WATERLOGGED STOCKS OF AMERICAN RAILWAYS

Figures Showing How Countless Millions Have Been Made by a Scratch of a Pen.---Will Payne in Everybody's

Mr. A. B. Stickney, president of the Chicago Great Western, recently discussed railway rates before the Transportation club of St. Paul. Taking the complete statistics for 1905, he found that the average rate of interest paid on all the railroad bonds in the United States was 3.65 per cent, and the average rate of dividends paid on all the railroad stock was 3.02 per cent.

"Here," said Mr. Stickney, "is the average margin of profit of all the railways in the United States. * * * There is no other business in the country which is done on so small a margin of profits as 3.02 per cent dividend. No other invested capital gets such small returns as the capital invested in railroads."

If anybody asks how much of the stock upon which the average dividends of 3.02 per cent are paid is water, and, therefore, entitled to no dividend whatever, they reply that there can't be any water because the capitalization per mile of American railroads is much less than that of English railroads— which is exactly like arguing that Florida is an ideal summer resort because it is much less disagreeable than Panama.

But one fact is rather significant. That is, there are not many spots in the vast mass of capitalization where you can sink a drill without striking water.

Take, for instance, that conspicuous group of railroads known as the "hard coalers."

The anthracite industry naturally invited monopolistic ambition. The supply is confined to a region in Pennsylvania all of which could be put in an area twenty-two miles square. This region, roughly speaking, is only 100 miles from Philadelphia and 150 miles from New York. Transportation, of course, is the key.

Eight railroads tap the territory—namely, the Reading, Erie, Pennsylvania, Lehigh Valley, Delaware & Hudson, Delaware, Lackawanna & Western, New York, Ontario & Western, and the Central of New Jersey. There were, early, various fragile pools and gentlemen's agreements; but the first really important step toward monopoly was made in 1871 by F. B. Gowen, then president of the Reading. He began buying all the independent coal lands he could get hold of.

He seems to have had the right idea—namely, that it doesn't make any particular difference what price you pay for property provided it enables you to get a monopoly of a staple commodity. Having a monopoly, you can easily make consumers pay dividends on the purchase price. He bought about a hundred thousand acres of undeveloped coal lands, therefore, or a third of the amount in sight. In so doing he loaded up Reading with an increased debt to the amount of $50,000,000. Hereafter there existed 50,000,000 additional motives for monopolizing hard coal.

The result was a pool in 1873, among the hard coalers, limiting output and fixing prices. This continued, with many vicissitudes, until 1884, when the Pennsylvania broke away. The price of coal fell, and Reading, with its load of debt representing undeveloped coal lands, went into the hands of receivers.

When an individual goes into bankruptcy the water is squeezed out of him. When a railroad goes into bankruptcy not only is the water not squeezed out, but more is put in. The process is called "reorganization." Every important railroad reorganization involves an inflation of capital.

Reading was reorganized and set going again. A. A. McLeod came into control, and promptly took up the plan to monopolize hard coal. Some brilliant financiering followed. Unfortunately the courts upset some of the McLeod leases. The whole structure fell. The fall touched off the panic of 1893.

Once more Reading went into the hands of receivers and was reorganized. Of course, none of the water was let out. On the contrary, more was put in. This time the capitalization was lifted above $300,000,000, or about $316,000 per mile of road.

This reorganization, however, brought in the powerful friendship of Mr. Morgan. Thanks largely to him, a spirit of amity began to pervade the hard coal roads; but this better understanding among the carriers did not increase the happiness of the "independent" operators who depended upon them for transportation. Certain of these operators projected an independent railroad to tidewater. But the project failed.

Still the independents were dissatisfied with freight rates. Presently, led by the Pennsylvania Coal company, they projected another road to be built along the old Delaware and Hudson canal. The Pennsylvania Coal company was a comparatively small concern. Its output amounted to only five per cent of the total. It had $5,000,000 capital stock—a good deal of it scattered in rather small holdings. Morgan & Co. quietly gathered in the majority of the stock.

Now just what Morgan & Co. paid for that $5,000,000 of Pennsylvania Coal company stock has never been disclosed; but the house turned the stock over to the Erie railroad, which issued therefore $32,000,000 of four per cent bonds and $5,000,000 of four per cent preferred stock. It was supposed that this $5,000,000 of preferred stock represented the bankers' commissions, or bonus; but that is neither here nor there. The Pennsylvania Coal company was the key to the monopoly of hard coal. The monopoly has been in perfect working order ever since. Interest and dividends on the securities issued by the Erie road in payment for Pennsylvania Coal company stock amount to sixty cents on each ton of that company's output. But what of that? They might as well have amounted to $1.60. Consumers of monopolized hard coal would have had to pay it.

THE WATER-LOGGED ERIE

Erie's previous experiences in the stock-watering line had been extensive and picturesque. From 1868 to 1872, in the able hands of Daniel Drew, Jay Gould, and James Fisk, its share of capital was increased from $17,000,000 to $78,000,000. Nearly all of this increase was mere fiat, put out for speculative purposes and with scarcely a pretense that any actual value lay behind the issue. Reams of stock were printed and put out by night for the purpose of breaking Commodore Vanderbilt's corner in the shares.

