

Section III

THE FICTITIOUS CRUDE DRUG BUSINESS

McKesson & Robbins, Incorporated (Maryland) when it was petitioned into receivership on December 5, 1938, had reported assets of approximately \$90,000,000 and was the result of a merger or consolidation of more than 50 separate corporations. The fictitious crude drug business accounted for approximately \$21,000,000 of these assets, represented by fictitious inventories, accounts receivable, and cash in bank carried on the books of the Connecticut Division of McKesson & Robbins, Incorporated (Maryland) and by one of its subsidiaries, McKesson & Robbins, Limited (Canada).²⁶ Prior to October 31, 1934, all of the business of the Connecticut Division was conducted by a separate subsidiary, McKesson & Robbins, Incorporated (Connecticut). At the time of the formation of McKesson & Robbins, Incorporated (Maryland), as a holding company in August 1928, when McKesson started acquiring numerous wholesale drug houses throughout the country, McKesson & Robbins, Incorporated (Connecticut) and McKesson & Robbins, Limited (Canada) were already in existence. The latter had been formed as a new enterprise in October 1927, and the former to give effect to the merger of the old McKesson & Robbins, Incorporated (New York) and Coster's Girard & Co., Inc. in October 1926.

In order properly to appraise the procedures followed in auditing the fictitious crude drug business, it is necessary first to understand the relationship between this business and the concern as a whole.

* See the following table:

| Fictitious assets as at Dec. 31, 1938 | McKesson & Robbins, Incorporated, (Maryland) (Connecticut Division) | McKesson & Robbins, Limited (Canada) | Together |
|---------------------------------------|---|--------------------------------------|-----------------|
| Cash in bank..... | \$ 361,472.86 | \$ 51,095.70 | \$ 412,568.56 |
| Accounts receivable..... | 8,472,630.10 | 1,564,688.00 | 10,037,318.10 |
| Inventories..... | 9,503,025.00 | 1,072,746.50 | 10,575,771.50 |
| | \$18,337,127.96 | \$2,688,530.20 | \$21,025,658.16 |

Second Report of William J. Wardall, Trustee, *In the Matter of McKesson & Robbins, Incorporated*, Debtor, at p. 25.

The fictitious assets comprised in excess of 75% of total reported assets of the Connecticut Division and in excess of 85% of total reported assets of the Canadian Company. See pages 43-45 *infra*.

Since, as above indicated, the corporate structure was constantly changing, this relationship can best be set forth by first tracing chronologically the various corporate steps by which the present McKesson concern was assembled, with Coster at its head, and then showing the exact place in the corporate structure occupied by the fictitious crude drug business.

A. BRIEF CORPORATE HISTORY

1. Girard & Co., Inc.

Frank Donald Coster's rise to the head of the \$90,000,000 drug concern had its start in the incorporation of Girard & Co., Inc. under the laws of the State of New York on January 31, 1923. The authorized capital stock of this company consisted of 2,000 shares of common stock of \$100 par value. However, only 1,250 shares originally were outstanding. The consideration reported to have been received by Girard & Co., Inc., for these shares was cash, merchandise, and other working assets with which the Company began operations on March 31, 1923, in leased premises at 209 Washington Street, Mount Vernon, N. Y. At the beginning of 1925 these shares were reputedly owned by the following persons:

| | |
|---|--------------------------|
| Frank D. Coster, president and treasurer..... | 850 shares. |
| P. Horace Girard, ²⁷ vice-president..... | 350 shares. |
| George Dietrich, bookkeeper..... | 50 shares. ²⁸ |

The firm was reputed to have been engaged in business as manufacturing chemists of products most of which contained alcohol.²⁹ Its books were first audited by Price, Waterhouse & Co. as of December 31, 1924 and covered operations for the 9 months preceding that date.⁵⁰ Speaking of the balance sheet prepared at this time Jaureguy, a partner of Price, Waterhouse & Co., testified:

"Q. [By Mr. GALPEER.] Now, as far as you know, this is the first published statement of Girard and Company, that I showed you before?

A. To the best of my knowledge and belief it is.

Q. And this statement, as far as your certification goes, contains no qualifications at all?

A. No, sir.

²⁷ Horace B. Merwin, who early became a director of Girard & Co., Inc. and continued his association when it was succeeded by McKesson & Robbins, testified concerning P. Horace Girard as follows:

"Q [By Mr. GALPEER.] Who is Mr. P. Horace Girard, or who was Mr. P. Horace Girard?

A. If you will look at the first page of Mr. Thompson's report in 1925 [Ex. 177] you will find that he was one of the first three stockholders of Girard & Co. I never saw him. I do not know of anybody else who ever did. I remember inquiring about him from Mr. Coster, and if my memory serves me correctly, he told me that he was ill; had tuberculosis and I believe was in Saranac or some where up in that vicinity, as I remember. He apparently eventually died off soon after that." R. 2291-2292. See also R. 66-67.

It seems that P. Horace Girard was another alias used by Philip Musica (Frank Donald Coster) up to the time of his suicide. See Second Report of William J. Wardall, Trustee, *In the Matter of McKesson & Robbins, Incorporated*, Debtor, at p. 14.

²⁸ Ex. 138, 177.

²⁹ Ex. 177.

⁵⁰ Ex. 2, 138.

Q. So you might really say that this was the start of Girard and Company on your name?

A. I think that is true.³¹

All subsequent regular audits of Girard & Co., Inc. and of McKesson when it succeeded Girard were performed by Price, Waterhouse & Co.³²

A short time prior to December 31, 1924, the Company entered into a contract to purchase from the First National Bank of Bridgeport the plant of the Hawthorne Company at Fairfield (near Bridgeport), Conn.,³³ which had been taken over by the bank. The terms were \$25,000 cash and the balance of \$100,000 was to be paid in 10 annual installments of \$10,000 each, all repairs to be made by the bank. Title passed on March 2, 1925, and Girard & Co., Inc. moved from Mt. Vernon to Fairfield in April 1925.³⁴

In May 1925 the firm borrowed \$80,000 from The Bridgeport Trust Company, and at the same time C. Barnum Seeley, then president of the bank, purchased 275 shares of Girard's authorized but unissued common stock, at par, for \$27,500. Seeley allowed two of his associates at the bank, Horace B. Merwin, later president of the bank, and Egbert Marsh, later also president and then chairman of the Board of Directors of the bank, to take a small portion of this stock.³⁵

In the first quarter of 1926 a 25% dividend in cash was paid on the outstanding stock.³⁶ In the second quarter the certificate of incorporation of Girard & Co., Inc. was amended, changing the authorized capital stock to 5,000 shares of 7% cumulative participating preferred of \$100 par and 50,000 shares of no par common. On June 10, 1926, the Company issued the full 50,000 shares of no par common in exchange for the then outstanding 1,525 shares of \$100 par value common. At the same time 3,000 shares of the preferred stock were sold by The Bridgeport Trust Company and The

³¹ R. 55.

³² Ex. 169.

³³ Because of its close proximity, this plant is sometimes referred to as being in Bridgeport.

³⁴ Ex. 138, 177.

³⁵ Ex. 139; R. 2241-2242. In this connection Merwin testified:

"Well, Mr. Seeley looked at their statement which, incidentally was, I think, at that time, it was a statement prepared by Price, Waterhouse and dated December 31, 1924. My files do not seem to have any May statement. That would be the one, I think, that was brought in to us at that time. At that time Mr. Seeley discussed with them the matter of the loan and noticed or got the information in the conversation with Mr. Carpenter, who came in at the time, that they had some capital stock that was unissued. He suggested that possibly they might sell a part of that stock and they would not then have to borrow quite so much money and that would strengthen up their financial statement.

After some conversation, he agreed to buy \$27,500 of that stock and about that time, we loaned them as our records show—I think it was during the month of May; probably the latter part of that month—\$80,000. That loan was paid off so that on December of that year, they owed us nothing.

He bought that [stock] for himself and later on spoke to me about it and asked me if I would like to buy part of it. He also spoke to Mr. Marsh, who was another officer of the institution and both of us bought a small part of it." R. 2241-2242.

³⁶ Ex. 140.

R. F. Griggs Company of Waterbury, Conn. After the deduction of a selling commission of \$30,000 the sale netted Girard & Co., Inc. \$270,000 in cash.³⁷ At this time Horace B. Merwin and Rowley W. Phillips, respectively representing the two firms above mentioned, became directors of the drug concern.³⁸

The purported growth of Girard & Co., Inc., is reflected in the following figures certified by Price, Waterhouse & Co.:³⁹

| <u>Date</u> | <u>Total assets</u> | <u>Capital and surplus</u> | <u>Net sales</u> | |
|-------------------|---------------------|----------------------------|------------------|------------------------|
| December 31, 1924 | \$ 295, 028 | \$ 161, 561 | \$ 251, 977 | (9 mos. to 12-31-24.) |
| December 31, 1925 | 584, 050 | 334, 392 | 1, 129, 302 | (Calendar year 1925.) |
| November 30, 1926 | 1, 306, 338 | 863, 601 | 2, 215, 811 | (11 mos. to 11-30-26.) |

2. McKesson & Robbins, Incorporated (Connecticut)

McKesson & Robbins, Incorporated (Connecticut) was organized on October 28, 1926 to effect the merger of McKesson & Robbins, Incorporated (New York) and Girard & Co., Inc., a project on which Coster had been working at least since the previous January.⁴⁰ A prospectus issued in connection with the financing at this time gives the following description of the merger and of the concerns involved:

³⁷ Ex. 141: R. 2245-2246, 2302-2304. For present purposes in this and subsequent stock offerings referred to herein, we treat only the shares sold by the corporate issuer. Sale of privately owned shares or use thereof as bonus stock in connection with the sale of corporate shares or resale or syndicate activities of the bankers are not included.

³⁸ R. 2306, 2263.

³⁹ R. 56-57; Ex. 2, 141, 142, 170.

⁴⁰ In a letter to Horace B. Merwin, then vice-president of The Bridgeport Trust Company, dated January 18, 1926, Coster said of the old McKesson:

"After a very careful investigation of the facts and circumstances surrounding this property, I am convinced that it is from the view point of standing and prestige in the international drug trade the leader, it having been before the public ninety-three years, their record with every retail and wholesale druggist in the United States is of the highest, and in determining the value of the good will the name alone aside from the valuable asset of the specialty trade names should be given careful consideration.

"I shall be glad to furnish you with any further information you might desire. What is essential this situation is action at the earliest possible moment." Ex. 174.

