CHAPTER XIII

THE ROLE OF THE TRUST COMPANIES

A FRIENDLY creditor, as accommodation plaintiff, and the shade of a broken corporation, as willing defendant, were not the only "parties" to the receivership proceeding deemed by the bankers' lawyers necessary for effecting their reorganization. These parties were used to get the property into the hands of the court. The bankers' attorneys were looking ahead to the time when they would want to get the property out of the hands of the court, the time when the bankers had completed their reorganization plans and had induced the owners of the property to agree to those plans. The property would then have to pass back from the court to its owners, in a reorganized financial society. This could not be effected, in the opinion of the men who handled the legal work for the bankers, by a simple return of the property. Just as it had been led to court in an obsolete ceremony, so it could be led out of court only by an obsolete ceremony. The bankers' attorneys planned that the court should sell the property on the auction block, and that their representatives should buy it for the owners. True, there would be no real auction, no real bidder, no real sale, no real buyer, no real purchase price, no real payment. But that was the way the attorneys felt it had to be done, under the existing procedure in the courts.

To accomplish this result the lawyers planned to use certain large trust companies in New York. These banking institutions

were called the trustees for the bondholders. When the bonds were sold to the public, they were sold in large numbers. A contract of formidable length was then drawn up, to be signed by the St. Paul company, for the bondholders' protection. Instead of having this contract tied physically to each bond, a New York trust company was selected to make the agreement with the St. Paul Railway Company. The agreement was to be for the benefit of all the holders of the bonds then sold to the public.

The trust company named in it as "trustee" for the bondholders was also given this name in the receivership proceedings. It was not a real trustee for the bondholders in the ordinary sense. An ordinary trustee owes a duty to his ward, of such quality that the trustee may have no opposing, conflicting, or compromising relationships with anybody else. The trust companies who were trustees for the St. Paul bondholders did have such relationships. They started out as beneficiaries of the bankers, and shortly after the beginning of the receivership became the bankers' servants, theirs to hire and fire. These trust companies joined the Binkley Coal Company and the defunct railway corporation as parties to the receivership proceeding arranged by the bankers.

The principal trust company in the case was Guaranty Trust Company of New York. Five other New York trust companies which played minor roles in the case became formal parties to the receivership proceeding in Chicago and in other districts. All of them had their own lawyers in the case—first their New York lawyers, then associate counsel in the main receivership proceeding in Chicago, then counsel in various other districts. For technical reasons there were also three individuals who joined three of the trust companies, as so-called trustees for the bondholders. All told, there were six trust companies and three individual trustees acting in connection with the St. Paul receivership, and they employed sixteen law firms to act for them—a luxuriant growth for the satisfaction of a procedural fiction.

The favors which the bankers showed to the trust companies were in the form of at least three profits which the bankers made

it possible for the banking institutions to receive, out of the assets of the St. Paul security-holders. First, they received fees as so-called trustees, beginning with the initial sale of the bonds to investors. The scale of such fees may be gauged from the amount received by the chief of these trust companies when it earned its first profit as trustee on new bonds issued by the reorganized St. Paul company. The first payment was $62,000, and there would be more and more later, as the years rolled on.

The second category of fees arose out of the receivership, when the trust companies were paid as "parties" to the affair and their lawyers were paid as attorneys for parties. Five trust companies, two of the individual trustees, and their New York and Chicago counsel received $835,000, of which $400,000 went to the Guaranty Trust Company, one of its vice-presidents, and its lawyers.

The third source of profit was in serving as depositary, so-called, under the bankers' reorganization plan. In this capacity the trust companies would perform such clerical labor as receiving the bonds of security-holders who consented to the plan, and issuing receipts to them. For this service all the trust companies acting as trustees for bondholders were employed, subject of course to dismissal. They received an aggregate compensation of about a third of a million dollars, of which about a hundred thousand dollars was paid to the Guaranty Trust Company.

