CHAPTER XXI

THE FEES

THAT part of the stockholders' assessment required for the payment of receivership and reorganization fees and expenses was estimated by Mr. Hanauer at from five to six and one-half million dollars. This did not include several hundred thousand dollars already paid in receivership fees at the time he made his estimate, in March 1926. The total amount actually paid has not been publicly disclosed; but there is evidence that it may have exceeded the maximum figure he mentioned.

Mr. Hanauer, to be sure, told the Senate committee that "it is our unpleasant duty at the end of the time to get these charges . . . as cheaply as possible." He told the Interstate Commerce Commission that "these are just estimates . . . and we hoped we could get them reduced. We had problems—great problems, in trying to reduce those expenses." But the expense which the bankers cut down was chiefly the charge of the State of Wisconsin for incorporating the new St. Paul company. They secured legislation in that state which they said enabled them to reduce its charges to one-eighth the amount estimated by Mr. Hanauer when he submitted figures to the Senate committee.

The charges of New York and Chicago lawyers and banks, in so far as there is public evidence on the point, appear to have expanded rather than otherwise. Mr. Hanauer estimated that receivership fees would be between $1,000,000 and $1,250,000. But the fees paid, including those at the wind-up and the

intermediate payments, were almost double his minimum estimate and fifty per cent above his maximum. He estimated $70,000 to $140,000 to trust companies for certifying the reorganization securities. But the National City Bank, which was in effect one of the reorganization managers, and the Guaranty Trust Company, received $160,000 for this work. Mr. Hanauer estimated the fees of the preferred stockholders' committee and counsel at $125,000 to $200,000, but its chairman, Mr. Buckner of the New York Trust Company, and its attorneys set the minimum at $200,000.

Mr. Hanauer was asked to explain how he computed the fees.

Senator Couzens: . . . You put in a statement . . . of the expenses . . . $5,000,000 to $6,500,000. I would like to ask if you consider those reasonable charges for the service that has been performed?

Mr. Hanauer: I should consider it, Senator, the minimum—that is, it is very reasonable. I hope it will not get to the maximum. . . . It is really unfortunate that in any reorganization the expenses are so high, but no one has ever been able to discover any method of materially reducing them. It is so complicated, it runs through so many states. The receivership, with ancillary receivers in other places—

The Chairman: How much do Kuhn, Loeb & Company get out of it?

Mr. Hanauer: . . . We get twenty-five cents per bond, and twenty cents per share, which amounts, altogether, for the National City Company and ourselves, to $1,044,000. . . . We make no additional charge for overhead or for the use of our employees or those of the City Bank. It is not all profit by a long ways. There is no additional charge, as far as we are concerned, for the use of our facilities, or anything of that sort.

Senator Couzens: How do you arrive at this figure $1,044,000 for your services?

Mr. Hanauer: Of course, it is very difficult to say how one arrives at anything. What we did was to take what had been paid

in some other reorganization and then charge a rate lower than any other reorganization. . . .

It appeared from other testimony that the figures which had been used for comparative purposes had been Mr. Hanauer's figures. Mr. Ecker, the chairman of the bondholders' committee, was questioned on the matter, as follows:

Mr. Grady: What was said about allowing $1,040,000 * to Kuhn, Loeb & Company for this plan, if anything?

Mr. Ecker: The subject of compensation was discussed with respect to . . . about twenty reorganizations, the various phases of what would constitute a basis of fixing compensation was considered and discussed, the basis on which charges had been fixed in other reorganizations, and then this was fixed at an amount considerably less than any other important reorganization.

.....

Mr. Grady: . . . To what other reorganizations do you refer as furnishing the basis for paying this $1,040,000 for this plan?

Mr. Ecker: . . . Now there was a list of some dozen or fifteen reorganizations that Mr. Hanauer submitted at this conference. If you are asking me specifically where that came from, it is from Mr. Hanauer. . . .

Further questioning developed the fact that the comparison with fees in other cases had been on the basis of computing a particular rate for each share and bond involved, rather than on the total received by the bankers.

Mr. Prentice: In regard to this compensation of the reorganization managers, you testified, as I understand, that you adopted a lower basis of computation than in other receiverships, is that correct?

Mr. Ecker: On this basis of computation, it is lower than any

* This figure, slightly different from the one usually mentioned, appears at this point in the official stenographic record.

other case that I know of.

Mr. Prentice: What I want to clear up is whether the compensation in dollars is less, or whether the basis of computation is less?

