CHAPTER XXVII

MODES OF SOLICITATION

With the Plan and Agreement printed and the tools for solicitation ready, the bankers published their first formal request for securities in the newspapers of June 3, 1925. The advertisement told nothing of what was in either the Plan or the Agreement. The published notice stated that copies could be obtained from the bankers or the depositaries. It did not tell security-holders that the bankers wanted them to give up the legal ownership of their bonds and shares. On the contrary, investors were asked merely to "deposit" their bonds. The effect of that act could be ascertained by reading the Agreement.

The advertisement notified St. Paul security-holders that they could get into the reorganization by depositing "on or before July 15, 1925." This gave security-holders just six weeks to get the Plan and Agreement, digest them, and decide whether they wanted to agree to everything in them and to give the ownership of their stocks and bonds to the bankers.

Three weeks later the committees sent letters to the security-holders whose names and addresses they had, urging them to "deposit . . . at once, and in any event before July 15, 1925."

Some question was subsequently raised about the propriety of fixing time limits at that stage of the affair, in that manner, and for the broad purposes required by the Agreement. (It will be remembered that the Plan had not yet been submitted to court or Commission, and it was not known whether the supervising au-

thorities would find it bad or good.) The attorneys for the bankers felt that such criticism was unjustified. They told the United States Circuit Court of Appeals in Chicago that provision for fixing time limits was part of the Agreement, and that it was "a conventional provision in agreements of this character. . . . Without a provision such as that . . . many a reorganization would break down in the middle. . . ."

They persuaded the court of the correctness of their view, and the court said that the fixing of time limits "is not only customary but necessary." An apparently different opinion emanated from an unexpected source: namely, Mr. Ecker, chairman of the bankers' committee for bondholders. He was speaking as a practical man experienced in reorganizations; indeed, Mr. Swaine called him "probably the most experienced man in railroad finance in the United States." Mr. Ecker compared the fixing of time limits by the St. Paul bankers with notices threatening the imposition of penalties upon security-holders who do not "deposit" until after the date specified by reorganizers.

Mr. Ecker: . . . Failing to deposit within a certain time, all opportunity of getting the benefit of this plan might be lost. Isn't that about the same in substance as saying that thereafter if received at all, it would be under conditions fixed by the reorganization managers? I would say the first might be more drastic than the second. The second intimates that under some conditions deposits may be made. . . .

It seems to me that that is not as harsh as saying that deposits . . . will not be received at all. There is at least an intimation that on some terms they may thereafter be received. . . .

Mr. Fisher: You mean, if you put in the advertisement the date of the last date, and you assume that it would be literally carried out, that the results might be more drastic than this?

Mr. Ecker: Yes, sir.

However, the reorganization bankers apparently did not intend to enforce the time limit they had fixed. When that limit

expired, they went to the security-holders and again urged them to send in their bonds and stock. Whether by way of explanation for this leniency or for some other reason, the bankers now told the investors about a reorganization practice which was not disclosed to them in the advertisements and circular letters of the preceding month. They said that "the period first fixed for deposits under any reorganization plan is invariably extended." They were now extending "the time for the deposit of securities . . . to and including September 15, 1925."

Evidently there was never any intention to enforce this later representation or any other representation to the security-holders that there was a date limit. Mr. Sunderland, the attorney of the Guaranty Trust Company of New York, told the court that ". . . it has been customary for plans of that kind to extend the time. . . . As a matter of fact they practically never close the doors."

A few days after the first extension of the date limit, in July, the bankers began to introduce the idea that penalties might be visited upon security-holders who waited beyond the advertised date. In a series of applications filed with the New York Stock Exchange, the bankers said that "the time within which . . . bonds . . . may be deposited . . . without penalty has been extended to and including September 15, 1925." Similar statements were made in official applications affecting the stock. In accordance with rules well known to the bankers, printed copies were sent by the Stock Exchange to all brokerage firms connected with it.

