CHAPTER XXIII

THE BANKERS' POWERS

THE bankers deemed it necessary to have certain powers in order to carry out their reorganization program. While Mr. Hanauer was developing his plans at White Sulphur Springs, his lawyer, Mr. Swaine, was there with him, developing the powers the bankers should have. These were placed in the Agreement of Reorganization.

The document prepared by Mr. Swaine complied fully with the advice which his senior partner, Mr. Cravath, gave to the lawyers of New York in his 1916 lecture. The latter said: "It is very important that counsel should see that the powers conferred by the agreement are sufficiently broad to meet every probable emergency. . . . The grant of power can hardly be too broad, so long as it is confined to the carrying out of the Plan. . . ."

Mr. Swaine bettered this suggestion. He conferred on the St. Paul bankers power to carry into effect any other plan they might later decide to substitute for the one Mr. Hanauer brought back from White Sulphur Springs.

The powers which the bankers were enabled to assume were divided into over forty categories, many of them constellations of powers in themselves. They were sufficient for dealing, to quote Mr. Cravath's words, with "every probable emergency."

The document went to great lengths in meeting the emergencies which occurred to Mr. Swaine's mind. For example, he

foresaw that St. Paul security-holders might not want to accept the bankers' plans, and that pressure would then have to be brought to make them change their views. The document gave the bankers power to use pressure. The bankers could fix any date limit they wished. If a security-holder did not make up his mind before that date, they could keep him out or make him pay extra for being late.

Another set of emergencies seemed to necessitate power to impose forfeiture on security-holders. The bankers were authorized, in the Agreement of Reorganization, to keep out of the reorganization any class of security-holders whom the bankers might want to exclude. They were also given the right to require bond- and share-holders to agree to the bankers' terms as a condition of being allowed to come into the reorganization at all.

Stockholders, required to pay an onerous assessment, would forfeit their stock if they did not pay on time. If they paid one installment and failed to pay the second on time, they might lose both the first payment and the stock.

Possible emergencies were foreseen in case the bankers decided to abandon the plan. This the bankers were given the power to do. They would then have the additional power to impose charges on the bond- and stock-holders who had consented to the plan. If the security-holders did not pay those charges within three months, the bankers might deem themselves confronted with an emergency. To meet it they were to have the right to sell the securities of the people who had not yet paid the charges for a plan which the bankers, not the security-holders, had abandoned. The bankers could sell these securities in any way they might decide. They could sell them privately. They could sell to themselves.

If the plan went through and any of the new reorganization securities were not taken up by the bond- and share-holders of the old St. Paul company, there might be another emergency. The bankers could sell such securities "upon such terms and conditions as they may, in their uncontrolled discretion, determine."

They were also given power to buy and sell securities in the stock market, at the risk of the St. Paul security-holders who went into the plan. Besides the general power to do this, there was a particular provision under which they could use twenty million dollars in buying reorganization securities if certain events occurred. If the events did not occur, they could not exercise that particular power; if they did occur, the bankers would be in a position, as an independent bondholders' committee said, to conduct "a gigantic stock-market operation in the purchase of adjustment bonds in the Stock Exchange."

Mr. Swaine's document also gave the bankers the right, in their role as managers, to organize underwriting syndicates and any other kind of syndicates.

Their power to determine what positions it was necessary to create for carrying the reorganization into effect, who should fill such positions, and how much they should be paid was left almost unlimited. The scale of possible expenditure is illustrated by the apparently humdrum item of printing and publishing advertisements. For this purpose the managers spent from $175,000 to $275,000 of the security-holders' money.

The danger of emergencies was not left to an enumeration of particular things or kinds of things the bankers were to be permitted to do. General language was also introduced by the lawyers, giving the bankers a blanket authority. Nor was any chance taken of the possibility that the lawyers might leave out powers for which they had not foreseen the need, or which they might have expressed inadequately. The bankers were to have the right to "supply any defect or omission." They were to be allowed to "reconcile any inconsistency in such manner and to such extent as shall be deemed by them necessary or expedient to carry out" the plan and agreement "effectively."

A security-holder might claim that he did not intend to consent to their having powers which were not included in the document. A court might say that additional powers introduced later by the bankers were not needed. But no such limitations were mentioned in the Agreement written by the bankers'

attorneys. They sought to provide fully for their own possible oversight, or what they might later say was an oversight.

They also wrote into the papers a provision seeking to keep out anybody else's understanding of what the words in the Agreement meant. The bankers were to have the right to say what it meant, and their decision was to be final.