Mr. Ecker: I said that the basis of computation was less than in any other case that I know of. But I do not consider any one yard-stick as an accurate method of determining what the compensation should be. . . .

Mr. Prentice: How does the absolute amount of compensation compare with other cases?

Mr. Ecker: The absolute amount, without relation to the size of the transaction?

Mr. Prentice: Yes.

Mr. Ecker: Well, I don't recall any reorganization that involves so important and large a property as this, so that I would expect that the total was greater. . . .

Mr. Mitchell, head of the National City Bank, testified that there had been four reorganizations in which the fees exceeded a million dollars. He acknowledged that he based his testimony on the list which the St. Paul bankers had prepared for their conference with the committee chairmen in fixing the St. Paul managers' fees. On this list it was stated that the managers of the Missouri, Kansas & Texas Railway Company reorganization had received $1,614,000. This figure was also stated to the Commission by Mr. Swaine, Mr. Hanauer's attorney.

But banker and lawyer neglected to mention the fact that the Interstate Commerce Commission had reduced the fees claimed by the reorganization managers in that case to well below a million dollars. The attorneys for the St. Paul reorganization managers, Cravath, Henderson & de Gersdorff, had been attorneys for the managers of the "Katy," railroad, as it was called, and had conducted the proceedings in which the Commission had ruled out the $1,614,000 fee as excessive.

Mr. Ecker was examined to ascertain whether the labors of the managers in the St. Paul reorganization were as heavy as

in the "Katy" reorganization.

Mr. Fisher: That is an extraordinary situation running over nine or ten years?

Mr. Ecker: It ran for a long period, and it involved adjustments among a great many interests.

Mr. Fisher: Some twenty-odd mortgages, weren't there?

Mr. Ecker: Yes. We did discuss the question of whether a very short receivership which might involve less work in term of years was not rendering any greater service to the company than a very lengthy one. . . .

Mr. Fisher: This situation of the St. Paul was really quite simple, wasn't it? There were not any complications about this situation at all, were there?

Mr. Ecker: There were not so many complications, but there were a great many difficulties. . . .

The general nature of the services performed by the St. Paul managers was stated by Mr. Hanauer, as follows: "If you were asking whether it includes any financial obligation, it does not, excepting the fact of the first few expenses that there might have been, but that is a minor matter. . . . It is entirely for personal services performed and to be performed in developing the plan, bringing about an agreement between committees, and then putting it into effect, and communicating with the security-holders all over the world."

Mr. Hanauer testified in other connections that "bankers are not the only ones that make handsome fees." He felt that "lawyers' expenses are usually heavy." The fees paid to lawyers in the St. Paul receivership and reorganization may be compared with the scale mentioned by Mr. Cravath, chief of the bankers' attorneys, when he was lecturing before the Bar Association of New York City in 1916. He said:

"When the Plan has been executed . . . and not until then, I am sorry to say, the time has come for the Committee to pay your fee. . . . I know not why, but . . . from time immemorial

it has been the custom for counsel not to receive or even ask for their fees until the reorganization has been consummated or abandoned. That is one reason why the fees paid to counsel in reorganizations are popularly supposed to be much higher than they really are.

"A fee of $100,000 to counsel upon the consummation of a successful reorganization may seem high to one who does not realize that it is compensation for two or even three or four years of perhaps the hardest work and the gravest responsibility which fall to a lawyer's lot and that there are few departments of professional activity where experience, familiarity with established practices, office organization and equipment and willingness to work under pressure without regard to personal convenience, count for so much."

The St. Paul reorganization and receivership took about three years, but the range of fees in that case was above the hundred-thousand-dollar fee which Mr. Cravath said might seem high to the uninitiated.

Mr. Cravath's firm was to receive, so Mr. Hanauer's estimate ran, from $350,000 to $450,000. The attorneys for the National City Company, acting as counsel for the bondholders' committee, were to receive from $200,000 to $300,000, also according to Mr. Hanauer's estimate. Mr. Shaw's firm, Winston, Strawn & Shaw, acting as special counsel to the receivers, was paid approximately a quarter of a million dollars. The New York lawyers who acted as one of the firms of attorneys for the Guaranty Trust Company of New York, one of the trust companies in the case, received a quarter of a million dollars. Among the minor lawyers' fees were seven or more ranging from $40,000 to $75,000 or more apiece, and some twenty-odd other law firms received payment of more modest amounts.