From that time onward the suggestion that penalties might be imposed on the security-holders if they did not promptly give their securities to the managers began to appear in news items and later in advertisements. The Chicago *Daily News* discussed the matter five days before September 15, the time limit announced in July, and said that "the question of a penalty for delayed deposits probably will be taken up" at that time. On September 16 the newspapers were given to understand that "the depositaries have been instructed to accept deposits for the pres-

ent without penalty." But the threat of penalties continued to hang over the security-holders. The New York *Times* was told by "bankers who have had experience with receiverships" that ". . . it was doubtful if a penalty would be attached to deposits offered during the next two or three weeks, but that the end of the period when deposits would be accepted without an additional fee was in sight."

Within a little more than three weeks the St. Paul bankers gave point to such interviews with unofficial spokesmen or commentators. On October 9, 1925 the bankers published advertisements throughout the country, containing the following warning:

"Bonds and stock . . . which have not yet been deposited may be deposited . . . without penalty on or before November 20, 1925. After that date deposits will be received only upon payment at the time of deposit of penalties in such amounts as may be imposed by the Reorganization Managers, who reserve power in their discretion at any time and from time to time to increase penalties."

From that time forward, the advertisements of prospective penalties, in unspecified amounts and subject to unspecified increases, were in full swing. The advertisement just quoted was repeated in New York newspapers week after week during October. Reasons were later assigned for extending the time to "deposit," but the threats of penalties continued.

This method of soliciting control of St. Paul securities aroused a storm of criticism. The attorney for the Iselin committee, representing stockholders opposed to the bankers' plans, said to the court:

". . . It is not always to the interest of the property to jam a thing through. . . .

"This method of ramming a thing down the throats of the security-holders in the way it is done here and in anticipation of the sale is unknown. . . .

"And what is the proposition that is at the present time put before the stockholders? We recognize, they practically say, that you have an equity in this property; you can come into this plan or you can leave it, but if you leave it, your equity will be swept away, you are to have no voice in reference to this matter, you are not even going to have a free choice . . . you are not going to have the opportunity of waiting until the Interstate Commerce Commission has completed its investigation and uncovers the troubles of this railroad, you are not even going to have the opportunity of choosing between this plan and some other plans that may be proposed; you have to come into this arrangement by the 20th of November, before any decree is entered by this court or can be entered by this court, or you will be penalized if you do not come into it.

"Now, I do not know of any railroad organization in which this method of intimidation has been used and I do not believe that any such method of intimidation will ever be sanctioned by the court."

Roosevelt & Son, leading an independent bondholders' group, characterized the bankers' actions as "desperate measures being used to force through the plan with unprecedented haste over the opposition of unwilling bondholders."

When the matter was aired in the Interstate Commerce Commission proceedings, the bankers said that they did not intend to impose any penalties at all.

Mr. Anderson: . . . What penalty did you refer to there to be imposed, and by whom?

Mr. Hanauer: No particular penalties, but the possibilities of penalties, as provided in the plan and agreement.

Mr. Anderson: The deposit agreement not only gave to you as reorganization managers the power to modify or abandon the plan, but also gave you the power to impose penalties on those who did not accept it within the time prescribed by you, isn't that true?

Mr. Hanauer: That is correct.

Mr. Anderson: Did you issue a single notice after the first notice calling for deposits which did not contain reference to those

penalties that might be imposed if they did not come in?

Mr. Hanauer: I am not prepared to say that we did not, but it is very likely that they all had the usual language. No penalty of course has ever been imposed, and the first advertisement of course was directed particularly at the advice of the Roosevelts to wait and do nothing. . . .

Mr. Anderson: I asked you a specific question, if you did not put into every one of these notices that you sent out, a reference to a penalty if the people did not come in and deposit these bonds with you?

Mr. Hanauer: The notices speak for themselves.

Mr. Anderson: You know their contents, don't you?

Mr. Hanauer: I have not recently been over them. There may be one or two that did not.

Mr. Anderson: As far as you recall them now, they all contain reference to a penalty?

Mr. Hanauer: It may be.

Mr. Anderson: Did you ever fix any penalty that you were ever going to impose?

Mr. Hanauer: No. There is not any.

Mr. Anderson: But you recognized the suggestion— I hardly use the word "threat," in every notice that you sent out, don't you?

