CHAPTER X

THE RECEIVERS AND THEIR ATTORNEYS

It was Mr. Hanauer who emphasized the breadth of power conferred upon the St. Paul receivers, and the need for scrupulous neutrality and impartiality in their conduct of affairs. He said they were "more or less czars of the situation," and "they are the court. . . . My belief is that the court . . . should stay absolutely impartial." It was generally agreed that the receivers and their lawyers "are officers of the court."

Mr. Cravath, the head of the bankers' law firm, dealt with the need for independent receivership administration when he addressed the lawyers' association in New York, nine years before his clients had to consider the same problem in the St. Paul case. He said: "The usual preference of the court to appoint at least one person of its own selection as an independent receiver is justified by the very grave responsibility assumed by the Federal Court in receiverships, which makes it proper that at least one of the receivers should be a person having the full confidence of the Court and known to the Court to be free from bias and entanglements. As has been well said, the Receiver is 'the eyes,' 'the ears' and 'the hands' of the Court and should be 'absolutely impartial.'"

The men to be appointed receivers of the St. Paul railroad needed exceptionally high qualities of understanding and skill in the discharge of their duties as guardians for over forty thousand scattered security-holders and in the performance of

their duties as officers of a United States court. They needed freedom from entanglements with the past and from embarrassing relationships with those who might have to be held responsible for any past transactions affecting the St. Paul. The receivers would require effective aloofness from contending sides, in the event of disputes among security-holders about the reorganization of the company or on any other issue. The magnitude of the property and such facts as were already public with respect to unfortunate chapters and dubious incidents in St. Paul history emphasized the pressing need for caution and independence in the selection of the receivers and their attorneys.

The selection of receivers for the St. Paul was, as the event showed, in the hands of its bankers, for they selected two of the three receivers, and the bankers' representative took part in a conference in which he agreed on the third.

To begin with, the bankers nominated one receiver by a process of assumption. Mr. Hanauer told the most active of the company's board, a lawyer representing the Harkness interests, that "it was of course generally believed that the court would appoint Mr. Byram, because the president of the company is always, as a rule, appointed receiver." Mr. Mitchell, president of the National City Bank, said that "of course in discussing receivers we assumed from the outset that the court would appoint the president of the road as an operating man."

This selection placed at the head of the court's administration of the property the head of that business administration under whose auspices the company had arrived at bankruptcy. The selection was therefore, at any rate on the surface, a departure from sound business policy as well as from the principle of independent court administration, free from past connections and embarrassments. For this appointment two reasons were given by the bankers: namely, that an operating man should be a receiver, and that the presidents of bankrupt companies are customarily made their receivers. The first argument disregarded the fact that some of the most successful railroad heads, such as Mr. Harriman, were not operating men. Just as railroad

chiefs and railroad directorates can employ operating executives, so can receivers of railroads; it would then be unnecessary to violate the requirement for independent and untrammeled receivers. The other argument of the bankers, that the head of a bankrupt business is conventionally one of its receivers, would result in a doctrine that the men in control of insolvent companies must always be accorded a friend at court, and in the highest post there. In the St. Paul case it gave the bankers a receiver desirous of continuing his employment with the property after its reorganization and cognizant that the bankers were likely to have an important, and perhaps a controlling, voice in the selection of the reorganized company's staff.

The second receiver chosen by the bankers was Mr. Potter, previously a member of the Interstate Commerce Commission and before that, for some ten or fifteen years, a partner of the principal New York attorney for the St. Paul company. The latter had had many years' dealing with the bankers and their lawyers on the numerous occasions when the St. Paul floated its bond issues. In the period just prior to receivership the New York lawyers for the company had worked in close collaboration with the bankers' lawyers, following their lead throughout.

The method chosen by Mr. Hanauer for bringing Mr. Potter into the receivership was one which made it clear to the latter that his appointment, if confirmed by the court, would be due to the bankers' good word for him. He was asked by Mr. Hanauer to call at the Kuhn, Loeb offices and did so, two weeks before the court turned the entire St. Paul property over to Mr. Potter and his two associates. Mr. Hanauer gave his recollection of the interview, as follows:

"Mr. Potter came in to see me at my request, and I turned around and said: 'Is it Mr. Potter or Commissioner Potter?' He said: 'It is Mr. Potter. I am out, and have been for some little time.' I said: 'Can I ask you this question? There is a very great possibility, it is definitely determined, that there may be a receivership of the St. Paul. We feel in the interest of the security-holders at large that there should be one of the receivers of large

experience, well known nationally, who has the confidence of everyone. Would you let me suggest your name?'