Mr. Hanauer's testimony also touched upon the scale of payment to receivers. He said: "Of course, receivers are paid as well as anyone else, and usually very highly." The receivers obtained a drawing account aggregating, for the three receivership years, over $200,000 for Mr. Byram and about $140,000 for each

of the other two receivers. In addition, each of the three was paid $100,000 at the conclusion of the period. They thus cost the property about three-quarters of a million dollars.

The rate of compensation for Mr. Byram was illustrative of the principle which prevailed in fixing the compensation of various St. Paul executives during the receivership period. Three theories were available for the purpose. Those who favored an increase in salaries during the reorganization period could point to the fact that executives were facing problems outside the ordinary routine of their work, and that lawyers and bankers were being paid on a more generous basis. A second theory would oppose any increase, on the ground that the security-holders' disaster should not be the occasion for profit by men who had earned their living out of the property and would be likely to earn a future living out of it after reorganization. A third theory would involve temporary salary decreases, on the ground that this is appropriate in times of trouble. This last is the theory followed during the present depression, when salaries of high St. Paul officials have been reduced ten to forty-five per cent.

The theory followed in the St. Paul reorganization was the first mentioned. Various high officials were paid the same salary they had before receivership and were to get after reorganization. In addition, they received a bonus ranging from $20,000 to $100,000 each.

The fees paid to the St. Paul receivers raised a question similar to one discussed in the "Katy" reorganization, the one to which Mr. Mitchell and Mr. Swaine had referred. In that case, Commissioner Eastman said: "The reorganization managers were two large banking houses in New York City. It is not clearly shown why one large banking house could not have carried on the work satisfactorily."

There was, apparently, duplication in the number of St. Paul reorganization managers. The evidence indicates that the brunt of the work was borne by Kuhn, Loeb & Company, and that the National City Company trailed along. The reorganization

period was like the period a decade earlier, when the two banking houses shared equally the $1,800,000 of profits in the 1916 refinancing, although Kuhn, Loeb & Company did most of the work.

The use of two banking houses for the one task, as well as of the counsel of each, was the subject of questions put to Mr. Hanauer.

Mr. Prentice: Now, what personal service did the National City Company propose to render at $522,000, and their counsel at $250,000, that could not have been adequately performed by Kuhn, Loeb & Company at $522,000 and their counsel at $400,000.

Mr. Hanauer: The statement is incorrect in reference to the City Bank's counsel. The City Bank's counsel in this matter was the same counsel as Kuhn, Loeb & Company had. Because the same counsel that the City Bank sometimes employ happened to have been chosen by the bondholders' committee has nothing to do with this situation. The counsel, and the only counsel for the reorganization managers—Kuhn, Loeb & Company and the National City Company—was the firm of Cravath, Henderson & de Gersdorff.

Mr. Prentice: Well, if that is true, what is the reason that the compensation proposed for the counsel for the bondholders' committee, who happened to be counsel for the City Bank, should be—

Mr. Swaine (interposing): I just wonder, Mr. Commissioner, whether this has anything to do with the reasons why the St. Paul went into receivership? Of course all this could be submitted at some time or other to a court of competent jurisdiction.

Commissioner Cox: The question had been asked, and it can be answered if the witness knows.

Mr. Prentice (continuing):—should be from three to four times as much as the counsel for the other committees?

Mr. Hanauer: The list from which you are doubtless reading is one which I furnished to the Senate Committee on Interstate Commerce, and it is, of course, definitely stated that these are

just estimates . . . and we hoped we could get them reduced. . . .

.....

Mr. Prentice: . . . This set-up reminds me of the phrase in the Scriptures about the carcass and the eagles. . . .

The duplication of work and of fees was strikingly illustrated in the hierarchical arrangement of counsel for managers, committees, and trust companies. It was the managers and their lawyers who made the decisions, controlled the committees and told them what to do. Directly and through the bondholders' committee, the managers and their lawyers could also tell the trust companies and their lawyers what to do. The committees and trust companies, being reduced to a state of vassalage, were merely registering the decision of the managers. Nevertheless, committees, trust companies, and their lawyers were paid on a scale disproportionate to the services they rendered.

The managers and their lawyers received from $1,400,000 to $1,500,000. The committees and their lawyers, who had reduced themselves to an unnecessary cog, received from $600,000 to $900,000. The trust companies and their lawyers, who were necessary only for compliance with a fiction of the law, received another $900,000.

