

*THE STOCKHOLDERS' PROTECTIVE
COMMITTEES*

THE testimony in the Interstate Commerce Commission's investigation reflected, though not expressly, an underlying difficulty in the formation of protective committees. Committees for different classes of security-holders may have to negotiate with each other and must be able to do so at arm's length. It is for this reason that separate committees are formed for security-holders who may have dissimilar or conflicting interests. Ordinarily, different classes of bonds are represented by separate committees, and separate committees act for stockholders.

Mr. Cravath, of the Kuhn, Loeb lawyers, emphasized this requirement in his lecture to the New York City Bar Association in 1916. He said: "Above all things, see to it that neither your committee nor any other committee represents conflicting interests. It is a rule to which there are few exceptions that the same protective committee should represent but one class of securities. It is rarely wise that the same committees should even represent both preferred and common stock. . . ."

The St. Paul bankers were subjected to embarrassment on this score, both with respect to the classes of bonds which their bondholders' committee sought to represent, and with respect to the formation of committees for stockholders. The bondholders' committee sought to act for two classes of bonds, the so-called refunding bonds and the Puget Sound bonds. The bankers gave

both sets of bonds the same treatment in the reorganization plan. This was later called in question by an independent committee, which claimed that the Puget Sound bonds were inferior and that the bondholders' committee members unduly represented the Puget Sound bonds. On the question of the relative values of the two classes of bonds, the bankers said that the independents were wrong, and that even if there was a difference in the values, the difference was comparatively small, and equal treatment for the Puget Sound bonds might be regarded as a desirable compromise of any dispute between the bondholders. The courts declined to upset the plan on the independents' objection.

The facts which were developed indicated that it would nevertheless have been more discreet to have had separate committees, or at any rate to have balanced the committee more carefully. Of its seven members, other than the St. Paul bankers who had liquidated their bond holdings, a majority represented interests which would profit by any favoritism shown to the Puget Sound bonds. In this aspect there was probably some cogency to the independents' argument that if possible disputes between the bondholders were to be compromised, the refunding bonds were entitled to separate representation in the compromise negotiations, and that their interests should not have been left to a committee overbalanced to the advantage of the Puget Sound bonds.

An embarrassing interrelationship was also present in connection with the formation of stockholders' committees. The bankers definitely cast their lot with the bondholders, and in principle could not organize, control, or influence the stockholders' committees with which the bondholders' committee would have to deal.

Here the advice given to the assembled lawyers a number of years earlier by Mr. Cravath involved bankers in possible difficulty. He advised that bankers should see to it that stockholders' committees were also organized. He was assuming for convenience, that his auditors, like himself, would have the task of guiding reorganization bankers. His words were these: "While you have been preparing the receivership papers, it may be assumed

that your client, the banker, has been engaged in forming a bondholders' protective committee. . . . If need be, you and your clients should arrange that committees are formed to represent the various other issues of securities . . . for, manifestly, when the time comes to prepare a Plan it is essential that there should be representatives of the other classes of securities with whom your clients can negotiate."

The practical difficulty with Mr. Cravath's advice was that it involved bankers in the necessity of drawing a fine line of conduct. It is not so easy to "arrange that committees are formed" without having something to do with the selection of their members. Once a banker takes part in the selection of members of stockholders' committees, at the same time that he plans to negotiate with them on behalf of bondholders, one or both sides to the transaction may suffer some loss of independence and protection.

Mr. Hanauer testified that he kept hands off the formation of the stockholders' committees. He said that the "stockholders' committees were formed . . . without any suggestions from us." The bankers said that they made clear their position that this was a task for the company's board of directors.

Mr. Hanauer's testimony was that he told directors "that it was the responsibility of the special committee, or the directors who had been elected by the stockholders, to see that proper committees were formed to represent the interests of the shareholders." Mr. Mitchell had apparently not given as careful thought to the delicate problem confronting the bankers, but he agreed that it was at least in part the directors' job. He testified: "My recollection is that we rather appealed to the members of the board of directors . . . to assist us in finding a chairman for those committees, and my recollection is that the chairmen very largely selected their own committees in the preferred and common."

Mr. Hanauer and the chairmen of the two stockholders' committees, as well as others, testified that each chairman was left free to choose his own members. The selection of chairmen was

therefore the important and controlling problem. It was the act from which the bankers had to keep themselves particularly distant.

Mr. Geddes, a director of the company, was made chairman of the common stockholders' committee. His banking firm had for years participated in the flotation of St. Paul securities by the St. Paul bankers. He told of his selection for the post.

Mr. Geddes: Mr. Hanauer . . . asked me if I would head a common stockholders' committee. I said I would take it under consideration.

