PITTSBURGH'S WORST CRISIS IN MUNICIPAL FINANCE—THE RAILROAD BOND AFFAIR (1859-64)

By James H. Thompson

There may be found in the recorded history of almost every American city the record of a critical period when the municipal government has been confronted by an unusually grave and ominous financial crisis. The Select and Common Councils of the City of Pittsburgh faced just such a desperate situation in the early 1860's, years when angry creditors attempted to have the city officials thrown into jail, levied upon the municipal water works for the purpose of selling them, and succeeded in "locking up" the city treasury for more than a year. Pittsburgh, like many another municipality, faced financial chaos for allowing itself to be sucked into the giddy whirlpool of speculation which characterized the railroad-building era.

Between 1849 and 1854, the City of Pittsburgh purchased $1,800,000 worth of capital stock in five railroad companies. The purpose of these stock purchases was to encourage the construction of railroad lines into Pittsburgh, in a period when city was competing against city in the granting of subsidies to railroad companies. As a result of the stock purchases, the City of Pittsburgh became the owner of 11,000 shares in the Pittsburgh and Steubenville; 10,000 shares in the Pittsburgh and Connellsville; 8,000 shares in the Allegheny Valley; 4,000 shares in the Ohio and Pennsylvania; and 3,000 shares in the Chartiers Valley Railroad Company.

Exhibiting a somewhat naive faith in the success of these pioneer railroad companies, the councilmen were convinced that this venture could be placed upon an entirely self-supporting basis. The $1,800,000 worth of railroad stocks were paid for by the issuance of a like amount of city bonds. However, each ordinance which authorized the issuance of city "Railroad Bonds" to finance stock purchases contained a clause to
the effect that each railroad company concerned must agree to pay the interest on its share of the bonds. This arrangement would continue until such time as the dividends on the stock purchased by the city would be large enough to cover the interest payments on the "Railroad Bonds." In short, an attempt was made to substitute the credit of the city for the shaky credit of the railroad companies, but to do so without placing any burden of interest payments upon the city taxpayers.

The interest payments on the coupons of these "Railroad Bonds" were met for a few years, but only because the city government advanced money to the railroad companies for that purpose. By 1855, it had become apparent that the railroads were unable to make any interest payments, and after that year little, if any, of the interest was paid. The city administration refused to make further interest payments to coupon holders, citing the agreements with the railroads and maintaining that these contracts relieved the city of all responsibility for paying interest on the "Railroad Bonds."

The courts, nevertheless, ruled that the payment of this interest was the legal responsibility of the City of Pittsburgh. On May 23, 1859, the first judgment was obtained against the city in the Circuit Court of the United States, on the coupons of City of Pittsburgh Railroad Bonds. In November, 1860, several more judgments were obtained, and the number increased at every succeeding term of the court until, by the end of 1862, sixty-five judgments had been obtained against the city, amounting to a total sum of $418,265.1

On the first judgments obtained, executions were issued and the stock held by the city in the Pittsburgh Gas Works was levied upon and sold at a marshal's sale, 450 shares of this stock being sold for the insignificant sum of $364.80. At the same time, January 19, 1861, the marshal sold 25,000 shares of the city's holdings of railroad stocks for the total amount of $6,696. Therefore, stocks for which the city had paid $1,272,500 were sold for just a trifle more than $7,000.2

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1 Report of the City Solicitor for 1862.
2 Ibid.
the judgments, these being mandatory writs directed to the controller and treasurer, requiring them to pay the judgments out of any unappropriated money then in the treasury, or out of the first revenue received. The city treasurer, acting on the advice of the city solicitor, refused to apply the revenues of the city in this manner, on the grounds that they had been previously appropriated by ordinance to the ordinary expenses of the city. While awaiting the decision of the court on this point, it was deemed advisable to keep the money in the treasury. No decision was made in the case until December, 1862, and thus for more than a year the treasury was virtually locked up. If the effort to require these executions to be paid out of funds in the city treasury had succeeded, the entire revenue of 1862 would have been swept away, and the city would have been left without a dollar to pay ordinary expenses or to sustain the municipal government. Fortunately for the city, the Circuit Court eventually set aside these writs.\textsuperscript{8}

Another effort was made by the bondholders, which, if successful, would have been equally as disastrous. They levied upon the municipal water works for the purpose of selling them, or taking them out of the hands of the city authorities. Once again, the court refused to sanction such a measure and set aside the levy.\textsuperscript{4}

