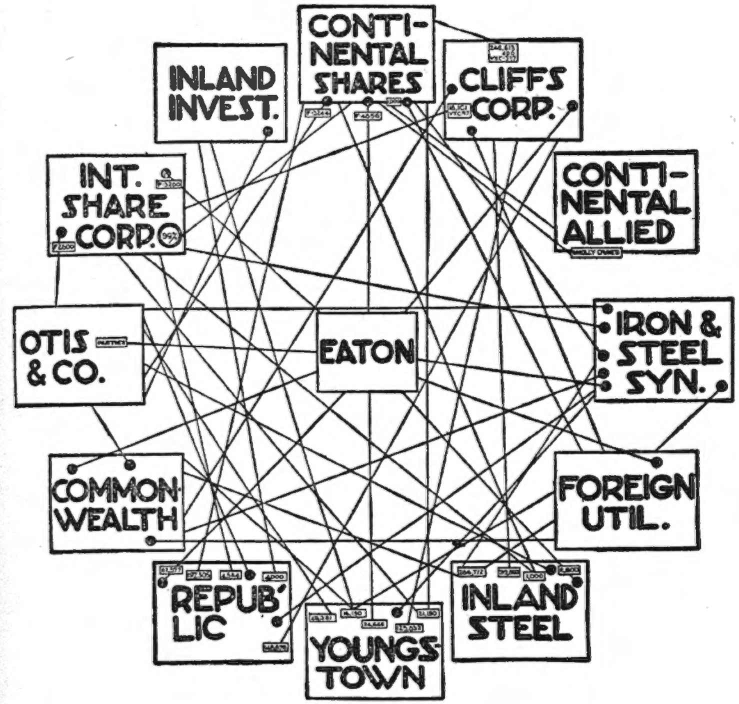
Mr. Eaton organized a group of investment companies, among them Continental Shares, Commonwealth Securities, Inc., International

Shares Corporation, Inland Investors and others into which large numbers of people were invited to put their funds. They did this and before very long Mr. Eaton had at his disposal several hundred million dollars which he was then at liberty to use to carry out his plans. Here is how he operated.

The Trumbull Iron and Steel Company needed money and requested Eaton and his associates to provide it. They did so and in the process had themselves elected controlling directors of Trumbull. About this time they were accumulating the stock of the Republic and Inland Steel companies for the purpose of bringing about their great Republic Corporation steel merger. To do this they were using the funds of other people concentrated in various investment companies which they had formed. As controlling directors of the Trumbull Steel Company, they had control, of course, of the funds of the Trumbull Steel Company and so they used $775,000 of the money of the Trumbull to buy 18,929 shares of Inland stock and 19,000 shares of Republic stock. The total cost of these two purchases was $2,400,000, but Trumbull's $775,000 acted as a safe margin with

Otis and Company, bankers, of which Mr. Eaton was a member. Having thus gotten large holdings of Republic stock Mr. Eaton caused himself and his associates to be elected members of the Republic board and as such directors voted to acquire the Trumbull company. When the Republic company, of which Mr. Eaton was a director, was about to purchase the Trumbull company, of which Mr. Eaton was also a director, Otis and Company, of which he was also a partner, turned up with an option to buy 100,000 shares of Trumbull stock at $9. This had to be adjusted. The adjustment was worked out by permitting Otis and Company to get one share of Republic stock for 5 shares of Trumbull. Under this they got 20,000 shares of Republic at $45, when its market price was approximately $60 a share at the time, a discount of $300,000. Where did Otis and Company get this option? When Otis and Company made a contract with Trumbull to finance it they were given this option in addition to their commission, which was $1,280,000.

The same thing was done when the Republic Corporation acquired Donna Steel Company,



EXPLANATION

The above chart represents the various investment and steel corporations involved in the complex plans of Cyrus S. Eaton. Eaton, at the center, holds direct interest in nearly all of these various corporations. Each of these corporations in turn has holdings in almost all of the other corporations in the group. The interest of each corporation in every other one is indicated by a black line. The black lines crossing and re-crossing produce a spider's web of interests by which one bold financier with a small investment in the center of the web controls the destinies of the whole group.

Central Alloy, Republic and Bourne-Fuller. In these cases Otis and Company turned up with an option to purchase 200,000 shares of the stock of the new company. Otis and Company had a contract for underwriting the preferred stock of the Republic Steel Corporation which amounted to $1,386,641. In addition to this they got 12,500 shares of Central Alloy for an underwriting operation for that company. In addition to this they had the option to purchase 200,000 shares of the common stock. The complexity of the vast web of interests which Eaton formed for the purpose of carrying out all these plans is difficult to describe in words, but a chart which was used at the Bethlehem-Youngstown trial and prepared by the Bethlehem lawyers, graphically and amazingly illustrates what went on in Eaton's schemes and what goes on in innumerable similar plans of financiers like Mr. Eaton.

Mr. Eaton found himself at the center of twelve corporations. They were Otis and Company, brokerage house, of which he was a partner, International Shares, Inland Investors, Continental Shares, Continental-Allied, Commonwealth Securities Corporation, Foreign Utilities, Iron and Steel Syndicate, Cliffs Corporation, Inland Steel, Republic Steel Corporation and Youngstown Sheet and Tube Company. If you will examine this you will find that while Mr. Eaton owned interests in all of these companies they in turn owned interests in all the other companies. These mutual and criss-crossing interests are so intricate that they are almost impossible to follow. However, I append a list of Mr. Eaton's ownership and the ownership of all other companies together with a list of the directors who co-operated with Mr. Eaton in the management of these companies, showing the interlocking directorates by which Eaton controlled with a very small money investment hundreds of millions of dollars.

CYRUS S. EATON

Partner in Otis and Company.
Chairman of the board of directors and Chairman of executive committee of Continental Shares, Inc.
Chairman of board of directors of International Shares Corporation and member of executive committee.
Chairman of board of directors of Commonwealth Securities, Inc.
Director and member of executive committee of Trumbull Steel Company at the time of acquisition by Republic.
Director of Republic at time of acquisition of Trumbull, Union Drawn

Steel Company and Trumbull Cliffs; also during negotiations and adoption of plan on merger of Republic Steel Corporation and Donner Steel Company, Inc. and the Bourne-Fuller Company.
Director of United Alloy Steel Company at the time of the acquisition of the Central Steel Company.
Director of Central Alloy Steel Corporation at the time of the acquisition of the Interstate Steel Company and also at the time of the merger with Republic Steel Corporation.
Director of Inland Steel Company.
Vice-President and Director of Cliffs Corporation.
Director of Cleveland Cliffs Iron Company.
Director and member of executive committee of Youngstown Sheet and Tube Company.

W. R. BURWELL

President and director and member of executive committee of Continental Shares, Inc.
President of International Share Corporation.
Director of Cleveland Cliffs Iron Company.
Director of Cliffs Corporation.
Director of Wheeling Steel Corporation.

F. H. HOBSON

Vice-President and member of executive committee of Continental Shares, Inc.
Vice-President of Cleveland Trust Company.
Director of Central Alloy Steel Corporation.
Director of Republic Steel Corporation.

L. G. WATSON

Secretary, Treasurer and director of Continental Shares, Inc.
Vice-President of International Share Corporation.
Director of Commonwealth Securities, Inc.

RICHARD INGLIS

Partner in Otis and Company.
Director of Continental Shares, Inc.

Director of Guardian Trust Company.
President and director of Inland Investors, Inc.
Director of Cliffs Corporation.

PHILIP WICK

Director and member of executive committee of Continental Shares, Inc.
Partner of Wick and Company.
Director of First National Bank of Youngstown.
Director of Republic Steel Corporation.
Director and member of executive committee of Trumbull Steel Company at the time of acquisition by Republic.

T. M. GIRDLER

Member of advisory committee of Continental Shares, Inc.
Chairman of the board of directors of Republic Steel Corporation.
Director of Donner Steel Company.

E. B. GREEN

Director and member of executive committee of International Shares Corporation.
Vice-President of Cleveland Trust Company.
Director of Trumbull Steel Company at the time of acquisition by Republic.
Director of Republic Iron and Steel Company at time of acquisition of Trumbull.
Director of Republic Steel Corporation.
Director of Cleveland Cliffs Iron Company.
Director of Cliffs Corporation.

FERDINAND EBERSTADT

Partner of Otis and Company.
Director of Commonwealth Securities, Inc.

S. E. KLINE

Partner of Otis and Company.
Director of International Shares Corporation.
Director of Inland Investors, Inc.

WM. G. MATHER

President of Cleveland Cliffs Iron Company.
President of Cleveland Cliffs Corporation.
Director of Central Alloy Steel Corporation.
Director of Republic Iron and Steel Company.
Director of Republic Steel Corporation.
Director of Trumbull Steel Company.
Director and member of executive committee of Central Alloy at time of acquisition of Interstate.

JOHN T. HARRINGTON

Director of Republic Iron and Steel Company.
President, member of executive committee and director of Trumbull Steel Company at time of acquisition by Republic.

J. O. EATON

Partner of Otis and Company.
Director Inland Investors, Inc.
Director of Trumbull Steel Company.
Director and member of executive committee of Central Alloy at time of acquisition of Interstate.

To use the words of the legal brief:

"The net result of the foregoing is that Mr. Eaton has organized around himself a series of financial institutions which by the sale of their securities, concentrate enormous sums of money entrusted to these institutions for investment purposes and thus place at his disposal the tremendous power of these aggregated sums, and that Mr. Eaton is using this power admittedly to direct, as he thinks best, reorganizations, mergers and consolidations in the steel industry which will centralize in him the control of the steel business in the Midwest from the mines and raw materials to the sales of finished products, with incidental banking and brokerage profits, stock options, founders' shares and underwriting compensations to himself and his associates."

Of course, Mr. Eaton's interests became so extensive that after a while they became difficult for him to juggle successfully and the disclosures in the Bethlehem suit began to warn stockholders in these various corporations that their interests were being utilized to advance the plans of Mr. Eaton instead of the interests of the various corporations of which he was a director. As a result numerous suits have been filed against Eaton by various stockholders in his different corporations. One charges that as a result of mismanagement and neglect Continental Shares' assets shrank over $38,000,000. Another suit charges that in October, 1930, Eaton and the Foreign Utilities Corporation, wholly owned by him, sold to Continental

Shares certain stock and received $2,400,000 in excess of the market value of these stocks.

Three more suits filed in Cleveland, April 15, 1931, charge that Eaton and others sold stock to the Continental Shares in excess of their value and ask the return of $9,110,934. Another suit charges that on December 3, 1929, the Continental Shares loaned $2,874,480 to Eaton, secured by his note backed by Otis and Company and Independent Shares, Inc. and a pledge of 31,000 shares of Republic Steel Corporation, that this note was not met at maturity and was continually renewed and that the value of the securities put up as collateral was only $470,000. As a result of all these suits Mr. Eaton on April 27, 1931, quit the field. Bankers called in to save Continental Shares and other corporations in which he was interested advised that because of the suits against him it was important to save the name and credit of the corporations, that he withdraw from them and this he has done, but the suits still hang fire against him.