In the President's Report to Stockholders and Directors of Girard & Co., Inc. dated January 25, 1926, Coster said:

"I also recommend for careful consideration the possibilities of amalgamating with an old established firm such as McKesson & Robbins. While I look upon with a great deal of satisfaction to the advancement of Girard & Co., I cannot lose sight of the fact that even by making a sacrifice at the present time in any such amalgamation, the ultimate result would undoubtedly be to the advantage of the present stock holders of Girard & Co. in that they would secure an element of good will and a method of high class distribution which takes years and incalculable expenses to acquire." Ex. 176.

Replying to Coster's proposal concerning McKesson, Merwin wrote to him on January 27, 1926:

"Our brief investigation seems to disclose the fact that such information as we have been able to get through trade, banking and other channels indicates that their expenses are entirely out of proportion to their profits and that they have been losing ground, and furthermore that their chances for future development do not look too bright.

"We cannot help but feel for the best interest of Girard & Company it might be better to drop any further consideration of this matter and look about for something else which would be much sounder from a banking point of view." Ex. 175.

"McKesson & Robbins, Inc. (A CONNECTICUT CORPORATION)

A Merger of McKesson & Robbins, Inc. of N. Y. with Girard & Co., Inc. of N. Y.

* * * * *

"CAPITAL STRUCTURE (UPON COMPLETION OF THIS FINANCING)

Authorized and outstanding

| | |
|---------------------------------------|-----------------|
| "Preferred Stock—par value \$100..... | \$1, 650, 000 |
| Common Stock—without par value..... | 100, 000 shares |

"HISTORY AND BUSINESS.—McKesson & Robbins, Inc. of New York was established in 1833 and during its ninety-three years of existence developed and maintained a high national and international reputation with the public, the medical profession and the trade as a purveyor of fine drugs and rare chemicals. Its sales were effected through branches in London, Paris and South America and through more than one hundred distributors selected from the oldest and most prominent druggists and jobbers throughout the United States. In addition to its standard line of fine drugs, chemical and pharmaceutical products it also manufactured and distributed such nationally known specialties as 'Calox' tooth powder, 'Liquid Alborlene', 'Analax', McK & R Milk of Magnesia and McK & R Asperin.

"Girard & Co., Inc. was for a number of years engaged in procuring from original sources of supply the basic raw materials essential to the manufacture of fine drugs, chemical and pharmaceutical products and converting them by mass low cost production into such finished products as McKesson & Robbins distributed.

"Thus the consolidation of McKesson & Robbins with Girard & Co. is an ideal one as, besides effecting the usual economies attendant upon centralization of production and management, it combines a most formidable sales organization of ninety-three years experience and standing with a modern and aggressive plant of almost unlimited capacity having direct established contact throughout the world with original sources of its basic raw materials."⁴¹

The prospectus also states that "* * * Mr. Frank D. Coster, for the past four years President of Girard & Co., Inc., has been chosen President of the new company and will be in active charge of operations. * * *"

All of the new common stock (100,000 shares) was issued in exchange for the 50,000 shares of Girard common outstanding. Of the new preferred stock, 3,000 shares were issued in exchange for the 3,000 shares of Girard preferred outstanding and 13,500 shares were sold for cash by a group composed of The Bridgeport Trust Company, The R. F. Griggs Company of Waterbury, Conn., H. C. Warren & Co., Inc., of New Haven, Conn., and Fuller, Richter, Aldrich & Co., of Hartford, Conn. From the proceeds of the sale \$1,000,000 went to pay off Messrs. Saunders Norvell and Herbert D. Robbins, the then owners of McKesson & Robbins, Incorporated (New York). The remainder apparently was made available to the new Corporation as additional working capital. After the deduction of a payment to the bankers of \$135,000 this amounted to \$215,000.⁴²

⁴¹ Ex. 259.⁴² Ex. 144; R. 2246-2248, 2303-2304.

The old McKesson firm was moved from Brooklyn, N. Y., to the plant at Fairfield, where an addition was built in order to house the combined concerns.⁴³ Another office was established at 79 Cliff Street, New York City, to which the bulk or trading department of the old McKesson firm was transferred.⁴⁴

In order to finance the new construction at Fairfield, as well as to provide additional working capital, on or about May 1, 1927, rights were issued to common stockholders of the new McKesson & Robbins, Incorporated (Connecticut) to purchase additional common stock at \$20 a share. Apparently, the full 15,000-share offering was subscribed for, the Corporation receiving \$300,000⁴⁵ less \$15,000 commission paid to the underwriters.⁴⁶

3. McKesson & Robbins, Limited (Canada)

The reasons for the formation of this new Company in October 1927 were stated in a prospectus covering the initial offering of 10,000 shares of its preference stock as follows:

"NATURE OF BUSINESS.—We quote the following excerpts from a letter written to us by Mr. Frank D. Coster, President of the Company:

"McKesson & Robbins, Limited, is to be organized for the purpose of expanding the trade of McKesson & Robbins, Inc., of Connecticut, not only in the Dominion of Canada, but throughout the British Empire, Colonies and possessions.

"McKesson & Robbins, Inc., for the past 40 years under its former management has enjoyed an appreciable amount of business within this territory; however, this business has been limited mostly to raw materials where the barrier of tariff could be overcome and to not more than two or three specialties that were not highly competitive with specialties manufactured under British dominion.

"Under the present management liberal national advertising has brought us to the point where we must either manufacture our most profitable and successful items within the British confines or else renounce this not only attractive but profitable trade.

"In order to keep abreast with the leading competitors in our line, we have determined that it is for the best interests of McKesson & Robbins of Connecticut to manufacture such preparations now in their line that are suitable for British trade in Canada, and that by doing so McKesson & Robbins Limited of Canada will be enabled to expand its trade as successfully in the Dominion of Canada and in other British possessions.

"In addition to the actual manufacturing of present preparations, fine chemicals, pharmaceuticals and surgical dressings, McKesson & Robbins of Canada will also be able to handle direct importations into Canada of basic raw materials in which McKesson & Robbins of Connecticut is now a large factor."⁴⁷

⁴³ Ex. 128; R. 2253.

⁴⁴ R. 2596, 2615.

⁴⁵ Ex. 146; R. 2305, 2258.

⁴⁶ R. 2306.

⁴⁷ Ex. 260.

In respect to the management of the new Company, the prospectus stated:

"MANAGEMENT.—The President, Frank D. Coster, is also President and active manager of McKesson & Robbins of Connecticut, and will be assisted by the full personnel of the organization of the latter company, which company has a ninety-four year record of success and prosperity.

"The officers and directors of this company will be practically identical with those of the Connecticut Company."⁴⁸

The details of the organization of McKesson & Robbins, Limited (Canada), and its relationship to McKesson & Robbins, Incorporated (Connecticut) were summarized in one of the Price, Waterhouse & Co. reports as follows:

"A new company, McKesson & Robbins, Limited, was organized on October 17, 1927 under the laws of the Dominion of Canada with an authorized capital of 10,000 shares of 7% cumulative convertible preference stock having a par value of \$100.00 each, and 80,000 common shares without nominal or par value. All of the preference stock and 52,000 of the common shares were purchased by McKesson & Robbins, Incorporated, the consideration being \$900,000.00 in cash and the goodwill of McKesson & Robbins, Incorporated, in Canada, the British Empire and British Colonies and possessions with the use in those countries of this company's trade names, copyrights, inventions, improvements, processes and franchises.

"Subsequently all of the preference stock and 10,000 common shares were resold [by McKesson & Robbins, Incorporated] to The Bridgeport Trust Company and The R. F. Griggs Company for \$900,000.00 in cash. In accordance with a vote of the board of directors, the remaining 42,000 common shares retained by the company [McKesson & Robbins, Incorporated] as an investment, have been taken up on the books [of McKesson & Robbins, Incorporated] at a valuation of \$420,000.00.

"Under the terms of the charter of the Canadian company, the preference stock is convertible before November 1, 1932 into common shares at the rate of two common shares for each share of preference stock; and 20,000 of its unissued common shares have been accordingly reserved for that purpose.

"In connection with the purchase and sale referred to above of the capital stock of the Canadian company, McKesson & Robbins, Incorporated, have guaranteed to McKesson & Robbins, Limited, gross sales of not less than \$1,000,000.00 per annum and annual net profits available for dividends of not less than \$100,000.00 so long as any of its preference stock is outstanding. In consideration of this guarantee, the Connecticut company has the first right to subscribe for the remaining 8,000 common shares of the authorized issue of the Canadian company which have not been reserved for the conversion of preference stock."⁴⁹

The reasons for this guaranty arrangement are indicated in the testimony of Horace B. Merwin, who stated:

"Well, Mr. Coster advanced the idea that he would like to form a foreign corporation, indicating that he had a large volume of foreign business that could be handled better through a foreign corporation and the matter was quite a difficult one to finance, as you might suspect. We were talking about a brand new corporation which had no past experience of earnings and we wondered how

⁴⁸ Ex. 260.

⁴⁹ Ex. 146.

we could wrap up a package like that and make it saleable so that an investor would put his money in it. So that, the matter was talked about for a long time. * * * And then, the Connecticut corporation stated its willingness to guarantee * * * that it could and would allocate to the British corporation, a volume of business not to be less than a million dollars a year and at a profit not to be less than \$100,000 a year. After our attorneys had convinced themselves that those guarantees had been drawn up to suit them and they felt they were good and valuable and protected the stockholders, we then offered that to the public * * *.”⁵⁰

Although the prospectus above quoted only makes reference to the public offering of \$1,000,000 preference stock, it appears that the 10,000 shares of common stock purchased by the bankers along with the preference stock, were also resold by them.⁵¹ The stock was offered by the same Connecticut group that theretofore had handled the financing of McKesson & Robbins, Incorporated (Connecticut), namely The Bridgeport Trust Company, The R. F. Griggs Company, Edward M. Bradley & Co., Inc.,⁵² and Fuller, Richter, Aldrich & Co.⁵³ As above stated, the net amount paid by the bankers to McKesson & Robbins, Incorporated for 10,000 shares of preference stock, and 10,000 shares of common stock was \$900,000, the same amount as the cash paid by McKesson & Robbins, Incorporated to McKesson & Robbins, Limited for the 10,000 shares of preference stock and 52,000 shares of common.

In 1931, McKesson & Robbins, Limited (Canada) established a small branch in London, England,⁵⁴ which, in 1933, was incorporated as a separate subsidiary, also called McKesson & Robbins, Limited.⁵⁵ Aside from the London unit, the business of McKesson & Robbins, Limited (Canada) since its inception, and despite the statements made in the prospectus above referred to, has consisted solely of the purported purchase and resale of crude drugs as distinguished from the sale of products already manufactured and ready for the retail drug trade, such as the “McKesson Line”, or the manufacturing of such products. The business conducted by the London Company was negligible in amount in comparison with the purported sales of its parent.⁵⁶

McKesson & Robbins, Limited (Canada) established offices at the Fairfield plant of McKesson, and its operations, besides being reflected in the consolidated McKesson accounts, were also separately certified by Price, Waterhouse & Co. for annual release to its own stockholders.⁵⁷

⁵⁰ R. 2255-2256.

