

The Northern Pacific

Panic of 1901



THE RUSH TO BUY NORTHERN PACIFIC, THURSDAY, MAY 9
 Drawn by S. M. Stone

Museum of American Finance

By Peter Low

ON MAY 10, 2007 while appearing on "The Charlie Rose Show," Warren Buffett mentioned that during the many seminars he conducted with MBA students from various schools very few had ever heard of the Northern Pacific Panic of 1901. Ironically,

Above: "The Rush to Buy Northern Pacific, Thursday, May 9," published in Harper's Weekly, May 18, 1901.

the airing of this segment took place 106 years, almost to the day, of the culmination of that fascinating episode in American financial history which involved a number of Gilded Age business titans and pitted JP Morgan and James J. Hill against Edward H. Harriman and Jacob Schiff.

In early March of 1901, Morgan organized the merger of Carnegie Steel, Federal Steel, American Steel & Wire, and a number of smaller

steel, wire and tube producers to form United States Steel, the first billion-dollar corporation. The company was initially capitalized at \$1.4 billion and Andrew Carnegie's share of \$226 million, in five percent bonds, made him the richest man in the world.

Later that month Morgan and Hill bought control of the Chicago, Burlington, and Quincy Railroad for the joint account of Hill's Great Northern and Northern Pacific Railroads. The CBQ was strategically important because it provided an entry into Chicago which Hill's systems, and Harriman's Union Pacific, lacked. Since Harriman's line reached no farther east than Omaha, and Hill's no farther than St. Paul and Duluth, ownership of the CBQ also represented a connection for a possible transcontinental railroad.

Harriman and his investment banker, Jacob Schiff, the senior partner of Kuhn, Loeb & Company, asked Hill and Morgan for a one-third interest but was rebuffed. Harriman's reply was, "very well it is a hostile act and you must take the consequences." Harriman then decided that to attain possession of the CBQ, he would attempt to purchase control of the Northern Pacific Railroad.

Edward Henry Harriman began his business career as a trader, speculator and "market operator." His interest in railroads was engendered by his marriage into the prominent north-



Northern Pacific Railroad Company stock certificate issued to E.H. Harriman & Co. in 1885.

ern New York State Averell family who controlled the Ogdensburg Bank and the local Ogdensburg and Lake Champlain Railroad. Brilliant in his understanding of railway operations and audacious in his business strategies, he eventually gained majority interests in the Illinois Central and the Southern Pacific railroads as well as in the Union Pacific, which he reorganized out of bankruptcy.

Harriman was described by Kuhn, Loeb partner Otto Kahn as a man who would attend group meetings “at which 10 or 12 men sat around a table with him...a large majority opposed to the measures he would propose. Yet I know of hardly an instance of any importance where his views did not prevail finally, and, what is more, generally by unanimous vote.” In Harriman’s own words, he told Kahn, “all the opportunity I ever ask is to be one among 15 men around a table.”

In addition to the support of Kuhn, Loeb, he was backed by the Union Pacific Treasury and National City Bank which, as a repository of millions of dollars of Standard Oil cash, had a particularly close relationship with the Rockefellers.

In early and mid-April, Harriman began to accumulate Northern Pacific

common and preferred shares in the open market. Morgan, unaware of Harriman’s bold tactics, left the United States for a vacation at Aix-les-Bains, France. His partners were so uninformed that as NP continued to rise in price, they actually sold about 23,000 shares of the partnership’s holdings and an additional 35,000 shares for customers and affiliates, thus unwittingly aiding Harriman in his quest for control.

By late April, numerous speculators assumed that the run-up in the shares of many railroads was due to the McKinley bull market and to the consolidation of the CBQ with NP. James Hill, however, became alarmed with the pace of trading in NP and decided to make a speedy rail trip from Seattle to New York City, arriving on Friday, May 3. He immediately visited the Kuhn, Loeb office where Schiff explained that the Harriman Group had invested a total of \$80 million and owned 420,000 shares of NP’s 750,000 preferred issue and 370,000 shares of its 800,000 common. Although these combined positions constituted a majority of all the NP stock outstanding, Harriman was 40,000 shares shy of a controlling interest of the common.

