

## Section II

### THE DISCLOSURE OF THE FRAUD

The first public intimation of the inflation in assets on the books and statements of McKesson & Robbins was contained in a complaint which sought the appointment of a receiver for the Corporation. The complaint was filed in the United States District Court at Hartford, Conn., on Monday afternoon, December 5, 1938, by Vincent W. Dennis, Corporation Counsel of that city, as a stockholder "\* \* \* suing on behalf of himself and on behalf of all other stockholders of McKesson & Robbins, Incorporated \* \* \*." It alleged merely that the Corporation "\* \* \* through its officers and directors, for a long time prior to the date hereof had fraudulently represented its assets to be of a substantial character and in its statement to stockholders, security holders and to the general public has included in its inventory and accounts receivable, inventories which do not and have not existed and accounts receivable which do not and have not existed." The complaint further stated that the fictitious inventories and accounts receivable aggregated in excess of \$10,000,000 and "\* \* \* that the affairs of the defendant corporation have been and are now, by its officers and directors, being negligently and carelessly conducted and mismanaged \* \* \*."<sup>2</sup>

Immediately upon filing of this complaint, Judge Edwin S. Thomas appointed Thomas J. Spellacy, Mayor of Hartford, and Abram S. Weissman, a New Haven attorney, as Temporary Receivers for the Corporation.

It is interesting now to be able to trace the origin of this suit. The complaint as filed by Corporation Counsel Dennis, in addition to the allegations concerning the shortages in inventories and accounts receivable, stated that the complainant, a stockholder, held 2,000 shares of the common stock of McKesson & Robbins. Dennis first was told of the shortages and received the shares in question from Mayor Spellacy early Monday morning just before Spellacy presented the complaint to him for signature.<sup>3</sup>

Mayor Spellacy had obtained his information concerning the existence of shortages in inventories and accounts receivable and the 2,000 shares of stock on the preceding Saturday afternoon from

<sup>2</sup> *Dennis v. McKesson & Robbins, Incorporated*, U. S. D. C. Dist. of Conn. Civil Action No. 86.

<sup>3</sup> Before the Att'y. Gen'l. of the State of N. Y., *In the Matter of McKesson & Robbins, Inc.* Testimony of Vincent W. Dennis, January 4, 1939.

Benjamin Slade, a New Haven attorney, who said he represented an undisclosed officer of the company. In addition, Mayor Spellacy had his information concerning the existence of shortages corroborated by Judge Thomas during a conference in the Judge's chambers early Monday morning, where it was finally decided that application for receivership should be made. The selection of Corporation Counsel Dennis as the plaintiff in the action was not made by Mayor Spellacy until after this talk with Judge Thomas.<sup>4</sup>

It would appear that Judge Thomas had been advised previously of the existence of shortages by Abram S. Weissman. On Sunday, Weissman, whom the Judge thereafter appointed Co-receiver with Mayor Spellacy, consulted with the Judge about a conference he had had with George E. Dietrich, assistant treasurer of the Corporation.

The certificates for the 2,000 shares of common stock<sup>5</sup> given Mayor Spellacy by Benjamin Slade on Saturday afternoon had been delivered that same morning by a New York Stock Exchange firm from the account of Mrs. F. Donald Coster to Robert J. Dietrich, the head of the shipping, receiving, and warehousing department of McKesson at Bridgeport.<sup>6</sup>

Later it was disclosed that George E. Dietrich and Robert J. Dietrich were George and Robert Musica, respectively, brothers of Philip M. Musica, who was masquerading as F. Donald Coster, the head of the drug concern.<sup>7</sup>

The origin of the suit and relationship of the parties were, of course, not publicly known when news of the receivership reached New York City on Monday evening, December 5.

When informed of the receivership action, over the telephone, by Wilbur L. Cummings, who was a director of the Corporation as well as a partner of Sullivan & Cromwell, counsel for the Corporation, Sidney Weinberg, partner of Goldman Sachs & Co. and also a director of McKesson & Robbins, suggested an immediate meeting of the executive officers. Weinberg, who was, in addition, a governor of the New York Stock Exchange, where the McKesson securities were traded, reported at once what he knew to John M. Hancock, chairman of the Committee on Stock List, who happened to be attending a dinner at the Waldorf Astoria which Weinberg also was attending when he received Cummings' call.

<sup>4</sup> Before the Att'y. Gen'l. of the State of N. Y., *In the Matter of McKesson & Robbins, Inc.* Testimony of Thomas J. Spellacy, January 5, 1939.