The total of the fees which the bankers made it possible for the trust companies and their attorneys to receive out of the St. Paul property was at least one and one-quarter million dollars; how much larger than this the profits were, the publicly recorded testimony does not show.

The bankers' attorneys felt that the profit to the trust companies was being unduly magnified in the minds of those who thought only of the size of the fees paid. The attorneys told the Interstate Commerce Commission "that the charges of the depositaries . . . are mainly for mechanical and clerical work and represent actual out-of-pocket cost to the depositaries." Incidents recorded in the Commission's investigation tend to indicate, however, that the favors shown by the bankers to the trust

companies were regarded by the latter as of a highly desirable nature. So fat are the profits of banking institutions in this quarter of their business that the heads of some of the largest banks in the country, with resources running into hundreds of millions of dollars, would go hat in hand to solicit favorable consideration from those who could bestow or influence such business.

When Mr. Buckner, head of New York Trust Company, was on the witness-stand, telling of trusteeship under railway mortgages, he said: "We have a corporate trust department, which simply handles the matter of acting as trustee for mortgages. . . . that is more or less routine. . . . I recall during the time that Mr. Charles W. Harkness was on our board, we had some active bidding for the trusteeship for the big mortgage of 2014 [i.e., maturing in the year 2014]. It was a fine piece of business and there was very active bidding to get that trusteeship, and we failed, the Guaranty Trust Company getting the business."

It is probable that the bidding referred to was solicitation, and not an offer of lower charges for this routine work, as the record indicates that the New York trust companies have agreed among themselves on what they call a "standard" scale of charges.

This "piece of business" was done a decade before the receivership. At the time, the Harkness interest was not important on the St. Paul board, and the bankers had no particular need for the co-operation of the Harkness family in St. Paul affairs. But it was different when the receivership was to be accomplished. Four of the directors were Harkness nominees. Of all the directors, they represented the only substantial investment in the company. The Harkness lawyer, a member of the board, had been one of the most active members in trying to avert receivership and had drawn into his activities another Harkness director, Mr. Buckner of the New York Trust Company. Several of the Harkness men on the St. Paul board were also on the board of the trust company. Mr. Hanauer was engaged in an effort to consolidate his forces, to win the special committee of the St. Paul directors to his program and have matters arranged before the St. Paul board was called together for the March 17 meeting,

"so that the matter could be handled in the best and most public and proper way," as he put it.

When those who were in the know realized that receivership was coming, mouths in the financial district began to water. One of the various financiers who considered how this might affect his institution was Mr. Buckner. He went to see the Harkness lawyer, "because I wanted to say a word to him for the New York Trust Company in the hope that, in the event of a receivership, the New York Trust Company might be named as a depositary. . . ." The man he went to see was the director whom Mr. Hanauer had been cultivating, and Mr. Buckner was able to add the postscript of the advertising fable: he got the job.

Another of the successful applicants was Mr. Davison, president of the Central Union Trust Company, also one of the largest trust companies in the United States. He got directly in touch with Mr. Hanauer. The latter testified that "Mr. George Davison said to me that he would like very much to become a depositary for some of these committees that were going to be formed."

What Mr. Hanauer failed to add was later obtained from Mr. Davison, in a statement which the Commission asked him to make. He said: "I had discussed the St. Paul situation with Mr. W. Emlen Roosevelt, who is a member of our board, and with Mr. Hanauer a number of times before default and the formation of any committees. I had explained to Mr. Hanauer that another member of my board was the owner of a large amount of St. Paul bonds and I hoped Central Union Trust Company would become depository for some of the committees if the committees were formed and the reorganization started."

What Mr. Davison explained Mr. Hanauer had already learned when he was canvassing the situation in Wall Street in February 1925, before the receivership, and lining up support for the St. Paul bankers. Mr. Roosevelt had a large block of the bonds, but his firm was proving not wholly amenable to the bankers' purposes, because it had the feeling "that fifty per cent protection was all that we were being offered." Conciliation of Mr. Davison might help with Mr. Roosevelt. Mr. Davison landed the desired

job for his bank, although Mr. Hanauer, as he was soon to learn, did not land the Roosevelts.