CHAPTER NINE

A LITTLE EXTRA OIL MONEY*

ON A November day back in 1921 a little group of men put their heads together in a room of the Vanderbilt Hotel in New York. One of them was a veteran oil prospector, A. E. Humphreys, able, much respected, a picturesque, square-shooting old wildcatter who had just hit it rich. He had oil to sell—millions of barrels. The other men in that room were there to buy it. Be sure now to look closely at them, for they are sitting down to the opening of one of the most remarkable episodes in American business history.

One was Harry M. Blackmer, Chairman of the Board of the Midwest Refining Company. He was a dashing figure; a lawyer who had made a fortune at the bar; a banker who had turned another fortune in finance; a railroader who had raised

poor old Moffatt's ill-starred Continental Divide from its ashes and made it into gold; and now an oil magnate, a gay, colorful, sport- and life-loving adventurer who lived like a prince and spent money like a Monte Cristo. Another was J. E. O'Neil, chairman of the board of the Prairie Oil and Gas Company, quiet, serious, religious, a bit frail in health but an astute trader. A third member of the buying group was Harry F. Sinclair, head of the Sinclair Consolidated Oil Company, worth many millions, a gambler in his soul, with the greatest stable of racehorses among his toys, spreading out his vast, intricate and audacious financial schemes over the globe.

The fourth member of this powerful quartet was Colonel Robert Wright Stewart—massive, breezy, shouldering, domineering master of the Standard Oil Company of Indiana, the largest single manufacturer and marketer of petroleum in the world.

These men wanted Humphreys's oil. They had been negotiating for it for months, not for themselves, of course, but for their companies. They went into that room, in fact, as the purchasing agents—the trusted purchasing agents—of the great corporations which they headed.

They had made a deal with Humphreys. They would take his oil—33,333,333 barrels—at $1.50 a barrel. The oil was to go to the Prairie Oil and Gas Company (O'Neil's corporation) and the Sinclair Crude Oil Purchasing Company. This last belonged jointly to Sinclair's corporation and to Stewart's. Everything was settled. Humphreys had called in ex-Senator Thomas of Colorado, his attorney, to draw up the contracts. Thomas had all the facts of the deal noted down. He was about to go into the next room to dictate a contract of sale to the Prairie Company and the Sinclair and Stewart companies at $1.50 a barrel when Blackmer spoke up.

"In making that contract, Senator," he said, "the oil is to be bought by the Continental Trading Company of Canada."

So the Stewart and Sinclair and O'Neil Companies are not to get it, eh? What is the Continental Trading Company? Who is in it? Has it any financial standing? Can it handle this oil and pay for it? These questions ran through Thomas's

mind and Humphreys's. But the four great oil men quickly quieted their fears. Their companies would guarantee all the payments. Never mind about the Continental. The Standard and the Sinclair Consolidated and the Prairie Company would put their credit behind this fifty-million dollar purchase. That satisfied Humphreys and his lawyer, and the latter withdrew to prepare his papers.

Next day the men met again. The papers were ready, a contract for the sale of 33,333,333 barrels of oil to the Continental Trading Company of Toronto, Canada. But another member had joined the cast of characters. He was Mr. H. C. Osler, of Toronto, introduced to Thomas and Humphreys as President of the Continental Trading Company. Blackmer and Stewart and Sinclair and O'Neil had handled all the negotiations for the sale of this oil by Humphreys at $1.50 a barrel. The President of the Continental never appeared until it was time to sign the contract. Stewart and Sinclair and O'Neil on behalf of their companies signed as guarantors. Then Humphreys and his lawyer withdrew.

Immediately Osler, as president of the Continental, signed another contract, selling that same oil to the Stewart, Sinclair and O'Neil companies at $1.75 a barrel. In other words, on the 33,333,333 barrels this Continental Company stood to make twenty-five cents a barrel, a total of more than $8,000,000.

Now then who was this Continental Trading Company? Who was to make this $8,000,000?

While Stewart et al. were in New York settling the details of the purchase from Humphreys, Osler, a lawyer in Toronto, with furious haste was bringing the Continental Trading Company into existence. It was organized the same day Stewart and his friends closed with Humphreys. And Osler came hurrying to New York to be in at the final rites. The directors and the stockholders were all clerks in Osler's office. The simple fact is that the Continental Trading Company was a pure fiction, a corporate ghost. Osler later declared that it was "nothing more than a corporate clerk in his office." He really acted for a client. Who the client was he would never divulge, taking refuge behind his professional privilege. And

now here is what happened to the Continental. It never really made $8,000,000 but did make $3,080,000. For two years Humphreys delivered his oil direct to the Prairie and the Sinclair Crude Oil Purchasing Company. These companies sent their checks to Osler in Toronto at the rate of $1.75 per barrel and he paid Humphreys at the rate of $1.50, withholding twenty-five cents on every barrel. After two years the Sinclair Company and the Prairie Company bought from the Continental the undelivered portion of its contract for $400,000.

This contract was sold back to this company at the time the oil scandals were beginning to be investigated by the Senate. Mr. Osler then returned the charter of the company for cancellation, destroyed all the papers and called the incident closed. The $3,080,000 of profits he invested in Liberty bonds. These Liberty bonds, less the expenses, were divided into four packages of $750,000 each. And Mr. Osler delivered one package to Blackmer, one to Sinclair, one to O'Neil and the other to Colonel Stewart.

In other words, these gentlemen, acting as purchasing agents for their respective companies, had the oil which they purchased nominally transferred to a dummy corporation, then re-sold it to the companies they represented at a profit of over $3,000,000. This rake-off was divided among these four corporation heads, each of whom wound up with $750,000 of Liberty bonds in his possession.

More than seven years passed, and no hint of this strange episode ever reached the public or the stockholders, and probably never would have but for one of those inexplicable twists of Fate which men always leave out of their calculations until it is too late to repair the damage they work.

Just about this time another and a wholly unrelated transaction was in progress. Harry Sinclair was dealing with Secretary of the Interior Albert B. Fall for that rich oil field, Teapot Dome, and E. L. Doheny was arranging for the equally valuable concession in the Elk Hills reserve, both belonging to the Navy Department. For these more than royal gifts both Doheny and Sinclair were forced to pay liberally by Fall. Sinclair gave him $230,500. But he *made his payment in bonds.*

And as Mr. Sinclair fumbled among his securities for the right amount to send Fall, one can imagine that impish Goddess of Fate slyly pushing into his fingers some of those very Liberty bonds which he had received from the Continental Trading Company. That was a pure accident. Other bonds might equally well have been selected. But by that one curious mischance Sinclair laid a trail which was to bare all the details of the transaction in Blackmer's Vanderbilt Hotel suite. When the bonds went to Fall the damage was done.

Then came an explosion. Fall's perfidy became known. The Senate, under Senator Walsh's leadership, began its famous investigation. Fall was driven from the Cabinet. He was indicted. So were Sinclair and Doheny. A civil suit was begun against both these gentlemen to recover the naval oil reserves. The whole episode dragged its slow length along. Finally the civil suit was set for trial at Cheyenne, Wyoming. A young law assistant, rooting among Fall's bank deals, came across a lot of Liberty bonds, $230,500 worth. He noted the numbers. Then through the Treasury Department, lawyers for the Government began to trace those bonds by the numbers. They turned out to be bonds which at one time had been bought by the Continental Trading Company. Thus the trails of these two scandals crossed—and all the result of that odd mischance by which Sinclair had casually selected those Liberty bonds to pay Fall.

Further digging by the Senate revealed that the Continental had purchased at different times \$3,080,000 of bonds. Then Senator Thomas came forward and told as much of the story as he knew—how the Continental had bought Humphreys's oil and how Stewart and Sinclair and Blackmer and O'Neil and Osler had appeared in the deal. Senator Walsh sent for these gentlemen. But they had flown, Blackmer to Paris, O'Neil to parts unknown, Osler to hunt lions in Africa, Stewart on an unknown mission. Sinclair was under indictment and hence could not be forced to testify. Whenever the Senate Committee wanted Stewart he seemed to have business for the Standard Oil in some other part of the world—in Cuba, in Mexico, in Europe. His evasion of the Senate's

process was assuming the proportions of a scandal. Finally in January of 1928, while he was in Havana and getting ready to go to Mexico, and the Senate was making preparations to go after him, young John D. Rockefeller wired him:

"Nothing short of the fullest and most complete statement of all the facts can remove the cloud of suspicion which hangs over the entire industry. . . . You owe it to yourself and to your associates, stockholders and the public to help bring these transactions into the fullest light. . . . I urge you with all the influence I possess not to wait for an invitation from the Senate committee which has been appointed to look into the matter, much less a subpœna, to appear before it, but to wire Senator Walsh at once offering to put yourself at the disposal of the committee to tell all you know about the matter."

In answer to that peremptory appeal from Rockefeller, Colonel Stewart decided to change his plans and appear before the Senate committee. He took the witness stand February 2, 1928 and faced Senator Walsh.

Now remember that at this time the committee did not yet know who the Continental Trading Company was or who had received the profits from that deal. Here is an excerpt from Colonel Stewart's testimony:

Senator Walsh: Did you have any interest in the Continental Trading Company in any way?

Stewart: None whatever.

Senator Walsh: Do you know who the parties were who did have an interest?

Stewart: I did not.

* * *

Stewart: I did not know anything about the bonds. I never had anything to do with the distribution of the bonds.

Now at that very moment Colonel Stewart had in his safe $750,000 of these bonds. In spite of that, when asked another question by Senator Nye, he replied: "Senator Nye, I did not personally receive any of those bonds or make a dollar out of them."

He repeated this statement over and over again. And when he was pressed as to the parties interested in the Continental Trading Company he refused to answer. For this he was indicted by the

Senate for contempt. It was after this incident that John D. Rockefeller, Jr., summoned before the Senate Committee, declared "that I am bitterly disappointed that Colonel Stewart did not answer all the questions asked of him."

But now that "tangled web we weave when first we practise to deceive" began to wrap its filaments about the Colonel. Senator Walsh, moving with the "dogged tread of doom", the very spirit incarnate of retributive justice, went on digging with almost demoniac obstinacy at this unholy mess. O'Neil, hiding from his conscience in a French monastery, feeling that his health was broken and that death looked into his face, crept back to Canada and returned to his corporation, the Prairie Oil and Gas Company, the amount he had received as his share of the Continental deal —$800,000, being $750,000 and accumulated interest. Blackmer, too, sneaked into Canada, met his attorney secretly, and disgorged $736,000.

