Max M. Kampelman Papers

THE RAILROAD HOLDING COMPANY

A Paper on its History, Nature, Significance, and Future; with Emphasis upon Government Regulations.

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Submitted by:

Max M. Kampelmacher

Jack Koteen

for:

Professor Myron W. Watkins

Economics 61

May 1940

United States Senate

COMMITTEE ON INTERSTATE COMMERCE

April 26, 1940

Mr. Max M. Kampelmacher, President
John Marshall Law Society
New York University
University Heights
New York, New York

My dear Mr. Kampelmacher:

I have your letter of April 15th and I am forwarding to you under separate cover a copy of the hearings on S. 1869.

I would suggest that you write the House Judiciary Committee for a copy of their extensive hearings and memorandum which was filed and later printed.

With my kindest regards, I am

Sincerely,

BKW
RBS:l

BF-MB

Interstate Commerce Commission
OFFICE OF THE SECRETARY
Washington

W. P. BARTEL
SECRETARY

April 24, 1940

File No. 767967

Mr. Max M. Kampelmacher, Pres.,
John Marshall Law Society,
New York University,
University Heights,
New York, N. Y.

Dear Sir:

The Commission is in receipt of your letter of April 15, in which you ask for such information as the "Committee" has uncovered in its investigation of railroad holding companies.

It is assumed that you refer to the investigation made by the sub-committee of the Committee on Interstate Commerce of the Senate, and it is, therefore, suggested that your request be addressed to that sub-committee. The Commission does not have copies of the hearings or the reports issued by the sub-committee available for distribution.

Respectfully,

W. P. Bartel

Secretary.

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C-MC

All correspondence should be addressed
"THE LIBRARIAN OF CONGRESS
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April 24 1940

Dear Sir:

We have referred to the Bureau of Railway Economics Library, Transportation Building, this city, your request of April 17 for a list of references on the "problem of railroad holding companies."

Very truly yours,

L. G. Caton

Secretary of the Library

Mr. Jack Koteen
New York University
Student Council
University Heights New York

ASSOCIATION OF AMERICAN RAILROADS
BUREAU OF RAILWAY ECONOMICS
TRANSPORTATION BUILDING
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April 24, 1940.

Mr. Jack Koteen,
New York University Student Council,
University Heights, New York City.

Dear Sir:-

Complying with your request of April 17, for material on railroad holding companies, we have forwarded to you today, under separate cover, our

1) A List of References of recent material on some railroad holding companies. 1930.
2) Current works on general transportation economics... Memorandum, March 12,1938.
3) Current works on general transportation economics - some material published from 1938 to 1940. Memorandum, April 9, 1940, supplementing memorandum dated March 12,1938.

3) lists on p.5, the Senate Committee on Commerce's report, parts 1 and 2, in its holding company investigation. Part 3 will become available at the U.S.Government Printing Office later this week, while parts 4 and 5 will become available sometime next month.

Earlier reports, hearings, and other material are listed in 2), that may help in your investigation, while the title of 1) explains itself.

Yours very truly,

R H Johnston

R. H. Johnston
Librarian.

c.
cc/with copies of lists
to Mr. T. F. Jones, Lbn.
Univ. Heights Library
New York University.

<u>BIBLIOGRAPHY</u>

for

The Railroad Holding Company

Used Extensively

<u>Government Publications:</u>

1. House Committee on Interstate and Foreign Commerce - <u>Hearings</u> (69:1, 70:1, 70:2, 71:2, 72:1).

2. House Committee on Interstate and Foreign Commerce - <u>Report Pursuant to House Resolution 114</u> Vol. I Part 1 (71:3)

3. House Committee on Interstate and Foreign Commerce - <u>Regulations of Stock Ownership in Railroads</u> - in three parts (1742 pp) - Report no 2789 pursuant to House Resolution 114 (71:3)

4. Senate Committee on Interstate and Foreign Commerce - <u>Investigation of Railroad Holding Companies,</u> 1937-1939 (73:1 - 74:2)

5. Interstate Commerce Commission - <u>Reports</u> for years 1906, 1921, 1929, 1938.

<u>Periodicals:</u>

1. <u>American Mercury,</u> "Empire in Hock" by D. Dodge, Feb. 1935, 34:160-174

2. <u>Business Week</u> "Are the Railroad Holding Companies Outside the Law?" Feb. 5, 1930, pp.41-42

3. <u>Business Week</u> "Rail Report Carriers Challenge to Holding Companies", March 4, 1931, pp. 5-6

4. <u>Business Week</u> "Clayton Law Suits May Mar Railroad's Consolidation", January 28, 1931, p. 20

5. <u>Congressional Digest</u> "American Railroad Problem" August 1939, pp. 192-200

6. <u>Literary Digest</u> "New Railroad Holding Companies" August 3, 1929, p. 56

7. <u>New Republic</u> "Bailing Out the Van Sweringens" by John T. Flynn, April 19, 1933, pp. 279-280

8. <u>New Republic</u> "Its Fun to be Fooled" by John T. Flynn, May 3, 1933, pp. 334-335.

9. Railway Age Volumes 1933, 1937, 1938, 1939.

10. Survey Graphic "Railroads on the Witness Stand " by Burton K. Wheeler, March 1940 pp. 149-151

Miscellaneous:

1. Bonbright and Means - Holding Companies

2. Congressional Record - 1933 Senate Bill 1580

3. "Railroads" by I.T. Sharfman and Shorey Peterson in Encyclopedia of Social Sciences, Vol. 13

PREFACE

To

The Railroad Holding Company

A study of this sort necessarily entails an insight into the complete picture of the railroad industry. There is too often the danger of becoming lost amidst a maze of accounting statistics and congressional reports without linking up the information obtained with the problem as a whole. This, the writers have attempted to watch out for.

In all their research through Congressional reports, investigations, pamphlets, and magazine articles, the writers have not found any complete or thorough treatment of the subject. The work, therefore, though interesting, has been quite cumbersome and at times trying.

To reach a discussion of the work of holding companies - one must wade through real estate deals. To obtain information about Congressional legislation - one must first read pages of useless comment. Flowery words by railroad magnates must be dissected - to get at the real facts.

This, we have done to the best of our ability in view of the time limitations we were laboring under.

The Railroad Holding Company

It is no secret that capital investment is lagging in our economy, that there is poverty of purchasing power, and that approximately eleven million workers are unemployed. There can be no doubt that ailing railroads have contributed greatly to this situation and that healthy railroads may very well lead the way out of it.

Before going into a detailed study of the purpose of this paper, let us briefly see how bad the condition of the railroads really is and how that condition compares with the pre-depression era. In normal times, railroads are the most important customers for our basic industries. Statistics show that they buy 23% of our national production of bituminous coal; 19% of our fuel oil; 17% of our domestic iron and steel produced; and from 16% - 20% of the total timber cut in this country.[1]

At the present time, not only has that consumption fallen to a ridiculously low figure, but 31% of the total railway mileage is in bankruptcy or receivership and only a few of the remaining are paying dividends. It is also pretty well established that if it were not for government loans this bankruptcy percentage would be materially increased.[2] This again further reminds us vividly of another way in which sick railroads affect our economy. By 1935, the federal government had poured more than one billion dollars into the railroads.

To go on, in 1929 there were, according to Senator Wheeler,

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1 "Railroads on the Witness Stand", Burton K. Wheeler, in Survey Graphic, March 1940, p. 150

2 Annual Report, Interstate Commerce Commission, 1938

1,779,000 people employed directly by the railroad industry. In 1935 that number had declined to about 900,000. Close to one million people were directly added to the unemployed rolls, with no way of determining how many hundreds of thousands more were indirectly deprived of jobs in mills, mines and factories.

We have no panacea or "cure-all" for this situation. But we are convinced that the existence of holding companies with their accompanying evils have been a contributing factor in bringing the problem into being and in hindering the recovery of the railroads. One of these accompanying evils is "waste", specifically through stock market operations and financial maneuvering. Through testimony presented before the Senate Committee on Interstate and Foreign Commerce we learn, for example, that stock market operations have resulted in losses by a few eastern railroads of one-third of a billion dollars. One of the biggest eastern roads after buying the shares of two other railroads has seen its holdings shrink by approximately one hundred million dollars. An associated holding company spent nearly seven and a half million dollars for the stocks of three southern railroads and then saw their market value decline more than 90%. In 1930, one of the largest railroad systems in the country, valued at more than two billion dollars, came under control of a holding company closely associated with a large banking firm. To satisfy the holding company's need for cash, payrolls were slashed and efficiency curtailed.[3]

It is not difficult to continue on and on with these examples and describe further the detrimental dealings, but for

3 "Railroads on the Witness Stand" Op. cit.

the time being, the above suffices.

Now that we have a general idea of the problem facing us, it is about time to define "holding company". Commissioner Eastman of the I. C. C. gives about as concise a definition as is available. He says that it is one whose essential business is the ownership of the shares or securities of other companies. It may be a corporation or a voluntary association operating as a trust.[4] In other words, a holding company in the railroad industry is a financial institution and not a carrier directly concerned with the operation of the railroad. Let us review very quickly the history of railroad development which finally led to the creation of holding companies.