⁵¹ R. 2257.

⁵² Successors to H. C. Warren & Co., Inc., R. 2304.

⁵³ Ex. 260.

⁵⁴ Ex. 154.

⁵⁵ Ex. 74.

⁵⁶ R. 108 ff., 2262.

⁵⁷ Ex. 161-167.

4. McKesson & Robbins, Incorporated (Maryland)

The next corporate move is described in the following testimony of Horace B. Merwin, who at this time, in addition to being a director of the drug concern and an officer of The Bridgeport Trust Company, became treasurer of McKesson & Robbins, Incorporated (Maryland) until succeeded by Julian F. Thompson in February 1930.⁵⁸

"By Mr. GALPHER:

Q. Let us take up the financial picture from that point, after the financing of the Limited Company, what was the next step?

A. Well, things moved pretty fast. We were impressed by the tremendous dynamic power behind this man Coster. He could think up a new idea about as fast as anybody I have ever met. He began then talking about a great idea that would make a lot of money. He said he had this fine name now, there was none better; we thought it was pretty good ourselves. He was now all set to develop the thing properly. He came to us with the idea that he wanted to get the drug distributor, the drug wholesaler, throughout the country, of which there were a good many, who was not doing as well as he should, and his idea would be to combine them into one huge national distributing organization under the name of McKesson.

He completely took our breath away. We country boys figured that we better let go the tail of the bear about then. We then tried to persuade him to make a test. I remember suggesting to him that he take something like the Eastern Drug of Boston and Whittlesey and Company of New Haven and possibly Gibson and Snow, who had offices in Rochester, Syracuse and up there through that way, making a little group, and see if the thing would work. It sounded logical, it sounded splendid. He claimed the salesmen overlapped each other's territory and they were in competition and all that sort of stuff.

It was obviously going to involve a lot of money; it was getting out of our class entirely. He said it wouldn't do any good to make a test, somebody else would swipe his idea. The only thing to do was to make a national job of it, so finally, in order to hold him down, I think we agreed on 17 or 18 distributors who were kind of hand picked and particularly good.

I was very much impressed that when these men were approached they were very much impressed with the idea, which made me believe there was a lot in it. After some conferences in New York, Mr. Coster himself, I believe, went to, I think, I am not sure, Goldman, Sachs who sort of turned him over to Bond & Goodwin with whom they had some pretty intimate association, and the developments and negotiations began.

That was the forerunner of the move which enlarged McKesson into quite a large outfit. In fact, I think it was then that they became McKesson & Robbins of Maryland, which is a holding corporation, which in turn purchased all these distributors. They were first held, I believe, as separate corporations.

* * * * *

The way that financing was done, it was done primarily under the auspices of Goldman, Sachs, Bond & Goodwin and we Connecticut bankers, the old originals, sort of tagged along and took small participation in the financing at the time."⁵⁹

As testified by Merwin, a new McKesson & Robbins was organized in Maryland on August 4, 1928 as a holding company for the purpose

⁵⁸ R. 2263, 2296-2297.

⁵⁹ R. 2263-2265.

Meanwhile, in preparation for these developments, McKesson & Robbins, Incorporated (Connecticut), on September 1, 1928, offered to its common stockholders the right to subscribe, at \$75 per share, to an additional share of its common for each two held. 57,500 additional shares of common were thus issued, netting the Connecticut Company \$3,881,250, after deducting an underwriting fee of \$7.50 per share or \$431,250. This money was used by the Connecticut Company to redeem its own outstanding preferred stock and to acquire preferred stock and notes of certain of the wholesale drug distributors whose common stocks were to be acquired by the Maryland Company as above stated. Thereafter, on September 28, 1928, at the time of the acquisition by the Maryland Company of the wholesale drug subsidiaries, the total outstanding common stock of the Connecticut Company, 172,500 shares, was acquired by the Maryland Company in exchange for twice that number, or 345,000 shares, of its own common stock.⁶⁵

In November 1928, the originally outstanding shares of the Maryland Company were admitted to trading on the New York Stock Exchange as were all subsequent securities issued by this Company.⁶⁶

Besides the 664,409 shares of common and 320,000 shares of preference stock originally issued by the Maryland Company in September of 1928, before the close of that year an additional 10,079 shares of common and 1,507 shares of preference stock were issued in connection with the acquisition of another wholesale drug com-

| | |
|-------------------------------------|-----------------------|
| Gibson-Snow Co., Inc..... | Troy, N. Y. |
| | Buffalo, N. Y. |
| | Albany, N. Y. |
| | Syracuse, N. Y. |
| | Rochester, N. Y. |
| The Hall-Van Gorder Company..... | Cleveland, Ohio |
| Kirk, Geary & Co..... | Sacramento, Calif. |
| Langley and Michaels Company..... | San Francisco, Calif. |
| Minneapolis Drug Company..... | Minneapolis, Minn. |
| The Murray Drug Company..... | Columbia, S. C. |
| Roeber & Kuebler Company..... | Newark, N. J. |
| Southern Drug Company..... | Houston, Tex. |
| Western Wholesale Drug Company..... | Los Angeles, Calif. |

⁶⁴ Ex. 152. Includes an appreciable amount of stock and cash issued to the bankers in this connection. McKesson & Robbins, Incorporated (Connecticut) was acquired on an earnings basis, while the wholesale houses came into the merger on an asset basis. R. 4270.

⁶⁵ Ex. 148, 152, 178.

⁶⁶ New York Stock Exchange Listing Applications, McKesson & Robbins, Incorporated (a holding corporation organized under the laws of Maryland, August 4, 1928). For securities outstanding and admitted to trading at the time of the receivership see page 15 *supra*.

During the year 1929, the Maryland Company issued 336,936 additional shares of common stock and 104,283 shares of preference stock.⁷³ Of these, 208,743 shares of common and 54,283 shares of preference stock were issued in connection with the acquisition of stocks of the companies mentioned above.⁷⁴ 100,000 shares of common and 50,000 shares of preference stock were sold to bankers for cash, netting the corporation \$6,350,000.⁷⁵ In addition, 5,219 shares of common were issued in connection with employee stock subscription plans, 22,964 shares of common in connection with retailer stock subscription plans, and 10 shares of common on the conversion of an equal number of shares of preference stock. The total number of shares issued on December 31, 1929 was 1,019,050 common and 425,780 preference stock.⁷⁶

On January 31, 1930, another wholesale drug house was acquired⁷⁷ and, in connection therewith, the Maryland Company issued an additional 28,517 shares of common and 2,476 shares of preference stock. About the same time, 36,648 shares of common were taken down for cash at 32 by bankers under an option netting the corporation \$1,172,736, which furnished part of the consideration for the purchase of two drug chains. The only other stock issued during the year was 305 shares of common in conversion of rights previously issued to retailers. On December 31, 1930 the total issued stock was 1,082,542 shares of common and 428,256 shares of preference stock.⁷⁸

As above stated, the securities of the subsidiary wholesale houses were acquired by the Maryland Company, partially in exchange for its own securities and partially for cash. In addition, some small wholesale drug houses were acquired wholly for cash and absorbed as branches of existing subsidiaries. However, the proceeds from the sale by the Maryland Company of its preference and common stocks to and through its bankers did not keep pace with the considerable amount of cash expended in this manner. On December 31, 1928, notes and acceptances payable amounted to \$4,538,993.71. By December 31, 1929 they had risen to \$16,753,904.97, and, in the first quarter of 1930, they increased still further.⁷⁹

Despite the 1929 crash, the company was able to fund this indebtedness by an additional public offering of its securities in April 1930. On

⁷³ Including 11,314 shares of common and 3,881 shares of preference to be issued in 1930 in connection with companies already acquired. Ex. 130, 152, 153.

⁷⁴ See footnote 73 *supra*.

⁷⁵ 25,000 shares of preference were sold at 51, less a commission of \$5 per share. The remaining shares were taken down under options, as follows: 25,000 shares of preference at 50, 20,000 shares of common at 37½, and 80,000 shares of common at 40.

⁷⁶ See footnote 73 *supra*.

⁷⁷ Van Vleet-Ellis Corporation, Memphis, Tenn.

⁷⁸ Ex. 153. As stated in footnote 73 *supra*, the number of shares of stock reported issued on December 31, 1929 included 11,314 shares of common to be issued during 1930 in connection with companies already acquired. Instead of issuing new shares in this amount, 1,973 of these shares were taken from treasury shares, thereby decreasing by this amount the number of new shares actually issued.

⁷⁹ Ex. 129, 130, 152, 153.

the twenty-first of that month, the Maryland Company entered into an agreement, under the terms of which \$22,000,000 of 20-year 5½% convertible debentures (out of a total of \$25,000,000 authorized) were issued and sold to an underwriting syndicate composed of Chatham Phenix Corp., Edward B. Smith & Co., Halsey, Stuart & Co., Inc., Stone & Webster and Blodget Incorporated, and Chase Securities Corporation. The debentures were dated as of May 1, 1930, to mature May 1, 1950, and provision was made for a sinking fund for this issue. The public offering was at 96 and the corporation received 90½ from the underwriters. The proceeds of the sale of these debentures were used principally to retire obligations of the Maryland Company and its subsidiary companies, amounting in all to \$19,275,266.53.⁸⁰

After acquiring the capital stocks or the assets and business of the various wholesale drug companies above referred to, the Maryland Company caused their businesses to be taken over by new subsidiaries in which the name McKesson preceded the name of the old concern. For example: The Murray Drug Company became the "McKesson-Murray Drug Company." In some instances several subsidiaries were grouped. For example: the McKesson-Murray Drug Company included not only The Murray Drug Company of Columbia, S. C., but also the Augusta Drug Co., of Augusta, Ga. At the end of 1930, there were 43 such McKesson wholesale subsidiaries located in 67 different cities in the United States. In many instances members of the family who owned and managed the original wholesale houses which bore their names remained as presidents of the new McKesson subsidiaries and became vice-presidents and, in some cases, directors of the Maryland Company as well.⁸¹

In succeeding years the grouping of these wholesale subsidiaries changed somewhat. In addition, other subsidiary corporations were formed to handle such trade investments as drug chains, sales agencies, and other miscellaneous activities that were engaged in from time to time.⁸²

In 1931 the only change in capital stock resulted from the issuance of 13 shares of common on conversion of rights held by retailers.⁸³

⁸⁰ Ex. 153, 184. In connection with the execution of the underwriting agreement, an option expiring May 1, 1931 was granted to the bankers, to purchase 300,000 shares of common stock of the Maryland Company, which, however, was never exercised. Ex. 153, 154.