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Mr. Fisher: In your talk with Mr. Hanauer, did he make any suggestion as to any reason why you should go on this particular committee?

Mr. Geddes: He did. He said I had been associated with the St. Paul a great many years.

Mr. Fisher: That is that you had?

Mr. Geddes: I had, yes, and naturally they wanted, he said, people who had been associated with the company and who were known in connection with the company.

Mr. Fisher: Is that all he said?

Mr. Geddes: No. He said if I did not go on, it would look as if I was deserting the ship.

Mr. Fisher: He appealed to your sense of loyalty, did he?

Mr. Geddes: I think he did. . . .

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Mr. Fisher: At that time did you have any interest yourself?

Mr. Geddes: Mr. Fisher, may I say I had no hankering to go on any committee, because I saw a great deal of trouble ahead, and a great deal of work. If it had been left to my own personal wishes I would not have gone on any committee, because I have been on a number.

Mr. Hanauer thereupon sought assistance in persuading Mr. Geddes to take the chairmanship. To quote the banker's testimony: "Next time I saw Mr. Fisher [the Harkness representative] I told him of my conversation with Mr. Geddes, and I said: 'I think if you urge Mr. Geddes to do it, he certainly is a man who has had experience, that if you urge him to do it as representing the Harkness interest, he might be willing to do it.' . . ." Mr. Fisher went to Mr. Geddes and told him that Mr. Harkness wanted him to represent the common-stock holdings of the Harkness family. Mr. Geddes consented to be chairman.

Mr. Hanauer's request for Mr. Fisher's help, and the line of persuasion outlined by Mr. Hanauer, involved them all in another departure from the general principle illustrated by Mr. Cravath in his lecture. For the Harkness interests were asked by Mr. Hanauer to accept the chairmanship of the preferred-stock committee. He first urged Mr. Fisher to take the post, but the latter desired a place on the bondholders' committee. In consequence, Mr. Buckner, also representing the Harkness stock, became chairman of the committee for the preferred stockholders. Thus the chairmanship of committees for the two classes of stock, which Mr. Cravath had urged should be independent of each other, was filled from the same source.

In the proceedings before the Interstate Commerce Commission relative to the bankers' reorganization plan, the following colloquy established the date when all the inner group recognized that Messrs. Buckner and Geddes were to be the chairmen:

Mr. Anderson: When that meeting adjourned on the 16th day of March 1925, it was pretty well understood that . . . Mr. Buckner would be chairman of the committee representing the preferred stock, and Mr. Geddes chairman of the committee representing the common stock, wasn't it?

Mr. Hanauer: Oh, very definitely.

This was the meeting when the two chairmen sat in as silent observers of the first gathering of the bondholders' committee.

As to Mr. Hanauer's participation in the formation of all these committees, the following general comment may be taken from the testimony of the Harkness lawyer, Mr. Samuel H. Fisher:

Walter L. Fisher: At what time was that matter of the appointment of the protective committees or the membership of such committees informally acted on by the board—

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Samuel H. Fisher: It was just informally spoken of at the meeting of March 17, that is all.

Walter L. Fisher: The process of actually inviting people to serve on these committees had been going on for some days prior to that?

Samuel H. Fisher: It had.

Walter L. Fisher: Now, in this matter Mr. Hanauer was one of the active participants, as I understand it.

Samuel H. Fisher: Yes.

Others in downtown New York knew that Mr. Hanauer was the man to see about matters relating to the committees. Mr. Davison's solicitation of business resulted not only in getting the post of depositary for his trust company, but also in getting him a place on one of the stockholders' committees. The incident appears in Mr. Hanauer's evidence. He said he made a suggestion.

"The only suggestion which I did make was to Mr. Geddes. It was a suggestion which was really giving him a message, 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, and I passed that message on to Mr. Geddes, and said he would make a very good member for the committee because of his great experience in this sort of thing, and that resulted in Mr. Davison becoming a member of the stockholders' committee. It was not a suggestion, but simply passing on this message to which I have referred."

It should be noted that Mr. Davison's request did not include

any reference to his being made a member of a committee, and this part of Mr. Hanauer's suggestion originated with the banker himself.

The criteria applied by the stockholders' committee chairmen in picking their members were described by Mr. Geddes and Mr. Buckner. With one or two exceptions, the members were not chosen for their holdings of the stock which the committees were to represent. Neither chairman had any stock himself, and Mr. Geddes's firm did not have sufficient stock to justify his taking the post on that account. Most of the members selected had no stock.

