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Author: Hasse, Adelaide Rosalia, ed.; United States. Securities and Exchange Commission.

Report on the study and investigation of the work, activities, personnel and functions of protective

SECURITIES AND EXCHANGE COMMISSION

REPORT  
ON THE  
STUDY AND INVESTIGATION  
OF THE WORK, ACTIVITIES, PERSONNEL  
AND FUNCTIONS OF PROTECTIVE  
AND REORGANIZATION  
COMMITTEES

PURSUANT TO SECTION 211 OF THE  
SECURITIES EXCHANGE ACT OF 1934

PART V  
PROTECTIVE COMMITTEES AND AGENCIES  
FOR HOLDERS OF DEFAULTED FOREIGN  
GOVERNMENTAL BONDS



WASHINGTON, D. C.  
May 14, 1937

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LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C., May 14, 1937.

SIR: I have the honor to transmit herewith another part of the Commission's study and investigation of the work, activities, personnel, and functions of protective and reorganization committees. This report was prepared and is submitted in pursuance of Section 211 of the Securities Exchange Act of 1934. It deals with Protective Committees and Agencies for Holders of Defaulted Foreign Governmental Bonds and includes specific recommendations regarding such protective committees, the Foreign Bondholders Protective Council, Inc., repatriation of foreign bonds, and certain aspects of future foreign loans.

This study and investigation was headed by Commissioner William O. Douglas who was then Director of the Protective Committee Study. Collaborating with him on this part of the report were Samuel O. Clark, Jr., Abe Fortas, and Francis F. Lincoln, of the Protective Committee Study.

Under dates of May 2, 1936, June 3, 1936, June 18, 1936 and May 10, 1937, we transmitted parts of this Commission's report which dealt with Committees for the Holders of Municipal and Quasi-Municipal Obligations, Committees for the Holders of Real Estate Bonds, Trustees Under Indentures, and the Strategy and Techniques of Protective and Reorganization Committees. There are in preparation three other parts of the report which will be submitted shortly.

By direction of the Commission.

J. M. LANDIS,  
*Chairman.*

THE PRESIDENT OF THE SENATE,  
THE SPEAKER OF THE HOUSE OF REPRESENTATIVES,  
Washington, D. C.

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## SECURITIES AND EXCHANGE COMMISSION

REPORT ON THE STUDY AND INVESTIGATION OF THE WORK,  
ACTIVITIES, PERSONNEL, AND FUNCTIONS OF PROTECTIVE AND  
REORGANIZATION COMMITTEESPROTECTIVE COMMITTEES AND AGENCIES FOR HOLDERS OF  
DEFAULTED FOREIGN GOVERNMENTAL BONDS

## SECTION I

## INTRODUCTION

This Commission, as part of its general study and investigation of protective and reorganization committees, pursuant to Section 211 of the Securities Exchange Act of 1934, has investigated the work, activities, personnel, and functions of protective committees and other agencies for holders of defaulted foreign governmental bonds.

It was not feasible, in view of the large number of issues in default, to study either all defaults or all protective committees or agencies in this field. Therefore the Commission selected for examination situations and protective committees or agencies which represented typical methods and practices employed. There were investigated and examined at public hearings the activities of three committees for holders of bonds of the Republic of Chile, three committees for holders of bonds of the Republic of Colombia, two committees for holders of bonds of the Republic of Cuba, two committees for holders of bonds of the Republic of El Salvador, and three committees for holders of bonds of the Republic of Peru. The Commission likewise examined and held hearings on certain aspects of the readjustment of the issues of the Republic of Brazil and of the proposed readjustment of the dollar bonds of the Republic of Guatemala. Hearings also were held, after investigations, with respect to the Foreign Bondholders Protective Council, Inc., the American Council of Foreign Bondholders, Inc., and the Latin American Bondholders Association, Inc., all incorporated agencies which have as their object or among their corporate purposes the protection of the holders of de-

faulted foreign securities. In addition, the Commission examined and held a hearing with respect to the Institute of International Finance, a statistical and advisory agency in the field of foreign bond investment.<sup>1</sup> Furthermore, this Commission in the preparation of this report utilized to some extent the reports and records of investigations of committees of the United States Senate in this field and other source material dealing with this subject.

This report deals with obligations issued directly by or guaranteed by foreign governments and sold by American bankers to the American public. It treats the issues of sovereign governments and their political subdivisions, such as states, provinces, departments, and municipalities, but not the obligations of foreign private corporations<sup>2</sup> unless such issues were governmentally guaranteed. The issues of private foreign corporations were widely sold in this country. Their reorganization, however, unless default was caused by some act of the foreign government such as the establishment of an embargo or of restrictions on foreign exchange, more closely resembles the reorganization of domestic corporate issues than of foreign governmental issues. If governmental intervention makes impossible the servicing by a foreign private corporation of its external bonds, a situation of frequent occurrence during the past few years, the readjustment process will necessarily involve the government. In such a case the process may involve use of many of the techniques described in this part of the report. In fact, as will be developed later, the Foreign Bondholders Protective Council, Inc., although not including foreign private corporations within the sphere of its activities, does concern itself with such issues if default is caused primarily by governmental action.<sup>3</sup>

Aside from the the public sale of foreign bonds in this country, there have been, of course, substantial American investments of other kinds in foreign countries. Since these investments directly or indirectly affect the defense of the foreign bondholders' rights, we have included a discussion of certain of their aspects in this report. Thus, for example, we have included a discussion of short term credits arising from advances to reinforce a distressed public treasury, to finance public improvements, or for other purposes, with or without the expectation of a later conversion into a long term bond issue.

<sup>1</sup> The organization and activities of the Institute of International Finance are described in Appendix F to this report.

<sup>2</sup> This Commission investigated and held a hearing on the protective committees acting for the secured debentures of Kreuger & Toll AB, a private Swedish corporation, and has referred from time to time in other parts of this report to these committees.

<sup>3</sup> See *infra* note 204, *supra*, p. 11.

These credits have their claims on the debtor's treasury and on its supply of foreign exchange, and thus of necessity are in competition with the claims of the bondholders.

#### A. PROPERTY INTEREST AT STAKE

Prior to the World War American foreign investments were relatively small in amount, and, as a consequence, their effect upon the country as a whole was not significant. There were then, as now, direct investments in plantations, mines, oil concessions, and otherwise. Foreign bonds were held in not unsubstantial amounts,<sup>4</sup> but these investments were comparatively few in number and the public which purchased them was small in comparison to the army of foreign bond buyers recruited at later periods. Upon default the bondholders' plight, though serious to the individual, was not a problem of national magnitude. In contrast, after the ownership of foreign securities became widely dispersed throughout the country in the 1920's and defaults<sup>5</sup> in the early 1930's assumed alarming proportions, the problems created necessarily affected the economy of the entire nation.

During the period of 1914-1919 the amount of foreign lending by American private interests was substantial in comparison with pro-

<sup>4</sup> The situation of foreign securities (both governmental and corporate) in the American market prior to the World War has been described by the U. S. Department of Commerce as follows:

"Prior to 1898 there were practically no public offerings of foreign securities on American markets. That there were occasional issues, however, for Canada and Latin America, is highly probable. . . ."

"At the close of the nineteenth century, . . . there were signs of a growing interest among investors in foreign securities. In 1890, five issues—\$34,280,000 par value, \$20,500,000 for Mexico and \$13,780,000 for Canada—were publicly offered to American investors [citing figures from an unpublished compilation furnished by Paul D. Dickens], and two American insurance companies took up a large part of the 4 percent bond issues of some Swiss cities [citing C. K. Hobson, *The Export of Capital*, London, 1911, p. 153]. . . ."

"According to the unpublished private compilation of foreign security offerings in the United States from 1900 to 1913 by Paul D. Dickens, just cited, 247 foreign issues were publicly floated in this country in the 14 years covered with an aggregate par value in round numbers of \$1,037,000,000. The amounts offered varied widely from year to year and ranged from \$18,125,000 in 1910 to \$176,170,000 in 1905. In only three years—1903, 1906, and 1910—were they less than in 1914. Latin American securities, especially those of Mexico and Cuba, were the most commonly underwritten; their total was \$374,054,000. Far-eastern securities, with those of Japan predominating, were second with a total value of \$310,350,000. European financing, strangely enough, came third with \$227,450,000; and Canada was last with \$174,663,000." U. S. Department of Commerce, *Handbook of American Underwriting of Foreign Securities Trade Promotion Series*, No. 104 (1930), at 9-10.

<sup>5</sup> Defaults on foreign governmental loans prior to 1920 occurred with respect to the obligations of Mexico (1914) and Russia (1918). Foreign Bondholders Protective Council, Inc., *Annual Report 1935*, at 248, 261. China in 1921 defaulted on its treasury notes issued 2 years earlier. *Id.*, at 181.

The first defaults after the market crash of 1929 occurred with respect to the bonds of Latin American countries. Bolivia defaulted on Jan. 1, 1931, to be shortly followed by Peru which first defaulted on Apr. 1, 1931. Chile and other Latin American countries also defaulted in 1931. The first European default, that by Hungary, occurred on Jan. 1, 1932. Madden, Nadler, and Saurain, *America's Experience as a Creditor Nation* (1937), at 111-121.

war years.<sup>4</sup> The year 1920, however, marked the beginning of a period during which American private capital, in the form of foreign loans, flowed abroad at an accelerating rate.<sup>5</sup> The American bankers found a ready sale for foreign bonds in a market which for a time apparently had no saturation point.

It has been stated that the total amount of dollar issues, including those of foreign corporations as well as of governmental entities, during the years 1920-1931, inclusive, reached the total of \$9,363,519,800 (face or nominal amount).<sup>6</sup> By virtue of sinking fund retirements and redemptions at or before maturity this amount had been reduced to \$7,489,992,000, the sum reported outstanding as of December 31, 1935.<sup>7</sup> This large figure cannot, however, be taken as indicating the present interest of the United States in foreign bond investments. There are several deductions that have to be made.<sup>8</sup>

<sup>4</sup>The following table reprinted from American Underwriting of Foreign Securities in 1931, Trade Information Bull. No. 802, published by the U. S. Department of Commerce, lists the foreign capital issues, both governmental and corporate, publicly offered in the United States from 1914 through 1931.

Period	Number of Issues	Total nominal capital	Estimated refunding to Americans	Estimated net nominal capital
1914	26	\$44,870,266	\$255,000	\$44,615,266
1915	80	817,529,272	13,476,000	804,053,272
1916	102	1,159,691,294	5,799,000	1,153,892,294
1917	25	720,297,160	87,050,000	633,247,160
1918	24	23,485,000	2,690,000	20,795,000
1919	87	771,044,700	379,257,000	391,787,700
1920	104	662,937,088	105,500,000	557,437,088
1921	110	632,412,068	68,105,000	564,307,068
1922	102	864,018,264	60,421,000	803,597,264
1923	76	487,597,350	72,000,000	415,597,350
1924	120	1,217,217,007	247,993,500	969,223,507
1925	104	1,310,166,150	230,700,000	1,079,466,150
1926	200	1,238,450,182	162,078,000	1,076,372,182
1927	265	1,577,414,260	240,654,000	1,336,760,260
1928	221	1,426,301,080	238,410,418	1,187,890,662
1929	148	705,767,081	34,536,875	671,230,206
1930	121	1,087,680,214	182,227,000	905,453,214
1931	41	285,192,500	58,205,000	226,987,500

The year 1931 marked the end of this era of foreign long term lending. Madden, *op. cit. supra* note 5, at 68.

<sup>5</sup>The table of foreign capital issues 1914-1931, *supra* note 6, shows a steady yearly increase in the amount of the issues after 1920 with the exception of the years 1923 and 1928, until the peak year of 1927 was reached. The 2 succeeding years showed reductions. There was a lull in 1930 to be followed by a precipitous decline in 1931.

<sup>6</sup>Madden, *op. cit. supra* note 5, at 70. Foreign Bondholders Protective Council, Inc., Annual Report 1934, at 9 states: "It has been estimated that during the years 1920 to 1931, inclusive, there were floated in the United States approximately \$10,500,000,000 of foreign dollar bonds." Figures for this period compiled by the U. S. Department of Commerce show the aggregate amount of all foreign capital issues including refunding issues, the stock of foreign corporations and certain other issues not strictly foreign bond investments at \$11,623,143,187. See list, *supra* note 6 and Madden, *op. cit. supra* note 5, at 65-70.

<sup>7</sup>Madden, *op. cit. supra* note 5, at 197-198; Institute of International Finance, Statistical Analysis of Foreign Dollar Bond Defaults, Bull. No. 65 (April 1930), at 2-4. In connection with its calculation of the balance of international payments of the United States, the U. S. Department of Commerce estimates that, during the years 1920-1931, bond redemption and the operation of sinking funds have amounted to \$2,473,000,000. This refers to dollars paid, not the par amount of loans retired. U. S. Department of Commerce, The Balance of International Payments of the United States in 1933, Trade Information Bull. No. 819 (1934), at 102.

<sup>8</sup>Proceedings before the Securities and Exchange Commission in the Matter of Foreign Bondholders Protective Council, Inc., et al. (1935), at 78.

Estimates for the years 1914-1929 indicate that approximately 13.6 percent of all foreign bonds publicly offered in the United States were sold abroad when first offered.<sup>9</sup> The holdings of American investors in these issues has been further reduced by the repatriation<sup>10</sup> of their bonds by debtor countries or their nationals, and by the purchase of such bonds by investors in other creditor countries.<sup>11</sup>

It has been stated that by reason of these various factors only about 55 percent of the amount reported outstanding as of December 31, 1935, is actually held in this country.<sup>12</sup> On this basis only approximately \$4,130,000,000 of the \$7,490,000,000 of bonds outstanding are held by American investors while approximately \$3,360,000,000 are held abroad.<sup>13</sup>

The foregoing figures relate to the dollar bonds of both foreign governments and foreign private corporations. The importance and the diversity of the American stake in the bonds of foreign governmental entities alone is made apparent by figures published by the Foreign Bondholders Protective Council, Inc., showing dollar bonds of foreign governmental debtors outstanding as of December 31, 1935, in the sum of \$5,345,449,590.00.<sup>14</sup> This amount, which is exclusive of the issues of foreign private corporations (unless governmentally guaranteed), is likewise subject to reduction by reason of securities held abroad.<sup>15</sup>

According to the following figures published by the Foreign Bondholders Protective Council, Inc., \$1,748,896,000.00 of \$5,345,449,590.00

<sup>9</sup>Madden, *op. cit. supra* note 5, at 197, where reference is made to a compilation by the U. S. Department of Commerce. According to the testimony of one of the partners of J. & W. Seligman & Co. before the Senate Committee on Banking and Finance, 20 percent of the loans of the Republic of Peru were placed abroad. Hearings before the Committee on Finance on Sale of Foreign Bonds or Securities in the United States, pursuant to S. Res. 19, 72d Cong. 1st Sess., at 1281.

<sup>10</sup>The repatriation of securities is a much discussed subject of present day international finance. Used broadly it covers purchases for sinking fund under the bond contract and repurchases by debtors while full bond service is being maintained; it has also been used in a narrower sense with special reference to instances where nations have defaulted in bond service, frequently pleading insufficient foreign exchange, and then have released exchange for the purchase of bonds at prices abnormally depressed by the cessation of interest and sinking fund payments. Repatriation of this sort must be condemned as bad faith by the debtor. See *infra* sec. IV, D. 2, of this report. It has reduced the amount of American owned foreign bonds though exact figures regarding the total extent of this reduction are not available.

<sup>11</sup>Madden, *op. cit. supra* note 5, at 198-198. See also Institute of International Finance, *op. cit. supra* note 9, at 3-4.

<sup>12</sup>Madden, *op. cit. supra* note 5, at 197-198.

<sup>13</sup>Ibid.

<sup>14</sup>Foreign Bondholders Protective Council, Inc., Annual Report 1935, at 262-263. See also Institute of International Finance, *op. cit. supra* note 9, at 12-13.

<sup>15</sup>Applying the estimate of a 45 percent reduction (see *supra* in text) to foreign governmental issues, the amount held by American investors as of Dec. 1, 1935, is reduced from about \$6,350,000,000 to about \$2,940,000,000. Wherever reference is made in this report to the amount of foreign bond issues outstanding, the figure shown, unless otherwise indicated, will be the amount reported outstanding inclusive of securities held abroad.

foreign bonds outstanding on December 31, 1935, were partly or entirely in default as to interest:<sup>18</sup>

	Outstanding	In default as to interest
Latin America.....	\$1,538,431,090	\$1,175,383,400
Europe.....	1,489,553,200	567,614,600
Far East.....	531,573,200	5,500,000
North America (Canada).....	1,785,891,210	400,000
	\$5,345,448,500	\$1,748,898,000

From this it will be seen that approximately one-third of the bonds were no longer paying in full the interest specified in the loan contract. The Latin American group of debtors showed proportionately a much higher ratio of default, as approximately 76 percent of their issues were no longer paying the agreed interest. The defaults were not complete in all cases: some debtors were maintaining partial service on their bond obligations. Thus of the \$1,748,898,000 foreign bonds in default as to interest, partial service was being maintained on \$717,797,300 through the issuance of refunding bonds or scrip or part payment in U. S. dollars or local currency; the balance of \$1,031,100,700 was in total default.<sup>19</sup>

It has been estimated that between six hundred and seven hundred thousand investors are holding foreign bonds now in default.<sup>20</sup> Dwight W. Morrow, in an article, "Who Buys Foreign Bonds", reported that on a basis of an examination of five foreign governmental issues, average holdings in a particular issue vary from \$2,994 to \$4,835.<sup>21</sup> The norm is usually taken as \$3,000.<sup>22</sup> Of interest in this connection is a description by the Foreign Bondholders Protective Council, Inc., of the bondholders who have registered with the committee for the Republic of Chile bonds formed by the Council and the extent of their holdings:

"\* \* \* The Committee of Bondholders for the Republic of Chile Bonds has included in the registrations with that Committee individual bondholders, banks, trust funds, schools, colleges, universities, theological seminaries, churches, church societies, libraries, hospitals, memorial homes, foundations, orphanages,

<sup>18</sup> Foreign Bondholders Protective Council, Inc. Annual Report 1935, at 284-285. Default in interest is almost invariably accompanied by default in sinking fund. The figure of \$1,748,898,000 also includes \$104,448,400 in default as to maturity. In addition the sum of \$900,000 is in default as to maturity only (interest still being paid) and the sum of \$76,565,600 is in default as to sinking fund only. The total amount in default is, therefore, \$1,826,303,600. *Id.*, at 282-283.

<sup>19</sup> *Id.*, at 286.

<sup>20</sup> *Op. cit. supra* note 19, at 82. This is probably an overestimate as it is based on the assumption that each investor holds about \$3,000 of bonds of but one issue only. While no precise figures are available, the total number of these bondholders must be large.

<sup>21</sup> (1927) 5 Foreign Affairs 210-232, reprinted as appendix to Hearings before Committee on Finance, *op. cit. supra* note 11, at 151-158.

<sup>22</sup> *Op. cit. supra* note 19, at 82. F. J. Lisman testified that the average holdings of El Salvador bonds was about \$3,949. Proceedings before the Securities and Exchange Commission in the Matter of Bondholders Protective Committee for the Republic of El Salvador (1935), at 41.

Y. M. C. A.'s, and cemetery associations. Every State in the United States, one territory of the United States, the District of Columbia, and thirty foreign countries are represented in the registrations so far received. While a number of the registrants hold substantial amounts of bonds, the average holding is very small, showing an extremely wide distribution of these bonds. 98% of the bondholders who have registered represent holdings of less than \$20,000 worth of bonds per person, and the average holding of this 98% of registrants is \$800 worth of bonds per person. The 4% of the bondholders who have registered holdings over \$20,000 represent an average holding of \$142,000 worth of bonds per registrant. The average holding of all categories is \$5,880 worth of bonds per person.

"It must be taken into account that many reported holdings of \$20,000 worth of bonds or over, as well as of smaller amounts, represent bonds reported by one institution but held by them in trust accounts for many individuals. If the breakdown of the holdings of all of such accounts were available, the average holding would undoubtedly be lower than shown here."<sup>23</sup>

These issues usually bore a high rate of interest. It was this fact, coupled with common belief that unusual safety was attached to governmental bonds, that made these issues unusually attractive to the investor of small means.<sup>24</sup> The Foreign Bondholders Protective Council, Inc., in its 1934 report listed 197 issues of foreign dollar bonds in partial or complete default as to interest or sinking fund or both. One hundred and eighty-two of these issues had been sold to the public since 1920; of these, 7 bore interest rates below 6%, 152 bore interest rates of 6% and over but less than 8%, while 23 issues bore 8% interest.<sup>25</sup>

## B. FLOTATION OF FOREIGN BONDS

Unlike the bankers in Great Britain and European countries where foreign lending had been carried on for generations, the American

<sup>23</sup> Foreign Bondholders Protective Council, Inc. Annual Report 1935, at 99.

<sup>24</sup> John Foster Dulles, of the law firm of Sullivan & Cromwell, writing early in 1933, said:

"The simplest and most effective way to educate potential investors is to bring them to understand that the rate of interest, or rather the yield, is an excellent criterion of the measure of risk. A very large part, about half, of the foreign bonds which were offered in the post-war decade were priced to yield from 5 to 6 1/2 percent. There have been practically no defaults in this category. The defaults have been almost exclusively confined to the bonds sold to yield more than 6 1/2 percent and up to 8 percent. If a bond is sold to yield 8 percent, then it is risky, however laudatory the prospectus and however conservative the reputation of the issuing bankers. This principle is generally recognized as applicable to domestic bonds. There appears, however, to have been an impression that its validity did not extend to foreign bonds, but that in this category high yield could be obtained without risk. It should be implanted in the investor's mind—as firmly that it cannot be eradicated by the highest of high pressure salesmanship—that as with domestic bonds, foreign bonds bear their own label. High interest yield means that in the judgment of the financial community there is risk. This simple principle alone, were it understood and acted upon, would largely prevent the imprudent purchase of speculative foreign bonds by banks, trusts and investors of small means who should not place their principal in jeopardy." Dulles, *The Securities Act and Foreign Lending* (1933) 12 Foreign Affairs 35, 44.

<sup>25</sup> Foreign Bondholders Protective Council, Inc. Annual Report 1934, at 162-217. John Foster Dulles reports the average interest rate on foreign bond issues of over \$10,000,000 is 8.33 percent as compared with a domestic bond average of 5.3 percent. This includes both defaulted and non-defaulted bonds. Dulles, *supra* note 24, at 40. The average interest rate on defaulted bonds only would undoubtedly be higher.

bankers by and large were untrained and inexperienced in this new field of finance.<sup>20</sup> But while lack of experience may partially explain, it cannot justify the recklessness, ineptitude, and in some cases outright chicanery of this era of foreign lending.<sup>21</sup> Many of these characteristics were developed in the investigation of foreign bond flotations by the Senate Committee on Finance in 1931 and 1932,<sup>22</sup> and in the general investigation by the Senate Committee on Banking and Currency of stock exchange practices in 1932-1934, which included within its scope an investigation of the flotation of several foreign bond issues.<sup>23</sup>

The report of the latter Committee contained the following indictment of the American houses of issue:

"The record of the activities of investment bankers in the flotation of foreign securities is one of the most scandalous chapters in the history of American investment banking. The sale of these foreign issues was characterized by practices and abuses which were violative of the most elementary principles of business ethics.

"Far from exercising discrimination in relation to these issues, the bankers failed to check adequately the information furnished by foreign officials; ignored bad debt records and bad market risks; disregarded political disturbances and upheavals; failed to examine, or examined only perfunctorily, economic conditions in foreign countries; failed to determine whether the proposed uses of the proceeds of loan issues were genuinely constructive; failed to ascertain whether the proceeds of loan issues were applied toward the purposes specified in the loan contracts; failed to ascertain whether revenues pledged for the service of loans were collected and properly deposited in accordance with the agreements; and generally indulged in practices of doubtful propriety in the promotion of foreign loans and in the sale of foreign securities to the American public."<sup>24</sup>

The Senate Committee based its statement on its investigation of the flotation of various Latin American bond issues, prominent among which were the Peruvian bonds, the Cuban Public Works bonds and the bonds of the Mortgage Bank of Chile.<sup>25</sup> The efforts of various protective committees and agencies to readjust the defaults

<sup>20</sup> *Op. cit.*, supra note 10, at 81-82. John Foster Dulles has stated: "We in turn have now become a creditor nation. This development, inevitable in the long run, was precipitated by the World War. It found our bankers and our investing public less experienced than if the shift from debtor to creditor position had been a gradual one." Dulles, supra note 24, at 44-45.

<sup>21</sup> It may also be said that the bankers evidenced little appreciation of the desirability of coordinating foreign lending with commercial and trade policies.

<sup>22</sup> Hearings before Committee on Finance, *op. cit.*, supra note 11.

<sup>23</sup> Hearings before Committee on Banking and Currency, pursuant to S. Res. 84, 72d Congress, and S. Res. 56 and S. Res. 97, 73d Congress.

<sup>24</sup> Report of the Committee on Banking and Currency on Stock Exchange Practices, 73d Congress, Senate Report No. 1455 (1934), at 125-126. For a discussion of the relationship between banker practices criticized in this report and the subsequent defaults, contending that many of the practices did not contribute to the defaults, see a recent book, *Mindlen, op. cit.*, supra note 5, at 200-231.

<sup>25</sup> Senate Report, *op. cit.*, supra note 30, at 125-150.

of these issues will be described in detail in this part of this Commission's report.

A further aspect of the issuance of these bonds reported by the Senate Committee was the inclusion of false or misleading statements in the sales prospectuses or the omission to state therein pertinent facts known to the bankers.<sup>26</sup>

The era was characterized by the most intense competition among American bankers for foreign bond business. Induced in part by this competition, bankers would pay substantial commissions known as "finders' fees" for the origination of the business; in some cases these commissions were paid to officials of foreign countries or their relatives.<sup>27</sup> One result of this competition was that the foreign obligors enjoyed a most favorable bargaining position with respect to the amount and terms of the loan. Another equally pernicious effect was a tendency on the part of the bankers to induce foreign governments to accept unwanted loans. Speaking on this point in an address before the Pan-American Conference in 1927, Thomas W. Lamont, a partner of J. P. Morgan & Co., said:

"From the point of view of the American investor it is obviously necessary to scan the situation with increasing circumspection and to avoid rash or excessive lending. I have in mind the reports that I have recently heard of American bankers and firms competing on almost a violent scale for the purpose of obtaining loans in various foreign money markets overseas.

"Naturally it is a tempting thing for certain of the European Governments to find a horde of American bankers sitting on their doorsteps offering them money. It is rather demoralizing for municipalities and corporations in the same countries to have money pressed upon them. That sort of competition tends to insecurity and unsound practice. The American investor is an intelligent individual and can be relied upon to discriminate. Yet, in the first instance, such discrimination is the province of the banker who buys the goods rather than of the investor to whom he sells them.

"I may be accused of special pleading in uttering this warning, yet a warning needs to be given against indiscriminate lending and indiscriminate borrowing."<sup>28</sup>

The tide of lending reached its peak and started to recede in the late 1920's. The early stages of the depression and the beginning of defaults marked the end of this amazing chapter in the annals of American finance.<sup>29</sup>

<sup>26</sup> *Id.*

<sup>27</sup> *E. g.*, the payment by American bankers of \$415,000 to Juan Leguia, the son of the Peruvian President. Proceedings before the Securities and Exchange Commission in the Matter of the Readjustment of External Obligations and Protective Committees and of Protective Organizations for Security Holders of the Republic of Peru, et al. (1935), at 205.