Mr. Hanauer: It is the usual notice—

Mr. Anderson: I did not ask you whether it was the usual notice. I asked you what you did.

Mr. Swaine: I object to this line of examination. The notices are all in the record themselves and will speak for themselves.

Director Mahaffie: There is no reason why the witness should not answer that question whether he had that in all the notices.

Mr. Anderson: You did renew them every time, did you not, that suggestion?

Mr. Hanauer: I believe so. Not always in the same language. . . .

Various lines of defense were set up by the bankers and their

lawyers when their use of such advertisements was attacked in court or before the Commission. They sought to discuss, not so much the advertisements which made outright threats of penalties, but other advertisements which did not put the matter quite so bluntly. The lawyers said to the United States Circuit Court of Appeals:

"The Reorganization Managers deny that an announcement that bonds may still be deposited without penalty involves, either as a matter of language or as a matter of fact, the slightest element of coercion. They have never heard of a case in any important reorganization in which the right to deposit bonds has been terminated without due notice and ample opportunity to deposit given before the right is finally terminated."

The same lawyers told the lower court that ". . . the efforts of the Jameson committee [a bondholders' committee opposed to the bankers] to twist the announcements of the Reorganization Managers that bonds may still be deposited without penalty into 'threats' and 'coercive measures' lend no substance to their charge."

It was claimed by various witnesses in the Interstate Commerce Commission investigation that the purpose of the penalty advertisements was not to bring pressure on the security-holders, and certainly not to compel them to accept the Kuhn, Loeb–National City plan.

Mr. Hanauer thought that the purpose was to stabilize the security-holders' minds against bad advice which the opposition was giving them.

Mr. Fisher: . . . There was a feature sometimes referred to as a penalty or punitive feature for failure to deposit. Was that particular feature of the reorganization plan discussed at any time prior to its promulgation?

Mr. Hanauer: I think you are referring to a statement made in one of the advertisements, not to something made in the plan. . . . The reason that was put in, we do not like to put those sort of things in, the reason that was put in was to offset the

advice which was then being given publicly by others, to the bondholders. . . . It was a measure of defense, the threat of a penalty which, of course, was never enforced and was withdrawn before the date expired, because by that time we had come to an agreement with the opposition. It was a threat put in in order to react [counteract] what we considered was very bad advice to the security-holders."

Mr. Mitchell, head of National City Bank, was examined, as follows:

Mr. Grady: You remember the advertisement in which the public was notified unless they deposited by a certain day they would be subjected to a penalty for their failure to deposit within that time? You remember that?

Mr. Mitchell: Yes.

. . . . .

Mr. Grady: Well, the purpose of that was really to frighten the public, to make them think that unless they did deposit it in a hurry, they were apt to lose something?

Mr. Mitchell: Not at all.

Mr. Grady: You knew of course that when that statement came out, or that advertisement, there would be thousands of those stockholders who would not know what in the world to do, who had no information as to whether they should deposit or should not deposit, and when you incorporated that penal provision it was sort of a threat to the public, wasn't it?

Mr. Mitchell: No.

Mr. Grady: That unless they joined, they would be frozen out?

Mr. Mitchell: No.

Mr. Grady: What other thought or effect could it have had?

Mr. Mitchell: It was to make them come to a conclusion.

Mr. Grady: And to make them come to the conclusion of depositing their bonds and stock as you desired. That was the

reason, wasn't it?

Mr. Mitchell: No. Urging them to deposit, if they approved of this plan which was definitely before them, and is nothing new in the situation. That was nothing new, and not an unheard of thing.

Mr. Grady: What was not?

Mr. Mitchell: That kind of a notice.

Mr. Grady: You mean that that has been the policy and the practice that has been followed through many years with your concern, is that what you mean?

Mr. Mitchell: There have been many practices.

Mr. Grady: Is that what you say?

Mr. Mitchell: There have been many practices, I say. Sometimes the practice is to absolutely close the door of opportunity to non-depositing security-holders. Sometimes, as in the case I think of the Denver & Rio Grande, there was a very heavy penalty put on, and if I mistake not, my recollection is that it was a progressive penalty.

Mr. Grady: And do you think that the experience and the precedent in the Denver & Rio Grande is one that ought to be followed in its whole history and outcome?

