CHAPTER XXV

THE VALUE OF GETTING THE SECURITIES EARLY

Mr. Cravath had said in his lecture that with the preparation of the papers, "we have now completed the first stage of our campaign." The subsequent stages of the St. Paul bankers' campaign were devoted to getting the bonds and stock into their control, and winning approval of their reorganization by the receivership court and the Interstate Commerce Commission.

Three courses were open to the bankers—to get control of the securities before seeking a decision from the government tribunals, or to go first to the tribunals, or to proceed simultaneously on all fronts. They chose the first of these methods. They did not submit their plan to the court until eighteen months after they had made it public, or to the Commission until almost two years had elapsed.

The procedure followed by the bankers gave them certain advantages. By first seeking control of the security-holders' bonds and shares the bankers were enabled to obtain a power over the situation which they might otherwise never have achieved. Once they had the bonds and shares in their own hands, they had something close to irrevocable control. If their plan subsequently failed of approval either in court or before the Commission, the bankers still had the securities, and no one else had them. Their plan, in the precise form of its promulgation by Mr. Hanauer, would then be dead; but nothing in the Agreement drawn by

Mr. Swaine said that security-holders could then be free.

Of course, the bankers had no assurance at the outset that this part of their campaign would bring them all the securities. Even so, it would be worth while to get whatever they could. Anyone having control of twenty, thirty, or forty per cent would be an important factor in the reorganization. He might be able to defeat anyone else who tried to reorganize the property. Other groups would have to consult with bankers holding such a proportion of the securities and would have to compromise and yield to the bankers in the usual give and take of such affairs.

Thus, whether the bankers were wholly successful or not in their effort to get control of most of the securities, their solicitation of bonds and shares could be carried far enough to give them power, position, and effective voice in the reorganization. Had they taken their plan to the court or the Commission before arriving at this goal, and had it been disapproved by a government tribunal, the bankers would have remained as they began, mere volunteers. By following the reverse method they made themselves, even with a plan which might be defeated in court, masters of those whose securities they had obtained.

They did more. They made themselves the equals of the court and the Commission. Just as the bankers could not reorganize without the approval of the government tribunals, so the latter could not reorganize the property, or the court free itself of the receivership, without the bankers' consent. Indeed, the tribunals and the security-owners might see eye to eye if open hearings were held and the facts disclosed; but the owners of the property, and the court and Commission, could not effect a reorganization without the bankers' approval. By getting the securities first and going to court and Commission afterwards, the bankers could stand in the road of reorganization and prevent any progress not to their liking. The bankers started out as solicitors and servants; the owners ended as solicitors and servants.

The practical value of getting control of the St. Paul securities and thus protecting the bankers against any mischance was demonstrated when question was raised as to the need for bankers at all. It will be remembered that Mr. Buckner, of the New York Trust Company, questioned on this point, admitted that they were not indispensable and that receivers or others might be able to reorganize the St. Paul. But by the time this testimony was given, it was already beyond the power of anyone to displace the bankers. They had obtained control of four-fifths of the bonds and two-thirds of the stock. No matter who might then conclude that the bankers were not needed—even if the security-holders themselves should come to this conclusion—the bankers' dominion over the reorganization would remain vested and intrenched.

The facts were brought out when Mr. Hanauer was being questioned about his Sunday telephone talks with Mr. Buckner regarding the latter's testimony.

Mr. Grady: You did suggest that he correct it?

Mr. Hanauer: After he told me that he was going to send a telegram, I called his attention to that. I said to him: "You better read that testimony, and if that is not what you understood that you said, you ought to correct it."

Mr. Grady: Testimony as plain as that, it would not be a correction that would be made, but it would be a positive change as distinct from a correction, wouldn't it?

Mr. Hanauer: It would seem so to me, if it was not for the fact that he told me that he did not think he ever said it.

Mr. Grady: Irrespective of that, your interest in calling his attention to it was nevertheless personal and financial, wasn't it?

Mr. Hanauer: Not at all, because eighty per cent of the bondholders and sixty-seven per cent of the stockholders are already agreed to our plan, so Mr. Buckner's opinion, whether right or wrong, would have no effect on our financial position.

The bankers' chosen procedure resulted in other advantages for them. Their solicitation of St. Paul securities was carried on at a time when the owners were still considerably in the dark about matters they needed to know in order to arrive at a sound

decision on the merits or demerits of the bankers' plan. The most effective probing into the facts and the most thorough airing of disputes about the plan could be had in a court-room or a Commission hearing. There lawyers and supervising officials could ask questions which had to be answered, could subpœna witnesses who had to testify, could compel the production of records, could cross-examine the bankers and their committees and their experts. There it would be possible to pierce the reticence of the bankers, to remove the cloak which committee anonymity casts over the individual responsibility of committee members, and to overcome the insulation of reorganizers who were not "parties" to proceedings. The security-holders needed such public hearings with respect both to those portions of the plan which the bankers had published and to those other portions reserved for subsequent determination by the bankers themselves.

