PART III

REORGANIZATION

CHAPTER XVIII

DEVELOPING THE ASSETS

THE receivers had it in their power to affect profoundly the benefits to accrue to the St. Paul security-holders. Those benefits would flow from two sources—the character and value of the property to be taken over by the reorganized company, and the nature and extent of the security-holders' interest in that property. Such questions as the operation of the road, improvements, the prosecution of claims for money due the old company or wrongs done to it, were all in the jurisdiction of the receivers.

In the management and improvement of the property the receivers had two great advantages. Before receivership the company had been obliged to find the necessary money for paying ten million dollars of interest charges each year on the junior bonds. The receivers were freed of that burden. Of course, the bondholders continued to have the right to claim the accumulating interest on their bonds, but as long as the court permitted the receivers to disregard those interest charges, the bondholders would have to wait for their money and see what they could get out of the reorganization.

The result was that the receivers over the period of almost three years of receivership operation earned millions more than their fixed charges, whereas the old company had been earning millions less than its fixed charges.

The second advantage which the receivers had was their ability to borrow money. The court had the power to authorize them to

borrow money which would have a higher right in the property than the junior bonds. This the old company could not have done. Thus, in addition to the benefit of a moratorium, the receivers could get court permission to bring in new creditors who would sit on top of the mortgage bondholders. As a result, lenders who would not give credit to the old company could safely extend credit to the receivers. It is obvious that, from the view-point of a man who is operating a railroad property, receivership has large advantages.

The St. Paul receivers drew upon the funds and credit at their disposal. In the first two years they spent, to quote the bankers' attorneys, "upwards of $25,000,000 for additions and betterments to the property." This made for reduced expenses and consequently for a better opportunity to earn profits. Mr. Potter, one of the receivers, explained this:

"If you could have sat in the conferences of the receivers, you would have been amazed to see the vast number of situations where an expenditure of $2,500, $5,000, $7,500, $10,000, will bring about economies which will mean a saving of 25, 50, and 75 per cent a year on the expenditure. We have made numberless expenditures of that sort. . . ."

The attorney for the Commission asked Mr. Potter, one of the receivers, to indicate how successful the receivers had been on the operating side of the work.

Mr. Hickey: Mr. Potter, what constructive action was taken by the receivers for the purpose of making the St. Paul system one of the strong and efficient transportation systems?

Mr. Potter: Well, it is difficult to point out to anything particular as a constructive action. The receivers, promptly after their appointment, took up the St. Paul affairs in all their aspects, with Mr. Byram . . . and the other officials. . . . We have tried to inquire, and ascertain and learn, and inspire, and stimulate, and economize, and cut and prune wherever we could. It is difficult to point to any particular thing. I do not even know that we have accomplished very much that would not have been accomplished if there had not been a receivership. . . . I do not know that I can point to anything specifically as constructive. In fact, the receivers are not claiming any particularly constructive action.

The opportunity for constructive action which would have meant most to the St. Paul security-holders lay in another direction. This was the investigation and prosecution of claims for the losses which had befallen the St. Paul company. These losses were large. Any substantial reimbursement which the receivers might obtain for the St. Paul society would to that extent benefit the bond- and stock-holders.

Such reimbursement would have a second value, far greater than that just mentioned. The collection of money for wrongs done to the St. Paul company, by reducing the seventy million dollars of new money which the bankers said was needed and which they assessed against the stockholders, would reduce the danger of forfeiture for those stockholders who could not provide their proportion of this sum.

Many stockholders were unable to pay such an assessment. In that event, they would get nothing under the bankers' reorganization and would therefore have to sell their stock in the market at receivership prices. For them the receivership precipitated by the bankers spelled, not a chance to have part in a reorganization and to recoup any of their losses, but forfeiture superadded to previous losses.

There were many such stockholders. Mr. Shatford, chairman of an association representing one-fourth of the St. Paul stockholders, told a committee of the United States Senate that ". . . there are 22,500 * stockholders of the . . . St. Paul, of whom I think I can truthfully say at least fifty per cent could not manage to finance the proposed assessment. . . . They would have to sell their stock for whatever it might bring, which at this time is but a fraction of its cost to them."

* The number of stockholders was variously estimated by different witnesses, but all agreed that the total exceeded 20,000.