Mr. Mitchell: No.

Mr. Grady: It resulted in creating a feeling in this country that when a receivership of a railroad was resorted to, that the stockholders' rights were immediately in jeopardy. That is the fact, isn't it?

Mr. Mitchell: I think the stockholders' rights are always in jeopardy.

Mr. Grady: I mean in jeopardy because of the method and the system that has been followed in these railway receiverships.

Mr. Mitchell: No, I deny that.

The attorneys for the bankers persuaded the United States Circuit Court of Appeals in Chicago that their view was sound. The court said: ". . . we fail to find in the record anything which suggests such coercion, or any wide or unconscionable departure

from the course usually followed in such cases. . . . Of the thousands of depositors . . . it does not appear that anyone has undertaken to withdraw."

The record before the court was a long one, and the judges apparently overlooked the evidence in it that attempts had been made to withdraw, that the attempts had been unsuccessful, and that the provisions of the reorganization agreement made it futile for an objector to demand the return of his bonds unless he was prepared to engage in a costly lawsuit with the managers.

Such considerations were overlooked also by a majority of the Interstate Commerce Commission, which said that no investor whose securities had been deposited "has complained in this proceeding as to the means used in obtaining the deposits."

As against this view was the opinion of Mr. G. E. Roosevelt, that the managers' advertisement of penalties "was bad public policy." This testimony was given months after settlement of his dispute with the St. Paul bankers. He was on the stand as their witness. Mr. Hanauer, also, as has been seen, said he did not like penalty advertisements. Mr. Ecker's opinion, though slow in its delivery, went further than Mr. Hanauer's.

Mr. Fisher: There was a provision in the advertisement, or certain of them, said to have been in the nature of a penalty. . . . Was that discussed?

Mr. Ecker: Yes, that was discussed.

Mr. Fisher: And by whom?

Mr. Ecker: I think in our general committee, at a meeting in Kuhn, Loeb's office, and they are the reorganization managers. You see, you come into promulgation of a plan, and then you have the responsibility passed on the reorganization managers. And in matters of that kind I should say that the reorganization managers' wishes would be followed. It was discussed. It was a question of whether it was not desirable to fix a time within which people should make their deposits, not to take advantage of any that did not, so much as to impress upon the holders of bonds the importance of determining, making a decision to de-

posit or not.

Mr. Fisher: Was anything further than that discussed, as to what should happen in the event that bondholders did not reach that decision promptly?

Mr. Ecker: Well, there was a feeling in the committee that the provisions would not be very rigorously enforced. There might be some extension.

Mr. Fisher: You mean that there might be a threat or notice served on these bondholders that they must come in quickly, but it would not be taken very seriously by the committee?

Mr. Ecker: It followed the usual practice. . . . My feeling is that it was not done in this case for the purpose of threatening anybody.

. . . . .

Mr. Fisher: . . . Do you recall any advertisement in connection with any situation of which you have any knowledge which contained language like that?

Mr. Ecker: I do not recall any, and personally I did not like that. . . .

. . . . .

Mr. Fisher: . . . There isn't any promise that the time for deposit will be extended.

Mr. Ecker: No. I had heard that discussed before. I do recall, when you speak of it, that I did not particularly like it, but I felt that it was a matter for the reorganization managers to determine, and not the committee.

Mr. Fisher: And do you recall at this time any reason given by the reorganization managers or anybody else for having that language in the advertisement?

Mr. Ecker: Only that they proposed it and preferred to have it there.

Mr. Fisher: They not only speak of penalties, but you note that the word "penalties" is in there twice in the same sentence. It reads rather threateningly.

Mr. Ecker: I thought so then.

Efforts were made to ascertain from Mr. Ecker the name of the author of the penalty method of soliciting securities. There were present at his examination Mr. Cary, of Shearman & Sterling, the National City Bank and the bondholders' committee lawyers, and Mr. Swaine, the Kuhn, Loeb attorney.