Independent committees fought against the bankers' procedure and urged that the plan be brought into open court for thorough examination. The attorneys for the bankers and for others in their group rejected this suggestion. They said that the bankers were not parties to the court proceeding and had not yet submitted their reorganization to the jurisdiction of the court, and that until they did so, their plan could not be made the subject of a court hearing. The following argument on this point, made by the attorneys for the Guaranty Trust Company, reflects the views which various lawyers in the reorganizers' group presented to the court:

". . . the so-called Kuhn-Loeb–National City Plan of Reorganization . . . has not yet been brought before the Court. . . . Obviously, since such Plan is not regularly and properly before the Court, any discussion thereof is quite premature and immaterial and irrelevant to this proceeding, and it is consequently quite improper for the Trustees [the Guaranty Trust Company and its vice-president, Mr. Callaway] to in any manner consider or discuss the elaborate criticism made by the petitioners [independent bondholders] of such Plan. . . ."

The reorganizers and their lawyers became involved in contradictions. On the one hand, their contention that the bankers' plan could not be submitted to the Judge at an early date delayed their reorganization. On the other hand, they urged upon the Judge that reorganization must be speeded. The following is from a statement to the court by Mr. Swaine, who took part in the proceedings at the very time that other lawyers subject to the bankers' directions were telling the Judge that the bankers and their plans were still outside the court's jurisdiction: ". . . As your Honor knows, that plan has not yet been submitted to the court. . . ."

This was fourteen months after the bankers had published it.

Mr. Swaine: ". . . The reorganization managers feel very strongly that the Court should proceed as rapidly as possible with the steps necessary to sell the property, consummate the reorganization, and lift the receivership.

"The Court knows and the public knows that the mere existence of the receivership is adversely affecting both the goodwill of the property, of the shipping public and the morale of the personnel. There have come to the reorganization managers many rumors about unrest within the personnel of the property. . . .

"Opponents of the reorganization plan have stated that they propose to question the validity of certain features of the plan. The determination of the issues which are thus expected to be raised, as well as the observance of the various statutory formalities required for the consummation of the plan and the issue of securities under the plan, will, at best, require several months, and we feel should proceed with the utmost dispatch and without any further delay. . . ."

The lawyers' view about proper procedure placed their clients in a difficult position. The clients believed what the lawyers said, and repeated it to the court. Some of them believed it so strongly that they put it in sworn affidavit form. Fifteen months after Mr. Hanauer had printed his plan and advertised it widely to the world (the advertising cost alone had run into tens of thousands of dollars), he swore: "I am advised by counsel . . . that

the Reorganization Plan is not before the Court." At the same time Mr. Ecker, chairman of the bondholders' committee, made an affidavit that he was "advised by the Committee's counsel [the National City Bank lawyers, it will be remembered] that any discussion of the Reorganization Plan . . . is out of place at this time." Mr. Callaway, the vice-president of the Guaranty Trust Company, also made an affidavit that he was "advised by counsel that the so-called Kuhn, Loeb and National City Company Reorganization Plan is not before the court. . . ."

In the same affidavits Mr. Hanauer and Mr. Ecker spoke of the great loss to security-holders which would result from any delay in completing the reorganization. Mr. Hanauer swore as follows: "The Reorganization Managers believed at that time [October 1925, eleven months before the date of this statement], and they believe now, that every interest of the security-holders . . . demands that the receivership be terminated and the property reorganized at the earliest possible moment. . . . In my opinion every day's delay in completing the reorganization is itself a penalty upon the bondholders. . . ."

Mr. Ecker said in his affidavit: "In conclusion I want to state as emphatically as it is possible for me to do that it is my judgment and the judgment of the other members of the Bondholders Committee that every interest of the bondholders requires that the receivership be terminated at the earliest possible moment."

To justify the continued refusal to have a court hearing on the bankers' plan, the statement was made that it was doubtful whether that plan or any plan would ever come before the court. Thus, on an appeal to the United States Circuit Court of Appeals, the attorneys for the Guaranty Trust Company of New York said: "No plan of reorganization is before the court. There is no certainty that the Kuhn-Loeb National City plan in its present modified form will come before the court. . . ." The bankers' attorneys later told the receivership court: "The plan was not then before the Court, and the Court had no assurance that it, or indeed any plan, would ever come before it."

Such a view was of course a theoretical one. No one supposed that a transcontinental railway property would be disposed of by the court without a reorganization. The very purpose of the receivership proceeding was reorganization. Indeed, the bankers had already subjected the security-holders to several millions of dollars of reorganization expense before the time when the bankers' lawyers told the court that there was no certainty that any plan of reorganization would be submitted to it.