At their beginning, railroads were characterized by competitive disconnected short lines. There was a complete absence, in the middle of the nineteenth century, of these inter-system arrangements necessary for effective through service. It was not until the development of American industry became evident that end-to-end railroad combinations were formed; and even this proceeded slowly. But by 1870, there were as many as fifty combinations, each comprising from 300-1000 miles of line. This growth, however, was not a planned or systematized one and the result was that important centers were connected by more than one combination of roads which created a competition often bitter and destructive.

This bitter rivalry led during the 1870's and 1880's to ruinous rate cutting.. It is not strange, therefore, to note that a reaction set in which manifested itself in agreements by independent lines to refrain from destructive rivalry. Rates were maintained by cooperative action; and

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4. Hearings, House Committee on Interstate and Foreign Commerce, 71 Congress, 2nd Session H.R's 114

pooling arrangements were often entered into to remove the incentive to rate cutting. These arrangements, in many instances, fixed the respective shares of rival roads in both competitive traffic and revenue derived.

The combinations, however, did not last long, though they seemed to fill a definite need, because the public, traditionally hostile towards every form of monopoly, protested. As a result of this indignation, coupled with the fact that the combinations tended to exact exorbitant rates, the Act to Regulate Commerce was passed in 1887. The Act provided for federal regulations of rates by a newly created Interstate Commerce Commission. It also declared unlawful the formation of pools. Within the next few years, however, it became evident that the railroads were circumventing the prohibition by setting up traffic associations to determine rates and practices. But even this was stopped in 1897 when the Supreme Court interpreted the Sherman Anti-Trust Law as applying to traffic association.[5]

The year 1897 convinced the railroads that the only way to exist profitably was to actually combine and unite lines. This was done chiefly at the turn of the centry by large transactions in the ownership of railroad securities. Even this scheme, however, did not have clear sailing when a decision of the Supreme Court in the Northern Securities Case of 1904 declared that corporate combinations, even through the holding company's device, was subject to the Sherman Law.

5 U.S. vs Trans-Missouri Freight Association, 166 U. S. 290; also U. S. vs Joint Traffic Association 71 U.S. 505

Until the World War, therefore, chiefly because of the Sherman Law, the railroad industry was mostly competitive in character. With the advent of the World War, however, the whole complexion of the problem changed. Because of the national emergency, the government, through the United States Railroad Administration, took over complete control of the industry. The suggestion was instituted, therefore, that it might be a good idea if some of the lines were permanently united to provide greater efficiency. The Transportation Act of 1920, accepted this suggestion and put it into legislation.

The Transportation Act, which looked toward a more effective organization of rail service so as to achieve economies and solve the problem of the weak roads, gave the I. C.C. power to authorize pooling arrangements and under "emergency" conditions to require the common use of facilities. A further provision was that combinations through the purchase of securities or lease of lines were to be carried out only if the Commission approved. The I.C.C. was also to create a plan which would permit the outright consolidation of properties. We clearly see, therefore, that the Act was a drastic modification of the "competitive" ideal insisted upon so vociferously in the past. Of course, competition was by no means abandoned for the Act provided that the new systems proposed by the Commission were to be of equal strength and preserve competition as fully as possible. In essence, however, the Transportation Act of 1920 exempted the railroads from the anti-trust laws.[6]

The object of the Transportation Act, therefore, was to

6 "Railroads" by I.T. Sharpman and Shorey Peterson in Encyclopedia of Social Sciences. Vol. 13

establish some sort of a design or plan for the unification of railroads through consolidation or acquisition of control. It allowed the Commission in Paragraph 2 of Section 5:

> "to permit the unified operation of common carriers even if it involved the elimination of competition when the unification would be in the public interest; and provided for the modification of the anti-trust laws to the extent necessary, stating certain pre-requisites, and imposed on the I.C.C. the duty of determining whether the conditions of this section have been or will be fulfilled and whether the proposed arrangement is in the public interest." 7

A bugaboo arose, however, to thwart this carefully prepared plan in the person of holding companies.

We have seen that railroad holding companies are not in themselves carriers but are financial institutions, though in reality they do control and own the railroads. It was through this technicality, however, of not being in themselves "carriers" that they escaped from regulation by the I.C.C. The question of whether they were covered by the Transportation Act of 1920 first came up in 1921. In the case of Denver & Rio Grande Western Railroad Company[8] a majority of the I.C.C. decided that "inasmuch as the holding company is not a carrier engaged in the transportation of passengers or property subject to the act, the acquitition of control of the applicant by the holding company is not within the scope of paragraph (2) of section 5".

This question of I.C.C. jurisdiction over holding companies was not a new one in 1921. A special report issued by the I.C.C. in 1906 entitled "Intercorporate Relationship of

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7. Remarks by Dr. Splawn before the House Committee on Interstate and Foreign Commerce, February 17, 1932, <u>Hearings</u>.

8. 70 I.C.C. 102

Railways in the U. S." reveals that the few holding companies of the period denied the jurisdiction of the Commission in so far as the investigation of inter-corporate relationship was concerned "on the general grounds that they are not railway companies engaged in interstate commerce" but are corporations organized merely for the purpose of holding securities.

The same report reveals, incidentally, that unification of railroads by holding companies was proceeding even in 1906. Summarizing the operations of the Rock Island Company, a particularly notorious holding company of the period, the report states "... it appears that a majority of the preferred stock of the Rock Island Co., $25,000,000. dominates the situation and controls solely and jointly, through the enormous issue of $370,000,000 of holding companies' securities, the vast network of railroad lines comprised in the Rock Island system, amounting to a total of over 15,000 miles, with a combined capitalization, stock and funded debt of $1,500,000,000." [9]

Through standard interpretation of the Transportation Act, therefore, holding companies were put beyond the pale of I.C.C. regulations and could go ahead with their efforts to achieve practiced unification at their own will without consent. As Commissioner Joseph B. Eastman said; "These holding companies are in a position to break down the commission's plan for a greater unification of railways and to set up other systems which would, by their remote control, be beyond our jurisdiction." [10]

This meant that it was now possible for the directors

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9 Page 26

10 "Are the Railroad Holding Companies Outside the Law?" in <u>Business Week</u>, February 5, 1930, p. 41

of a railroad, acting through an independent corporation over which the I.C.C. had no control, to deal in the stocks of competing carriers and thus either create or circumvent mergers.

We shall soon investigate the growth and working of the Van Sweringen system of holding company control of railroads, the greatest of them all, but before that let us identify a few others. Although railroad holding companies existed before 1929, they were, except for the Van Sweringen, only for individual railroad properties! Thus, the Atlantic Coast Line Co. of Connecticut had controlled for decades the Atlantic Coast Line system; and the Pennsylvania Company controlled the Pennsylvania lines west of Pittsburgh. The Western Pacific was also controlled by such a holding company since 1916 and the Chesapeake Corporation acted as holding company for the controlling interests in the Chesapeake & Ohio Railroad.[11]

But such holding companies along the lines of the Alleghany and Penn-road systems did not exist before 1929. The latter were different because they controlled large amounts of free capital and were at complete liberty to purchase the stock of any railroad either for investment or control. Penn-road incorporated in April 24, 1929 under a broad Delaware charter. It was created through a stock subscription by Pennsylvania Railroad stockholders who subscribed $87,000,000. The Delaware charter specifically did not give the corporation power to engage in transportation as a railroad company, though its other powers were broad enough, so as to make doubly sure that it would not come under the jurisidiction of Section 20-a

11 "The New Railroad Holding Companies", Literary Digest, August 3, 1929, p. 56

of the Act. Each director of Penn. road was also a director of the Pennsylvania Railroad Company. As a result of the organization of Penn. Road Corp. not only was Pennsylvania affected, but the Detroit, Toledo & Scranton, Pittsburgh & West Virginia, National Freight Co., Raritan River Railroad, Boston & Maine, Seaboard, New Haven - all were for all practiced purposes united without any consideration whether such actions were for the public welfare or not.[12]

A true and vivid picture of the developments described in the above few paragraphs cannot be obtained unless we become acquainted with an actual story as it unfolds itself. We have taken for that purpose the story of the development of the Van Sweringen system up until 1930.

Oris Paxton and Mantin James Van Sweringen started in the Railroad business by buying in July 1916 the Nickel Plate Railroad in Cleveland from the New York Central. The I.C.C. had ordered the latter to divest itself of Nickel Plate and the price decided upon was $8,500,000 for its holdings of 51% of the shares. To consummate the agreement, a loan was made by the Van Sweringen brothers for $2,100,000. the down payment demanded by Central.

The brothers then formed a holding company - Nickel Plate Securities Corporation - which assumed the obligation to pay off the loan and the remainder of the purchase price in return for the title to the Nickel Plate shares. The loan was paid off by the sale of non-voting preferred stock in the holding company, the brothers buying $520,000. and wealthy friends about $1,600,000. worth of the shares. Voting common stock was

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12 Hearings, House Committee on Interstate and Foreign Commerce, 71 Congress, 2nd Session, p. 6

issued to the preferred stockholders share for share as a bonus, but the brothers took 83% of the total as compensation for "services."