"He thought a moment, and said: 'Yes, I think that you might. I think that would give me an opportunity of really doing some good work,' and I said, well, of course, I was not appointing receivers, but that I was in hopes that the judge of the court would follow a suggestion like that if it could be made to him."

Thereafter, to quote Mr. Potter's testimony, "Mr. Hanauer did not speak to me again. Mr. Miller [Mr. Potter's former law partner, and New York lawyer for the road] called me on the telephone one Sunday morning and wanted to know if I could have dinner with him that evening, and I did. That was on a Sunday evening [March 15] I went to his house and had dinner with him, and he then said: 'It has been decided to put the St. Paul in the hands of a receiver. I understand that you said that you would take the appointment if the Judge would appoint you.' I said, 'Yes.' He said: 'Could you go to Chicago tomorrow and qualify if you are appointed?' I said, 'Yes,' and I went."

Mr. Hanauer felt that Mr. Potter would qualify as one "in whom the public had the greatest confidence, in whom the investors would have the greatest confidence." Former Governor Philipp of Wisconsin, the so-called "Wisconsin" director of the St. Paul road, said, however:

"As far as I can make out, the small stockholders of the St. Paul system were not represented in the appointment of the receivers. I mean those people in Wisconsin and the northwest who invested their money in the stock of the company when it was regarded as a gilt-edge security and from which they hoped to receive dividends for the support of themselves and their families."

Though the reasons given for Mr. Potter's selection disregarded his connection with the old St. Paul managing group and the friendly connection between nominator and nominee, others did not forget these considerations. Even Mr. Potter was aware of them, as shown in a statement made shortly after his

appointment, to Louis Seibold, who was preparing a series of special articles on the St. Paul receivership for the New York *Evening Post*. Mr. Potter was thus quoted in one of the articles: "My first intimation came in the form of a request, a few days before my appointment as receiver, that I represent banking interests who had large sums of money invested in St. Paul securities."

These banking interests were the St. Paul company's bankers, although the investment was that of their customers and not of themselves. No other banking interests were behind Mr. Potter's selection, for he testified that "I am absolutely certain that no person in any way suggested or referred to the possibility of my appointment, except Mr. Hanauer that first day in the office. . . ."

The connection between Mr. Potter and the bankers as the real basis for his being made receiver is further borne out by a report of distinguished lawyers speaking for the Chicago Bar Association. They said that it was felt he was qualified to meet the need for a receiver who "could be helpful in advising the reorganization managers in the preparation of a plan."

Mr. Hanauer denied the propriety of any participation by receivers in the drafting of reorganization plans, saying that it was their duty to do as the court itself must do, "stay absolutely impartial and be prepared to consider any plan that may be prepared and presented before it." He felt that the receivers "could not enter into differences of opinion between various classes of security-holders." When Kuhn, Loeb & Company and the National City Company issued their reorganization plan and it was assailed by independent bondholders in a vigorous contest, Mr. Potter publicly advocated the bankers' plan. This was long before there had been any public hearing on the fairness of the plan, and before opposition groups had been able to develop the pertinent facts on the issue and present them to the court or the receivers.

With respect to the means of carrying out Mr. Hanauer's

proposal that Mr. Potter be made a receiver, Mr. Hanauer testified to complete ignorance. He said that he had put his thought to Mr. Byram, who "said he thought it would be a very good idea," and to the representative of the Harkness interests, who "said it was a very wonderful idea." Mr. Hanauer said that he "discussed it, of course, with our own counsel." But beyond this he had no hand in the matter. He did not know who conveyed the idea to the court or who made the recommendation, and he "heard nothing more about it . . . until Mr. Potter was appointed."

