CHAPTER XVI

THE BANKERS CONTROL THE PROTECTIVE COMMITTEES

When the committees were formed, the pace for all three of them was set by the bondholders' committee. It was to represent the dominant security-holders, the owners of the mortgage. The stock committees assumed, as the chairman of the preferred-stock committee said he assumed, that "when the road went into the hands of the receivers, the stockholders became beggars." The pace for the bondholders' committee, though it was not a mendicant, but a master, was set by the bankers. They did not control the committee at the time, but matters were at the outset in their hands. Besides places on the committee for themselves, other places filled by friendly interests, and the important committee posts manned by their own lawyers, the banker members had a large practical and tactical advantage over the other members. The bankers could speak as experienced reorganizers. They could speak with special experience and equipment for dealing with St. Paul affairs. They came to the committee with months of study of the current emergency. They, alone among the committee, started out with close relations to most of the other important personages in the situation: the receivers, the attorneys for the receivers, the lawyers for the various "parties" in the receivership, the consulting engineers, the trust companies. Thus, when the committee was in its early days, the bankers had already centered in themselves the contacts, relationships, and

almost the entire machinery requisite for reorganization.

The bankers attended the opening meeting of the bondholders' committee with their general procedure already defined in their own minds. And so when suggestions not fitting in with that procedure were made, they said their say, and the other members acquiesced. The first issue arose when a member proposed that the committee solicit the bondholders to authorize it to act for them. Mr. Hanauer advised against this. He said that the bankers hoped to submit a plan of reorganization promptly, and that solicitation of bondholders' support might then be more effectively carried on. Bondholders would then know the specific purposes and plans for which the committee desired to represent them.

This sound advice was, however, followed by proceedings which turned it into a weapon against the committee. It remained a committee somewhat in a vacuum, without authority from the general body of bondholders, until the bankers had prepared their reorganization plan. To that plan the bankers attached an agreement by which any authority which the committee might obtain from bondholders would belong, not to it, but to the bankers, at any moment that the bankers wished to turn the committee into such a cipher. The same provision was made with respect to the stock committees. All three committees signed this agreement.

It was signed at the beginning of June, eleven weeks after the committees were formed. During this period, pursuant to the bankers' advice, the committees had not sought or received the formal support of bond- or share-holders. The committees were therefore, on the day they signed the papers, virtually as full and as empty of power, as full and as empty of right or justification for assuming to be committees, as at the time when the bankers helped them into being. Thus it was almost at the outset of their careers that the committee members formally contracted to give up their right to be free, and to take the orders of the bankers for the future.

The papers which they signed did not put the matter so baldly

as all this. They had been prepared by the bankers' lawyers. The documents were formidably long and complex. In this, they conformed to the standard which prevailed among lawyers in the financial community. Mr. Cravath, the head of the law firm acting for Kuhn, Loeb & Company, discussed the need for contracts of such length in his lecture before the Bar Association. "There is a common impression," he said, "that the modern long reorganization agreement . . . is a delusion and a snare. . . . This idea is entirely wrong. . . . I doubt not that the modern corporate mortgage and the modern reorganization agreement are needlessly long and needlessly complex, but the genius who has the combination of time, wisdom and experience materially to shorten and simplify, without weakening, them has not yet appeared."

The strength of the agreement prepared for the St. Paul committees to sign did not appear on the surface, and a skilled lawyer was needed to tell them how that strength was going to bind them. For the language by which the committees were made to surrender themselves into the bankers' hands was scattered throughout the almost endless document and had to be pieced together before its significance could be grasped. It will be worth while to take up the thread of a journey in this labyrinth, in order to see how the net result of much legal phraseology was abdication by the committees that purported to protect the St. Paul security-holders.