As a result, by a capital outlay of only $520,000. the brothers had captured control of the holding company that in turn controlled a railroad with total assets of 72 million dollars.

On January 9, 1922 the Van Sweringens organized a mysterious Vaness Company as their own "personal basket" into which were dumped their holdings in Nickel Plate Securities Corp. and diverse real estate stock. By this time, the "war prosperity" had increased the value of their stock and another part of the $8,500,000. debt to the Central was paid off. This payment increased their credit standing and they were now able to expand their manipulations.

The first thing that they did was to use the Nickel Plate shares to borrow two and a half million dollars from New York Central. To this they added another $500,000. and bought control of the Lake Erie & Western. They then borrowed another three and a half million dollars on Nickel Plate credit and bought control of the Toledo, St. Louis & Western. Finally, in 1923 by an exchange of stock, the three railroads were merged into a new Nickel Plate Railroad Co. This brought together about 1600 miles of track and further increased the credit base available to the Van Sweringen by consolidating assets totalling about 200 million dollars.

The Van Sweringens now increased their debt $7,200,000, by borrowing from the public through the sale of mortgage bonds. With $5,600,000. of the proceeds they bought 73,000 shares of the common stock of the Chesapeake & Ohio

Railway. Although this amount was only a minority of the shares, it was a controlling interest. Now their empire included 3,144 miles with assets of $550,000,000. But to reach this end both the Vaness Co. and the Nickel Plate Railway had to go heavily into debt,

The brothers now continued their acquisitions and used the Chesapeake & Ohio's funds to buy 26% control of the Erie Railroad. Thus, 2,236 miles of track and $570,000,000. were added to the empire. A loan from J. P. Morgan and the use of more railroad funds added 33% of the shares of Pere Marquette, with 2,265 miles and assets totalling $168,000,000.

By the fall of 1925, there was under Van Sweringen's domination a network of railroads that stretched from New York and Newport News to Chicago, St. Louis, and Peoria, an unmerged string of railroads with tracks spread over 9,245 miles and assets of $1,500,000,000.

The whole structure, however, was tremendously in debt, especially to J.P. Morgan, and the problem facing the Van Sweringens was how to get out of indebtedness and still control their shares; also how to preclude the possibility of the I.C.C. forcing a divestment of one railroad's share into another.

The answer to both was the creation of the Chesapeake Corporation:

During May and June 1927 this new holding company took over the 600,000 Chesapeake & Ohio shares, issuing in return all its common stock. The railroad shares were then placed in the hands of a trustee and used as a base for borrowing $48,000,000. from the public through a bond issue. With the proceeds from the bond sale, the Van Sweringens paid off at the banks the obligations incurred in buying Chesapeake & Ohio control.

This transaction was extremely valuable to them for it taught the Van Sweringens how to shelve the cost of buying a railroad's control on to the public's shoulders and it taught them that any type bond would sell that has the backing of such firms as J.P. Morgan & Co.

The successful creation of Chesapeake Corp. prepared the way for the Van Sweringen's masterpiece - Alleghany Corp - As far as they were concerned, there was a definite need for this formation because the law prohibited railroads from owning these competitors as the I.C.C. was in a position to order the railroads to divest themselves of shares held in competing companies. These limitations could be evaded by dumping all their interests into a holding company beyond the jurisdiction of the Commission, and this they did when they organized Alleghany in 1929. In addition this also gave the Van Sweringens an opportunity to pass on to the public the huge financial burdens they had assumed in buying control of the various railroads. It also provided a public vehicle through which to throw on their holdings without constantly going to the banks to get money for future railroad purchases.

Let us observe how the Alleghany worked, but before that let us briefly recapitulate.

By exchange of stock with the Van Sweringens, Alleghany received large blocks of Chesapeake Corp, Chesapeake & Ohio, Erie, Nickle Plate and other railroad stocks. The total cost of all the stock to the brothers was roughly $52,000,000.

In return for this, the Van Sweringens, as president and vice-president of the new company, paid themselves $36,300,000. in cash taken in by the Alleghany from public sale of its own stocks and bonds, plus 2,250,000 shares of Alleghany stock.

During 1929, they sold 682,810 shares of the Alleghany stock in the open market at a profit of $23,000,000. The average sale price was $48.50 and this sum multiplied by the number of Alleghany shares they received in 1929 results in a total value for them in 1929 of $109,000,000. Add to the $36,300,000. in cash to the total - more than $145,000,000 - represents the value which the "Cleveland magicians drew out of a hat" into which they had put securities costing them over $52,000,000.

In the next fifteen months the Alleghany augmented its holdings by purchases in the open market made with money realized by sale of its own stocks and bonds.

In other words, whereas in 1927, as we shall see, the I.C.C. refused to permit the Chesapeake & Ohio to control the Erie and had refused to approve acquisition by the Nickel Plate of control of the Chesapeake & Ohio, by the directors of the Alleghany Corp. all these roads were brought under common control.

The Van Sweringens were riding high, but here they made a fatal error. Immediately after assuming control of the Alleghany, they mortgaged some of the new assets by selling bonds to the public with security being the common stock of Van Sweringen's railroads. Then they made a contract with the bondholders that at all times the aggregate value of the pledged securities would be at least 150% of the amount of the bonds outstanding. They assumed, therefore, that the price of securities would always remain high. Three bond issues were floated, totalling - $85,000,000, which meant that $127,500,000. worth of securities had to be kept pledged as security. For the time being the market price of securities stayed up and they had nothing to worry about.

In fact now, the ambitious brothers went for larger stocks attempting to hold, what nobody had ever done before, a vast net-work from Coast-to-Coast. They started to buy control, therefore of the $660,000,000 Missouri Pacific. To do this, they borrowed on May 1st, 1929 $19,200,000 from J.P. Morgan; on June 26, 1929 another $11,500,000; on Oct. 29, 1929 - $5,500,000 from the Union Trust Company of Cleveland; another $8,900,000. from Morgan and the same day $9,000,00 on Nov. 1, 1929 from the Union Trust Company again, and on Dec. 5, 1929 they borrowed $1,200,000 from the Midland Bank of Cleveland.

No sooner were the funds borrowed than they whipped into the market. By the end of 1929 Chesapeake Corp. was $7,500,000 in debt to stock brokers; Virginia Transportation Corp. $9,000,000 - Alleghany $14,000,000; and Vaness $41,000,000. A total of more than $60,000,000. Yet even the collapse in October 1929 did not stop them. They continued to borrow from Morgan and run up additional debts with the brokers.

Their railroad buying did not stop either and by March 1930 they bought control of the Wheeling & Lake Erie, Chicago & Eastern, and completed the purchase of the Missouri Pacific. Under their command, there was now 27,000 miles of track and assets of more than two billion dollars.

Finally, by the end of 1930 the bubble had burst. On October 24th the financial pages of "The New York Times" announced "Van Sweringens' Securities drop". The brothers were now caught between the frantic demands for cash by their brokers to whom they were more than $20,000,000. in debt and the need for supplying, as market values fell, more and more securities to the Van Sweringen Corporation, as had been agreed with their noteholders. The two billion dollar pyramid now threatened to collapse and the brothers had to do something rapidly. A "rescue party" headed by Morgan and the National City Bank was found which loosened the strangle-hold by raising $39,500,000. But to secure the loan, the Van Sweringens had been forced to pledge the controlling shares in Alleghany.[13]

We have presented the necessarily half story of the Van Sweringens to more concretely show the methods used to gain control and circumvent the Transportation Act of 1920. It is not necessary, therefore, at this time, to continue with the story for the point is already evident. We can show, for example, how useless the plan of the I.C.C. to allow competition between eight eastern railroads was. Their plan was to allow only eight systems, these being - N.Y. Central, Pennsylvania, B.& O. Erie, Nickel Plate, Pere Marquette and Chesapeake & Ohio; but the latter four were already under control of the Van Sweringens

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13 "An Empire in Hock" By Daniel Dodge in American Mercury February 1935, pp. 160-174

and certainly would not compete with one another. Incidentally, as stated above, the brothers asked the I.C.C. for legal permission to consolidate the four lines and the application was vehemently refused.

If we may get back again to the problem, thus in 1930 the only possible regulation of holding companies was that which could come from the application of the Clayton Anti- Trust Law to "in some measure after protracted litigation enable control over the situation (to) be maintained."[14] (Note: Anti-trust laws as a solution to the problem will be discussed below.)

At this time, before going into a discussion of the solution to the problem, it might be of value for us to better understand it. Let us, therefore, examine the advantages, disadvantages, motives, and the effect of the holding company upon the public interest.

Upon analysis by James C. Bonbright[15] the advantages of pure holding companies may be both administrative and financial.

> "From the point of view of administration, the holding company gives to each subsidiary a co-ordinate position in the system of controlled companies ... But without the holding company, and using the parent company, one operating company must be singled out and made to dominate all the other properties in the system. Where one of the operating companies over-towers all the others in its size and its importance, its dominating role as a parent company may well be justified, but where, on the other hand, there are several operating companies of more or less co-ordinate size, there is at least an apparent objection to singling out any one of these companies to become the parent of the others."

