CHAPTER XXII

CONTROL OF THE REORGANIZED COMPANY

CONTROL of the St. Paul railway system was one of the major prizes in the American business world when William Rockefeller was in the saddle at the beginning of the century. It was an even greater prize when Kuhn, Loeb & Company and the National City Company reorganized the system a quarter of a century later. That control would determine who should have the profitable posts as its bankers, its lawyers, and its suppliers of equipment and materials. The control of a property valued at two-thirds of a billion dollars or more carries with it innumerable benefits as well as vast power and influence, direct or indirect, in other large corporations. The favors at the disposal of so important a railway system affect financial, industrial, and public utility concerns from coast to coast.

The reorganization plan published by the bankers did not say who was to control the reorganized St. Paul company. Certain people, however, thought they knew, and said what they thought.

United States Senator Gooding of Idaho said in the committee hearing on March 19, 1926: "The facts are that if Kuhn, Loeb & Company go on with the reorganization of this railroad they will control it. That is the danger in the situation."

Independent security-holders asked for disclosure by the bankers. Mr. Ecker, whom Kuhn, Loeb & Company had made

chairman of the bondholders' committee, was interrogated in the course of the Interstate Commerce Commission's investigation.

Mr. Grady: Now, you went over the various provisions in this plan of reorganization with Mr. Hanauer, personally, do I understand, Mr. Ecker?

Mr. Ecker: I did that with him.

Mr. Grady: And in connection with it I suppose you noticed the provision as to the voting trust. . . .

.....

Mr. Ecker: I was representing the bondholders. My interest in this property was in the bonds. Under this plan, the bonds were to have control of that . . . voting trust. I felt that it was of the utmost importance to the bondholders that for a period of five years they should control this property. Thereafter they would not control it. . . .

Mr. Fisher: After five years?

Mr. Ecker: Yes.

Mr. Grady: It would pass from your control. . . .

.....

Mr. Ecker: If I thought about it at all, and I did not, because I will tell you I was considering this property and its future over a period of five years. If I thought about it beyond that, I would have thought that a majority of the stockholders would control the property in any event.

The bankers' attorneys emphasized the fact that control was to be in the owners of the property. They said to the United States Circuit Court of Appeals, in one of the St. Paul proceedings: "The public has an interest in having insolvent properties promptly taken out of the hands of receivers and restored to their owners for operation and development. Agreements in aid of reorganization, when not abused, are in the public interest."

This statement was an application to a particular case of the general thought expressed by Mr. Swaine in a lecture to the New York City Bar Association, some four years before the St. Paul receivership: "There is a real public interest in expediting reorganizations of insolvent corporations and reducing to a minimum the period during which businesses are carried on by the Courts for their owners rather than by their owners for themselves."

Mr. Swaine's statement was one of theory and not of practical reality. It has already been noted that the St. Paul business during receivership was carried on, not by the courts, but by the bankers' nominees. It will now be seen that after reorganization the business was carried on, not by the owners, but by nominees of the bankers.

Certain offices were or could be made the important offices in the management and control of the St. Paul property. The attorney for independent bondholders asked Mr. Hanauer what he was planning on this subject. The testimony was given May 6, 1926, twenty months before the reorganization was completed.

Mr. Prentice: Now, you have advised in the selection of the reorganization committees; in the selection of receivers; in the selection of the voting trustees; have you also advised in the matter of the officers of the proposed new company, or any of them?

Mr. Hanauer: No, sir, not only have not advised, but have never discussed it.

Mr. Prentice: With anybody?

Mr. Hanauer: With nobody. That is a matter which will be entirely in the hands of the first board of directors of the company to be elected by the voting trustees which, in the modified plan, have been nominated, and which are the Honorable Elihu Root, Mr. Frederick H. Ecker, Henry S. Pritchard of the Carnegie Foundation, Mr. Rea, formerly president of the Pennsylvania Railroad, and Mr. W. D. Van Dyke, president of the Northwestern Mutual Life Insurance Company.

Mr. Prentice: Have you heard of the president—that the

president of the new company has been tentatively selected?

Mr. Hanauer: I have not only not heard of that, but I am willing to say that it has not been discussed. I have never even heard that such a thing has been discussed.

The method of electing the president, outlined in Mr. Hanauer's testimony, required the following: the five voting trustees he named would organize; they would select a board of directors; that board would organize; it would canvass the field of available men for the presidency. (When Mr. Byram was chosen, in 1917, it was, as Mr. Percy Rockefeller said, after two years' deliberation and search.) The board would finally select a man. Thereupon the board would offer the post to its choice and would induce him to accept if he were reluctant. Thereafter he would sever his connection with other activities, which might take some time.

