CHAPTER XXIX

THE TRUST COMPANY AS SPOKESMAN FOR BONDHOLDERS

Reorganization bankers and lawyers have long known that activities in court during the foreclosure period are often simply maneuvers by one side or another for the purpose of strengthening their hand in the reorganization.

The bankers in the St. Paul case sought to use the court proceedings as an aid to their strategy during the twenty-one months before they let their plan be taken into court. During this period much that went on in court, including efforts to keep various matters out of court, was interrelated with reorganization problems. A number of the Judge's decisions during this time actually helped one of the contending groups and hurt the other. Issue after issue was of importance to both sides and seriously affected their position in court and out of court, in their relations with the security-holders and in their settlement negotiations with each other.

The bankers and their opponents both cared deeply what the Judge did or did not do, on such matters as the time for court scrutiny of the bankers' plan, the use of threats to influence security-holders, the use of the receivers in aid of the bankers' plan, the use of receivership property and power in support of either side, the investigation of such transactions as the Terre Haute and Gary railroad acquisitions, and the time for the technical foreclosure sale of the St. Paul railway.

Mention has been made of the settled policy of the bankers to prevent any opponent from becoming a "party" to the court proceeding. One exception to this policy is to be noted. To avoid the risk of attack on their reorganization as unfair after its completion, reorganizers often seek to obtain a court ruling in advance that their plan is fair and to make this decision binding upon all security-holders by giving them an opportunity to appear in court when the merits of the reorganization plan are considered. But before that hearing and on all other issues bearing either on the plan or on the reorganizers' campaign to get control of the securities, they usually oppose any efforts by independents to intervene in the court proceedings.

Independents tried to become "parties" to the court proceedings. Applications for this purpose were made to the court by the Iselin stockholders' committee, and by the Bondholders' Defense Committee (known also as the Jameson committee). But distinguished lawyers, in opposing them, urged the court to believe that disputes between the security-holders had nothing to do with the foreclosure proceedings. They also said that no benefit could accrue to the independents by becoming "parties" to the court proceedings in the period before the bankers' plan was tested in court.

The principal argument for excluding the independent bondholders from the court proceedings was based on the claim that all the holders of the principal issues of junior bonds were represented by the Guaranty Trust Company as so-called trustee. This representation, it was said, gave them adequate protection. It was also said that the mortgage agreement under which the bonds were issued forbade intervention by bondholders for their own protection; but this construction of the document was at best a doubtful one and was not vigorously pressed. Reliance was placed mainly on the point that the trust company was the representative and spokesman for the bondholders. Its lawyers said to the court: "A trustee under a railroad mortgage represents all the bondholders. A principal reason for such trusteeships is to afford bondholders—scattered individuals holding small

pieces of the mortgage debt—a representative and spokesman."

The independents objected that since the Guaranty Trust Company was under the bankers' control, it could not represent bondholders who were opposed to the bankers. The trust company did not deny that the bankers had the right to direct its activities and could even remove it from the case altogether. Its lawyers simply said that the bankers had not attempted to exercise any control: "Notwithstanding the repeated charges of control by the majority bondholders, the fact remains that these Trustees have not acted and are not acting under the direction and control . . . of the Managers under the Plan. . . ."

The attorneys for the Guaranty Trust Company felt that they were proceeding to bring about a foreclosure of the property, as a thing in and of itself, and not to serve the purpose of the managers. They said: ". . . It is further denied by the Trustees that any of the action taken by the Trustees has been for the express purpose of enabling the Reorganization Managers under any plan or agreement of reorganization to bid in the property. . . ."

The independents recalled the fact that the Guaranty Trust Company was one of the depositaries under the bankers' plan. It was paid on a piece-work basis. The more bonds deposited with it as depositary for the reorganization managers, the more it would receive from them. The more effective the independents were in trying to defeat the bankers and dissuade investors from delivering their bonds to the bankers' depositaries, the less it would receive.

The trust company's lawyers acknowledged that a trustee under a mortgage for bondholders ". . . must be disinterested. It must not conspire with other interests to bring about results unfair or burdensome to . . . the bondholders. It must not have a financial interest adverse to that of the bondholders."

The Guaranty Trust Company repeatedly denied that its position as depositary under the bankers' plan affected the situation in any way. Mr. Sunderland, its New York lawyer, said: "The complainants, Guaranty Trust Company of New York and

Merrel P. Callaway, as Trustees . . . have no interest whatsoever . . . in the proposed Reorganization Plan . . . except as representing all of the holders of said . . . Bonds as a whole." Mr. Sunderland did not explain how the trust company could at the same time benefit by the success of the bankers' plan and adequately represent men who believed it was unfair to them.

