

*MACHINERY OF SOLICITATION*

THE first public step in obtaining the bonds and stock of the St. Paul investors was to stake out the managers' claims to the field of solicitation. In the reorganization rush, as in the receivership rush, the bankers wanted to be first—to solicit the securities before anyone else and to prevent solicitation by anyone else.

The announcement of a receivership is usually the first notice to the outside world that the time has come for the organization of committees. That notice was not given until the afternoon newspapers carried the report of the appointment of receivers on March 18, after Mr. Shaw and Mr. Dynes had gone to Judge Wilkerson's chambers at nine in the morning. The bankers, having arranged this in advance, were therefore confident that they could safely send advertisements of the formation of their committees to the newspapers the night before. These appeared in the morning papers on the 18th. As a result, the world knew that the committees were in the field before it knew that the occasion had arisen for the creation of committees.

The purpose of being first in the field is to discourage others from trying to fill the vacuum left if no one pre-empted the function of offering to protect security-holders. Bankers realize that this usually works. An illustration of their belief was furnished in the testimony of Mr. Wetmore, who arranged the deal in which the St. Paul acquired the Terre Haute railway and guaranteed its income bonds. The holders of those bonds had no occasion

for immediate concern, as the receivers were paying the interest on those bonds and treating them differently from the St. Paul junior bonds. But Mr. Wetmore did not want anybody else to form a committee for the Terre Haute bonds and spoke to a representative of one of the large holders of those bonds. In Mr. Wetmore's opinion, committees not organized by the bank group would be outsiders and undesirables—a point of view reminiscent of Mr. Swaine's opinion of independent receivers appointed by judges and of independent creditors who applied for the appointment of receivers. Mr. Wetmore testified in the Commission investigation as follows:

"I advised Mr. Percy Eckhart that I thought it would be advisable for him and some of his associates to organize a committee to represent the income bondholders, for the purpose of preventing an outside committee, who had little or no interest in the situation in order to see what they might get out of it, coming in and organizing such a committee and advised them not to solicit the deposit of bonds at the time. . . ."

Mr. Hanauer also advised the committees which he organized not to seek the deposits of bonds and stocks for the time being. His reasons were different from Mr. Wetmore's, but both shared the belief that advertisement of the formation of their committees would keep out intruders. The advertisements for the St. Paul bondholders' and stockholders' committees discouraged outsiders as forcefully as possible and avoided mention of facts which might lessen that discouragement. No reference was made to the fact that the committees did not intend to solicit bonds for the present and were going to await Mr. Hanauer's preparation of a plan. On the contrary, the notice published in the name of the bondholders' committee recited that "A deposit agreement is being prepared and in due course the Committee will inform the bondholders of the depositaries for the several issues and will call for the deposit of bonds."

The advertisements for the two stock committees went further and published the names of depositaries, although it was going to be some time before they would use any depositaries or

call for any securities.

The bankers did not, however, take any avoidable chances during the period when their committees were not soliciting securities; preferring committee solicitation only under their ægis and potential control, they made preparations to forestall others who might venture into the field before they themselves were ready. The bankers had put up "No trespassing" signs, but independents might claim that the bankers' committees were no better than squatters, and the field was free for all who might want to solicit the security-holders.

Careful preparations were therefore made, not to solicit bonds, but to be ready to do so at a moment's notice, if outsiders appeared to dispute the exclusive jurisdiction of the bankers' committees while they were waiting for the plan from White Sulphur Springs. Had an independent group sought to obtain the support of the bondholders during this period, the bankers' committee was prepared for soliciting bonds forthwith.

A deposit agreement under which such emergency solicitation could be carried on was promptly written by the lawyers, printed, and held ready for use. The expense of printing it and having it ready for distribution in final form would not be sheer waste even though, as it was hoped, this agreement were never used. Much as the bankers preferred that bonds be obtained from bondholders only under the reorganization agreement which Mr. Swaine was drafting, giving the bankers potential control, they were prepared, if need be, to forego this extra advantage and to get the bonds into the hands of their own committee in advance of the completion of the Swaine document rather than let a rival be the sole active solicitor of bonds, even for a day.