Before such a person would consent to give up what he was then doing, he would want to know that the new company was sure to be reorganized, so that he would not be giving up a job in the hand for a presidency which was only an expectation. He would not know this until Mr. Hanauer's reorganization plan was approved by the Interstate Commerce Commission. After such approval the property would be transferred to the reorganized company by an order of the court.

The president of the reorganized St. Paul company was, however, chosen before the voting trustees were organized, before the directors were announced, and before the Commission approved the plan. The time schedule follows:

December 30, 1927.	The press announces that Henry A. Scandrett has been chosen president of the new St. Paul company.
December 31, 1927.	The document creating the board of voting trustees which was to elect the board of directors is signed.

January 4, 1928.	The Interstate Commerce Commission, by majority vote, approves the securities to be issued under the reorganization plan.
January 11, 1928.	The United States Court orders transfer of the property to the new company.
January 13, 1928.	The property is transferred to the new company.
January 13, 1928.	The board of directors to control the company is elected.
January 13, 1928.	Mr. Scandrett leaves Omaha to assume the presidency of the new St. Paul company.
January 14, 1928.	Mr. Scandrett takes his seat as president in the executive offices at Chicago.

The new president resigned a vice-presidency of the Union Pacific railway system to become president of the new St. Paul company. He had been connected with the Union Pacific during his entire career. The bankers for the Union Pacific were Kuhn, Loeb & Company, from the time they reorganized that railway in the eighteen-nineties and during all the twenty-seven years of Mr. Scandrett's business connection with that road.

The Harkness interest, which had the only substantial investment on the old St. Paul board and was represented on all three protective committees, had been hopeful that Mr. Byram would be continued as president. This was indicated when Mr. Fisher, the Harkness lawyer, was on the witness-stand.

Mr. Prentice: Have you had any part in any of the conferences that I understand have taken place in regard to the selection of a successor to Mr. Byram?

Mr. Fisher: I have never had any conversation on the subject

whatever.

Mr. Prentice: With anybody?

Mr. Fisher: With anybody. And I wish to add that I sincerely hope there won't be.

Mr. Byram remained with the company, as chairman of the board, at one-third his former salary. There was other evidence that his position did not continue to be one of large importance in the company's affairs.

Next to the presidency the post of New York counsel for the company could be made the most important for purposes of influence and control. It was in New York that the board of directors and the executive committee held their meetings. It was in New York that most of the directors, including the important ones, had their offices. The company had its financial office and officers in New York. Its financing was done there. The New York counsel chosen for the reorganized company were not the firm of Cravath, Henderson & de Gersdorff, attorneys for Kuhn, Loeb & Company. They were three individual lawyers, headed by Mr. Swaine, all of this law firm.

Another important post was that of bankers to the reorganized company. The selections for this place became officially known within a few months after the reorganization. In May 1928 the reorganized company submitted to the Interstate Commerce Commission an application, as required by law, for permission to sell a bond issue. The banking houses named in that official application were Kuhn, Loeb & Company and the National City Company.

The officers of the reorganized St. Paul company were subject to the authority of the executive committee of the new board of directors. The committee had seven members, as follows:

The Kuhn, Loeb lawyer, Mr. Swaine.

The consulting engineer, Mr. Colpitts, brought into the St. Paul by Kuhn, Loeb & Company.

The company president, Mr. Scandrett, brought into the St. Paul from a Kuhn, Loeb road.

The insurance official, Mr. Ecker, whom Kuhn, Loeb made chairman of the bondholders' committee.

The Harkness attorney, Mr. Fisher, whose request to become a member of the bondholders' committee was made to Kuhn, Loeb and acceded to by them.

Mr. Byram, whose various relations and attitude toward Kuhn, Loeb have already been discussed.

Mr. G. E. Roosevelt, the independent who fought the company's bankers to a compromise and secured places on the board of voting trustees for his nominees.

The executive committee was subject to the board of directors. This board had fourteen members, of whom seven were the executive committee members above listed. The other seven included two western directors, one resident at Milwaukee and the other at Seattle, and not likely to be active on the board. Of the remaining five members, four were the following:

Mr. Potter, the man to whom Mr. Hanauer offered the post of receiver in advance of the receivership and in advance of consultation with the judge or with any director of the old company.

Mr. Buckner, the New York Trust Company head, and a great admirer of Mr. Hanauer as a reorganizer and of his St. Paul reorganization.

Mr. Geddes, whom Mr. Hanauer urged to act as chairman of the common-stock protective committee. Mr. Geddes' firm had participated in the various syndicates organized by the St. Paul bankers for St. Paul bond flotations.