<sup>28</sup> This quotation appears in Hearings before Committee on Finance, *op. cit.*, supra note 11, at 25, and in Report of Committee on Banking and Currency, *op. cit.*, supra note 30, at 125.

<sup>29</sup> On abuses in the flotation of foreign bonds see, in addition to the Senate Report, *op. cit.*, supra note 20, Senator Hiram Johnson's speech, 76 Cong. Rec. 6052-6062 (1932), and Winkler, *Foreign Bonds, An Autopsy* (1933).

The unsavory circumstances attending the issuance of many of these foreign bonds are matters of history. But their existence cannot be ignored in considering the readjustment of the defaults which followed. In the first place, they colored the debtor's views towards its bond obligations; in fact, in some instances debtors have attempted to find justification in the bankers' conduct for the cessation of bond service and even for the denial of the validity of the debt.<sup>24</sup> In the second place, the bankers shortly became the target of criticism by the purchasers of the bonds and by committees organized on default to represent the bondholders. Furthermore bondholders and protective committees have tried to find in the circumstances surrounding the issuance of the bonds a basis for rescission or damage suits against bankers. In the third place, the self-same bankers who sold the bonds at times undertook to assume a commanding or dominating role in the readjustment, as representatives of the bondholders. We develop the vice of that practice hereafter. At this point it is sufficient to note that the problems arising out of these fraudulent acts and the enforcement of these claims by bondholders or their representatives cannot as a practical matter be divorced from the readjustment of the debt itself.

The defense of the American interest in these debts, scattered as they are over five continents and requiring in their readjustment negotiations with a score of foreign nations, has brought to light serious shortcomings in the various protective methods which have been employed to safeguard the American bondholder. When this country entered the depression few persons had any considerable experience in handling the readjustment of defaulted foreign bond issues and the complex and unique problems thereby presented. The nature of these problems and how they differ from those of domestic default situations must be examined prior to any detailed study of the methods of handling them.

### C. THE READJUSTMENT OF FOREIGN DEFAULTS

Foreign bond defaults are handled by techniques differing in many respects from those employed in the domestic field. This is fundamentally due to the fact that in the foreign field there is an almost complete absence of feasible legal remedies available to the bondholders. The solution for a default is necessarily to be found in the adoption of a voluntary arrangement effected through negotiation and compromise. In this connection, governmental aid, through diplomatic intervention or otherwise, has been of assistance to the

<sup>24</sup> *Op. cit. supra* note 10, at 48-52.

bondholders. But in the last analysis, the negotiations have been carried on by protective committees or other agencies acting on behalf of the bondholders.

### 1. FOREIGN LOAN DOCUMENTS: ABSENCE OF LEGAL REMEDIES

The principal documents governing the issuance of foreign bonds are the loan contract between the debtor and the house of issue and the fiscal agency agreement between the debtor and its fiscal agent. The latter is often the house of issue or an affiliated corporation. In fact, of the 172 defaulted foreign bond issues listed in the annual report of the Foreign Bondholders Protective Council, Inc., for the year 1935, concerning which information with respect to fiscal agents is available, the house of issue is either the fiscal agent or co-fiscal agent in 83 cases; in 32 cases a bank formerly an affiliate of or which had other apparent connection with the house of issue is fiscal agent; while in only 57 cases is there no apparent connection between the fiscal agent and the house of issue. Where the loan calls for the appointment of a corporate trustee, there will also be a trust indenture. These documents set forth the conditions under which the money is borrowed and is to be repaid, the security for the loan, if any, and the terms under which the fiscal agents administer their agency or the trustees their trust.

The obligor government invariably promises unconditionally to pay the agreed interest on the bonds, the principal at maturity and to amortize the issue in a specified manner. To the fulfillment of this covenant, it pledges its full faith and credit. If the loan is unsecured a negative pledge covenant is often inserted. Of the 172 foreign loans referred to above, 63 were unsecured and of these, 53 contained negative pledge clauses. Security in various forms is frequently given by the obligor. There may be granted a specific mortgage of physical property owned by the obligor government; more frequently the security takes the form of a pledge or a charge on revenues accruing to the obligor. Thus of the 172 loans previously referred to, 109 were secured, and of these, 70 were secured by pledges of revenues while but 11 were secured by mortgages of physical property only. Twenty-eight loans were secured by both the mortgaging of physical property and the pledging of revenues.

The legal provisions which create the security are set forth in meticulous detail. The provisions of the loan agreement between the Republic of Peru and J. & W. Seligman & Co. and F. J. Lisman & Co., dated March 15, 1927, which secured an issue of 7% sinking

fund gold bonds," illustrate some of the types of covenants and guarantees used in foreign loans. They were as follows:

"2. The Republic pledges its good faith and credit for the prompt payment of the principal of, and the premium and interest upon, the bonds as and when the same shall become due and payable and for the due and punctual performance of all the other covenants and agreements, in this agreement and in the trust agreement and in the bonds contained, to be performed or observed by it; and covenants that in case the revenues hereinafter pledged as security for the bonds shall prove insufficient to make any payments to be made as provided herein or in the bonds, or in the trust agreement, it will make up such deficiency out of its other revenues.

"3. As security for the payment of the principal of, and interest upon, the bonds, the Republic agrees to specifically pledge, and create a direct first lien and charge upon, and hereby does pledge and create a direct first lien and charge upon, the gross tobacco revenues subject only to the liens or charges existing thereon in favor of the outstanding 8 percent bonds of 1924, the building notes, the machinery notes and the secured gold notes: \* \* \*

"4. The Republic covenants that so long as any of the bonds are outstanding it will not reduce, abolish, or in any manner impair, or permit the reduction, abolition, or impairment of, the gross tobacco revenues as existing at the date of this agreement, or abolish or impair the tobacco monopoly or in any other manner impair, or permit the impairment of, the security of the bonds.

"5. \* \* \* The principal of, premium on, and interest of the bonds of 1927 shall be paid in time of war as well as in time of peace and whether the holders be citizens or residents of a friendly or of a hostile state, and shall be paid without deduction or diminution for any taxes, assessments, charges, or duties of any nature, now or at any time hereafter levied or imposed by the Republic, or any State, province, municipality or other taxing authority thereof or therein." \*

In some cases of secured loans, particularly where secured by physical property, the documents spell out the steps which creditors may take to realize on the value of the security by foreclosure or by reduction to possession. These and other provisions contained in the loan documents specifying the bondholders' rights and remedies are set forth in the conventional language of the domestic loan agreements, but are coupled with a jargon of new phrases to cover additional aspects peculiar to international finance. These provisions give the appearance of affording the bondholders the protection of ironclad covenants. The protection to be had from these agreements, however, is illusory. For, as we have stated, a significant characteristic of a bond claim against a foreign government is the absence of any legal remedies which as a feasible matter the creditors can enforce by court action.

\* The activities of protective committees for this and other Peruvian loans will be developed subsequently in this report.

\* *Op. cit.* supra note 33. Commission's Exhibit No. 48, at 1367.

An important factor in this situation is the immunity of a sovereign foreign government from suit without its consent.<sup>39</sup> And even if such consent be forthcoming the creditor has not improved his position materially by obtaining a judgment against the obligor country, as no legal machinery is ordinarily available for the collection of the judgment. He merely has altered the form of his claim.<sup>40</sup> Edwin

\* This doctrine has frequently been applied by the United States courts. *Principality of Monaco v. State of Mississippi*, 292 U. S. 313, 321, 330 (1934); *Deister & Carpenter, Inc., v. Kunglig Jarnvagnstyrelsen*, 43 F. (2d) 705 (C. C. A. 2d, 1930); *Heers v. State of Arkansas*, 20 Howard 527, 529 (U. S. 1857); *Oliver American Trading Co., Inc., v. Government of the United States of Mexico*, 5 F. (2d) 659 (C. C. A. 2d, 1924); *Gallopin v. Winsor*, 251 N. Y. Supp. 448 (1st Dept. 1931); *Kara v. Lamont*, 248 N. Y. Supp. 222 (Sup. Ct. 1933); *Howard v. United States of Mexico*, 61 N. Y. Supp. 939 (1st Dept. 1899); *The Schooner Eschlinge v. McEadden*, 7 Cranch 116 (U. S. 1812); *Molina v. Comision Reguladora del Mercado de Henequen*, 91 N. J. L. 382, 108 Atl. 398 (1918); *Maurin v. International Railway of Canada*, 127 Mass. 349, 83 N. E. 876 (1908); (1931) 40 Yale L. J. 784.

Statutory consent to sue the United States in contract, with some exceptions, was granted by the creation of the United States Court of Claims in the year 1855. 10 U. S. Stat. 612. At that time the jurisdiction of the court included the right to "hear and determine all claims founded upon any law of Congress, or upon any regulation of an executive department, or upon any contract, express or implied, with the government of the United States, which may be suggested to it" \* \* \* and also all claims which may be referred to said Court by either house of Congress." *Ibid.* At the present time, the court has jurisdiction, among others set forth in the amended statute, "to hear and determine":

"\* \* \* All Claims (except for pensions) founded upon the Constitution of the United States or any law of Congress, upon any regulation of an executive department, upon any contract, express or implied, with the Government of the United States, or for damages, liquidated or unliquidated, in cases not sounding in tort, in respect of which claims the party would be entitled to redress against the United States either in a court of law, equity, or admiralty if the United States were suable; Provided, however, That nothing in this section shall be construed as giving to the said court jurisdiction to hear and determine claims growing out of the late civil war, and commonly known as 'war claims', or to hear and determine other claims which, prior to March 3, 1857, had been rejected or reported on adversely by any court, department, or commission authorized to hear and determine the same." 28 U. S. C. A. § 250.

The United States Court of Claims was established, among other purposes, to remove the bar of the non-suitability of the United States. *Sioux City & St. Paul Ry. Co. v. United States*, 30 Fed. Cl. 616 (C. C. Iowa, 199). It should be noted, that in every case in which the Court of Claims has jurisdiction, the district courts of the United States have a like jurisdiction, limited however to actions on claims not exceeding the sum of \$10,000. 28 U. S. C. A. § 41 (20). *Sochi v. United States*, 206 Fed. 946 (E. D. Pa., 1920).

But the principle of immunity from legal proceedings does not extend to corporations organized under the laws of foreign governments. *Cook v. Societe Cooperative Suias Des Charbons, Siste*, 21 F. (2d) 190 (S. D. N. Y., 1921); *United States v. Deutsche Kaffeehandels Gesellschaft*, 31 F. (2d) 199 (S. D. N. Y., 1929); *Molina v. Comision Reguladora del Mercado de Henequen*, supra, at 356 of sup.; *Perry v. Norddeutscher Lloyd*, 208 N. Y. Supp. 525 (Mun. Ct., 1934), aff'd without opinion by App. Term, 1st Dept. (unreported); *Central Hannover Bank and Trust Co. v. Suomen & Balask Aktiengesellschaft*, 15 F. Supp. 927 (S. D. N. Y., 1936); *Halzer v. Deutsche Reichsbahn Gesellschaft*, 289 N. Y. Supp. 943, 944-945, 290 N. Y. Supp. 181, 198-198 (Sup. Ct., 1936); (1936) 45 Yale L. J. 1463, 1464.

\* The case of *Deister & Carpenter, Inc., v. Kunglig Jarnvagnstyrelsen*, supra note 39, affords an illustration of the inefficacy of a judgment obtained against a foreign government. In that case, proceedings supplementary to execution were instituted by the plaintiff, a judgment creditor, against the Swedish State Railways (considered by all parties as a part of the Swedish Government and in no way a distinct entity from the Swedish Government), judgment debtor. The judgment had been rendered following the failure of the Swedish Government to file a proper plea of immunity. An order of attachment was levied against the property in the United States of the Kingdom of Sweden after execution had been issued on the judgment. The order of attachment and writ of execution were vacated on application of the Envoy Extraordinary and Minister

M. Borchard, an authority on international law, has described the inability of bondholders to effect collection by means of judicial process:

"While most states now freely subject themselves to suit in cases of ordinary contracts, many states still decline to extend this right so far as the public debt is concerned.

"Again, as the public loan is created by legislation, an act of sovereignty, so it may be suspended, reduced or even repudiated by a similar act of sovereignty, by which the national courts are bound. The creditor, therefore, is juridically opposed to a sovereign who may with perfect legality, by an act of sovereignty, deprive him of his substantive right and of his remedy. In other words, the state in the exercise of its sovereign powers may regulate the execution of its contract of loan in any manner conformable with its public interest. Again, the improbability in many states of securing an impartial judicial determination by national courts in cases of this kind makes the creditor's position precarious. To sue the debtor state on a public loan, therefore, is practically useless. There are some states whose national courts might grant a creditor relief. These are the states that are never sued on their national debts.

"If there were still any doubt as to the impracticability of relief by suit against a foreign government in [its] municipal courts, it would be dispelled by the certainty that execution of the judgment, even if obtainable, is practically impossible. \* \* \* Even attachment and garnishment proceedings against the movable property of foreign sovereigns are almost uniformly dismissed."

*Plenipotentiary of Sweden by the District Court of the United States for the Southern District of New York. The judgment creditor appealed to the Circuit Court of Appeals. The latter court in confirming the order appealed from stated:*

"In such cases, when judgment has been rendered and the liability judicially ascertained, the power of the courts ends and the sovereign is at liberty to determine for itself whether or not to pay the judgment. \* \* \* It is regrettable that Sweden may thus escape payment of a valid judgment against it. \* \* \* It is hoped that the judgment of our courts will be respected and payment made by the Swedish government." *Id.*, at 709, 710.

See also *Mason v. Intercolonial Railway of Canada*, 197 Mass. 349, 83 N. E. 676 (1908); *Hassard v. United States of Mexico*, supra note 39, at 640, wherein it was stated: "So far as jurisdiction is concerned there is no difference between suits against a sovereign directly and suits against its property."

In an article, *Foreign Bondholders Protective Organizations*, by William H. Wynne and Edwin M. Borchard (1933) 43 Yale L. J. 281, 282, introduced as Commission's Exhibit No. 36 in Proceedings before the Securities and Exchange Commission in the Matter of Bondholders Protective Committees for the Republic of El Salvador (1935), it is stated:

"The holders of the defaulted bonds of a foreign state occupy a peculiar position. They cannot sue in the bondholders' state, nor, even where foreign governments permit themselves to be sued, have they any effective remedy in the courts of the foreign country.

"A governmental default is quite different from any other. The creditor cannot obtain judgment against and levy execution upon a debtor government, nor can he take over the management of its affairs. The functioning of the debtor government cannot be impaired, so that the creditor is perforce driven to negotiate and make such adjustments as he can."

Also see Edwin M. Borchard, *Contractual Claims in International Law* (1919) 13 Col. L. Rev. 457, 481; Amos A. Hershey, *Essentials of International Public Law and Organization* (1927), at 261-264.

<sup>4</sup> Borchard, *The Diplomatic Protection of Citizens Abroad* (1928), at 806, 807.

Mr. Borchard concludes that "it is thus apparent that national municipal courts, either of the debtor state or of the country of the creditor, are unable to secure the unpaid creditor any remedy."<sup>42</sup> Another writer has concluded that "proceedings before American and foreign law courts are thus of very limited importance in the protection of foreign bondholders."<sup>43</sup>

The promise to allocate certain revenues to the payment of bond service ordinarily avails the bondholders little or nothing. Should the obligor nation refuse or fail to make the allocation, no legal sanction ordinarily exists to compel the obligor to comply with this covenant for the protection of its creditors.

Nor does the mortgaging of physical property as security for the bond issues materially improve the bondholder's legal status upon default as no effective legal machinery is available to him to foreclose a mortgage or a lien on property.<sup>44</sup> The only courts which have jurisdiction to enter the foreclosure decree are those of the debtor itself. While these courts may as a theoretical matter be open to the foreign bondholders to foreclose on the mortgaged property of a foreign municipality or other political subdivision of lesser dignity than a sovereign foreign government,<sup>45</sup> as a practical matter

<sup>42</sup> *Id.*, at 306.

<sup>43</sup> Quinby, *Bonds and Bondholders* (1934), Vol. 11, Ch. 21; Ernest H. Felchenfeld, *Rights and Remedies of Holders of Foreign Bonds*, sec. 601, at 273.

<sup>44</sup> While the inability of the bondholders to reduce the pledged security to possession prevents their forcing the debtor to observe the terms of the pledge, a security provision may be of some value to the bondholders in strengthening their bargaining position in negotiating debt settlements. In fact Mr. Borchard draws from the history of debt adjustments that although security provisions are not an assurance of uninterrupted service they are an aid in obtaining a preference at time of readjustment. Proceedings before the Securities and Exchange Commission in the Matter of Bondholders Protective Committees for the Republic of El Salvador (1935), at 427; Commission's Exhibit No. 87, at 150-152. Thus in the case of Buenos Aires the pledge of revenues for one of the dollar loans apparently placed the Foreign Bondholders Protective Council, Inc. in a sufficiently strong bargaining position to demand and receive substitute security upon the readjustment of the default. See *infra* sec. IV, A. 2, d. Allen W. Dulles, of the law firm of Sullivan & Cromwell, however, regards the ordinary pledge of revenues as of little value even in negotiating a debt settlement. See his testimony *infra* this section.

<sup>45</sup> Prior to default a pledge of revenues may be of value. A pledge of all available revenues under existing laws might prevent overborrowing by weak states. Mudden, *op. cit.*, supra note 5, at 217. Furthermore, under more stable economic conditions than have existed for the past years, a pledge of revenues may restrain the debtor government from defaulting, or enable it more readily to resist pressure from its citizens to default.

<sup>46</sup> See Institute of International Finance, *Publ. No. 22* (1929), at 18, stating:

"In a number of countries, however (not in the United States), the states and provinces can be sued; for example, the provinces of Argentina, despite provisions in the national law to the contrary in some of the provincial constitutions, can be sued before the Supreme Court of Argentina and decisions against them are enforceable. In almost every country municipalities can be sued and judgment against them can be enforced. In the event of default, therefore, court action can be brought in many cases against provinces and municipalities whose bonds are secured by a pledge of revenues."

See *Principality of Monaco v. State of Mississippi*, supra note 39, in which Monaco sought leave to sue Mississippi to collect on its defaulted bonds which the plaintiff

the remedy cannot feasibly be pursued. In most cases the mortgaged property serves as an adjunct of the debtor in the performance of a governmental service to its citizens. Thus, for example, the security may be a governmentally owned and operated power plant. The difficulties inherent in the creditors seizing a power plant in a foreign state and operating or selling it for their benefit are sufficient to persuade the bondholders in most cases to forsake such remedy and proceed by negotiation. Whether a foreign government, if a judgment of foreclosure is entered, would provide the means for its execution is not known as this Commission's attention has not been drawn to any case where such remedy has been pursued.<sup>40</sup> It is apparent that any foreign state would regard such attempt as an affront to its dignity and an interference with its sovereignty.<sup>41</sup>

held. The Supreme Court in denying leave held that a State of the United States being a sovereign government may not be sued without its consent.

To the same effect holding that a State of the United States may not be sued without its consent, see *Beers v. State of Arkansas*, supra note 39; *Oliver American Trading Co., Inc. v. Government of the United States of Mexico*, supra note 39.

However, in the United States a local political subdivision of a State though it may have been invested with governmental power by a State, may be brought into court against its will to answer to a contract claim. *Ashton v. Cameron County Water Imp. Dist.*, No. 7, 298 U. S. 542 (1936) (dissenting opinion of Justice Cardozo); *The County of Lincoln v. Luning*, 123 U. S. 529 (1887); *Hopkins v. Clemens Agricultural College of South Carolina*, 221 U. S. 836, 645 (1911). See supra in text as to methods for mandamus or injunction and as to enforceability of judgments against municipalities.

A municipal corporation, however, is generally immune from liability in tort resulting from performance of its "governmental" duties unless liability is specially imposed by statute, but such immunity ordinarily does not exist in case of tort committed in performance of "non-governmental" functions. *McQuillen, The Law of Municipal Corporations* (2nd ed., 1928) Vol. 6, sec. 2792-2793; *Wells v. The Village of Bedford*, 58 Vt. 429 (1887).

<sup>40</sup> One bondholders committee for foreign bonds apparently is of the opinion that bondholders' interests can be furthered by resorting to legal actions including foreclosure against foreign obligors. The Colombian bondholders committee, through L. E. de S. Hoover, their secretary, announced in the press that the committee

"are preparing to call upon the trustees and fiscal agents to take steps provided for in the trust indentures in the event of defaults, by declaring the bonds due and payable in full and, if payments are not made, to take foreclosure proceedings. . . . Legal steps can properly be taken against Agricultural Mortgage Bank, as well as the Mortgage Banks, to enforce the rights of the bondholders by either a suit in the Colombian courts or by a request for the appointment of a receiver for the respective banks. It is stated." *N. Y. Times*, Apr. 28, 1936.

It was also stated that "actual suit against the Colombian Government on its direct obligations cannot be taken without its consent because of the sovereign right of the Republic." *Ibid.*

On Oct. 28, 1936, the secretary in a notice to bondholders stated that the committee "have received the opinion of competent Colombian counsel to the effect that legal proceedings may be successfully instituted in the Colombian courts for the collection of the matured unpaid arrears coupons detached from the external bonds of the various Departments and Municipalities." A similar statement was made respecting the enforcement of a pledge of shares of stock of a municipal power company as security for the bonds of the city of Bogota, Colombia. *Notices to Bondholders*, Sept. 17, 1936, and Sept. 22, 1936. It has been reported that the committee have decided to proceed with legal action against the Department of Antioquia in the Colombian courts to collect matured coupons. *N. Y. Times*, Oct. 23, 1936. It was also reported that collections so made in Colombian pesos would be remitted in dollars when permission could be obtained from the board which controls Colombian foreign exchange. *Ibid.*

<sup>41</sup> The considerations discussed in the text would not apply to a foreign private corporation, even though its foreign obligations had been guaranteed by its government.

The testimony of Allen W. Dulles, a partner of the firm of Sullivan & Cromwell, concerning protective provisions in loan agreements, is of particular interest as that firm has drawn many such foreign bond contracts. At a hearing before this Commission where some aspects of the default on bonds of the Republic of Chile were being examined, he testified:

"So far as these protective provisions are concerned, they are what we call 'holder plate', and I frankly feel, from past history, they are not worth the paper they are written on, either from the point of view of the borrower or from the point of view of the lender."<sup>42</sup>

And at a later point he added:

"There are certain features of these agreements that are holder plate. Whether it is good or bad I don't know, but it has appeared in these agreements for a great many years, and very little of it has value today."<sup>43</sup>

The situation with respect to domestic bonds is, of course, quite different. The courts are open to creditors of a domestic private corporation for the enforcement of their claims. Unless receivership, bankruptcy, or statutory reorganization proceedings stay the creditor's hand, judgment will be entered and the sheriff will levy execution on the debtor's assets. In the case of municipal corporations, it is true that under the law of most States, either by specific statutory provision or by judicial decision, the property of a public corporation presently devoted to a public use and appropriated to that end is exempt from execution at a suit of a holder of a defaulted municipal obligation.<sup>44</sup> Nor are the assets of the citizens of the defaulted municipality subject to levy of execution in such instance in most States. An exception, however, obtains in the New England States. In those States, the creditor of a town or other quasi-public corporation, and in some instances of a city, may levy execution against the private property of the inhabitants of the debtor entity to satisfy a judgment against the latter.<sup>45</sup> But the creditors of municipalities outside of the New England States are by no means helpless. They can resort to a writ of mandamus, or in special cases, to a petition for a mandatory injunction, to compel the payment of surplus funds, or to compel the levy and collection of a tax. But even here, as we have shown, these remedies are capable, as a practical matter, of playing but an ancillary role to negotiations for readjustments through refunding.<sup>46</sup>

<sup>40</sup> *Op. cit.* supra note 33, at 1139.

<sup>41</sup> *Ibid.*, at 1143.

<sup>42</sup> See Part IV of this report, *Committees for the Holders of Municipal and Quasi-Municipal Obligations* (1936), at 16-17.

<sup>43</sup> *Ibid.*, at 17.

<sup>44</sup> *Ibid.*, at 16-26.

In the case of private domestic corporations, to be sure, the sheriff seldom levies execution on the plant and equipment of a company which is unable to service its bonded indebtedness. Receivership, bankruptcy, or reorganization proceedings will intervene. But all these proceedings providing for the ultimate settlement of the creditors' claims by liquidation or reorganization, whether authorized by statute or based on the fundamental powers of a court of equity, have as one of their principal objectives the prevention of a race of diligence among creditors for the seizure of the debtor's assets. Other legal rights and remedies enforceable by the courts are substituted for the right to levy execution. A domestic corporation cannot ordinarily remain for long in default on its bonded debt without finding itself involved in court proceedings.

Edwin M. Borchard has summarized the difference between private debts and government debts as follows:

"\* \* \* In the case of an insolvent individual who goes into bankruptcy, all his property, with trifling exceptions, becomes subject to attachment and sale for the benefit of creditors; in the case of a private corporation all the property may be sold. The state is subject to no judicial forum, cannot be compelled to pay except through the need for credit or through diplomatic political pressure, and its assets are not at the disposal of its unpaid creditors. \* \* \*"

It is probable that the great mass of purchasers of foreign bonds were quite unaware of the weaknesses inherent in these foreign bond issues. It is certain that most bond buyers did not read the lengthy legal documents pursuant to which the bonds were issued; if read, they probably would not have been understood. But it was the practice to emphasize in the prospectuses the protective and security provisions of the loan agreements. They were thus brought directly to the attention of the buyers. Furthermore, editors of investment manuals and services turned to the original documents for confirmation and summarized them in books of reference. In news columns the vital passages were passed on to the financial community and to the public.

The buyer learned of the numerous provisions of the issue inserted for his apparent protection. But he did not learn of their ineffectiveness. He was not advised that, to use Mr. Dulles' phrase, they were "boilerplate." Prospectuses of the bankers contained nothing to warn him of this. It may be wondered whether foreign bonds could have been sold in such staggering amounts even in the speculative era of the 1920's if the bankers had disclosed to their customers the virtual impossibility of obtaining legal redress against defaulting nations.

\* Borchard, address International Loans and International Law, before American Society of International Law, Proceedings before the Securities and Exchange Commission in the Matter of Bondholders Protective Committees for Republic of El Salvador (1935), Commissioner's Exhibit No. 87, at 140.