It was now plain to the Senate that Blackmer had received a fourth, O'Neil a fourth and Sinclair a fourth of the Continental profits. Who had got the other fourth? All eyes turned toward

Stewart. The net was closing around him. Then came to light the final inculpatory fact. An investigator of the committee traced to Stewart's bank account the cashing of Liberty bond interest coupons in June and December, 1922, and in June and December, 1923. These sums were for $13,125 each. This represented precisely the interest on $750,000 of bonds, the amount of the unaccounted-for fourth. Stewart's whole massive body was now completely in the trap. He was called before the Senate committee again and this time he came under a moral compulsion to explain his embarrassing position. And he told an amazing story:

He admitted that he had received $750,000. He admitted that the bonds had been for seven years in his possession until three days before his last appearance. He declared that when the Continental deal was made he did not know he was to get any part of the profit. Some time later, however, Osler visited him in Chicago and delivered the first instalment of the bonds he received. He protested against it, he said, but took the bonds. He kept them for seven years. He never told his

board of directors anything about it. He testified, however, that he called in an employee of the Standard—the tax commissioner—and confiding in him, announced that he wanted to put the bonds in trust for the Standard, asked the employee to act as trustee, wrote out in pencil a hasty trust assignment and put the bonds in the trustee's possession. Four times thereafter Colonel Stewart cashed interest coupons and put the money in his own bank account; but that he made good, he swore, by delivering to the trustee Liberty bonds to cover the interest. Then—after the interest payments had been traced to his bank account and three days before his testimony—he told the whole story to his directors, took them to his bank vault and delivered the bonds to them—seven years after he had received them and only after the Senate had come practically into possession of the facts.

This is the plain statement of the unpleasant incident which formed the basis of John D. Rockefeller's campaign to oust Stewart from the chairmanship of the board of the Standard Oil Company of Indiana. As an incident of how little this was understood the editor of the *New York Evening Post* poured a libation on the fine ethics of modern big business in this generation and observed that even the effort of Mr. Rockefeller to thrust Colonel Stewart from his high post was not based on any moral turpitude in the management of that business but because of his failure to enlighten the public, as Colonel Stewart should have done, in connection with the scandalous proceedings of a corporation using secret and reprehensible methods.

Of course the editor completely missed the point. The transactions which I have narrated above had nothing to do with the oil scandals. They came out merely as an incident of the probing of those scandals and because the trail of one ugly deal by a strange mishap happened to cross the trail of the other. Mr. Rockefeller asked the elimination of Colonel Stewart because, as the purchasing agent of the Standard, he went into a deal with others in which the Standard was to pay an illegal profit of twenty-five cents a barrel on the oil it bought and because Colonel Stewart kept this business a secret from his board of di-

rectors and then turned up seven years later with part of these profits in his possession and an explanation which strains credulity.

Colonel Stewart testified that he had been sent after that oil by the Standard directors. The actual negotiations for the Continental deal were handled by Blackmer, now in Paris. But Blackmer was in constant correspondence with Stewart preceding the deal; he wrote saying he would "follow Stewart's instructions"; he was head of the Midwest Refining Company and that concern was owned by Stewart's corporation—the Standard of Indiana.

There would be something pathetic in this unlovely dénouément to one of those Horatio Alger success careers which American business loves to celebrate, were it not for the rude and pugnacious insolence with which Colonel Stewart bore himself throughout the whole deal. He flung insults about him with a free tongue. Sitting on the witness stand, and with the incriminating bonds locked secretly in his safe, he yet shook his finger under the very nose of Senator Walsh and challenged any insinuation that he had profitted a dollar out of the transaction. Another day, after the bonds had been traced to his possession and when he was retailing under oath the amazing yarn with which he explained his share in the deal, he turned upon Senator Nye, with a blustering sneer and said: "Why, you're crazy."

American business is still cursed by the feeling among a certain type of corporate director that he has a right to exploit his corporation. The director of a railroad should be primarily concerned with the welfare of that road. But you are apt to find he is more directly concerned with selling coal to his road. Naturally this is not true of all corporate directors; but it is true of so many that it helps to explain the sluggishness of the reaction to the oil scandals. The day after Stewart defied the Senate he declared he had received hundreds of congratulations from big business men. For six years the oil scandal dragged and big business never opened its lips to denounce the infamies. If it did speak it was to grumble at the prying and snooping of the Senatorial investigators.

No part of this whole episode had a greater significance than the battle which was waged to

defeat Stewart for re-election to the Board of the Standard of Indiana. First of all, it will be recalled that all the corporations to which the various men involved in the oil scandals belonged took no measures whatever to bring the delinquent officials to book. Here it should be observed that this whole transaction involved not just a few persons but many men, and among them leaders in American business. The heads of half a dozen great industrial corporations had been caught red-handed grafting on their corporations. Some of them had actually fled from the country but not one hand was raised against any of them in the corporations they managed. No stockholder moved against them. No director criticised them. In the case of Colonel Stewart it is doubtful if there would have been any such vigorous movement against him if the Senate Committee had not hauled the younger Rockefeller into the spotlight and put him in the position of personally and publicly endorsing Stewart's job or protesting against it. When Rockefeller then started his campaign therefore, Stewart was swamped with offers of help and support from all sorts of respectable gentlemen who understood perfectly what he had done but who remembered only that he had made dividends for them. This he most certainly did. He had made an extraordinary success of the Indiana company. In a brief space it grew under his direction from a $175,000,000 company to a $900,000,000 corporation. While it did not make enough to pay its regular dividend in 1927, it prospered amazingly in 1929, so that Colonel Stewart and his fellow directors were able, as a kind of last minute desperate pre-election offer to the stockholders, to declare a $116,000,000 dividend. He was accused of conduct which brought his company and his whole industry under a cloud of disgrace. His answer was "I made money for you."

Though in the end they were fully apprised of what Colonel Stewart had done, his directors stood by his act. And while at the final counting of votes he was defeated, because some of the larger stockholders had rallied around Rockefeller, the vote, counting noses and not shares, was overwhelmingly in favor of Colonel Stewart. His acts received as magnificent an endorsement

from his stockholders in the proportion of about five to one as any man has ever had. And when he went out of office, instead of going disgraced as poor Fall went and poor Denby, the latter having done nothing dishonorable at all, he went out with a magnificent life pension from the company from which he was ejected.

Graft in business! High standard of business morality as compared with public life! Who can feel that this is so in the presence of these records.

* "Colonel Stewart", *Outlook*, February 20, 1929.

CHAPTER TEN

MANY LITTLE TRICKS

I

WE HAVE now seen a variety of examples of the various secret ways in which directors and officers of corporations help themselves to what we have been calling indirect profits—profits which came neither from salaries nor capital investment but which are made possible by reason of the positions of trust which these officers occupy and, of course, by the secrecy in which their management operations are cloaked. We have seen a great railroad hurried on toward a vast transcontinental extension to advance the interests of its officials. Then we have seen it pushed on toward a large electrification scheme followed by large sales of copper and contracts for power with con-

cerns owned by other directors; large profits made by its bankers. We have seen how directors in railroads and other companies have practically no interest in the corporations they direct, their interest being rather in other corporations which can profit by the connection. We have seen the manner in which large corporations in distress become the prey of those called in to save them; how fortunes are made in security transactions through information gotten on the inside and by men charged with the duties of trustees; how enormous portions of the profits of other corporations are taken by means of excessive bonuses; how the corporation laws are employed to get control of great groups of corporations with little capital. These, of course, do not exhaust the ways of men who exploit corporation positions of trust for their own enrichment. There are still others. And there are many examples of the manner in which directors and officers fall into the habit of looking upon corporations they manage as their own property.

I give now an example of large profits made out of a position of trust. For various reasons I withhold the names of the persons in this little drama. There is no special necessity for this, since the whole case was thoroughly aired in the courts, though for some reason the facts brought out did not get very much public attention at the time. I leave out the names of the parties because they are so well-known and occupy such high positions in business that I might be accused of throwing mud if I were to revive the little scandal now. The purpose of this book will be as well served by relating the incident with the identity of the parties left out, with this assurance, however, that all the facts are given precisely as they were determined by a high court of law.

The president of one of our great corporations during the war was about to leave on a long trip. Before going away he conferred with the vice-president, next in authority, who would be in control during his absence. To the vice-president he made, in effect, the following statement:

"I am now going away. As you know I hold a very large amount of stock in this company, which has been very successful. I would like to sell a good block of this stock to the employees of the

company. I do not do this because I want to unload the stock on them. I would just as soon hold it, for it is very valuable and will grow in value. But I think it would be a good thing for this company if its employees had an actual investment interest in it and I think it would be a good thing for the employees too. I am therefore willing to part with a portion of my stock to them to bring about this desirable end. I put a price of $160 a share on it and I suggest that you take the matter up with the board of directors. If they approve it I will turn the stock over to them and they can arrange for distributing it among the employees and the method of payment."

There is no reason whatever to doubt that the president was quite sincere in the reasons he assigned for selling the stock. In any case the vice-president submitted the proposal to the board. The directors thought the idea a good one but suggested that the price asked by the president was too high. They therefore directed the vice-president to communicate with the president and propose a slightly lower price. This the vice-president did and got a letter from the president insisting on the price he had named.

"Not only is it not too high," said the president, "but it is very low. I am in a position to know that we are about to get huge orders for war material from which the company will make very good profits and the value of the stock will, in a very few months, go very much higher." As a matter of fact, these war orders did come along in a tremendous volume and the price of the stock did go to a very much higher figure.

When the vice-president got this letter, however, he did nothing more about the matter so far as pressing the proposal of having the employees buy the stock. Instead he began to think that, in view of these approaching war orders, it might be an excellent thing to buy the stock himself. He therefore took the matter up with some of his fellow directors and several of the officers of the company. He proposed to them that they form a syndicate and purchase the stock. They thought this a splendid plan and immediately organized a company to buy the stock. But the purchase involved many millions—more ready money than

they had. So the two leaders in the plan went to New York and conferred with the banks which held the deposits of the corporation. They made an arrangement with these banks for a loan of $8,000,000. In return they increased the deposits of the corporation in the various banks handling the loan by $5,500,000. In other words, they used the credit of the corporation of which they were officers and directors to make a loan to buy stocks for themselves. They bought the stock and the whole matter passed into history.

Nothing of this deal would have ever come to light had not some of the stockholders learned of it and charged that the officials involved had betrayed the trust they owed the company and demanded the return of the profits made by them. It is an amazing thing that they refused to make a settlement and permitted the matter to go to the courts with a resulting exposure of the part they had played. The court declared that they had committed a fraud on their company. The "director of a corporation," the high court said, "stands in a fiduciary relationship which requires him to exercise the utmost good faith in managing the business affairs of the company with a view to promote, not his own interests, but the common interest, and he cannot directly or indirectly derive any personal benefit or advantage by reason of his position distinct from his co-shareholders. If he acts for himself in matters where his interests conflict with his duty, the law holds the transaction constructively fraudulent."

The men who engaged in this adventure were among the leaders in American business. When the deal was in process of completion, one of the company's officials went to the vice-president, the leader of the group, and said:

"I do not think you should go through with this deal. It is wrong. Your father and my father were brothers. They were honorable men and they cherished above everything their good names. For the sake of that good name I think you should not go on with this plan. If it becomes known your business reputation will be ruined. Is it not better to lose this profit than to have this thing get out and destroy your name in the business world?"