Mr. Callaway, the trust company vice-president, argued that its acceptance of a job from the St. Paul bankers was proper because the trust company always accepted such jobs in cases where it was trustee for bondholders. This and other explanations left untouched the problem which concerned the independents: that they did not want to look for protection of their interests to a bank which would profit by their defeat and suffer by their victory.

Mr. Callaway also claimed that the appointment of the trust company to a post under the bankers' plan did "not in the slightest degree disqualify" it as trustee for bondholders. This argument hardly met the point which the independents were making. They were not trying to remove the trust company from its position as trustee or even from its position as depositary. They wanted merely to remove the trust company's claim that it could and would represent them, and that they did not need and should not be permitted to represent themselves.

On the question whether there should be an early trial of the merits of the bankers' reorganization, the Guaranty Trust Company, as has already appeared, was opposed to the independents. It said that the procedure they proposed was futile. When the independents called attention to other cases in the federal courts where plans of reorganization had been considered by judges before the properties in receivership had been sold, the lawyers for the Guaranty Trust Company proceeded to lengthy arguments and many printed pages of briefs to demonstrate how different was the St. Paul receivership from these other cases.

One of the examples mentioned by the independents was "distinguished" in the following fashion by Mr. Sunderland: "But that situation you had, there was in existence a completed plan,

so far as the . . . trustees were concerned. So far as this record is concerned, there isn't any plan that we know of, or that we have had anything to do with."

This remark was made in April 1926, ten months after the St. Paul bankers first published their Plan, ten months after the Guaranty Trust Company became a depositary under that plan.

Victorious on this issue, the Guaranty Trust Company asked the court to fix a date for the foreclosure sale. The independent bondholders' committee urged that a delayed reorganization would be better than the bankers' reorganization, and opposed the trust company's request as a step in aid of the bankers. Thereupon the Guaranty Trust lawyers made a distinction: "It is denied by the Trustees that in the . . . conduct of the foreclosure proceedings they were acting under instructions from the reorganization managers . . . save that the Trustees pursuant to the request . . . in which . . . the Managers of the so-called Kuhn, Loeb and National City Plan of Reorganization joined . . . made application to this court . . . to fix the date of sale."

When the trust company conveyed the managers' "request" to the court, the question debated was whether an early or a later date for the sale should be fixed by the Judge. The independents objected that an early date would assist the effectuation of the bankers' plan. The Guaranty Trust Company lawyer again claimed that it was impartial and again made a distinction. He said that "as to the time of sale . . . the position of the Trustees is that that date should be fixed at such time as the Court shall determine," and, because of the reorganizers' request for an early sale, he said that the date "should be fixed as early as conveniently may be." Five months later, after the sale had been held, the attorney denied that ". . . the Trustees in their submission of the matter to the Court suggested . . . the date of sale. . . ."

At the same time that the bankers and the independent committee were disputing about the date of sale, they were also contending against each other on the subject of the minimum price for the sale of the railway. Courts usually fix a minimum price,

called an "upset" price. The independents said they did not care about the upset price if the fairness of the plan was scrutinized by the court before the property was sold; but otherwise they wanted a higher price than the bankers proposed. The independents feared that the minimum price to be fixed by the court would become the maximum which the bankers would pay for the property. On this issue, statements made by Mr. Sunderland, attorney for Guaranty Trust Company, tended to indicate, not that it was opposed to the independents, but that it was actually helping them. He said that "the interest of such Trustees is to obtain the highest and best bid from a responsible bidder or bidders for such properties."

Those were the words used by the trust company lawyer. What he did in fact was to introduce his expert and exhaustive study of the railroad reorganizations which his firm and other law firms of New York had conducted through the federal courts in various sections of the United States. He prefaced his statement to the Judge as follows: "It has occurred to me that it might not be out of place to call to the attention of the Court the basis upon which upset prices have been fixed in other large and generally similar steam railroad receiverships."

He thereupon showed that in case after case conducted by his and other New York law firms the upset price amounted to much less than the market value of the bonds. He set up a formula for determining the ratio of upset price to market value. He found, as has been recited, that the upset price in the cases analyzed by him was equivalent to from forty to seventy per cent of the market value of defaulted bonds in the period when they are usually at their lowest. He then presented to the court the market values of the St. Paul bonds during the corresponding period. An affidavit was submitted showing elaborate tables. He did not tell the court that it should fix an upset price that would yield St. Paul bondholders forty to seventy per cent of the market prices of the St. Paul bonds at their lowest. All the statistics for drawing this conclusion were presented in detail and in summary. There he stopped. Mr. Swaine picked the argument up from that point

and proposed to the court an upset price on the very basis discussed by Mr. Sunderland. To Mr. Swaine, Mr. Sunderland's presentation was the exposition of a "principle."

Mr. Miller, attorney for independents, asked Mr. Sunderland's intentions in volunteering his elaborate study.