The receivership Judge had it fully in his power to serve the security-holders by reversing the sequence which the bankers followed. There were a number of practical expedients he might have adopted to put a stop to effective solicitation of securities by the bankers until their plan had been submitted to the court and to the Interstate Commerce Commission.

To begin with, the Judge was in a position to dispose of the technical arguments that the bankers were not "parties" and that their plan was not in court. When the bankers asked him to put the St. Paul into receivership, he could have withheld action until the men really directing the affair and their committees had agreed to subject themselves and their plans to the court's jurisdiction at all times. Even without the bankers as parties, he could have conducted a hearing on the fairness of their plan.

The Judge might have done a great deal more. He could have held hearings on reorganization without restricting them to the bankers' plan. All plans, all suggestions, could have been discussed, and all facts brought to light. The Judge had control of the receivers, the railway staff, and the railway books and records. Even facts known only to the bankers or their associates could have been ascertained. Whether they were willing to disclose such facts or not, they could have been subpœnaed.

The Judge could have rendered the bankers' solicitation of securities ineffective by warning the security-holders to wait until after court and Commission hearings on reorganization plans.

Judge Wilkerson was repeatedly told that by letting the bankers follow their own procedure he was, at any rate in a negative way, actually helping the reorganizers. The following

is from a discussion in court between the attorney for the Iselin committee and the Judge:

Mr. Rosenthal: . . . Everybody else in this case, the company, the receivers, speaking now of the majority, the president of this railroad, the trustees, every single one of them from beginning to end are committed to this plan. What has the court been doing up to now? It has been registering the will of this same group.

Judge Wilkerson: What has the court done to register the will of anybody?

Mr. Rosenthal: Well, the court—it is more in a negative way than a positive way.

Judge Wilkerson: The court is entering orders in the case as always seemed proper to do upon petitions which have been presented to the court.

Mr. Rosenthal: Yes, but now is the time, now is the time, a reorganization plan has been put out, and everything depends upon this reorganization plan. Nothing is left after that. Now is the time where we ought to be given an opportunity to be heard upon that plan, which the court ultimately will have to pass on.

The Judge had a further means for curbing the bankers' method of dealing with the security-holders. He had control over the property and could say when it should pass out of his hands. Instead of leaving it to the bankers to determine when they would be ready to complete their reorganization and take over the property, he could have notified them that he would determine when the property could be taken from the hands of the court in order to complete the reorganization. This method of exercising control for the sake of the St. Paul security-holders was suggested to the Judge in October 1925 by the attorney for the Iselin committee.

Judge Wilkerson: Isn't it the limit of this court here to exercise control over its receivers?

Mr. Rosenthal: No, it is not.

Judge Wilkerson: What more can it do?

Mr. Rosenthal: The court can do this thing: The court can say, for example, I am not going to sell this property until the time is ripe for a sale.

Judge Wilkerson could have done more than regulate and restrict the bankers' activities. He could have made them of little or no consequence in the reorganization. He could himself have formulated a reorganization plan. Or he could have instructed his receivers to do so.

Judge Wilkerson was willing to conduct a hearing on the fairness of the bankers' plan long before they were willing to let him do it. His attitude was indicated in the course of a discussion between himself and two of the lawyers—Mr. Sunderland, the Guaranty Trust Company attorney, and Mr. Dickey, attorney for an independent committee.

Mr. Sunderland: . . . 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.

. . . . .

Mr. Dickey: There is some reorganization yet to come up before the Court in this matter, that is very evident, why not let it come up and get it?

The Court: I will be willing to have it come up if somebody will bring it in here in a way that I can act on it judicially, bring it in.

Various practical suggestions were from time to time urged upon the Judge. He did not regard them as appropriate. He could not extricate himself from the technical arguments which had been pressed upon him. For example, when asked by independents to consider the bankers' plan, five months after it had been issued to the public, the Judge said: "Just at this stage of the proceedings how would the court be concerned with any

of these plans? . . . Just how is this court judicially concerned with that now?"

Later in the discussion the Judge said: "Just how, just what action, before the time came for the approval of the plan that was submitted after the decree had been entered and the sale of the property had been ordered, would the question of the propriety of this plan be put before the court in such a way that the courts could make some order about it; that the court could do something more than talk about it, act about it, because after all the test is not whether the court can say anything about it as a volunteer, say some things about it, but whether the court can act about it. . . ."

The Judge refused to act even in the ensuing year, after it was certain that the bankers would be the successful bidders at the foreclosure and therefore would be obliged to file their reorganization plan with the court.