<sup>5</sup> Registered in "street names."

<sup>6</sup> Ascertained by comparison of certificate numbers.

<sup>7</sup> For the sake of clarity, the brothers Musica will be referred to hereinafter under their assumed names which, in the order of their ages, are:

Frank Donald Coster	—Philip M. Musica
George Vernard	—Arthur Musica
George E. Dietrich	—George Musica
Robert J. Dietrich	—Robert Musica

A meeting at Weinberg's apartment that evening was attended by Charles F. Michaels, executive vice-president of the Corporation, William J. Murray, Jr., first vice-president of the Corporation, Julian F. Thompson, treasurer of the Corporation, Cummings and Weinberg. Except for Coster, who was not present, and aside from Thompson, who was not then a member, these men composed the Executive Committee of the Board of Directors of the Corporation. Weinberg described the meeting in part, as follows:

"\* \* \* During one stage of the discussion at the meeting I suggested that as Price, Waterhouse & Company were the accountants for the company I thought this was an important and startling enough matter to get hold of Mr. May, the Senior Partner of the firm and have him come down, and they all agreed, and I did that. I called him up at his home in New York City and he came down immediately.

\* \* \* \* \*  
 "None present knew why the Receivership had taken place, and it was agreed that I try to get Mr. Coster on the telephone at his home in Bridgeport, as they were not able to get him. I put in a call for him and, strange to those who had been trying to get him all afternoon, he got on immediately, and I said to him, 'This is a frightful thing that has happened. What is it all about?' He said, 'I know nothing about it. Here I am, living in Connecticut. Surely some one would have told me.' 'Well', I said to him, 'It is a very serious matter, and I think you ought to come down to New York immediately, tomorrow morning, and have a meeting with the Executive Committee', and he said, 'I have got to go to the Bridgeport office to get my mail, and I will come down, and I'll be there at 10 o'clock.'

"Mr. Thompson during the course of the evening outlined certain suspicious that he had as to what appeared to him to be fraudulent transactions in the crude drug department,<sup>8</sup> and after a long discussion, in which Mr. May agreed to come to the meeting the following morning at the Company's office with one of his partners and the man in charge of the work at McKesson & Robbins, we adjourned.

\* \* \* \* \*  
 "Now the next morning we met informally, the Members of the Executive Committee of the Company met informally at the offices of the Company, hoping that Mr. Coster would be present, but as I got into the office he called me on the telephone and said that it was impossible for him to be there due to the fact that a Receiver of the Company had just shown up at the Bridgeport office and ordered him to stay there \* \* \*."<sup>9</sup>

Meanwhile, at the opening of the market on Tuesday morning December 6, the New York Stock Exchange held up trading in McKesson securities. At the time there were listed on the Exchange \$15,834,000 principal amount 20-year 5½% convertible debentures, due May 1, 1950; 605,964 shares preference stock \$3 series, cumulative, convertible, no par value; and 1,282,983 shares common stock, \$5 par value. At 11:30 a. m. the Board of Governors met and voted an indefinite suspension, emphasizing "\* \* \* that they had ordered

<sup>8</sup> See pages 128 ff. *infra*.

<sup>9</sup> Before Committee on Stock List, New York Stock Exchange. Testimony of Sidney J. Weinberg, December 7, 1938.

the indefinite suspension, not because of things that they knew but because of things which they did not know."<sup>10</sup>

Later the same day Cummings called the then Chairman of the Securities and Exchange Commission, William O. Douglas, "\* \* \* and told him we'd welcome an investigation \* \* \*. They [the SEC] have much more power than the auditors or even Receivers, definitely, and I think it would considerably expedite clearing up the situation."<sup>11</sup>

It was at this point, and with this background, that the Securities and Exchange Commission instituted proceedings. Finding reasonable grounds to believe that the financial statements contained in the most recent annual report filed by McKesson & Robbins with the Commission and the New York Stock Exchange as required by Section 13 of the Securities Exchange Act of 1934 "\* \* \* did not fairly present the financial position of the company and its subsidiaries as of the date of such statements, and were false and misleading with respect to various items whereby the assets of the company and its subsidiaries were made to appear substantially greater than was actually the fact \* \* \*," the Commission, on Tuesday afternoon, entered an order for investigation.<sup>12</sup> Representatives were sent at once from the Commission's New York Regional Office to Fairfield, just outside of Bridgeport, Conn., where the head office and manufacturing plant of McKesson were located.