Hill was originally from Ontario, Canada but he settled in St. Paul, Minnesota at the age of 18. Blind in the right eye from a childhood bow and arrow accident, he was known as the Little Giant because of his short stature and huge ambition. Later that day he visited JP Morgan and Company and while combing through records, discovered to his delight that NP directors had the right to retire the preferred issue on January 1, 1902. Therefore, 51 percent ownership of the common was crucial.

The following day, Saturday, May 4, Harriman instructed Kuhn, Loeb to buy an additional 40,000 shares of common (the NYSE conducted Saturday trading sessions from 10 am to 12 pm until 1952). Schiff was in Synagogue observing the Jewish Sabbath and when found by one of his partners, he instructed that the order not be filled and indicated that he would take personal responsibility for the decision. The historical record generally assumes that Schiff was observant and would not conduct business on the Sabbath. However, Jean Strouse, in her biography of JP Morgan, offers the possibility that Schiff did not want to further antagonize the powerful House of Morgan. In any event, no portion of the order was executed.

In addition, Morgan partner Robert Bacon wired his senior partner in France for permission to purchase 150,000 shares of common, and the reply which reached Bacon on Monday, May 6, ordered him to “buy at any price.” Frenzied trading ensued, and that day NP closed up 17½ points at 127½.

By Tuesday, May 7, it became clear that the stock was cornered. Many speculators, unaware of the behind-the-scenes struggle for control, saw the price increase as an opportunity to sell short, thus attempting to profit from a possible decline. As a result, about 100,000 more shares were sold than had been printed. In addition, under the then existing rules of the NYSE, a

seller had the obligation to deliver sold shares by 2:15 pm the following day.

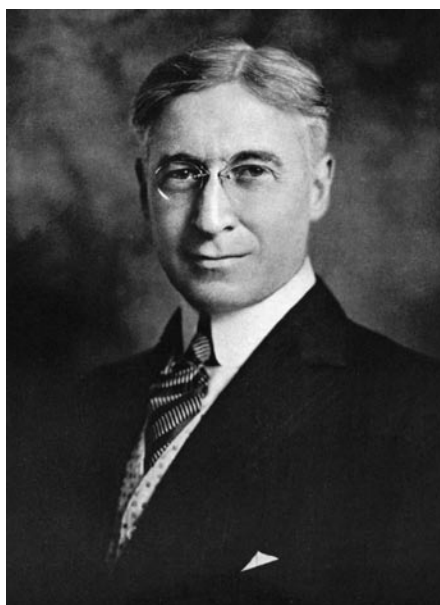
As Bernard Baruch, the famous speculator and advisor to presidents, relates in his autobiography, neither side intended to set off a short squeeze, and as a result Al Stern, of Herzfeld & Stern, was sent to the NYSE Floor that Tuesday, after the 3 pm closing bell, as a Kuhn, Loeb emissary to lend stock to panicked short sellers. NP had already finished the session at 143 after touching 149 earlier in the day, but brokers had not yet left the trading post. As Stern entered the crowd he inquired, "Who wants to borrow Northern Pacific? I have a block to lend." Baruch, who was a NYSE Member, and therefore, an eyewitness to the pandemonium that followed, explains that "...the desperate brokers rushed at Stern. Struggling to get near enough to him to shout their bids, they kicked over stock tickers. Strong brokers thrust aside the weak ones. Hands were waving and trembling in the air." Continuing his narrative, Baruch describes the frantic brokers as acting like "...thirst-crazed men battling for water, with the biggest, strongest and loudest faring best." Stern finally broke away after he had no more stock to lend.

The next day, Wednesday, May 8, the hysteria continued, and as NP advanced in price other stocks were being sold in panic at considerable discounts. Many speculators were facing catastrophic losses and financial ruin.

Baruch further explains that during that era many traders and brokers often assembled after hours at the Waldorf Astoria Hotel, which was on the site where the Empire State Building now stands. He describes the scene that Wednesday evening, "one look inside the Waldorf that night was enough to bring home [the] truth of how little we differ from animals after all. From a palace the Waldorf had been transformed into the den of frightened men at bay... It was, in short, a mob swayed by all the unrea-

sonable fears, impulses and passions that play on mobs."