In short, the Agreement which was to be the charter of their authority could be amplified by them and could be given by them exclusively such meaning as they thought it should have. Security-holders were to be bound to such *ex post facto* decisions by the bankers.

Mr. Ecker was asked about the breadth of authority conferred upon the bankers in Mr. Swaine's document.

Mr. Grady: You also notice that . . . there was vested in the organization managers the very broadest discretion, that is the power of one to express, you notice the breadth of the expression that is conferred upon the reorganization managers?

Mr. Ecker: Yes, I think there were reasons for it in each case.

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Mr. Grady: . . . They had the absolute discretion to determine every question in reference to reorganization, financing, policy, and control?

Mr. Ecker: I think there were some instances where it was with the consent or approval of the bondholders' committee.

Mr. Grady: In what particular do you recall that consent being required?

Mr. Ecker: I would have to have the plan to look at it.

Mr. Swaine [*the bankers' attorney*]: In the formation of the mortgage.

Mr. Grady: As to the form of the mortgage?

Mr. Ecker: Yes.

Mr. Grady: And in all other matters—

Mr. Ecker: That had to do with the reorganization of the property, the purpose was to give them such powers as might

be necessary, and might I say that the effect on my mind is just as we draw in a board of directors a resolution empowering officers to do some specific thing, and what might prove to be necessary in carrying out this direction of the board, a sort of blanket and broad authority that enables you to perform and carry out a contract.

The Agreement deemed necessary to carry out the plan emphasized throughout the wide extent of the discretion which the bankers were to have in exercising their powers. They were to take action "in their sole discretion," "in their unrestricted discretion," "in their absolute discretion," "in their sole and unrestricted discretion," "in their absolute and uncontrolled discretion." On a variety of important matters the agreement drafted by their attorneys made the bankers the "sole judges," or "the sole and final judges." Their decision was to be "conclusive," or "final and conclusive," or "final, binding and conclusive."

Mr. Mitchell, head of the National City Bank, was asked about this.

Mr. Grady: . . . You provided in this plan that your company and Kuhn, Loeb shall, in all important matters in relation to conduct of the whole affair, be clothed with what is termed absolute discretion, sole discretion, and other terms meaning an absolute control to do whatever they see fit with the property entrusted to them?

Mr. Mitchell: The plan gives us working authority.

Mr. Grady: Working authority; you mean authority to work as you see fit, that is what it means, doesn't it?

Mr. Mitchell: It means that, working within the limitations of the plan.

Mr. Grady: Within the limitations of the plan?

Mr. Mitchell: We shall have authority to do those things that are necessary to make that plan effective.

Mr. Grady: Do those things that the organization managers

deem necessary, and in doing so they may exercise an absolute, uncontrolled, and uncontrollable discretion?

Mr. Mitchell: Uncontrolled working authority.

Mr. Mitchell was laboring under a misapprehension in saying that the managers' authority was limited to the plan which was included in the printed document—the plan worked out by Mr. Hanauer at White Sulphur Springs. As already noted, the agreement which Mr. Swaine worked out at the same time gave the bankers all the powers and authority for any other plan they might substitute.

Mr. Hanauer was asked about the powers reserved to the bankers:

Mr. Grady: . . . So that the reorganization managers have the absolute power to do as they see fit?

Mr. Hanauer: That is the reason that the reorganization managers must have the confidence of the depositors.

Besides powers to meet probable emergencies, Mr. Swaine's agreement gave the bankers privileges to meet possible opportunities. Among these were opportunities for personal profit, additional to the fees to be paid to the bankers as managers. In this aspect Mr. Swaine again followed and bettered the advice of his senior partner in the 1916 lecture. Mr. Cravath was telling what should be written into protective committee agreements, which in this respect are like reorganization agreements.

"In practice, members of a committee are frequently owners of securities of the issue which it is their duty to protect and they may wish to be free to purchase further securities of the same issue as well as certificates of deposit issued by the Depositary. The agreement should expressly authorize such transactions. It should also authorize the members of the Committee to form, or take part in, syndicates for underwriting the cash requirements of the Plan or otherwise aiding the reorganization.

"It frequently happens that the same banking firm is represented on the Committee, acts as reorganization managers, and also forms and manages the syndicate to provide the cash requirements. Manifestly the provisions permitting these interrelationships must be clear, full and explicit."

Mr. Cravath did not speak of profits bluntly, but his words dealt with the subject of profits.