Wednesday and Thursday they interrogated officers and employees at the plant and examined the books and records and accounting system. Although it was impossible to track down all the ramifications in that short period, they reported a sufficient outline of the situation to impel the Commission on Friday morning, December 9, to refer the matter to the Department of Justice for necessary criminal proceedings.

Commission representatives then conferred with agents of the Department of Justice in Washington, with the result that about noon of the same day it was announced that the case would be con-

<sup>10</sup> New York Times, December 7, 1938. The securities (less \$100,000 debentures held in treasury at December 31, 1938) were restored to trading at the opening of business, March 29, 1940.

"These securities still remain subject to the changes which will undoubtedly be made in the Company's financial and corporate structure as the result of the reorganization proceedings now pending. All that is being done at this time is to restore to McKesson security holders the broad national market which the New York Stock Exchange affords and which was lost to them through the automatic suspension by the Exchange of trading privileges when the Company's difficulties arose in December, 1938.

"This restoration of trading privileges has been dependent not only upon providing the S. E. C. with acceptable data as to current operations of the Company, but also upon correcting annual reports and registrations filed during the period of the Coster-Musica manipulations of the Company's financial affairs. This has taken time." New York Stock Exchange, Supplement to Listing Application, McKesson & Robbins, Incorporated, March 22, 1940, Exhibit A.

<sup>11</sup> Before Committee on Stock List, New York Stock Exchange. Testimony of Wilbur L. Cummings, December 7, 1938.

<sup>12</sup> Before the Securities and Exchange Commission, *In the Matter of McKesson & Robbins, Incorporated*, December 6, 1938.

sidered by a Federal Grand Jury under the direction of the United States Attorney's Office in New York.

In the interim the Executive Committee of McKesson & Robbins held a meeting (which Coster did not attend) at which it was decided that a petition be filed in the United States District Court for the Southern District of New York for permission to reorganize the corporation under Chapter X of the Chandler Act. On Thursday, December 8, Judge Alfred C. Coxe in New York approved the petition and appointed William J. Wardall and Charles F. Michaels as Trustees for the Corporation. On the same day, Judge Coxe signed an order allowing the Securities and Exchange Commission to intervene and take part in the reorganization proceeding. The Trustees appointed by Judge Coxe immediately took charge of the business superseding the Receivers previously appointed by Judge Thomas.<sup>13</sup>

Following the reference to the Department of Justice, the Commission broadened its criminal investigation. In addition to continuing its inquiries in and around Bridgeport and developing the parts played by Coster and the two Dietrichs in operating the fictitious foreign crude drug business at the plant, investigators from the New York Regional Office were sent to Brooklyn, N. Y., to check on George Vernard (later disclosed as Arthur Musica, the fourth brother) and the Brooklyn offices and bank accounts kept in the names of W. W. Smith & Co., W. W. Smith & Co., Ltd. and W. W. Smith & Company, Inc., pretended sales agencies, and Manning & Company, pretended Montreal bankers, which he handled in connection with the fictitious transactions. Investigators also were sent to Mt. Vernon, N. Y. to check Coster's antecedents and dealings in connection with his original firm of Girard & Co., Inc.; to Montreal, Canada, to check the Montreal offices and bank accounts kept in the names of Smith and Manning, and to check the Canadian concerns (disclosed as mere mailing addresses) which supposedly were warehousing the crude drugs in question; and to Stamford, Conn., where they located an abandoned office, which the Musicas had used as headquarters for preparing their fictitious documents. There a discarded piece of wrapping paper, addressed to George Vernard in Brooklyn, gave the clue to the location of the source of the printing of all the letterheads, statement forms, bill heads, and other stationery of Smith, Manning, and the Canadian vendors which had been used to report the fictitious transactions. In New York City investigation of the past history of Coster resulted in a Commission representative obtaining from a Brooklyn attorney an unwitting disclosure that F. Donald Coster was known to him as Philip Musica.

<sup>13</sup> *In the Matter of McKesson & Robbins, Incorporated*, Debtor, U. S. D. C. So. Dist. of N. Y. In proceedings for the reorganization of a corporation No. 72697.

In addition confirmation of the non-existence of the inventories and accounts receivable of the foreign crude drug business as recorded on the books of McKesson was speedily obtained, by cable and telephone, through the cooperation of Adolphe Routhier, Registrar, Securities Act, Province of Quebec, Canada; of Edouard Asselin, Deputy Attorney General for the Province of Quebec, Canada; of John E. Crankshaw, Crown Prosecutor at Montreal, Canada; and of the Commissioners of Police of the Metropolis and for the City of London, England.