The third receiver, Mr. Brundage, was suggested in the private conference between Judge Wilkerson and Mr. Shaw the week before the receivership. There is a difference of opinion on the question of the source of the suggestion. The Chicago lawyers' committee said that ". . . the personnel of the receivers was discussed by the bankers with their New York counsel, who in turn discussed this matter with Chicago counsel, the firm of Winston, Strawn & Shaw, represented by Mr. Ralph M. Shaw. The New York bankers suggested Mr. Byram . . . and Mr. Potter . . . and Chicago counsel suggested the name of Edward J. Brundage. . . . Mr. Shaw, as local counsel for bondholders and other creditors, recommended to the court the three gentlemen mentioned. The court took the suggestions under consideration and later made the appointments so recommended, Judge Wilkerson not having insisted upon, urged, or suggested the appointment of Mr. Brundage."

In Mr. Hanauer's advance discussions of the personnel of the receivers he said to an associate "that it was very likely that he [the Judge] would appoint someone well known to him." Mr. Brundage was apparently the receiver so appointed. When Judge Wilkerson was a practicing lawyer, he had served under Mr. Brundage as Attorney General of Illinois, and had later formed a partnership with him for the private practice of the law.

Evidence bearing on Mr. Brundage's fitness appeared later, not only in the St. Paul case, but in the receivership of a large

industrial corporation of which Judge Wilkerson had appointed him receiver one month before the St. Paul receivers were named.

That receivership was obtained by fraud. It was Mr. Brundage's duty to protect the Judge and, upon learning of the fraud, to report it to him. Mr. Brundage did not prove alert in ascertaining the facts and protecting the processes of the court which appointed him. Instead of detecting the fraud upon the court and denouncing what had been done, he retained former partners of Judge Wilkerson to act as his attorneys in the receivership and resisted attempts to quash the proceeding. This resistance was carried all the way to the United States Supreme Court, which decided that there had been "a fraud not only upon the state court but upon the federal court itself, and when the federal court learned the method by which its jurisdiction to appoint a receiver had been invoked, it should have denied to those who were guilty the further use of its jurisdiction. . . ."

Mr. Brundage's task in the St. Paul case was, of course, a more difficult one than in the other receivership, where he was the sole receiver. In the St. Paul administration he was in effect the minority receiver, coupled with others who could not be said, again quoting from Mr. Cravath's address, "to be free from bias and entanglements."

Each of the three receivers had, theoretically, power equal to that of each of the others. Practically, the president of the company was the head of the receivership administration. He was the full-time receiver, resident in Chicago, where the company had its principal offices and its principal books. Mr. Potter resided in New York. Mr. Brundage was conducting a private law practice in Chicago. He had many other things to do. For example, he was at the same time a receiver of a large industrial corporation. He was also attorney to a governmental body in Cook County, Illinois.

In addition to the disproportionate power which comes to that one among several who devotes himself exclusively to a business and is right on the spot, Mr. Byram had the advantage

over his colleagues which comes from special knowledge of the property and the staff. President Byram also was raised above his co-receivers by the force of habit and inertia. It was to him that the officers and employees would look, rather than to the other receivers. He stepped from many years' chieftainship as a president to a practical chieftainship as receiver. Special efforts would have to be made to renounce any of that long-exercised authority; little if any effort would be needed to retain it.

The difference in the extent of the service and activities of Mr. Byram and his two associates was emphasized promptly after their appointment. Mr. Byram's monthly salary was made fifty per cent larger than that of either of his colleagues. To be sure, this difference in salaries was probably suggested to the Judge by those who were really in charge of affairs. But the difference was officially approved and recorded in a court order. If notice were needed, here was notice that the court expected Mr. Byram to shoulder a much larger portion of the work of administering the property than was expected of either of the other receivers. And with this larger portion of the work went the larger portion of the power.

Mr. Byram was accustomed to serving with a board which did not function and which left things of major importance to him. Having had years of experience of this sort with a board of directors, being singled out by court order to serve with two other receivers, but to carry a larger part of the work, it would be easy for him to go ahead single-handed and not give to his colleagues any greater participation than might seem to him necessary. This was made clear quite early in the receivership.

The demonstration came in connection with the need for doing some financing. Mr. Byram was an operating man and, as the Commission found, inexperienced in finance. One of the other receivers, Mr. Potter, had been for some years in constant and close touch with railway financing. He had been a member of a special division of the Interstate Commerce Commission dealing with that subject. In that post it had been his duty to consider what was the best way to safeguard railway investors.