Mr. Buckner testified: "I didn't think a preferred stock committee made up of members of stock exchange houses would present the best picture." Three of the four men he chose were bank heads, as was Mr. Buckner himself. "I knew those were outstanding men in the community, that they were heads of other institutions and that they would carry confidence in advertising a stock committee. . . . I wanted to keep away from dressing up a committee with the names of brokers—not that I have any thing against the brokers." One of Mr. Buckner's committee, the head of the Equitable Trust Company, said: "I do not own and . . . never have owned any of the . . . stock or bonds of the . . . St. Paul Railway Company. . . . I believe his reason for asking me to join the . . . committee was because of his desire to have on the committee one or two bankers who are prominent in financial circles throughout the country."

Mr. Geddes said that in making his selections "I wanted to get men on the committee, of standing, because with that it has a great deal to do with the success of a committee, getting in deposits." He did not share Mr. Buckner's feeling about brokers and put two of them on his committee. Mr. Percy Rockefeller was also put on the committee, as the Harkness attorney felt he should be.

Samuel H. Fisher: . . . There was only one man that I thought should be on this committee, and that was Mr. Rockefeller. I

thought he had such an interest in this road that I felt he should be on that committee.

Walter L. Fisher: You did not know, then, that Mr. Rockefeller had disposed of his holdings?

Samuel H. Fisher: I did not.

The bankers were questioned about the propriety of filling the stockholders' committees with men who had no stock interest in the company. Mr. Hanauer was questioned with respect to Mr. McHugh, who had been made a member of the preferred stock committee.

Mr. Grady: Did you read the testimony . . . of Mr. McHugh, the president of the Metals & Mechanics Bank, is it not?

Mr. Hanauer: I read some newspaper account of it.

Mr. Grady: Do you know whether or not any of the other members of this committee hold any more stock in the St. Paul road than Mr. McHugh did, while he was a director?

Mr. Hanauer: I have no knowledge on that subject.

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Mr. Grady: And you think it is perfectly proper that a man who has acted as director, without even having a share of stock to qualify him, should act as the protector of holders of preferred stock in this company, do you?

Mr. Hanauer: I have no opinion on that subject.

Mr. Grady: You have no opinion?

Mr. Hanauer: No.

Mr. Mitchell, of the National City Bank, was willing to go a little further.

Mr. Grady: I ask you if you favor as a practical, as a just plan of reorganization the creation of committees composed of men supposed to protect the interest of stockholders if they have no stock themselves; do you approve that?

Mr. Mitchell: I think it would be very much more fortunate if they did have stock or represented stock, and I assume that they did represent stock, or had stock.

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Mr. Grady: It is all the more unfortunate then if they have not the stock, isn't it?

Mr. Mitchell: Yes.

Mr. Grady: So in so far as these stockholders representing a very limited number of shares of stock and some of them no stock at all, you would say that to that degree it was unfortunate?

Mr. Mitchell: Yes, I would.

On the subject of "dressing up a committee" and the contribution to committee activities which is likely from members who have no interest in the securities, the testimony of Mr. Rockefeller, member of the common stock committee, and of Mr. McHugh, member of the preferred stock committee, is illuminating. Mr. Rockefeller said he sailed abroad within a few days after he was put on his committee, and was greatly occupied with other matters after his return. Mr. McHugh went on his committee in circumstances described by Mr. Buckner, as follows:

"Mr. McHugh was on a Mediterranean trip, and I went over and saw Mr. Gates McGarrah [in the same bank as Mr. McHugh] and asked him if he would consent to my using Mr. McHugh's name in his absence. He said that he would not, but if I would draft a cable, he would code it and send it to him. We caught Mr. McHugh in Egypt."

The latter was asked about his going on the committee.

Mr. Fisher: Did it occur to you to ask Mr. Buckner or anybody else why you were being selected as a member of the protective committee with reference to preferred stock?

Mr. McHugh: No, I did not attach any importance to it.

Mr. Fisher: First let us get the fact, if we can, whether anybody

explained to you, or stated to you, any reason why you should be on that particular protective committee?

Mr. McHugh: No.

Mr. Fisher: Do you now see or have you ever seen any particular reason why you should have been asked to serve on that particular committee?

Mr. McHugh: No, no particular reason at all.

Mr. Fisher: You have no affiliations or past history that would make it particularly appropriate why you should be on a protective committee to protect the preferred stockholders?

Mr. McHugh: No.

Mr. Fisher: You might just as well have been put on a protective committee for the common stock?

Mr. McHugh: Might just as well have been left off.

He was asked to describe what went on at one of the "two or three, or three or four" meetings of his committee which he attended subsequent to his return to this country.

Mr. Fisher: What was the substance of what happened at that meeting?

Mr. McHugh: Well, what usually happens in meetings of that kind. I do not know that I recall even the detail of it.