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14 Regulation of Stock Ownership in Railroads, p IX

15 "Should the Holding Company be Outlawed" in House Report 2789, Op. cit p. 63 ff.

Mr. Bonbright continues: "Suppose, for example, that the present Nickel Plate Railway were to assume control of stock ownership of the Chesapeake & Ohio, the Pere Marquette and other railways -that are now under control ofthe Van Sweringens." This sudden expansion would create tremendous responsibilities for Nickel Plate directors and officers and thus the old personnel would have to be added to or dropped. It isn't easy to make these changes, he says, but with the aid of a new holding company created to take control over all the hitherto independent companies, the task is made easy.

The possible financial advantages are considered the most important.

> "If one of the operating companies were to attempt to secure stock control of all of the other properties in that system, it would have to reorganize completely its financial plan in order to undergo the necessary expansion. Vast amounts of new securities, including perhaps, bonds, preferred stock and common stock, would have to be issued by the parent company in exchange for the stocks of the subsidiary company. Very often, however, the Charter of the parent operating company and the indenture securing the bonds will be found to interfere seriously with any adequate expansion of its capital structure. An amendment of the railway charter, permitting the issuance of the required new securities, may be blocked by dissenting minority stockholders."
>
> "Where these difficulties prevail, the pure holding company offers a very effective way out. This company may take out a completely new charter and may then set up a financial plan best designed to finance the requirements of the subsidiary companies". [16]

Now that we have seen the advantages claimed by a spokesman of railroad holding companies, let us examine the more

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16 Ibid

realistic motives for utilizing holding company activities for combination and unification as summarized by Commissioner Eastman of the I. C.C. Holding companies are used:

(1) Sometimes to serve certain practical advantages in management, accounting or financing which are facilitated by the maintenance of separate corporate identities.

(2) Often to escape public supervision, which is provided in the case of other forms of combination, like consolidations or leases, but usually not in the case of combination through holding companies.

(3) Often to escape public supervision of security issues since the securities of holding companies are not usually regulated.

(4) Often to reduce the investment necessary to obtain control, by the process of pyramiding and unloading the remainder on the public.

(5) Often to drain profits indirectly from the controlled companies by making contracts for management, financing, engineering and the like, which are not subject to public supervision.[17]

From the preceding testimony, it is evident that the holding company is advantageous. But advantageous to whom, we must ask ourselves? What are its effects on the general public interest? The answer, which by now must be obvious, can be best borne out by an examination of some of the aspects of the financial structure of holding companies.

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17 __Hearings,__ Senate Committee on Interstate and Foreign Commerce, __Op. cit__

The most flagrant aspect is that the capitalization of holding companies is not subject to public regulations and hence may be inflated practically at will, which results in placing unregulated securities on the market for the investing public. Over-capitalization is in itself harmful to the public interest for at least two reasons. First, it means poor credit and railroads with poor credit certainly cannot be depended upon to give good service. Secondly, over-capitalization invites attempts to drain off profits by deceptive means in various indirect ways which again may lead to neglect of maintenance and more depreciation.

Thus, it seems to us that the holding company has been a convenient vehicle for defeating the process of orderly consolidation and has been used to effect results subversive to the public interest.

Now that we have revealed the problem, we shall discuss its treatment. Thus, back in 1930 there were three alternative ways to solve the holding company problem. The least restrictive was to permit the holding company to remain beyond the pale of existing railroad law and be restrained only by the jurisdiction of the Sherman and Clayton Anti-Trust Laws. This, however, would be but a useless gesture, quite ineffective for the holding company problem would be lost amidst a maze of interlocking holding companies as evidenced by the Van Sweringen Interests. Even for the most competent lawyer, it would be very difficult to analyze and still more difficult to trace and prove any violation in a court of law. Some realistic observers have mentioned that the Government lawyer would prove no opposition to the trained railroad lawyers at their own game. The issue would be confused further by the fact that exemptions to anti-trust laws have been granted to certain railway consolidation, which is further confused by the fact that the consolidation program is not definitely crystallized and may be subject to change.

The other extreme was the complete abolition of holding companies. This was a too radical step for the time for there had not been sufficient study of the problem to realize what was to be cut out or in what manner.

The policy finally adopted in 1933 was the cautious, yet progressive, middle of the road policy of sanctioning the holding company within certain prescribed limits, but subjecting it to the jurisdiction of the I.C.C. to whatever extent may be required. The law was based on the results of a thorough investigation which began way back in 1930. In that year, the House of Representatives, at the request of the 1929 Report of the I.C.C. adopted Resolution No. 114 which set up a committee "for the purpose of obtaining information necessary as a basis for legislation ... of the ownership and the control, direct or indirect ... of ... any common carrier ... by holding companies." 18

The Act itself, in Title II, sections 201, 202, 203, 204 to amend Section 5 of the Interstate Commerce Act, brings within the jurisdiction of the I.C.C., for approval or disapproval ~~of~~ control of a railroad which would result in bringing it into affiliation with, in control of, or under the management of another railroad, whether the acquisition be by holding Company or otherwise; and to provide that when a holding company

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18 House Resolution 114, 71 Congress, second session.

is thus permitted to control a railroad, directly or indirectly, thereafter the accounts and capitalization of that holding company shall be subject to regulation by the Commission. This brings all forms of acquisition or unification within the jurisdiction of the Commission and requires the Commission to find before approving them that they are in harmony with and in furtherance of its general consolidation plan and will promote the public interest.[19]

Thus, the first piece of legislation seemed to satisfy the needs of the time. Actually, however, it did not solve the problem. The 1937 Report of the I.C.C.[20] revealed that the Act provided a loophole and did not sufficiently cover the problem. It provided that railroads must get the permission of the Commission only when they desire to get control of another railroad. It thus does not prevent them from acquiring as many holdings as they have funds for as long as control is not obtained . This still allowed for financial manipulations to rectify the situation. Commissioner Splawn wanted every non-carrier corporation which owned the stock of a common carrier to have the approval of the Commission after applying tests of the public interest specified by law - Still trying to solve the problem, Senator Wheeler, who had been studying the problem seriously, brought to light some of his astonishing findings. A Mid-America Corporation controlled by G. A. Ball, Muncie, Indiana, glass manufacturer, purchased the securities of Alleghany Corporation at a price less than 10% of the market value of $3,000,000,000.

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19 Railway Age, Vol. 94, 1933.

20 (Issued May 8, 1937)

Then Senator Wheeler's report delivered this stinging criticism of the present situation.

> "(1) Irresponsible persons can acquire control of a railroad system if the system is organized in a holding company.
>
> (2) The interests not only of investors in such enterprises but those of employees, of shippers, of the travelling public, and of innumerable other persons effected by the management and financing of the country's railroads are subject to the danger that, by the device of holding company pyramids, such control once acquired may be mal-administered without restraint by a person who happens to have some thousands of dollars and a certain amount of luck and ingenuity." 21

The Wheeler report further lashes into the present situation when he states that the transaction whereby this Alleghany Railroad empire was handed back to Messrs. Van Sweringen and later transferred to Mr. Ball had never been subjected to the scrutiny of any governmental agency.

Before continuing any further, let us remain in the year 1937 and take stock by asking ourselves three questions. First, under existing law, does the I.C.C. have the power to pass on holding company acquisitions; and if they have, is it sufficient to protect the public interest? Secondly, is it necessary or desirable for the Commission to have this power? And thirdly, if necessary and desirable, what form should such power take?

We have seen that the Act of 1933 has not been sufficiently effective in dealing with the problem of railroad holding companies and that hence, although technically, the I.C.C. has power, in reality that power is not sufficient to protect the public interest. In order to protect the public interest, there-

21 Railway Age. Vol 102, 1937 p. 530 ff.

fore, question two is answered by saying that it is necessary and desirable for the I.C.C. to have the power. As the Wheeler Report referred to above, maintains:

> "Amendments are desirable to make it unequivocally clear that the Commission has authority to supervice the accounts and other security transactions by holding companies which control railroads indirectly, as well as those which control railroads through direct stock ownership, irrespective of whether such control existed prior to or established after the 1933 amendments ....[22]

As to the form such power should take, we are faced in 1937 with two alternatives: supervision and regulations, or limitation or prohibition of the privilege of utilizing holding company pyramids. There is, therefore, no definite answer to the third question asked above, though it seems that the complexities of organization and the confusion of interests associated with holding companies would make it so difficult for adequate governmental supervision that their complete abolition may be justified. There may clearly be a point beyond which adequate supervision cannot be effective without excessive cost or perhaps cannot be effective at any cost.

