CHAPTER XXX

COURT AND COMMISSION SCRUTINY OF THE PLAN

The reorganizers followed these policies in dealing with court and Commission: they tried to restrict the government agencies to a consideration of the bankers' plan alone and to as limited a portion of it as possible; they tried to discredit and silence protesting bondholders, before the court and the Commission; they tried to prove that the parts of the reorganization submitted to the tribunals were fair; they attempted to persuade them to permit the reorganization to become effective, for reasons apart from the merits of their plan.

The bankers opposed the preparation of any plan by the government authorities, or their consideration of any plan prepared by any independent. Mr. Swaine said to the Judge: ". . . it is not the business of the courts to write reorganization plans. It is their business to determine whether or not there is a reasonably fair opportunity to come into a fair reorganization."

When the bankers submitted their reorganization to the court and the Commission, they left out such important sections as those dealing with management, control and their exercise of the broad powers and personal privileges reserved to them by the agreement. The bankers themselves did not suggest any supplemental proceedings to deal with these matters.

Having restricted the subject-matter of supervision, the bankers and their group sought to obtain a favorable decision

on the merits of the plan. They had to meet objections by independent bondholders, and did so in part by discussing those objections and in part by trying to discredit the objectors. The attorneys for the bankers charged that some of the people connected with the opposition had purchased bonds at receivership prices. This charge began to color the proceedings and affected the standing of the independent committee in the receivership court, even before the fairness of the bankers' plan came up for consideration. About a year after the charge was first made, however, the bankers were asked whether they had been buying any of the St. Paul bonds during the receivership. It then appeared that the two banking houses had been buying, at the very time their lawyers were attacking one of the committees on that ground.

Mr. Swaine, the bankers' attorney, offered an explanation. Kuhn, Loeb & Company, he said, "is a dealer in securities." When he came to tell of the $17,000,000 of bonds purchased by the National City Company during the receivership, he explained that that company "is an active dealer in securities." The attorneys for the independent committee later called attention to the fact that the National City Company had sold its St. Paul bonds in advance of receivership, and then bought after receivership, and that the independents who bought did so largely before receivership and kept what they bought. The lawyers for the independents added: "It is a strange perversion of logic to say that a security-holder who sold out and ran to cover at the prospect of trouble is a proper person to represent investors, but that a security-holder who stood by in time of trouble is a speculator."

Commissioner Eastman later dealt with this issue. He intimated that the question whether a plan is fair or not should be determined on its merits. He added: "If speculation is a reason for discrediting the views expressed by the protestants, it is equally a reason for discrediting other views that have found voice before us."

In both the court and the Commission proceedings, the bankers sought to discredit the arguments of the opposition on an-

other ground: namely, that it was trying to delay the reorganization. This charge was frequently made in court while the bankers were engaged in withholding their plan from both court and Commission, and delaying its consideration by those tribunals for about two years.

When the bankers finally brought their plan to the court, they submitted testimony and elaborate briefs to prove that it was fair. But they also urged the court, and later the Commission, to approve the plan on grounds which did not deal exclusively with its soundness and its fairness. Both the courts and the Commission were told by the bankers' attorneys that rejection of their plan, or serious modification of it, would keep the property in the hands of the government tribunals for a long, possibly indefinite time.

The attorney for one of the trust companies urged the court to confirm the sale ". . . because of the fact that in the event of another sale, great expense and delay would necessarily be entailed."

When the plan came before the United States Circuit Court of Appeals, the attorneys for the Guaranty Trust Company said that they ". . . desire to avoid, if possible, the great delay and expense . . . which would be entailed in a resale of the properties of the railway company."

The attorneys for the preferred-stockholders' committee told the Interstate Commerce Commission that if it rejected the bankers' plan, there would have to be further negotiation among the security-holders; and that ". . . negotiation would take a great amount of time; it would add greatly to the expense. Approval of the courts would have to be again obtained. Meantime all measures for rehabilitation would be in chaos."

In short, just as the security-holders had been hurried in without the help of adequate public hearing and scrutiny, the courts and the Commission were to be hurried in on grounds of expense and delay.

Another of the arguments of the reorganization group was drawn from the fact that the bankers already had control of a

large proportion of the St. Paul bonds and shares. They said that the owners of these securities had approved the plan. The attorneys for the bankers called Judge Wilkerson's attention to ". . . the mute testimony to the fairness of the Plan of thousands of . . . bondholders who have deposited their bonds. . . ." The same lawyers said to the United States Circuit Court of Appeals: "The overwhelming support of the Reorganization Plan by all classes of security-holders . . . is a practical guaranty of the equity of the provisions of the Plan." They used the same words in a brief to the Interstate Commerce Commission. And when independent bondholders, having failed in their efforts against the bankers' plan in the lower courts, asked the Supreme Court of the United States to examine the plan, the bankers' attorneys said that ". . . the real parties in interest . . . are the bondholders and stockholders . . . numbering over forty thousand . . . who share with the general public the vital interest that the Plan be promptly carried out. . . ."