⁸¹ Ex. 131. On the Board of Directors of the Maryland Company at the time of receivership were:
 J. L. Bedsole—formerly Bedsole-Colvin Drug Company, Inc. acquired by McKesson 1928;
 George V. Doerr—formerly Minneapolis Drug Company acquired by McKesson 1928;
 T. O. Duff—formerly Duff Drug Company acquired by McKesson 1929;
 Henry D. Faxon—formerly Faxon & Gallagher Drug Company acquired by McKesson 1928;
 B. B. Gilmer—formerly Southern Drug Company acquired by McKesson 1928;
 Charles F. Michaels—formerly Langley and Michaels Company acquired by McKesson 1928;
 W. J. Murray, Jr.—formerly the Murray Drug Company acquired by McKesson 1928;
 A. H. Van Gorder—formerly The Hall-Van Gorder Company acquired by McKesson 1928;
 McKay Van Vleet—formerly Van Vleet-Ellis Corporation acquired by McKesson 1930.

⁸² E. g. Ex. 154.

⁸³ Ex. 154.

There were no further changes in the number of shares of preference and common stocks issued until a plan of recapitalization was adopted in the latter part of 1935.

Meanwhile in 1932 the Maryland Company organized two wholly owned subsidiary holding companies, McKesson Wholesalers, Inc. and McKesson Development Corporation. To the former the Maryland Company transferred all of its interest in the McKesson wholesale houses and to the latter all of its trade and miscellaneous investments.

As a result of the transfers to McKesson Wholesalers, Inc., and McKesson Development Corporation, the Maryland Company's investment as at December 31, 1932, consisted of only three companies: (1) McKesson & Robbins, Incorporated (Connecticut), the manufacturing unit, (2) McKesson Wholesalers, Inc., the holding company for the wholesale houses, and (3) McKesson Development Corporation, which held various small wholly owned companies and trade and miscellaneous investments. As to the foreign subsidiary companies, McKesson & Robbins, Incorporated (Connecticut) retained its interest of approximately 80% in McKesson & Robbins, Limited (Canada) and McKesson Development Corporation held the capital stock of Isdahl & Co., A/S, Bergen, Norway.⁸⁴

Also in 1932, the common stock of the Maryland Company was changed from shares without nominal or par value to shares having a par value of \$5 each. The stated value of the common stock prior thereto had been \$15 per share. The reduction to a par value of \$5 per share on the 1,082,555 common shares issued resulted in a credit of \$10,825,550 to capital surplus, against which there were charges in the same year of \$5,033,125.34 resulting from revaluation of fixed assets of subsidiary companies as at December 31, 1932, and \$4,889,-263.19 operating deficit⁸⁵ as at December 31, 1932.⁸⁶

For the first time since its organization in 1928, the Maryland Company, in 1932, reported an operating loss⁸⁷ and paid no dividends on either its preference or common stocks. At December 15, 1932, four quarterly dividend payments on the preference stock were in arrears, and, pursuant to the certificate of incorporation, voting rights thereupon became vested exclusively in the holders of the preference stock.⁸⁸

In 1933 the Maryland Company again paid no dividends on either its preference or common stocks, although the Company reported net

⁸⁴ Ex. 155.

⁸⁵ After providing for a general reserve of \$3,000,000 against non current receivables and \$1,000,000 against trade investments. Ex. 155.

⁸⁶ Ex. 155, 133, 134.

⁸⁷ After provision for debenture interest (over \$1,000,000), adjustment of inventory values and other charges, including a provision for doubtful notes and accounts in the amount of \$2,639,053.09. (\$1,109,754.80 in excess of a similar charge the year before) the operating loss reported for the year ending December 31, 1932, was \$921,641.62. The two general reserves of \$3,000,000 and \$1,000,000 each (see footnote 85 *supra*) were charged directly to earned surplus. Ex. 133, 155.

⁸⁸ Ex. 155.

earnings for the year of \$936,700.09. The annual report to stockholders stated that,

"During the year a new wholly-owned subsidiary was organized under the name of Spirits Import Company, Inc., for the purpose of giving adequate service to our distributing houses for their requirements of both foreign and domestic wines and liquors made possible through the Repeal of the Eighteenth Amendment. * * *"⁸⁹

In 1934 the management decided to discontinue the operations of as many subsidiary companies as possible and to operate the various units of the business as divisions of the Maryland Company. Prior to this the Maryland Company had been exclusively a holding company. With this end in view, the two sub-holding companies, McKesson Wholesalers, Inc., and McKesson Development Corporation, were dissolved and their "net assets" taken over by the Maryland Company as of October 30, 1934. The Maryland Company then held directly the capital stocks of its operating subsidiary companies and thereupon the "net assets" of these companies, with minor exceptions, were transferred to the Maryland Company as of October 31, 1934, in the form of liquidating dividends. In the case of four companies which operated both a wholesale drug and liquor business, only the "net assets" relating to the wholesale drug business were transferred, and these companies continued to operate a wholesale liquor or alcohol business. After October 31, 1934, all of the manufacturing and wholesale drug units were operated as divisions of the Maryland Company and there were only nine operating subsidiary companies, exclusive of miscellaneous small and inactive companies.⁹⁰

As part of this simplification procedure, McKesson & Robbins, Incorporated (Connecticut) whose stock was wholly owned by the Maryland Company was liquidated on October 31, 1934, and the Maryland Company acquired all the assets of the Connecticut Company, including the shares of McKesson & Robbins, Limited (Canada) theretofore held by the Connecticut Company. In this connection, the Maryland Company assumed "* * *" the liability of the Connecticut Company under its agreement with McKesson & Robbins, Limited [Canada] to guarantee sales yielding profits available for dividends of not less than One Hundred Thousand Dollars (\$100,000.00) per annum as long as any of the Preference shares of McKesson & Robbins, Limited [Canada] should be outstanding."⁹¹ The business of the Connecticut Company was thereafter carried on as the Connecticut Division of the Maryland Company.

Although the Maryland Company in 1934 again reported net earnings which for the year amounted to \$1,720,259.78, no dividends were

⁸⁹ Ex. 134.

⁹⁰ Ex. 157. In subsequent years there were some additional changes in the number of active subsidiary companies maintained, principally in connection with the wine and liquor division. Ex. 158, 159, 160.

⁹¹ Ex. 164.

paid on either its preference or common stocks, allegedly because of the appreciable additional working capital required by the development and expansion of the wine and liquor business.⁹²

On November 1, 1935, the Board of Directors of McKesson & Robbins, Incorporated (Maryland) recommended to its stockholders a plan of recapitalization for the purpose of liquidating the dividends accrued on the 7% preference stock which, at December 15, 1935, amounted to \$5,969,600, or \$14 per share, on the 426,400 preference shares then outstanding.⁹³ In lieu of the theretofore authorized 500,000 shares of \$50 par preference stock, the Company recapitalized with 750,000 shares of no par preference stock (entitled to \$55 on voluntary liquidation). There was no change in the authorized common of 5,000,000 shares of \$5 par value.⁹⁴

Holder of the then outstanding 7% preference stock of \$50 par received $1\frac{1}{4}$ shares of the new preference stock \$3 series,⁹⁵ $\frac{1}{2}$ share of common stock and 50 cents in cash for each share of old preference stock. The plan was approved and carried into effect, with the result that the Maryland Company had issued and outstanding on December 31, 1935, after giving effect to the exchange, 1,282,983 shares of common and 533,000 shares of \$3 preference stock.⁹⁶ Dividends were regularly paid on the new preference stock up to the time of the receivership.⁹⁷ For his advice and work in connection with this recapitalization, which cured the default in the preference stock, Sidney Weinberg, who became a director of the Maryland Company in 1934, received \$15,000, which he turned over to his firm, Goldman, Sachs & Co.⁹⁸

In 1936 the wine and liquor activities of the Corporation were increased through the formation of the Hunter Baltimore Rye Distillery, Inc., and the acquisition by it of the Gwynn Falls Distilling Corporation for the distilling, blending, rectifying, and bottling of whiskies, gins, cordials, and so forth.⁹⁹ Although earnings applicable to common stock of the Maryland Company were reported at \$1.32 per share on the 1,282,983 shares issued and outstanding, no dividends were paid on these shares, because, as stated by F. Donald Coster in the annual report for 1936,

“* * * it is a fact that the soundest and strongest businesses have been built on the policy of ploughing a substantial part of the earnings back into the business. It has never been considered sound business management to withdraw and dis-

⁹² Ex. 135.

⁹³ 428,256 shares issued less shares held in treasury.

⁹⁴ Ex. 158.

⁹⁵ Recorded at a stated value of \$50 per share when issued. Ex. 136.

⁹⁶ Ex. 158, 136. 1,856 old preference shares and 12,772 common shares held in the treasury had been retired on November 14, 1935.

⁹⁷ Ex. 136, 137, 106.

⁹⁸ R. 2403.

⁹⁹ Ex. 159.

tribute profits from a business having substantial debt obligations; and in the case of this company increased sales of \$21,000,000.00 necessitated a resort to bank borrowing to carry increased inventories and accounts receivable."¹⁰⁰

In 1937 three more established wholesale drug houses were acquired by the Maryland Company.¹⁰¹ 21,654 shares of preference stock \$3 series were issued as partial consideration for two of these acquisitions.¹⁰² Earnings for the year were reported at \$1.47 per share on common stock. 51,310 shares of preference stock \$3 series were issued on December 15, 1937, as a stock dividend on the common, the payment being in the ratio of 1/25 share of preference for each share of common held.¹⁰³ Including the above, the total stock issued by the Maryland Company prior to the receivership amounted to 605,964 shares of preference stock \$3 series and 1,282,983 shares of common.