The vice-president, however, went on with the

deal. And the deal did get out, and it was branded by one of the highest tribunals in the country as a fraud. But the vice-president's sensitive relative was wrong. The deal did not, apparently, hurt the business reputation of anybody involved in it. For later most of them have been honored in many and various ways in business and public life. Like the unjust steward of the Bible, apparently these gentlemen have been commended, for the children of this world are wiser in their generation than the children of light.

The instances of known corporation graft are not at all few. Here is an example: A large corporation makes a contract with a certain person who owns a patented device which the corporation wishes to use. The corporation gets a license to use the device. In return it agrees to pay a fixed royalty on all articles made by that device. When this is complete certain of the directors go to the persons who own the patent and are to get the royalties and buy from them their royalty rights. Thereafter the corporation would have been compelled to pay the royalties to its own directors. But certain stockholders got wind of this, took the matter into court and the court held that the directors would have to turn the royalties over to the corporation.

In still another case a group of men had a claim against a corporation. The officers of the corporation went to the creditors and bought their claim for $25,000. Then through a third person the full claim was presented to the board. The directors then voted to settle the claim for $68,000, making a secret but none the less neat profit for themselves of $43,000.

Many cases can be found like the following: The treasurer and director of a large corporation knows that the company will need a certain piece of land in a year or two. Armed with this information he goes to the owner of the land and buys it in his own name. Later when the corporation wants the land the treasurer is in a position to sell it at double the price paid for it. I use the facts from an actual case.

The Anaconda Copper Company and the Amalgamated Copper Company wanted the property belonging to the Alice Gold and Silver

Mining Company. There was, apparently, no reason why it should not make such a purchase. As a matter of fact, it did buy the properties of this company, but for a price which two courts held to be inadequate. The President of the Anaconda Copper Company was a director and officer of the Alice Company and it was he who engineered the deal and as a director of the Alice Company voted to sell its properties for an inadequate sum to the Anaconda Company of which he was President.

It would be possible to multiply these cases indefinitely. It is a well-known fact which needs no proof that all of the countless performances which take place behind the private offices of corporation officials do not come to light. As has been observed by the head of the Better Business Bureau about commercial bribery, there are a thousand cases of graft for every one which comes to light. Undoubtedly very little comparatively becomes known because of the privacy which surrounds business. Yet in spite of this it is the simple truth to say that I could fill a volume many times this size with specific instances of corporation graft which have come to light and which are known and have been proved.

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This matter of privacy in business corporations lies at the root of much of this trouble. Much of it arises out of the notion which corporation rulers frequently get that the business belongs to them and that the stockholders are merely so many outsiders who have been permitted to tag along behind the men who run the business. Courts have frequently commented on this attitude of directors and officials and sometimes with something akin to sympathetic understanding. Out of this attitude grows the secrecy which surrounds the company's financial affairs, its stockholder personnel and the holdings and interests and compensation and connections of its officers. Directors frequently refuse to give even to stockholders essential information about their own affairs. And the conditions which attend corporate elections when there is a contest are enough to

make those expert vote manipulators who dominate political election booths blush with shame for their innocence.

The trough of a business cycle, which we call a depression, seems to be the happy hunting time for rebels, rebels in business as well as in politics, and the period following the famous crash of October, 1929, will always be remembered for the numerous revolts which were launched in various great industrial corporations. Among the corporations which felt the shock of rebellion was the Loft Candy Company. Here was an excellent example of the manner in which the rulers of large corporations come to think of them as their own personal property.

The Loft Candy Company, it is true, had been started and built up by George W. Loft from very humble beginnings. There is no doubt that Loft had exceptional ability, saw great possibilities in the rising tide of mass production and chain distribution and was, if our capitalistic system is to be accepted, entitled to a large measure of material reward for his business ability and initiative.

However, there comes a time when the organizer's or leader's ability and initiative are not sufficient by themselves; when his own resources are inadequate and he is compelled to take in partners. The popular method of doing this is to incorporate and join together in a large co-operative enterprise the resources of many people. And so as Loft built his candy business larger and wider and needed more and more funds he had to take in more and more partners until finally he had 5,000 of them in the shape of stockholders—owners of shares in the Loft Candy Company.

Of course, Loft himself had a large part of his own fortune in the candy company. Like his stockholders he depended for his profit on this investment, but unlike his stockholders he got also a salary of $50,000 a year as President of the company and this salary he got whether the business was good or bad. As it turned out, the business was not good. At least it was not good enough to pay any dividends to the stockholders who for seven years went without any profit whatever on their investment. Indeed, after a while Loft seemed to grow weary of business and in the end he retired from the presidency and was succeeded by his son

at a salary of $25,000 a year. It cannot be contended that these salaries were excessive as corporation salaries go. But it soon came to light that the salaries represented practically the only interest of the Lofts in the candy business, for Loft and his son had divested themselves of their stocks. About the beginning of January, 1929, all the officers of the Loft Candy Company put together owned only 201 shares of stock out of a total of 650,000 shares, with a value of about $1,600 out of a total of $5,000,000. In spite of this, however, the Lofts continued to consider themselves as the masters of the Loft company. They still continued to feel that the 5,000 stockholders counted for very little and they resented criticism of their methods or inquiry into their management.

However, the people whose money was invested in the business without any profit began to become at first dissatisfied and then curious and finally indignant. A committee of stockholders was organized, chiefly under the inspiration of Mr. Alfred Miller, an investment banker. In the statement of the company covering 1928 there was an item of $286,214 represented as general expenses and without any explanation as to the items. The failure of the Lofts—indeed their refusal to explain this item—precipitated the trouble and so Miller, assisted by others, had little difficulty in getting the proxies of 370,122 shares, a majority of the stock in the company. When the annual meeting arrived on March 20, 1930, the stage was set for a battle on the Lofts—a battle to oust them, to demand an accounting from them and to take over the control of the company. What followed revealed once again this dangerous proprietary attitude of certain corporation managers towards their corporations. Miller's crowd had a clear majority of the stock but when the stockholders' meeting assembled, the Lofts, in possession of the election machinery—like a political boss in a political primary or convention—proceeded to utilize that machinery to defeat the will of the majority of the stockholders. Here is a phase of corporate management which is growing more and more important. As corporations expand in the number of their stockholders and the complexity of their interests they come to resemble more and more political units

in which there is a sharp difference between the constituents or suffragans on one side and the officials on the other. The development and perfection of political machinery for controlling the corporations grows more and more like the political machine which is used to control political corporations.

It was clear to the Lofts that they were in a hopeless minority. Their downfall was inevitable if the meeting was held and a vote taken. They could stave it off only by preventing the meeting from being held. In modern corporate practice the election of officers is brought about each year at corporate meetings by the directors in control. Most corporate charters require more than fifty per cent of all outstanding voting shares to be represented at such a meeting and many corporations have difficulty in getting a majority of the stockholders to appear either directly or by proxy. Hence officers are held over from year to year.

When the Lofts stockholders' meeting was assembled the Lofts immediately raised a point of no quorum. This necessitated a roll call of the stockholders and a presentation of proxies by those who held them. As the roll was called Miller and his group presented one after another the proxies they controlled and the Lofts continued to challenge the legality of the various proxies. Being in control of the election machinery, like the election commissioners in a political voting booth, they held numerous Miller proxies to be illegal. At the end of the roll call Miller was able to show only 302,000 proxies held to be valid by the Loft machine, some 70,000 of his proxies being ruled out as illegal. This was less than one-half of all the shares outstanding. The Lofts had a good many proxies—several hundred thousand—but very many too few to contend successfully in an election with Miller's proxies. However, the Lofts did not present any of their proxies. Had they done so, their shares and Miller's together would have been sufficient to make a quorum. By withholding their proxies Miller had to have enough votes himself to make a quorum and by ruling out as illegal a large number of Miller's proxies they were able to defeat the quorum and thus prevent the holding of a meeting. The performances at this meeting make an interesting chapter, par-

ticularly for those who watch with growing concern the gradual evolution of corporate units into quasi-public bodies. The stockholders and proxy holders and managers and candidates were all present and the meeting lasted all of one day and entirely through the night into the next day. Speeches were made, florid orations, charges and countercharges, violence was threatened, indeed averted only by the presence of twelve policemen and two police captains, but in the end the meeting had to be adjourned because there was no quorum and the Lofts, with 201 shares of stock, continued in control of a corporation with 650,000 shares outstanding.

However, the insurgents continued their battle, charged that dividends had not been paid because earnings had been eaten up by high salaries and bonuses to managers, denounced the Lofts and their political manipulations and finally in the fervent tones of a political orator asked:

"How long will stockholders permit the affairs of their corporation to be directed by men who will stoop to such proceedings to precipitate themselves in office?"

In the end Miller and his group got enough proxies to force the meeting and oust the Lofts.

A year later Miller and his group were ousted at an election equally violent. After Miller was ejected he and his associates were sued by the Loft Company under its new management for two million dollars. One of the allegations was that Miller, an investment banker, had promptly increased the stock of the company from 650,000 to 1,500,000 shares, marketing 372,862 of the new stock, from the proceeds of which he was asserted to have paid $305,365 to Russell Stewart for underwriting. Other sums sought to be recovered were $57,000 collected by one of the directors for introducing efficiency methods under which the Loft Company lost over $300,000 the first year, $30,000 to another director for advertising services while his firm was paid $224,206; $32,000 to another director, a lawyer, and $9,500 to still another lawyer; $64,000 collected by the various directors for expenses and salaries for themselves from March 19, 1930 to May 1st when they were ejected.

CHAPTER ELEVEN

BANKING RACKETS

I

A CRIMINAL court has convicted some of the officers of the Bank of United States in New York. These gentlemen were charged with certain criminal acts the purpose of which was to defraud the bank and which actually resulted in wrecking it. The indictment of these officials furnished the business world with the necessary scapegoat. It dramatized the acts by which this bank was destroyed. It seemed to lift the case of this bank out of the general mass of banking practice and fix the cause of the bank's ruin as the unlawful management of a group of men who were exceptions to the general run of bankers.

As a matter of fact the outrageous performances of the Bank of United States were not the criminal acts for which the bank's officers were prosecuted but a group of acts which did not figure in the trial at all—a group of acts which are not against the law—a collection of acts which can be duplicated in numerous other banks. To put the matter more seriously, the acts which were responsible for the destruction of that institution are those which now characterize the tendency in bank management.

The crime of the officials of the Bank of United States consists in having failed, in not having been intelligent enough bankers to manage the mechanism they set up without a crash. Their fault in this respect was accentuated by the bad times into which we moved. There is good reason to believe that if the business depression had not overtaken us the Bank of United States would not have failed and all the acts committed by the officers would not have become known and they would now be operating the bank at full speed.