An effort was made to justify certain of the fees for work of a clerical or mechanical nature. New York trust companies and banks received hundreds of thousands of dollars for such services in the St. Paul case. The charges for certain of these services, it was said, were "in accordance with the standard scale of rates for like service in effect among trust companies and banks in New York City performing corporate trust and corporate agency functions." This "standard" scale was simply one agreed upon among themselves. Such a method of justifying charges was comparable to justification of railroad rates on the ground that roads having a virtual monopoly had agreed upon particular rates. Unlike the latter, however, bank and trust-company

charges have not yet been made the subject of investigation.

The charges for certain other services of the banks, those which they rendered as so-called depositaries and sub-depositaries, were justified on the ground that they "represent actual out-of-pocket cost to the depositaries" (the banks). It is unlikely that the cost of clerical help and other out-of-pocket expenses of the banks in this branch of their St. Paul activities aggregated the $450,000 to $610,000 estimated by Mr. Hanauer as their charges for depositary work. Any theory that there was no profit in these dollars would have to dispose also of the incongruity of eager solicitation of this very work by such experienced New York financiers as Mr. Davison of the Central Union Trust Company and Mr. Buckner of the New York Trust Company.

The St. Paul reorganization managers were in no position to negotiate effectively with the banks and trust companies. The National City Company, which was in effect one of the managers, was itself engaged in the business of acting as mortgage trustee and depositary, was a party to the "standard scale" of charges, and awarded to itself work of this nature, and large fees for such work, in the St. Paul reorganization.

The spirit which permeated the process of determining the St. Paul fees was accentuated by the presence of numerous holders of sinecures. An illustration is afforded by the so-called post of special master to sell the property. This job meant nothing except the satisfying of a technical form. Technical papers, drawn by the managers' lawyers and published through an advertising agency, had at their foot the name of the special master. He also signed a report on which the managers' lawyers had worked. It was his business to travel from Chicago to Butte, Montana, to conduct the "sale" of the entire St. Paul system at the railroad depot there. His function was to read certain legal papers aloud, declare the ceremony ended, and take the train back to Chicago. At the time of this trip, and for almost the entire period of the receivership, he acted as a subordinate judge to determine contested claims against the railroad company, receiving almost two thousand dollars a month for this work. His

job as special master to sell the property was performed on the time of his job as subordinate judge. For this interpolated, mechanical and fictional work he received an additional fee of ten thousand dollars.

This was only one, and among the smallest, of many fees paid for work which was largely the product of scissors and paste and served no real purpose. The amounts paid for the spinning of the airy nothings required or permitted in the satisfaction of procedural fictions totaled, in the receivership proceeding alone and exclusive of what was expended for mere duplication of work, about one million dollars.

The fees paid to the trustees for the bondholders illustrated what was going on when the fees were being distributed. One instance was furnished by the Guaranty Trust Company of New York, the largest institution of its kind in the country. As is usual in such matters, the trust company could not act alone, for technical reasons. It is customary to supply a co-trustee in the person of some officer of the trust company. He is like the New York Trust Company vice-president who was put on the St. Paul directorate just before its receivership—a mere convenience.

The Guaranty Trust Company placed in this formal post Mr. Callaway, its vice-president in charge of the department which handled all such work. When the Guaranty Trust Company exercised any judgment as St. Paul "trustee," the brain it used for the purpose was Mr. Callaway's. If it took action as "trustee," it did so through him. If he took action as co-trustee, he was also acting as vice-president of the Guaranty Trust Company. For the purpose of the St. Paul case he was the trust company, and the trust company was himself.

The question arose as to whether the trust companies acting as St. Paul "trustees" should get one fee, and the officers through whom they acted should get additional fees. This was answered curtly by Mr. Sheldon, an officer of one of the other trust companies who was acting as its co-trustee. He refused to accept a fee personally while his trust company was earning one also. The fact was, of course, that the slightest motion, action, or

thought by such officers in their capacities as co-trustees was on the time of their trust companies.

Mr. Callaway, of the Guaranty Trust Company, was a full-time official of his company. But he and his trust company each received fees, $25,000 for him and $125,000 for his company. The evidence does not show whether his fee was a perquisite of high office in a large financial institution or was turned over to his trust company and became an indirect additional compensation to it.