In 1895 the road, being bankrupt, underwent a typical reorganization, conducted by Mr. Morgan. There were outstanding, for example, $33,597,000 second mortgage bonds. In the reorganization these bonds received seventy-five per cent of their face value in new four per cent bonds, and fifty-five per cent in new four per cent preferred stock, or 130 per cent in all. The old $77,837,000 bogus common stock was converted into a like amount of new common stock. There was issued $63,000,000 of first and second preferred stock, a large part of which was distributed as sweeteners and bonuses to reconcile the old security holders.

In defending the capitalization of the hard coal roads in 1901, Mr. McLeod pointed out that four of them—namely, Reading, Erie, New York, Ontario & Western, and Lehigh Valley—had outstanding $382,554,000 of stock upon which no dividend had ever been paid and which had a merely nominal value in the market.

So, if this was water, who was hurt by it—no dividends being paid and the stuff being of little value? Why bother about the old rags heap? But today dividends are paid upon all of this stock with the exception of Erie common. Last year common seemed so bright that the stock sold at above $50 a share, while Reading's watered common sold at $164 a share. The Baltimore & Ohio and the Lake Shore roads have jointly bought over $60,000,000 of Reading stock, out of a total of $140,000,000—thereby passing it on toward a form of capitalization with fixed charges. The New York, New Haven & Hartford has bought $29,000,000, or one-half, of the common stock of the New York, Ontario & Western, thereby putting it also in the way of becoming a form of capitalization bearing fixed charges—for these purchases by one road of the stock of another are generally financed in th: end by an issue of bonds.

THE LOOT IN UNION PACIFIC

How could all this watered stock be so handsomely supported and become so agreeably valuable unless the railroads were charging the public for coal and for transportation much more than enough to yield a reasonable return upon the actual investment?

After the Credit Mobilier scandal, congress investigated the Union Pacific and found that it had cost the contractors a little under $51,000,000 to build the road.

For this there was issued

Government subsidy bonds.......	$ 27,000,000
First mortgage bonds...........	27,000,000
Land grant and income bonds....	18,000,000
Common stock...............	36,000,000
Total	$108,000,000

The Northern Pacific fared even better in this regard. The government gave it 40,000,000 acres of public lands—a piece of generosity which in no wise restrained the stock watering proclivities of the builders and reorganizers.

The road has been reorganized three times and is now capitalized at more than $65,000 a mile, excluding the bonds that it issued jointly with the Great Northern to pay for Chicago, Burlington & Quincy stock. Canadian Pacific is capitalized at only $29,000 a mile. Northern Pacific's funded debt per mile, excluding the Burlington bonds, is greater than the entire capitalization per mile of the Canadian road. To understand how Northern Pacific's capitalization has been boosted to this figure we need only glance at the last reorganization. There were $42,000,000 of first mortgage bonds outstanding. In the reorganization:

Each $1,000 bond received $1,350 in new prior lien bonds.

All second and third mortgage bonds received 118½ per cent of face value in new prior lien bonds and fifty per cent value in preferred stock.

Each $1,000 bond received $1,685 in new securities.

The old stock, practically all water, was exchanged for new stock of the same amount.

The Atchison, Topeka & Santa Fe has been reorganized twice. In the last reorganization the old general mortgage four per cent bonds received seventy-five per cent in new general mortgage fours and forty per cent in new adjustment fours. Thus $129,320,770 was converted into $148,718,983 in new fours. Old second mortgage "A" bonds received 113 per cent in new preferred stock. Second mortgage "B" bonds received 118 per cent in new preferred stock.

Of the "A" and "B" bonds there were $87,937,500 outstanding, and they drew four per cent a year interest. The holders paid in a cash assessment of four per cent, and received $99,869,375 of new preferred stock which draws five per cent a year in dividends. The old common stock, about all water and of very little value at the time of the reorganization, was exchanged for the same amount—$102,000,000—of new common stock. This new common stock now draws five per cent a year in dividends, and until the recent deplorable slump in stocks it sold above par.

They will tell you that it would not be fair to squeeze out the water in a reorganization. For example, a great many small investors had bought Union Pacific, Northern Pacific and Atchison stock during boom times. Times turned bad. The roads could no longer carry the overcapitalization and the profitless branch lines with which financial geniuses had loaded them. Bankruptcy followed. But the small, innocent investors must not be frozen out. They must be permitted to exchange their old stock for new, and so given a chance to recoup when good times come again. Such is the argument.

As a matter of fact, it doesn't work that way. The ordinary innocent investor gets frightened when he sees the road approaching insolvency, and dumps his stock on a falling market for what little it will fetch; or he is pinched in his own small business and has to sell; or he can't pay the assessment. In any event, he throws over the stock. The opulent "reorganization syndicate" or individual financiers scoop it in.

In 1902 the Messrs. Moore and their friends bought up $70,000,000, in round numbers of the stock of the Chicago, Rock Island & Pacific—which had paid from two to three and a half per cent a year in dividends through the hard times. By the simple devices of a lease and a holding company they converted this $70,000,000 of Rock Island into

Four per cent bonds............	$ 70,000,000
Four per cent preferred stock......	49,000,000
Common stock	70,000,000
	$189,000,000

In short, a capitalization of $70,000,000 was converted into a capitalization of $189,000,000 out of hand and without adding a single dollar to the actual investment in the road itself.

And this $189,000,000 enters into Mr. Stickney's calculation as a part of that poor, starved railroad capital that gets hardly any return because rates are so low.