The various devices which they set up in that bank and which other banks have also set up to circumvent the banking laws and get around

good banking practice would still be well known to bankers but that would make no difference. The bank's officers would be riding high, serving on citizens' committees, perhaps taking part in the present rising crusade against the "graft of Tammany Hall."

Much has been printed about the Bank of United States scandal, little is yet known by the public, even the financial public, of precisely what was done in that institution. All the things, or many of them, which the bank's officers were charged with having done are acts made possible by the financial structure of the bank. In other words when the collection of corporations which constituted that institution was formed it could have been done with no other purpose than to permit the doing of the very things which were later done. If such devices are found in other banks, what are we to conclude is the reason for their presence there?

Let us now examine this banking structure and see how artfully it was framed for the purposes to which it was later put.

The Bank of United States was a state bank.

It was empowered to engage in the business of banking and nothing else. The banking laws of New York State, as of most states for that matter, are quite severe. They have been developed over a course of years and out of many painful experiences. They have been designed to protect the depositors directly and indirectly the community because of the necessity of having the funds, which are the life blood of business, carefully guarded against the cupidity of men. But in recent years many bankers have looked with growing restlessness upon those vast reservoirs of funds and the barriers of law which have kept them more or less safe from exploitation. They have chafed to get at those funds, not indeed to steal them but to get the use of them unhampered by the laws which have restrained them.

Once again be good enough to remember that I am not talking about scoundrels. I am not speaking of bank robbers, embezzlers. I am speaking of perfectly fine gentlemen, men looked upon as pillars of society. But there are many such who have felt that our banking laws were a little bit old-fashioned; who thought our banks should

be a little more like the banks of other countries, Germany for instance, where the banks get into all sorts of business and control it. And so they gradually invented a form of banking affiliates which has now enabled them to do the very things which half a century of banking law development was needed to prevent. The officers of the Bank of United States did not invent this. They merely used a device which had already been invented. Now here is what they did:

In 1927 Mr. Marcus and Mr. Saul Singer, President and Vice-President of the bank respectively, organized the City Financial Corporation. This was a separate corporation, had nothing to do with the bank, was not apparently connected with it in any way. They provided for two kinds of stock, Class A and Class B. The Class A stock was sold to the public. The Class B stock was taken by the insiders. What they paid for this Class B stock I do not know, but it was not very much. The money for this corporation was supplied by the Class A stockholders. But under the charter of the City Financial Corporation, these Class A stockholders who put up the money had no control over the corporation whatever. They did not have the right to vote for directors or on any other matter. The entire voting power was lodged in the hands of the Class B stockholders, who had put up practically no money and who, of course, included in a controlling degree Mr. Marcus and Mr. Singer. There was nothing unlawful about this and, so far, there was no connection with the bank.

But in fact this corporation was organized as part of a scheme to use the bank's funds for the profit of the insiders. How was this done? Let us examine the next step in the process:

Mr. Marcus now organized another corporation. This he called the Bankus Corporation. This operation is a little complicated, so it must be followed closely. After some feeling about this new corporation, the Bankus Corporation, issued 357,336 shares at $25 a share. This corresponded with 357,336 shares of Bank of United States stock. The shares of Bankus Corporation stock and of the Bank of United States stock were then coupled in units—one share of bank stock and one share of Bankus stock. Then the stockholders of the

bank were asked to subscribe to these units. And after a good deal of clever salesmanship and a little pressure the stockholders of the bank subscribed for all the Bankus stock. When the operation was over the bank's stockholders had 357,336 shares of bank stock and 357,336 shares of Bankus stock. So far the matter is simple. There is now in existence an affiliate pretty much like the affiliates of many other banks, which belongs not to the bank but to the stockholders of the bank. Being no part of the bank the banking laws do not apply to it. And the bank examiner cannot examine it. But belonging to the bank's stockholders and having the same officers as the bank, and practically the same directors, and being operated from the same building, it can actually be run as a department of the bank, yet unhampered by any of the laws designed to protect banks. However up to this point this must be said of it; that any profits made through the Bankus Corporation would belong to the stockholders of the bank, not to the officers and promoters. Where then did they come in? Now we must watch very closely the next step, for here the operation begins to get more complicated and then you begin to see where the bank promoters come in—where in fact begin those secret and indirect profits which I have included under the term graft.

The next step was to have the bank issue 357,336 new shares and to have the Bankus Corporation do the same thing. Here now was another batch of Bankus and bank stocks which could be combined in units.

The next step was to turn the bank shares over to the Bankus Corporation. The Bankus Corporation was now ready to combine its shares and the bank's shares into new units, one share of each corporation in a unit. But of course when the bank turned its shares over to the Bankus Corporation the bank had to be paid for the shares. Where did the Bankus Corporation get the money for this purpose? You will recall the City Financial Corporation which Mr. Marcus and Mr. Singer organized. Well, the Bankus Corporation got the money from the City Financial Corporation. It made a loan.

Now see the next step. The Bankus Corporation now had 357,336 units made up of one share

of bank stock and one share of Bankus stock in each unit. It owed the City Financial Corporation the money it had borrowed to buy these bank shares. Now it was ready to sell the units. To whom did it sell them? Why to the same City Financial Corporation from which it had borrowed the money to buy them. But it did not sell them for cash. You must remember here the Class A shares issued by the City Financial Corporation. That concern now provided an issue of 714,672 Class A shares. It bought the bank and Bankus units from the Bankus Corporation paying for them with its own stock—giving two shares of its own stock for each unit of bank and Bankus stock. When all these swaps were completed here then is how matters stood:

There were outstanding two groups of bank and Bankus units—357,336 units in each group.

One group belonged to the stockholders of the bank. Another group belonged to the City Financial Corporation.

In other words, there were 714,672 shares of bank stock out. Half of these shares belonged to the original stockholders of the bank. The other half belonged to the City Financial Corporation. Half of the bank's stock, therefore, was controlled absolutely by the City Financial Corporation. But you will recall that the control of that corporation was in the hands of the Class B stock, which belonged to Mr. Marcus and Mr. Singer and the insiders of the bank and which they had gotten for little or no cash. In other words, they now had the Bank of United States irrevocably in their hands without putting up any money to speak of. The same thing, of course was true of the Bankus Corporation. They held half the stock of that in the same way.

It is now plain that the City Financial Corporation dominates the Bank of United States and the Bankus Corporation and that the bank's officers dominate the City Financial Corporation. Moreover the earning power of the City Financial Corporation is very great if it is managed with adequate shrewdness. But who will get these profits of the City Financial Corporation? That is the next stage in the proceeding. It is necessary to remember that there were two kinds of stock in the City Financial Corporation—Class A and Class B.

The dividend provision of the charter of this company was so arranged that the Class B stockholders —Mr. Marcus and his friends, who put up little or no money, got the lion's share of the profits. The first dividend of the Class A stockholders was 62½ cents a share; on the Class B stock it was $1.25 a share.

This, however, was but the beginning of the process. A new corporation was formed—the Municipal Financial Corporation. Once more we see the ever-present Class A and Class B stock. The Class A stock sold amounted to $8,000,000. The Class B stock was only $360,000, if that much. The Class A stock was almost all sold to the Bankus Corporation. The officers of the bank took the Class B stock. The Bankus Corporation put up $8,000,000; the bank's officers put up about $360,000. The Class A stock had no vote whatever; the entire voting power was in the hands of the Class B stock. In other words the bank's officers, who now controlled the bank through the City Financial Corporation, and controlled the City Financial Corporation through the Class B stock, now also controlled the Municipal Financial Corporation through its Class B stock.

Here is the way the profits of the Municipal Corporation were to be divided. The Class A stock cost $50 a share. The Class B stock cost $4.50 a share. Now without going into an abstract statement of dividend arrangements here is a concrete illustration of the way profits would be divided. Let us suppose the profits to be divided are $6 a share. First the Class A shareholder will get $2.75. Then the Class B shareholder will get $1. After this the remaining $2.25 will be divided equally between them, or $1.12½ each. Here is a tabular statement of the division of the profits, based on earnings of $6 a share:

Class A—Invest. $50 —Div. $3.37½—rate 6.75%
Class B—Invest. $4.50—Div. $2.12½—rate 47%

As a matter of fact, the Bankus Corporation, which was in reality the bank, held most of the Class A stock which would get the 6.75 per cent. *The bank's trusted officers were the Class B stockholders who would get the 47 per cent.*

The important fact now is not that Marcus and

his friends made bad loans here and there, but that they started off with this carefully set up manipulation of the bank's powers with the intention of exploiting the bank's funds.

Is all this honest? Apparently bankers think it is. It was all within the law. It was a scheme deliberately cooked to deprive the bank's stockholders of a large part of the profits accruing from the management of their funds. The point I am laboring to make is that the failure of the bank was a mere incident. Even if the bank had not failed, and all these affiliates had pursued their appointed courses, the profits arising from all the variety of transactions of the Bankus Corporation and the City and Municipal corporations would have been cleverly detoured from the bank's stockholders to the pockets of the officials. With these three corporations, unrestricted by law and outside of all official scrutiny, the bankers proceeded to organize some fifty-seven other corporations engaged in all sorts of business. It was through these three initial affiliates that they were enabled to carry out their schemes. Is this sound banking? Is there any reason why it should be permitted to exist? One of the chief flaws in permitting it is that it invites into banking the kind of men who run to racketeering in business. It must not be supposed, however, that the men who formed the directorate of the Bank of United States were not reputable business men. That is the most serious phase of the affair. That bank had a large board of directors practically all of them widely known as business men. Yet most of them approved the things that were done, all of them were thoroughly aware of the intricate web of affiliates organized and some of them had full knowledge of everything that went on. The disturbing thing is that an organization, carefully devised, rigged from the outset to perform secret services for the gentlemen who run the bank, invented for no other purpose than grafting in bank credit, should have among its directors a group of well-known business men. The managers of the bank have truthfully said that the crash of the bank was due to the stock market crash and the wide shrinkage in security values. There is no doubt about that. It was the market collapse which wiped out the bank's security values and caused the failure and

in turn made possible the revelation of what was going on behind the secrecy of its cages and doors. If the market had not collapsed there is very good reason to believe that the bank would have gone ahead and, of course, the managers would have continued to ply their grafting activities unmolested and with the approval of the board. But they would have been none the less grafters.

2

Of course, it must not be supposed that the Bank of United States was the only one carrying on these activities. In a somewhat different way we have been treated to a similar spectacle in Tennessee, Kentucky and Arkansas, where the failure of a group of banks has brought to light the operations of another group of very distinguished business men.

This banking scandal has gotten curiously mixed up in the politics of the state of Tennessee and of course the purely banking elements in the story are obscured. As I write this Tennessee is in a state of explosive excitement as one faction in the legislature is attempting to impeach the governor for what it holds is his part in the series of moves by which over $6,000,000 of the state's funds have become entangled in the failure of various banks in Nashville and Louisville which went down in the failure of Caldwell and Company, investment bankers of Tennessee.* What must be kept in mind is that the part of the state in this little banking drama is only an incident. The most serious part of the Caldwell failure was its purely banking and business section, all of which throws a flood of light on the present menace of holding company control in banking.