The St. Paul reorganization agreement provided that the managers of the reorganization could appoint themselves managers of syndicates also. Mr. Hanauer was questioned on this score by the Senate committee, which was considerably disturbed about possible profits through underwriting. He gave assurances that underwriting would probably be eliminated. He was also questioned in the Commission investigation. His statement in reply was: "If a syndicate were formed to do that, that syndicate would have to be paid, and we would doubtless have a participation in such a syndicate, yes."

The Reorganization Agreement also gave the bankers the privilege of dealing in the securities for which they undertook to become guardians, and in the certificates of deposit issued under their plan. The National City Company exercised this privilege to a total of seventeen million dollars par amount of the bonds. Mr. Hanauer was asked whether he thought there was anything discreditable in such dealings by bankers while acting as reorganization managers. His answer was: "Decidedly not. . . ."

On the subject of personal buying of securities in such circumstances testimony was given in another connection by Mr. Wetmore, the Chicago banker who sold control of the Terre Haute to the St. Paul company. He said:

"I did not sell a dollar of these bonds during the time these negotiations were on, because I do not believe in those things. . . .

"I have been in as many of these cases, I guess, as most bankers, in the organizations [*sic*] and things of that kind, and in all of my activities I have never bought or sold a single security in anything that I was working on, in the thirty years that I have

been in this class of work, personally. I have never allowed the First National Bank during the time that a thing was moving through to buy or sell the securities, where I have been active in the management of a reorganization."

The Agreement gave the bankers in their private capacity other opportunities for dealing with themselves in their official capacity. They were given the right to compromise claims belonging to the company. Under this right, if the receivers had instituted a suit against them as bankers, they would have been in a position as managers to bring matters to a conclusion. They could have settled the disputes between the property and the persons sued and have made the settlement effective after the assets were "sold" to their nominees at the "sale."

The bankers were empowered to ratify contracts and make them binding on the reorganized company. Under this authority they could ratify such contracts as those between the old company and Mr. Ryan's power concerns and make them binding on the new company. The friendly relations between interests in the National City Bank and the power concerns were not at this time merely a phenomenon of the past.

The managers were authorized to buy, in their individual capacity and for their private purposes, "property or matters with which the Plan . . . concerns or to which it relates. . . ." The possible conflict of private interest with official duty opened up by these words is obvious and obviously great.

The document also authorized the bankers to act as bankers to the managers. If they in this capacity received any moneys for the account of the managers, the bankers might commingle the money with their own personal funds—a privilege not ordinarily permitted to trustees of other people's money.

The possible danger of a commingling of private self-interest and guardianship duties recalls testimony given by Mr. Hanauer when he was explaining why receivers should not be permitted to prepare a reorganization plan. He said: "I do claim that anyone to reorganize a large railroad property . . . you must have no duty to anyone which might be inconsistent."

The Agreement which the lawyers drew for the bankers sought to cope with possible emergencies arising out of the responsibilities which their position, their powers, and their personal privileges placed upon them. They did not exercise all these powers and privileges, but they exercised some of them, and their possession of the others might involve them in responsibilities. The lawyers endeavored to get rid of such emergencies by so wording the document that the bankers would be under no responsibilities whatever. They were to have powers and privileges, but not duties enforceable against them by others. If there was to be any conceivable liability, it was to be limited to "wilful malfeasance or neglect"—and, as will be seen, even this was to be canceled.

A student of the Agreement might question whether it contained one substantial undertaking by the bankers. It may be that there was one, in the words reading: "the Reorganization Managers will endeavor to carry out the Plan" devised at White Sulphur Springs or some other plan. This mild obligation was immediately reduced to zero by the following additional words: "But neither the Reorganization Managers, nor the Committees . . . assume any personal responsibility for carrying out the Plan and this Agreement."

The lawyers inserted other language also neutralizing the obligation of the managers. Their Agreement said: "The Reorganization Managers shall have power and authority, whenever they shall deem it proper, at any time either before or after the Plan shall have been declared operative, to abandon . . . the Plan and this Agreement. . . ."

The concern for the bankers' protection, which these phrases show to have been in the minds of their lawyers, did not cease with such provisions. The lawyers foresaw the possibility that some security-holder might say to the managers: You have not done your duty, or you did it incorrectly. The lawyers therefore inserted in their document one defense, that the bankers did not really undertake to do anything. They armed the bankers with another defense. In the same paragraph which said that

the bankers would "endeavor to carry out the Plan" they added these words: "The Reorganization Managers . . . shall incur no liability for anything done or suffered to be done in good faith in reliance upon the advice of counsel."

This covered almost every contingency, for, as Mr. Hanauer testified, "we never do anything without the advice of counsel."