The prospectus would lay particular emphasis on any security for or pledge under the loan, and served to inculcate the belief that such security or pledge possessed as great legal validity as a security under domestic bond issues. But the holder of a defaulted foreign bond, as we have stated, is without feasible remedy to enforce his rights to such security or pledge. As one writer on foreign bonds has said:

"The existing system of draftsmanship is not merely inadequate in not providing against all major risks and in not providing sufficient protection for the future, but is partly to blame for the purchase by the public of foreign bonds which were unsafe investments from the outset. The insufficient analysis of risks conceals from the public certain dangers which become apparent if a clause mentions them. The public bought many loans because it was thought that they were secured by the equivalent of a valuable mortgage; in reality many pledges and charges provided for in government loans amounted only to additional promises which did not even afford a clear priority in case of bankruptcy. An unsound psychology was cultivated because the public was taught to rely on security provisions instead of investigating the paying capacity and reliability of the debtor country. Without the names 'secured loan' the public would probably have refused to buy bonds of countries with which it was entirely unfamiliar. It would also have realized that few security provisions will do more than salvage a fraction in case of real distress."\*

And Edwin M. Borchard, in testifying before this Commission as an expert on the legal aspects of international loans, described further the ineffectiveness of security clauses, except in those cases where the bondholders themselves collect the pledged revenues through a collection agency which enjoys the protection of their government:

"Q. Could you discuss briefly the different types of foreign loans, that is, I assume that there is a class of foreign loans which is unsecured, relying on the good faith and credit of the obligor government?

A. Yes.

Q. There are other loans which carry specific security?

A. Yes. \* \* \*

Q. And such security may take the form of a specific pledge of certain revenues?

A. Yes.

Q. Such as customs revenues?

A. Yes; in Latin America it is usually customs revenue.

Q. Certain taxes?

A. Yes.

\* Quindry, *op. cit.* supra note 43, sec. 637.

George Nebelaine, a member of the New York bar, has suggested that provision be made to insure foreign bond issues for arbitration of disputes between the debtor government and the bondholders. *Am. Soc. Int. Law, Proceedings 1934*, at 155. See Quindry, *supra*, sec. 664. Mr. Borchard testified at a hearing before this Commission:

"Q. \* \* \* Do you think that arbitration could profitably be used \* \* \* as a method of reducing defaults?

A. Yes; I do, both on the legal side and on the economic side.

In effect, the Council of Foreign Bondholders in England does in its objective capacity, act in a quasi-arbitral capacity, taking account of the needs of the debtor and of the requirements of the creditor." *Proceedings before the Securities and Exchange Commission in the Matter of Bondholders Protective Committees for Republic of El Salvador (1935)*, at 484.

Q. In rare cases the security takes the form of a specific mortgage on property?

A. Rarely; but occasionally it has. That was the 19th century practice, more than the 20th.

Q. What is the general value of the security to the holders of the bonds?

A. Well, that varies with the case. In principle I would say so far as the immediate collection of the security goes, when a country goes into default it is not great, unless the creditors, the bondholders themselves, as in the cases of Egypt, Greece, Turkey, Nicaragua, Haiti, and Santo Domingo have their own administration to collect the revenue, and that collecting agency has the protection of strong government. In that event the security has an immediate value, but where that does not exist, then the value of the security is mainly for its indirect aid in obtaining preference in the reorganization of the debt, and there, I think, it has some value, as experiences of reorganization would indicate.

Q. That is, it is only in the rare case that creditors have the ability or the opportunity to reduce the security to possession?

A. That is true. Where they speak of a pledge, it is not really a pledge, because the creditor, as a rule, gets nothing. It is a misnomer, therefore, to use the legal term "pledge."

Q. That term, however, was used in foreign bond prospectuses?

A. Yes; by courtesy.

Q. You think that the use of the word may have tended to mislead the public?

A. I really could not say on that. People who know something about it are not misled, but perhaps the uninformed might be.

Q. Do you not think these foreign bonds were, to a very large extent, purchased by the uninformed?

A. I fear so."

In the case of Haiti, referred to in Mr. Borchard's testimony, the collection agency was in effect controlled by the United States Government. A treaty proclaimed on May 3, 1916, between it and the United States provided that the President of the United States should nominate for appointment by Haiti a general receiver to collect customs levies.<sup>40</sup> Pursuant to this arrangement bonds, of which approximately \$9,000,000 are presently outstanding, were issued by Haiti and sold to the American public secured by a pledge of customs revenues.<sup>41</sup> The general receiver nominated by the President of the United States has collected revenues to the present time and full bond service has been maintained.<sup>42</sup> The Foreign Bondholders Protective Council, Inc., in its 1935 annual report protested a suggested plan to remove this government's power to nominate a collector of customs and to lodge such power in the Bank of Haiti, four

of the directors of which would be nominated by non-governmental agencies in this country.<sup>43</sup>

The United States Government in the past on a few occasions involving exceptional circumstances has lent its support, as in the case of the Haitian loan, to the bondholders, in establishing and maintaining an agency to collect pledged revenues. Such governmental action would be inconsistent with our present foreign policy. Lacking such governmental protection, however, the mere fact that the bondholders appoint or control the collection agency is not full assurance against default. Thus in the case of the El Salvador dollar and sterling loans the fiscal agent, a United States bank, through a local fiscal representative collected the customs revenues pledged as security for the bond issues. But in 1932 the Government of El Salvador found itself faced with financial difficulties and to obtain funds for its internal needs assumed control of customs revenues with a resultant partial default on its external bonds.<sup>44</sup> Furthermore, an embargo on foreign exchange prevents the collection agency from transmitting funds abroad for bond service. In the case of the city of Barranquilla (Republic of Colombia) an administrative board, controlled jointly by the American bankers and the debtor, was created pursuant to the loan contract. This board collected the pledged revenues specified in the agreements, but due to restrictions of the Colombian National Government on foreign exchange was unable to transfer funds for bond service to the United States, with the resultant default in interest and sinking fund payments.<sup>45</sup>

A paucity of foreign exchange may result in default in bond service even though the collection of pledged revenues is under the control of the government whose nationals hold the bonds. As we shall subsequently develop, an inability to obtain sufficient foreign exchange has caused many foreign debtors to default. The debtor's internal revenues are often sufficient to permit continuation of debt service measured in the debtor's own currency, but the debtor is unable to obtain exchange to convert such funds into the currency of the creditors. Thus in the case of certain loans of the Greek Government the collection of pledged revenues allocated to the loan is under the control of an International Finance Commission composed of representatives of various creditor governments.<sup>46</sup> While the Commission has been suc-

<sup>40</sup> Proceedings before the Securities and Exchange Commission in the Matter of Bondholders Protective Committee for Republic of El Salvador (1935), at 120.

<sup>41</sup> Foreign Bondholders Protective Council, Inc., Annual Report 1935, at 122.

<sup>42</sup> *Id.*, at 123, 264.

<sup>43</sup> *Id.*, at 126, 294.

<sup>44</sup> *Id.*, at 124-126.

<sup>45</sup> *Op. cit. supra* note 53, Commission's Exhibit No. 52, at 9-10.

<sup>46</sup> See Part VI of this report, Trustees under Indentures (1936), Appendix D (A), describing the Barranquilla situation.

<sup>47</sup> Foreign Bondholders Protective Council, Inc., Annual Report 1935, at 239-241; Moody's Governments and Municipalities, 1936, at 2591-2592; Madden, *op. cit. supra* note 5, at 237.

cessful in collecting pledged revenues, the scarcity of foreign exchange has permitted only partial payments to the bondholders.<sup>64</sup>

The Young and Dawes loans of the German Government were secured by pledges of various revenues of the Reich.<sup>65</sup> Since May 17, 1930, the Bank of International Settlements at Basle, Switzerland, has acted as fiscal agent of the trustees for the Dawes loan of 1924 and as trustee for the Young loan of 1930.<sup>66</sup> In such capacities it received the revenues pledged under the two loans and, after setting aside the specified amount of bond service, transferred the balance to the German Government.<sup>67</sup> But this system of supervision and control of the collection of pledged revenues, which was founded on international treaties,<sup>68</sup> did not insure against default. On June 14, 1934, the German Finance Minister announced that owing to economic conditions no further foreign exchange would be available after July 1, 1934, for the service of the Reich loans.<sup>69</sup> The dollar series of these two loans have been in partial default since July 1, 1934.<sup>70</sup> We shall subsequently discuss the action of our Department of State in protesting these defaults and the discriminatory treatment of American bondholders by the German Government.<sup>71</sup>

Allen W. Dulles also expressed his opinion of the inefficacy of specific hypothecation of revenue in his testimony before this Commission:

"A. I have reached the conclusion the pledges of revenues are not worth the paper they are written on, on foreign loans, unless the revenues are collected and disbursed by persons other than the debtor.

Q. The question is who is to collect and disburse it?

A. Yes.

Q. That would be an important question to be traded out?

A. Generally you are forced back to the situation where the borrowing government is the collector and the disbursor, and when that is the situation I don't think the security is worth anything.

Q. You are speaking of 'worth anything' in terms of being able to collect it as a sheriff can go down and collect a particular fund or particular chattel?

A. I don't think it is worth appreciably more than the general obligation of the foreign government to pay.

<sup>64</sup> *Ibid.*

<sup>65</sup> Securities Registration Statement, Form 18, Deutsches Reich, filed with Securities and Exchange Commission April 18, 1930, Exhibit M1, Statement German Minister of Finance, at 2 (Dawes loan), Exhibit M11, Statement German Minister of Finance, at 1-5 (Young loan).

<sup>66</sup> *Id.*, Exhibit B11, Statement German Minister of Finance, at 3-5.

<sup>67</sup> Hague Agreement, Jan. 20, 1930, modifying earlier international agreements.

<sup>68</sup> *Ibid.* See Experts Plan for Reparation Payments published by the Reparation Commission (1929).

<sup>69</sup> Securities Registration Statement, *op. cit.* supra note 64, at 7.

<sup>70</sup> Foreign Bondholders Protective Council, Inc., Annual Report 1934, at 176. See Fifth Annual Report of Bank of International Settlements.

<sup>71</sup> *Infra* sec. IV, C, 5.

Q. Don't you think these priorities in a foreign field have any practical significance in view of negotiations?

A. What type of priorities? You mean whether you have a first or second lien on tobacco revenues?

Q. That is one example, or where specific funds or specific revenues are pledged to a loan? Don't you think those have practical significance?

A. Relatively little in the face of a situation such as we are facing today.

Q. You mean to say you would just as soon enter negotiations without a priority as with a priority?

A. It depends somewhat on the priority. If I had revenues that were collected by some other agency, I think you would have something of value. In a debt negotiation in which I had a part I don't think where we had a first or second lien on some revenue that was not being collected would prove of any value in any situation.<sup>72</sup>

This is a frank admission by a partner of a firm which drafted many of the foreign loan agreements<sup>73</sup> that to him the protective covenants are empty phrases. Yet there was no hesitancy by houses of issue to emphasize in prospectuses their effectiveness as weapons for the bondholders' protection. And in this, the members of the financial bar whose names appear on the prospectuses must bear as much of the onus as the issuing bankers.

It is apparent that holders of foreign bonds lack the ordinary means to put life and substance into the agreements when a foreign government defaults. They must turn to other devices to obtain any recovery upon their investment. These will now be described.

## 2. GOVERNMENTAL ASSISTANCE

### a. Economic Sanctions

A possible means to obtain some recovery available to creditors holding defaulted foreign bonds lies in the application of economic sanctions against the defaulting government. But the use of economic weapons in retaliation for the failure of the obligor to provide bond service, or as a pressure device to induce resumption of bond service, is not a part of our international policy.<sup>74</sup> And in the last analysis such methods are of doubtful utility to the creditors.

In theory the government of the creditors could impose discriminatory tariffs or regulate foreign exchange in a manner detrimental to the defaulting government. Furthermore, if the obligor nation has a favorable balance of trade<sup>75</sup> with respect to the country of the

<sup>72</sup> *Op. cit.* supra note 33, at 1140-1142.

<sup>73</sup> *Id.*, at 1131.

<sup>74</sup> *Op. cit.* supra note 65, at 439-440.

<sup>75</sup> In addition to trade in merchandise, other items such as freight and shipping, tourists' expenditures, immigrant remittances, etc., would be reflected in the balance of payments between the two countries.

creditors, the latter may arrange for the compulsory clearance of international payments through an official agency and apply the balance of exchange seized against bond service. This form of international garnishment has in fact been threatened (and applied in some instances) against Germany, Roumania and other debtor countries by European governments in recent years. Following these threats a large number of so-called trade clearing agreements or similar arrangements have been concluded between the debtor and creditor governments. While such agreements are usually designed to effect payment of trade credits, a number of agreements contain additional provisions directing the application of a share of the balance of payments in favor of the debtor to the payment of bond service. By means of such agreements, Switzerland, Holland, France, England, and other governments have obtained for a period full bond service on the German Reich Loans while American bondholders were receiving only partial service. This discriminatory treatment of American bondholders, as we shall subsequently relate, was the subject of several protests by the U. S. Department of State to Germany.

It cannot be questioned that the use of this form of economic pressure has resulted in interest payments on long term indebtedness which otherwise would not have been made. We shall reserve for subsequent discussion the subject of trade clearing agreements and their utility as a debt collection device.<sup>79</sup> It will suffice here to note two points. In the first place this use of trade clearing agreements is founded upon a balance of trade between the debtor and creditor nations adverse to the latter. The United States possesses a substantial unfavorable trade balance with respect to only a few countries which have defaulted on their dollar bonds. Hence, with these few exceptions, such agreements would be of no utility as a device for debt collection. In the second place such agreements are subject to serious drawbacks. The experience of European nations with them has been far from satisfactory. Such agreements dislocate international trade, forcing it to flow in unnatural channels. Furthermore experience has shown that the effect of such agreements is to equalize trade between the two countries, thus reducing or destroying the trade balance which is a condition *sine qua non* to their successful use in debt collection. These and other objections to this use of economic pressure to collect debts will be developed subsequently.<sup>80</sup> While such agreements, where the requisite conditions obtain, may result in some payments to the bondholders, the conclusion seems inevitable that from a long range point of view their detrimental effects

<sup>79</sup> *Infra* sec. IV, C. 5.

<sup>80</sup> *Ibid.*

may overbalance the immediate benefits to bondholders. Indeed their natural tendency to cripple commerce and to equalize the trade between the two nations may make the sanction itself ineffective. The possibility of the use of trade clearances and other similar devices on behalf of the American bondholders is small.

#### b. Armed Force

Creditor nations do not resort to the use of their armed forces to collect overdue accounts.<sup>81</sup> In the few instances in the past where there has been a show of armed force against a delinquent country, other issues between the two nations more aggravating than the failure to meet bond service have been involved.<sup>82</sup> The show of naval force by Great Britain, Germany, and Italy against Venezuela in 1903, according to Mr. Borchard, had as its principal motivation the existence of tort claims against Venezuela and its refusal to arbitrate them. Venezuela's default on its external bonds was regarded as an ancillary issue.<sup>83</sup> As an outgrowth of the Venezuelan incident, Senor Drago, the Minister of Foreign Affairs of Argentina, developed the doctrine (bearing his name) that force should not be used to collect a contract debt.<sup>84</sup> It led to the "Convention Respecting the Limitation of the Employment of Force for the Recovery of Contract Debts" at the Second Hague Conference. By this Convention the contracting powers agreed not to use force except in certain circumstances, *viz.*, (1) when the debtor government fails to reply to an offer of arbitration, (2) when arbitration had been offered and accepted but the debtor prevents the framing of the special agreement, (3) when the debtor government fails to submit to an award made in an arbitration.<sup>85</sup>

Commentators have pointed out that the net result of the Drago Doctrine was to sanction the use of force under certain circumstances although theretofore the use of force to collect contract claims had not been customary under any circumstances.<sup>86</sup>

The bondholders may eliminate from their consideration the use of armed force as a means of debt collection. In the final analysis, therefore, there are available to the holders of defaulted foreign

<sup>81</sup> See Borchard, *The Protection of Citizens Abroad by Armed Force* (1920), Publication No. 2235 of the Acad. of Pol. and Soc. Sci.

<sup>82</sup> *Op. cit. supra* note 55, at 430.

<sup>83</sup> *Ibid.*

<sup>84</sup> *Id.*, at 437.

<sup>85</sup> *Ibid.* See *Foreign Relations of the United States* (1907), at 1159-1204; *The Hague Conventions and Declarations of 1893 and 1907*, edited by James Brown Scott, Carnegie Endowment for International Peace (1915), at 59-95.

<sup>86</sup> See J. Reuben Clark, Jr., address before Bond Club, Jan. 18, 1936, reported in *N. Y. Herald Tribune*, Jan. 14, 1936.

bonds but few legal or economic sanctions which can be applied against the defaulting nation, and these are of doubtful utility.

#### e. Diplomatic Representations

In the absence of any feasible means of bringing compulsion to bear on a defaulting government to service its bonded indebtedness, the bondholders perforce must resort to negotiations with the debtor to induce it to resume debt service in whole or in part. Creditors of defaulting foreign nations are prone to turn to their own government to carry on the necessary negotiations with the debtor. The proper role to be assumed by the government of the lender when such default situations arise has often been the subject of discussion by commentators on international loans.

Leland Hamilton Jenks has described how British holders of defaulted foreign securities during the second quarter of the nineteenth century besieged their foreign office with demands for intervention in their behalf.<sup>33</sup> This culminated in a circular which Lord Palmerston in 1848 addressed to the British representatives in foreign states. In this circular was set forth the British policy with respect to governmental interposition in a defaulted debt situation involving British citizens and foreign governments. He said in part:

"It is, therefore, simply a question of discretion with the British government whether this matter [the non-payment of public loans] should or should not be taken up by diplomatic negotiation, and the decision of that question of discretion turns entirely upon British and domestic considerations."<sup>34</sup>

This seems to assume the right of a government to intervene diplomatically in a default situation and to carry on the necessary negotiations with the debtor, although the exercise of the right is entirely discretionary with the government. Commentators on the subject usually take the position that the right to intervene exists only if the defaulting government has been guilty of an "international delinquency."

It is difficult to read specific content into this phrase. The outright repudiation by the foreign government of its loan as distinguished from the mere failure of the government to maintain debt service while recognizing the validity of the loan is usually regarded as constituting an international delinquency. Examples of such outright repudiations by sovereign governments, however, are rare. The action of a borrowing government in discriminating against the citizens of a particular state is also regarded as an international delinquency. Edwin M. Borchard in testifying before this Commission empha-

sized the difference between repudiation and discriminatory treatment on the one hand, and ordinary default on the other:

"Q. Could you state, Mr. Borchard, the difference between a default in bond service and a repudiation of the bond by the foreign government?

A. Well, the default is assumed to be a mere inability to pay. The repudiation evidences an unwillingness to pay.

Q. The difference is one of intention?

A. The difference is, yes, one of intention; but in practice the inability to pay is often advanced as the ground for a refusal to pay. For example, the debtors of the United States may be taken, and their 'inability' to pay. I judge there is more refusal to pay than inability to pay, in many cases. The repudiations are not many. Governments do not repudiate, except in revolutionary times, such as the Soviet government's repudiation. They can get all the results they want by merely pleading inability to pay; and it is awfully hard to prove that they are in error.

Q. Do I understand you to say that repudiations are quite rare?

A. Rare. I may say that inability to pay is not regarded as an offense in international law; and that is of some importance.

Q. Could you explain a little more in detail the significance of that rule?

A. The significance of that rule lies in the fact that it is for that reason that governments will not take drastic action to compel a government that has defaulted in its foreign bonds to make good, if they maintain that they cannot pay, and, in view of the fact that the bondholder has bought the bonds, theoretically, with his eyes open, the government maintains there has been a mere default, which might have been expected. Therefore there is no international law on the side of the government of the bondholder warranting it in taking diplomatic action on his behalf.

Q. But in a case of repudiation, diplomatic action would be warranted?

A. Yes. In the case of repudiation or in the case of the diverting of security or in the case of unfair discrimination between bondholders of different nationalities, the foreign office does assume that that is a delinquency warranting diplomatic interposition, involving bad faith. This is a distinction between bad faith and good faith.

Q. You mentioned that discrimination might warrant diplomatic action. That is, in the case of the United States, discrimination by foreign governments against the bondholders who are citizens of this country?

A. Yes.

Q. Such discrimination would warrant the State Department in taking diplomatic action?

A. Yes.

Q. Have there been any recent cases of such a situation?

A. Well, the most recent is the case of the representations made to Germany when Germany is alleged to have given a preference to the Dutch and Swiss bondholders, where, however, there was a trade balance which they could seize and we could not. And they used compulsory clearings in those countries which we could not use. The result, however, was that Swiss and Dutch bondholders were treated more favorably in getting a larger proportion of their coupon interest than were citizens of the United States.

Q. Do you recall that the State Department made rather vigorous protest against that discrimination?

A. Yes, they did."<sup>35</sup>

<sup>33</sup> Jenks, *The Migration of British Capital to 1875* (1927), 115 et seq.

<sup>34</sup> Borchard, *op. cit. supra* note 63, at 158, and see his comment at 159.

<sup>35</sup> *Op. cit. supra* note 63, at 429.

The action which the bondholders' government may take in the event of a so-called international delinquency usually takes the form of official or formal representations to the government which borrowed the money, consisting of a protest against the action taken and a request or demand that the situation be rectified. Examples of such action by our State Department were the protests made to Germany in 1934 and 1935 referred to in Mr. Borchard's testimony quoted above and discussed subsequently in this report.

The occasions under existing international law and practice for the employment of strictly official representations are rare. And it must be remembered that the decision to intervene is discretionary with the government of the lenders. National or international considerations transcending in importance the immediate interest of the bondholders may dictate a policy of nonintervention. The policy of our State Department, except under the unusual circumstances typified by the German case, is definitely one of noninterposition in a formal and official capacity in the default situation. This is not to say however that the Department is inactive in the ordinary case. It finds frequent occasion to exert its influence on behalf of the bondholders. The exact nature of the action taken naturally varies with the circumstances. It may consist, for example, of an indication to the foreign government of the Department's interest in the default, or of a suggestion that negotiation of a debt settlement be initiated. The Department's views may be communicated to the debtor's Minister of Finance by the diplomatic representative of this country, or by the State Department to the debtor's foreign representative at Washington. Such action while usually unofficial and informal may nevertheless be effective.

While freely rendering assistance of this nature to the bondholders, it is the policy of the Department that the actual conduct of the negotiations should rest in private hands. It has expressed its policy thus:

" \* \* \* The Department has consistently taken the position that settlement of the questions arising out of default in debt service by foreign governmental entities may best be obtained through direct negotiations of the bondholders or their representatives with the entities concerned. The Department uses its informal good offices on all appropriate occasions to facilitate such negotiations between the directly interested parties."<sup>\*</sup>

<sup>\*</sup> *Op. cit. supra* note 10, Commission's Exhibit No. 177. J. Houston Clark, Jr., has described the participation of the British Foreign Office in debt settlements:

"The Foreign Bondholders Corporation of Great Britain operates directly in representation of the bondholders with the foreign government, but the British Government has gone a good deal farther in helping than our Government has so far felt able to go in helping the Council. How that aid shall develop with the future years, I do not know. But, for example, in Great Britain, it not infrequently has happened that the British Government will permit the Corporation to delegate or constitute as its agent the minister of Great Britain in the defaulting country, and, if not the minister, then the consul-general." *Op. cit. supra* note 10, Commission's Exhibit No. 29, at 3.

We are informed, however, that the cases in which the Corporation of Foreign Bondholders has been permitted to empower the British representative in the foreign state to

As negotiations with a foreign government obviously cannot be carried on by the numerous and widely dispersed bondholders acting individually, protective committees or agencies come into play and serve an essential function. The situation calls for the centralization of the interests of the mass of bondholders in one compact group, the members of which will act as the representatives or spokesmen of the bondholders in their discussions with the debtor nation looking toward a debt readjustment.

In emphasizing that the lack of effective means for exerting pressure on a defaulting nation forces the bondholders to resort to negotiations, we do not intend to say that nations as a rule take advantage of the situation either by arbitrarily defaulting or by arbitrarily refusing to resume debt service. Default is usually accompanied by an official or unofficial statement from the obligor government, of the existence of a national emergency or distress, making impossible the service of the bonded indebtedness.<sup>77</sup> No doubt most of these statements are made in good faith based on a genuine dearth of internal revenue, or available foreign exchange, or both. The incidence of the world-wide depression on government treasuries has, of course, been severe. The decreased volume of world trade and the drastic drop in the prices at which it moved seriously affected the economy of many debtor nations and curtailed severely their supplies of foreign exchange. The conditions have made many

negotiate on its behalf are restricted to those where the Council itself acts as the legal representative of the bondholders, that is to say, where the Council takes the deposit of bonds. As we shall subsequently develop, the British Council has not accepted deposits in every case. It is also understood that the foreign representative may act generally in the interest of the British bondholders without specific request from the Council.

Mr. Clark testified, however, that British bondholders are not as prone to call upon their Foreign Office to aid in the readjustment of foreign defaults as the American investors are to call upon the State Department:

"I might say, generally speaking—and this is contrary to the popular impression—there is less inclination among British investors abroad to try to do their business through their Foreign Office and their embassies and legations than there is on the part of American citizens. That is due entirely to our lack of experience. And you will nearly always find that British financial interests in foreign countries do their own negotiating and drop out their own troubles rather than applying to their Department of State or to their Foreign Office. I make that statement merely by way of clearing the ground on the general assumption that Great Britain does so much more for its subjects than the United States does for its citizens. That is not true." *Id.*, at 233.

See also Mr. Clark's testimony before this Commission. *Id.*, at 226-228.

<sup>77</sup> *E. g.*, advertisement of the Republic of Uruguay in the New York Times, July 28, 1932, stating in part:

"The Republic of Uruguay, in spite of intense efforts to maintain a favorable balance of international payments, is faced with an acute shortage of foreign exchange due to the decline in its exports and the low prices for which its products can be sold in foreign markets, and it thus finds it increasingly difficult to obtain the necessary foreign exchange even for the most pressing commercial purposes of its people. It is clear that the continued full payment of its interest on its foreign obligations in the currencies in which they are expressed to be payable would have a disastrous effect on the gold reserves of the Bank of the Republic, which have already been substantially reduced. These reserves cannot be further depleted without endangering the industrial and commercial structure of the country. In view of this situation, the Government has issued, under date of July 3, 1932, a decree, under the terms of which the Government will deposit in Montevideo an amount in Uruguayan pesos equivalent, at par of exchange, to the interest to become due on its external long term debts. The pesos so deposited will be transferred, from time to time, for payment to coupon holders converting to accept the same, at the rate of exchange prevailing at the time of transfer."

defaults inevitable, especially in those cases where the government borrowed foreign capital far beyond its needs.

Arbitrary defaults no doubt do occur occasionally, induced perhaps by the example of other nations that have ceased servicing their indebtedness without apparent penalty. It is probable that the defaults by various European nations on their huge war debts owed to the United States Government have colored the attitude of governments indebted to American citizens, making them more ready to resort to default on their external bond issues as the solution of their internal financial problems. It is of interest in this connection that the Republic of Chile in a memorandum explanatory of the terms of a decree and the circumstances of its enactment, by which debt service of the Chilean external loans was to be scaled drastically, made reference to these defaults in the following language:

"One of the unfortunate results of the world crisis was to force into default the debts incurred by even the greatest and wealthiest countries, including debts contracted for the purpose of safeguarding national existence in time of war. The great depression smote Chile with more devastating force than any other country."<sup>1</sup>

More frequent perhaps than the case of arbitrary default is the situation where cessation of bond service in the first instance was justifiable but the rectification of the default is unreasonably delayed. There often will be a considerable lag between the restoration of a nation's capacity to pay and the resumption of even partial debt service.