Roger Caldwell was the head of Caldwell and Company, an old established investment banking house in Nashville, Tenn. founded in 1876, but which rose to be one of the largest, if not the largest in the South.

James B. Brown, of Knoxville, Tenn. was another figure of importance in the Tennessee financial world. Brown was President of the National Bank of Kentucky and of the Knoxville Herald-Post. Col. Luke Lea, former United States Senator

* This attempt failed.

from Tennessee, owner of the Memphis Commercial Appeal, the Nashville Tennessean, the Evening Tennessean and the Knoxville Journal and Tribune, was also affiliated with Caldwell. Lea is a dynamic and colorful character who attained a kind of serio-comic national notoriety during the war when he invented a scheme to kidnap the Kaiser. He was, however, a member of the Federal Reserve Bank for the Nashville district.

Under Caldwell's domination was a group of powerful banks. They were the National Bank of Tennessee, the Liberty Bank and Trust Company, the Holston Union Bank of Knoxville and the National Bank of Kentucky. Backed by the financial resources of these institutions and many smaller affiliated banks, Caldwell and Company embarked on one of those widespread programs of expansion so familiar to us, in which they got under their control industries and financial concerns of all sorts, including banks, security companies and insurance companies, as well as newspapers and manufacturing establishments. In June, 1930, they formed one of those bank holding companies with which we are also familiar—

the Banco-Kentucky Corporation, a name strangely reminiscent of the Bankus Corporation of Mr. Marcus and Mr. Singer. Immediately began that shifting of interests, that crossing and criss-crossing of holdings such as I have already described in the case of Mr. Eaton's operations. These things are difficult to follow and I will not lead the reader through the maze. But an example of the process will be seen in the announcement made June 1, 1930. On that day Roger Caldwell, president of Caldwell and Company and James B. Brown, president of the Banco-Kentucky Corporation announced:

1. That Roger Caldwell had acquired a "substantial" interest in the Banco-Kentucky Corporation.

2. That the Banco-Kentucky Corporation had bought a half interest in the banking firm of Caldwell and Company.

It was then proudly pointed out that this created a structure which controls banks and insurance companies with combined assets of $615,000,000. The two chief companies, we were told, had combined capital and surplus of $100,000,-

000, with a control of banks having resources of $285,000,000 and deposits of $225,000,000, while the insurance companies related in like manner have admitted assets of $216,000,000 and insurance in force of $1,840,000,000. Quite a juicy collection of financial melons! And please remember this was not in Wall Street, but out in Nashville, Tenn. and Louisville, Ky.

In a few more weeks it was announced that Caldwell and Company were forming a holding company to handle and control its insurance affiliations in Kentucky, Arkansas, South Carolina, Texas, Ohio and Missouri. And it is interesting to observe that they were being joined in this highly useful public service by Otis and Company, the banking outfit of Mr. Cyrus S. Eaton. Many pages would be required to follow the financial operations of the Caldwell crowd. What we have seen in other banking outfits, and what has been detailed above, will serve to give a sufficient picture of this now more or less familiar scene.

In the Fall this extensive collection of financial cells was threatened with disintegration. The persistent shrinkage of securities began to tell on it.

Then the gentlemen sitting in the center of the web began to shift funds around from one bank to another, from the banks to other financial affiliates, huge loans to Caldwell and Company by banks, great sums used in the market to support the market price of the stocks and finally the deposit of millions of state funds in various banks belonging to the group to save them from disaster. It is this last feature of the scandal which caused all the stir in Tennessee politics. It will be seen, however, from what I have outlined above, that it is but an incident in the sorry mess.

On November 5, 1930, the crisis was reached. Caldwell and Company placed their affairs in the hands of a committee of bankers for the sake of protecting the firm and its clients. The Nashville Clearing House formally declared that all the Caldwell loans were well secured.

But on November 13 the Caldwell house, crushed under the load of its vast imprudences, was forced into a receivership. This was the signal for one of the most disastrous series of bank failures that the South has ever known.

Immediately the important banks with which

these gentlemen were associated were closed. The National Bank of Tennessee, the Holston Union Bank of Knoxville and the Liberty Bank and Trust Company shut their doors. This was on the thirteenth. Next day a run started on the Hermitage Bank in Chattanooga because of reports that it had loaned heavily to Caldwell. But this bank withstood the run. In Knoxville three banks had to be hurriedly merged and supported to save them from actual ruin.

On November 17, fifty-seven banks in the South closed in one day. The National Bank of Kentucky, after ninety-six years of operation and growth, closed its doors. This was in Louisville, in another state. But Mr. James B. Brown of the Banco-Kentucky Corporation was President of this bank. Immediately four more Louisville banks were closed. Meanwhile smaller banks all over Kentucky, Tennessee and Arkansas were closing down. In Memphis 100 citizens formed themselves into a vigilance committee to push the prosecution and punishment of any officials guilty of misconduct in office in connection with the use of state funds in the wrecked banks.

On November 18 an even more remote repercussion of the Caldwell crash was heard—it was the sound of thirty-nine banks in Arkansas, either closing or suspending. This was precipitated by the closing of the American Exchange Bank of Little Rock, Ark., for five days. This bank was the largest in the state and was one of the large group of banks dominated by A. B. Banks and Company. Caldwell and Company had had a large interest in the American Exchange Bank. Before the end of this process of hysteria and failure was reached over seventy banks in Arkansas either suspended or were closed completely. In Kentucky not less than eleven were closed through association with the wrecked National Bank of Kentucky. Many were closed in Tennessee, while even in Ohio, Cincinnati metropolitan banks had to come to the rescue of four banks controlled by Nashville interests and two by the Banco-Kentucky crowd. Caldwell has since been convicted for certain irregularities in connection with these transactions.

This is not the only group which has run upon the rocks. There have, however, been many others

which have not failed but which have been practicing precisely the same kind of finance. They differ from the Bank of United States and the Caldwell crowd only in that they managed their cluster of interests more intelligently and hence have escaped ruin and at the same time the exposure of their methods. There are some groups of chain banks united by means of the holding company and with various kinds of affiliates which are in the main formed for the purpose of meeting certain needs in the trade areas which they serve. Anyone who wishes to pursue this subject more fully may go to the reports of hearings before the House Committee on Banking and Currency, where under the guidance of Chairman McFadden of that committee, a very full exposition has been made of the conditions which have lead certain bankers to organize many banks into groups united by means of the holding company. New conditions in trade, the tendency of industry to move toward those great financial centers like New York and Chicago where it can find adequate financing, the further tendency, as a result, toward the loss to smaller trade areas of important industries—all these considerations are given as the reasons back of certain chain or group banking organizations. There is no purpose here to ascribe other than proper motives to these groups. But this system of group banking, in which widely scattered banking interests are held together by means of the holding company and are tied up with the extensive and promotional schemes, including security affiliates, insurance companies and financial enterprises of every character—this system lends itself admirably to the ambitions and designs of unscrupulous or at least of adventurous men. It has been the parent of racketeering in the banking business. The profits which financial adventurers make by means of these banking devices are hidden, carefully held away from the public eye, concealed even from the scrutiny of the bank examiner. No bank examiner can possibly follow them. Even if bank examination were to be extended to bank holding companies and to banking affiliates, it would not be possible for examining departments to follow the intricate details of promotion which are possible under this system. My own view is that the holding company as applied

to banks should be forbidden by law. But this would not be sufficient. Security affiliates should also be rigorously detached from the bank and the trust company. I see no objection to the investment affiliate of a trust company. But to unite both the security affiliate, which is a seller of securities, and the investment affiliate, which is a buyer of stocks and bonds, is to shut our eyes to the experience of all time, which tells us that no man should be permitted to be on both sides of a bargain.

The American Bankers' Association has adopted as almost the first article in its Code of Ethics this declaration of faith:

"A banker should never accept personal profit from any of the bank's transactions with its customers. A banker should not use the cash or credit of his bank for the promotion of his own personal business enterprises or of concerns in which he is largely interested. He should only sell or recommend for investment to his customers securities of the highest character and never anything of a speculative nature or securities of any concern in which he has a personal interest or for personal profit.

"A certain noblesse oblige, an obligation of honorable and generous behavior in the sight of God and man, is impressed upon all who bear the name and wear the badge of this profession."

If this means anything it means that the banking fraternity should take the lead in the establishment of sound ethical principles in business and that it should show the way in banking itself. Instead it has been somewhat more ingenious and resourceful than other branches of business in the invention of devious devices for diverting funds entrusted to its care to its own uses.

3

The financial world has just witnessed the most outrageous spectacle of grafting finance that this country has ever known through the exploitation of the investment trust along with the holding company. I have no intention of going here into the countless abuses of investment trusts. That subject I have explored more fully in another

volume published more than a year ago.* The revelations of financial graft through the investment trust since that book was written have amply justified the criticisms included in it. There has been a good deal of talk about those bankers whose bad judgment brought them into the spotlight along with their crippled investment trust stocks. The amazing feature of the whole incident, however, is that there has been no criticism of the fundamental error in the whole institution as practiced in America—the fact that it has fallen into the hands of the investment banker. The investment banker is a merchant of stocks. The investment trust is a buyer of stocks. When an investment banker with securities for sale creates an investment trust with money to buy securities and asks small investors to put their money into it and proceeds thereafter to occupy the double role of seller of stocks for his investment banking house and buyer of stocks for his investment trust he is travelling very far, it seems

* *Investments Trusts Gone Wrong!* New Republic, Inc., 1930.

to me, from that ideal of noblesse oblige which the bankers' code so loudly proclaims.

One of the best investment trusts I know of—at least it was entitled to be described as such six months ago (Heaven knows what changes a few months may produce)—is a glaring example of this indefensible practice in finance. Here is its set-up: It was organized ostensibly as an aid to banks. The average banker is constantly importuned by customers for advice as to the stocks they should buy. If he remembers his code, which is not always the case, he will realize that the business of investment is an intricate one and that he is not really very well equipped to advise his client. The very large banks in a few of the great cities have research departments and they are well qualified to study securities and the fundamental business conditions behind them. They are able to give intelligent advice, if their advice is not mixed with an element of interest which grows out of the fact that through a security affiliate they also have stocks to sell. But this is true of only a few banks. The great majority, even of good-sized banks, are not equipped to advise their clients on securities.

"Go to your banker", which was once the popular answer to the man seeking investment advice, is, in my judgment, about the worst advice you can give him.

Moreover, the intelligent banker also realizes that it is quite impossible to advise wisely a man with a few thousand dollars as to where he shall put it in the stock market. The truth is that he should not put it anywhere and that for the simple reason that he cannot invest so small a sum without putting almost all of it in a single company. This is held to be a perilous thing to do. It is putting all one's eggs in a single basket. The rich man distributes his investments among a large number of stocks, thus getting the security which comes from diversity. But a man with two or three thousand dollars cannot do that.