Mr. Dick, of the banking firm of Roosevelt & Son, told the same Senate committee that ". . . the large and wealthy stockholder with credit was not affected so seriously . . . but for the large majority of the small stockholders the effect of this arrangement was the loss of their stock. . . . We received many hundreds of letters from the small stockholders all over the country . . . showing the universal distress that . . . the necessity of putting up a large amount of money would entail on the small stockholders. . . ."

Former Senator Frelinghuysen told a committee of the House of Representatives that "the plan is practically confiscatory . . . if they are unable to pay this assessment." An independent group of security-holders said to the same committee that ". . . the practical effect of this reorganization plan on a large percentage of the stockholders will be the total loss of their stock by forfeiture. . . . Stockholders . . . have seen their holdings decline in market value from $246,000,000 to $30,000,000 since January 1, 1917. . . . Despite this heavy loss it is now proposed to assess them $70,000,000, or two and one-third times the present value of their stock."

The forcing-out of stockholders by the assessment imposed in the bankers' reorganization plan might have been ameliorated in at least two ways. One method was available to the bankers, the other to the receivers. However, as will appear shortly, action which it was possible to take was not taken or was entered upon so tardily or maladroitly as to be self-defeating. The result was that St. Paul security-holders were left to shift for themselves, and many of them, unadvised or unable to invest more money, to be shaken out for the benefit of men directing the receivership or the reorganization.

The plight of the security-holders called for urgent activity, which the receivers were in the best possible position to undertake. The order of the court appointing them directed them "to collect all outstanding . . . things in action." This legal phrase meant all claims, whether for money lent, for credit given, for wrong done by anyone's failure to perform his full duty as a

director or officer or banker or in any other capacity which imposed duties upon him. The court's order also provided that the receivers were "authorized . . . to institute and prosecute . . . all such actions . . . as in their judgment may be necessary for the recovery or proper protection of said property."

The receivers had, more amply than any other person or group, the materials for thorough investigation. All the records of the company were in their possession. The employees of the company were on their pay-roll and were under a duty to disclose everything to them. The receivers also had ample funds to finance an investigation.

Either the loss of hundreds of millions of dollars was due wholly to conditions beyond the control of the St. Paul directors, officers, and bankers, or part of the responsibility could justly be laid on these men. Under the law, officers and directors might be found liable for neglect of duty, carelessness in performance of their duty, or improperly benefiting at the company's expense. It might also be possible to establish that bankers, as guardians for security-holders on certain occasions, might be subject to obligations similar to those of directors or other trustees of large corporate affairs.

The question before the St. Paul receivers was of course not one of educating directors and officers of big corporations, nor one of promoting business ethics for companies at large, but of furthering the financial interests of the receivers' wards, the St. Paul stock- and bond-holders. The receivers had no right to dispense condonation or charity at the expense of the people for whom they were in effect trustees. In this view, the receivers were under obligation to ascertain and press rights to secure damages, whether the persons sued had sought to do wrong to the St. Paul company or had been merely careless and neglectful of their duties as directors, officers, or bankers.

It was a cold question of dollars and cents. Whatever sum the courts might say the security-holders were entitled to collect from the men under whose tutelage the property had arrived at bankruptcy, that was the amount the receivers were

obligated to seek. The receivers' discharge of their duty would enable them to make this a time of reckoning on behalf of, rather than simply at the expense of, the St. Paul investors.

An early pronouncement showed whether it was the small group of directors and bankers who had to worry lest the receivers become active in bringing lawsuits, or the large inchoate group of security-holders who had to worry lest the receivers be inactive with respect to the lawsuits the security-holders sorely needed. An interview with Mr. Byram was published in a special article written for the New York *Evening Post* by Louis Seibold. It there appeared that, in Mr. Byram's view, bygones should be bygones. He was quoted as follows:

"I am quite sure that the system was as honestly and efficiently managed as any other railroad in the country. There may have been some irregularities in the old days, but these could not be avoided, and I am sure were not dictated by other than proper motives. The reasons given by the board of directors in announcing their decision to apply for a receiver as the best way out of present difficulties are absolutely correct. . . . There is no good in raking up old problems and sores. The stockholders will find greater benefits by assisting the company to regain its former prestige and business."