Mr. Miller: Does counsel suggest an upset price?

Mr. Sunderland: Counsel does not. I am very anxious to make it clear that the trustees were not making any suggestion as to upset price. That is a matter for the Court to determine.

What Mr. Sunderland failed to tell the Judge was that the reorganizations which were the sources of his statistical report to the court had been conducted largely, if not entirely, by the same group from which the St. Paul reorganization staff was drawn, and in many instances by the very men participating in the St. Paul case on the bankers' side. Just as his trust company cited as justification for its accepting a job under the St. Paul bankers' plan the fact that it always conducted itself in that way, so Mr. Sunderland thought he should tell the Judge what the lawyers on the bankers' side in the St. Paul reorganization had invariably done in the past.

The final test of the Guaranty Trust Company's impartiality between the Kuhn, Loeb–National City Bank group and the independents came when the reorganization plan of the former was tested in the courts. The trust company's lawyers said: "The Trustees . . . neither approve nor disapprove the Plan. . . . The Trustees . . . are given no authority by the terms of that mortgage to speak for the holder of any bond . . . in respect to the fairness or equity of any . . . plan of reorganization. . . . Consistent with the position maintained by the Trustees throughout the foreclosure proceedings they do not now undertake to express any view as to the equity or fairness of the Plan now being considered by this Court."

The matter went to the United States Circuit Court of Appeals, and there the Guaranty Trust Company attorneys still main-

tained: "They [the Guaranty Trust Company and Mr. Callaway, its vice-president and co-trustee] have not and do not now attempt to express the views of any bondholder in respect to the equity of the Plan of Reorganization. . . ."

However, the attorneys told the upper court that "there is no question before the Court on this appeal other than the equity of the Plan of Reorganization." They submitted a printed brief to the Circuit Court of Appeals, in the course of which they said: "It would appear, therefore, that the Plan of Reorganization under which the only bid was made is presumptively an equitable Plan of Reorganization."

The trust company's attorneys concerned themselves with the bankers' plan in the Circuit Court of Appeals to the point of cautioning that court against upsetting the approval which Judge Wilkerson had given the plan. They said that it was not "the function of this Honorable Court to reverse the order of the District Court because on matters of business judgment its own views as to a desirable plan of reorganization" might differ from Judge Wilkerson's views or from what they called "the views of the majority bondholders' committee."

Finally the bankers' plan was presented to the Interstate Commerce Commission. The Commission did not pass upon the technical validity of the foreclosure sale. It was concerned with the reorganization plan. But this fact did not keep the Guaranty Trust Company out of the Commission proceeding. Mr. Sunderland followed the bankers' lawyers to the Commission. The attorneys for the bankers asked the Commission to grant an application for approval of the reorganization securities under the bankers' plan. Mr. Sunderland told the Commission that he appeared before it in support of that application.

Guaranty Trust Company also opposed the application of the Iselin stockholders' committee for permission to be a "party" to the receivership proceeding. The trust company did not claim that it was the spokesman for the independent stockholders, but nevertheless objected to their speaking for themselves.

The affidavits submitted to the court by the greatest American trust company, and the arguments made by its attorneys, one of the most important American law firms, aided by Mr. Tenney, the legal mentor of Judge Wilkerson in his early days at the bar, were successful. No independent was permitted to become a "party" to the court proceeding while it continued in opposition to the bankers. The Iselin committee achieved substantially this result, so far as proceedings before Judge Wilkerson alone were concerned, by effecting a settlement with the bankers in New York. Another of the independents, the Bondholders' Defense Committee, was permitted to speak to the Judge. But not as a matter of right. It was in court on sufferance. It could never be sure, as a "party" would be sure, that the doors might not be closed to it on the next issue that might arise. Its presence in court was permitted, to quote the words of the Guaranty Trust Company lawyers, "as a matter of courtesy," or, to follow the Judge's view of the matter, as an aid to inform the Judge.

Deprived of the opportunity to be a party, the committee was unable to appeal in ordinary course from the use of the foreclosure action for the furtherance of the bankers' aims. It had to resort to a far more difficult and far less effective procedure in getting before the appellate court on such matters. To be sure, the bankers had chosen the receivership Judge for the foreclosure proceedings, but no appellate judges were to hear an appeal from his rulings (other than on the merits of the bankers' plan) in ordinary course. On the other hand, the Guaranty Trust Company's lawyers earned for it the high encomiums of the Judge in charge of the receivership. He said: "The trustees have acted in strict accordance with their duties under the terms of the mortgages and indentures of which they are trustees. . . . To a very high degree the trustees have acted in the interests of all the bondholders, giving due effect to the terms of the mortgages and indentures which are binding upon trustees and all bondholders alike."