Now to meet this situation a large investment trust management corporation was organized and some fifty or sixty banks were invited to own the stock in it. It was to form other companies, subsidiaries, which were to be true investment trusts. And the shares of these investment trusts were to be sold to small investors, the customers of the banks who had banded together to create it. The idea was an excellent one. The customer of the bank, let us say in Des Moines, who approached his banker for advice as to what he might do with his two thousand dollars would be given the following counsel by his banker.

"The safest thing for you to do with that two thousand dollars is to put it into an investment trust. This bank has not the research department necessary to study all stocks, so we have united with some fifty other large banks in other cities to establish a security research bureau which will at all times be able to select the very best and soundest of stocks. In addition we have created an investment trust which will buy groups of fifty or sixty different stocks. Instead of buying shares in just a single corporation therefore you can buy shares in this investment trust which will give you a fractional interest in the fifty or sixty stocks which it has assembled. I therefore advise you to do that."

Now this is good advice if we suppose that the company thus created has established a real research bureau and that the men who manage the

company in New York are free and disinterested advisers and have no interest in selling any securities in which they are interested. But when we follow the concern to New York and examine its structure we find a committee of gentlemen who meet frequently and have the final authority on the purchase of all stock. And who are these gentlemen? They are the representatives of seven very large investment banking houses who are among the largest sellers of securities. I think it a fair point that these men ought not to be permitted to occupy such a position, that of all the people in New York they should be the last to be called in for such a service and the fact that such a condition exists is an evidence of the utter callousness of the banking fraternity to the essential proprieties of their calling. It will be no answer to this that these men are honest and can be depended upon to put the interests of the investment trust first when they sit on its purchasing committee. Such an assumption violates the conclusions of all time and the whole world about men acting in conflicting capacities—serving two masters. But more than this when the leading bankers put themselves in this position and defend their right to serve two masters there is no way to close the door to the horde of adventurers who infect the purlieus of high and low finance and who lose no time in following the lead of their more distinguished brothers.

CHAPTER TWELVE

SOME PROPOSED MEDICINE

I

THE importance of correcting the conditions I have been picturing must be very obvious. To no interest is it more important than to business itself. Beyond that, the defender of the present order of private industry must see in these abuses, not in the more or less remote and vague menace of Russia, the real enemy of his system.

There can be little doubt that this whole business of graft is the prime cause of an unjust distribution of rewards in business. I take the capitalistic system as I find it, assume it is the soundest, assume at least, with some reason, that it will be with us some little time; certainly is with us now and must be lived with for a space. That being so there is no reason why the inequities in the rewards of work should not be corrected if that is possible. I take as assumed that the popular notion that brain workers ought to be paid more than others and that management—the men who supply the initiative, the talent, the executive direction which inspires an enterprise and keeps it afloat—ought to be well paid. I take for granted that the capitalist, by which I mean the man who supplies the money, should be paid for his capital the usual going rate when his funds are well secured and the element of risk is reduced to the minimum; a better rate and, perhaps, an eventual premium in the way of increased increment, when he puts up the needed funds under conditions of great risk. All this may be conceded. But after so much is admitted, we must also acknowledge that in industry wholly unwarranted sums find their way to men who contribute but little if anything either in brains or capital to its management. Further we will have to admit that others, who do make, perhaps, very valuable contributions for which they are paid and perhaps well paid, manage to divert

to themselves other sums, frequently very large sums, unwarranted sums, all of which is made possible by this system of graft or indirect profits of which I complain. What defense can be made of the act of a banker who organizes or reorganizes a business and who for his share takes more money from the business than would be required to pay all the executive officers of the business for a dozen years? He supplies neither capital nor management brains. In a moment of distress he finds people who will supply the capital. Those who do put up the money get a modest sum for that service. The banker who locates them takes a huge cut for himself. What defense can be made of the very common practice of corporation officers and directors using their positions as strategic posts from which they can make large sums directly and indirectly out of the corporation?

This inequity in the distribution of the rewards of industry is a potent force for discontent among the most conservative elements in our society. The worker has been more or less mollified—or was until 1929—by the rising tide of better wages and better working conditions in this country. If that condition could have gone on forever without the disturbing interruption of a depression he might have been counted on to be the bulwark of the present system. Indeed the Federation of Labor has come to assume in the eyes of our so-called radical elements the role of chief supporter of the bourgeois state. Of course, the deep blue of organized labor has been subject to some radical dilution in these last two years. However, what has not been so apparent has been the slow yet growing recalcitrance of the middle class. Our big business friends have little conception of the tolerance which these people have come to have for the incessant current of angry criticism of the existing order. They, more than anyone, feel the injury which this system of graft imposes upon all.

There has been a movement for the eradication of what is called commercial graft, but no movement at all inside business so far as I can find, for the elimination of that kind of graft which emerges from the manipulation of corporation machinery and this, of course, is the most serious.

2

The movement against commercial bribery has already gotten a start. But it is only in its first stages. The next step to be taken is the passage of the proposed federal law known as the Graham bill.

We do a great deal of talking about states' rights. And the principle is an excellent one within certain limits. No one, however, talks about the state control of the railroads any more because the interstate character of that business has been obvious for half a century. Equally it is useless to talk about the enforcement of state laws against commercial bribery when so much of it is carried on across state borders.

That other well worn objection to "passing another law" must, of course, be looked for here. It is true that we, as a people, suffer under the mad illusion that the morals of men can be regulated by law; there is nevertheless a legitimate area within which it is quite proper, indeed essential, that society shall assert its rights through laws. No one will urge the revoking of the law against murder merely because a good many people resort to that form of self-indulgence at times. No one will insist that there should be no law against bribery of public servants because so many public servants have a way of subjecting themselves to the indignity of receiving occasional questionable honorariums. When one man bribes the employee of another, he commits an offense not only against the man he bribes, but against his employer as well and against the competitor who loses the business because a dishonest agent took a bribe, to say nothing of society which suffers through the spread of this system. The employee who takes the bribe has his chance to protect himself by the decent exertion of a little will power. But the employer is quite helpless; usually he is kept in the dark. So also is the competitor, who is doubly wronged, for he not only loses the business but is driven, in the end, to adopt the same practice himself or to shut up shop. Against the acts of others which inflict injury on helpless third persons there ought to be protection in the law. This is not a case of sumptuary legislation. It is a case of recognizing what the conscience of the nation ought to

reprobate as an offense and provide a penalty to discourage it.

A federal law is essential. The manufacturer in a state subject to the laws of the state which has a law against commercial bribery is handicapped as against the manufacturer who is located in another state. Or at least he would be handicapped if the state law were enforced. It is not enforced for this very reason, because it would be a discriminatory law, hitting the local manufacturer and not affecting his foreign rival.

Moreover the passage of such a law would be an expression of state policy and would be of the greatest aid to those trades which are earnestly desirous of building up a sentiment against commercial bribery within their own ranks. Almost every important commercial country in the world has such a law and in some of them, at least, certainly in England, the law has been an aid in the war on commercial bribery.

It is a little unfortunate that we turn, in this country, to the expedient of prison sentences as the chief punitive sanction for our laws. It is not difficult to get jail sentences enforced in the case of crimes involving force or the more well-understood crimes against society involving violent infractions of the peace, such as robbery, theft, embezzlement and the like. But it is not easy to get juries to convict or judges to impose jail sentences against men who do what so many very respectable members of our society do. And the presence of the jail penalty in the law frequently operates as a mitigating influence on the minds of juries, if not judges. Of course, there is the fine as an alternative, but so often in the case of minor offenders it is not possible to collect a fine. If a prison sentence is to be imposed it ought to be a very brief one. In offenses like this, conviction, particularly if attended with sufficient publicity, is enough punishment and a prison sentence of a day or two or a week at most would be quite sufficient, or even conviction without a definite punishment—probation, in fact, would be effective.

Prison sentences under the proposed law might very well operate as a restraint upon employers in taking action against offending employees. If the penalty were lighter there would perhaps be less

reluctance on the part of both victimized employers and rivals.

There should, therefore, be in addition to this criminal federal statute a law giving to an employer whose agent is given a bribe a right of action against the employer who gives the bribe either directly or through an agent. In the end the responsibility for the system must rest upon the tolerance of business men who get the benefit of business thus corruptly gotten. When an employer is fully determined to stop his employees from giving bribes he can do so. A civil action, therefore, should rise in favor of any business concern whose employee is either offered or given a bonus or premium or payment of any sort without its knowledge or consent.

One of the difficulties in the way of enforcing statutes against commercial bribery is the unwillingness of employers to bring upon themselves the reflected odium of corrupt practices by their employees. Last year the president of a large corporation discovered that the manager of his purchasing department had collected some $250,000 through crooked deals in connection with purchases over a period of several years. The president came to me to urge me to do what I could with our city papers to keep the whole matter out of their columns. He was thinking, of course, of the reflection upon his own administrative efficiency and the general character of the corporation's manager if the news got out.

Among the functions of the various private trade organizations charged with the warfare on commercial bribery one of the most important is the matter of publicity. There is no more powerful weapon. A bureau to give publication to every case of commercial bribery is an essential of the movement against the practice.

Of course it will be of little use to provide penalties for commercial bribery against offenses committed in interstate commerce if state laws are not also passed and strengthened to cover offenses within the states. Less than half the states have laws on the subject and many of the laws are aimed at only certain types of commercial bribery. Moreover in almost all of the states the laws are dead letters. Those who have been pressing for more effective legislation insist that the laws are

weakened by the lack of immunity clauses. They declare that as bribery always involves two persons, it seldom involves more and that it is carried on very secretly and hence is difficult of proof. They believe that if the law will offer one of the guilty parties an inducement to disclose the facts by offering him immunity it will be possible in many cases to provide legal proof of offenses. Accordingly they propose to make, in the law, a definite grant of immunity to the first of the parties to the offense of bribery who will reveal the fact to the properly constituted authorities within a specified time. New York State has already passed such an amendment to its penal code and Michigan and Louisana have followed suit.

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Along with all this, of course, must go the persistent effort of men engaged in those lines of business affected by this practice. In the end the law will be able to accomplish little without a strongly developed feeling against the system in business itself. While a great many trades have formally endorsed the movements against commercial bribery and still others have embodied articles respecting it in their codes of practice, but few have taken energetic measures to stamp it out, Some trades, however, notably the Paint and Varnish Manufacturers, have made vigorous assaults upon this ancient vice. They have not been content with a codal denunciation. They have set up a bureau to deal with it and keep up an incessant warfare against bribery throughout the country. Manufacturers who feel they have been injured by the bribery practices of other manufacturers can report their wrongs to this central bureau which will investigate them and take measures to end the practice. This organization has also kept up an agitation for the passage of federal and state laws. It is impossible to believe that where such an earnest effort is put forward results will not follow. It is inevitable that the sounder and more respectable ethical elements in the business will begin to exercise an influence on the trade as a whole. The association insists that it has gone a long way toward stamping out the evil in the paint and varnish industry.