It is evident, therefore that although the country was not prepared in 1937 for any definite categorical answer to the problem of the holding company, the tendency was present which undoubtedly pointed towards their ultimate abolition. On January 14, 1938, for example, President Roosevelt in a press conference stated that he could see no good in railroad holding companies per se and that theymust be eradicated for the good of the country.[23]

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22 Ibid

23 The New York Times, January 15, 1938.

The long awaited step finally occurred on March 31,1939 when Senator Wheeler introduced Senate Bill 2016 which stated as to primary purpose "to present the continuance of abuses associated with holding company activities by providing for adequate government supervision of such activities and by hinging about the elimination of certain holding companies, if it is determined by the Interstate Commerce Commission that their continuance would be contrary to the public interest." [24]

The Wheeler Bill, in other words, is nothing more than an extension of the principles already adopted and made effective by Congress in the fields of power and light utility companies. It provides that the Commission can only require a holding company to cease from existing after or finding that the continued esistance of the company would be injurious to the public interest. The sa me part of the Bill gives the Commission certain powers to lay down requirements with respect to corporation permitted to continue as holding companies. The Commissionis also authorized to require such holding companies to simplify their structures, dispose of certain of their assets or take other steps which will prevent the recurrence of abuses of the types enumerated in the Bill.

Congress has not as yet passed the Wheeler Bill, perhaps because it has not felt the problem immediate enough, and the present international crisis makes it extremely doubtful that the Bill will be considered at the present session. We can only hope, therefore, that positive action will be taken in the near future.

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24 "Railroads on the Witness Stand" by Burton K. Wheeler, in Survey Graphic March 1940.

Even this, however, will not completely solve the problem for the holding company phase is but a part of the whole railroad industry. The writers are firmly convinced that the only eventual solution is government ownership and operation. As Commissioner Eastman said:[25]

> "Theoretically and logically public ownership and operation meets the known ills of the present situation better than any other remedy. Public regulation of a privately owned and operated industry, reaching deeply into such matters as rates, services, capitalization, accounting, extensions and abandonments, mergers and consolidation, is a by-bid arrangement. When an industry becomes so public in character that such intimate regulation of its affairs becomes necessary, in strict logic it would seem that it should cease to masquerade as a private industry and the Government should assume complete responsibility, financial and otherwise."

We realize, however, that the time is not ripe now for such action. Were the government to attempt to take over the railroads today, it would necessarily have to assume all obligations, and with our financial conditions as they are today, the burden would be much too heavy. In addition, before the government can successfully take over the railroad structure, a thorough study designed towards accomplishing that end should be undertaken.

The eventual solution of the railroad problem, therefore, would not only entail the passage of the Wheeler Bill of 1939, but would also require a definite statement of policy designed towards ultimate government operation and ownership and an evaluation of all legislation and action with that end in view.

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25 (Ibid , p. 212)

COMMENTS AND GRADE

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Focuses attention on a single phase or facet of a general problem, and probes that thoroughly, without losing sight of, or neglecting, the broader implications.

Well done.

Max M. Kampelmacher
Economics 51
Professor Watkins

"Economic Control"

The questions I shall attempt to present in the following paper are whether it is possible for our modern economy to function without general economic planning and control and whether such planning can be reconciled with our American democratic institutions and traditions.

A close study of the modern economy will clearly show that the classical laws of supply and demand, so theoretically perfect in a competitive society do not function in our semi-monopolistic machine age society. Whereas, therefore, formerly the laws of supply and demand automatically adjusted the whole economy to changing conditions and regulated the movement and behavior of the price structure in accordance with the shifting of labor force and resources, we find today that the automatic regulations and adjustments are lacking.

With the disappearance of the automatic controls by the laws of supply and demand there were no factors remaining to insure the best use of resources and the fairest distribution of income. To attain that end and eliminate waste, it is necessary to provide for a system of economic planning.

Of course every large firm and corporation today has some measure of a planning system. Business planning, however, is motivated by the profit motive and not by the consideration of what is healthy for society hence it often leads to decisions contrary to the interests of the economy as a whole.

In addition planning by individual businesses or particular industries, which is nothing more than partial planning, does not concern itself with the effects its decisions will have upon other economic cogs in our machine technology. Partial planning, therefore, may only lead to decisions which can disrupt our economy and throw it completely out of gear.

It is obvious, therefore, that in planning it is necessary to do so completely and not partially. Decisions are to be based on their effects upon our whole economic system. It is a complicated process involving complete study and thought; an activity in itself.

The next question to present itself now is whether general economic planning is permissable under our democratic system. It is obvious that were we to create a plan and then force the people to accept it, we would be following the pattern of the dictatorial countries and hence that is impossible. What remains, therefore, is for the nation to proceed along the path of a planned economy step by step and thus determine how far it can go under our democratic institutions.

Experience has taught us that advisory planning may be somewhat successful, although it is generally ineffective. Another method used a great deal in previous years was to plan for those companies with whom the government had contracted. The A.A.A., for example, gave benefits to those who adjusted their activities to the plan decided upon by the government. A "yardstick" is another method used to force adherence to government plans. All of these methods can somewhat alleviate the problem of how to make a system of general planning work yet they too are clearly insufficient. It is to be hoped that the U.S. can go ~~yet~~ forward along the path and yet remain true to its democratic institutions.

The question that now presents itself is exactly what part government should play in solving the various economic factors; how far should it go? Until recently it was a part of our tradition for the government to assume a "hands off" policy. The old economy was governed by certain laws and any interference by government might prevent the automatic adjustments. With the advent of the modern economy and the destruction of these laws, economic power got into the control of the corporate interests who grew as powerful, in some instances, as the state itself. With the obvious danger of complete control within the hands of corporations it becomes necessary for government to interfere and challenge the power of those interests.

In discussing the question of how far government should go it is perhaps wiser to first investigate how far it is necessary to go to make the economy function, rather than how far it could legally go. A minimum of interference, therefore, should be our first aim and then see if it is desirable before going further.

It is impossible of course in our economy to lay down set rules and regulations for the role of government. There are certain minimum controls, such as bank deposit insurance; guiding industry through acting as arbitrator between labor, business, and consumer; programs of public works; tariff regulations; and social security. Beyond these minimum controls, however, there is a wide area in which government can operate directly or indirectly up to the point of ownership. There is wide belief in the necessity of government ownership of public services, and with the expansion of society and its interests the concept of what a public service is grows to include more fields of endeavor. In addition, it may be necessary for government to take over industries which are not necessarily considered public services because private control cannot run it profitably.

To say the least, therefore, government will play an important part in the future of our economy, and the methods by which it can control should be studied most carefully.

Poses the problem
Does not advance much its solution

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Max M. Kampelmacher
Economics 51
Professor Watkins
November 28, 1939

"Brandeis on Corporations"

a review of

The Curse of Bigness

"Brandeis on Corporations"

a review of

The Curse of Bigness

The following paper is an attempt to analyze the views of Mr. Justice Brandeis, both in his younger days and after he became a member of the U. S. Supreme Court, regarding the corporate system as it is exemplified in the twentieth century.

Ever since the turn of the century, Louis D. Brandeis ~~took~~ has taken an active part in the struggle against "bigness" and in favor of the working man. One of his first efforts led to the establishment in Massachusetts of savings-bank life insurance. During 1906 Mr. Brandeis wrote articles and made speeches on the subject and in June 1907 Massachusetts enacted his proposals into law. He started his work for savings-bank life insurance after studying the report of the New York Committee which in 1905 investigated life insurance companies.

The first thing Mr. Brandeis did was to bring statistics showing that if a man, beginning with his 21st birthday, pays throughout his life 50 cents a week into Massachusetts savings banks, the survivors will, in case of his death at the average age of 61 1/4 years, inherit \$2,265.90, if an interest rate of 3 1/2 % a year is maintained. If the same man, however, were to start at 21 and pay throughout his life the 50 cents a week to an industrial life insurance company as premiums on a so called "industrial" life policy for the benefit of his family, the survivors would be legally entitled to receive, upon his death at the age of 61 1/4 years, only \$820.

These facts convinced Mr. Brandeis that something was wrong and that were savings banks to issue life insurance policies the worker, who needs every cent he could save, would have more money for other needs. Since life insurance is in itself a method of saving he asked himself "Why, then, does the workingmen's investment in industrial insurance prove relatively so disastrous?"

The answer, he continued, can perhaps become obvious when we note that in 1904 the managing expenses of the industrial department of the Metropolitan Insurance Company of New York was 42.08 % of all premium receipts, and that of the other companies hovering about that figure. Since "premium receipts" correspond to deposits of savings banks it is interesting to note that in the 188 Massachusetts savings banks in 1904 the percentage of management expenses to deposits was 1.47%. In other words, the percentage of management expenses to premium receipts of the insurance companies was 25 times as great as that of the savings banks to their deposits. Here then is a reason for the difference in savings.

Were we to look for other reasons, it is significant that the directors of insurance companies receive high salaries; and that to receive legislative favors it is necessary to spend hundreds of thousands of dollars. It takes more than financial depravity, however, to explain why in "15 years the workingmen of Massachusetts have paid \$55,285,744 in industrial premiums" and received back in all only \$19,881,353, that is 35.96% of the total premiums paid without interest.

The real cause comes from the tremendous waste which necessarily accompanies the system of supplying life insurance for workingmen at reasonable "only 50 cents a week" premiums. Briefly, there is first the initial expense of issuing the policy, then the expense of collecting the premiums weekly which amounts to at least 20% of the premium, plus the cost of an elaborate system of superintending and accounting.