The long experience of the older creditor nations indicates that most foreign defaults are eventually readjusted with the resumption of at least partial debt service. Dr. Herbert Feis, in his book, "Europe, the World's Banker, 1870-1914", points out the persistence and patience of the British Corporation of Foreign Bondholders in effecting this.<sup>2</sup> This corporation, which was formed in 1868, acts as the central protective agency for defaulted British foreign bond issues. Dr. Feis states that by tempering doggedness with moderation it had, by 1930, readjusted through some form of compromise, all the defaults it had taken in hand, except those of certain of the states of the United States.

### 3. BASIS FOR NEGOTIATING A PLAN

A willingness on the part of the debtor government to discuss the situation created by its default must obviously precede negotiations and in itself usually implies a willingness to make some offer, perhaps an unattractive one to its creditors. The extent to which the

<sup>1</sup> Foreign Bondholders Protective Council, Inc., Annual Report 1935, at 39.

<sup>2</sup> At 118.

government will go to meet its obligations and satisfy the demands of its creditors rests partly on the existence of a genuine desire to pay, coupled with a willingness to make the sacrifices which a resumption of payment will entail. Restoration of debt service obviously means that revenues otherwise employed, possibly in serving internal needs, must be allocated to its bonded indebtedness, or in the alternative additional revenue must be raised by taxation. Lack of available foreign exchange has caused many defaults as the debtor may be able to pay bond interest in its own currency but a scarcity of exchange prevents its transmitting such payments to its foreign bondholders.<sup>3</sup> Accordingly, a resumption of interest payments requires that exchange must go to the bondholders rather than to meet the claims of other creditors, to pay for imported merchandise or to serve other national ends. In short, the resumption of bond service even in part may necessitate some sacrifices on the part of the debtor government and its citizens.<sup>4</sup>

The willingness of the issuer to negotiate with representatives of the bondholders and eventually to agree to readjust its default generally has two motivations: a desire to restore the prestige and reputation of the nation, and a desire to borrow more money.<sup>5</sup> Many

<sup>3</sup> See Madden, *op. cit. supra* note 3, at 186-184. A debtor government, lacking foreign exchange, may service its foreign indebtedness by exporting gold. The limited supply of this metal and the debasement of a debtor's currency consequent upon substantial shipments of gold make such payments at best a temporary expedient.

<sup>4</sup> In this connection it is interesting to note that the Chilean Special Financial Commission in connection with a plan drastically to scale bond service on Chile's external loans quoted with approval the following excerpt from the 1925 report of the American Debt Funding Commission on the settlement of the war debts:

"While the integrity of international obligations must be maintained, it is axiomatic that no nation can be required to pay to another government sums in excess of its capacity to pay. The Commission in its settlement with Great Britain . . . has adhered to the principle that the adjustments made with each government must be measured by the ability of the particular government to put aside and transfer to the United States the payments called for under the funding agreement.

"Nor does the principle of capacity to pay require the foreign debtor to pay to the full limit of its present or future capacity. It must be permitted to preserve and improve its economic position, to bring its budget into balance and to place its finances and currency on a sound basis, and to maintain, and if possible to improve, the standard of living of its citizens. No settlement which is oppressive and retards the recovery and development of the foreign debtor is to the best interest of the United States or of Europe." Foreign Bondholders Protective Council, Inc., Annual Report 1935, at 39-40.

The Chilean memorandum continued:

" . . . The citizens of Chile and the Government of Chile regard their national indebtedness with as high a feeling of honor as do the citizens or governments of any nation of the world; yet, after the severe sacrifices to which we have been subjected through the economic pressure of the past four years, we cannot in justice force our people into still more acute distress in order to meet this burden of interest." *Id.*, at 42.

<sup>5</sup> The Johnson Act (31 U. S. C. A. § 804a (Supp. 1945), approved Apr. 13, 1934) is aimed principally at European governments which have defaulted on their so-called "war debts" to the United States. The Act prohibits the making of any new loans to governments in default on their indebtedness to the Government of the United States (not to the citizens thereof). The Act provides:

"It shall be unlawful within the United States or any place subject to the jurisdiction of the United States for any person to purchase or sell the bonds, securities, or other obligations of any foreign government or political subdivision thereof or any organization or association acting for or on behalf of a foreign government or political subdivision thereof issued after April 13, 1934, or to make any loan to such foreign government, political subdivision, organization, or association, except a renewal or adjustment of existing indebtedness while such government, political subdivision, organization, or association, is in default to the payment of its obligations, or any part thereof, to the Govern-

debtor countries are still in the process of development, requiring capital in amounts greater than can be raised from internal sources. Foreign capital raised by bond issues or by the granting of short term credits will be required for public works and improvements and to finance industry and agriculture. If bonds are in default, the issuance of additional bonds is almost impossible and bankers dislike to make new short term loans until the credit of the nation is restored. Default on governmental indebtedness will necessarily have its effect on the ability of the government's citizens to obtain foreign credits for their own needs. These purely practical considerations support a desire to brighten the nation's reputation by honorable treatment of its foreign creditors.

Negotiation for a debt readjustment will involve a complexity of financial, economic, and political problems. The discussions are likely to have as their central theme the capacity of the debtor to pay—capacity both in the revenue of the government and its available foreign exchange. The revenues a nation can raise by taxation and devote to debt service and the sums which it can transfer abroad to its creditors are not susceptible of precise mathematical determination, but are matters which must be traded out by the representatives of the debtor and the creditors. The determination of the capacity to transmit funds abroad for bond service is likely to have an important bearing upon the nation's foreign trade.

Obviously, the debtor nation must continue to exist and discharge its essential governmental functions and its foreign trade cannot be destroyed. Proper recognition must necessarily be given to these considerations by the bondholders' representatives. To attempt to insist upon too drastic a reduction of internal expenditures, the levying of too onerous taxes or the allocation to bond service of too excessive an amount of foreign exchange is to invite an early recurrence of default. It is hardly likely, however, that the representatives of the bondholders will drive too hard a bargain as the debtor in the negotiations concerning its capacity to pay has the stronger bargaining position. Complete and accurate statistical data as to existing and prospective revenues and expenditures and as to the available foreign exchange of a debtor nation may not be available to the bondholders' representatives who are thus deprived of the essential facts on which to predicate the negotiations. Furthermore, the

ment of the United States. Any person violating the provisions of this section shall upon conviction thereof be fined not more than \$10,000 or imprisoned for not more than five years, or both.

"As used in this act the term 'person' includes individual, partnership, corporation, or association other than a public corporation created by or pursuant to special authorization of Congress, or a corporation in which the Government of the United States has or exercises a controlling interest through stock ownership or otherwise."

For a statement of the amount of the war debts and a brief history thereof, see Foreign Bondholders Protective Council, Inc., Annual Report 1935, at 375-380.

knowledge by the debtor that the bondholders ordinarily can apply no effective sanctions against it will not induce it to fix its capacity to pay at a figure so high as to entail substantial sacrifices by its citizens. J. Reuben Clark, Jr., president of the Foreign Bondholders Protective Council, Inc., out of his experience in negotiating debt settlements, testified to the difficulty of persuading a foreign government to reduce its internal expenditures in order to increase debt service:

"May I say that in all these negotiations you have to have in mind this fundamental principle, that, after all, a government must live; it must have enough money to function. Otherwise your bonds are no good. You may get into differences of opinion, and you frequently do, as to how much money a government should spend and what the purposes of that spending should be for what we may call its own maintenance, as distinguished from spending on its own foreign debt service. One of the problems which always presents itself in these negotiations is that of trying to induce the government to cut down its expenditures for maintenance and devote more of its money to its foreign debt service. But that is never a very popular undertaking and it is frequently difficult to persuade them to make any change."<sup>22</sup>

In addition to the problem of capacity to pay there are often involved in negotiations the questions of priority and relative treatment to be accorded the various dollar bond issues of the foreign government with their varying interest rates, maturities, security and sinking fund provisions. These matters, complex in themselves, become yet more complicated when loans floated in other countries are included in the proposed debt settlement. Furthermore, short term bank and commercial credits frequently exist and must receive consideration. They all have their bearing on the debt readjustment finally reached. Compromise and settlement of these various conflicting claims are necessary if a fair and equitable readjustment is to be consummated. But in view of this existence of conflicting claims, bondholders can be assured of effective and vigorous championship only if their representatives are free of interests and loyalties adverse to those of the bondholders.

#### 4. UNILATERAL PLAN

The foregoing discussion has been predicated on the assumption that a readjustment plan follows negotiations between representatives of the debtor nation and of the bondholders, and that it reflects an agreement or an understanding previously reached. Usually it takes the form of a reduction of interest and a modification of amortization provisions in the original loan contract. Sometimes, the security for the loan is altered and occasionally the principal of the

<sup>22</sup> Op. cit. *supra* note 33, at 26.

debt is scaled downward. There appears, however, to be a tendency to maintain the principal intact.

But the procedure described is by no means the unvaried practice. A debtor nation may readjust its foreign obligations unilaterally, without consulting the bondholders or their representatives.

The mechanics involved in the consummation of a unilateral plan are essentially simple. The obligor nation enacts a decree or makes a formal pronouncement that debt service is scaled to the amounts specified by the debtor or that the original covenants of the loan are otherwise modified. The debtor nation will further provide that a bondholder may "accept" the new arrangement by cashing his coupon at the reduced rate or by otherwise accepting the treatment accorded him under the plan. This "acceptance" is at most one of form only as the plan proposed by the government either explicitly or impliedly states that the alternative to the reduced bond service specified will be no payment whatsoever. It is a take-it or leave-it proposition.

Readjustments thus consummated are not likely to be favorable to the bondholders. If the debtor is acting sincerely the plan will at best embody only its own judgment of its capacity to pay. If sincerity is lacking the plan may constitute only a gesture toward the bondholders or a means whereby the debtor removes itself from the category of nations in complete default.

The device of the unilateral plan finds no counterpart in the domestic field. Its employment is made possible only by reason of the absence of effective sanctions which the bondholders may apply against the debtor. As previously discussed, the lack of such sanctions permits a government if it so chooses to default arbitrarily on its debt service. By the same token, a government has the power to readjust its foreign bond issues without consulting its creditors and in such manner as it, and it alone, deems proper.

From the viewpoint of the bondholders, the element in the unilateral technique most prejudicial to their interests is the lack of consultation or negotiation with their representatives or spokesmen. The mechanics of consummating a negotiated plan may be the same as for an unilateral plan; *i. e.*, each bondholder by the acceptance of any benefits under the plan becomes bound to its terms. If, however, the bondholders have been effectively represented in the negotiations leading up to the plan, and the agreement reached reflects the best treatment the bondholders could expect consistent with the debtor's capacity to pay, the "acceptance" assumes a more substantial meaning. The merits of this procedure as compared with a plan of readjustment requiring acceptance of the bondholders other than through acceptance of benefits, *i. e.*, a plan which is fully bilateral, will be discussed in a subsequent part of this report.

## 5. TYPES OF PROTECTIVE COMMITTEES AND AGENCIES: NUMBER OF PROTECTIVE COMMITTEES

Following default in interest payments by foreign governments different types of agencies have arisen to defend the interests of the bondholders. Before examining them and their functions, activities, and personnel in detail, they may be named and classified.

The banking firm or corporation which originally floated the issue in default may act on behalf of the bondholders, either directly as the house of issue, or through the medium of a protective committee which it has organized and on which its representative may or may not serve. The fiscal agent which, as previously stated, in a substantial majority of cases is the house of issue or an affiliated corporation, may attempt to rectify the default. In fact, a number of readjustments, mostly of a temporary nature covering only one or two interest coupons, have been effected by the houses of issue or fiscal agents in negotiations with debtors without the intervention of protective committees or other agencies.

Protective committees whose members had no connection with the original financing may offer themselves or be requested by bondholders to act as representatives of the bondholders. They often designate themselves as "independent" committees. This term will be used in this report to distinguish them from "banker" committees.

Attention must also be given to permanent protective organizations. Their development has been one approach to the problem of adjusting foreign defaults by older creditor nations. They have many distinctive characteristics. Such a central organization, the Foreign Bondholders Protective Council, Inc., was formed in 1933 in the United States. Its present and potential importance to the holders of foreign bonds requires that careful study be given to its organization, financing, and operations.

Protective committees, irrespective of whether organized by the houses of issue or by others, in turn may be classified into three groups: first, the committee whose authority flows from the deposit of the outstanding bonds; second, the committee which takes only a proxy or power of attorney from the bondholders who retain possession of their bonds; and third, the committee which receives neither deposits nor proxies or other form of legal authorization from the bondholders and hence is not their legal representative.

A significant feature of the defaulted foreign bond situation is the relative scarcity of protective committees as such. Various banks and trust companies, at this Commission's request, reported to it in December 1934 that they were acting or had acted as depository for 17 protective committees for foreign government issues, which had been in existence at some time since January 1, 1928. The num-

ber of protective committees in the foreign field is, however, somewhat larger than this. Not all banks and trust companies were requested to report. Furthermore, some committees operated under proxies taken from security holders and therefore did not require the services of a depository. In addition a few committees have been organized subsequent to December 1934. It is not believed, however, that the addition of such committees as were not reported by depository institutions and of committees recently formed would bring the total number to more than forty.\* This figure is to be compared with 197, the number of foreign bond issues listed as being in some stage of default as of December 31, 1934, by the Foreign Bondholders Protective Council, Inc., in its 1934 report. It is true, of course, that certain committees represented more than one defaulted issue and a few committees represented all the bond issues of a particular nation and its political subdivisions. But the fact remains that many foreign issues which have been in partial or complete default for a number of years have not received the attention of a protective committee as such. Moreover, a number of committees appear to have been relatively inactive. Some committees apparently have taken no steps except to perfect their formal organization and to make a public announcement of their formation. The extent to which the Foreign Bondholders Protective Council, Inc., has displaced the conventional protective committee in the foreign field will be discussed subsequently.

We have heretofore emphasized the helplessness of the bondholders in obtaining redress against a defaulting foreign government. We have shown that in contrast to their remedies in the domestic field, the holders of foreign bonds possess no effective legal remedies or extra-legal sanctions which can be applied against a defaulting foreign state. Hence the bondholders perforce must rely on negotiations with the debtor to induce it to resume debt service on a basis that is fair and equitable. The importance of the role of the negotiators is thus apparent. And such importance is accentuated by other features which distinguish the foreign from the domestic readjustment process.

In the first place, a plan for the settlement of a foreign default is not ordinarily submitted to the bondholders for acceptance or rejection. To be sure, no bondholder can be forced to accept the treatment accorded him under the plan. But, as will be developed subsequently, the typical foreign bond readjustment makes no provision for the dissenter; accordingly he who will not accept the plan

\* See Madden, *op. cit.* *supra* note 6, at 266-269.

receives nothing. The practical consequence of this situation is that substantially all bondholders are driven to accept the plan, whether it be fair and reasonable or inequitable in the extreme. In the second place, no court has jurisdiction over foreign bond settlements, such as is exercised over the reorganization of domestic corporations by federal courts pursuant to Sections 77 and 77B of the Bankruptcy Act. There is, therefore, no judicial scrutiny or supervision of either the activities of those who negotiate for the holders of foreign bonds or of the plan of readjustment which they negotiate. And also, of course, administrative control of the readjustment process is likewise absent.

In the domestic field, certain checks on abusive tactics or over-reaching by those who dominate the reorganization processes are present. A plan of reorganization must ordinarily be submitted to security holders for their approval. Furthermore, although exceptions do exist, a plan of reorganization must be submitted to the scrutiny of a court for confirmation or rejection. A dissenting minority which finds the plan objectionable is accorded a day in court with full opportunity to submit its objections for judicial consideration. And such minority has other remedies, some of an extra-judicial nature. As explained in other parts of this report, a minority may gain a strategical position with the power to obstruct or delay the proceedings. The leverage thus obtained is often instrumental in exacting concessions from those who control the reorganization machinery. These various checks on the majority group existing in the domestic field are not sufficient by themselves under the present system to insure that either all plans will be fair and equitable, or that the conduct of the dominant group will be above reproach. It suffices here to point out, however, that these various checks do act as a brake on a group which may be bent on perverting the reorganization procedure to its own ends.

These checks being absent in the foreign field, one may accurately characterize the representatives of holders of foreign bonds as possessing extensive power, free from control or restraint.<sup>22</sup> On their ability, faithfulness, and integrity, the bondholders perforce must rely. And by reason of the lack of supervision and control, these qualities are even more clearly demanded in the foreign than in the domestic field. Among other things the bondholders must be assured of prompt and vigorous representation of their claims. Their representatives must be freed from all interests which conflict with those

<sup>22</sup> As we shall develop subsequently in this report, no protective committee or agency in the foreign field can function effectively without the cooperation or support of the U. S. Department of State. Some control over committee action may be exercised by the Department by withholding its assistance from a committee not conducting itself in the best interest of investors.

of the bondholders. The absence of regulation or control makes it possible for the representatives of the bondholders to serve their own self-interests with impunity if the intent to do so is present. Even though such intent be absent, the existence of a conflict of interest will tend to condition the action taken. In the light of these vital considerations we shall in the pages that follow explore the various types of protective committees and agencies which act for the bondholders in the foreign field. We shall examine their genesis, the qualifications of their members, the processes which they have adopted, and the procedures which they have utilized. We shall seek to determine whether or not they have competently and faithfully discharged the high fiduciary duties which they have expressly or impliedly assumed.

## SECTION II

### PERMANENT BONDHOLDERS' PROTECTIVE AGENCIES

#### A. CORPORATION OF FOREIGN BONDHOLDERS

(Great Britain)<sup>1</sup>

When American interests decided upon the creation of a permanent protective agency to readjust foreign defaults they sought out the experience of older creditor nations in the use of such agencies. The British Corporation of Foreign Bondholders which was formed in 1868 is the oldest institution of the kind.<sup>2</sup> It was followed by a number of similar central agencies in European countries.<sup>3</sup> Over a period of more than 60 years the British Council has represented the interests of the British holders of defaulted foreign bonds. During this period it has by and large been accepted as the authoritative agency to negotiate settlements of British bondholders with foreign governments. By virtue of its accomplishments in the handling of numerous foreign default situations it has gained wide prestige. It was natural, therefore, that American interests, in organizing the American council, used the British Council as a model.<sup>4</sup> By reason of this and of the British Council's outstanding success in readjusting foreign defaults, the circumstances which brought it into being, its organization and its method of functioning, will be developed in this report.

Great Britain's experience with loans to foreign governments extends back well over a hundred years.<sup>5</sup> During this long period of foreign lending its bankers and its investors have not been strangers to the problems created upon default. British loans were

<sup>1</sup> The discussion herein of the British Corporation of Foreign Bondholders is based chiefly on the testimony at a Commission hearing of Edwin M. Borchart, who had made a special study of the British Council, on its published reports, on the writings of various commentators, and upon various contemporary newspaper and magazine articles.

<sup>2</sup> Wynne and Borchart, *Foreign Bondholders Protective Organization* (1933) 43 Yale L. J. 281, 284, Proceedings before the Securities and Exchange Commission in the Matter of Bondholders Protective Committees for the Republic of El Salvador, Commission's Exhibit No. 86.

<sup>3</sup> Such agencies were organized in Belgium (1898), France (1896), Switzerland (1916), Germany (1926), and in other countries. See Wynne and Borchart, *supra* note 2, at 293-294; Ronald, *National Organizations for the Protection of Holders of Foreign Bonds* (1932) 8 Geo. Wash. L. Rev. 411, 426-436.

<sup>4</sup> See *infra* this section.

<sup>5</sup> See Jenks, *Migration of British Capital to 1876* (1927), for a treatment of the early British experience in lending to foreign governments.

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not always providently placed. In fact, we find that with few exceptions the first British loans to Latin American countries made in the 1820's went into default before 1830,<sup>7</sup> and defaults followed on loans placed elsewhere.<sup>8</sup> These defaults generated a constant succession of readjustment agreements between the defaulting government and the bondholders.<sup>9</sup>

Reference has previously been made to the fact that this country first entered the field of foreign lending upon a wide scale in the years during and following the Great War. Our investment bankers at that time had at their disposal the lessons imparted to the British financiers during over a hundred years' experience with loans to foreign governments. Instead of profiting from the experience thus gained, oftentimes at huge cost to the British investors in defaulted interest and principal, our bankers adopted some of the most abusive practices of their British predecessors.

British foreign lending has not been free from its scandals. As was the case in this country, a governmental investigation was required to unearth the unsavory transactions. British lending to certain Latin American states was made the subject of an investigation by a Select Committee from the House of Commons, which issued its report in 1875.<sup>10</sup> In many respects its findings criticize the selfsame practices which received the condemnation of our Senate Committees almost 60 years later. The report developed the improvidence of many of the loans, the patent lack of ability of the borrowing nations to service the loans (except for a limited period out of the loan proceeds), the excessive fees and commissions received by the houses of issue, the gross diversion of proceeds from the declared objects of the loan, the misrepresentations and omissions which characterized the prospectuses and the extensive market rigging and manipulative practices of the bankers in floating the loans to the public.<sup>11</sup>

<sup>7</sup> *Id.*, at 57-58, and the annual reports of the British Corporation of Foreign Bondholders, setting forth the default records of various debtor countries.

<sup>8</sup> Among the early defaults were those of the British loans to a few States of the United States. See Jenks, *op. cit.* supra note 5, and the annual reports of British Corporation of Foreign Bondholders.

<sup>9</sup> Jenks, *op. cit.* supra note 5, at 110-115.

<sup>10</sup> Report from the Select Committee on Loans to Foreign States (ordered to be printed by the House of Commons July 29, 1875). As to the extent of defaults at about this time, it has been stated that "about 54 percent of the entire amount of foreign government obligations listed in London were in default." Defaults and Repudiations of Foreign Loans (1928), 4 Foreign Policy Ass'n. Information Service 235, 242.

<sup>11</sup> *Id.*, at 111-1. Excerpts from the report follow:

"In respect of all these loans, those who introduced them to the public seem to have been regardless of the financial resources of the borrowing State; such resources, if inquired into, would have been found to have been totally inadequate to meet the liabilities incurred. In no case before your Committee, with one unimportant exception, has the borrowing Government repaid any portion of its indebtedness incurred in respect of these loans, except from the proceeds of the loans themselves.

"By means of exaggerated statements in the prospectus the public have been induced to believe that the material wealth of the contracting State formed a sufficient security for the repayment of the money borrowed. Even if such were the case, the several Govern-

It was during this era of high finance that the Corporation of Foreign Bondholders took form. There was theretofore no permanent organized agency for the readjustment of the constantly recurring defaults on British loans to foreign governments. The situation then existing has been described:

"Prior to the establishment of the Corporation of Foreign Bondholders, British holders of foreign bonds (and the same was, of course, true at that time of the relatively few bondholders of other nationalities) had no recognized means of organization for the protection of their interests. They were in many instances represented by committees which were either self-constituted or appointed by an informal meeting of holders of bonds which had gone into default; but there was in existence no institution whose object it was to represent the interests of the holders of foreign bonds in general, to represent their claims to the British Government, and to negotiate terms for the settlement of the default and the resumption of payment."<sup>12</sup>

And the issuing bankers also appear to have actively participated in the negotiations of debt settlements.<sup>13</sup>

## 1. ORGANIZATION OF BRITISH COUNCIL

The first early steps toward the formation of the British Council were taken in 1868. The initiative appears to have been provided by the London financial community including the houses which had issued foreign loans. Leland H. Jenks in describing the genesis of the Council writes:

"The original plan seems to have been to form an international organization, headed by the leading loanhouses and brokers, under the presidency of Baron Lionel Rothschild (the London Rothschild of the day). It might be spoken of not unfairly as the 'consensus of the loanmongers.' It was prompted by a sense of obligation on the part of bankers toward people to whom they sold bonds. And perhaps, too, there was the reflection that it was bad business to sell bonds which proved unprofitable. . . .

"However, when the time came to effect the organization, a Rothschild could not be put at its head; for Italy and Austria were menacing their bondholders with a heavy tax upon their interest coupons, and the securities of those countries had largely been issued thru Rothschilds. Moreover, the inclusion of influential money markets proved impracticable. The houses of Paris and Berlin

ments have taken no steps to apply the revenues of the State, or the other subjects of special hypothecation in discharge of their liabilities.

"In order to induce the public to lend money upon a totally insufficient security, means have been resorted to which, in their nature and object, were sagaciously deceptive.

"When the money of the public had been received, its application to the alleged purposes of the loans depended upon the good faith of those issuing them. In some instances these funds have been sagaciously misapplied.

"Much evil has been caused by the misstatements and suppressions to be found in the prospectus." *Id.*, xlii-xlvi.

<sup>12</sup> Wynne and Borchard, *supra* note 2, at 285.

<sup>13</sup> Proceedings before the Securities and Exchange Commission in the Matter of Bondholders Protective Committees for the Republic of El Salvador (1930), at 444.

were controlled by the governments in such a way that cooperation with them could not be untrammelled. Thus the only bondholders to be organized were the English.

"That is to say, it was the English stockbrokers and bankers interested in foreign government securities who organized. The most active promoter was Isidore Gerstenberg, a prominent stockbroker who had been identified with several of the special bondholders' committees which had dealt in the affairs of defaulting Latin American republics. The original council included a Scotch viscount, two generals, an admiral, an alderman, and a few private gentlemen. But the majority of its members were members of private or merchant banking firms, or of brokerage houses. Doubtless most of them were large proprietors of foreign bonds. They were certainly interested in maintaining a market for some kinds of them. So far as the interests of private bondholders lay in the same direction, they were probably the best representation they could have had."<sup>13</sup>

To discuss the formation of such an agency, a general meeting of bondholders was held in London on November 11, 1863.<sup>14</sup> The meeting adopted the following resolutions:

"1. That in the opinion of this meeting, the formation of a Council for the purpose of watching over and protecting the interests of holders of foreign bonds is extremely necessary and desirable.

"2. That with the view of giving weight to its recommendations and a practical character to its policy, the Council should comprise some members of those eminent houses who have had experience in dealing with foreign governments."<sup>15</sup>

and proceeded to appoint a committee to draw up a plan to organize the Council.<sup>16</sup> It is interesting to observe that this committee was cognizant of certain disqualifications of the issuing bankers in negotiating debt settlements for bondholders, for it reported:

"\* \* \* contractors [bankers] have found themselves in an embarrassing situation towards the Government and Bondholders, being under certain obligations to both. On such occasions the Council will be ready to act as mediator between the Foreign Government and the Bondholders, relieving thereby the contractor from his unpleasant and sometimes equivocal position. \* \* \*"

The committee recommended, however, that the members of the Council should be composed of the issuing bankers, stock exchange members, and private bondholders.<sup>17</sup> The report of the organizing committee was adopted at a second general meeting held February 2, 1869, and the Council launched as an unincorporated association.<sup>18</sup> Its early formative years were beset with many difficulties. Many of these grow out of its financial problems, problems which, as we shall develop later, were also troublesome to the American Council.

<sup>13</sup> Jenks, *op. cit.* *supra* note 5, at 288-290.

<sup>14</sup> Wynne and Borchard, *supra* note 2, at 285.