The deposit agreement which was ready but never had to be used was drawn up by the National City Company lawyers and was a true forerunner of the Agreement of Reorganization written by the Kuhn, Loeb lawyers. It provided that ownership of the bonds should be transferred by the bondholders to the committee. It gave the committee broad powers, conferred upon its members large rights to make side profits as well as to receive

direct compensation, and protected them by elaborate safeguards against legal responsibility or liability to bondholders.

This printed agreement named some of the financial institutions which were chosen depositaries for the bondholders' committee. The selection of these trust companies and banks constituted one of the major steps in assembling the machinery for solicitation. The important thing was to get depositaries whose names and standing would vouchsafe to security-holders the fairness and high quality of the bankers' reorganization, and the safety and desirability of turning their securities over to the bankers. The advertisements published by the latter could include the names of the depositaries, and usually did. Their selection was as important as that of the committee members, and for the very reasons assigned by the stock-committee chairmen in choosing those members—to advertise the reorganization plan effectively and to get the securities of the St. Paul investors.

The depositaries did not represent that they deemed the bankers' reorganization sound and fair. They did not even represent that they had read the bankers' reorganization plan. The duty of the depositaries, as an officer of one of them told the court, ". . . is confined solely to the custody of the securities deposited and their delivery or the delivery of their proceeds as called for in said certificates."

However, many or most of the security-holders would not be likely to indulge in such refinements. They would see, in newspaper advertisements and in circular letters mailed to them, the names of banking institutions acting as aids to the plan. Investors would be likely to assume that those institutions favored and recommended the bankers' plan.

The St. Paul bankers chose well for their purposes. They did more than choose the largest and most influential institutions. The bankers attached to their plan, and had in their pay, almost every institution of prominence in New York City. This had a double value. It multiplied the persuasiveness which flowed from such names. And it almost monopolized, in the bankers' service, the important trust companies and banks, so that independents

would be hard put to it to find any others of sufficient prominence to act for them.

The bankers appointed both depositaries and registrars, so called, of the receipts issued by the depositaries. They employed, in one capacity or the other, fourteen of the largest banks and trust companies of the financial capital of the country, including six of the seven biggest New York trust companies, and six of the seven biggest national banks in New York. An indication of the power and influence of the fourteen banks and trust companies enlisted is to be noted in their combined resources. The aggregate amount was five and one-half billion dollars, or more than one-tenth of the total resources of the 23,000 commercial banks and trust companies in the United States.

Mr. Hanauer selected the maximum number of New York institutions for his St. Paul personnel. It was not possible to add any more, because he could not make more jobs. His testimony bears this out.

*Mr. Hanauer:* . . . No such trust companies as you mention are on the bondholders' committee.

*Mr. Prentice:* No, but they have been provided for, among the list of depositaries, at fees ranging from, apparently, an average of seventy-five to one hundred thousand dollars.

*Mr. Hanauer:* You meant as depositaries? If there had been any more securities to go around, we could have included a few more trust companies, but we could not include any more trust companies than there were different kinds of securities to deposit.

The enlistment of the names of great New York banks was likely to have an indirect, as well as direct, influence with St. Paul security-holders. Many investors scattered throughout the country would feel the need for advice and would turn to their local banks. A large number of these banks had as their New York correspondents institutions on the muster-roll of the St. Paul reorganization managers. Whether the local banker ac-

cepted this fact as a sufficient basis for a recommendation to his customer or wrote to the New York correspondent bank, the result was more likely than not to be favorable to Kuhn, Loeb & Company and the National City Company.

They did not rely on New York banks exclusively, but also appointed so-called sub-depositaries, in cities from New England to the Pacific coast. The sub-depositaries were twenty-four trust companies and national banks in eight of the largest cities of the country. The metropolitan banks, in turn, were correspondents for country and local banks in their respective territories, and thus were of use as regional points from which the fan of the St. Paul bankers' influence unfolded throughout the land.

The bankers were also in a position to influence another important group to whom St. Paul bond- and share-holders might turn for advice. This was the somewhat newer profession which went by the name of investment banker and securities dealer. In seeking a favorable attitude on the part of these last, the name of Kuhn, Loeb & Company was a name to conjure with. That firm was one of the few large originators, as they were called, of securities. The originators were the bankers who initially secured stock and bond issues from railroad and other companies. The originators would then distribute these to wholesalers, or direct to retailers, in the investment banking business. The latter then sold to investors.