Mr. Grady: Who was the author of the penal provision to which you refer?
Mr. Ecker: Of this advertisement?
Mr. Grady: Yes.
Mr. Ecker: I was not.
Mr. Grady: We might, by a process of exclusion, locate the author.
Mr. Ecker: I am afraid I cannot tell you specifically who was the author.
Mr. Grady: Who seemed to be most interested in that provision of all those present?
Mr. Ecker: I would like to ask my counsel if he knows who wrote it. If there is no objection to my doing it?
Mr. Grady: No objection at all.
Mr. Ecker: Mr. Cary is here, and can probably tell me.
Mr. Cary: The notice was prepared by counsel for the reorganization managers, and submitted to counsel for the bondholders' committee, approved by them, and passed on to you, and your attitude was as you have stated, that it was a matter in which the wishes of the reorganization managers should be observed.
Mr. Grady: That is delightfully indefinite. If you will come down and tell us who was the first man you heard mention this penal provision, we might get somewhere on it.
Mr. Cary: I have not been sworn as a witness.
Mr. Grady: I will take your word without swearing.
Mr. Cary: Notice was presented to me by Mr. Swaine.
Mr. Grady: Mr. Swaine, can you tell us who was the author

of this penal provision?
Mr. Swaine: I was.
Mr. Grady: Now, then, to go a little further.
Mr. Swaine: I am not sworn.
Mr. Grady: You have had a great deal to say for a man who was not sworn.
Mr. Swaine: I am not a witness, and I am not testifying now. If you want to call me, call me, and I will be sworn—
Mr. Grady: I am trying to get some facts—
Mr. Swaine: Presumably I wrote it for my clients.
Mr. Grady: Well, the fact is, unless you care to claim privilege on it, you were asked to do it by representatives of Kuhn, Loeb & Company, were you not?
Mr. Swaine: And the National City Bank.

While the subject of threats and penalties was under investigation in the Commission hearings, the bankers abstained from any advertisements threatening, suggesting, or implying that penalties might be imposed. Not long after Mr. Ecker's testimony, there was a hearing in court, and Mr. Swaine then said:

"We have no hesitation in saying to the Court that those security-holders who, through inertia or lack of knowledge . . . , have not been reached, will be allowed indefinitely to come in. . . .

"As to those security-holders who know. . . about the plan. . . . We will . . . assure the Court that they shall have a reasonable opportunity . . . say ninety days after the Court shall have approved some plan of reorganization."

Mr. Swaine made these statements in the course of an argument urging the court to fix a date for the so-called sale of the railway, so that it might be "bought" for the reorganized company. The court made an order as requested. Within two days after the order was signed, the bankers had advertisements in newspapers all over the country, with the following sentences, one at the head, the other at the foot of the notice:

"The District Court of the United States . . . has fixed

November 22, 1926, as the date for the foreclosure sale of the property of Chicago, Milwaukee & St. Paul Railway Company.

. . . . .

"Holders of bonds and stock . . . which have not yet been deposited under the Plan may still participate in the reorganization, without penalty, by depositing their bonds or stock . . . , and are urged to do so prior to November 22, 1926, the date fixed for the foreclosure sale."

The delicate balancing of this advertisement, between the suggestion of penalties and the assurance given to the court negativing penalties, was forgotten when the National City Company sent a communication to bondholders a few days later. It said:

"If you have not yet deposited your bonds we urge you to do so at once, as the Reorganization Managers state that holders of bonds and stock which have not been deposited under the Plan may still participate in the reorganization, without penalty, by depositing their bonds or stock prior to November 22, 1926. . . ."

This course of dealing with security-holders, after the assurances which had been given to the court, and without disclosure to the former that such assurances had been given, was criticized by an independent committee. An effort was made, at hearings subsequent to the new advertisement and the National City circular, to ascertain whether the bankers intended to repudiate Mr. Swaine's statements to the court.

Mr. Miller: . . . Was that statement made with your authority?

Mr. Hanauer: No, it was made without consultation with us.

Mr. Miller: Do you approve or disapprove that?

Mr. Hanauer: I greatly regret it.

Mr. Miller: As the matter stands now, do you wish to repudiate it?

Mr. Hanauer: I would never repudiate anything that had

been agreed to by my counsel. . . .