The headline in the *New York Herald* on Thursday, May 9, read, "Giants of Wall Street in Fierce Battle for Mastery, Precipitate Crash That Brings Ruin to Horde of Pygmies." That morning, Northern Pacific opened up 10 points at \$170 and by 11 am it was selling at \$400. Around noon, the price hit \$700 and at about 2 pm there was a transaction of 300 shares at \$1,000. Then, a few minutes before the 2:15 pm settlement deadline Al Stern again visited the Floor accompanied by JP Morgan's representative, Eddie Norton of Street and Norton. The men announced that neither Kuhn, Loeb



Bernard M. Baruch

nor JP Morgan would enforce delivery of NP shares purchased the day before. The crisis was over and NP sold off to \$300 although it eventually closed at \$325, up 165 points for the day. Later that afternoon, both investment banks announced that they would provide stock to short sellers at the reasonable price of \$150.

As for Baruch's personal trading during the panic, he reports that on Monday morning, May 6, he was considering an NP arbitrage opportunity between the New York and London markets and shared his thoughts with

Talbot Taylor, a reliable and well-connected colleague. Taylor, who's father-in-law, James Keene, was handling the NP buy order for JP Morgan & Company, admonished Baruch to "Be careful and don't be short of this stock. What I buy today must be delivered now. Stock bought in London will not do." Taylor then informed his friend, in strict confidence, about the covert struggle for control. Privy to extremely sensitive information and sworn to secrecy, Baruch decided to avoid trading in NP and chose an alternative strategy. Anticipating a corner, he sensed that the rest of the market might collapse as shares of other companies would have to be sold to raise money to support losing short positions. He shorted various leading issues from the general list and referring to Wednesday, May 8, indicates that "when stocks were dumped I bought... My net profit that day was more than I made on any other one day before or after."

The two sides of this financial tug of war eventually made peace, and in November of 1901 the Northern Securities Company was formed to hold the Northern Pacific, Great Northern and CBQ railroads. Its board of directors included three JP Morgan partners along with James J. Hill, Edward H. Harriman, Jacob Schiff and John D. Rockefeller's brother, William. However, previously on September 6, President William McKinley, who had a friendly bias toward Morgan's economic interests, was shot by an anarchist at the Pan-American Exposition in Buffalo, New York. He died eight days later and Theodore Roosevelt, whose viewpoint toward trusts and large business combinations was more skeptical, became President. In February 1902, Northern Securities was sued by the Roosevelt Administration under the Sherman Antitrust Act of 1890. It was dissolved in 1904 by order of the Supreme Court.

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In 1970, the Great Northern, Northern Pacific, CBQ and the Spokane, Portland, and Seattle Railway merged to form the Burlington Northern Railroad. The merger was allowed in spite of a challenge by the highest court, essentially reversing the 1904 ruling. On December 31, 1996, Burlington Northern merged with the Atchison, Topeka, and Santa Fe Railway to form the BNSF.

In his 2008 Annual Letter to shareholders, Warren Buffett reported that Berkshire Hathaway Inc. owned at least 20 percent of the Burlington Northern Santa Fe Corporation. On November 3, 2009, he announced that in a \$44 billion transaction Berkshire

would acquire the entire railroad. In his statement to the press, Buffett explained that he viewed the purchase as an investment in the economic future of the United States. **FH**

Peter Low is Chairman of the Griswold Company, Inc. He was previously an independent Member of the New York Stock Exchange for more than 40 years.

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The Panic of 1826

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enacted or amended in response to historical financial crises; the current crisis will almost certainly produce a new round of legal changes. **FH**

Notes

1. This firm was chartered in 1812 as “The President, Directors and Com-

pany of the City Bank of New York.” In 1865, it converted to The National City Bank of New York.

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threat of losing everything was a governor to greed.

By the end of the 18th century, two very different viewpoints on speculation had been demarcated, and a battle waged between a class that lived off its land and a risk-taking class intoxicated by the paper wealth of a concentrated banking system. This latter group—championed by Hamilton—was so at odds with the country’s agrarian ideals that it reinforced Jefferson’s fear that New York was inhabited by nothing more than a bunch of English-sympathizing stock

jobbers who dressed like, spoke like, and wished to be the English he so detested. Put another way, the notion that it was un-American to play in the financial game is nearly as old as the country itself. The battle among the founding fathers foreshadowed how economic blame would be distributed for the next 230 years. **FH**

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