The argument was a successful one. Even before the bankers' plan was submitted to Judge Wilkerson, he was already talking of the need for letting the "great majority of the bondholders" have their way on various matters. His assumption that the security-holders had assented voluntarily, after adequate opportunity to know the facts, was shared by the Circuit Court of Appeals. In its decision appear the following words: "While in such matters majorities do not govern, the approval thus signified by this vastly greater number, whose interests are identical . . . with those of the objectors, is entitled to much weight in determining whether or not the Plan is equitable and fair."

The majority of the Interstate Commerce Commission were also impressed with the talk about numbers and percentages, and said: "Against the interest represented by a great number of security holders and by high percentages of the amounts of securities outstanding, is the interest of a small number of bondholders owning a relatively small percentage of . . . bonds. It has not been shown wherein such bondholders will be injured to any greater degree than the bondholders assenting to the plan;

nor has it been shown wherein the public interest will be served by denial of the application."

Commissioner Eastman and two other members of the Commission were outspoken in their rejection of the bankers' claims of majority approval. In discussing the methods by which the security-holders had been induced to assent to the bankers' plan, they said:

"In advertisement after advertisement the possibility, if not the probability, of serious penalties if they did not come in within the time limit was made very clear to the security holders. . . .

"Nor is this all. . . . This sale price . . . determines the cash that a nonassenting bondholder who is not a party to the reorganization plan will receive, and it means about 48 cents on the dollar. A nonassenting stockholder will receive not one cent.

". . . Resistance upon the part of security holders involved a probability of heavy expense and also grave risk of ultimate disaster. That they at length flocked to the standard of the reorganization managers after considerable evidence of reluctance is not a fact which should weigh heavily in our deliberations."

The contention of the bankers' attorneys meant that the government tribunals, having more experience than the rank and file of the investors, and being far better equipped to get the facts and arrive at a sound judgment on the bankers' reorganization plan, were to be persuaded by something more than that judgment alone.

The receivership Judge conducted hearings on the merits of the bankers' plan and approved it as it stood. He said that both Mr. Hanauer's Plan and Mr. Swaine's Agreement of Reorganization were "equitable." He signed an order that everybody should be "forever barred from making hereafter any complaint" about the Plan or the Agreement or anything contained in them.

One of the independent committees thereupon indicated that it would appeal to a higher court, and also contest the bankers' plan before the Interstate Commerce Commission. The bankers tried to prevent this by threatening that if the independents did not yield before a given date (which was prior to consideration of the plan by the appellate court or the Commission), they might be excluded from the reorganization altogether. In this extremity the independent committee asked the receivership Judge for help. But he refused to forbid the bankers' use of such pressure. The committee nevertheless took the risk of grave loss, continued its appeal, and told the higher court of the attempt to block the appeal. The bankers' attorneys thereupon, to quote the words of the Circuit Court of Appeals, "openly disclaimed all intent to cut off the exchange right of appellants' bondholders" (that is, the independents' right to share in the reorganization if they were unsuccessful in the appeal).

The appellate court did not, however, rely on this disclaimer, but directed that "to allay all fear of oppressive or speculative action" the bankers should be deprived of the power which Mr. Swaine conferred on them in the reorganization agreement, to fix any date limits they wanted. The appellate court required that the bankers must first obtain the consent of the receivership Judge.

The Circuit Court of Appeals at the same time rejected the arguments of the independent committee on the merits of the bankers' plan, and the only obstacle which still remained before them was the Interstate Commerce Commission.

The reorganization managers demurred against dual supervision by courts and Commission. Their attorneys said to the Commission: "Surely there cannot be two independent tribunals to decide the same question." They wanted the court to make the real decision, and the Commission to accept automatically the court's determination on any matters adjudged by it.

Such jurisdiction as the Commission had was conferred upon it by Act of Congress in 1920, requiring it to investigate and approve or reject issues of railroad securities (including, of course, reorganization securities). Such jurisdiction as the court exercised in the St. Paul case was not conferred upon it by Congress, but was a development by some federal judges at the request of several New York financial lawyers. These decided in 1916 to persuade federal judges in charge of receiverships to do what

they had not done before: to supervise reorganizations, and to render decisions which would be binding upon all security-holders. In this way, they thought, they might escape the consequences of a United States Supreme Court ruling, made in 1913, that creditors who received unfair treatment in a reorganization could collect the full amount of their claims. The lawyers hoped that a court decision on the fairness of a reorganization plan before its consummation would prevent security-holders from attacking it thereafter.