As the results of this widespread investigation began to accumulate, evidence of criminal responsibility in connection with the false financial statements contained in the application for registration and annual reports filed by McKesson & Robbins, Incorporated, with this Commission and the New York Stock Exchange<sup>14</sup> became increasingly clear. On Tuesday, December 13, a complaint was sworn out by the Securities and Exchange Commission's Chief Accountant-Investigator for the arrest of F. Donald Coster, George E. Dietrich, and George Vernard on the charge of conspiring to violate Section 32 of the Securities Exchange Act of 1934.<sup>15</sup> The complaint was approved by the office of the United States Attorney, and Commissioner Garrett W. Cotter of the Southern District of New York issued orders for the arrest of the defendants.

The arrests of Coster and George Dietrich were made on the next day, Wednesday, December 14,<sup>16</sup> when for the first time Coster's picture and, more important, fingerprints were obtained. It was not until the next evening, however, that a copy of Philip Musica's fingerprints were finally located in the old files of the Sheriff Street Police Station in New York City and Inspector Joseph J. Donovan, in charge of the Bureau of Criminal Identification, was able to announce that the comparison proved that F. Donald Coster was Philip M. Musica, notorious swindler who had twice before pleaded guilty to commercial frauds. In 1909 he pleaded guilty to having bribed a customs official to mark down weights on cheese imports. And in 1913 he pleaded guilty to having committed grand larceny in connection with the affairs of the United States Hair Company, in which faked shipments and documents on human hair are estimated to have involved 22 banks in a loss of over \$1,000,000. In the first case, Philip Musica was sentenced to 1 year in prison and fined \$5,000, but in less than 6 months he received a Presidential pardon. In the

<sup>14</sup> The original application for registration on Form 10 was filed on May 21, 1935 and annual reports on Form 10-K for the fiscal years ending December 31, 1935, 1936, and 1937 were filed on June 29, 1936, May 19, 1937, and April 29, 1938, respectively, File No. 1-1435.

<sup>15</sup> " \* \* any person who wilfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this title \* \* \* which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than \$10,000, or imprisoned not more than two years or both \* \* \* "

<sup>16</sup> George Vernard was arrested on December 15.

second case, after the Musica family had been apprehended on a boat leaving New Orleans for Honduras (where they could have avoided extradition), Philip Musica took the entire blame upon himself but had his sentence delayed for 3 years and then suspended,<sup>16a</sup> apparently in return for aiding the authorities in investigatory work. Later, he was employed as a private investigator until indicted for subornation of perjury in 1920 in connection with the Barnett Baff "chicken murder" case. It was not until 1929, after he had been well launched on his new career as F. Donald Coster, president of McKesson & Robbins, that bail was discharged and the indictment of Philip Musica on this last charge was dismissed.<sup>17</sup>

Earlier in the day on which the identity of F. Donald Coster as Philip Musica was established by comparison of fingerprints, the United States Grand Jury at New York, acting on the evidence already assembled, indicted F. Donald Coster, George E. Dietrich, George Vernard, and McKesson & Robbins, Incorporated for violating Sections 13 and 32 of the Securities Exchange Act of 1934 in connection with the annual reports of McKesson & Robbins, Incorporated filed with the Commission and the New York Stock Exchange, and for conspiring to violate those sections. It was at noon of the following day, Friday, December 16, after his past career had been exposed and just as the United States Marshal reached his home to rearrest him under this indictment, that Philip Musica, alias F. Donald Coster committed suicide. The three remaining Musica brothers, known as George Dietrich, George Vernard, and Robert Dietrich<sup>18</sup> were taken into custody.

Having been occupied theretofore solely with the criminal investigation, the Securities and Exchange Commission, on Monday, December 19, turned its attention to investigating the auditing practices and procedures which, for a period of 14 years, failed to disclose the gross inflation of assets on the books of McKesson & Robbins and Coster's earlier concern, Girard & Co., Inc. A preliminary survey was undertaken immediately with a view to determining the best way to study and present this matter for consideration.

On the same day, Monday, December 19, Charles F. Michaels resigned as Co-trustee<sup>19</sup> but was immediately thereafter elected by the Board of Directors as president of the Corporation, to replace Coster.<sup>20</sup>

<sup>16a</sup> Two of his brothers, George Dietrich and George Vernard, also pleaded guilty and received suspended sentences.