Notes and acceptances payable which, on December 31, 1930 (after the debenture issue had been floated), amounted to \$2,710,594.59, again rose and by December 31, 1937, the date of the last annual report prior to the receivership, amounted to \$11,954,076.32. In the same period \$5,494,000 principal amount of debentures were retired through operation of the sinking fund leaving \$16,192,000 outstanding as at December 31, 1937.¹⁰⁴

At the date of the receivership there was pending a proposed private sale by the Maryland Company to the Equitable Life Assurance Society of the remaining authorized but unissued \$3,000,000 5½% 20-year convertible debentures at 103. Goldman, Sachs & Co. were to have received ½% for their services in negotiating this placement. Apparently, all that remained to be done to conclude the sale was the certification of figures by Company officials^{104a} and the approval and execution of a formal contract, but the receivership intervened.¹⁰⁵

This completes the brief outline of the story of the corporate expansion of the companies under the direction of F. Donald Coster from the organization of Girard & Co., Inc., on January 31, 1923, to the filing of the petition for receivership of the Maryland Company on December 5, 1938; from the first balance sheet certified by Price, Waterhouse & Co. dated December 31, 1924, which stated capital and surplus at \$161,560.52, and total assets at \$295,028.12¹⁰⁶ to the last, dated December 31, 1937, which stated capital and surplus at

¹⁰⁰ Ex. 137.

| | |
|--|------------------|
| ¹⁰¹ Milwaukee Drug Company..... | Milwaukee, Wis. |
| W. A. Hover & Company..... | Denver, Colo. |
| Blumauer-Frank Drug Company..... | {Portland, Oreg. |
| | {Seattle, Wash. |
| | {Spokane, Wash. |

¹⁰² 14,269 of these shares were not delivered until the early part of 1938 and were therefore not carried as issued on the December 31, 1937 balance sheet.

¹⁰³ Ex. 106.

¹⁰⁴ Ex. 131, 106.

^{104a} See page 132 *infra*.

¹⁰⁵ Ex. 182, 183; R. 2409 ff.

¹⁰⁶ Ex. 2.

\$46,118,734.14, and consolidated total assets at \$87,182,765.74;¹⁰⁷ and from reported sales of \$251,977 for the 9 months ended December 31, 1924¹⁰⁸ to reported sales of \$174,572,229 for the year 1937.¹⁰⁹

B. THE AMOUNT AND LOCATION OF THE INFLATION IN ASSETS, SALES, AND GROSS PROFITS

Although the petition for receivership filed on December 5, 1938, alleged only generally that the published statements of McKesson & Robbins, Incorporated, included fictitious inventories and accounts receivable aggregating in excess of \$10,000,000, investigations thereupon instituted quickly disclosed that the false items were those arising in connection with the wholly fictitious foreign purchase and sale of "crude drugs."¹¹⁰ As previously stated, this fictitious foreign crude drug business was conducted by both the Connecticut Division (formerly Company) and the Canadian Company.¹¹¹

The exact amount of inflation in assets, sales, and gross profits arising from this fictitious business, and the relation which this bore to the real business of the Connecticut Division (formerly Company), the Canadian Company, and the Maryland Company as a whole, will be the subject of this subsection. The manner in which the fictitious transactions were handled and recorded on the books of McKesson, and the nature of the documents involved, will be described in the following subsection.

At the outset of the present hearings, Albert B. Ritts, Price, Waterhouse & Co.'s senior in charge at Bridgeport since 1932 and assistant to Ralph E. Thorn, manager of the McKesson engagement, testified that the operations of the Connecticut Division (formerly Company) consisted of both the manufacture and sale of McKesson products and the purchase and sale of crude drugs and essential oils. Included in the latter, however, was the domestic business done out of the Cliff Street, New York City office, but Ritts stated that the proportion this (real) Cliff Street business bore to the (fictitious) foreign business

¹⁰⁷ Ex. 106.

¹⁰⁸ R. 56-57.

¹⁰⁹ Ex. 106.

¹¹⁰ In their testimony at the very outset of the present hearings the auditors (following their practice in their various memoranda and reports) referred to the items in question as "crude drugs" and sometimes as "crude drugs and essential oils." R. 108 ff. Later, Charles Hermann, an employee of the old McKesson & Robbins, Incorporated (New York) since 1903, who continued working for the firm after it was acquired by Coster and who, at the Cliff Street office, actually dealt in the kind of bulk drugs and chemicals that were listed on the foreign "crude drug" inventory (R. 2595-2596), testified that "crude drugs" was an incorrect name for them (R. 2624). However, the term "crude drugs" had already so permeated the testimony that, for the sake of consistency therewith, they will hereinafter also be referred to by that name.

¹¹¹ See *infra* this and following subsections.

handled at Bridgeport was not substantial.¹¹² In the Connecticut Division in 1937, this foreign crude drug business accounted for in excess of 60% of total net sales and gave rise to approximately 88% of the total current assets.¹¹³

As for the Canadian Company, Ritts testified that the total sales of the London subsidiary were negligible and that, except for this (real) business, all the business of the Canadian Company consisted of the (fictitious) foreign purchase and sale of crude drugs. Of the total foreign crude drug business supposedly carried on by McKesson in 1937, approximately 83% was put through the books of the Connecticut Division and 17% was allotted to the Canadian Company.¹¹⁴

After the institution of the reorganization proceedings, S. D. Leidesdorf & Co., certified public accountants, were engaged by the Trustee, with the approval of the Court, to conduct an examination of the affairs of the debtor, McKesson & Robbins, Incorporated (Maryland). Such examination has shown that the inventories, accounts receivable, cash, sales, purchases, and gross profits, as carried on the books and records of McKesson and as stated in the annual reports, were materially overstated as the result of the non-existence of the inventories, receivables, and cash reportedly carried and the falsity of the purchases and sales reportedly effected in connection with this foreign crude drug business.¹¹⁵

Specifically, at December 31, 1937,¹¹⁶ inventories, accounts receivable, and cash of the Connecticut Division and Canadian Company combined were found to include fictitious items in the sum of \$19,249,100.64, and for the year 1937 consolidated net sales were found to include \$18,247,020.60 in fictitious transactions, on which a fictitious gross profit of \$1,801,390.60 was recorded. In detail, the amount of the inflation in assets, in sales, and in profits arising from this fictitious foreign crude drug business in the Connecticut Division and in the Canadian Company and as reflected on the consolidated accounts of the Maryland Company and its subsidiaries, compares, as follows, with the previous reports for that period:

¹¹² This domestic business was managed by Charles Hermann assisted by Simon Baum. Also at the Cliff Street office, there was conducted a Spanish-American or export business in McKesson products, crude drugs, and other merchandise under John T. Stebe. When used in this report and in the testimony, the term "foreign" refers to the fictitious crude drug business of the type purportedly done through Smith and does not include Stebe's "Spanish-American" or "export" business or imports made in connection with production or for domestic resale through Hermann's department or otherwise.

¹¹³ R. 110-113 and tables on pages 43-44 *infra*.

¹¹⁴ R. 109-110 and tables on pages 43-44 *infra*.

¹¹⁵ R. 4547 ff.

¹¹⁶ The end of the last full fiscal year prior to the receivership on December 5, 1938.

Comparison of Assets

| Connecticut Division | Reported as at December 31, 1937 ^a | Fictitious ^b | Reported Less Fictitious ^c |
|--|--|-------------------------------|--|
| Cash in banks and on hand.. | \$ 498, 762. 66 | \$ ^d 44, 041. 06 | \$ 454, 721. 60 |
| Notes and accounts receivable, less reserves..... | 7, 774, 541. 95 | ^e 7, 505, 730. 50 | 268, 811. 45 |
| Inventories of merchandise.. | 10, 634, 943. 94 | ^f 9, 097, 115. 00 | 1, 537, 828. 94 |
| Total current assets.. | \$18, 908, 248. 55 | \$16, 646, 886. 56 | \$ 2, 261, 361. 99 |
| Interbranch and intercompany accounts receivable.. | 1, 268, 435. 97 | — | 1, 268, 435. 97 |
| Investment in common stock of McKesson & Robbins, Limited..... | 420, 000. 00 | — | 420, 000. 00 |
| Other assets, less reserves.. | 1, 089, 448. 48 | — | 1, 089, 448. 48 |
| Total Assets..... | \$21, 686, 133. 00 | \$16, 646, 886. 56 | \$ 5, 039, 246. 44 |
| Canadian Company and Subsidiary | | | |
| Cash in banks..... | \$ 60, 778. 94 | \$ ^d 32, 486. 08 | \$ 28, 292. 86 |
| Accounts receivable..... | 1, 582, 703. 39 | ^e 1, 579, 143. 00 | 3, 560. 39 |
| Inventories of raw materials..... | 1, 002, 321. 60 | ^f 990, 585. 00 | 11, 736. 60 |
| Total current assets.. | \$ 2, 645, 803. 93 | \$ 2, 602, 214. 08 | \$ 43, 589. 85 |
| Goodwill, tradenames, franchises, etc. (Valued by directors as of October 28, 1927)..... | 420, 000. 00 | — | 420, 000. 00 |
| Other assets, less reserves.. | 1, 627. 64 | — | 1, 627. 64 |
| Total assets..... | \$ 3, 067, 431. 57 | \$ 2, 602, 214. 08 | \$ 465, 217. 49 |
| Maryland Company and Subsidiaries Consolidated | | | |
| Cash in banks and on hand.. | \$ 3, 358, 571. 39 | \$ ^d 76, 527. 14 | \$ 3, 282, 044. 25 |
| Notes and accounts receivable, less reserves..... | 28, 405, 495. 05 | ^e 9, 084, 873. 50 | 19, 320, 621. 55 |
| Inventories of merchandise, materials, and supplies.. | 44, 254, 735. 70 | ^f 10, 087, 700. 00 | 34, 167, 035. 70 |
| Total current assets.. | \$76, 018, 802. 14 | \$19, 249, 100. 64 | \$56, 769, 701. 50 |
| Other assets, less reserves.. | 11, 163, 963. 60 | — | 11, 163, 963. 60 |
| Total assets..... | \$87, 182, 765. 74 | \$19, 249, 100. 64 | \$67, 933, 665. 10 |

^a Ex. 261, 167, 106.

^b Ex. 255.

^c In computing assets as at Dec. 31, 1937, allowance should also be made for adjustments in intercompany items, possible recoveries in connection with these fictitious transactions, including tax adjustments, and other relevant items. For corrected statement of assets of Maryland Company as at Dec. 31, 1938, see Second Report of William J. Wardall, Trustee, *In the Matter of McKesson & Robbins, Incorporated*, Debtor, Exhibit B, in which the Canadian Company and its subsidiary are not consolidated with the Maryland accounts and in which the Maryland Company's advance of \$1,000,000.00 to the Canadian Company and the Maryland Company's investment (represented by 42,000 of the 52,000 common shares outstanding) in the Canadian Company were charged off because such investment and advances were believed to be worthless.

^d Balances carried as due from Manning & Company.

^e Balances carried as due from approximately 650 foreign accounts (Connecticut Division) and 115 foreign accounts (Canadian Company). Cf. Ex. 255; R. 935, 4436.