The trust companies just named were not among the trustees for the bondholders. Whether the trust companies which were trustees for the bondholders did or did not have to ask for the post of depositary under the bankers' reorganization plan is not clear in the record. Probably they did not have to ask. It is the regular custom, said the vice-president of the Guaranty Trust Company, to make the trust-company trustee a depositary. Its lawyers disclaimed any ulterior motive on the part of the bankers and denied that the job biased the trust company in their favor.

The money gained by the trustees out of the funds of the old St. Paul company was not the only business consideration helping to predispose them toward the bankers. The latter would have other business of the same kind, both when the St. Paul was reorganized and in other matters. Bankers having the position of Kuhn, Loeb & Company and the National City Company for railroad bond issues, industrial corporation bond issues, foreign government bond issues, and reorganization work in general would have the disposal of more business patronage attractive to great trust companies than most other concerns in financial America. Kuhn, Loeb & Company alone had the exclusive sale of the new bond issues of a long list of railroads. They had reorganized a number of the biggest roads of the country and become their bankers also. The plan for the reorganization of the St. Paul itself called for some new bond issues; thus, at the outset, trust companies had the possible opportunity of earning a fourth profit in the St. Paul property. The Guaranty Trust Company was the most fortunate of them in this respect, just as it had been the most important and active of them in the receivership proceedings. The other trust companies played a minor role, but one of them got one of the new mortgage issues. There was a third issue, which was the most desirable of all. If evidence were wanting that trusteeships for railway mortgage bonds are attractive to banking institutions, that evidence was furnished in connection with the last-mentioned bond issue. This trusteeship

was taken by the National City Bank, one of the St. Paul bankers which acted as a reorganization manager and had half the say on the distribution of these plums.

Gratitude for past favors and hope for future favors were not the only ties between the trust companies which became parties to the receivership proceeding and the St. Paul bankers. Within a few months after the bankers had published their reorganization plan, they were in a position to control the activities of the trust companies in the receivership. This was based upon the language of the mortgages providing that anyone who controlled a majority of the bonds had "the right . . . to limit, direct and control in all respects the acts and proceedings of the trustees and the method and . . . places of conducting . . . all proceedings." The bankers, by means to be described later, obtained control of a majority of the bonds within a few months, in ample time to be able to issue to the trust companies such orders as the bankers might desire to have carried out.

The bankers shortly thereafter obtained control of enough additional bonds to put them in a position to exercise another power over the trustees. The principal mortgage provided that anyone controlling two-thirds of the bonds might get rid of the trust company at any time and put another in its place.

It was in such circumstances that the trust companies which became parties to the receivership found themselves, during most of the period of their participation in the proceeding. The attorney for the Guaranty Trust Company, the largest trust company in the United States and the most important "party" in the receivership, told the court that "these trustees have not acted and are not acting under the direction and control" of the bankers. His client was under contract to accept the direction and control of the bankers. It is not particularly material whether they exercised their authority by word of command or in more polite language, or whether the attorneys for the bankers gave the trust company's attorney his instructions or conferred with him more amiably. The practical and legal state of affairs was that the trust company would be guilty of violation of contract

if it disobeyed or showed any stubbornness, and both the trust company and its lawyer could have been removed from the case by the bankers at any moment.

The Guaranty Trust Company of New York, though in the receivership on fictional grounds no more substantial than those which nominally brought the Binkley Coal Company and the spent St. Paul company into court, played a much larger role than either of those two. Its activities will be discussed in a later chapter. For the present it is sufficient to note that the relationship between the trust companies and the bankers was much closer, more that of beneficiary and benefactor, and later of servant and master, than the relationship between the creditor plaintiff and the bankers, or the debtor defendant and the bankers.