Mr. Miller: What I want to find out is, do you repudiate or accept this statement which I have read to you, of your counsel?

Mr. Hanauer: I certainly accept the statement in the context in which it was made.

Efforts were made in October 1925 to induce Judge Wilkerson to put a stop to the bankers' use of threats. His powers were ample, but he did not exercise them. He did not even notify security-holders that they need not be frightened by the threats. When the independent stockholders' committee called his attention to the bankers' advertisements, he said: "What more is there? What more could the court do? Could the court reach out and stop these New York gentlemen from advertising this plan?"

Subsequently, in the course of the same argument, the attorney for the Iselin committee suggested that the Judge instruct the bankers in effect as follows: withdraw your threat to impose penalties on security-holders, or the reorganization plan which you are seeking to effectuate by such methods will be disapproved by the court.

Mr. Rosenthal: . . . the announcement was made and published in newspapers and it has been repeated constantly since, that after the 20th of November no one could come in under this reorganization except under a penalty.

Judge Wilkerson: Now what order can I make about that? Supposing I disapprove of that?

Mr. Rosenthal: Yes.

Judge Wilkerson: Assuming for the argument that the court disapproves that as strongly as you; assume that. What can I do about it?

Mr. Rosenthal: Yes. Why, the court can say, for example, the court can say and even enter an order that stockholders and bondholders, other parties interested in this property—they must be given a fair opportunity to choose between relative

reorganization plans.

Judge Wilkerson: How would I enforce that order?

Mr. Rosenthal: Well, your enforcement of that order would be if the reorganization committee in this case did not immediately announce that it would waive this requirement or withdraw this requirement that after the 20th of November it would enforce a penalty against any non-assenting bondholder or stockholder, that the court would refuse to confirm any sale under that reorganization plan.

Judge Wilkerson: Should I decide that in advance? There is nobody asking to have it confirmed.

Mr. Rosenthal: Yes.

Judge Wilkerson: Shall I anticipate something that may never come before the court?

Mr. Rosenthal: It may be.

Judge Wilkerson: And say unless something is done I will enter an order or will not enter an order? I never heard of such a thing being done in a lawsuit. It may have been done, but I never heard of it.

Suggestions of this nature for the practical protection of the security-holders did not appeal to the Judge. For some reason or other he thought that was not the way a judge should conduct himself. He said in the course of the argument: "How would the court say that? Shall I issue a proclamation on that? Does the court speak by proclamation or order?"

The bankers' attorneys felt that their clients had been highly successful as solicitors of St. Paul securities. At different stages in the process, the lawyers said, their clients' efforts brought about "an astonishingly large amount of deposits," and "a perfectly amazing result."

Those who were interested in the reasons for this success had each his own view of the matter. Mr. Ecker put it: "I am not unmindful of the tribute paid to the judgment and integrity of my Committee by the support of this overwhelming majority of the bonds. . . ."

Cravath, Henderson & de Gersdorff told the United States Circuit Court of Appeals that: ". . . every possible issue affecting the security-holders was fully developed in acrimonious public discussion—and the bondholders, as soon as the issues were clear, flocked to the support of the Reorganization Plan."

The lawyers told the Interstate Commerce Commission the same thing, and also said: ". . . Every dollar of these securities had been voluntarily deposited by the holders *after* the announcement of the Plan. . . ."

One of the members of that body, Commissioner Eastman, in an opinion supported by two of the other commissioners, made the following comments:

"The security holders were, therefore, in this predicament. They could either join in the reorganization plan, or they could stay out and contemplate the necessity of employing counsel and experts in an endeavor to persuade the courts or the commission that the plan ought not to be approved. If they chose the latter alternative and failed, they ran the risk that they could then become parties to the plan only upon the payment of unknown penalties fixed at the discretion of the reorganization managers, or that they would be doomed to accept a ruinous cash settlement. From observation in the past the security holders knew also that a fight against reorganization managers behind Wall Street intrenchments is an uphill struggle against heavy odds.

"Summing up the situation, once the reorganization managers and their personally selected committees had agreed upon a plan, resistance upon the part of security holders involved a probability of heavy expense and also grave risk of ultimate disaster."