The attitude of the receivers and their counsel toward the desirability of an inquiry for the sake of the St. Paul security-holders was demonstrated some months later, particularly with reference to the Gary deal. An independent committee, representing some eighteen million dollars' worth of the St. Paul bonds, asked for an opportunity to be a "party" to the receivership proceeding. To this the bankers and the receivers were opposed. One of the matters to which the committee called the court's attention was the acquisition of the Gary road. The committee referred to the employment of Messrs. Winchell and Pryor, to their sharing in the commission, to the association of Mr. Pryor with Mr. Percy Rockefeller and his father in various business enterprises, and to the fact that "Percy A. Rockefeller, though resigning as a director in 1921, continued to exercise great influence in the

management of the railway."

All these facts were established in the Interstate Commerce Commission's investigation, except that there was no evidence of any relationship between Mr. Pryor and the elder Rockefeller. Facts which the committee did not mention were Mr. Percy Rockefeller's indirect participation in Mr. Pryor's commission, Mr. Rockefeller's participation in the consideration of the Gary deal by Mr. Byram and by the St. Paul board, and Mr. Byram's assumption that Mr. Rockefeller was advising him as a friend of the St. Paul, and not on the other side of the fence. These facts did not appear until later, when Messrs. Rockefeller and Pryor were put on the witness-stand in the Commission inquiry.

The receivers submitted affidavits to the court in opposition to the committee. One affidavit was by Mr. Byram. He told the court that "the statements . . . that said acquisition . . . was brought about because of the influence of, and in order to benefit, Mr. Percy A. Rockefeller, formerly a director of the Railway Company, or his associates, are, from beginning to end, sheer fiction and without any foundation in fact. . . . Neither Mr. Percy A. Rockefeller nor any associate of his caused the Railroad Company to acquire . . . the Gary Company."

An affidavit by Mr. Percy Rockefeller was also handed to the Judge. This affidavit contained the following: "I was a director of the St. Paul Railway Company . . . prior to January 1921, when I resigned. Since then, I have had no connection with the said Railway Company and have in no way influenced or attempted to influence its policies or management; and the statement to the contrary in the said petition is untrue."

At the time of the submission of these affidavits to the court, the doings of Messrs. Rockefeller and Pryor had not yet been disclosed in the Interstate Commerce Commission hearings. The independent committee put in an amended petition from which it excluded the statements about the Gary deal. But when the testimony had begun to trickle through, its attorney, former Governor Miller, sought to develop further facts in the court proceedings. To this Mr. Condit, of the firm of Winston, Strawn

& Shaw, attorneys for the receivers, was opposed. Mr. Byram was being examined by former Governor Miller on the subject of Mr. Byram's penciled notation on Mr. Rockefeller's letter about the Gary: "P.A.R. not on the board."

Mr. Miller: Now, why did you make that notation—

Mr. Condit: I object to that, your Honor.

Mr. Miller: —"P.A.R. not on the board?"

Mr. Condit: I understand that all charges of fraud have been withdrawn here by Governor Miller. . . . All these little questions like this . . . it doesn't seem to me that they are material to the issues here. . . .

The Court: . . . He may answer.

Mr. Byram: . . . I felt that Mr. Rockefeller would probably be subjected to more criticism than he has been if he mentioned the Gary railroad while he was a director of the St. Paul.

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Mr. Miller: Did you know of the Owenoke Corporation prior to learning of this commission having been turned over to him [Pryor]?

Mr. Byram: Well, I know there was such an institution.

Mr. Miller: Well, you knew that Mr. Rockefeller had a personal corporation, didn't you?

Mr. Byram: No, I did not know; I did not know what that name meant. To be frank with you, the name "Owenoke" is on the door, among other titles, on Mr. Rockefeller's office in New York. I had seen it on the door, but I never knew what Owenoke was.

Mr. Miller: But you know now?

Mr. Byram: Well, I am not sure that I do. I know what the newspapers reported it to be.

Mr. Condit: In view of this last examination I am wondering how sincere the Governor was in his withdrawal of these charges, because it seems to be a thing that he likes to bear down here again on this Rockefeller matter.