A talking point for a compromise with the bondholders was finally provided by the fact that trustees appointed by the city were able to dispute in the courts the titles of the marshal's vendees to the railroad stocks which they had purchased in 1861 and 1863, the remaining 11,000 shares having been sold by the marshal in the latter year. Previous to the marshal's sales, in May 1860, the city had transferred the greater part of its railroad stock to five persons as trustees. These trustees were instructed to hold the stock of each railroad for the benefit of the holders of the "Railroad Bonds" pertaining to that road. Although some of the railroad stocks were transferred to the purchasers following the marshal's sales, the trustees persuaded the Pittsburgh, Fort Wayne and Chicago,\textsuperscript{5} and the Chartiers Valley railroad to refuse to permit the transfer of the stocks which the

\textsuperscript{8} Ibid.  
\textsuperscript{4} Ibid.  
\textsuperscript{5} Successor to the Pittsburgh and Steubenville Railroad.
trustees held in those companies. As a result, one of the purchasers filed a bill in equity to compel the transfer of the contested stocks. The trustees and city defended, and claimed the stocks, alleging that the marshal's sale was illegal and conveyed no title.6

Strenuous efforts were made by the finance committee of city council, during 1862 and 1863, to effect a compromise with the bondholders whereby the old "Railroad Bonds" would be replaced by new issues of long-term city bonds. These efforts were seriously hampered by the fact that about one-half of the original "Railroad Bonds" were held by Germans, who were inaccessible except through agents in this country. Some of these agents were unfriendly to the idea of a compromise, and refused to communicate to their clients the terms proposed by the city. The first proposal of the finance committee for a compromise was a bond-for-bond exchange of new fifty-year, four per cent bonds for the thirty-year, six per cent "Railroad Bonds." The agents for the German bondholders objected to four per cent bonds, whereupon the finance committee proposed five per cent bonds, but only upon the condition that the new bonds be exchanged for the old at a ratio of 86 to 100. About one-fourth of the old "Railroad Bonds," more than $400,000 worth, were compromised on these terms in 1863.7

The "break" which assured the successful completion of the "Railroad Bond" compromise finally came in 1864. One of the largest bondholders, August Siebert of Germany, had filed a bill in equity in 1862 against the Pittsburgh, Fort Wayne and Chicago Railroad Company, the city, and the trustees, setting forth the assignments as fraudulent, null and void, and to compel the railroad company to allow 4,000 shares of stock sold at the marshal's sale to be transferred to the plaintiff. In 1864, an offer was made by Herr Siebert's counsel to settle that controversy by giving each party half the stocks in dispute. At the same time, assurances were given that he and all the German claimants would compromise all their claims. The city agreed to Siebert's offer, and by the end of the year 1864 the city controller had either cancelled or made arrangements for the compromise of

6 The Municipal Record, April 28, 1873.
7 Ibid.
all but $288,000 of the old “Railroad Bonds.” In each case, the old “Railroad Bonds” were exchanged for new fifty-year bonds according to the basis previously mentioned.

Following the acceptance of Siebert's offer, Colonel William Phillips, a city councilman and member of the finance committee, offered to buy absolutely and unconditionally the city's claim to all the railroad stocks which the city had owned, whether in dispute or not. The Colonel gave his four-month notes to the city in payment for the claims he acquired, payable in money or in the five per cent Compromise Bonds at 86 cents on the dollar. By the time the notes were due, Colonel Phillips had disposed of some 4,700 shares of railroad stock and had paid the city $92,300 of the Compromise Bonds for his obligations. He found that he had made $33,000 on the operation and turned this over to the finance committee as a donation to the city, to form the nucleus of a sinking fund for the retirement of the railroad debt.

The "flier" taken by the City of Pittsburgh in railroad bonds resulted in the total loss to the city of more than two million dollars, since $2,180,000 worth of Compromise Bonds were issued in exchange for the old “Railroad Bonds” and accrued interest liabilities. These Compromise Bonds represented more than two-thirds of the total bonded indebtedness of the City of Pittsburgh in 1865. Moreover, the credit standing of the city was seriously impaired for two decades by the abortive attempt to repudiate interest payments on city bonds. In the 1860's and 1870's, City of Pittsburgh bonds sold on the securities markets for as little as 65 and 70, although similar securities of other cities were selling at par or above.

A bright spot in the otherwise dark picture of the “Railroad Bonds” affair was provided by the success of the Railroad Compromise Sinking Fund established by Colonel Phillips. This proved to be the first scientifically-managed sinking fund of the City of Pittsburgh and the first instance in this city where sinking fund moneys were invested in municipal bonds. Regular contributions were made to the Railroad Compromise Sinking Fund, and when the Compromise Bonds matured in 1913 a suffi-
cient sum was available in the sinking fund to provide for their redemption. Although the City of Pittsburgh had possessed a municipal sinking fund as early as 1850, contributions to this fund had been highly irregular, and the cash assets of the fund had often been "borrowed" to meet current expenses of the city. Thus the railroad stock purchases provided a horrible example, and the Railroad Compromise Sinking Fund quite another type, for future officials of the City of Pittsburgh.