It is obvious that industrial life insurance companies cannot serve most workingmen well. A system is necessary which will recognize that the best way to increase the demand for life insurance is to furnish a good article at a low price. An institution is necessary which will give the workingman an opportunity to obtain life insurance at more nearly its necessary cost without waste. Such an institution is the savings bank.

The savings banks could handle the job well because they are managed by men already trained to recognize that the business of investment is a quasi-public trust and not a selfish money making institution. No elaborate system of operation will be necessary because very few additions will be necessary to the already existing bank system and personell.

For the workingman, therefore, a system of savings bank life insurance is both economical and necessary.

After his success in the insurance reform, Mr. Brandeis turned his efforts toward the problem of labor and capital. His aim was to achieve a system of "Industrial Democracy and Efficiency" to displace the evils of monopolistic control. He advocated, therefore, regularity of employment to insure the worker's security; and warned that strong labor unions were necessary to achieve equality for labor. He denounced continuously the hostility of the big trusts to unions and their holding of labor in virtual peonage. In all, he maintained, economic independence was essential to the proper workings of any democracy.

The first example introduced as evil was the Steel Trust. With a capital of $650,000,000 and paying tremendous dividends. Mr. Brandeis brought facts to show that they employ men who do not even earn enough to subsist, let alone live. According to statistics released by the Associated

Charities of Pittsburgh, even were the common laborer in the steel industry to work 12 hours a day for 365 days a year, an impossible task, he would be unable to earn even the minimum cost to support a family consisting of himself, his wife, and three children. The mere statement of the above figures is enough to demonstrate that there is something radically wrong with the steel industry and society as a whole which permits such conditions to exist.

Industrial slavery, Mr. Brandeis contends, is not compatible with political liberty.

It is necessary to introduce the concept of democracy to industry and the first step is to balance the combinations of capital, which now exists, with combinations of labor, another name for labor unionism. The mere presence or tolerance of labor unions, however, is not sufficient. After labor and capital are on equal par it is necessary to go further and give labor a voice in the management of industry. That is true democracy. What he wants, therefore, is a representative of labor on the Board of Directors of a corporation and when questions of increasing production, cutting expenses, declaring dividends, changing wage levels, present themselves, labor should participate in arriving at the decision. In this way, both capital and labor will have a clearer understanding of each other's problems and any decision which is arrived at will be mutually satisfactory to both sides.

Mr. Brandeis of course realizes that his ideals are not likely to be carried out in practice for quite some time, if at all. He realizes that large and powerful trusts with supreme power will not willingly surrender even a part of the power they possess to another group. He looks, however, to the future.

As to the future, Mr. Brandeis has stated "In my judgment, we are going through the following stages: We already have had industrial despotism. With the recognition of the unions, this is changing into a constitutional monarchy, with well-defined limitations placed upon the employer's formerly autocratic power. Next comes profit sharing. This, however, is to be only a transitional, half way stage. Following upon it will come the sharing of responsibility, as well as of profits. The eventual outcome promises to be full-grown industrial democracy. As to the last step the Socialists have furnished us with an ideal full of suggestion".

Throughout his writings, Mr. Brandeis has shown himself opposed to large corporations. He fought the interests, however, not only because of their hostility towards labor, but also because he believed them opposed to the good of society at large. In spite of his objections to monopoly, however, he did not approve of mere "trust busting" for it failed to reach the roots of the problem. And while he advocated the preservation of competition he insisted that competition itself needed regulation. One of his favorite measures designed to both curb cut-throat competition and deprive monopoly of a weapon was the maintenance of retail prices set by manufacturers of nationally known products. Before going deeper into the study we must understand that he championed smallness not because he merely disliked large units but because he doubted the efficiency of great aggregations of capital.

In 1911, Mr. Brandeis vehemently protested against a decisions of the U. S. Circuit Court which declared legal a plan of reorganization submitted by the American Tobacco Company. The Supreme Court had previously declared the Tobacco Trust an illegal combination, applying the Sherman Anti-Trust Law. The Supreme Court further declared that the company was to be considered illegal until it submitted a plan to the Circuit Court which would be in harmony with the law and restore conditions essential to fair competition. The American Tobacco Company then drew up a plan dividing the corporation into three parts owned by the same persons, in the same proportions, and controlled by the same individuals who were originally responsible for the violation of the Sherman Law. The Circuit Court then, without going into much detail to see whether the plan was in accordance with the principles of "fair competition," accepted it. To Mr. Brandeis, that was a flagrant violation of the Supreme Court decision and nullified 5 years of intense investigation by the Bureau of Corporations.

It is interesting to note that the investigation proved the monopoly so successful that a single branch, the Duke business, which was valued in 1885 at $250,000 yielded by 1908 in securities and cash dividends an aggregate of $37,000,000. In view of the facts, Mr. Brandeis interpreted the Circuit Court decision to mean invoking the Constitution to protect, not only vested rights, but vested wrongs. And he saw a new implied Constitutional prohibition "What man has illegally joined together, let no court put asunder".

In arguing for "regulated competition" instead of "unrestricted competition", Mr. Brandeis likes to bring the Constitutional liberties as an analogy. Regulation is essential to the preservation of competition just as regulation is necessary for the preservation and development of civil and political liberty. In order to insure the preservation of liberty for the many, it is necessary to limit the liberty of a few. The physically strong, for example, are curbed to protect the physically weaker. The right of competition, he reasons, must be similarly limited, for excesses of competition lead to monopoly just as excesses of liberty have led to despotism.

Going back again to monopolies, Mr. Brandeis states that it is false to speak of any monopoly as a "natural monopoly" for there are none in industry. The Oil Trust, for example, did not acquire its control because it was "natural" but through ruthless conduct and flagrant violations of the law. Were it not for criminal rebating the Standard Oil would not have acquired the vast wealth and power which enabled it to destroy its smaller competitors by price cutting and similar means.

Similarly, a monopoly like the Steel Trust cannot be called "natural" when it resulted chiefly through the purchase of the Carnegie Company for at least $250,000,000 more than its value, thus bribing Carnegie to retire from the field in which he was master.

The attempt to remove illegal trusts, therefore, is not an attempt to interfere with the "natural" law of business but an endeavor to restore health to the economy.

Mr. Brandeis now proceeds to further tear down the claims which favor the existence of monopolies. That mere size does not bring success, he continues, is illustrated by looking at a few records. First, most of the trusts which did not secure monopolies have failed to show marked success as compared with the independents. Those used as examples are the Newspaper Trust, the Woolen Trust, and the Sole Leather Trust.

Secondly, most of those trusts which have shown marked success secured monopolistic positions either by controlling the whole business themselves or in combination with others. And their success came about mainly through their ability to fix prices. Examples of these are the Standard Oil Trust, the Tobacco Trust, the Steel Trust.

Thirdly, most of the trusts which were not monopolies but controlled only through price agreements with competitors, were unable to hold their own share of the market against the independents. Examples of these are the Sugar Trust, the Steel Trust, the Rubber Trust.

Fourthly, most of the efficiently managed trusts have found it necessary to limit the size of their own units for production and distribution. This was true of the Tobacco Trust, Standard Oil Trust, and Steel Trust.

Another false argument usually used is that monopolies and trusts mean efficiency. Let us look at the facts. In the Carnegie Company, the Steel Trust inherited the best and most efficient organization in the world. Yet only ten years later our country was about five years behind Germany in iron and steel metallurgy. As the Engineering News, the trade periodical, observed: "We believe the main cause is the wholesale consolidation which has taken place... A huge organization is too clumsy to take up the development of an original idea. With the market closely controlled and certain of profits by following standard methods, those who control our trusts do not want the bother of developing anything new".

But even if monopolies were efficient there would be no justification for their existence unless the community benefitted from the efficiency. But with the few trusts that are efficient, the trusts themselves reap the benefits and the community gains substantially nothing. With efficiency, for example, in the Standard Oil Trust and Tobacco Trust instead of prices decreasing, they maintained their high level and profits increased. Efficiency, on the other hand, under a competitive system clearly means a decrease in prices.

Observing that monopolies are artificial, Mr. Brandeis summarizes that were society to have taken care to prevent that course of conduct by which in the past monopolies have been established, and were to have used legal methods to prevent illegal combinations, we would have no problem today. In spite of conditions being as they are, however, it is possible to preserve competition where it exists and restore it where it has been suppressed, by taking stock of our laws and law enforcing agencies and start from the bottom to root out those conditions which brought about the artificial monopolies.

Mr. Brandeis' early opinions and social philosophies were not forgotten by him after becoming a member of the Supreme Court. He continued his

Liggett v. Lee - 288 U.S. 517
Liebmann - 285 U.S. 262

fight against "bigness" and monopolies and in favor of a regulated competitive system. The two cases which illustrate and typify the problems were Liggett Company v. Lee and New State Ice Company v. Liebmann. In both of these cases, Justice Brandeis was in the minority and rendered a dissenting opinion.