A decade after the first use of this new device, Mr. Swaine said in his lecture to the Bar Association that the courts had "undisputed jurisdiction" over the question of the fairness of reorganization plans. He warned the Commission against exercising jurisdiction over the same subject-matter lest there be a conflict between the decisions of the two government agencies. He said that the court hearing usually precedes the Commission hearing, and that the court decision should be binding on the Commission.

In the St. Paul case, the court hearing came first. This procedure was determined by the bankers and their attorneys, not by the courts or by the Commission. The value to the bankers in going to court first and then saying that the Judge's decision bound the Commission also was a substantial one. Their tactics, if successful, would enable them to pick the government official who would decide whether their plan was fair or not. Their choice, as between a tribunal with a permanent staff of its own independent selection and a judge dependent upon a staff chosen by the bankers, would fall on the judge. As between a commission which had dealt with the St. Paul railway for years, and a judge who had had only the most occasional contact with it and knew little or nothing of the railway's affairs, the choice would fall on the judge. As between a commission which knew a good deal about the practices and standards in the banking business, and a judge without such contact and knowledge, the choice would fall on the judge.

To prove to the Commission that it must accept the Judge's

decision on the question of the fairness of the plan, Cravath, Henderson & de Gersdorff sought to invoke a doctrine which lawyers call *res adjudicata*. They said that the dispute as to fairness was a dispute raised by an independent bondholders' committee, that the courts had decided against the committee, and that the dispute was therefore an adjudicated affair. But the Commission was not persuaded by this argument. A majority of the Commission said: "As the public interest is to control us in the determination of such applications, the doctrine of *res adjudicata* is inapplicable."

Minority members, agreeing on this point with their colleagues, said:

"This doctrine has no application here. . . .

"In making the findings which the law requires it is our own judgment which must govern, and not the opinion which some court may have expressed upon a similar issue. . . .

"The law makes it our duty to *investigate,* and if applicant or interveners do not develop the facts necessary to an informed judgment, it is our duty to develop them."

The reorganizers used another argument to persuade the Commission that it had no concern with the fairness of the plan. They said that the Commission was limited to dealing with matters of public interest, and that the question whether the St. Paul reorganization was a fair one or not related to something altogether private. The bankers' lawyers said that the bondholders opposed to them "have attempted to introduce into these proceedings questions solely affecting private rights arising out of a dispute between majority and minority bondholders with respect to the terms of the reorganization."

Gradually they came to put their argument less broadly. "The truth of the matter is that there is no public interest in the details of the arrangements by which the various classes of security holders, after negotiation, adjust their respective claims in a reorganization, so long as the terms of such arrangement are not so clearly inequitable as to indicate fraud or overreaching and so long as the aggregate of the new securities does not constitute

such a burden on the property as to impair its ability to perform its public duties."

The Commission rejected such claims, saying: "The terms and conditions of such reorganization and the treatment to be accorded such security holders may have a material bearing on the public interest."

In spite of the failure of these arguments, the bankers got most of their reorganization past the Commission. This was in face of the fact that its members did not like what had been done in the St. Paul reorganization, and said in their investigation of the St. Paul affair that with respect to receivership and reorganization "we have a situation which is fundamentally unsatisfactory and requires reform." A majority of the commissioners nevertheless felt that they should yield to the bankers' argument about the danger of delay.

Four of the eleven members of the Commission disagreed with the majority. The minority felt that the property and the security-holders would not suffer if the receivership continued while a better plan for the St. Paul investors and their railway was being prepared. It will be recalled that the receivership administration had certain large advantages over administration by the old St. Paul company, that the receivers were able to operate free from the annual burden of almost ten million dollars in interest charges on the junior bonds, and that they were therefore in a position to make considerable improvements to the property.

Commissioner Eastman wrote a dissenting opinion, in which Chairman Campbell of the Commission and Commissioner McManamy joined, in which he said: "Moreover I believe that reasonable changes in the plan could and would be made without undue difficulty. But even if delay ensued, it would be no dire misfortune for the property to remain a little longer in receivership. It has so far been much improved during the receivership, and doubtless this improvement would continue."

This statement was preceded by the following comments of the minority:

"As I understand their position, the majority of the Commission are not here authorizing the desired securities because they regard all of the provisions of the reorganization plan with favor. On the contrary it is made quite clear in the final paragraphs of the report on the general investigation of St. Paul affairs that they recognize the 'obvious shortcomings' of the plan.

"They find themselves faced with the alternatives of either approving a poor plan or compelling the negotiation of new agreements with the likelihood of further considerable delay and expense in taking the railroad out of receivership. In this dilemma they choose approval of the plan as the lesser evil in the public interest.

"Such a conclusion, it seems to me, is ill-considered. This is not the first time that the commission has approved reorganization plans upon such a theory, and in at least two instances there have been successive reorganizations of the same property. The need for a more positive policy is clearly indicated. The effect upon the country of a rejection of this plan would be tonic."