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*

<sup>17</sup> *Ibid.*

<sup>18</sup> *Ibid.*

<sup>19</sup> *Ibid.*

The organizers of the British Council from the first contemplated that the Council in some cases would receive payments from bondholders but that in the main it would be supported by fees received from foreign governments in connection with debt negotiations.<sup>20</sup> The Council supported itself mainly by payments from these two sources for three years.<sup>21</sup> Then desiring to set up a permanent fund, subscriptions of £100 each were secured from members who were given a bond in like amount bearing 5% interest.<sup>22</sup> The sum of £60,280 was eventually raised in this manner.<sup>23</sup> The plan at that time was to operate the Council on a profit basis, paying a financial return to its members from income on invested capital and from fees received from bondholders and foreign governments.<sup>24</sup> But it was deemed necessary to incorporate so as to avoid personal liability of the members.<sup>25</sup> The Council, however, found it impossible to incorporate as a profit making enterprise<sup>26</sup> and finally on August 1, 1873, accepted a license from the British Board of Trade as a non-profit corporation.<sup>27</sup> Its members who had each advanced £100 toward the Council's capital fund became its permanent members.<sup>28</sup>

The Council had now entered upon its permanent phase. As early as 1890, the president of the Council summarized its accomplishments:

"\* \* \* Looking at the debt arrangements effected by the council, as a whole, during the last 18 years, some \$2 debt settlements have been made, dealing with defaults of from 1 to over 50 years' standing, and embracing an indebtedness of no less than \$749,500,000 of principal, and of \$108,500,000 of arrears of interest and drawings, making the gigantic total of \$858,000,000, one-half of which at least may be considered as having been held by British investors. The exertions of the council, which involved an infinite amount of painstaking labor and great expense, resulted in obtaining the payment of a commencing minimum of \$18,500,000 per annum for the first year's interest, besides a large cash payment, and a still larger value in lands and securities. That an association which is, after all, only a combination of private individuals should have acquired so great an influence, and should have dealt

<sup>20</sup> *Id.*, at 285-290. The Council states in the preface to its annual reports: "In most cases the expenses have been borne by the governments concerned, and no charge has fallen on the Bondholders. \* \* \* The Council receives payments from the bondholders only if it accepts the deposit of bonds.

<sup>21</sup> *Id.*, at 286.

<sup>22</sup> *Ibid.*

<sup>23</sup> *Id.*, at 287, note 19.

<sup>24</sup> *Id.*, at 286.

<sup>25</sup> *Ibid.*

<sup>26</sup> *Id.*, at 287.

<sup>27</sup> Proceedings before the Securities and Exchange Commission in the Matter of Readjustment of External Obligations and Protective Committees and of Protective Organizations for Security Holders of the Republic of Peru, et al. (1935), Commission's Exhibit No. 288, at 1-2.

<sup>28</sup> Wynne and Borchard, *supra* note 2, at 287. Other classes of membership provided in the charter were life members and subscribing members. *Op. cit.* *supra* note 27, Commission's Exhibit No. 288, at 2. There were five life members but no subscribing members. *Id.*, at 3.

with debts amounting to the enormous total of £856,000,000, seems almost fabulous—almost like a fairy tale of finance."<sup>28</sup>

Its finances prospered to such an extent that it was enabled by 1885 to repay its original capital fund in full with 5 percent interest if demanded by its members.<sup>29</sup> In fact the Council by 1896 had in addition built up a reserve fund out of income of about £100,000.<sup>30</sup> But the members whose advances had been repaid retained their membership certificates, giving them the power to vote and thus control the Council.<sup>31</sup> These certificates were fully transferable and did to a considerable extent pass out of the hands of original members; in fact it is stated that many were acquired by speculators.<sup>32</sup> The certificate holders began to clamor for payment of dividends out of the reserve fund, notwithstanding that such payments would be in violation of the Council's charter, or for the dissolution of the Council and the distribution of its capital fund among its members.<sup>33</sup> In fact, in the 1890's these matters became the subject of acrimonious discussion at several annual meetings of the Council.<sup>34</sup>

In addition to these internal dissensions the Council was the target for considerable criticism.<sup>35</sup> It is interesting to observe that it was criticized on the same grounds which formed the basis for the allegations levied against the present American Council.<sup>36</sup> It was charged, *inter alia*, that the Council had come under the domination of the houses of issue which were using it to serve their own ulterior purposes and not the interests of the bondholders. The following is typical of the criticisms then being made:

"The principal charge which has been made against it is that it has shown too much leniency in its dealings with foreign Governments, and that it has lent its sanction to and aided in carrying out arrangements with defaulting States essentially vicious in principle and calculated to encourage dishonest Governments in the belief that if they only show themselves sufficiently exacting and persistent they will ultimately be able to impose any terms they choose on their creditors \* \* \*. It must not be forgotten, however, that the position of the Council of Foreign Bondholders is a very different one. In the first place, it is notorious that in all the negotiations for the rearrangement of the debts of foreign States a powerful influence is exercised upon bondholders by the issuing houses, who find it practically impossible to do fresh business with the debtors while the default lasts, and who are, therefore, naturally anxious that some sort of a settlement should be arrived at, more especially as settle-

<sup>28</sup> Speech of Sir John Lubbock at General Meeting of Council held February 24, 1890, reprinted, Davies, *Investments Abroad* (1927), 138-139.

<sup>29</sup> Wynne and Borchard, *supra* note 2, at 287; *op. cit. supra* note 27, Commission's Exhibit No. 288, at 3.

<sup>30</sup> *Ibid.*

<sup>31</sup> Wynne and Borchard, *supra* note 2, at 287.

<sup>32</sup> *Id.*, at 287; *op. cit. supra* note 27, Commission's Exhibit No. 288, at 4; Ronald, *supra* note 3, at 419.

<sup>33</sup> Wynne and Borchard, *supra* note 2, at 287; Davies, *op. cit. supra* note 28, at 134.

<sup>34</sup> Ronald, *supra* note 3, at 420.

<sup>35</sup> *Id.*, at 420; Wynne and Borchard, *supra* note 2, at 287.

<sup>36</sup> See *infra* sec. V, B, 2.

ments of the kind yield substantial pickings in the way of commissions, are frequently followed by new loans; and, in the second place, in cases of default the bonds fall more or less heavily in price, and are then picked up by speculators who are prepared to vote for any proposition however inequitable, that would enable them to realize at a profit \* \* \*. The Council is said to have largely become a mere co-optive body, composed, no doubt, of men of high standing and integrity \* \* \* but it is complained that many of the members of the Council have no especial knowledge of business at all, or, at any rate, of the particular business that the Council has to transact.

"A further objection to the Council is that it has departed from its original constitution as a practically philanthropic association, in which the management was to be provided gratuitously \* \* \*. But, of course, as the work of the Council developed, it would have been idle to expect practical, busy men to devote a large portion of their time to the interests of the bondholders without any payment \* \* \*. It is absolutely essential, if the institution is to work effectively, that it should have a fund out of which the current expenses can be met. You cannot have a permanent organization living upon the chances of casual employment \* \* \*. Bondholders do not want to be represented by people who are anxious to make big profits out of their misfortunes, but by a body which will work, as it were, at cost price, and if the business is worked practically at out-of-pocket expenses that is as much as anybody can expect."

## 2. THE RECONSTITUTION OF BRITISH COUNCIL.

To meet the situation which had developed it was decided to reincorporate the Council under a special act of Parliament. This act was authorized at meetings of the Council held in November of 1897 and passed by Parliament but over what has been described as violent opposition.<sup>37</sup> The act (sometimes hereafter referred to as the "Charter" of the British Council), the Council's Rules and Regulations, and a statement of its origin, functions, and regulations appearing as a preface to its annual reports, are printed in full as Appendix A hereto. There is also set forth in Appendix A a contemporaneous newspaper account of the hearing before a select committee of Parliament on the then pending act, describing the prior history of the Council and the controversy which led to its reconstitution.

The main purpose of the act is stated in its preamble:

"And whereas it is desirable to secure that the Corporation should in the future more directly and exclusively represent the interests of the holders of

<sup>37</sup> (1897) 56 *Economist* 1024-1025. A more vigorous criticism appeared in another periodical: "As we have again and again failed, the dealings of the Council with defaulting States have become little short of scandalous; and it has seemingly become impossible to check it in its unworthy career of surrender \* \* \*. The Council of Foreign Bondholders now presents itself to the public as a mere servant of the loan monger, and seems to be infinitely more intent on earning commissions than on furthering the real interests of those who have been robbed by States to whom default is familiar." (1897) 10 *Investors Review* 154.

<sup>38</sup> Ronald, *supra* note 3, at 421. The Act, 81 and 82, Vict., ch. cxlix (1898), was passed on July 23, 1898. *Op. cit. supra* note 27, Commission's Exhibit No. 288.

foreign and other public securities and that the application of the accumulated funds and property of the Corporation to the public objects for which it was constituted should be further safeguarded and the possibility of the voluntary winding-up of the Corporation and the distribution of its surplus funds amongst its members prevented and that with these objects the existing Corporation should be dissolved and a new Corporation established and that the objects and scope of the Corporation should be enlarged: \* \* \*

To accomplish these purposes the new corporation acquired the assets of the old corporation and assumed its liabilities. It became strictly a non-profit enterprise. The act contained a specific provision that all the property and income of the reconstituted Council should be held inviolate for the furtherance of its corporate purpose, even after its dissolution, except that certain sums were to be appropriated for the purchase of the outstanding membership certificates.<sup>41</sup>

The new corporation was given general power to protect the interests of the holders of all public securities, but the Council in practice, it is said, confines its activities to foreign public securities only.<sup>42</sup> It was given the further power to negotiate the resumption of debt service, to represent bondholders, in their name or on their behalf, and to invite and accept deposits of bonds.

#### a. Membership

Under the act of Parliament, the Council consists of 21 members, each holding office for three years, with their terms staggered so that seven members are appointed each year.<sup>43</sup> In practice the members are reappointed upon the expiration of their terms.<sup>44</sup> Under the act the 21 members are appointed as follows:<sup>45</sup>

Six by the British Bankers' Association (formerly the Central Association of Bankers).

<sup>41</sup> *Op. cit. supra* note 27, Commission's Exhibit No. 288, at 4. See Appendix A, I.

<sup>42</sup> *Id.*, at 1-12.

<sup>43</sup> Wynne and Borchard, *supra* note 2, at 288, note 28.

<sup>44</sup> *Op. cit. supra* note 27, Commission's Exhibit No. 288, at 8-7, and preface, annual reports of Council. See Appendix A, I. The act provides (art. 6, sec. 1) the Council with the power to increase its membership to not exceeding thirty. The Council in 1888 availed itself of this power by appointing four additional members. Its 1888 report states at pages 8-9:

"To enable the necessary consideration to be given to the various problems arising, the representation on the Council has been increased. It is interesting in this respect to refer to the Council's *Interim Annual Report* for the year 1873, page 53, where reference is made to the formation of Trust Associations. The Report remarks: 'The organization of these large companies being conducted with intelligence, exercises a very great and salutary influence, which will be the more felt in the future. . . . It will be noticed that great Corporations are growing up which in their sympathies must be altogether allied with the Bondholders and give a new element of stability to the general body, and which even the co-operation of larger individual Bondholders did not so well afford.'

"The passage of 33 years has shown how accurate this forecast was and, in order to give practical effect to alliance of their interests, the Council have pleasure in announcing that they have included in their membership representatives of the Association of Investment Trusts and the British Insurance Association. They therefore welcome as colleagues Mr. J. H. Clifford Johnston and the Hon. A. O. Creighton from the former, and Sir Arthur Worley and Mr. E. H. Lever from the latter, of these two organizations."

<sup>45</sup> Ronald, *supra* note 3, at 422.

<sup>46</sup> *Op. cit. supra* note 27, Commission's Exhibit No. 288, at 8-8 and preface, annual reports of Council. See Appendix A, I.

Six by the London Chamber of Commerce.  
Nine by the Council as a whole.

Of the nine members appointed by the Council as a whole, the act specifies that six shall "be persons who at or before the time of their election shall have respectively proved to the satisfaction of the said Council that they are the *bona fide* holders of foreign bonds to the nominal amount of five thousand pounds."<sup>46</sup>

It has been said of the Council's membership:

"\* \* \* A body thus chosen is representative of the whole financial and commercial interests of the City as well as of the bondholders at large. The present Council includes directors of the Bank of England, the chairmen of the Big Five joint-stock banks, men of importance in commerce and industry or of considerable experience in public affairs. The bondholding community is thus able to rest assured that, whenever the necessity unfortunately arises, its affairs will be handled by the Corporation with ability and good judgment, and that the financial guidance with which it is furnished will be both competent and disinterested."<sup>47</sup>

It will be noted that through the power of appointment of six of the twenty-one members by the British Bankers Association, the body analogous to the American Bankers Association, the British commercial bankers have a substantial voice in the Council. There is no specific prohibition against representatives of issue houses serving on the Council, in fact as previously related it was originally contemplated that they should serve. But this policy has not been followed in practice as the issuing bankers do not serve either as members of the Council or of its committees.<sup>48</sup>

#### b. Finances

The Council is financed by the income on its invested funds and by fees paid it by defaulting governments at the conclusion of debt negotiations. It also in some cases acts as the paying agent of foreign governments, and in this capacity receives commissions for the payment of coupons, the retirement of bonds under the amortization provisions, and for other analogous services. On few occasions it takes payments from bondholders.<sup>49</sup> After its reconstitution in 1888, the Council has continued to increase the amount of its "corporation" fund until it now has reached the book value of £182,405 with a market value of £159,110 on December 31, 1935.<sup>50</sup>

<sup>47</sup> *Op. cit. supra* note 27, Commission's Exhibit No. 288, at 8.

<sup>48</sup> Wynne and Borchard, *supra* note 2, at 288.

<sup>49</sup> *Id.*, at 289, note 28. The act provides (art. 7, sec. (1) (c)) that a member shall vacate his office unless he declares any personal interest he may possess in any contract or transaction with the Council. See Appendix A, I.

<sup>50</sup> *E. g.*, in connection with the El Salvador settlement described *infra* sec. IV, B, 1.

<sup>51</sup> Corporation of Foreign Bondholders, Sixty-Second Annual Report (1935), Balance Sheet, insert opposite p. 54.

The Council states that its ordinary expenditures, apart from the expenses involved in negotiations or litigations, amount to about £15,000 annually.<sup>51</sup> Approximately one-third of this is met by interest on invested funds.<sup>52</sup>

The Council pays its officers very moderate salaries. Under the act of Parliament which incorporated it, the president's salary is limited to £1,000, the vice president's to £500, and each member's salary to £100 annually.<sup>53</sup>

The Council during its existence of over sixty years has been concerned in the settlement of debts aggregating well over £1,000,000,000.<sup>54</sup> We shall reserve for later discussion, its general procedure in forming protective committees and in negotiating debt settlements.<sup>55</sup>

## B. THE LATIN AMERICAN BONDHOLDERS ASSOCIATION, INC.

Prior to the creation of the present American Council, there were two attempts in this country to form a central protective agency for holders of foreign bonds modelled generally on the British Corporation of Foreign Bondholders. The initiative in both cases came from private interests, not from the Federal Government as in the case of the present Council; in both cases the attempts were unsuccessful.

One of these early attempts was made by Thomas F. Lee, the organizing spirit of the Latin American Bondholders Association, Inc. He had formerly been a member of the investment banking firm of F. J. Lisman & Co., the underwriter of several foreign bond issues.<sup>56</sup> He caused the Association to be incorporated in the State of New York on October 9, 1931, as a non-profit corporation,<sup>57</sup> with the purpose of promoting and protecting the interests of security holders, especially the holders of obligations of Latin American countries.<sup>58</sup>

These objects were to be achieved in two ways: first, by the "dissemination of accurate and correct information concerning all foreign countries,"<sup>59</sup> and second, by the centralization of the interests of

<sup>51</sup> *Id.*, at vi.

<sup>52</sup> The 1935 return was £5,304, s. 0, d. 2. *Id.*, Revenue Account, insert opposite p. 54.

<sup>53</sup> *Op. cit. supra* note 27, Commission's Exhibit No. 288, at 11; preface, annual reports of Council. See Appendix A.

<sup>54</sup> *Op. cit. supra* note 27, Commission's Exhibit 287, at vii. See Appendix A, 117.

<sup>55</sup> *Infra* sec. IV, A and B.

<sup>56</sup> Proceedings before the Securities and Exchange Commission in the Matter of Foreign Bondholders Protective Council, Inc., et al. (1936), at 882.

<sup>57</sup> *Id.*, at 883; Commission's Exhibit No. 194. Its certificate of incorporation provided:

"No director, officer, member, or employee of this corporation shall receive or be lawfully entitled to receive, directly or indirectly, any pecuniary profit from the operations thereof, except proper and reasonable compensation for services in attempting to effect one or more of such purposes." *Id.*, Commission's Exhibit No. 194, at 2.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*, Commission's Exhibit No. 193.

bondholders including when advisable the formation of protective committees. The latter purpose was described in a circular descriptive of the Association:

"The purpose of the Association, following the procedure established by the Council of Foreign Bondholders in England, is to enable the holders of Latin American dollar bonds to combine and organize for mutual benefit and protection. These bonds, of which there are approximately \$1,600,000,000 per value outstanding, are held by thousands of individual and institutional investors throughout the United States and Canada. Concerted action by the holders of one or more of the issues is frequently essential to the protection of their interests. This Association affords a vehicle for such concerted action.

"Readjustment and revision of various loans may be necessary in some cases and advisable in others. The Association will promote the appointment of protective committees when careful investigation indicates that the interests of the bondholders and the borrowers can thereby best be served. In such cases, bondholders will be requested to deposit their bonds with suitable depositories. The Association, through its representation on all committees, will be in a position to assure its members that measures adopted will tend to conserve the best interests of the bondholders."

At the time of the Association's formation it was hoped to bring together a group of fifty distinguished persons from different parts of the country to act as its board of directors "whose duties would be nominal other than the important function of passing judgment on occasion in the matter of policy."<sup>60</sup> Invitations to serve were extended, a few acceptances were received, but lack of general support caused the plan to be abandoned.<sup>61</sup> The real direction of the organization was to be vested in an executive committee. Such a committee, under the chairmanship of Montgomery Schuyler, formerly United States Minister to El Salvador, did function for a few months.<sup>62</sup>

Several types of membership were contemplated. The owners of one to ten bonds were invited to take "bondholder" memberships at \$10 a year; trustees, attorneys, and large bondholders could become "active" members at \$25; banks, investment houses, and corporations could be "dealer" members at \$100; a supporting membership at \$250 a year was visualized, and also the possibility of extending honorary membership "to a few outstanding individuals who may desire to contribute services or funds."<sup>63</sup>

Only two types of membership were actually taken out: 44 individuals became "bondholder" members, three institutions joined as "active" members.<sup>64</sup> This indicates the limited extent to which the

<sup>60</sup> *Id.*, Commission's Exhibit No. 197.

<sup>61</sup> *Id.*, at 980-990; Commission's Exhibit No. 198.

<sup>62</sup> *Id.*; Commission's Exhibit No. 199.

<sup>63</sup> *Id.*, at 993, 1002.

<sup>64</sup> *Id.*, at 991-992; Commission's Exhibit No. 200.

<sup>65</sup> *Id.*, at 998-997.

Latin American Bondholders Association, Inc., was supported by security owners.

Its active life was short; it was testified that Mr. Lee ceased supporting the Association after the end of 1931. The records show that in three months he put over \$12,000 into his venture.<sup>60</sup> Its only revenue was \$515 by way of members' dues.<sup>61</sup>

These three months following its incorporation covered what may be termed the active existence of the Association. It carried on an extensive correspondence with owners of foreign bonds and built up a mailing list of bondholders and their securities. Realizing that there was no broad support for the enterprise, Mr. Schuyler tried to secure the cooperation of one of the foundations.<sup>62</sup> The attempt failed, and when, at the end of 1931, Mr. Lee withdrew his financial support and Mr. Schuyler resigned, the active life of the Latin American Bondholders Association was over.<sup>63</sup>

Fred Lavis, a consulting engineer, became its president, and thereafter a dwindling correspondence with members and other bondholders was carried on from his office and at his expense.<sup>64</sup> He testified:

"I kept on Mr. Bradford (secretary of the Association) and one stenographer, and from that time on at my own expense, I tried to meet the obligations of the Latin American Bondholders Association, in giving information to those who had subscribed.

"I was left almost entirely alone. Now, as a matter of fact, in the Association or such, it really as an Association didn't exist. \* \* \*

It will be recalled that one of the avowed purposes of the Association was the formation of protective committees. Its president, Mr. Lavis, became a member of a committee for the holders of bonds of the Republic of El Salvador, and of a committee for the holders of bonds of the Republic of Colombia. We shall subsequently discuss the formation and activities of these two committees. Douglas Bradford, secretary of the Association, served as secretary of these two committees. Mr. Bradford had written in answer to a letter of inquiry that the Association was "active" in the organization of these two committees.<sup>65</sup> But Mr. Lavis testified that the Association "died before it got a chance" to form any protective committees,<sup>66</sup> that he was using his "personal efforts" and not those of the Association in the formation of the El Salvador committee.<sup>67</sup>

<sup>60</sup> *Ibid.*

<sup>61</sup> *Ibid.*

<sup>62</sup> *Id.*, at 984.

<sup>63</sup> *Id.*, at 1002-1003.

<sup>64</sup> *Ibid.*

<sup>65</sup> *Id.*, at 1003.

<sup>66</sup> *Id.*, at 1000-1001.

<sup>67</sup> *Id.*, at 988.

<sup>68</sup> *Id.*, at 1003.

Nevertheless his title "President of the Latin American Bondholders Association" was believed to have publicity value to protective committees on which he served. In the initial circular of the El Salvador committee dated March 28, 1932, Mr. Lavis was described as "formerly President of the International Railways of Central America, the principal railway of El Salvador, and now President of the Latin American Bondholders Association."<sup>68</sup> And the fact that the Association had "died"<sup>69</sup> did not deter Mr. Lavis a year later from allowing his title and connection with the Association to be prominently featured by the Colombian committee on which he served. In a communication to bondholders dated February 10, 1933, the committee stated:

"Mr. Fred Lavis is a Consulting Engineer of international reputation. \* \* \* For the last year or so, as President of the Latin American Bondholders Association, he has applied himself to the problems presented by the defaulted bonds of the Republics to the South of us. \* \* \*

To still another committee Mr. Lavis' title appeared attractive. He accepted membership on a protective committee for the 7% Tobacco Loan of the Republic of Peru formed by the houses of issue. Mr. Lavis testified:

"\* \* \* At the time the Peruvian committee was formed by Seligman's, they asked me to be a member. After some consideration, I said that I would, and I wanted my name to appear as F. Lavis, and they said that they would like to have it appear as President of the Latin American Bondholders Association, and I said, 'All right, go to it.'"

In still another respect the Association proved helpful to Mr. Lavis' protective committee work. Reference has been made to the bondholders' names acquired in the course of the Association's few months of active life. These names were made available to the El Salvador and Colombian committees on which Mr. Lavis served, for the solicitation of deposits.<sup>70</sup>

Although his own association was not successful in becoming a central protective agency for the holders of foreign bonds, Mr. Lavis did not give up hope that he might become identified with such an agency formed by others. The Latin American Bondholders Association, Inc., although dormant, provided him with a convenient vehicle for the furtherance of his plan. We shall subsequently discuss in detail the Corporation of Foreign Security Holders en-

<sup>68</sup> *Op. cit.*, supra note 12, Commission's Exhibit No. 11, at 68-67.

<sup>69</sup> *Op. cit.*, supra note 68, at 988.

<sup>70</sup> Proceedings before the Securities and Exchange Commission in the Matter of Institute of International Finance, et al. (1935), Commission's Exhibit No. 82, at 20.

<sup>71</sup> *Op. cit.*, supra note 56, at 1009.

<sup>72</sup> *Id.*, at 1026-1030; *op. cit.*, supra note 77, at 202.

visaged under Title II of the Securities Act of 1933. Mr. Lavis testified that he had hoped to become connected with this corporation:

Q. Did you anticipate, Mr. Lavis, that you or the Latin American Bondholders Association would play some part in the corporation created under Title II?

A. Yes; I think I might have personally.

Q. What part did you consider that you would play?

A. Well, you can call it a consulting engineer or expert on Latin American Affairs or anything you want to."

Under the name of the Association Mr. Lavis circulated petitions among bondholders addressed to the Federal Trade Commission urging the immediate creation of the corporation under Title II.<sup>61</sup> Some nine hundred signatures were obtained to these petitions.<sup>62</sup> Questioned as to the propriety of soliciting the bondholders in this manner under the name of a defunct organization, Mr. Lavis testified:

A. The name of the Association was used, and there was no Association at that time, and it was myself and Bradford as Secretary, and if that is an Association, why, the Association sponsored it.

Q. You say that there was no Association at that time, but yet you send out letters enclosing petitions to be signed under the name of an Association?

A. That is right.

Q. Does that strike you as entirely proper in all respects?

A. Probably not. Except this, that I have felt very keenly that there was a great lack of effort on behalf of the Latin American holders, and I had done a great deal to try to help that situation, and this was one way that possibly it could have been done, and if I improperly used the word of a more or less defunct Association, I don't care, because I was doing what I thought was a good job."

As Title II never became effective, these efforts were to no avail.

In the fall of 1933 Mr. Lavis heard that an organization was to be created in place of the Corporation of Foreign Security Holders contemplated under Title II of the Securities Act of 1933. The Latin American Bondholders Association, Inc., was offered as a nucleus of the proposed agency. Douglas Bradford, as secretary of the Association, wrote in a letter dated October 11, 1933, to the Secretary of State:

"\* \* \* Statements which seem to be authentic have recently appeared to the newspapers to the effect that the State Department, in cooperation with other departments of the Government, is considering the advisability of the organization of a private corporation or bureau of foreign bondholders in this country rather than the creation of the Corporation of Foreign Security Holders under Title II of the Securities Act of 1933.

<sup>61</sup> *Op. cit. supra* note 58, at 1032.

<sup>62</sup> *Id.*, at 1023-1024.

<sup>63</sup> *Id.*, at 1025.

<sup>64</sup> *Id.*, at 1024.

"In such case, I beg leave to submit that the Latin American Bondholders Association would seem to be the logical medium through which to establish communication with the holders of the Latin American bonds, and might well serve as a nucleus for the proposed organization with respect to the entire foreign bond situation.

"We therefore respectfully bespeak your favorable consideration of the suggestion that this Association be regarded by the Government as the logical and appropriate medium for the protection of the bondholders. \* \* \*"

While the Foreign Bondholders Protective Council, Inc., was in the process of formation in December, Mr. Lavis offered his services to those connected with it.<sup>65</sup> Again, three days after its organization had been completed, he wrote a member of its executive committee expressing "the hope that I may have some voice in the conduct of its Latin American affairs."<sup>66</sup> These offers were not accepted.

For over two years the Association had been little more than a name and *alter ego* for its president. In its short active life prior to this, the record of the Latin American Bondholders Association, Inc., must be considered insignificant. Thus, this attempt to organize a central protective agency for holders of foreign bonds ended in failure.