Still, the lawyers felt that they had not quite covered the bankers in every conceivable way. Somehow, in some way, at some time, the bankers might make statements, or the committees they had organized might make statements, which might be inaccurate. Some security-holder might claim that the bankers should be responsible for any such inaccuracies. The lawyers introduced into the Agreement words calculated to protect their clients against such responsibility as would fall upon ordinary men in such circumstances. The document on which Mr. Swaine worked in White Sulphur Springs relieved the bankers of responsibility for any statement made by them or by anyone else either in the Plan or in the remarks with which the bankers introduced the Plan to the security-holders or in any circular, past, present, or future.

The theory underlying the initial invention of such immunity for bankers is perhaps to be deduced from Mr. Cravath's lecture, in which he advised that every plan of reorganization include "a provision that the statements contained in the plan have been compiled from sources believed to be accurate and reliable, but that . . . none of them are to be construed as representations."

Mr. Cravath's partner went so much further than Mr. Cravath that the underlying theory, whatever its merit or demerit, would not cover all that Mr. Swaine did. The latter sought to protect the bankers from responsibility for statements of which they could not possibly have been mere transmitters, but were necessarily originators.

Such methods for granting the bankers immunity from responsibility were not deemed sufficient by their lawyers. Several all-embracing protections were added. The Agreement of Reorganization had a sentence which converted a security-holder's

acceptance of reorganization securities into "ratification . . . of all acts and proceedings of the Reorganization Managers." No exception was made in case the security-holder did not know what he was ratifying. In fact, it would be an exceptional person who would know, or would have an opportunity to ascertain, what the managers had done. It would be an exceptional person, as will be noted shortly, who would even know that there was any such language in the reorganization papers, or that it was binding upon him.

The bankers' lawyers also made provision to absolve the managers even if a security-holder did not get his reorganization securities. If a majority of the bondholders received the new bonds, the Agreement gave the managers blanket protection against every bondholder entitled to receive reorganization securities. It made no difference that neither the bondholders who had received their bonds nor those who had not, knew enough about the situation to make any claims against the managers. It made no difference that the bondholders were entitled to receive the reorganization securities as a matter of right, without being obliged to give up something additional. Once a majority of the bondholders had received what they were entitled to receive, every bondholder who had agreed to take reorganization bonds virtually granted to the bankers "a release and discharge . . . from all liability and accountability of every kind, character and description whatsoever."

The lawyers thought of another way to protect the bankers against any possible claims for anything they might have done or failed to do. They accepted the theory which for centuries has governed people who handle other people's money or property. In the old times stewards of noblemen's estates, in modern times guardians, banks, and others who act as agents or trustees for other people, customarily make reports to their patrons, showing what has been done with their property. This process is known as the filing of accounts, or an accounting of one's stewardship. The smallest official handling public money, the cashier in business, the agent who expends or receives money, all

account to those who own the money.

The reorganization managers of the St. Paul were undertaking the custody of half a billion dollars in property values, for forty thousand owners. The managers undertook to file accounts, but the lawyers did not provide for filing those accounts with the owners or with the receivership court or with the Interstate Commerce Commission. The accounts were not to be filed in any place where the owners could see them as a matter of right, or with facility, or in circumstances affording them any genuine chance of knowing what was in the accounts.

The Agreement of Reorganization said that the accounts of the managers should be filed with the board of directors of the new company—the board, it will be remembered, which the managers themselves were going to appoint. No one could be on that board unless the bankers put him there. The lawyers made their document read as follows:

"Such accounts, when approved by such Board of Directors and until disapproved by said Board, shall be final, binding and conclusive upon the Depositors [the St. Paul security-holders in the reorganization] and upon all other parties having any interest therein, and upon such approval, whenever and however given, the Committees and the Reorganization Managers shall respectively be discharged, and all liability and accountability on their part shall cease."

The fourteen directors who would have the opportunity to approve the managers' accounts included nine men whose fees in the St. Paul reorganization had been within the orbit of the managers' approval or disapproval.

The document which the lawyers prepared was of course an unusual achievement. It placed above their clients an umbrella so large, so closely woven of protective threads, and of such tough material that the minutest drop of liability and legal responsibility would have difficulty getting through.

The fact that the security-holders were to pay the lawyers for this excellence should not confuse persons inexperienced in reorganization practice as to the clients for whom the lawyers

were acting. Their clients were not the security-holders. Nor should confusion result from the fact that the bankers had advanced the money for advertisements saying that the committees "had been formed to protect the interests of the holders" of St. Paul securities. The protection mentioned in this chapter was not for, but from, the security-holders.