Mr. Sparrow, the St. Paul vice-president who went to London on Mr. Hanauer's request for the list of foreign bondholders' names, and to the Chicago Athletic Club to get a friendly creditor to carry out the receivership plans of Mr. Hanauer's lawyer.

No man from the Kuhn, Loeb firm or the National City Bank was put on the St. Paul board. The federal law against interlocking directorates stood in the way. Mr. Hanauer said to the United States Senate committee, twenty-one months before the election of the new St. Paul board was announced: "And there

I wish to say that if you are bankers for a property, you cannot be on the board of directors. That is the worst thing in the world for best results, because the banker then does not know anything that is going on until it is too late. He should have a representative on the board and have the responsibility, having everything public, of course, but by being there know what is going on. But with the present requirement that cannot be done."

It may be of interest to trace what was done. The important step in arranging the future control of the reorganized company was the selection of the first board of directors to control the St. Paul railway system. It was likely to continue in office. Some of the circumstances which made the board of the old company "self-perpetuating" continued after the reorganization. The electorate of St. Paul security-owners was too numerous, widely scattered, and unorganized to insist upon exercising power, except on extraordinary occasions.

Mr. Hanauer's plan made provision for the selection of the first board of directors. But that provision did not look to election by the security-holders or by any class of them, whether bondholders or stockholders. Nor was it provided that the choice of directors, when made, should be submitted to the security-holders for acceptance, rejection, or modification.

The power to make the choice was assumed, in the Hanauer plan, by the reorganization managers. They were to select five voting trustees, who in turn would choose the directors. The managers' selection of the voting trustees was to be subject to the veto of the committees organized by the bankers.

The Roosevelt committee, representing independent security-holders, objected to this plan and refused to come to a settlement with the bankers until they changed it. They yielded, but only in form. They jettisoned some of their power with reference to the voting trustees, but reserved to themselves the power to name the first board of directors, and provided that the voting trust arrangement should come to an end after a brief period.

Independent bondholders told the Interstate Commerce Commission that the bankers had retained their grip on the reorganized company. The bankers' attorneys said in answer:

"Of course, the Reorganization Managers have no control over or power to interfere with either the Voting Trustees or the directors elected by them, and the intimations to the contrary . . . are an insult to the distinguished gentlemen who are to be the Voting Trustees and to the intelligence of the Commission."

However, the board of directors named by the bankers at the outset remained virtually unchanged in the ensuing years. The four annual reports of the St. Paul company show that the board has had only two changes in its membership as constituted by the bankers for the first year.

A narrative of events leading up to the control of the reorganized company calls also for a statement of the part played by the bankers' lawyers and the use of the new company before there was a reorganized property. Cravath, Henderson & de Gersdorff incorporated the new company on March 31, 1927. This was nine months before the reorganization was completed and the new company took over the control of the railway. In the intervening period all steps taken by the new company were in the hands of the bankers' attorneys. The officers of the new company were for that period lawyers in the law office of Cravath, Henderson & de Gersdorff. That firm was more than the legal representative of the new company in all its activities prior to completion of the reorganization. Until that time, the company was simply a marionette in their hands.

During this period the lawyers, in the new company's name, applied to the Interstate Commerce Commission for approval of the reorganization securities; they decided what should go into the by-laws of the new company; they acted for it in making various agreements in the nine-month period before the property was delivered to it; they drafted the proposed voting trust; they conducted its meetings during that period and wrote up the minutes of those meetings.

The inference which might be drawn from these facts by a person inexperienced in reorganizations would not accord wholly

with a statement prepared by the bankers' lawyers for submission to the Interstate Commerce Commission. The statement was made in May 1927, after various acts above enumerated had been performed by the lawyers and while they were in the process of continuing such activities. The Commission put some questions to the new company. One of the questions, and the answer to it prepared by the lawyers, follow.

Question: Whether or not any corporation, individual, or trustee holds control over the applicant [the new company] at the date of filing this return. . . .

Answer: No corporation, individual or trustee holds control over the applicant at the date of filing this return.

The answer went on to say that the new company had agreed to comply with the reorganization plan.

Subsequent to the date of this answer the lawyers continued to hold the new corporation in their office; they represented it before the Commission in the ensuing proceedings; they caused it to ask the court to transfer the property to their client, the new company.

It was, therefore, merely a continuance of an established fact when the attorneys for the bankers continued as attorneys for the reorganized St. Paul railway after the transfer of the property out of the court's control.

The relation of the bankers to the St. Paul system was thus, in various respects, a further development of that growth to which Mr. Hanauer testified in the Commission proceedings in 1926, when he said: "We never were as close to the St. Paul people as I believe the relationship between bankers and railroads should be. . . . We have been getting much closer to the St. Paul since their troubles in the last few years, than ever before."