The agreement said that the bankers should manage the reorganization. It also said that "upon the plan being declared operative" certain things should happen. One was that the bankers should then have the same powers as the committees. Another was that the bankers could forbid the committees to exercise their own powers and authority. A third was that the bankers could have the use of the committees' names in exercising all the committees' powers. A fourth was that the bankers would have the right to get all the bonds and shares deposited with the committees by the St. Paul security-holders—both the securities already deposited and any others that might be

deposited afterwards. A fifth was that the bankers could require the committees to deliver any other property in their possession to the bankers. A sixth was that the bankers should then become the legal owners of all those bonds and shares of stock and property. In short, upon the happening of one event—"upon the plan being declared operative"—the committees virtually passed into the hands of the bankers.

The controlling event was dependent upon two things. One was that circumstances should make it appropriate to declare the plan operative. The other was that some appropriate person should make the declaration. The bankers assumed jurisdiction over both matters. They did not let the phrase: "declare the plan operative" have its ordinary meaning. Financiers and financial lawyers mean by it that enough of the security-holders of a distressed corporation have agreed to a reorganization to make it feasible to complete the reorganization. The lawyers for the St. Paul bankers rubberized the words. They provided in the reorganization agreement that the bankers could determine when there was sufficient support for the plan. This they could do "in their sole and unrestricted discretion," as the legal document said. The declaration that the plan was operative was also to be left to the bankers. "Their determination in that respect," so ran the agreement which they induced the committees to sign, "shall be final, binding and conclusive. . . ."

This meant, in effect, that whenever the bankers wished, the committees could themselves be put into receivership, with the bankers as their receivers. So drastic a provision did not go unnoticed, at least by the attorney of the preferred-stockholders' committee. He received a copy of the proposed agreement twelve days before it was signed by the committees. In that interval various minor changes in the language of the document were made. His copy of the first printed draft of the agreement was submitted to the Interstate Commerce Commission when called for by the Commission's attorney "in view of the importance of this episode, if I may minimize it by so calling it." The attorney for the preferred-stockholders' committee had marked a number of suggestions on his copy at various points, including several in which the bankers were trying to reserve to themselves discretion and power to do different things. His notations suggested that the bankers' power should be subject to approval by the committees, and on several minor items the attorneys for the bankers did as he suggested.

Not so with respect to the all-important matters of declaring the plan operative. Too much in other parts of the document hinged on this vital phrase. At the point where it was used in the plan, the preferred stock attorney had written in the margin: "Shd not Comtes [Should not committees], or at least two of the three concur?" That suggestion went by the board. He did not repeat that marginal notation, either on the next draft of the agreement, printed five days later, or on the final draft which preceded the order to the printer for completed copies. This lawyer was, after all, acting for a committee whose chairman thought it was a beggar in dealing with the bankers and the bondholders. And the attorney for the bondholders' committee, which was not a beggar and could take the lead in curbing the bankers if any of the committees could, was the attorney for the National City Bank, one of the banking houses which sought to have this complete power over all the committees. Whether he pieced these separate passages of the agreement together for his committee and told them what the language did to their independence does not appear in the record. What does appear is that the provisions for stripping the committees to the bone remained in the document drafted by the bankers' lawyers.

If the matter was explained to the committees by counsel, it may still have seemed to them that they were surrendering merely the power to say how the plan of reorganization should be effectuated, and not the power to say what the plan should be. They may have felt, what a lawyer might deduce from the contract at first blush, that they had maintained their independence for the important stage, the stage in which the terms of the reorganization plan were being determined. Those terms were made a part of the papers which were signed by the com-

mittees. It may thus have seemed to them, as would appear from a hasty reading of the complicated document, that they had been independent and served the security-holders on the most important matter of all, the structure of the reorganized company, and that what was being given up to the bankers was merely the mechanics of carrying out that independent decision. But the contract said that the bankers could change the plan to which they and the committees were agreeing. It said that the bankers could "substitute any other plan, even though it . . . depart from the original plan." If the bankers exercised this power, security-holders could cancel the authority they had given to the committees, but in circumstances and on conditions which, as will be detailed in a later chapter, were likely to make that right an illusory one. Whatever the security-holders might or might not do, however, the committees could not cancel their agreement with the bankers. The rights of the bankers continued for the new plan. They could continue to exercise all the powers of the committees, deprive them of any right to exercise their own powers, use the committees' names as if they belonged to the bankers and not to the committees, and do all the other things previously enumerated.