One such problem was that of the monopoly which certain bankers had of the railway financing business. On the very first financing deal which fell within his jurisdiction as one of the receivers, he was committed by Mr. Byram's actions, without an opportunity to express an opinion. Before the other receivers knew it, Mr. Byram had given the business to Kuhn, Loeb & Company and the National City Company.

This was early in April 1925, a few weeks after the receivers were appointed. They discussed among themselves and informally with the Judge the question of buying new equipment. Before the middle of April Mr. Byram called for bids from car companies, and within a month thereafter he placed written orders for over twelve million dollars' worth of equipment. Neither the other receivers nor the Judge knew that he had called for bids or made a contract to buy equipment.

In order to finance the purchase he arrived at an understanding with Kuhn, Loeb & Company and the National City Company, to sell to them over nine million dollars' worth of high grade, readily salable securities, known as equipment trust certificates. Mr. Byram did not call for competitive bids or give any other bankers an opportunity to obtain the business. Nor did Mr. Potter learn of this understanding with the bankers of the St. Paul road until some time later.

Of these and other aspects of the deal Commissioner Eastman of the Interstate Commerce Commission had the following to say:

". . . It seems to me extraordinary that one receiver should have committed the carrier to an expenditure of about $12,000,000 for cars without the knowledge of the court or even of his co-receivers. It seems equally extraordinary that even after this knowledge had been gained, at least one of the receivers should for some weeks have been unaware that a practical understanding had been reached many weeks before as to the bankers to whom the issue of equipment trust certificates should be sold, and that these bankers should, from the very beginning, have had a more intimate relation with the entire transaction, including the determination of the need for the equipment, than all but one of the three receivers."

Just as the bankers could look to a friend in the receivership administration for continuance of their monopoly of St. Paul financing, so they and the old St. Paul régime had the benefit of seeing their friends in the posts of counsel to the receivers. The appointments to these all-important posts were made by order of the Judge, but he apparently appointed the men whom the receivers suggested. His conception of his function in signing such orders is probably indicated by his statement with respect to the choice of counsel for a special piece of work. The Judge said: "What more could the Court do in administering the affairs of any corporation than to say to the receivers: Get the best lawyers available in that particular field and be governed by their advice."

The best lawyers whom the receivers deemed available for the legal work of administering the St. Paul receivership were the western representatives of the St. Paul bankers' attorneys.

"As a matter of fact," said Mr. Shaw in the Commerce Commission's inquiry, "I was working for the receivers from the instant they were appointed . . ." From the time of their appointment, he later added, "I was in court every minute of the time there for two or three days. Applications were made verbally, and in every conceivable way. . . . If you know anything about a big receivership," he said to the lawyer who was examining him to ascertain his relation to the affair, "you know that for the first three or four days you are in a great rush, asking the court and asking the receivers that [sic], and doing this and doing that." As soon as the first few days' rush was over, an order was submitted to Judge Wilkerson appointing Mr. Shaw's firm special counsel for the St. Paul receivers. Mr. Shaw himself denominated his firm "western representatives" of the Kuhn, Loeb lawyers. The receivers also had other lawyers. But the important ones were Mr. Shaw's firm, as indicated by the final fees awarded by the Judge's order, when Winston, Strawn & Shaw were granted additional fees of $175,000, and all the other law-

yers for the receivers put together received $70,000 additional.

The other lawyers were connected with the defunct company. Two of them were the regular Chicago attorneys of the company, handling the ordinary railroad law work. In addition, the order signed by the court appointed, as eastern counsel for the receivers, the same lawyers who had acted in a corresponding capacity for the St. Paul company.

The United States Supreme Court commented on the subject of friendly receivers when it dealt with the fraudulent receivership case which began one month before the St. Paul appointments (the case in which Judge Wilkerson appointed Mr. Brundage receiver). Chief Justice Taft said: "Circumstances which should have no influence lead the parties in interest to prefer one court to another in the selection of the person to be appointed as receiver, with the hope on the part of those in charge of the embarrassed corporation that the appointment may fall to one whose conduct will be in sympathy with, rather than antagonistic to, the previous management of the corporation, in the hands of which the embarrassment has arisen. There should be no 'friendly' receiverships, because the receiver is an officer of the court and should be as free from 'friendliness' to a party as should the court itself."