^f Supposedly held by the 5 Canadian vendors for the account of the McKesson Companies.

| Connecticut Division | Comparison of Operations | | |
|---|--|----------------------------------|--|
| | Reported for the year 1937 ^a | Fictitious ^b | Reported less Fictitious ^c |
| Net sales----- | \$ 24, 210, 714. 41 | \$ 15, 126, 825. 20 | \$ 9,083,889.21 |
| Cost of sales----- | 20, 290, 170. 14 | ^d 13, 610, 355. 00 | 6,679,815.14 |
| Gross profit on sales----- | \$ 3, 920, 544. 27 | \$ 1, 516, 470. 20 | \$ 2,404,074.07 |
| Expenses, other income, and other deductions (net)----- | 1, 980, 486. 23 | — | 1,980,486.23 |
| Net profit----- | \$ 1, 940, 058. 04 | \$ 1, 516, 470. 20 | \$ 423,587.84 |
| Canadian Company and Subsidiary | | | |
| Net sales----- | \$ 3, 811, 422. 45 | \$ 3, 365, 070. 40 | \$ 446,352.05 |
| Cost of sales----- | 3, 500, 211. 48 | ^d 3, 080, 150. 00 | 420,061.48 |
| Gross profit on sales----- | \$ 311, 210. 97 | \$ 284, 920. 40 | \$ 26,290.57 |
| Expenses, other income, and other deductions (net)----- | 132, 938. 05 | — | 132,938.05 |
| Net profit or (loss)----- | \$ 178, 272. 92 | \$ 284, 920. 40 | \$ (106,647.48) |
| Maryland Company and Subsidiaries Consolidated | | | |
| Net sales----- | \$174, 572, 229. 57 | \$ ^e 18, 247, 020. 60 | \$156,325,208.97 |
| Cost of sales----- | 147, 634, 438. 71 | ^d 16, 445, 630. 00 | 131,188,808.71 |
| Gross profit on sales----- | \$ 26, 937, 790. 86 | \$ 1, 801, 390. 60 | \$ 25,136,400.26 |
| Expenses, other income, and other deductions (net)----- | 23, 270, 466. 11 | — | 23,270,466.11 |
| Net profit----- | \$ 3, 667, 324. 75 | \$ 1, 801, 390. 60 | \$ 1,865,934.15 |

^aEx. 261, 167, 106.

^bEx. 255.

^cA number of expenses actually paid for in connection with the fictitious transactions, such as the Smith fees, clerical and administrative overhead, taxes, and other relevant items, should also be deducted if it be desired to establish the past results of operations of the real business alone. (However, expenses in connection with these transactions do not appear to be substantial in relation to the totals shown. See pages 311-313 *infra*.) And to the extent that the Trustee may recover any such items they should also be deducted to establish the final results of past operations. For a reconstructed comparative consolidated statement of income and profit and loss of the Maryland Company, for the years ended Dec. 31, 1936, 1937, and 1938, see Second Report of William J. Wardall, Trustee, *In the Matter of McKesson & Robbins, Incorporated*, Debtor, Exhibit E, in which the Canadian Company and its subsidiary are not consolidated with the Maryland accounts because the Maryland Company's investment in the Canadian Company was believed to be worthless, and in which, pending the treatment by the Court of such claims as may be filed, no provision was made for possible claims by the Canadian Company, pursuant to the agreement whereby the Maryland Company, as successor to the Connecticut Company, was obligated, in the event the net profits of the Canadian Company available for dividends were less than \$100,000.00 in any year, to pay in Canadian currency to the Canadian Company such difference.

^dComputed by adding or subtracting difference between opening and closing inventories to or from purchases.

^eAfter elimination of purported intercompany sales of foreign crude drugs by Canadian Company to Connecticut Division of \$244,875.00.

As indicated in the foregoing tables, the fictitious items comprised approximately 88% of the total reported current assets of the Connecticut Division as at December 31, 1937; approximately 98% of the total reported current assets of the Canadian Company and subsidiary; and approximately 25% of the total reported current assets of the Maryland Company and subsidiaries consolidated.

Since total current assets in all three units comprised a very substantial part of total assets,¹¹⁷ the fictitious items were found to comprise approximately 77% of total reported assets in the Connecticut Division as at December 31, 1937; approximately 85% of total reported assets in the Canadian Company and subsidiary; and approximately 22% of total reported assets of the Maryland Company and subsidiaries consolidated.

Also, as indicated by the foregoing tables, the fictitious transactions comprised approximately 62% of reported net sales of the Connecticut Division for the year 1937; approximately 88% of reported net sales of the Canadian Company and subsidiary; and approximately 10% of reported net sales of the Maryland Company and subsidiaries consolidated.

Finally, as shown by the foregoing tables, the fictitious gross profit arising from these items comprised approximately 39% of reported gross profit of the Connecticut Division for the year 1937; approximately 92% of reported gross profit of the Canadian Company and subsidiary; and approximately 7% of reported gross profit of the Maryland Company and subsidiaries consolidated. But, since expenses in connection with the fictitious business when compared to the real business were not large; it should be noted that the elimination of fictitious items had a far greater proportional effect on reported net profit.¹¹⁸ And, since in earlier years total reported net profit of the Maryland Company and subsidiaries consolidated was not as large as it was in 1937, the elimination of these fictitious transactions would have had an even greater effect on net profits in those years.

For the 6 years 1932-1937, gross profit on the fictitious sales purportedly effected through Smith for both the Connecticut Company (later Division) and Canadian Company combined amounted to approximately \$8,800,000,¹¹⁹ while combined inventories and accounts receivable purportedly carried by the two units in connection with

¹¹⁷ Ex. 28. See also tables on pages 43-44 *supra* and page 250 *infra*.

¹¹⁸ For amounts involved see tables on page 44 *supra*.

¹¹⁹ The Canadian Company accounted for approximately \$1,500,000. Ex. 43, Q. The Connecticut Company (later Division) accounted for approximately \$7,300,000, Ex. 124, 267, N. The latter figure includes for 1932 "Special Finished Stock," apparently comprising part of "Export sales of crude drugs and finished stock through W. W. Smith & Co." Ex. 81, 82. For "Special Finished Stock," see section IV, subsection I *infra*.

these foreign crude drug transactions increased during the same period approximately \$9,600,000.¹²⁰

The situation in the Connecticut Division was summarized by Julian F. Thompson, treasurer of McKesson, who stated, in a memorandum to F. D. Coster dated April 18, 1938, copies of which were sent to Charles F. Michaels and William J. Murray, Jr., that

"It will be observed¹²¹ that the inventory and receivables of the Bulk Department¹²² increase annually and approximately the amount of the profit of the department, and that the Connecticut Division has not contributed a net balance to the [Maryland] Corporation for the purposes of bond interest, dividends or bank debt reduction during the past three years. In mentioning this fact, however, it would not be fair to fail to point out that through the use of the capital in the Connecticut Division there is contributed approximately two-fifths of the profits [of the Maryland Company] available for interest, dividends, taxes, etc."¹²³

As to the period prior to 1932, there are references in the Price, Waterhouse & Co. papers indicating that the inventories and accounts receivable in question were large in amount (though smaller in each preceding year).¹²⁴ Some idea of the amount of the transactions can be obtained from the report by S. D. Leidesdorf & Co. to William J. Wardall, Trustee of McKesson & Robbins, Incorporated, relating to the crude drug fraud. In considering the figures mentioned in this report, it should be remembered that the great bulk of the actual cash payments referred to therein occurred prior to 1932, after which more and more of the transactions were purportedly cleared through the pretended bank, Manning & Company, until, with the exception of the Smith service and guaranty fees, all transactions were so handled. Speaking of the Leidesdorf report, the Trustee in his report dated July 1, 1939 says:

"The report in summary shows that cash disbursements, all in connection with payments for purchase of fictitious drugs or for non-existent services in connection with the operation of the Crude Drug Department, aggregated \$24,777,851.90. Of this total cash outgo, \$17,571,546.46 was paid out in the first instance by the Company,¹²⁵ and \$7,206,305.44 by McKesson & Robbins, Limited, a Canadian

¹²⁰ The combined inventories and accounts receivable of the Canadian Company remained fairly constant, the increase taking place in the Connecticut Company (later Division). In some years the increase was in either inventories or accounts receivable, with a slight decrease in the other. Ex. 43, Q.

¹²¹ The paragraph here quoted follows a table of figures for the years 1935, 1936, and 1937.

¹²² Included real domestic crude business, as well as fictitious foreign. However, the figures for the former comprised by a minor portion of the total. R. 110-113 and tables on pages 43-44 *supra*.

¹²³ Ex. 114. See also R. 1388-1389; Ex. 115.

¹²⁴ For notations during this period as to increases in inventories of crude drugs of the type later purportedly sold through Smith, see Ex. 154 at p. 19, Ex. 153 at p. 20, Ex. 151 at p. 6, Ex. 148 at p. 11, and Ex. 147 at p. 7. On accounts receivable of the type later purportedly resulting from sales through Smith, see Ex. 83 at p. 1 and Ex. 151 at p. 2. Gross profit on "Export sales of crude drugs and finished stock through W. W. Smith & Co." for the Connecticut Company in 1931 are stated in the memorandum of accounts for that year at \$1,413,889.25, Ex. 82. (An interesting breakdown of this latter figure as between "Resale Stock" and "Finished Stock," and by months, is contained in Ex. 105, prepared by a McKesson employee.) On the Canadian Company, see Ex. 149, 150, 161. Finally, a number of the concerns in the fictitious chain, e. g., W. W. Smith & Co., J. P. Meyer & Co., George Vernard & Co., appear among the early accounts receivable of Girard & Co., Inc., indicating that fictitious transactions most probably existed even then, although possibly not with foreign accounts. Ex. 170; R. 4580-4581.

¹²⁵ When used in this quotation, "Company" refers to Connecticut Company, a subsidiary of the Maryland Company and after October 31, 1934, a division of the Maryland Company.

subsidiary. These payments were principally made to George Vernard, a brother of F. Donald Coster, whose real name was Arthur Musica, who received \$9,316,770.76; Simon Brothers, who received \$5,877,942.22; W. W. Smith & Company; J. P. Meyer & Company; The Woodtone Co., Inc.; Liberty Drug & Chemical Company; United Chemical & Drug Corporation; and Ramse's, Inc. The figure given above of \$24,777,851.90 consists only of initial payments made by the Company and its Canadian subsidiary and does not include deposits on subsequent transfers of these funds. The aggregate of all deposits in bank accounts other than accounts of the Company and its Canadian subsidiary, involved in the circle of funds in the crude drug fraud was \$43,764,585.00.