The committees might not like the substitute plan, or might even disapprove it. That made no difference. On the contrary, the committees agreed, by one of the innumerable provisions of this document, that they would co-operate with the bankers to carry into full effect any substitute plan which the bankers might prefer. The independence which the committees may have thought they were enjoying when they signed the agreements was retroactively destroyed. By that signature they turned themselves over to the bankers, lock, stock, and barrel. The committees became the subordinates and the equivalent of agents of the bankers, not in the sense that the latter could oust the members of the committees, but in the sense that they had agreed to do as they were told. They could resign, but they could not hold office and disobey.

So absolute was the masters' sway, under the contract agreed to by the committees, that the members' compensation was to be fixed by the bankers "in their unrestricted discretion." The same power of the purse was accorded to the bankers over the compensation of the committees' attorneys and of any other agents of the committees. Even if the committees should favor a smaller compensation to their own lawyers and employees than the bankers were willing to award them, the decision of the latter was to be conclusive. It was in the light of such provisions that the committees were expected to look to their subordinates for service.

Some light on the committees' acceptance of such a document is obtainable from the court testimony of Mr. Ecker, the chairman of the bondholders' committee.

Mr. Miller: When, according to your best recollection, within that period was the first draft submitted to you?

Mr. Ecker: Six weeks or two months . . . after the receivership.

Mr. Miller: Do you know whether any changes were made in that before it was promulgated?

Mr. Ecker: Changes made in the first draft I saw?

Mr. Miller: Yes?

Mr. Ecker: Oh yes.

Mr. Miller: Of substance? What changes of substance were made?

Mr. Ecker: Well, probably no changes of substance. There were some items changed. . . . There were changes made in the phraseology.

Mr. Miller: What I am talking about is the matter of substance.

Mr. Ecker: There were changes made . . . but in substance the high spot of the plan, there were no changes made between the time I saw the first draft and the draft which was presented to my committee for approval, but please understand that the

first draft followed the many conferences and many discussions of the important things which were to go into the plan.

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Mr. Miller: Your committee took formal action according to the plan?

Mr. Ecker: Yes.

In an affidavit Mr. Ecker said that "the reorganization plan was worked out originally by the reorganization managers [the bankers] with me and was approved by me before it was submitted to any other member of the committee." Mr. Hanauer also made an affidavit, saying "the reorganization plan was prepared in negotiation with Mr. Ecker . . . and was approved by him in substantially the form in which it was finally adopted prior to its submission to any other members of the bondholders' committee."

One of their opponents said to the court that he did "not believe that the eminent members of the bondholders' protective committee would agree that they had acted as mere dummies." This comment disregarded the possibility that those members had found the plan a satisfactory one. Whether they did what Mr. Ecker said he did about the first draft—"which I discussed at great length with Mr. Hanauer, every paragraph in it, and almost line for line"—is doubtful. At best they may have read the first part of the document and omitted the technical, legal part at the end. It was this latter part of the document that surrendered the committee to the bankers.

The latter part was named by the lawyers "Reorganization Agreement," and the first part, containing a description of the reorganized financial structure, was called the "Plan." Reorganization lawyers assume that laymen are not likely to read the "Reorganization Agreement." This is brought out by a passage in Mr. Cravath's lecture to the New York City Bar Association. He said:

"Your effort should be to make the Plan clear . . . and . . .

free from legal technicalities. . . . You should save for the reorganization agreement all provisions which are not deemed essential to inform the security holder regarding the essential elements of the Plan and the procedure for his participation."

Unfortunately, the procedure for the participation of the committees was in the technical half of the paper, the reorganization agreement, and most of the committee members were not lawyers. What part the committee lawyers played in warning the committees is not shown in the testimony. Warned or unwarned, the committees became merely instruments of the bankers, important names to induce the security-holders to put their bonds and their stock in the control of the bankers.