This method of drawing fees left another unexplained inconsistency on the record. Assuming that Mr. Callaway and his trust company were to be paid separately, no reason appears for paying him in one capacity $125,000, and in another capacity in which he performed the selfsame acts $100,000 less. The trust company supplied such clerical service as may have been required. It seems improbable that the cost of such clerical service, for the performance of a nominal duty in the conduct of an obsolete legal ceremony, could have cost the $100,000 difference between the amount paid to Mr. Callaway and the amount paid to his institution. Either Mr. Callaway did not get enough, or his trust company got too much.

Under modernized legal procedure, recently proposed in Congress, the functions performed in the St. Paul reorganization by the Guaranty Trust Company, through Mr. Callaway, would be brought to an end. The same is true of the activities in the St. Paul receivership of a number of New York trust companies which were there as mere satellites of the Guaranty Trust Company. These satellites could not even perform the technical function of getting the property "sold" to the St. Paul security-holders. But they became "parties" to the receivership and as a result the number of trust companies and attorneys to be paid was increased.

An example was furnished by the United States Mortgage & Trust Company. Its co-trustee was not one of its own officers, but a prominent New York lawyer, William Nelson Cromwell. This trust company and Mr. Cromwell retained a firm of Chicago lawyers to act for them in the receivership. They also retained New York lawyers to direct the Chicago lawyers. But in New York, nine hundred miles from the main receivership proceeding, they employed two firms of lawyers. The trust company selected for itself its regular New York attorneys. Mr. Cromwell selected for himself the law firm of which he was the head, Sullivan & Cromwell. In consequence, the St. Paul security-holders' assets were used to pay a fee to the trust company, a fee to its lawyers, a fee to Mr. Cromwell, a fee to Sullivan & Cromwell, and a fee to the Chicago attorneys they selected—all for the performance of acts which amounted to nothing real.

Throughout the record on the St. Paul fees, unreality played a large part. The men who had the important work received compensation not higher, in true proportion, than the compensation of the men and institutions performing the clerical and the directed work. If the fees of the latter were not excessive, the former were grossly underpaid; if the former were not underpaid, the latter were grossly overpaid.

This blurred the criteria applicable to receivership and reorganization fees. There is no evidence, for example, that those who made indirect profits while required to devote themselves single-mindedly as guardians for security-holders suffered by reason of that fact any reduction of the fees paid them directly. The chairmen of the two stockholders' committees organized by the bankers, one of the receivers, members of the committees, and others in official relation to the receivership property or to the security-holders bought St. Paul securities on the side while functioning in an official capacity. Each of the reorganization managers bought and sold junior bonds, though represented on the bondholders' committee which offered to be the guardian for the owners of such bonds. One of the managers, the National City Company, dealt in millions of dollars' worth of bonds. The scale of profits available to men who had an inside position and inside knowledge is to be noted in one receiver's purchase in 1925 of preferred stock at ten dollars a share, which was selling at thirty-seven dollars before the reorganization was

completed. The men who made side profits by using information coming to them in their official capacity were given fees just as if they had served no one but the security-holders, and least of all their own individual interests.

Nor is there any evidence that fees bore any adequate relation to the true performance or non-performance of duties, to the skill and ingenuity, or lack of skill and ingenuity, in serving the interests of the security-holders. For example, the prosecution of suits by the receivers and their lawyers against directors for neglect of duties, against bankers and others for undue profits secured in questionable circumstances, and against persons whose duty to the St. Paul company was subordinated to self-interest might have been worth all the fees paid and more. The security-holders' good was to be measured by the net results achieved for them, rather than by the size of fees. Recovery of sizable judgments for past wrongs to the company would have helped the St. Paul security-holders, no matter how substantial the fees for such a service.

If sound criteria had been applied in fixing the St. Paul fees, trust companies, plaintiff-creditor, their lawyers, and others participating to satisfy a fiction would not have been paid as if their posts were of intrinsic importance. The case would have been free from any imputation that places were filled and compensation fixed as a matter of patronage. It was Mr. Swaine who said, in a lecture to the New York City Bar Association, that the independent receiver selected by a judge—"this outside receiver," as Mr. Swaine called him—"is appointed sometimes as a matter of political patronage. . . ." The reorganization managers in the St. Paul case had many more appointments at their disposal than the St. Paul Judge, and the fees which give value to patronage were much more in their hands than in those of the Judge.

The distribution of fees in the St. Paul case leaves one impression: that in the triumphant days of a completed reorganization select circles shared in largesse drawn from the purse of the security-holders and dispensed by those whose money it was not.