"Of the total cash outgo mentioned above, by far the greater part was traced back by Messrs. S. D. Leidesdorf & Co. into the Company or its Canadian subsidiary. The amount of these refunds so traced and identified amounted to \$19,674,858.66, of which \$12,719,503.14 was returned to the Company and \$6,955,355.52 to McKesson & Robbins, Limited. The bulk of these refunds was made through cash payments against fictitious accounts receivable. The bank account most actively used as a medium for making these refunds was that of The Woodtone Co., Inc., through the medium of which repayments of \$9,744,477.70 were made, and the second most active account used as a medium for making these refunds was that of Liberty Drug & Chemical Company, through the medium of which repayments of \$2,481,982.44 were made.

"From the foregoing it appears that of the approximate \$24,000,000 of cash outgo from the Company and its Canadian subsidiary in connection with fictitious transactions, approximately \$19,000,000 was actually traced dollar for dollar through the course of various bank accounts and shown to have been eventually refunded. The net cash loss, however, is not as great as the difference between these two figures as there was also paid in and credited on the accounts receivable cards of fictitious customers an additional amount of \$2,203,544.20. Of this amount, \$397,410 was paid in from sources indirectly involved in the circle of funds. The detail records are not sufficient actually to identify the transactions relating to the balance of \$1,806,134.20 paid in against fictitious accounts receivable; but the transactions were similar to those which were reconciled with the detail records in the amount of \$19,674,858.66, above mentioned. Accordingly, the balance of \$1,806,134.20 has been assumed to have been returned in the same manner as the \$19,674,858.66 actually traced.

"It appears that the amount definitely lost by virtue of the crude drug fraud is now set at a figure of \$2,869,482.95, of which the largest items were \$958,323.79 traced to bank or brokerage accounts of F. Donald Coster, payments of \$715,676.12 made by McKesson & Robbins, Limited to William T. Truxtun & Company and not traced to any bank account, payments to Simon Brothers of \$278,453.65 also not traced to a bank account, and \$30,749.29 traced to a bank account of Benjamin Simon.

"Following the adoption of the fiscal agency of Manning & Company in 1931, the amount of cash in the circle of funds described above steadily diminished. At the commencement of this proceeding on December 8, 1938, the cash circle of funds had substantially disappeared, and the mechanism which was then being used was that described in the First Report of the Trustee, consisting of fictitious purchases of crude drugs purportedly stored in Montreal and then purportedly shipped to purchasers abroad, the payments to the sellers and the collections from the purchasers being purportedly made through the fiscal agents, Manning & Company. In connection with this mechanism, the principal outgo was the payment of commissions and a guaranty fee to W. W. Smith & Company. The amount of such payments to W. W. Smith & Company over the period 1931 to 1938 was \$886,999.26, of which \$206,290.22 was paid by McKesson & Robbins,

Limited. These figures are included in the aggregate figures given above for the outgo in connection with the fictitious operations of the Crude Drug Department."¹²⁶

Leidesdorf's examination further indicates that the fictitious transactions in crude drugs go back at least to early in 1927, the first year of the Connecticut and Canadian Companies.¹²⁷ The inclusion of accounts of this type on the Connecticut Company's books in a category known as "Special foreign (Girard division),"¹²⁸ and the inclusion of W. W. Smith & Co. as an account receivable at the time of the first Price, Waterhouse & Co. audit of Girard & Co., Inc. as at December 31, 1924,¹²⁹ indicate that fictitious entries probably go back to the inception of that concern also.

C. THE MANNER IN WHICH THE FICTITIOUS ACCOUNTS WERE HANDLED

Since the middle of 1935, the fictitious foreign crude drug purchases were pretended to have been made from five Canadian vendors, who thereafter purportedly retained the merchandise at their warehouses for the account of McKesson. Sales were pretended to have been made for McKesson's account by W. W. Smith & Company, Inc. and the goods shipped directly by the latter from the Canadian vendors to the customers. Payments for goods purchased and collections from customers for goods sold were pretended to have been made by the Montreal banking firm of Manning & Company also for the account of McKesson. W. W. Smith & Company, Inc., Manning & Company, and the five Canadian vendors are now known to have been either entirely fictitious or merely blinds used by Coster for the purpose of supporting the fictitious transactions.

Invoices, advices, and other documents prepared on printed forms in the names of these firms were used to give an appearance of reality to the fictitious transactions. In addition to this manufacture of documents, a series of contracts and guaranties with Smith and Manning, and forged credit reports on Smith were also utilized. The foreign firms to whom the goods were supposed to have been sold were real but had done no business of the type indicated with McKesson.

Prior to 1935 the fictitious goods were supposed to have been physically received at and reshipped from the Bridgeport plant of McKesson. And prior to 1931 McKesson made actual cash payments directly for the fictitious purchases, which at that time were supposed to have been made from a group of domestic vendors, but recovered a large

¹²⁶ Second Report of William J. Wardall, Trustee, *In the Matter of McKesson & Robbins, Incorporated*, Debtor, at pp. 11-12. Figures introduced by S. D. Leidesdorf & Co. in the present hearing, R. 4573-4574, were preliminary and therefore differ somewhat from the final figures above quoted.

¹²⁷ R. 4554 ff.

¹²⁸ Ex. 146.

¹²⁹ Ex. 170.

part of this cash purportedly as collections on the fictitious sales. The change from using actual cash to the supposed clearance through Manning & Company was not effected abruptly but for some time after 1931 both systems were used. The Canadian vendors, however, were used only in connection with the Manning clearance system. For about a year prior to August 1, 1931, the date of the first purported sales agency arrangement with W. W. Smith & Company, Inc., the sales supposedly were made for the account of McKesson by the purported sales agency of Charles Manning & Company, Limited.

A detailed account of the manner in which the fictitious accounts were handled will be described in the following subsections:

1. The Office at Bridgeport

All of McKesson's records pertaining to the foreign crude drug transactions both for the Connecticut Division (formerly Company) and for the Canadian Company were kept in offices at the Bridgeport plant. The relationship of these offices and the people who ran them is important to a consideration of the manner in which the transactions themselves were handled.

As previously stated, F. Donald Coster was president of the Maryland, Connecticut, and Canadian Companies. He also acted as the treasurer of the Connecticut and Canadian Companies in which the foreign crude drug transactions were centered. The office of treasurer in the top Maryland Company was held by Horace B. Merwin until February 19, 1930, when he was succeeded by Julian F. Thompson. Throughout the whole period George Dietrich was the assistant treasurer of all three companies, the Maryland, Connecticut, and Canadian, and, after the Maryland Company absorbed the Connecticut in October 1934, continued in charge of the detailed financial transactions of that Division. Thompson, the treasurer of the Maryland Company, spent most of his time in New York and took no part in the routine functioning of the Connecticut Division business but rather concerned himself with the financial problems of the Maryland Company as a whole.¹³⁰

Speaking of the personal relationship between Coster and George Dietrich, as well as of the physical location of their offices, Thorn, of Price, Waterhouse & Co., testified:

"* * * George Dietrich's office adjoined Mr. Coster and there was a connecting door, of course, and that door was always open except when Mr. Coster was in conference and the two men worked together almost the same as if their desks were side by side, and anyone seeing the two men, watching them for a short time could have no question about who gave the orders and who did the clerical work."¹³¹

¹³⁰ R. 1593, 2064-2065.

¹³¹ R. 1166.

Referring further to the relationship of the two men, McGloon, the comptroller, said:

"If you look at the organization chart, dated September 1, 1937 [Ex. 97] it appears that Mr. George Dietrich was responsible to Mr. Dewell, but in practice, Mr. George Dietrich was very close to Mr. Coster and many of us considered Mr. George Dietrich as Coster's right hand man or confidential secretary."¹³²

And Thompson, the treasurer, speaking of Coster and George Dietrich, the assistant treasurer, said:

"He [George Dietrich] was scarcely my assistant at all and was very definitely Mr. Coster's agent.

* * * * *

"I don't think I ever mentioned any subject to Mr. George Dietrich that wasn't mentioned [by him] to Mr. Coster in our entire relationship."¹³³

As stated by Thorn, on one side George Dietrich's office had a door leading into Coster's room and on the other side adjoined the cashier's office, where three girls worked under George Dietrich's supervision, recording remittances and disbursements and preparing deposits, outgoing checks, bank reconciliations, and so forth.¹³⁴ George Dietrich, as assistant treasurer, also signed practically all the checks of the Connecticut Company (later Division),¹³⁵ at first alone, later with the co-signature of one of the girls who worked under him.¹³⁶ He also routed incoming remittances to the cashiers¹³⁷ and was custodian of petty cash funds.¹³⁸

In addition to the foregoing, George Dietrich, under Coster, ran the foreign crude drug business for both the Connecticut Division (formerly Company) and Canadian Company, which, as previously stated, comprised well over two-thirds of the total business done at Bridgeport. While the exact assumption of initiative between Coster and George Dietrich in the supposed running of this business is not clear, it was George Dietrich's initials or verbal clearance, at any rate, that furnished the internal authority for all foreign crude drug purchases and sales orders.¹³⁹

Besides, George Dietrich also exercised control over all incoming mail. Ritts, of Price, Waterhouse & Co., stated:

"All incoming mail would be received by George Dietrich, which would not necessarily mean that he opened all incoming mail. In fact, a number of these mailing boys opened the mail and laid it on his desk; in other words, he was the

¹³² R. 1590. See also R. 1158, 1360.

¹³³ R. 2096, 2079.

¹³⁴ R. 118, 1172, 1358, 1381, 1590, 2642, 2659. Although the actual cashier's work was under the supervision of George Dietrich, Johnson, the office manager, planned their office hours and routine. R. 1401.

¹³⁵ R. 1159, 1432.

¹³⁶ R. 1639.

¹³⁷ R. 1158-1159 and footnote 140 *infra*.

¹³⁸ Ex. 17.

¹³⁹ R. 772-773, 1347, 1413-1414, 1617, 1661-1662, 2068, 4528 and see subsections 3 ff. *infra*. Ritts and Thorn, of Price, Waterhouse & Co., testified that it was their impression that Coster made the decisions and told George Dietrich what to do. R. 697, 736-738, 1133, 1163-1168; Ex. 83.

first person in the organization, apart from those mailing boys, that saw the mail. He would sort it for classification * * *." ¹⁴⁰

After the mail was sorted it was placed in a rack in George Dietrich's office, in pigeon-holes for the different departments. The same procedure would be followed as to mail marked for personal attention as well as to mail addressed to the firm.¹⁴¹ As hereinafter pointed out, George Dietrich also controlled outgoing mail on foreign crude drug transactions, particularly customers' sales invoices and monthly statements.¹⁴²

As previously stated, on one side Coster's room had a door leading into George Dietrich's office, which, in turn, adjoined the cashier's office. On the other side of Coster's room there was a door leading into the Board of Directors' room.¹⁴³ Next to this was the office occupied by Margaret Walsh, the sole employee of the Canadian Company,¹⁴⁴ who kept all of its books and who also received all of her instructions from George Dietrich.¹⁴⁵ Neither the cashier's office, referred to above, nor the main accounting office, referred to hereinafter, handled any of the detailed transactions of the Canadian Company.¹⁴⁶

All of the offices previously described were on the side of the building. Across a hallway in the center were the main accounting offices, which included the billing, bookkeeping, and cost departments.¹⁴⁷ Then there was "* * * the comptroller's office, of course, that was separate from everything else."¹⁴⁸ And, finally, there were the offices of Robert J. Dietrich on the same floor as the other offices but in the back part of the building.¹⁴⁹ He had charge of shipping, receiving, plant purchasing,¹⁵⁰ and warehousing.¹⁵¹

¹⁴⁰ R. 715. See also R. 1361, 1427, 1588.