When other lines of industry set up bureaus or commissions to hunt down bribery in their trades and pursue it ruthlessly we will begin to get somewhere in this important, indeed essential, crusade.

4

A fine beginning has been made in the war on commercial bribery. But we have not travelled very far in the matter of setting up severe ethical standards for corporation managers and directors. These gentlemen do not, perhaps, engage in those raw, unvarnished dishonesties which their lesser business fellows employ who permit bribers to cross their palms with cash. Their ways are more subtle. Well-established and more or less respectable fictions varnish over the unfinished surfaces of their dishonesty. But their offenses are far more serious in every way.

First of all, the most important single movement we have to face is a complete and drastic recasting of our corporation laws. The corporation was never intended to be used in the manner which is now common. Unfortunately, while the effects of the corporation are almost wholly economic, the development of the corporation has been altogether in the hands of the lawyer who, very naturally, has thought in terms of his client, not in terms of economic laws. Moreover the corporation is, in its beginnings, essentially a legal device. As it has developed and taken on new forms and involved new and vast complexities, they have been wholly legal. It is difficult, indeed, almost impossible, for anyone to understand them unless he is a lawyer or has had at least a legal training. For this reason the layman has been rigidly ruled out of the discussion of corporation law. He has had little standing before legislatures dealing with corporation laws because law-makers have been disposed to leave the whole matter to the lawyers.

We have got to get a clear understanding of the fact that the corporation has now become our most serious economic problem. I do not speak of the trust and I am not thinking of monopolies. The ordinary corporation poses for us so many serious industrial and financial problems that there is no way of considering them intelligently with-

out taking the subject of corporation law bodily over into the domain of economics. That done, nothing short of a general and drastic revision or remaking of corporation practice should be accepted.

For the benefit of those who are forever talking about the interference of government in business it is important to remark here that the corporation itself, as an institution, represents a tremendous interference by government in business. It amounts to the creation of a separate legal entity to do business just as a human being does, but with a limited liability. This being so, will anyone contend that if it was proposed now de novo to any legislature in America expressly to authorize such a proceeding as we have seen in the corporate structure of the Bank of United States group or the Eaton collection of corporations, any lawmaker would for one moment approve it?

We have got to come to the point of prohibiting the holding company altogether—of prohibiting one corporation from holding stock in another corporation, save in very carefully guarded exceptions. The holding company will utterly destroy the capitalistic system if it is not checked. I have tried to be moderate in this volume. Certainly I have indulged in no angry denunciations. I have sought to make it plain that I understand the process by which, through easy stages, very decent men are brought to practices of a questionable nature. I have no intention of predicting the collapse of our present system. But the system has enemies who would gladly destroy it. As has so frequently happened with other systems in history, the most dangerous enemies are within its lines and not outside them. All the agitation of so-called radical groups; all the propaganda activities of Russian internationalists; all the Communists in and out of America, will never deal to the industrial system of the United States such fatal strokes as it is now getting and will continue to get with increasing violence from the holding company and the inevitable and inescapable abuses which are bound to follow in its wake.

I have no intention of proposing any program for corporate reform here. But I indicate a few things which are essential.

1. The use of the holding company should be

made illegal under all circumstances. There is and can be no objection to the corporation. It will undoubtedly be—already is in fact—the universal method of doing business. But there is no reason why all the business of a corporation should not be done under the shelter of a single corporate entity.

I am aware of the difficulties which face many large corporations operating in numerous states which find it convenient to have separate incorporations in different states. Also there are several large industrial corporations which have numerous subsidiaries, all operating under separate incorporations. The Standard Oil Company of New Jersey, for instance, has about seventy. So far as I know no abuses grow out of this. But it is not possible to permit it without opening the doors to all comers. And whatever convenience large corporations making a more or less legitimate use of corporate subsidiaries enjoy is far more than offset by the injury which the public interests suffer from the extensive abuses of the system.

2. Furthermore, no corporation should be permitted to own stock in any other corporation. Obviously this must permit of exceptions. For in-

stance, insurance companies which invest their funds in corporate securities might well be permitted to invest in the stocks or bonds of other corporations. Investment trusts might well be permitted to buy and own the stocks of other corporations subject to certain drastic limitations, such as, for instance, a rule against investing more than one per cent of the trust's funds in any one corporation or owning more than one-half of one per cent of the stock of any one corporation. Other exceptions of course would have to be made.

3. The fullest publicity of corporate affairs should be compelled for the benefit of stockholders and in certain respects for the benefit of the public. Stockholders should have very complete statements worked out on some basis of uniform accounting methods which will enable the ordinary investor to understand them. The New York Stock Exchange has for years carried on a campaign amongst corporations listed on the Exchange to force them to do something like this. Unfortunately only a small percentage of the corporations in the country are listed on the New York Stock Exchange.

4. The names of all persons owning stock in corporations should be a matter of public property. This will of course fall with a shock upon the ears of certain conservative souls, yet there is nothing shocking about it. In years gone by when the chief form of investing one's surplus was real estate there was no secrecy about the matter. Today, for that matter, the ownership of all real estate is quite open to public inspection. The ownership of every parcel is registered in most states and anyone having an interest in the matter can look it up. Similarly every corporation ought to be compelled to file with some public authority a list of all its stockholders and the amount of their holdings each year. This might be limited to corporations of a certain size and might also be limited to stockholdings over a certain amount—say over 100 shares or $10,000 in amount.

5. The stock holdings of all directors and officers should be a matter of public knowledge, together with a full statement at all times of all sums paid to them or corporations in which they are interested.

6. The compensation of all officials and direc-

tors, including all sums received by them directly and indirectly, should be made known to all stockholders.

7. The problem of the directorate of corporations will have to be considered. As matters stand the directorate and the officers constitute a group of officials responsible to a perfectly helpless electorate. It is so widely scattered and so little able to follow the conduct of the directors that the directors become in a measure autocrats. As a result they find it to their advantage to keep their operations as carefully hidden from the eyes of the stockholders as possible. This they do even when they are acting in perfect good faith as managers and giving to the stockholders a perfectly honest and efficient administration. It is natural for men to desire to exercise their functions without interference. And the best way to avoid interference is to avoid attention. Even when stockholders discover irregularities in the administration of their property it is difficult for them to express their dissatisfaction. This, indeed, is so difficult that as a rule rather than become involved in a long political struggle for the control of the

corporation they simply call up their brokers and sell their stock. And if they should decide upon a contest the board of directors has in its hands the election machinery and, along with it, the support of the vast mass of indifferent stockholders who send in their proxies as a matter of course.

How this is to be remedied it not very clear. It will result, I think, in certain evolutionary developments which will have a profound influence on our social system. But in the meantime something ought to be done to curb the dangerous and wasteful autocracy of the management. It is difficult to get many sincere students of industrial conditions interested in this because they feel, particularly those disposed toward the principle of industrial democracy, more sympathy with management than with stockholder ownership. Whether the ownership and control of industry will take the form of industrial democracy remains to be seen. There is a good deal to be said against it. I feel that we will rather see stockholder ownership develop until it takes on the character of general social control. But all this is in the realm of prophecy. In the meantime we ought to provide some means of restraining the present unrestrained management where it is disposed to exploit the corporation for its own benefits.

I venture to propose that the way toward this lies in providing two boards of directors. One will be a purely management board, not unlike the boards of certain of the Standard Oil units where all the directors are men whose sole activity is within the company they direct. They are heads of departments, some being presidents of certain subsidiaries. They have but a single interest—the management of the Standard Oil Company of which they are directors. There are no outside directors, no bankers, no pure investors. The management of these companies therefore has been on a plane of very high efficiency and honesty. One board, therefore, would be such as this, made up exclusively of administrative leaders within the industry. The other board would be a purely supervisory one. It would deal with none of the mechanics of management. Its sole function would be to scrutinize the activities of the managing board. It would be made up only of large inves-

tors in the stock of the corporation, investors whose holdings are so large that they would have a substantial interest in the honest and efficient management of the company. They would have complete access to all the acts, minutes, resolutions, accounts and affairs of the management board and would in turn make full reports to the stockholders on the activities of such a board. Members of both boards would be paid for their services in a sum sufficiently large to enforce attention.

8. An end must ultimately be put to the practice of men holding membership on innumerable boards. The effect of this is to treat most of the memberships as honorary and of no consequence. The men do not attend meetings, certainly do not follow the affairs of the companies they are supposed to direct. This multiplying of directorships also results in that condition pointed out in this book where corporations are run by men who have no other interest in them save to use them for the advantage of some other corporation in which they are vitally interested. The old evil of interlocking directorates is still a serious one.

One would have to be an optimist indeed to believe that there can be very much improvement in corporate ethics until this vicious practice is brought to an end.

9. The relations between bankers and corporations ought to be regulated more clearly. It is difficult to suggest any way in which this can be done by law. But corporation executives ought to cultivate a practice of limiting bankers in their arrangements with corporations to profits which are definite, clear, capable of being expressed at the outset in dollars and cents, with the most stringent stipulations against all forms of secret profits.

10. Non-voting stocks of all sorts should be discouraged. The New York Stock Exchange has taken a stand against this. But the prohibition ought to be extended to all corporations by law.

11. Covering all these subjects, I earnestly urge the formation of a joint commission of the American Bar Association, the American Economic Association and the American Bankers' Association to study the subject of changes in our corporation law and in our corporation policy, to explore

the subject at least, if not to make definite recommendations. Our business has grown vastly. It has more or less run away from our antiquated corporation law. It must be admitted that many of those devices under which the gravest abuses have been committed have been invented by perfectly honest men and for perfectly honest purposes to meet situations not provided for in our archaic corporation laws. But once in use other persons have not been slow to employ them for questionable purposes. There ought to be no objection to studying the subject. And I suggest these three interests, the bar, the economists and the bankers, because they will have expert knowledge of the various phases of the subject. Certainly such a collaboration would result in valuable proposals for remedying many vices now existing in our whole corporate structure.

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All this leaves out the fundamental weaknesses in the whole business structure—weaknesses which do not necessarily originate in business, but which find there, because business involves the pursuit of profit, their most extensive expression. Our ethical standards are not yet as high as they might be. In matters of actually handling cash, in respecting the cash of other people, in regard for the sacredness of property rights in property where actual possession is visible we are quite sound. We have gone further. We have made notable gains in the development of what I have called the ethics of trading, the relationships between dealer and customer. But in the more obscured fiduciary relationships between official and stockholder, between employer and employee—in short in those conditions where all the familiar forms of graft germinate—we have much territory to traverse. Business must do a great deal to clean its own house, to set up ethical standards that are couched not in general terms, but aim directly at the specific vices which are so well known. In addition to this the subject, at least in a nation like ours, should get some treatment in our schools. This is a task for educators. I offer no suggestions as to how it ought to be approached, but content myself with laying the problem on the doorsteps of our schools and their rulers.

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