#### C. AMERICAN COUNCIL OF FOREIGN BONDHOLDERS, INC.

The American Council of Foreign Bondholders, Inc., represented a further unsuccessful effort to establish a permanent, central protective agency for the holders of foreign bonds. The moving spirit in its formation was Dr. Max Winkler,<sup>67</sup> a writer and teacher of subjects dealing with international finance and trade. Dr. Winkler had formerly been connected with the investment banking house of Bertron, Griscom & Company.<sup>68</sup> In 1932 he and associates formed the firm of Bernard, Winkler & Co. with membership on the New York Stock Exchange, to deal in domestic and foreign securities.<sup>69</sup> For some ten years before the organization of the American Council of Foreign Bondholders, Inc., Dr. Winkler had periodically urged the formation of a central agency similar to the British Corporation of Foreign Bondholders.<sup>70</sup>

In 1931 Dr. Winkler began to develop the idea more actively, and in July caused the incorporation of the first of three corporations, each of which had similar aims and bore the same name, "American

<sup>65</sup> *Id.*, at 1033-1035; Commission's Exhibit No. 207.

<sup>66</sup> *Id.*, at 1035-1036.

<sup>67</sup> *Id.*, at 1040-1038; Commission's Exhibit No. 208.

<sup>68</sup> *Id.*, at 684.

<sup>69</sup> *Id.*, at 691.

<sup>70</sup> *Id.*, at 877, 891.

<sup>71</sup> *Id.*, at 878-879.

Council of Foreign Bondholders, Inc." The first was formed under the law of Delaware as a profit-making enterprise.<sup>81</sup> The expenses incidental to its incorporation were borne by Joseph H. Scheuer, a friend of Dr. Winkler's and a dealer in securities in New York.<sup>82</sup> Shortly thereafter, however, Dr. Winkler sought new support, as, according to his testimony, he felt that his original backer was not "sufficiently equipped from the standpoint of foreign information and background in regard to foreign securities."<sup>83</sup> Such new support was obtained from J. Ros McIntosh, of J. R. McIntosh & Co., Inc., and his business associates.<sup>84</sup> Mr. McIntosh was the principal stockholder in Analyst Associates, an investment trust, in which Dr. Winkler also held a stock interest.<sup>85</sup> In addition, Mr. McIntosh, either through his firm or Analyst Associates, acted as investment counsel; his firm was a dealer in both domestic and foreign securities.<sup>86</sup> To bring the new group into the enterprise, a New York corporation, American Council of Foreign Bondholders, Inc., was incorporated in November 1931 and financed by Analyst Associates, which acquired all its capital stock.<sup>87</sup> Dr. Winkler became its president.<sup>88</sup> Apparently the earlier Delaware corporation was discarded. A year after the formation of the New York corporation, 90 percent of its capital stock was sold to three friends of Dr. Winkler.<sup>89</sup> Ten percent of its capital stock was retained by Analyst Associates, thus preserving Mr. McIntosh's connection with the corporation.<sup>90</sup> The members of the new group, according to Dr. Winkler, were also "purchasers and sellers of foreign securities", although their primary business interests lay elsewhere.<sup>91</sup>

The New York corporation, like its Delaware predecessor, was organized as a profit corporation.<sup>92</sup> Both corporations, under their respective certificates of incorporation, were endowed with broad and extensive powers.<sup>93</sup> In brief, however, the Council's main

functions were to render an investment service to the holders of foreign securities and to participate in the formation of protective committees. These are set forth in a circular describing the American Council of Foreign Bondholders, Inc.:

"For more than two generations the British Corporation of Foreign Bondholders has served well in protecting the interests of English holders of foreign securities. Similar bodies have functioned with success over shorter periods in France, Belgium, Switzerland, and Holland. To meet the need of such an organization in this country, the American Council of Foreign Bondholders, Inc., has been formed along the lines of its British counterpart. \* \* \*

"The principal object of the Council is to collect and disseminate information regarding foreign bonds and to keep its subscribers informed as to the true economic and financial conditions of countries in whose securities or enterprises American investors have placed their funds. By pursuing this course, the Council will often be able to detect from the drift of events those issues which are likely to encounter difficulties, if not actual default, and to recommend the sale of such securities before the unfavorable conditions are reflected in the market price. When a default does occur, it is the intention of the Council to participate in the formation of protective committees to arrange a satisfactory settlement.

"The Council will publish and send to all subscribers a semi-monthly letter in which it will review and analyze current conditions in foreign countries, and produce critical studies of the fiscal policies and bond issues of debtor nations.

"The Council will maintain a department for consultation with holders of foreign bonds regarding their securities, and will make recommendations for the sale or exchange of the same into other securities if deemed wise."<sup>94</sup>

As an adjunct to the Council a so-called "Advisory Board" was established. Its membership was listed in a folder descriptive of the American Council as follows:

John M. Chapman, Ph. D.—Professor of Banking, New York.

Thomas H. Healy, Ph. D.—Assistant Dean, Georgetown School of Foreign Service, Washington, D. C.

Chester Lloyd Jones, Ph. D.—Director, School of Commerce, University of Wisconsin, Madison, Wisconsin.

Edmond H. Jones—Former acting President of the Permanent Fiscal Commission of Bolivia.

Denys P. Myers—Director of Research, World Peace Foundation, Boston, Mass.

J. Ros McIntosh—President, J. R. McIntosh & Co., Inc., Investment Counsel, New York.

Ernest M. Patterson, Ph. D.—Professor of Economics, Wharton School of Finance, University of Pennsylvania; President, American Academy of Political and Social Science.

Winthrop C. Swain—Vice-President and Director of Research, Analyst Associates, Inc., New York.

<sup>94</sup> Op. cit. *supra* note 50, at 909-911; Commission's Exhibit No. 183.

<sup>81</sup> *Id.*, at 870-880, 884-885.

<sup>82</sup> *Ibid.*

<sup>83</sup> *Id.*, at 886.

<sup>84</sup> *Id.*, at 887-888.

<sup>85</sup> *Ibid.*

<sup>86</sup> *Id.*, at 888-890.

<sup>87</sup> *Id.*, at 886, 888, 892.

<sup>88</sup> *Id.*, at 893.

<sup>89</sup> *Id.*, at 892-896.

<sup>90</sup> *Ibid.*

<sup>91</sup> *Id.*, at 893-894.

<sup>92</sup> *Id.*, at 885.

<sup>93</sup> *Id.*, Commission's Exhibits, Nos. 178, 179. Both certificates of incorporation contained the conventional immunity clause permitting directors or their affiliated interests to contract with the corporation without legal liability or the right on the part of any person to avoid the transaction. *Ibid.* The certificate of incorporation of the Delaware corporation did provide, however, that the director should disclose the fact of such interest to the board. *Id.*, Commission's Exhibit No. 178. Cf. Charter of British Council providing that the interest of a director shall be disclosed to the Council and for non-disclosure he shall vacate his office. See Appendix A.

Jacob Viner, Ph. D.—Professor of Economics, University of Chicago, Chicago, Illinois.<sup>108</sup>

The duties of this board appear to have been limited to the scrutiny and criticism of the Council's bimonthly letters to subscribers. Dr. Winkler testified:

"Q. Are they officers or directors of the Council?

A. No; they are men who comprise the so-called Advisory Board of the American Council. That means this: the reports which I prepare are sent to the various members of this Advisory Board, and they are requested to suggest improvement or changes in the reports that are being prepared and sent to them.

"Q. Now, is this a formal organization of an Advisory Board or are they just friends of yours to whom you submit the pamphlets?

A. Just friends of mine who receive these pamphlets and who, if they have time to read them and to criticize them, are perfectly welcome to do so.

"Q. Their names are not publicly identified with the American Council, however?

A. Not to any large extent, except in some of our literature their names are mentioned, at least originally their names were mentioned."<sup>109</sup>

The corporation (and its successor) has carried out one of its purposes, that of rendering investment service in the foreign bond field. Bimonthly letters on foreign bond investments, prepared by its president, have been forwarded to its subscribers and to others.<sup>107</sup> And specific advice has been given in response to inquiries as to whether a subscriber should buy, sell, or hold a particular foreign security.<sup>108</sup> In this work, however, the Council has been handicapped by its inability to obtain a substantial number of subscribing members. Such members were divided into two classes, "regular subscribers" at \$25 annually who receive the bimonthly reports and the opportunity for reasonable consultation with the officers of the Council, and "special subscribers" at \$100 annually who, in addition to the service rendered regular subscribers, are entitled to "consultation privilege commensurate with the fee."<sup>109</sup> Only about 90 subscribers were obtained, although a 25 percent commission to agents for new subscribers was offered.<sup>110</sup> Very few special subscribers at the \$100 rate were obtained; most of the subscribers were in the \$25 class, while a number of subscriptions were accepted at lesser sums down to as little as \$3 per year.<sup>111</sup>

The second object of the Council, that of participating in the formation of protective committees, was accomplished to only a very

<sup>108</sup> *Id.*, Commission's Exhibit No. 185.

<sup>109</sup> *Id.*, at 943-944.

<sup>110</sup> *Id.*, at 697, 817-818.

<sup>111</sup> *Id.*, at 895-903, 912-913, 915.

<sup>112</sup> *Id.*, at 914-916; Commission's Exhibit No. 187.

<sup>113</sup> *Id.*, at 921-923; Commission's Exhibits Nos. 185-187.

<sup>114</sup> *Id.*, Commission's Exhibit No. 187.

limited extent. Early in 1932 Dr. Winkler formed an independent committee for the holders of Kreuger & Toll secured debentures, on which he and Messrs. Healy, Patterson, and Myers, members of the Council's advisory board, served.<sup>112</sup> Also, he and Dr. Healy served on a committee for the holders of Cuban Public Works bonds.<sup>113</sup> Furthermore, Dr. Winkler was instrumental in the formation of a committee for the holders of Colombian bonds of which Dr. Healy served as chairman.<sup>114</sup> While the foregoing does show considerable protective committee activity on the part of the president and members of the advisory board of the Council, Dr. Winkler testified that it was only in respect to the Kreuger & Toll committee that he was acting as "part of my connection with the American Council."<sup>115</sup> His service on the Cuban committee was regarded as "a separate enterprise", not as part of his activities as president of the Council.<sup>116</sup> To what extent his title lent him prestige or was of publicity value in his protective committee work is a matter of conjecture.

Thus the principal function of the Council to the present time has consisted in the rendering of investment advice. Whether this is a proper function for a central protective agency for the holders of foreign bonds is open to considerable question. Although its organizers described the Council as the "counterpart"<sup>117</sup> of the British Corporation of Foreign Bondholders, the latter does not apparently act as investment counsel. It is true that the British Council collects and makes available to investors detailed statistical data regarding the economic and financial condition of foreign countries with whose defaulted issues it is concerned. In fact, much of this data is published in its annual reports which are circulated all over the world.<sup>118</sup> But there is a distinction between the submission of statistical information to investors for such use as they may make of it and the giving of specific advice as to whether a person should buy, sell, or switch from one security to another.<sup>119</sup> To couple the rendering of investment counsel to the holders of foreign bonds with the protection of the interests of such holders upon default by the foreign obligor and the negotiations of debt settlements will place an undue emphasis on the possibilities of profitable speculation rather than on obtaining the best debt set-

<sup>112</sup> *Id.*, at 943-945, 952.

<sup>113</sup> *Id.*, at 943, 945.

<sup>114</sup> *Id.*, at 944-945.

<sup>115</sup> *Id.*, at 947.

<sup>116</sup> *Ibid.*

<sup>117</sup> *Id.*, Commission's Exhibit No. 153.

<sup>118</sup> *Op. cit. supra* note 27, Commission's Exhibit No. 287, at v.

<sup>119</sup> Apparently the Latin American Bondholders Association, Inc. adopted the procedure in this respect of the British Council, rather than that of the American Council of Foreign Bondholders, Inc. *Op. cit. supra* note 56, at 1020-1028.

tlement possible. It may in effect place a price on any inside information which comes to the bondholders' representatives in their negotiations with foreign debtors. Information so acquired should be considered a property right of all bondholders represented by the central protective council and not the exclusive possession of those willing to subscribe to the council's service.<sup>120</sup>

The situation is aggravated when, as in the case of the American Council of Foreign Bondholders, Inc., those who comprise its inner circle are brokers or dealers in foreign securities. Reference has been made to the fact that both Dr. Winkler and Mr. McIntosh were so engaged, although the record does not show that either of them were dealing in the selfsame securities concerning which the Council was rendering investment advice. The possibilities of advantageous trading on the part of those who are in a dominant and strategic position occupied by a central authoritative agency or by a protective committee are developed herein. Those possibilities are as great whether the agency or committee is composed of professional traders or by others. But the inference is irresistible that when such an agency is manned by those whose livelihood depends on the buying and selling of securities and whose investment advice and purchases and sales cannot as a practical matter be divorced from information secured by them as members of such an agency, the dominant interest of such a group will be in trading in the securities. We shall see hereafter how dangerous such activities may become.

In April 1933 the third of Dr. Winkler's corporations was formed, also with the name "American Council of Foreign Bondholders, Inc." This was a non-profit corporation incorporated under the membership law of New York.<sup>121</sup>

Its purposes were not as broad as those of its two predecessors; there was greater emphasis on the creation of an agency for the cen-

<sup>120</sup> Dr. Winkler, in testifying on this general subject, stated his opinion that the Foreign Bondholders Protective Council, Inc., was under a duty to furnish an inquiring bondholder with information whereby to judge whether to hold or sell his bonds:

"Let us assume that the foreign bondholders' executive committee . . . is negotiating with a view to effecting a settlement of certain defaulted foreign bonds; and let us further assume that I am a bondholder who goes to the Foreign Council and asks them 'What shall I do with my bonds?' After all, they are a body set up to protect, or they were set up to protect the interests of bondholders. What is the stand or the attitude that they are going to take with respect to my inquiry? Are they going to tell me 'Don't sell the bonds. Don't hold the bonds,' or are they going to say 'We don't give out any information.' Well, they have the information. If they don't give it out they are not performing their public duty. What will their attitude be?" *Op. cit. supra* note 77, at 583.

In answer to the foregoing, Francis White, vice president of the Foreign Bondholders Protective Council, Inc., testified that it was not the Council's function to render advice of this nature:

"The Foreign Bondholders Protective Council . . . never gives any advice to any bondholder as to whether he should buy, sell, or hold the bonds. We do not concede that to be our function.

" . . . If a bondholder writes in during negotiations, we tell him we are negotiating with the foreign government regarding the matter; what the outcome will be we have no way of telling. When there has been an adjustment we make a public statement so that everybody will have it at the same time." *Id.*, at 663-664.

<sup>121</sup> *Op. cit. supra* note 66, at 903.

tralization of the interests of the holders of foreign bonds than on the rendering of investment service.<sup>122</sup> The directors of the new corporation, in addition to Dr. Winkler, were J. Ros McIntosh and Victor J. Valles, both of J. R. McIntosh & Co., Inc.; John M. Lewis, whom Dr. Winkler thought might be connected with the same firm; Ralph E. Samuel, "formerly President of The Samuel Stores, about to become a partner in Weingarten & Company, members of the New York Stock Exchange"; Bernard Reis, a certified public accountant; and John T. Flynn, author and journalist.<sup>123</sup> The new corporation was organized in order that the Council might be a non-profit rather than a profit corporation. Dr. Winkler testified that in this he hoped to accomplish two objectives:

"Q. Why was this corporation formed? Didn't you have one perfectly good corporation, or two perfectly good corporations, in existence?"

A. Well, I wouldn't say perfectly good. They may have been perfectly good; but from the standpoint of receiving or getting subscriptions to the bi-monthly report, or securing clients, it was not very successful, and it may have been felt at that time that if it were definitely converted into a nonprofit making organization it would perhaps become easier for it to obtain subscribers to the bi-monthly reports.

Q. That is, you felt that you might get more support if you were operating as a nonprofit corporation?

A. Yes.<sup>124</sup>

A . . . I think the main reason was the belief on the part of one or two that if the Government genuinely desired to organize a corporation of foreign bond holders, it might possibly entrust an existing non-profit corporation with carrying out such functions.

Q. The purpose then was to get ready to convert the American Council of Foreign Bondholders into a Governmental or quasi-Governmental corporation?

A. Call it that, if you like.

Q. Well, that, in effect, is a correct description?

A. Yes; and for that reason the character of the enterprise was changed—may have been changed. That may have been the reason for effecting the change.<sup>125</sup>

<sup>122</sup> The purposes of the corporation as expressed in its certificate of incorporation were:

"To provide an agency through which the citizens and residents of the United States and all other countries holding bonds and/or debentures and/or securities issued by all foreign countries and all political and geographical sub-divisions thereof, may secure protection and advantages of organized and united action, and thereby further promote, facilitate, aid, and protect their interests, rights, and economic welfare, and by endeavoring to obtain payment of principal and interest on said bonds whenever payment thereof becomes due, and by establishing, maintaining, and providing clearance facilities for compilation, analysis, publication, and dissemination of accurate and correct information concerning the political, economic, and financial conditions of, or affecting all foreign countries and concerning securities issued or proposed to be issued by said foreign countries or their political and geographical sub-divisions, and particularly with reference to and concerning the soundness and value of any and all such securities, and with reference to the issuers and/or guarantors thereof and all others bound thereby or connected therewith, and to attain these ends by all other lawful ways and means." *Id.*, Commission's Exhibit No. 182.

<sup>123</sup> *Id.*, at 889, 893, 905-906; Commission's Exhibit No. 195.

<sup>124</sup> *Id.*, at 804.

<sup>125</sup> *Id.*, at 803-809.

Neither of these objectives was achieved. Subscriptions did not increase and the Council was unsuccessful in obtaining government sanction. Such governmental support was deemed essential for the successful functioning of the Council. In an earlier endeavor to endow the Council with a semi-governmental character, the Council had drafted a rather extraordinary bill for submission to the Congress. This proposed act is printed in the footnote.<sup>126</sup> In brief it provided that the President of the United States should designate two persons "skilled in international financial affairs" as directors of the American Council of Foreign Bondholders, Inc. These two directors were each to receive \$1 a year from the United States Government but could receive "reasonable compensation" from the Council. Dr. Winkler transmitted this bill to a United States Senator with the request that he sponsor the measure.<sup>127</sup> Nothing, however, developed from this attempt to make the Council a quasi-governmental agency.<sup>128</sup>

Title II of the Securities Act of 1933, providing for a governmentally sanctioned corporation to protect foreign security holders, was actively championed by the American Council of Foreign Bondholders, Inc.<sup>129</sup> As in the case of Latin American Bondholders Association, Inc., it was the hope of the American Council that its services would be retained by the corporation provided for under Title II. In fact, in furtherance of this ambition the Council prepared a proposed slate of eight directors of the Title II corporation, of which five—Messrs. Winkler, Healy, Samuel, McIntosh, and Chester Lloyd Jones—were members of the Council's advisory board, or otherwise identified with the Council.<sup>130</sup> The corporation, however, as previously noted, never came into being; the Foreign Bondholders Protective Council, Inc., was organized in its stead.<sup>131</sup>

\* \* \* \* \*

"A Bill

"Authorizing the President to Appoint Two Members of the Board of Directors of the American Council of Foreign Bondholders, Inc.

"Be it Enacted by the Senate and House of Representatives of the United States of America in Congress Assembled, That the President be, and he hereby is, authorized to designate and appoint two members of the board of directors of the American Council of Foreign Bondholders, incorporated, a corporation organized and existing under and by virtue of the laws of the State of New York, in accordance with the terms of its charter, and of this Act.

"SEC. 2. The directors so appointed by the President shall be officers of the United States and of said corporation, but shall receive from the United States compensation of only one dollar per year each, and no other allowances, but may receive from such corporation such reasonable compensation and allowances for expenses as may be provided by said corporation.

"SEC. 3. The directors so appointed by the President shall be persons skilled in international financial affairs, and it shall be their duty to aid, through said corporation, the people of the United States holding bonds and other evidences of indebtedness of foreign Governments, states, and municipalities." *Id.*, Commission's Exhibit No. 194, at 2.

<sup>126</sup> *Id.*, at 970-972; Commission's Exhibit No. 194.

<sup>127</sup> *Id.*, at 970-972.

<sup>128</sup> *Id.*, at 933-934.

<sup>129</sup> *Id.*, Commission's Exhibit No. 195.

<sup>130</sup> *Id.*, at 975 and see *infra* sec. II, D.

Dr. Winkler, as will be discussed subsequently in more detail, has been a persistent critic of the Foreign Bondholders Protective Council, Inc.<sup>132</sup> One of the grounds for his criticism is that it receives financial support from the banking firms which issued foreign bonds.<sup>133</sup> He, however, evidenced no reluctance in allowing the American Council of Foreign Bondholders, Inc., to receive their financial support. Several of the large issue houses are included among the subscribers to the New York corporation and to the membership corporation which succeeded it;<sup>134</sup> others declined the invitation.<sup>135</sup> Dr. Winkler attempted to distinguish the two situations on the basis of the smaller payments to his Council and the fact that it gave something in return for the financial support.<sup>136</sup> He testified:

"Q. Dr. Winkler, the letter which has just been received as Commission's Exhibit, from Mr. McIntosh to Mr. Brown, dated May 19, 1932, says that a council, such as yours, to be unbiased, must not be supported to any extent by the interests who brought out the bonds originally.

Do you subscribe to that principle?

A. Certainly.

Q. How do you reconcile it with your Council's seeking subscriptions from houses of issue?

A. It seems to me that a bi-monthly report which attempts to analyze and interpret a foreign situation and which in addition answers all sorts of inquiries about foreign securities, and which for all that receives \$25.00 a year—I would not consider that financial support.

Q. Well, in addition to the pamphlets you were to supply consultative advice, and you were to form protective committees, and for your services, in all three respects, you, or the Council, solicited support and contributions from these houses of issue.

A. Not as houses of issue.

Q. Now, on the other side of the picture, we have a statement by you subscribed, that the Council, in order to be independent, must not be supported by houses of issue; and I am asking you how you reconcile those two statements, which, it seems to me, are in conflict.

A. If these houses of issue were to contribute funds and receive nothing in return, I would consider that support; but if they are paying for what we might call service, then that certainly is not support.

Q. Well, Dr. Winkler, I think that the record shows that you were trying to sell three things: One, your bi-monthly reports; and two, consultative advice; and three, the formation of protective committees.

A. That is right.

<sup>132</sup> *Op. cit. supra* note 50, at 933, 975.

<sup>133</sup> *Ibid.*

<sup>134</sup> *Id.*, at 925-928, 930.

<sup>135</sup> *Id.*, at 926.

<sup>136</sup> *Id.*, at 930-930.

Q. That is correct?

A. Yes.

Q. And you were offering to sell those three things to the houses of issue in return for financial support.

A. To anybody who wanted it.

Q. Now, does that mean that it is your opinion that a council for the protection of foreign bondholders can receive financial support from the houses of issue and still remain independent and still be deserving of public approval?

A. It depends upon the extent of the support received, I should say. It depends upon the nature of the support.<sup>137</sup>

The American Council of Foreign Bondholders, Inc., has not been a financial success. From its formation to December 31, 1934, it incurred an operating deficit of over \$7,000.<sup>138</sup> It failed in its endeavor to become the central agency to protect the interests of foreign bondholders. Its president aptly summarized its history when he testified: "It started out very ambitiously, and due to circumstances really became a relatively unimportant corporation."<sup>139</sup>

#### D. THE FOREIGN BONDHOLDERS PROTECTIVE COUNCIL, INC.

##### 1. EARLY DEVELOPMENTS

As we have seen, two unsuccessful attempts were made early in the depression to create a central protective agency for foreign bondholders. Private interests furnished the initiative for these efforts. In the spring of 1932, however, the United States Government took steps which finally resulted in the formation of the present Foreign Bondholders Protective Council, Inc. At that time the Department of State and the Treasury Department were concerned with the problems created by the rapidly increasing defaults in foreign governmental bonds and the defense of the interests of the American investor in such bonds.<sup>140</sup> To discuss the problems involved, an invitation was extended by W. R. Castle, Acting Secretary of State, to various individuals to attend a meeting at the State Department.<sup>141</sup> The following were present at the meeting held April 15, 1932:

Ogden Mills, Secretary of the Treasury.

W. R. Castle, Harvey Bundy, and Herbert Feis, State Department.

Grosvenor M. Jones, Department of Commerce.

Charles P. Howland, Yale University.

Pierre Jay, chairman, Fiduciary Trust Company of New York.

Edwin Kemmerer, Princeton University.

<sup>137</sup> *Id.*, at 930-932.

<sup>138</sup> *Id.*, Commission's Exhibit No. 189.

<sup>139</sup> *Id.*, at 898.

<sup>140</sup> *Op. cit.*, supra note 27, Commission's Exhibit No. 204, at 12.

<sup>141</sup> *Id.*, at 79, Commission's Exhibit No. 203.

Thomas N. Perkins, of the law firm of Ropes, Grey, Boyden & Perkins, Boston, Mass.

George Rublee, of the law firm of Covington, Burling, Rublee, Acheson & Shorb, Washington, D. C.<sup>142</sup>

At the meeting Mr. Bundy stated that the State Department was receiving communications from many different directions regarding the foreign bond situation with the accusation that the Government was maintaining a weak attitude in regard thereto.<sup>143</sup> Mr. Bundy also informed the meeting that "this very situation had afforded the development of what might be termed a 'racket', as many lawyers and bankers whose occupations and remunerations therefrom had been reduced to a very low scale were now entering the reorganizing field and creating irresponsible associations purporting to protect the interest of the small investor, \* \* \* [that] the time had arrived when it should be possible to create an organization of unquestionable standing \* \* \* that the main object in the calling of the present meeting was to start a movement and investigate what could be done in this direction."<sup>144</sup>

It was indicated at the meeting that the Government, while taking the initiative in the movement toward the formation of a central protective agency, could in no way assume the responsibility and that the matter should be investigated carefully by responsible private citizens.<sup>145</sup>

Following the meeting an informal committee of private citizens composed of Messrs. Howland, Jay, Kammerer, Perkins, and Rublee, who had attended the meeting, together with Alanson B. Houghton, former Ambassador to Germany, was organized to study the possibility of organizing a central protective council.<sup>146</sup> This committee submitted an informal report to the State Department on May 23, 1932, containing tentative suggestions for the formation of a council composed of 15 men "whose eminence would command the confidence of the country."<sup>147</sup> The British Corporation of Foreign Bondholders served as a "general model" for the proposed council.<sup>148</sup> The powers and functions of the proposed council were described in the committee's report to include, *inter alia*:

"\* \* \* consultation, in cases of default, with bondholders and other interested parties as to the formation of protective committees; cooperation with

<sup>142</sup> *Id.*, at 1178-1179, Commission's Exhibit No. 204. Mr. Alanson B. Houghton and Mr. Clarence M. Woolley had been invited but did not attend the meeting, the former because of a previous engagement, the latter because of his position on the Federal Reserve Board. See *id.*, Commission's Exhibit No. 204.

<sup>143</sup> *Id.*, Commission's Exhibit No. 204, at 8.

<sup>144</sup> *Id.*, Commission's Exhibit No. 204, at 8-9.

<sup>145</sup> *Id.*, Commission's Exhibit No. 204, at 10.

<sup>146</sup> *Id.*, at 1188-1189.

<sup>147</sup> *Id.*, at 1188-1206, Commission's Exhibit No. 204, at 3.