For wholesalers and retailers a favorable connection with Kuhn, Loeb & Company was highly profitable. That firm had a virtual monopoly on the securities issues of many of the great railroad systems and industrial corporations of the country. Distributors were therefore in the same delicate position as retailers of patented articles or of articles manufactured or controlled by monopolies. It was no wonder that securities dealers everywhere catered to Kuhn, Loeb & Company.

The following, from the testimony of Mr. Hanauer, throws light on the relations between his firm and the investment securities retailers in the United States and abroad.

*Mr. Hanauer:* Of course most of them have been doing business with us for a number of years, and the smaller ones have developed since the war, and all of those have come to us and said:

"We would like very much to distribute some of the securities you bring out from time to time. We have a clientele in this, that, or the other territory, and we believe we can sell the kind of securities you bring out; the fact that you have looked into them and passed upon them is something that helps us with our clients and makes it easier to sell the securities, and we would like very much if you would consider us on your list," so we go through a process of trying them out.

*Mr. Fisher:* Yes, you go through the process of trying them out?

*Mr. Hanauer:* Yes.

*Mr. Fisher:* And you are influenced, to some extent, by the results?

*Mr. Hanauer:* Yes.

Kuhn, Loeb & Company and the National City Company had on their lists a large proportion of the securities wholesalers and retailers of the country, favorably inclined to them, and dependent on them for desirable business. This influence was intensified by the market conditions during the period when the St. Paul bankers were engaged in their campaign to obtain control of the St. Paul securities. Dealers were in a position to market all the bonds they could get from Kuhn, Loeb & Company and National City Company. As Mr. Hanauer testified when he was on the stand in 1926, ". . . there wasn't any bond market in years equal to the bond market in 1925 and 1926. . . . The wonderful bond market we are having now. . . ."

Mr. Hanauer could count on even more than the influence of his firm and Mr. Mitchell's bank with the country's security dealers. The institutional staff which the bankers had gathered together for their St. Paul reorganization had weight, also. More than two-thirds of the banks and trust companies serving the

Kuhn, Loeb-National City reorganization plan were at the time members of the Investment Bankers' Association of America. Officers of some of those institutions were on the governing committee of the association and on more than half of its other committees and held office in four of its regional groups. Among the members of its committee on railroad securities were Mr. Hanauer himself and two officers of institutions to which he had accorded the post of depositary or sub-depositary.

As the period of solicitation of St. Paul securities continued, Mr. Hanauer's rise in the association continued. He became a member of its board of governors, and before the St. Paul reorganization was completed he was vice-president of the association.

He was in a highly favorable position to influence the third of the three classes of advisers whom St. Paul security-holders might consult on the question of turning over their bonds and shares to the St. Paul bankers. This third class was made up of stock-brokers. These would find it undesirable to antagonize such houses as Kuhn, Loeb & Company and the National City Company. Brokers were sometimes permitted to have a part in distributing syndicates, and the commission they received on such transactions was often larger than they could make on the sale or purchase of seasoned securities on the stock exchanges. Brokers were of course also interested in the latter class of business, and the bankers had a large volume of such business available from time to time to brokers who pleased them.

Both brokers and securities distributors wanted also to maintain satisfactory relations with the institutional staff which was in the pay of the St. Paul bankers under their reorganization plan. Both had frequent occasion to borrow money for the financing of their business and were dependent on a number of those banks and trust companies for loans. There was a further reason for desiring undisturbed relations. By the year 1925 the intermingling of trust-company business, commercial banking, and the origination and flotation of securities, all under the roof of a single institution, with or without affiliates, had already gone

far. Just as retailers and brokers were desirous of being on the syndicate lists of Kuhn, Loeb & Company and the National City Company, so many of them desired to be on the lists of some of the banking institutions which had tried to become, as was felt at the time, department stores of finance.