This Rockefeller matter might have been made the basis for the recovery of money for the St. Paul property from men concerned in the Gary deal. It was therefore a subject calling for aggressive action by receivers' counsel, to seek the facts and help others seek the facts. It was the failure of the receivers and their counsel to perform this duty which left the independent committee in the dark and resulted in its dropping of various charges later shown to be correct. All that receivers' counsel could see was the desirability of holding the independent bondholders to a retraction erroneously made.

The position of the receivers was made clear also in connection with an inquiry into the acquisition of the Terre Haute railroad. Mr. Byram denied that the terms of this transaction were improvident. His co-receiver, Mr. Potter, testified that the purchases of the Terre Haute and Gary roads were "the two things shown by St. Paul history which were truly Harrimanesque." A portion of his examination by the attorney for the State of Wisconsin is here quoted:

Mr. Grady: I presume you followed the testimony given in Chicago in relation to the price paid for the income bonds on the Terre Haute railroad?

Mr. Potter: Not very closely.

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Mr. Grady: . . . Were you aware of the fact that these bonds that were purchased by the St. Paul are guaranteed under this contract of $100 each, or par, were being sold on the market for $48 and as low as $38?

Mr. Potter: When?

Mr. Grady: Shortly before the purchase or at about the time of the purchase.

Mr. Potter: I did not give any consideration to that or to the effect of that at all. I assumed that the property was bought as cheaply as it could be bought, but whatever the facts were as to how it was bought, I became of the opinion that it was cheap

property at the price it was bought, and I haven't heard anything indicating that the company has any claim which the receivers should follow up in connection with the purchase of the property.

Mr. Grady: In assuming the position that it ought to be retained rather than returned back under this lease, did you consider the fact that the bonds purchased from the First National Bank of Chicago, $440,000 worth, had been considered of so little value that the National Banking Department had stricken them off as assets?

Mr. Potter: I did not care and I did not consider that, and I did not care what anybody at any time had thought the bonds were worth. I knew the company did purchase them and had purchased them at a price which was a good buy at that price. I later heard Mr. Frank Wetmore testify as to the circumstances of that sale, and I then had my conclusion confirmed by his very clear and positive testimony that those who bought the property for the St. Paul bought it as cheaply as they could at that time.

It was Mr. Wetmore whose files, brought to light in his examination, raised the question whether he had not been willing to take thirty per cent less than the St. Paul paid. Yet the receiver relied on Mr. Wetmore's "very clear and positive testimony that those who bought the property for the St. Paul bought it as cheaply as they could at that time."

The view-point of the receivers that they would not act on their own initiative to get the facts, but would sit back and wait for others having less ready access to the facts to produce them if they could, became evident in this receiver's statement: "I haven't heard anything indicating that the company has any claim which the receivers should follow up in connection with the purchase of the property."

The receivers' policy was in marked contrast with that of the Interstate Commerce Commission. The difference was not only between passivity and activity in bringing the facts to light, but in the interpretation put on the facts which the Commission, not the receivers, had unearthed. The Commission roundly con-

demned what had taken place in the years prior to receivership. The receivers, under a duty to proceed as partisans on behalf of the security-holders, were more than neutral and judicial in their attitude. They were lenient toward those who had failed in their duty to the company. They became apologists, even protagonists, for such persons.

How beclouded the facts had become for the receivers, probably because of the relationship which some of them bore to the persons whom the Commission criticized, may be observed in the brief which Mr. Dynes submitted to the Commission. He wrote, to be sure, as attorney for the old company, but his labors were performed on the time of the receivership property, and at its expense. Purporting to summarize the evidence after the investigation was completed, he said:

". . . the evidence clearly establishes there has been no corruption, no dishonesty, no private profiteering, no misapplication of funds, no breach of trust, no neglect of opportunity and no lack of earnest and sustained effort to serve the best interests of the property . . .

"The second generations in some instances had succeeded their fathers as Directors of the St. Paul. . . . They took their duties as Directors seriously and like others on the Board they had invested their own money in the railroad. The interests of the St. Paul were their interests. Individually and collectively, their integrity is shown by this record to be above reproach. Their fidelity is a worthy example. . . ."

The exercise of the receivers' power to save the security-holders was neutralized and defeated from the outset by the embarrassment of long-established relations between the men in the receivership administration and the men against whom they should have proceeded. A charitable softening of the color of past transactions was not unnatural; it was virtually ordained from the moment of the selection of receivers and their counsel, by the method of their selection.