<sup>148</sup> *Id.*, at 1192, Commission's Exhibit No. 204.

such committees, when formed, for the purpose of effecting just settlements with debtors. We think it better that the proposed body should in the main, and certainly at the outset, exercise powers of consultation and cooperation rather than powers of initiative, direction, and control."<sup>120</sup>

And the report described the proposed council's relations with protective committees and the occasions when it would itself directly intervene in a foreign default situation, as follows:

"It is our judgment that in the normal cases the bankers, supported by the investors, will continue to organize committees. In such cases the Council would exercise its good offices in the formation of strong and proper committees, recognizing the responsibility of the bankers who issued the bonds in question. There may be cases in which the issuing house has gone out of existence, or for one reason or another cannot take or ought not to have the responsibility for organizing a committee to serve the interests of a particular issue. In such cases the Council might take the initiative in the formation of a committee or in assisting the bondholders to that end.

"The Council should have the right to appoint on any committee one or two members who should have the right to attend meetings of the committee but not to vote. Probably it will be advisable for members of the Council not to serve on committees. But in exceptional cases the Council might have to intervene abroad directly on behalf of American investors; for example, in order to maintain the status quo as against some measure of a seriously prejudicial character which threatened the bondholders when they were not yet organized to deal with the matter. The Council might also intervene directly when a situation was so serious and involved principles of so far-reaching a character that proper handling would call for greater authority and solemnity than could otherwise be supplied. Such instances of direct intervention abroad should, however, be treated as exceptions to a general policy of leaving the conduct of foreign negotiations to the sponsor bankers or the proper protective committee."<sup>121</sup>

It is evident from the above quotation that the advisory group, in submitting its informal and tentative suggestions, contemplated that bankers<sup>122</sup> would continue to form protective committees which

<sup>120</sup> *Id.*, Commission's Exhibit No. 266, at 2.

<sup>121</sup> *Id.*, Commission's Exhibit No. 266, at 4.

<sup>122</sup> The attitude of the Investment Bankers Association toward the creation of a central protective agency in the United States changed in the years prior to the creation of the Foreign Bondholders Protective Council, Inc. In 1924 (Proceedings, 13th Annual Convention, I. B. A., at 187), it expressed itself as opposed to the formation of a body similar to the British Corporation and in favor of separate protective committees. In the large scale underwriting of the next few years, default did not present itself as a pressing matter. When default did become a problem the attitude toward a central agency had changed. In 1932, at a time when preliminary work had been done by the advisory group called together by the Federal Administration, Mr. Nevil Ford, chairman of the Foreign Securities Committee, said to the annual meeting of the association:

" . . . we have been concerned with the default problem as a whole and more particularly with the advisability of the formation in this country of an organization similar to those existing in other countries. . . . The Investment Bankers Association two years ago endeavored to develop such a council. For various reasons which came up, and they were practical reasons, it was not possible to create such a council."

In commenting on the work of the group that had been called together by the Federal Government, Mr. Ford said:

" . . . I believe that they have now progressed as far as to actually draw up a council (this was about a year before the Foreign Bondholders Protective Council, Inc. was actually formed), by-laws and charters, and so on, have been drawn by prominent

would assume the primary responsibility for the readjustment of foreign defaults and that, except in unusual situations, the council would neither form protective committees nor intervene directly in a default situation. Instead, except when unusual circumstances existed, it would act as an advisory body in the formation of committees and in the effecting of debt settlement. On these matters Pierre Jay testified before this Commission:

"Q. . . . Was it contemplated at the time that the bankers would undertake the primary responsibility, ordinarily, in the formation of protective committees, for the protection of bondholders' rights, and the Council would form committees only when for one reason or another the bankers could not or would not form a committee?

A. Or the Council thought they should not.

Q. Or should not. That is correct, you believe, Mr. Jay?

A. Yes.

Q. The report continues: "The Council should have the right to appoint on any committee one or two members who should have the right to attend meetings of the committee but not to vote." Just what did you have in mind in making that provision, Mr. Jay, to have the Council's representatives attend meetings only to keep in touch with a particular situation to know what was happening?

A. That was the thought we had at that time.

Q. But not to have any voice or control?

A. Not to attempt to override the individual responsibility of a committee or an issue house which might form a committee.

Q. But the whole thread of the report, running through this prepared report, is that the bankers, the houses of issue, would still retain the primary responsibility?

A. The one thought that we had from the very start . . . was that the house of issue in case of defaulted bonds had a distinct moral responsibility toward the bondholders, and that nothing in the formation of this proposed body should relieve them one whit of their responsibility."<sup>123</sup>

The council which eventually was organized, as will be related subsequently, developed its functions in a manner quite different than suggested in this early report. Instead of acting as an advisory agency only, it has itself intervened in default situations to negotiate debt settlement. It also has on occasions formed its own protective committees.

While the council proposed by the informal committee was to cooperate with bankers in the manner described above, bankers were not to be members of the council. The committee's report stated:

"It would probably not be wise to have any representatives of issuing houses as members of the Council, but the men selected should have the confidence of

New York counsel, and they are now considering the names of the men who shall actually form the council.

"That part of it is easy. The Investment Bankers Association did that two years ago, but they are now struggling with the main problem, and the problem which we found the difficult one, namely, raising of funds to carry on this work." Proceedings, 21st Annual Convention, Investment Bankers Association of America (1932), at 38-40.

<sup>123</sup> *Op. cit. supra* note 27, at 1198-1199.

the houses of issue, and this should be ascertained before their appointment. The successful functioning of the Council in our opinion will depend as much upon the confidence of the investment bankers as upon that of the general public."<sup>148</sup>

George Rublee testified as to the reason prompting this restriction:

"Q. . . . Why did you believe that it would be wise not to have any representatives of issuing houses as members of the Council?

A. I think there were several reasons. One was that the bondholders themselves might not have confidence in the issue house. There was a general prejudice on the part of the public against issue houses. There were some cases where the representative of an issue house might be a worthy representative, but he might have some conflicting interests. It seemed to us rather obvious that the Council to act entirely in a disinterested way should be composed of men who never had anything to do with the issue of the bonds.

Q. That is, I understand you to say you recognized a feeling, among bondholders, of antagonism?

A. I believe it existed. I did not know it of my own knowledge.

Q. You also recognized that houses of issue might have interests which might conflict with the interests of the bondholders?

A. They might.

Q. And you decided it would be better that houses of issue be not connected with the Council?

A. Yes."<sup>149</sup>

There is indication that the State Department was likewise of the opinion that the new council should not be too intimately associated with the houses of issue. Officers of the Department expressed the opinion to the committee that "if the organization lets itself in any way be closely identified with the New York issuing banks or the small group of corporation lawyers who drew up the contracts for these foreign bond issues, its usefulness would be impaired."<sup>150</sup>

For financing the council, which was estimated would require between \$50,000 and \$100,000 a year, the report suggested that contributions be made by various bodies including Chambers of Commerce, the Investment Bankers Association, the American Bankers Association, and by houses of issue, bondholders, and other individuals.<sup>151</sup> Here again the State Department was concerned lest the new council be too closely identified with the issuing bankers. An officer of the Department wrote:

"Mr. Rublee told me when I last discussed the subject with him, that the New York issuing houses and banks would be willing to put up the money [to finance the Council], but I think this would defeat the whole idea."<sup>152</sup>

<sup>148</sup> *Id.*, Commission's Exhibit No. 266, at 3.

<sup>149</sup> *Id.*, at 1189-1191.

<sup>150</sup> *Id.*, Commission's Exhibit No. 265, at 8.

<sup>151</sup> *Id.*, at 1199-1200, Commission's Exhibit No. 266, at 5.

<sup>152</sup> *Id.*, Commission's Exhibit No. 270, at 3.

After the filing of the report on May 28, 1932, the committee, at the request of the State Department, proceeded to take steps toward the actual formation of a council of foreign bondholders.<sup>153</sup> Articles of incorporation and by-laws of the new body were drafted.<sup>154</sup> A tentative selection of members of the council was made.<sup>155</sup> Norman Davis had been offered the chairmanship of the board of the new council and had agreed to accept.<sup>156</sup> The committee had sought financial assistance from certain foundations which had taken under advisement the contribution of part of the necessary funds to defray the council's expenses.<sup>157</sup>

At the start not all investment bankers approached by the committee were favorable to the suggestion of a central protective agency.<sup>158</sup> The position of J. P. Morgan & Co. in June of 1932 was described as follows in a memorandum prepared by an officer of the State Department:

"No single thing could help the movement more than the support—even the passive support—of J. P. Morgan. That house has continued to remain completely on the fence, from which position its glances have been cool rather than sympathetic."<sup>159</sup>

Mr. Howland, in reporting a conversation concerning the proposal for a central protective organization with Parker Gilbert, of the firm of J. P. Morgan & Co., stated that Mr. Gilbert "was pleased with the assurance that so far as we know no one contemplates an organization which would take entire control, forbid or deter the formation of committees containing representatives of issuing houses and investors and exercise a sort of dictatorship, discharging the issuing houses of all moral responsibility and depriving them of all opportunity to assist in retrieving losses; a plan on any such lines would, of course, be absurd."<sup>160</sup> This firm, as will be related, subsequently supported the council which was formed by contributing substantially to it.

<sup>153</sup> *Id.*, at 1189-1190, 1200.

<sup>154</sup> *Id.*, Commission's Exhibit No. 269, at 3.

<sup>155</sup> *Id.*, Commission's Exhibit No. 269, at 4.

<sup>156</sup> *Ibid.*

<sup>157</sup> *Id.*, Commission's Exhibit No. 265, at B, No. 249, at 4.

<sup>158</sup> It is interesting to observe in such banker reluctance to accept the proposal of a central agency, a repetition of the experience of the British Council at the time of its formation in 1868. I. Gerstenberg, one of the principal sponsors of the British Council wrote at the time:

"The cause of the Council has met with almost unanimous support, only some of the loan contracting houses (underwriters) seemed to fear it might interfere with them and look upon it as a kind of supervision over their operations. That idea is far from the intentions of the originators of the movement. There is not the remotest idea to interfere with freedom of trade in foreign loans." "London Times, November 14, 1868.

<sup>159</sup> *Op. cit. supra* note 27, at 1202; Commission's Exhibit No. 267.

<sup>160</sup> *Id.*, Commission's Exhibit No. 268.

When Title II of the Securities Act was approved on May 27, 1933, the work of the informal committee ceased, as it was thought "that the corporation set up under Title II, when the Act would become effective, would take the place of and supplant the private protective committee."<sup>100</sup>

While nothing tangible developed from the work of the informal committee, it nevertheless laid the groundwork for the formation in the fall of 1933 of the Foreign Bondholders Protective Council, Inc. Many of the committee's suggestions were incorporated in the new Council, although the latter, as previously pointed out, has functioned in many ways quite differently than was contemplated by the committee. Furthermore, some of the members selected by the committee to act as directors of the organization when formed, were appointed to the board of the Council.

As related above, the Treasury and State Departments took the initiative in bringing the informal committee together to consider the problems involved. The State Department, particularly, had an especial interest in the formation of a protective agency, as it was hoped that such an agency would relieve the Department of many of the vexing and difficult problems presented by the flood of foreign bond defaults. An officer of the State Department, writing in March of 1933, described the situation and the advantages to the Department of such an organization as follows:

"Each default situation creates difficulties. The investors have no recourse in law; they therefore tend to appeal to this Government. This Government cannot wisely undertake to follow and constantly intervene in these situations, for such intervention would color and complicate the whole conduct of our foreign relations. In regard to each default, there is a tendency for agitation to arise in favor of punishment for the foreign defaulting government, to which agitation some members of Congress are apt to give assistance. This situation will continue to aggravate itself as time goes on.

"It seems plain that there is a great need for an adequate organization of the bondholders themselves to protect their own interests. The issuing banking houses have proven to be, in many cases, either unwilling to take the responsibility and cost of following the situations, or unwelcome either in the eyes of the bondholders or of the governments concerned. In some important instances the banking houses are the object of such severe criticism in foreign lands (especially where the loans were made to some regime which was subsequently overthrown), that their actions are ineffective. In other instances issuing banking houses have gone out of existence—such as the Lee, Higginson Company—or are about to go out of existence (such as the security companies organized by the Chase and the National City Banks). A great number of bondholders' protective organizations sprang into existence to fill this need. Some of them were organized with the thought that they would spread throughout the whole field; others were organized merely to take care of the holders of a few issues of one country. These organizations vary tremendously in the character of their personnel and in their purposes. Some are wholly reputable;

<sup>100</sup> *Id.*, at 1209, 1210.

some verge on being disreputable. All must sustain themselves from the beginning by seeking deposits of bonds and putting charges upon the bondholders who have already suffered loss. None have achieved any substantial degree of public repute or influence. In some situations rival protective committees have sprung up to contest each others' efforts. In a few situations . . . the notions of the committee have been such as to actually prejudice seriously the interests of the bondholders.

"The State Department, when approached by these committees, has avoided comment and held itself free to give or refuse assistance, as circumstances seem to make wise.

"The growing number of defaults, the agitation among the bondholders, the development of inadequate protective associations, the complicating effects on the foreign relations of this country of these default situations all brought home to the Department the desirability of having an adequate and disinterested organization among the bondholders themselves for their own protection. This was visualized by the Department, not as a step towards dollar diplomacy but as a step away from it. In the absence of such an organization it is almost inevitable that the Government will be dragged into various situations in an effort to protect the American investors against wholly unfair or discriminatory treatment. For one thing, the investors of European countries are solidly organized, and naturally exert themselves to get from foreign governments as favorable terms as possible. Several important instances of discrimination against American investors have already arisen. *It has been the thought of the State Department that if an adequate influential disinterested body were formed among the investors themselves, the Department could keep free of situations it otherwise would have to enter. Then in addition to the extent to which Government action and support seemed appropriate, it could be given to an effective body—a body whose general purposes and standing was established, rather than the bodies whose general standing and purposes might be doubtful.* [Italics supplied.]

"When it became clear that the investors themselves were too helpless to organize without encouragement, the State and Treasury Departments decided (about 18 months ago) to endeavor to encourage the formation of a suitable body. It selected a committee of five persons known for their ability and disinterestedness (George Rublee, Charles E. Howland, Professor Kummerer, Thomas Nelson Perkins, and Pierre Jay), to study the problem and to report upon it. This group studied and submitted an outline of the constitution for the desired organization. The Department then asked this group to undertake to try to bring it into existence. That effort is being continued at present and seems to be approaching success."

"The preceding sets forth in summary the reasons for believing the creation of the right type of bondholders organization is to be greatly desired. It would be a move towards simplifying the work of the Department and of other branches of the Government in regard to foreign default situations, rather than the contrary. What assistance the Government may give the organization when and as it may come into existence will remain entirely within the discretion of the Government itself. No pledge of any kind has been or should be given."

"\* \* \* Further, according to the conception, if [the proposed council] would be one that was definitely not under the control of the bankers or any

<sup>101</sup> *Id.*, Commission's Exhibit No. 265, at 3-7.

<sup>102</sup> *Id.*, Commission's Exhibit No. 265, at 8.

other group in the community (though on its sub-committees handling special situations, banking interests undoubtedly would have to be represented) \* \* \*. Lastly, when created it should have an independent existence (perhaps incorporated under law), and conduct its own negotiations with foreign authorities. The Department of State would not be committed to any action in regard to any situation. In fact, it was hoped that the existence of the council would perhaps lessen the necessity under which the Department of State might have to take cognizance of default situations \* \* \* (Italics supplied.)

Mr. Rublee testified concerning the advantages to the State Department from the formation of a protective organization:

Q. Did the State Department or any representatives of the State Department ever discuss with you the benefits which would accrue to the State Department through the formation of a central authoritative protective organization such as you had in contemplation?

A. I think they did on a number of occasions. They did at the very first meeting. They thought such a body, if it were possible to establish one in this country, would be of great benefit to the State Department.

Q. \* \* \* Do the quotations which I have read [i. e., the italicized passages in the above quotation] describe the benefits to the State Department as you understand them?

A. Yes; they are precisely those we understood as the benefits stated by the Department.<sup>177</sup>

On the same matter J. Reuben Clark, Jr., president of Foreign Bondholders Protective Council, Inc., in writing of the value of such an organization, stated:

"It could relieve the Department of State of burdens and responsibilities which oftentimes come at inconvenient periods when other national interests prevent the exercise of a legitimate interest and influence in behalf of such bondholders. \* \* \*"

As the State Department has so clearly indicated in the above quoted memorandum, defaults on foreign bond issues inevitably affect and color our international relations. The State Department hoped that a central protective agency of the "right type" could relieve it of much of the embarrassment involved in taking official cognizance of or intervening in default situations. This, to a large extent, as we shall subsequently develop, has been accomplished through the medium of the Foreign Bondholders Protective Council, Inc. But the effect of defaults and the resulting negotiations with defaulting governments on our foreign relations necessarily requires the State Department to maintain a continuing interest in default situations. Accordingly, the relations which exist between the Department and the Foreign Bondholders Protective Council, Inc., as well as any other agency or protective committee in the foreign field, assume significance. These matters will be explored subsequently in this report.

<sup>177</sup> *Id.*, Commission's Exhibit No. 268, at 1-2.

<sup>178</sup> *Id.*, at 1207, 1208.

<sup>179</sup> *Op. cit. supra* note 56, Commission's Exhibit No. 19, at 11.

## 2. ENACTMENT OF TITLE II OF THE SECURITIES ACT OF 1933

When defaults on foreign bond issues began to assume alarming proportions, a feeling also developed in Congress that the United States Government should take all proper steps to create an agency to defend the interests of the holders of defaulted foreign bonds. The initiative was taken by Senator Hiram Johnson, who had conducted an intensive and effective investigation of the flotation of foreign bonds.<sup>177</sup> On May 8, 1933, he submitted on the floor of the Senate an amendment, designated as Title II, to the then pending Securities Act of 1933, providing for the creation of a Corporation of Foreign Security Holders as a quasi-governmental agency.<sup>178</sup> On the same day, Title II was accepted by the Senate with only two changes and, together with Title I of the Securities Act, was referred to conference with the House of Representatives.<sup>179</sup> Title II emerged from the conference unchanged, except that the number of directors of the corporation was reduced from twelve to six and two important sections were added.<sup>180</sup> Both the Senate and House passed the Securities Act of 1933, containing both Title I and Title II, on May 24, 1933,<sup>181</sup> and the Act was approved by the President on May 27, 1933. One of the new sections added by the House and Senate conferees, however, prevented the immediate creation of the Corporation of Foreign Security Holders. This section provides:

"This Title shall not take effect until the President finds that its taking effect is in the public interest and by proclamation so declares."<sup>182</sup>

As the proclamation has never been made, Title II has never become effective.

We shall reserve for later detailed discussion an examination of the provisions of Title II and an appraisal of the corporation to be created thereunder as a medium for the readjustment of defaulted foreign bonds. At this point we shall develop its terms only in so far as they have a bearing upon the Foreign Bondholders Protective Council, Inc. In brief, Title II provides by the terms of the Act itself for the incorporation of a Federal "Corporation of Foreign Security Holders" for the purpose of "protecting, conserving, and advancing the interests of the holders of foreign securities in default."<sup>183</sup> Its six directors and their successors would be appointed

<sup>177</sup> Hearings before the Committee on Finance, pursuant to S. Res. 19, 72d Cong., 1st Sess.

<sup>178</sup> 77 Cong. Rec. 2987 (1933).

<sup>179</sup> *Id.*, at 2987-3000.

<sup>180</sup> House of Representatives Conference Report on the Securities Act of 1933 (73d Congress, 1st Session, Report No. 162), at 28-29. Secs. 210 and 211 of the bill were added in conference.

<sup>181</sup> 77 Cong. Rec. 4088, 4140 (1933).

<sup>182</sup> Securities Act of 1933, Title II, sec. 211.

<sup>183</sup> *Id.*, sec. 201. See discussion on floor of Senate relative to its incorporation by an act of Congress, 77 Cong. Rec. 2980-2983 (1933).

by the Federal Trade Commission.<sup>179</sup> No person could be eligible as a director who within the preceding five years possessed any interest in any agency which had sold foreign bonds.<sup>180</sup> The Reconstruction Finance Corporation would be authorized to loan the corporation \$75,000.<sup>181</sup> The corporation would be broadly empowered to protect the interests of the holders of foreign bonds; it could, *inter alia*, organize protective committees, accept deposit of bonds, and negotiate debt settlements with foreign governments.<sup>182</sup> Title II of the Securities Act of 1933 is printed in full as Appendix B hereto.

While some objection to the measure developed from private interests, the principal objection came from the Government itself. Raymond B. Stevens, then a Commissioner of the Federal Trade Commission, after a study of the Title II corporation and the private protective agency proposed by the informal committee, concluded that the interests of the bondholders could be served to better advantage by the proposed private agency.<sup>183</sup> The State Department was of the same opinion.<sup>184</sup> Their principal objection was founded on the governmental character of the proposal. The measure did contain a section, added by the Senate and House conferees, that the corporation was in no way to be considered as representing or acting for the Department of State or the United States Government.<sup>185</sup> Notwithstanding this disclaimer, it was believed that by virtue of Federal incorporation of the protective agency created by Act of Congress, of the appointment of its directors by the Federal Trade Commission, of the loan to the corporation which the Reconstruction Finance Corporation was authorized to make, and of the general circumstances surrounding the enactment of the Act, American bondholders and foreign debtors would consider it in effect as an instrumentality of the United States Government itself. Other objections of lesser significance were raised to the Act. All such objections will be reserved for later discussion.<sup>186</sup>

<sup>179</sup> *Id.*, sec. 202. As originally introduced by Senator Johnson, the board of directors of the corporation were to elect their successors. This was changed the day the Act was introduced to provide that successors of the directors first appointed would likewise be appointed by the Federal Trade Commission. 77 Cong. Rec. 2088-2090 (1933).

<sup>180</sup> Securities Act of 1933, Title II, sec. 202.

<sup>181</sup> *Id.*, sec. 209. Title II, in the form introduced by Senator Johnson, authorized the Reconstruction Finance Corporation to loan the corporation \$50,000 a year for three years. The present provision was accepted as an amendment the day the measure was introduced. 77 Cong. Rec. 2983-2984 (1933).

<sup>182</sup> Securities Act of 1933, Title II, secs. 203, 204.

<sup>183</sup> *Op. cit. supra* note 27, at 1210.

<sup>184</sup> See *id.*, Commission's Exhibit Nos. 270, 272.

<sup>185</sup> H. R. Conf. Rep., *op. cit. supra* note 175, at 29; Securities Act of 1933, Title II, sec. 210.

<sup>186</sup> See *infra* sec. V, D.

As might be expected, the investment bankers who floated foreign bonds were opposed to Title II.<sup>187</sup> It is but fair to say, however, that their opposition apparently was neither organized nor effective<sup>188</sup> and that the responsibility for the noncreation of the Title II corporation may properly be attributable to the Government itself.

### 3. STEPS PRECEDING FORMATION OF FOREIGN BONDHOLDERS PROTECTIVE COUNCIL, INC.

When the decision was reached not to bring the Title II corporation into existence at that time, Raymond B. Stevens became active in the formation of a private council.<sup>189</sup> Although the informal committee brought together in April 1932 by the State and Treasury Departments no longer continued to function, two of its members, Pierre Jay and George Rublee, actively assisted Mr. Stevens.<sup>190</sup> Mr. Stevens, however, was considered the mainspring of the movement.<sup>191</sup> Final plans for the launching of the Council were rapidly developed. Mr. Stevens, together with Mr. Rublee and Mr. Jay, undertook the selection of the first board of directors of the new organization, using as a nucleus a few of the persons originally chosen by the informal committee. The testimony before this Commission concerning the selection of directors is as follows:

Q. Could you state, Mr. Rublee, and you also, Mr. Jay, when you come to particular names who selected the particular person involved? The first name is C. F. Adams.

Mr. RUBLEE. I don't know. Perhaps I suggested him. His name was one of those that we had invited to become a member of the Council when our group was running the thing before Title II was enacted. We had gotten a list of names and we made selections from the list, and we picked his name out of that list.

Q. You would say that he was selected by the original group?

Mr. RUBLEE. Yes; he was selected by the original group.

Q. The next name is N. D. Baker.

Mr. RUBLEE. He was also selected by the original group in the same way as Mr. Adams.

Q. Mr. Bell.

Mr. RUBLEE. I suggested Mr. Bell's name. He wasn't selected by the original group.

Q. Mr. Chubb.

Mr. JAY. I suggested his name.

<sup>187</sup> See testimony of Ralph T. Crane, formerly president of the Investment Bankers Association of America, *op. cit. supra* note 27, at 1002-1004, and of John C. Traaphagen, *id.*, at 1242.

<sup>188</sup> See testimony of Mr. Crane, *op. cit. supra* note 27, at 1002-1004.

<sup>189</sup> *Op. cit. supra* note 27, at 1210.

<sup>190</sup> *Id.*, at 1210, 1211.

<sup>191</sup> *Id.*, at 1217.

Q. He wasn't a member of the original slate?

Mr. JAY. No.

Q. The next name is J. R. Clark.

Mr. ROBLEE. I suggested Mr. Clark's name.

Q. W. L. Clayton.

Mr. JAY. I suggested his name.

Q. Was he selected by the original group?

Mr. JAY. Not by the original group.

Q. Mr. J. Cowles.

Mr. JAY. Mr. Stevens, in making inquiries as to people in that section of the country, turned up his name. Who suggested it to him I don't know.

Q. He was or was not suggested by the original group?

Mr. JAY. No; the only others suggested by the original group were Mr. Morris and Mr. Traphagen.

Q. That is, all the remaining names which I will read were not selected by the original committee?

Mr. JAY. Except Morris and Traphagen.

Q. The next name is E. L. Ekern.

Mr. JAY. That Mr. Stevens found from inquiry.

Q. Mr. E. M. Hopkins.

Mr. ROBLEE. I suggested his name.

Q. And the next name is Mr. Jay, and the next name after that is Mr. P. La Follette.

Mr. JAY. I suggested that name.

Q. Mr. B. Lane.

Mr. JAY. His name was on a list. Mr. Stevens asked Governor Black of the Federal Reserve Board if he would suggest someone from the Eastern South. He suggested some names and Mr. Lane's name was suggested. I happened to know him personally.

Q. F. O. Lowden.

Mr. ROBLEE. I am inclined to think that I suggested his name, but he was on a general list.

Mr. JAY. The list that the committee had, but was never branched.

Q. O. K. McMurray.

Mr. JAY. Mr. Stevens made inquiry of people on the Pacific Coast, and they suggested a number of names together with this one.

Q. You have already mentioned Mr. Morris and Mr. Stevens. Mr. T. D. Thacher.

Mr. JAY. I suggested him.

Q. You have already mentioned Mr. Traphagen. Q. Wright.

Mr. ROBLEE. Mr. Feis suggested him.<sup>122</sup>

On October 20, 1933, it was announced that upon joint invitation of the Secretary of State, the Secretary of the Treasury, and the chairman of the Federal Trade Commission, the following persons (selected as directors as above related) had attended a conference at Washington to discuss "the creation of an adequate and disinterested organization for the protection of American holders of foreign securities", and to "cooperate in the formation of such an organization":

<sup>122</sup> *Id.*, at 1218-1221.