In New State Ice Company v. Liebmann, the issue before the Court was as follows: Oklahoma passed a law declaring the manufacture of ice for sale and distribution a "public business". It then made it a misdemeanor to engage in the business without a license from the Corporation Commission; providing likewise that the application for license may be denied if "the facts proved at said hearing disclose that the facilities for the manufacture, sale, and distribution of ice by some person, firm, or corporation already licensed by said commission at said point, community, or place, are sufficient to meet the public needs therein". New State Ice Company was legally established as a business in a district of Oklahoma providing for the ice needs of the community. Liebmann opened another ice plant in the vicinity without getting a license, and after being stopped brought suit charging Oklahoma with a violation of the 14th Amendment depriving him of "liberty" without due process of law. Mr. Justice Sutherland, writing for the majority, held the law invalid on the ground that it was an arbitrary attempt to restrict a business essentially private in character.

Mr. Justice Brandeis, however, was of the opinion that the law was a valid exercise of the state's police power. Any business, he argued, whether originally private in character or not, may under changing circumstances become a matter of public concern. In this case, conditions existing in the affected community convinced the state legislature that the ice business was a matter of public concern and subject to some regulation on its part. Peculiar economic conditions made it advisable to restrict cut-throat and unlimited competition hence the legislature decided that it was good for the community to restrict that competition. Surely, Mr. Brandeis maintained, that was not an unreasonable or arbitrary regulation for it was for the "public welfare".

There is room to believe that unbridled competition as well as unbridled monopolies is one of the major contributing causes for the widespread depression. The State of Oklahoma so believed and decided to do something about it. It started an experiment, therefore, and regulated competition along the lines of the law in question. The action it took was legal and within its police powers. The Supreme Court, he maintained, should not hinder it but should permit the experiment to continue and perhaps find a solution to the problem. "If we would guide by the light of reason, we must let our minds be bold".

The case of Liggett Company v. Lee dealt with the Florida Anti-Chain Store Laws. The State of Florida imposed license fees on all stores, but stores located in more than one county, commonly considered chain stores, were charged with heavier fees than privately owned or cooperative retail stores. The original plaintiffs, a group of corporations representing the chain store interests, claimed that they were being discriminated against unjustly. Mr. Justice Roberts of the majority upheld their claim and said that the Court could find no reasonable legal basis for such a classification as the law made.

Mr. Justice Brandeis, in a dissenting opinion, looked at the question from a different angle. He recognized that the statute attempted to protect the individually, independently owned, retail store from the competition of chain stores by subjecting the latter to financial handicaps which might conceivably compel their withdrawal from the state. As to the question whether the classification is a reasonable one or not, Mr. Brandeis maintained that the particular plaintiffs involved could not object to the law because they were corporations and as such were subject to whatever non-discriminatory regulation the state desired to impose. He then entered into a treatise on the development and status of corporations.

It is wrong to believe that because corporations are prevalent today, the citizen has an inherent privilege to do business in corporate form and that the evils which accompany the unrestricted use of the corporate mechanism are inescapable, for our history shows a different view prevailing. For years in this country, we feared to issue corporation charters because we feared monopoly, encroachment upon individual liberty, subjection of labor to capital, and the menance in large aggregations of capital. We finally succumbed only after much pressure and a belief that the law would control the corporate form.

At first, there was a limitation placed on the amount of authorized capital. New York, for example, had a limit of $100,000 for some businesses and as little as $50,000 for others. Gradually, however, the limitations were removed. Another limitation was on the scope of the corporations' power and activities. It was not until 1875 that permission to incorporate for "any lawful purpose" was granted; and until that time corporate franchises were generally limited to a period of 20, 30, or 50 years. In addition, all or a majority of the directors were required to be residents of the incorporating state. Severe limitations were imposed on the amount of indebtedness and the power to hold stock in other corporations was prohibited, thus making the holding company impossible.

The breakdown of the corporations began when the smaller states, eager for the revenue derived from the presence of corporations, removed the safeguards from their lawbooks. Other states were forced to follow suit. The result was a race in which all states took part to see which could become more lax in its regulation of corporations. New York, for example, had a terrific time keeping up with New Jersey during the end of the 19th century for the latter state seemed to attract more corporations. From 1890 to 1901, therefore, New York revised its corporation laws four times, each revision dropping further restrictions.

It was only logical, therefore, that corporations grew and became dangerously big until they eventually dominated the states themselves. "The typical business corporation of the last century, owned by a small group of individuals, managed by their owners, and limited in size by their personal wealth, is being supplanted by huge concerns in which the lives of tens or hundreds of thousands of employees and the property of tens or hundreds of thousands of investors are subjected, through the corporate mechanism, to the control of a few men". In fact, the power of corporations has become so great that it is not too far wrong to compare its effects with the feudal system.

Knowing these facts, Mr. Brandeis continued, the people of Florida attempted to take back some of the privileges which it gave up. It could have taken away the corporate privilege completely, but instead it elected to aid the individual retailer fighting a struggle for existence by imposing a license fee on those corporations. The license fee, therefore, is but a form of compensation exacted for the privilege of carrying on intrastate business in a corporate form. As that privilege, with the above facts in mind, is one which it may grant or withhold, the state is free to charge such compensation as it pleases and it need not even be "reasonable".

There is no question, therefore, Mr. Brandeis contends, but that the Florida law should be upheld.

The above study demonstrates, if I may take a few sentences to conclude, that Mr. Brandeis' thesis is indeed worthy of action. Fortunately, he has not been alone in his fight and there seems to be a tendency today to put his principles into practise. Most of us are beginning to realize that corporations "have gotten away with murder" and that now is the time to stop them. It is to be hoped that we can look forward to a future where all will realize that a corporate form of business is a privilege granted by the state; that it is to be managed as a public trust for the public interest and not for selfish gain; and that its activities and powers should be limited.

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Might be improved by (a) reference to actual course of development of the Mass. sav. bk.-life insur plan (b) an analysis of the degree of consistency between his dissent in the New State Ice case and his reiterated opinion that there is no such thing as "natural monop."

BRANDEIS ON CORPORATIONS

On February 6, The New York Times featured a story by Russell B. Porter under the headline "Many Industries Moving Into Friendly Connecticut" that a large number of corporations were leaving New York, because of that state's "high costs, especially taxes and labor" and moving into Connecticut, a "friendlier" state eager to compete with its wealthier neighboring state.

We do not have to read much further in the story to discover that the attraction in Connecticut is "old-fashioned Yankee thrift and individual initiative" put into practise by the "lack of a personal income tax, sales tax or income tax".

Again on February 18, Mr. Porter continued with his Chamber of Commerce revelations and described the exodus of New York industry into New Jersey, another state convinced that policies "based on the absence of any State income tax, corporate or personal" are the best.

The above incidents coming to our attention at the same time with the SEC and TNEC reports on utilities and monopolistic practices in industry, bring vividly to mind a problem that has been hampering our economy since the turn of the century.--- How to deal with corporations growing so big that they control the very entities that created them, the states?

Louis D. Brandeis, both in his younger days and after he became a member of the Supreme Court, devoted a great deal, of thought to the problem; and before we begin to study any of the proposed solutions being introduced at this time, it might be valuable to investigate the findings once again of that great pioneer in corporate reform.

"Bigness" to Mr. Brandeis was the root of all economic evil for it was contrary to the good of society at large. That bigness, however, could never be ~~a~~ eliminated through mere "trust-busting" or "head-hunting", he insisted, for no illness can ever be cured unless the cause or roots of the malady are understood and reached. What is necessary, therefore, is to first see whether there is any necessity for the existence of monopolies and bigness; and this Mr. Brandeis proceeds to do.

It is false, we are told, to speak of any monopoly as a "natural monopoly" for there are none in industry. The Oil Trust, for example, did not acquire its control because it was "natural" but through ruthless conduct and flagrant violations of the law. And were it not for criminal rebating the Standard Oil would not have acquired the vast wealth and power which enabled it to destroy its smaller competitors by price cutting and other similar methods.

Similarly, a ~~xxxx~~ monopoly like the Steel Trust cannot be called "natural" when it resulted chiefly through the purchase of the Carnegie Company for at least $350,000,000 more than its value, thus bribing Carnegie to retire from the field in which he was master.

The attempt to remove illegal trusts, therefore, is not an attempt to interfere with the "natural" law of business but an endeavor to restore health to the economy.

Mr. Brandeis now proceeds to further tear down the claims of those who favor the continued existence of monopolies. That mere size does not bring success, he continues, is illustrated by looking at a few records. First, most of the trusts which did not secure monopolies have failed to show marked success as compared with the independents. Those used as examples are the Newspaper Trust, the Woolen Trust, and the Sole Leather Trust.

Secondly, most of those trusts which have shown marked success secured monopolistic positions either by controlling the whole business themselves or in combination with others. And their success came about mainly through their ability to fix prices. Examples of these are the Standard Oil Trust, the Tobacco Trust, the Steel Trust.

Thirdly, most of the trusts which were not monopolies but controlled only through price agreements with competitors were unable to hold their own share of the market against the independents. Examples of these are the Sugar Trust, the Steel Trust, the Rubber Trust.