Mr. Fisher: Was there any discussion about what attitude your committee should take?

Mr. McHugh: Why, yes, the usual discussion of meetings of that kind.

Mr. Fisher: What was it?

Mr. McHugh: It was a committee that represented the preferred stockholders, and the usual detail of such meetings, I suppose.

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Mr. Fisher: Does anything whatever that happened at that meeting remain in your memory?

Mr. McHugh: No.

Mr. Fisher: Not at all? You just remember that there was a general discussion of the situation, and what you thought was quite the usual character, and that tells the whole story?

Mr. McHugh: That was all.

Mr. Fisher: In what form did you get this message from Mr. Buckner, asking you to serve?

Mr. McHugh: I do not remember, and I do not remember the date. It was simply the usual message, as I recall it, that the stockholders' committee is organized, would I be willing to serve.

Had the members of the stockholders' committees undertaken to be active in any negotiation with the bondholders' committee, the need of the stockholders for independent representatives, free from affiliation with the bondholders' committee, could not have been satisfied. The chairmen of the stockholders' committees had gone on as representatives of the Harkness interests, which had a block of the bonds and were on the bondholders' committee. In market value their bondholdings were the more important; and the superiority of their interest in the bonds is attested by the fact that Mr. Fisher, their chief representative in St. Paul matters, preferred a place on the bondholders' committee to the chairmanship of a stock committee. The chairman of the common stock committee was also laboring under the difficulty that he had been in the banking syndicates for the distribution of the bonds to the public. His relationship to the bonds rather than to the stock corresponded with Mr. Hanauer's. This relationship led Mr. Hanauer to say that, so far as his own firm was concerned, it was their duty to work for the bondholders and not for the stockholders.

A majority of each stock committee was involved with members of the bondholders' committee or with bond interests. The preferred-stock committee had five members. As already noted, its chairman was acting for interests weighted on the bond side of the affair. Another of its members represented a family interested in the bonds much more than in the stock. A third was chosen by the chairman because "his institution was fairly close

to the . . . John D. Rockefeller interests"; and those interests were represented on the bondholders' committee. The other two preferred stock members were Mr. McHugh and a Milwaukee banker who was too far away to have any part in negotiations with the bondholders.

The common stock committee had six members. In addition to the affiliations of its chairman with the bond side of the matter, there were others also affiliated in some way with the bonds. Mr. Percy Rockefeller was a director of the National City Bank, which the bankers said was concerned to protect the bondholders and whose president was on the bondholders' committee. Mr. Davison, without any interest in the stock, and soliciting business on the strength of the bondholdings of his bank director, Mr. W. E. Roosevelt, had been put on the committee through the recommendation of Mr. Hanauer, interested in the bond side. Two members were brokers, one of whom said that "no reason for my selection has ever been mentioned to me," and the other had bondholder customers as well as stockholder customers.

The interlocking of the committee memberships in this manner and the intermingling of interests which had to be kept independent of each other if they were to negotiate fairly to all is in marked contrast to the policy followed by one group of St. Paul participants. The Harkness group, when left to determine its own policy without suggestions from the bankers, endeavored to adhere to the general rule of business conduct which found one expression in the law against interlocking directorates, and another in Mr. Cravath's lecture of 1916. Mr. Harkness testified that, being a director of the St. Paul road, he sold a large block of stock of the National City Bank which he owned because "I thought it wiser and better in every way to not have any connection with the bank which had been the bankers for the road." That was his view of the undesirability of having a man sit on both sides of the table in corporate affairs.

That view was also entertained by his counsel, Mr. Fisher, who resigned from the St. Paul board when he formed the hope of being on the bondholders' committee; he thought it was "not

consistent" to represent bonds and at the same time own stock or be on the board. But this policy, followed on an independent judgment, was the policy of the only interest on the St. Paul board that did not sell out its St. Paul securities.

The confusion of interests in the personnel of the committees apparently did not result in any embarrassments to the stock committee members as negotiators with the bond committee. For such evidence as the record yields on the matter tends to indicate that there were no such negotiations. The reorganization plan as submitted by Mr. Hanauer to the chairmen of the stock committees remained, as to any points on which negotiation with bondholders might have been attempted, virtually unchanged. Such negotiation as there was at all seems to have been between the two stock committees, with reference to the respective portions of the assessment to be borne by the two classes of stock.

The members of the stock committees were apparently selected, not with a view to their ability or interest in acting for the stockholders, but for their advertising value in attracting the stockholders to the bankers' program. The Interstate Commerce Commission's report of its investigation included a finding that the members of the stock committees "represented no substantial stock interest. They were selected with the idea that the prestige of their names and positions would insure the success of the committees in securing deposits of stock."