¹⁴¹ R. 1427.

¹⁴² See page 86 *infra*.

¹⁴³ R. 236.

¹⁴⁴ Besides Miss Walsh, at one time there appear to have been two watchmen and another man on the pay-roll of the Canadian Company for a short while. R. 4392. The watchmen were employed in connection with a building the company leased but did not occupy in Canada. R. 4401 ff. Concerning the other man, Miss Walsh testified that she did not think he did anything for the Canadian Company, that she paid him on George Dietrich's instructions and that the only time she saw him was in George Dietrich's office, not working, but talking. R. 4402-4404. In addition to the work done by Miss Walsh, certain other work was done for the Canadian Company, e. g., tax work by the tax department; shipping, receiving, and duplicate inventory records by Robert J. Dietrich's department; and billing. See testimony of Walsh at R. 4383, 4389, 4394-4395, quoted in part at pages 93 ff. *infra*.

¹⁴⁵ Ex. 19 (A3, A3a); R. 4391-4392.

¹⁴⁶ R. 2692, 1371.

¹⁴⁷ R. 4391, 1358.

¹⁴⁸ Testimony of Johnson, R. 1358.

¹⁴⁹ R. 1500.

¹⁵⁰ "* * * Mr. Robert Dietrich purchased materials for the factory. Mr. McGloin purchased office supplies and machinery and equipment for the office, and George Dietrich purchased raw materials and crude drugs." Testimony of Johnson, R. 1359.

"* * * I think of Mr. Robert Dietrich as the purchasing agent for items other than these crude drugs, and in general in charge generally of the shipping and receiving. * * *." Testimony of Thorn, R. 1161.

¹⁵¹ R. 1358.

Concerning the responsibility of Robert Dietrich, Johnson, the office manager, testified:

"Q. [By Mr. GALPEER.] And whom would you say Mr. Robert Dietrich was responsible to?

A. Mr. Coster and Mr. Dietrich.

Q. That is, Mr. George Dietrich?

A. George Dietrich.

Q. Now, there is a number of clerks and employees in Mr. R. Dietrich's division?

A. Yes, sir.

Q. Are they all responsible to Mr. Robert Dietrich?

A. Every one of them.

Q. Are any of them under your orders or Mr. McGloon's orders?

A. No, sir."¹⁵²

On the same subject McGloon testified:

"Q. [By Mr. GALPEER.] How about Mr. Robert Dietrich, to whom was he responsible?

A. According to the charts of September 1, 1937 [Ex. 97], he too was responsible to Mr. Dewell.

Q. But in practice?

A. Well, I guess in practice he was responsible to Mr. Dewell, but he is a very difficult man to control and he formulated his own rules and regulations and always had access to Mr. Coster's office.

Q. Do you know of Mr. Dewell having given him any orders?

A. Oh, at times, yes; I have often seen in the last two years, Mr. Robert Dietrich in Mr. Dewell's office with others.

Q. Did others have the same access to Mr. Coster's office as Mr. Robert Dietrich had?

A. No, not the same as Mr. Robert Dietrich, no."¹⁵³

Regardless of what control Dewell could or could not exercise over Robert Dietrich in the other branches of the business, in respect to the foreign crude drug transactions, in any event, there was no connection between them,¹⁵⁴ and on this phase, therefore, Johnson's testimony would appear wholly applicable.

Somewhat the same idea as that expressed by McGloon concerning Robert Dietrich's access to Coster's office was perhaps differently stated by Harry W. Osterhout, an employee in the cost department at Bridgeport since November 1925,¹⁵⁵ who testified:

"Q. [By Mr. STEWART.] Did you know of any relationship between Mr. Coster and the Dietrichs?

A. No, sir, although it was rumored—we heard all sorts of rumors. I did hear a rumor that they were cousins, or something like that, but nothing definite."¹⁵⁶

Moreover, it was well established that neither of the Dietrichs took any vacations. With one exception,^{156a} the longest George Dietrich

¹⁵² R. 1360.

¹⁵³ R. 1590-1591.

¹⁵⁴ R. 1182.

¹⁵⁵ R. 4523-4524.

¹⁵⁶ R. 4525. Osterhout stated that this did not make him suspicious and that he never communicated this rumor to Price, Waterhouse & Co. See page 269 *infra*.

^{156a} In *U. S. of America v. George Musica, et al.* (footnote 23 *supra*), George Dietrich testified that during the whole ten years he was only away from the plant because of sickness for one period of five weeks.

was away from the plant while it was in operation, including time off for sickness, was a half day. Similarly, the longest Robert Dietrich stayed away was 2 or 3 days. Whenever George Dietrich did leave, even for a few hours, Robert Dietrich would move up and occupy his office, next to Coster's, but while occupying George's office would never do any of his work.¹⁵⁷

2. Smith and Manning

At the time of the 1937 audit, all of the sales of foreign crude drugs, both by the Connecticut Division and Canadian Company, were purportedly made for their account under a contract with the pretended sales agency, W. W. Smith & Company, Inc., while payment for goods purchased and collections on goods sold were purportedly made direct by the assumed bankers, Manning & Company, also for the account of the respective McKesson Companies. The goods themselves were supposedly retained by the five Canadian vendors previously mentioned until sold and shipped by W. W. Smith & Company, Inc., under the contract referred to above.¹⁵⁸ The contract also contained collection guaranty provisions. As previously stated, Smith and Manning would now appear to have been either entirely fictitious or, to the extent that they had any reality, were blinds used by Coster for his fictitious transactions. In order properly to appreciate the various documents and methods of handling the fictitious transactions it is necessary first to know the purported relationship of Smith and Manning to the McKesson Companies and the predecessor, Girard & Co., Inc., and the details of the contracts under which they were supposed to have been operating.

In 1925, while still with Bond & Goodwin, Inc., investment bankers, Julian Thompson prepared a report on Girard & Co., Inc.,¹⁵⁹ in which he gave the following description of the purported origin of that concern and the prior connection of its personnel with W. W. Smith & Co.:

"Frank D. Coster and P. Horace Girard were for many years associated together in the employ of W. W. Smith & Company, importers, exporters and brokers of chemicals under the Senior Mr. Smith, now deceased. A few years ago W. W. Smith & Company found themselves owed a substantial amount of money by the Adelphi Pharmaceutical Mfg. Company and Mr. Coster was sent over there by W. W. Smith & Company as General Manager to try and assist them in their difficulties and incidentally to try and get W. W. Smith & Company's money.

* * * * *

"At about the time he [Coster] withdrew [from Adelphi Pharmaceutical Mfg. Company], the Senior Mr. Smith died and Mr. Girard had decided to go into busi-

¹⁵⁷ R. 1361-1362, 1430-1433, 1472, 1489-1493, 1591, 1701-1704, 4431-4432, 4435-4436. However, Price, Waterhouse & Co. representatives who testified at the hearings stated they were not aware of the situation mentioned in this paragraph.

¹⁵⁸ See page 48 *supra* and page 63 *infra*.

¹⁵⁹ Ex. 177; R. 2242-2243. A copy of the report was given to Horace B. Merwin but nothing in the record indicates that Price, Waterhouse & Co. saw this report or knew its contents.

ness for himself, having already applied for a corporate charter under the name of Girard & Company. Mr. Coster therefore joined forces with Mr. Girard, put in a larger amount of capital and they started business, securing Mr. George A. Dietrich, who is a practical experienced accountant, to handle the billing and bookkeeping end."¹⁶⁰

In Thompson's report there is also set forth the following answer he received from W. W. Smith & Co., in response to a trade inquiry on Girard & Co., Inc.:

"In reply to your inquiry on Girard & Co., Inc., Mount Vernon, New York, we have sold them both for account of ourselves and for foreign accounts that we represent on a basis of 10 days less 1 or 2% or 30-60 days net, the range of billings has been from \$200 low to \$50,000 highest. They have at all times taken advantage of discounts.

"We consider them a very desirable account and fully reliable and responsible for their engagements.

Very truly yours,

W. W. SMITH & Co.,
(signed) by WILLIAM W. SMITH."¹⁶¹

From the work sheets of Price, Waterhouse & Co., it appears that W. W. Smith & Co. was also an important account receivable on the books of Girard & Co., Inc. So, too, was the Charles Manning Chemical Company.¹⁶² The amounts owing by these firms, and the percentage this bore to the total reported accounts receivable of Girard & Co., Inc., are indicated in the following table:¹⁶³

| Audit date | W. W. Smith & Co. | Charles Manning Chemical Company | Percentage of the two accounts combined to total accounts receivable |
|----------------|-------------------|-------------------------------------|--|
| Dec. 31, 1924 | \$ 9,305.05 | \$ — | 27% |
| Dec. 31, 1925 | 22,750.00 | — | 13% |
| Mar. 31, 1926 | 32,246.00 | 31,025.00 | 29% |
| June 30, 1926 | 20,025.00 | 21,875.00 | 18% |
| Sept. 30, 1926 | 31,650.00 | 24,100.00 | 13% |
| Nov. 30, 1926 | 18,925.00 | 24,700.00 | 11% |

An additional relationship with Manning is indicated in the Price, Waterhouse & Co. report on the operations of the Connecticut Company for the 4 months ended March 31, 1927, where reference is made to the receivable owing by:

"Estate of Charles Manning for improvements at 79 Cliff Street,
New York chargeable to owners..... \$20,995.54"¹⁶⁴

¹⁶⁰ Ex. 177. See also R. 2119. P. Horace Girard appears to be another of the Musica-Coster aliases. See footnote 27 *supra*.

¹⁶¹ Ex. 177.

¹⁶² R. 48.

¹⁶³ Ex. 170.

¹⁶⁴ Ex. 145. The premises referred to, 79 Cliff Street, New York City, were then being occupied by the Connecticut Company and were still being used by McKesson at the time of the present hearings. R. 2611 and footnote 44 *supra*.