Fourthly, most of the efficiently managed trusts have found it necessary to limit the size of their own units for production and distribution. This was true of the Tobacco Trust, Standard Oil Trust, and Steel Trust.

Another argument usually used to favor monopolies and trusts is that they foster efficiency. Let us look at the facts. In the Carnegie Company, the Steel Trust inherited the best and most efficient organization in the world. Yet only ten years later our country was about five years behind Germany in iron and steel metallurgy. As the Engineering News, the trade periodical, observed: "We believe the main cause is the wholesale consolidation which has taken place... A huge organization is too clumsy to take up the development of an original idea. With the market closely controlled and certain of profits by following standard methods, those who control our trusts do not want the bother of developing anything new".

But even if monopolies were efficient, Mr. Brandeis continues, there would be no justification for their existence unless the community benefitted from the efficiency. But with the few trusts that are efficient we see that the trusts themselves reap the benefits and the community gains substantially nothing. With efficiency, for example, in the Standard Oil Trust and Tobacco Trust instead of prices decreasing, they maintained their high level and profits increased. Efficiency, on the other hand, under a competitive system clearly means a decrease in prices.

Observing that monopolies are artificial, Mr. Brandeis summarizes that were society to have taken care to prevent that course of conduct by which in the past monopolies have been established, and were to have ~~taken~~ used legal methods to prevent illegal combinations, we would have no problem today. In spite of conditions being as they are, however, it is possible to preserve competition where it exists and restore it where it has ~~been~~

been supressed, by taking stock of our laws and law enforcing agencies and start from the bottom to root out those conditions which brought about the artificial monopolies.

It is interesting to note that in 1911 Mr. Brandeis vehemently protested against a decision of the U.S. Circuit Court which declared legal a plan of reorganization submitted by the American Tobacco Company. The Supreme Court had previously declared the Tobacco Trust an illegal combination, applying the Sherman Anti-Trust Law. The Supreme Court further declared that the company was to be considered illegal until it submitted a plan to the Circuit Court which would be in harmony with the law and restore conditions essential to fair competition. The American Tobacco Company then drew up a plan dividing the corporation into three parts owned by the same persons , in the same proportions, and controlled by the same individuals who were originally responsible for the violation of the Sherman Law. The Circuit Court without going into much detail to see whether the plan was in accordance with the principles of "fair competition" accepted it. To Mr. Brandeis, that was a flagrant violation of the Supreme Court decision and nullified 5 years of intense investigation by the Bureau of Corporations. In view of the facts, Brandeis interpreted the Circuit Court decision to mean invoking the Constitution to protect~~xx~~,not only vested rights, but vested wrongs. And he saw a new implied Constitutional prohibition "What man has illegally joined together, let no court put asunder".

Fortunately, Mr. Brandeis' early opinions and social philosophies were not forgotten by him after becoming a member of the Supreme Court. He continued his fight against "bigness" and monopolies and in favor of a regulated competitive system. The two cases which illustrate and typify the problems were Liggett Company vs. Lee (288 U.S. 517) and New State Ice Company vs. Liebmann (285 U.S. 262). In both of these cases, Justice Brandeis was in the minority and rendered a dissenting opinion.

In New State Ice Company vs. Liebmann, the issue before the court was as follows: Oklahoma passed a law declaring the manufacture of ice for sale and distribution a "public business". It then made it a misdemeanor to engage in the business without a license from the Corporation Commission; providing likewise that the application for license may be denied if "the facts proved at said hearing disclose that the facilities for the manufacture, sale, and distribution of ice by some person, firm, or corporation already licensed by said commission at said point, community or place, are sufficient to meet the public needs therein". New State Ice Company was legally established as a business in a district of Oklahoma providing for the ice needs of the community. Liebmann opened another ice plant in the vicinity without getting a license, and after being stopped brought suit charging Oklahoma with a violation of the 14th Amendment depriving him of "liberty" without due process of law. Mr. Justice Sutherland, writing for the majority, held the law invalid on the ground that it was an arbitrary attempt to restrict a business essentially private in character.

Mr. Justice Brandeis, however, was of the opinion that the law was a valid exercise of the state's police power. Any business, he argued, whether originally private in character or not, may under changing circumstances become a matter of public concern. In this case, conditions existing in the affected community convinced the state legislature that the ice business was a matter of public concern ~~In this case conditions existing~~ and subject to some regulation on its part. Peculiar economic conditions made it adviseable to restrict cut-throat and unlimited competition hence the legislature decided that it was good for the community to restrict that competition. Surely, Mr. Brandeis maintained, that was not an unreasonable or arbitrary regulation, for ~~it was~~ WAS IT NOT for the "public welfare"?

There is room to believe that unbridled competition as well as unbridled monopolies is one of the major contributing causes for the widespread depression. The State of Oklahoma so believed and decided to do something about it. It started an experiment, therefore, and regulated competition along the lines of the law in question. The action it took was legal and within its police power. The Supreme Court, he maintained, should not hinder it but should permit the experiment to continue and perhaps find a solution to the problem. "If we would guide by the light of reason, we must let our minds be bold".

The case of Liggett Company vs. Lee dealt with the Florida Anti-Chain Store Laws. The State of Florida imposed license fees on all stores, but stores located in more than one county, commonly considered chain stores, were charged with heavier fees than privately owned or cooperative retail stores. The original plaintiffs, a group of corporations representing the chain store interests, claimed that they were being discriminated against unjustly. Mr. Justice Roberts of the majority upheld their claim and said that the Court could find no reasonable legal basis for such a classification as the law made.

Mr. Justice Brandeis, in a dissenting opinion, looked at the question from a different angle. He recognized that the statute attempted to protect the individually, independently owned, retail stores from the competition of chain stores by subjecting the latter to financial handicaps which might conceivably compel their withdrawal from the state. As to the question whether the classification is a reasonable one or not, Mr. Brandeis maintained that the particular plaintiffs involved could not object to the law because they were corporations and as such were subject to whatever non-discriminatory regulation the state desired to impose. He then entered into a treatise on the development and status of corporations.

It is wrong to believe that because corporations are prevalent today, the citizen has an inherent privilege to do business in corporate form and that the evils which accompany the unrestricted use of the corporate mechanism are inescapable, for our history shows a different view prevailing. For years in this country, we feared to issue corporation charters because we feared monopoly, encroachment upon individual liberty, subjection of labor to capital, and the menace of large aggregations of capital. We finally succumbed only after much pressure and a belief that the law would control the corporate form.

At first, there was a limitation placed on the amount of authorized capital. New York, for example, had a limit of $100,000 for some businesses and as little as $50,000 for others. Gradually, however, the limitations were removed for reasons described later. Another limitation was on the scope of the corporations' power and activities. It was not until 1875 that permission to incorporate for "any lawful purpose" was granted; and until that time corporation franchises were generally limited to a period of 20,30,or 50 years. In addition, all or a majority of the directors were required to be residents of the incorporating state. Severe limitations were imposed on the amount of indebtedness and the power to hold stock in other corporations was prohibited, thus making the holding company impossible.

The breakdown of the corporate limitations began when the smaller states, eager for the revenue derived from the presence of corporations, removed the safeguards from their lawbooks. Other states were forced to follow suit. The result was a race in which all states took part to see which could become more lax in its regulation of corporations. New York, for example, had a terrific time keeping up with New Jersey ~~during~~ at the turn of the century for the latter state seemed to attract more corporations . From 1890 to 1901, therefore, New York revised its corporation laws four times, each revision dropping further restrictions.

It was only logical, therefore, that corporations grew and became dangerously big until they eventually dominated the states themselves. "The typical business corporation of the last century, owned by a small group of individuals, managed by their owners, and limited in size by their personal wealth, is being supplanted by huge concerns in which the lives of tens or hundreds of thousands of employees and the property of tens or hundreds of thousands of investors are subjected, through the corporate mechanism, to the control of a few men". In fact, the powre of corporations has become so great that it is not too far fetched to compare its effects with the feudal system.

Kgnowing these facts, Mr. Brandeis continued, the people of Florida attempted to take back some of the privileges which they gave up. It could have taken away the corporate privilege completely, but instead it elected to aid the individual retailer fighting a struggle for existence by imposing a license fee ~~for~~ on those chain-store corporations. The license fee, therefore, is but a form of compensation exacted for the privilege of carrying on intrastate business in a corporate form. As that privilege, with the above facts in mind, is one which it may grant or withold, the state is free to charge such compensation as it pleases and it not even be"reasonable".

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The above study demonstrates, to conclude, that ~~M~~ Judge Brandeis' thesis is indeed worthy of action. Fortunately, he has not been alone in his fight and there seems to be a tendency today to put his principles into practise. More and more people are beginning to realize that corporations "have gotten away with murder" and that now is the time to do something about it. It is to be hoped that we can look forward to a future where all ~~men~~ will realize that a corporate form of business is a privilege granted by the state; that it is to be managed as a public trust for the public interest and not for selfish gain; and that its activities and powers should be limited. A system of Federal Incorporation may be the answer.

(signed)

Meyer Kaye (pseudonym)