The important factor in connection with local banks, distributors, and brokers to whom St. Paul investors might apply for guidance was that the guides did not have the time to study Mr. Hanauer's plan carefully or the skill to understand Mr. Swaine's agreement. Many of these advisers would therefore have to act to a considerable extent on outward or superficial appearances. Here the names connected with the bankers' plan would weigh heavily. Besides the greatest trust companies and the greatest national banks, as depositaries, registrars, and the like, the bankers had on their committees officers of four of the largest life-insurance companies, the president of the American Bankers' Association, and a vice-president of the New York Stock Exchange.

Mr. Hanauer also arranged, as has been seen, that his plan should be accompanied by a commendatory letter from the consulting engineers, Coverdale & Colpitts. Investors and the financial community had been told, months before Mr. Hanauer's plan was issued, that this firm was to make an independent study of the St. Paul road and its problems. The bankers thus had the support of these widely advertised experts on St. Paul affairs.

It was denied that the bankers had solicited the help which they had from the receivers. However it came about, the bankers nevertheless had the backing of two of the receivers, trustees appointed by a high court to protect the St. Paul investors. To many the receivers' public advocacy carried with it the name of the United States Court, the great neutral and impartial guardian of the interests of all the St. Paul security-holders. Such support as the receivers gave was handsome and expeditious. Less than three weeks after Mr. Hanauer's plan was made public, the newspapers carried Receiver Potter's statement that the plan was "a wise one, beneficial to security holders," and one news-

paper reported that "Mr. Potter said he had been completely won over to the program of the reorganization managers and was convinced it would stand scrutiny from any angle."

The bankers arranged to give to the receipts which their depositaries issued for actual St. Paul securities, the appearance of real bonds and stock. These receipts were "listed," as it is called, on the New York Stock Exchange. In following this practice the bankers gave to their receipts the name of New York Stock Exchange securities. Those receipts said that they were issued under the terms and provisions of Mr. Hanauer's plan and Mr. Swaine's agreement. It was thus implied that the greatest stock exchange in the world gave its sanction to the methods by which the bankers were seeking to deal with the St. Paul investors, as consonant with sound and decent financial practice.

In addition to the names of imposing trust companies, national banks, bankers' associations, and the New York Stock Exchange, which were interwoven with the bankers' advertisements from time to time, the bankers had the names and addresses of many of the St. Paul bondholders themselves. The importance of such lists was stressed again and again by Mr. Hanauer, in urging that receivers should not reorganize distressed corporations. His view of the great value of being able to get into direct touch with bondholders had behind it the authority of long experience in reorganization work. The bankers used the list of owners who had bonds maturing in 1925—the list secured by the company from its paying agents in 1924 at Mr. Hanauer's suggestion. Speaking of this list, Mr. Hanauer testified that "a great deal of use has been made [of it] in reaching security-holders in connection with the reorganization plan."

The bankers also had the best access to the lists of purchasers of the St. Paul bonds from retailers who had been on the original syndicate lists. There were many such distributors, as appears from Mr. Mitchell's testimony.

*Mr. Fisher:* Now, in these St. Paul securities that were marketed, in part, through your company, would you make an

approximate estimate of the number of concerns that were invited to participate in connection with it?

*Mr. Mitchell:* I have not refreshed my mind on that, and I would not want to guess at it—a large number.

These concerns were beholden to the bankers for the profits made in distributing the bonds originally. Many of them were also, as appeared in the testimony of Mr. Hanauer already quoted, desirous of further occasion for remaining beholden.

The lists secured by them from these sources enabled the secretary of the bondholders' committee to send out seventy thousand letters to persons who were thought to have St. Paul bonds.

These lists were likely to be quite incomplete. To meet this difficulty, the attorneys for the bankers provided a system by which the bankers could, without financially burdening themselves, conduct a large advertising campaign. It might turn out to be an expensive one. The bankers actually published large advertisements in half a hundred newspapers from coast to coast and in a score of financial periodicals.

To pay the bills, the bankers or their committees had the right to take each St. Paul bond sent by an investor to one of their depositaries, and borrow money on it at the bank. If the bankers' reorganization plan had failed and the bonds became returnable to their real owners, the latter would have been unable to get them back without paying the money which the bankers had borrowed. Money borrowed in this way could be used for more advertisements, to get in more bonds, and so on continuously. All this was permitted under the Agreement of Reorganization.

The St. Paul bankers thus went to work soliciting the securityholders' bonds and stock with elaborate, shining, and attractive tools.