The reasons he gave were in substance the reasons which the attorneys for the Guaranty Trust Company and for the bankers had urged upon him. The Judge stated that his decision on the plan prior to the sale of the property would not be binding—although his rejection of the plan would have put an end to it, and the earlier he acted, the safer for the security-holders. He said that even if he approved the plan, he could not compel the bankers to buy the property at the sale—though it was clear that that was their intention, and that the sale was merely an anachronistic formality. He held that it would be improper for him to consider the plan "until an opportunity has been given to all stockholders and bondholders to be heard," although of course there was no greater difficulty in letting them be heard before the foreclosure sale than after. He added: ". . . And, of course, the Court should not enter a finding upon these matters until they are before the Court in such a way that its finding may be enforced."

Judge Wilkerson felt that a hearing on the reorganization plan after the sale of the property "is in harmony with orderly procedure in the court." Others of his reasons were as follows:

". . . It is not proper that a Court should announce in advance how it will decide a case which may be brought before it. Nor, as a matter of law, may plaintiffs [the foreclosing trust companies] be deprived of their rights under the decree [of foreclosure] until someone has volunteered to submit in advance to the Court what he proposes to do at the sale. Plaintiffs are entitled to a reasonable execution of their decree [of foreclosure]. . . ."

Such reasons seem to place the form of foreclosure before the reality of reorganization. The Judge's language would raise the inference that he assumed the St. Paul proceeding was really a liquidation of half a billion dollars' worth of railroad and that there was going to be a real auction, with a real sale and a real purchase.

The Judge was so concerned with the form of the proceedings that he interrupted a statement by Mr. Swaine lest the latter give the impression that the bankers were certain to bid in the property and were certain to submit their plan to the court. Argument was being made before the court with respect to the proposed technical foreclosure sale. Mr. Swaine assumed, what every practical mind in the case assumed, that the bankers would buy in the property and present their plan to the court. Judge Wilkerson would not permit this assumption to be made.

Mr. Swaine: If the Court please, I speak for Messrs. Kuhn, Loeb & Company and the National City Company, the reorganization managers under the only reorganization plan that has as yet been promulgated.

As your Honor knows, that plan has not yet been submitted to the Court, and under the machinery provided for in the final decree will be submitted to the Court by the special master upon his report of the bids received at the sale.

I take it there are two questions—

Judge Wilkerson: That is, if you see fit to offer any.

Mr. Swaine: If we see fit to offer the plan at that time, I take it there are two questions to be decided now: first, what is to be the date of sale; and, second, what is the minimum bid which the

special master will be authorized to receive.

The independents, unsuccessful in their attempts to hasten consideration of the bankers' plan in court, tried to do so in the investigation conducted by the Interstate Commerce Commission. As has been noted, efforts were made to learn what the bankers were planning with respect to the undisclosed portions of the reorganization, such as control and management. But Mr. Dynes, the attorney for the company, objected. The Commission's investigation, he said, was not the proceeding in which such matters could be discussed. A separate proceeding would have to be brought for the purpose of considering the bankers' reorganization plans. The reorganizers, not the Commission, would initiate that proceeding. They would do so after the court had approved their plan. Such was the order of procedure which the lawyers in the bankers' group favored and upon which they insisted.

Mr. Dynes said that the bankers ". . . at some future date will take something to the court that has charge of the property under receivership and ask for an approval, an official approval of it there and then by a court that is the one court that has jurisdiction over such things in the first instance.

"After that and apart from that and separately, a separate proceeding, there may come before this Commission, and entirely apart and separate from this proceeding, the question of whether securities can be issued under the plan, and what securities can be issued and at what terms, that have been approved by the judge who has charge of the property."

When the attorneys for the bankers finally brought their plan to the Commission, they urged upon it the need for the greatest expedition. They said that at the beginning of the receivership, two years earlier, "it was agreed by all . . . that every interest of the security-holders demanded a quick reorganization. . . ." They called attention to the saving in interest charges which they said their plan would effect. Referring to this, they claimed that "every day's delay [in the consummation of the reorganization] costs the property two thousand dollars in interest alone which will be saved in the reorganization." Almost seven hundred days had been allowed to elapse between the time that the security-holders were asked to accept the plan and the time that the Commission was asked to do so.

The attorneys felt that their order of procedure was the only proper one—to go first to the security-holders, then to the court, then to the Commission. But when the reorganization came finally before the last-mentioned body, it brushed all these technicalities aside, saying that not only could the plan have been brought before it earlier, but future railway reorganizations should be brought before the Commission much earlier than had been done in the St. Paul case. The Commission concluded its report with these words:

"It is therefore deemed desirable that hereafter in each case of reorganization application by the new company be made at an early stage . . . and that the plan be not declared operative until such approval has been had."

In the proceeding initiated by the bankers to get Commission approval of their plan three members of the Commission said: "The plan should be submitted to the commission for its approval before the security-holders are asked to assent to it, and an opportunity should be afforded for the presentation of protests at a public hearing."