<sup>17</sup> From records and news clippings in files of New York City Police Department, Bureau of Criminal Identification.

<sup>18</sup> A complaint had meanwhile been sworn out against Robert Dietrich.

<sup>19</sup> In the latter part of October and November 1938, about a month prior to the receivership, Michaels sold 15,600 shares of McKesson common stock for himself and his family. As to the reasons for this sale, see footnote 466 *infra*.

<sup>20</sup> New York Times, December 20, 1938.

Also on Monday, December 19, the three surviving Musica brothers were indicted by the New York County Grand Jury on charges of grand larceny and forgery.

The United States Grand Jury on Thursday, December 22, re-indicted George Dietrich, George Vernard, and Robert Dietrich. The indictment charged the same offenses as did the first Federal indictment returned on December 15, 1938, but cited the brothers as George Musica, Arthur Musica, and Robert Musica, respectively, with their assumed names as aliases. All three have since pleaded guilty to this indictment.

On March 30, 1939, the United States Grand Jury returned its third indictment in this matter, naming, in addition to the three surviving Musica brothers, Benjamin Simon, John Jenkins, Leonard Jenkins, John H. McGloon, Horace B. Merwin, and Rowley W. Phillips. The indictment charged violations of the mail fraud statute, of Sections 13 and 32 of the Securities Exchange Act of 1934,<sup>21</sup> and a conspiracy to violate the foregoing statutes. The Musica brothers pleaded guilty before trial. So did Benjamin Simon. In so far as the fictitious crude drug transactions were concerned, it appears that at an early date he performed some of the functions later carried on by George Vernard. John Jenkins and Leonard Jenkins, brothers-in-law of Coster, both pleaded guilty during the trial, the latter only to the conspiracy count. It appears that they signed contracts, checks, and so forth, in the names of persons supposedly connected with the fictitious concerns used to carry on the fraud.

Horace B. Merwin and Rowley W. Phillips, who were directors of McKesson & Robbins, Incorporated (Maryland) and of its predecessors and subsidiaries, McKesson & Robbins, Incorporated (Connecticut), McKesson & Robbins, Limited, and Girard & Co., Inc., were acquitted by the jury on all counts. John H. McGloon, controller of McKesson & Robbins since 1928, was acquitted of being a party to the conspiracy, of mail fraud, and of violating Sections 13 and 32 of the Securities Exchange Act of 1934 in connection with the 1935 and 1936 annual reports filed by McKesson & Robbins, Incorporated, but was found guilty on the count charging violation of Sections 13 and 32 of the Securities Exchange Act of 1934 in connection with the filing of the 1937 annual report, the last prior to the disclosure of the fraud.<sup>22</sup> An appeal by McGloon is now pending.<sup>23</sup>

<sup>21</sup> See footnote 15 *supra*.

<sup>22</sup> Cf. pages 128 ff. *infra*.

<sup>23</sup> *U. S. of America v. George Musica, et al.*, U. S. D. C., So. Dist. of N. Y. No. 80995. The sentences imposed by Judge Grover M. Moscovitz at the conclusion of the trial on May 22, 1940, were as follows: George Dietrich, two years and six months; George Vernard, three years; Robert Dietrich, one year and six months; Benjamin Simon, three years; and John Jenkins, one year and one day; all on one count of the indictment, sentences on other counts being suspended with periods of probation imposed to start after imprisonment. John H. McGloon was sentenced to one year and one day and was fined \$5,000.00. Sentence as to Leonard Jenkins was suspended and he was placed on immediate probation.



Meanwhile, in view of the false and misleading information set forth in the financial statements prepared and certified by Price, Waterhouse & Co., which were contained in the application for registration and annual reports filed by McKesson & Robbins with the Commission and the New York Stock Exchange,<sup>24</sup> and on the basis of its preliminary investigation into the auditing phases, the Commission, on December 29, 1938, entered an order<sup>25</sup> directing that public hearings be held for the purposes mentioned at the outset of this report. The facts developed in the course of these hearings, together with the conclusions of the Commission with respect thereto, are contained in the sections of this report which follow.

<sup>24</sup> See footnote 14 *supra*.

<sup>25</sup> Before the Securities and Exchange Commission, *In the Matter of McKesson & Robbins, Inc.*, December 29, 1938. A copy of the order is appended to this report as Appendix C.