"Laird Bell.....	of Fisher, Boyden, Bell, Boyd and Marshall, Chicago, Illinois.
Hendon Chubb.....	of Chubb and Son (Marine Insurance), New York City.
W. L. Clayton.....	Anderson, Clayton and Company, Houston, Texas.
John Cowles.....	Publisher, Des Moines Register and Tribune.
Herman Ekern.....	former Attorney General of Wisconsin.
Ernest M. Hopkins.....	President, Dartmouth College.
Philip LaFollette.....	ex-Governor of Wisconsin.
Willis H. Lane.....	The Citizens and Southern National Bank, Savannah.
Frank O. Lowden.....	ex-Governor of Illinois.
Ordo K. McMurray.....	Dean, Law School, University of California.
Roland S. Morris.....	former American Ambassador to Japan.
Thomas D. Thacher.....	former Solicitor-General.
J. C. Traphagen.....	President, Bank of New York & Trust Co., New York City.
Quincy Wright.....	Professor, International Law, University of Chicago. <sup>123</sup>

All of the foregoing became directors of the new Council. In addition, Messrs. Charles Francis Adams, former Secretary of the Navy; Newton D. Baker, former Secretary of War; J. Reuben Clark, Jr., former Ambassador to Mexico, were invited but were unable to be present at the Washington meeting.<sup>124</sup> They also became directors, together with Raymond B. Stevens and Pierre Jay.<sup>125</sup>

The same day a statement was released by the White House to the press concerning the meeting and the contemplated organization. This read in part as follows:

"The situation now existing in regard to foreign securities is one of substantial concern to the American people. American funds were put at the disposal of over forty foreign governments and had assisted in their economic development. Many of these loans are now wholly or partly in default. The bonds are held by large numbers of Americans who live at the present no adequate means of getting in touch with each other and organizing in order to keep themselves informed of events affecting their interests and of arranging for the proper handling of the debt situations in which they are concerned. In some instances American interests may be suffering unfair discrimination as compared with the investors of other countries.

"A task of adequate organization obviously exists to be undertaken. In many situations the proper organization of the American bondholders is urgently

<sup>123</sup> *Op. cit.*, supra note 56, Commission's Exhibit No. 19 (Foreign Bondholders Protective Council, Inc., Annual Report 1934), at 16.

<sup>124</sup> *Id.*, Commission's Exhibit No. 19, at 11.

<sup>125</sup> Subsequent changes in the directorate are as follows: Ordo K. McMurray resigned and was succeeded by Francis White; Raymond B. Stevens resigned and was succeeded by James Grafton Rogers; Ernest M. Hopkins resigned and the resulting vacancy has not been filled. *Id.*, at 151, 152, and Foreign Bondholders Protective Council, Inc., Annual Report 1935, at 7-8.

needed in order to make possible fair and satisfactory arrangement with foreign governments undergoing difficulties, and to properly protect American interests.

"This is a task primarily for private initiative and interests. The traditional policy of the American Government has been that such loan and investment transactions were primarily private actions, to be handled by the parties directly concerned. The Government realizes a duty, within the proper limits of international law and international amity, to defend American interests abroad. However, it would not be wise for the Government to undertake directly the settlement of private debt situations.

"It was decided, therefore, to call together a small group to take upon themselves the patriotic duty of bringing into existence an adequate, effective, and disinterested organization to carry on this work. The organization should exist not for profits but for aiding the American interests which it will represent, and of aiding them at the lowest possible expense to the many thousands of bondholders.

"Because of the fact that these interests are widely scattered, the fact that there are so many different loan issues to be considered, and so many different groups to be consulted, this is no easy task. But it must be achieved, and the Government expects that it will be achieved. *The organization when it comes into existence is to be entirely independent of any special private interest; it is to have no connections of any kind with the investment banking houses which originally issued the loans. It will decide its own affairs independently. Naturally, its decisions will ultimately depend on the will of those who possess the securities. Too, another of its duties naturally will be to keep intimate contact with all American interests concerned and to unify, so far as possible, all American groups that seek to act in protection of American interests. The organization contemplated in a sense will be a unifying center for the activities of all proper American interests.* [Italics supplied.]

"The meeting was called in order to get the task well launched. Administration officials will follow the course of developments with interest. They have no intention, however, of seeking governmental direction or control of the organization, nor will they assume responsibility for its actions. Towards this organization, as towards all other legitimate American interests, the Government will seek to give such friendly aid as may be proper under the circumstances. The group undertaking the foundation of this organization will announce, as soon as possible, its plans. In the meeting today all phases of the form and work of the contemplated organization were discussed."<sup>197</sup>

The foregoing announcement must receive careful consideration in any examination of the subsequent history of the Foreign Bondholders Protective Council, Inc., for the Council has been the subject of vigorous and widespread criticism. Its critics have turned to the foregoing press release as a statement of the Council's objectives and purposes and have claimed that in numerous respects it has failed to follow the course so clearly marked out for it in this announcement. There have been frequent allegations that, contrary to what the bondholders had been led to expect, the Council is dominated by the houses of issue, that bondholders have no voice in

<sup>197</sup> *Op. cit. supra* note 58, Commission's Exhibit No. 19, at 11-13.

its affairs and that in no sense has it unified all American groups which seek to protect American interests. The bases of these criticisms and their validity will subsequently be explored in detail.<sup>198</sup>

Following the formal announcement of the Council, a small group was chosen to perfect its organization, composed of:

Raymond B. Stevens, Chairman,  
Hendon Chubb,  
Thomas D. Thacher,  
John C. Traphagen.<sup>199</sup>

#### 4. ORGANIZATION OF FOREIGN BONDHOLDERS PROTECTIVE COUNCIL, INC.

##### a. Organization Meeting

Another meeting of those who had been selected as the first directors of the Council was held at the Treasury Department, Washington, on December 18, 1933. To this meeting the special organization committee referred to above submitted its report,<sup>199</sup> together with the proposed certificate of incorporation and by-laws of the new organization.<sup>200</sup> The certificate of incorporation having been filed on the morning of December 18th, the group proceeded to adopt by-laws and perfect a formal organization.<sup>201</sup>

The Foreign Bondholders Protective Council, Inc., was incorporated as a non-stock, membership corporation under the laws of Maryland.<sup>202</sup> It is a non-profit corporation in the sense that its members may receive no dividend or other distribution except as compensation for services rendered.<sup>203</sup> The certificate of incorporation and the by-laws of the Foreign Bondholders Protective Council, Inc., are printed in full as Appendix C hereto.

<sup>197</sup> See *supra* sec. V, C, 2.

<sup>198</sup> *Op. cit. supra* note 58, Commission's Exhibit No. 19, at 13.

<sup>199</sup> *Id.*, Commission's Exhibit No. 19, at 13-20. Certain aspects of this report will be discussed *infra* with respect to the functioning of the Council.

<sup>200</sup> *Ibid.*

<sup>201</sup> *Id.*, Commission's Exhibits No. 19, at 20-21, No. 20.

<sup>202</sup> *Id.*, Commission's Exhibit No. 20.

<sup>203</sup> *Id.*, Commission's Exhibit No. 20, at 4, and see *id.*, at 138-143. The relevant provision of the certificate of incorporation is as follows:

"The Corporation is not organized for and shall not engage in any business or undertaking for the pecuniary profit of its members and no funds or property of the Corporation may be paid or transferred to its members by way of any dividend, distribution, or otherwise, except as compensation for services rendered, expenditures incurred, or as interest for advances made. Upon the final dissolution of the Corporation and the liquidation of its affairs, its assets shall be applied first to the discharge of its liabilities and the balance of its assets then remaining shall be devoted to the objects and purposes for which the Corporation was organized or to some of them or to objects or purposes analogous or similar thereto in accordance with any scheme or plan approved by the vote of a majority of those persons constituting its Board of Directors at the time of such final dissolution and liquidation." See Appendix C, 1.

The general purport of the foregoing is the same as analogous provisions of the charter of the British Council. See *Op. cit. supra*, note 27, Commission's Exhibit No. 289, at 12, set forth in Appendix A, 1.

## b. Corporate Powers

Under its certificate of incorporation the Council is authorized to protect the holders of obligations of foreign governments, direct and governmentally guaranteed,<sup>204</sup> and to negotiate and effect debt settlements, and when necessary to invite the deposit of bonds with itself or with others and to issue certificates of deposit therefor.<sup>205</sup> The Council is also empowered to collect statistics and information concerning foreign bonds which may be made available to bondholders if deemed expedient by the Council.<sup>206</sup> Its powers in general closely parallel those of the British Council.<sup>207</sup>

<sup>204</sup> It should be noted that the bonds of foreign private corporations carrying no governmental guarantee are not included within the Council's sphere of action except under special circumstances. Respecting this, J. Reuben Clark, Jr., testified:

Q. I believe you mentioned yesterday that the Council did not undertake to protect foreign corporate issues. That is correct, is it?

A. Yes, sir.

Q. What happens to holders of foreign corporate issues? Who does protect them? Is there any agency that does?

A. As I said yesterday, there are certain circumstances under which we do undertake to protect them.

Q. But they are rather special?

A. They are circumstances where the exchange is taken over, or the handling of the exchange, by the foreign government, or where the government has guaranteed the bonds. That is not so special nowadays, because a great many of our foreign defaulters have undertaken to control their exchange.

Q. But don't you think an authoritative central organization should include the foreign corporate issues?

A. No, sir. I think a man making an investment in a foreign corporate issue is supposed to make it not on the faith of a government or any of its auxiliary organizations; he makes it on the faith of a given industry. Now, when he makes it on the faith of the given industry and not on the faith of the nation, he must look to the industry. And usually speaking, an investment made under those circumstances has some sort of machinery set up to take care of it.

To repeat what I have said, when that foreign government steps in and interferes with the normal operation of that industry and the transmission of the necessary funds to this country, then it goes over into the category of issues of bonds which the Council does try to protect.

Q. I understand the distinction you are making. But do you know if the British Foreign Council embraces foreign corporate issues?

A. I don't know; but it is my understanding that it handles only government issues. I may be wrong about that.

Q. Has your Council ever discussed, or have your directors or the executive committee discussed, the desirability of broadening the scope so as to bring in these foreign issues?

A. Only in the case I mentioned, where there is a control of exchange or where the foreign government interferes with the transmission of funds.

Q. Has the Council ever been asked to represent foreign corporate issues?

A. Yes; we have frequently had people come and desire that we intervene on behalf of some foreign industry.

Q. Except for the special cases unmentioned, you do not act?

A. No, sir; we do not.

Q. Do you recall whether the Council has been criticized for excluding such issues?

A. No, sir. I recall no criticism of that. You will recall that our charter restricts to governmental issues except under exceptional circumstances.

Q. I recall that. But my questions were addressed to the possibility of an amendment of that charter so as to include foreign corporate issues.

A. I might add that with nearly two billion dollars and 188 issues in default on government securities, to take on the vast additional amounts that are involved in private corporate securities would swamp almost any organization you could set up. Op. cit. supra note 58, at 242-246.

<sup>205</sup> Id., Commission's Exhibit No. 20, at 2. The Council has not exercised this power to solicit deposits. Id., at 131.

<sup>206</sup> Id., Commission's Exhibit No. 20, at 2.

<sup>207</sup> See Appendix C. I. Of powers of British Corporation set forth in Appendix A, I.

But the British Council has one power which is not included among the American Council's specific powers. This is the power "to take such steps as may be deemed expedient with the view of securing the adoption of clear and simple forms of public securities and just and sound principles in the conditions and terms thereof." See Appendix A, I. Whether the British Council has ever exercised this power is not known. The Title II corporation was given the same authority in practically identical language. Securities Act of 1938, Title II, sec. 204 (7).

## c. Membership: Election of Directors

The members of the Council are divided into classes; viz., full members, contributing members, and founders.<sup>208</sup> The full members are the directors of the Council and the only class of members entitled to vote. Their membership automatically terminates upon their ceasing to be directors.<sup>209</sup> These full members elect directors<sup>210</sup> at the annual meeting of the Council. As the voting is vested exclusively in the full members, who all in turn are directors, the directorate of the Council is obviously a self-perpetuating body. All other members, although not vested with voting power, are permitted to attend general and special meetings of the Council.<sup>211</sup>

No dues are required of the full members, although they may contribute voluntarily to the Council.<sup>212</sup> The contributing members and founders are elected to membership by the board of directors or executive committee.<sup>213</sup> Contributing members pay annual dues. The founders pay no dues but do contribute one fixed sum upon election and thereby become entitled to life membership.<sup>214</sup> In practice each payment by a founder has been in the amount of \$500.<sup>215</sup>

## d. Directors, Officers, and Executive Committee

The number of directors as fixed in the certificate of incorporation is nineteen.<sup>216</sup> The first directors were named in the certificate of incorporation,<sup>217</sup> and were selected in the manner previously described. Directors as such receive no compensation but do receive traveling expenses in attending meetings.<sup>218</sup>

The certificate of incorporation provides for an executive committee "to exercise all the powers of said Board during intervals between meetings of the Board."<sup>219</sup> The members of the executive com-

<sup>208</sup> Op. cit. supra note 50, Commission's Exhibit No. 20, at 5. The British Corporation of Foreign Bondholders has only one class of members; viz., its council of 21. See supra this section.

<sup>209</sup> Op. cit. supra note 56, Commission's Exhibit No. 20, at 5.

<sup>210</sup> Id., Commission's Exhibit No. 20, at 7. See Appendix C. II. The term of office of each director is 3 years. Terms are staggered so that approximately one-third of the directors are elected each year. The British Council has an identical arrangement. See Appendix A, I.

<sup>211</sup> Op. cit. supra note 58, Commission's Exhibit No. 20, at 6. See Appendix C. II.

<sup>212</sup> Op. cit. supra note 50, Commission's Exhibit No. 20, at 5.

<sup>213</sup> Ibid. In practice the executive committee elects the contributing members. Id., at 143-145.

<sup>214</sup> Id., Commission's Exhibit No. 20, at 5. The founder members of the Council are Hendon Chubb, Greenville Clark, Alanson B. Houghton, Frank O. Lowden, Andrew Mellon, Ogden L. Mills, Henry L. Stimson, and Thomas D. Thacher. Foreign Bondholders Protective Council, Inc., Annual Report 1930, at 525.

<sup>215</sup> Op. cit. supra note 27, Commission's Exhibit No. 20, at 292.

<sup>216</sup> Op. cit. supra note 56, Commission's Exhibit No. 20, at 8.

<sup>217</sup> Ibid. See id., at 136-138, and Appendix C.

<sup>218</sup> Op. cit. supra note 58, at 146; Commission's Exhibit No. 20, at 8. The members of the British Council may be paid a sum not to exceed £100 a year. See Appendix A, I.

<sup>219</sup> Op. cit. supra note 56, Commission's Exhibit No. 20, at 4.

mittee may be compensated but in practice no member has received pay for service on the committee.<sup>220</sup> The executive committee as originally constituted at the first meeting of the board of directors held December 18, 1933, was composed of:

Raymond B. Stevens.  
Laird Bell.  
Hendon Chubb.  
Ernest M. Hopkins.  
Pierre Jay.  
Thomas D. Thacher.  
John C. Traphagen.<sup>221</sup>

Raymond B. Stevens was the first president of the Council at a salary of \$20,000 per year.<sup>222</sup> An illness prevented his serving but a short time; he resigned on April 1, 1934.<sup>223</sup> He was succeeded by J. Reuben Clark, Jr., who became acting president on February 26, 1934, and president on May 8, 1934.<sup>224</sup> Mr. Clark's annual salary was \$20,000, later reduced to \$15,000, plus a "maintenance" sum of \$400 monthly. Concerning these matters, Mr. Clark testified:

Q. And you are the president today?

A. I am president today.

Q. Do you work for a salary?

A. I do.

Q. Could you state for the record what your salary is?

A. The salary is \$15,000 a year, and I have an allowance for my traveling expense and maintenance in New York, the travelling being to and from New York and Salt Lake City, of \$400 a month.

Q. Why the special provision for maintenance, Mr. Clark?

A. That relates to the conditions under which I came into the Council.

Q. Will you state them briefly for the record?

A. The salary of the president was originally fixed at \$20,000. That contemplated his residence in New York. When I returned from Brazil Mr. Stevens was absent on sick leave, and the executive committee desired that I undertake to carry on during Mr. Stevens' absence. My commitments in Salt Lake City were such that I could not spend all of my time at the work. The executive committee had desired that I undertake the work, even though I could not spend all of my time, and they proposed that I should receive something for maintenance and traveling. In view of the fact that I had to live in Salt Lake City and

<sup>220</sup> *Id.*, at 147-148. Commission's Exhibit No. 20, at 12.

<sup>221</sup> *Id.*, Commission's Exhibit No. 20, at 11. Subsequently the personnel of the executive committee has changed as follows: Ernest M. Hopkins, Pierre Jay, and Raymond B. Stevens resigned and J. Reuben Clark, Jr., James Crafton Rogers, and Francis White have been elected. *Id.*, Commission's Exhibit No. 19, at 26; Foreign Bondholders Protective Council, Inc., Annual Report 1935, at 7, 10.

<sup>222</sup> *Op. cit. supra* note 56, Commission's Exhibit No. 19, at 19.

<sup>223</sup> *Id.*, Commission's Exhibit No. 19, at 25-26.

<sup>224</sup> *Ibid.*

not in New York. Accordingly the salary was continued to me which was paid to Mr. Stevens, and there was added thereto \$400 a month for maintenance.

Q. And that has been paid since—

A. (Interposing). That was paid up until January of this year. January of this year it became necessary to get in more help because of my necessary absence in Salt Lake City. Thereupon we secured the services of Mr. Francis White, former Assistant Secretary of State, to come in and be Executive Vice President and Secretary. His salary was made \$15,000; \$10,000 of that had been theretofore paid to the secretary, and the extra \$5,000 was taken from the salary of the president.

Q. Do you mean to say that your salary was thereupon reduced to \$15,000?

A. Yes, sir; my salary was reduced to \$15,000.

Q. Plus maintenance or including maintenance?

A. Plus the maintenance.

Q. And the maintenance has been paid ever since?

A. The maintenance has been continued to be paid, because I have to travel back and forth once a month or once every six weeks.<sup>225</sup>

The remaining officers of the Council are:

Francis White, Executive Vice President and Secretary.

Laird Bell, Vice President.

Mills B. Lane, Treasurer.

Aristides Moreno, Assistant Secretary and Assistant Treasurer.<sup>226</sup>

Mr. White's salary is \$15,000 and Mr. Moreno's \$6,500 annually. Mr. Bell and Mr. Lane serve without compensation.<sup>227</sup>

It will be noted that the directors of the Council are persons of prominence drawn from all parts of the United States. The directors have not been active in the work of the Council. As we shall subsequently relate, they are, in a sense, directors who do not direct. Mr. Clark, testifying on October 30, 1935, stated that only one

<sup>225</sup> *Id.*, at 148-150. As of February 1, 1936, this payment had been reduced voluntarily to \$100 per month plus Mr. Clark's traveling expenses. The new arrangement is set forth in the following statement from the minutes of the directors' meeting of the Council held February 27, 1936:

"The first business to come before the meeting was the election of officers. Nominations were made, and Mr. Clark having been put in nomination for President, he stated that before further proceeding he wished to make the following statement: "That if elected it would probably not be possible for him during the next four or five months to spend much time in New York, though it might turn out otherwise, and he would be always available for consultation; that in no case could he spend more than half of his time at the office in New York during the year; that in view of the foregoing his resignation was at the disposition of the Council, though he was prepared, if the members desired it, to serve another year under the conditions named; however, he stated that in view of the foregoing he would, if elected, reduce his expense allowance to a flat \$100 per month for maintenance and, in addition, actual traveling expenses; this adjustment would save the Council, as he estimated it, approximately \$2,000 from his present allowance," which has been \$400 per month, or \$4,800 per year."

The actual figure for Mr. Clark's "Traveling & Maintenance Expenses" for the year 1936 was \$2,155.79. See Appendix D, setting forth the receipts and disbursements of the Council for 1934, 1935 and 1936.

<sup>226</sup> Foreign Bondholders Protective Council, Inc., Annual Report 1935, at 7.

<sup>227</sup> *Op. cit. supra* note 56, at 150-151.

annual meeting and one special meeting of the board of directors had been held since the Council was formed on December 18, 1933.<sup>225</sup> The work of the Council is performed by the executive committee and its officers. Negotiation of debt settlements usually has been carried on by the president (J. Reuben Clark, Jr.) and the executive vice president (Francis White) in consultation with the executive committee. Concerning these matters Mr. Clark testified:

"Q. Mr. Clark, I believe you stated yesterday that the meetings of the members of the Council were held annually except for special meetings that might be called.

A. That is, the meetings of the directors.

Q. The full members?

A. Yes, sir.

Q. And I believe you stated that there had been one special meeting called?

A. One special meeting.

Q. Then it would be fair to say that the directors, the full members, do not actively participate in the work of the Council? Is that true?

A. Yes, sir. But I should like to make something of an explanation there, if I may. We are not conducting a business in the sense of investing money or incurring monetary obligations, or anything of that sort. There is only the work of the detail of negotiations after broad, general principles are settled, and these principles have from time to time been reported to the directors; so that unless you were to ask the directors to come to New York to participate in any kind of negotiation there would be very little that the directors could do.

Q. May I ask you this question? Do the directors serve a real function, from your point of view? Are they useful?

A. Yes; they are useful.

Q. In what way are they useful?

A. Well, they are useful because they are able to explain in their various areas the functions and purpose of the Council. They are useful in giving us the advantage of their views and wisdom on broad principles of policy.

Q. Do you get their views?

A. Yes; when they come to meetings. They have settled some of these questions of policy; and they have been reported to them and discussed by them.

Q. The discussions are largely on matters of policy, general policy, not specific situations? Is that true?

A. Yes, sir; that is true.

Q. Have they been useful in bringing in members and getting contributions or advances?

A. Yes, sir; they have been useful in that respect.

Q. Your executive committee is the group that does the work?

A. Yes, sir; that is correct. We hold an executive committee meeting once a week, and at that meeting everything which the Council is doing or contemplating doing is reported to the executive committee and passed upon by the committee, including the details of all negotiations.

Q. Mr. Clark, are the negotiations carried on by the president and the vice-president?

A. Primarily; subject, of course, to this consultation with the executive committee.

<sup>225</sup> *Id.*, at 143-146. An annual meeting was held in 1936.

Q. That is, the president or the vice president of the Council?

A. Yes, sir; the executive vice-president.

Q. The executive vice-president?

A. Yes, sir; the executive vice-president.

Q. Would you feel that the Council would operate and function as well without a board of directors of the size that it has?

A. Not at the present time. If the Council were more firmly established or were in the position, let us say, of the British Bondholders Council, it might be that the actual service of the directors could be performed by a fewer number of persons.

Q. May I ask you this question, Mr. Clark? Are the directors useful primarily from the point of view of public relations of the Council?

A. I should hardly like to say that \* \* \*. That is certainly one of their principal uses and values. But we have had some very valuable suggestions from them in the matter of our policies.<sup>226</sup>

As stated previously, the actual work of negotiating with foreign governments is usually carried on by J. Reuben Clark, Jr., and Francis White. Mr. Clark had been Ambassador to Mexico, Solicitor of the State Department, and Under Secretary of State. He is experienced in international law and diplomacy. He might be said to have brought to the Council the viewpoint and experience of the diplomatic service rather than of the world of finance.<sup>227</sup>

Francis White, who joined the Council on December 11, 1934, had been Assistant Secretary of State, and his training and experience were likewise of a diplomatic rather than of a financial character.

The New York members of the executive committee may be said to a considerable extent, however, to bring to the Council the financial and business knowledge that its executive officers lack. Mr. Chubb is a director of Central Hanover Bank and Trust Company; Mr. Trap-hagen is president of the Bank of New York & Trust Company; and Mr. Thacher, former Solicitor General of the United States, is a partner of the prominent New York law firm of Simpson, Thacher & Bartlett.

## 5. COUNCIL'S FINANCES

The raising of funds for the support of the Council has proven to be a difficult and embarrassing problem. The informal committee created in 1932, as previously related, had hoped that various organizations, including the American Bankers Association and the Investment Bankers Association, together with houses of issue and holders of foreign bonds, might contribute. There was also the expectation that some foundation would defray the Council's expenses in whole

<sup>226</sup> *Id.*, at 218-221.

<sup>227</sup> Mr. Clark, in addressing the Investment Bankers Association, said:

"For my part, I am not a financier, and I am not a banker (some say there is a distinction between them). I never bought a bond, and, I regret to say, I was never a member of one of these preferential lists for underwriting securities. So what I do not know about bonds is all that you gentlemen do know." *Id.*, Commission's Exhibit No. 29.

or in part. This possibility was explored further in the summer and early fall of 1933 when plans for the organization of the Council were being formulated. But apparently at some time prior to the meeting in Washington on October 20, 1933, it was learned that no financial support could be obtained from a foundation.

The organizing committee of the Council reported to the Washington meeting on December 18, 1933, that the Council's estimated annual budget would be \$100,000, of which \$60,000 would be required for salaries, rent, and other general overhead and \$40,000 would be required for travel and other unusual expenses in connection with the negotiation of debt settlement.<sup>241</sup> The report pointed out that similar bondholders' councils in other countries have financed themselves from sums received in connection with completed negotiations with debtors, that the American Council might eventually finance itself in the same manner.<sup>242</sup> But for the present support of the Council it was hoped that contributions would be made by those "who should benefit from its assistance and work." These persons were described in the report as follows:

"First: Holders of foreign bonds, whether individuals, corporations, or banks. The benefit of the Council to this class is obvious.

"Second: Banks and bankers who issued or distributed foreign bonds. This class will benefit directly from the existence of an authoritative and disinterested body, on which they are in nowise represented, which may adjust conflicting interests either at home or in debtor countries, and pass on the fairness of the settlements or arrangements proposed in respect of defaulted bonds. Moreover, this class has a special responsibility for the financial support of a council dealing with defaults arising in securities which they themselves issued or distributed.

"Third: Banks, which, though not holders of foreign bonds, are engaged in financing exports and imports. Here the benefit may be measured by the assistance the work of the Council, in respect of foreign long term credits in the United States, may render to the recovery of world trade.

"Fourth: Manufacturers or merchants engaged in exporting or importing as well as producers of staple exports such as cotton, wheat, corn, live stock, copper, etc. This class benefited greatly from the increased purchasing power of foreign countries while their bonds were being floated in the United States. When these ceased and widespread defaults ensued, foreign purchasing power was greatly reduced. Whatever can be done towards settling defaulted obligations and restoring the credit of the countries affected will benefit both exporters and importers. Moreover, many exporters, through the imposition of foreign exchange controls by debtor countries, have now become investors through having been forced to convert their cash balances in such countries into bonds.

<sup>241</sup> *Op. cit. supra* note 50, Commission's Exhibit No. 19, at 17. The Council's actual total disbursements for the period Dec. 18, 1933, to Dec. 21, 1934, were \$109,860.65. *Id.*, Commission's Exhibit No. 21.

<sup>242</sup> A substantial part of the expenses of the British Council is met in this manner. See *supra* this section.

"Fifth: Foundations and public spirited citizens. To this class the Council affords a medium through which they may contribute towards solving one of the largest financial problems in the recovery program."<sup>243</sup>

During the interval between the first meeting on October 20, 1933, and the second meeting in Washington on December 18, 1933, Messrs. Stevens, Traphagen, and Jay were actively engaged in an endeavor to obtain promises of financial support for the Council.<sup>244</sup> In furtherance of these efforts, they turned to the large New York banks and issue houses. On December 6, 1933, a meeting was held at the Federal Reserve Bank in New York upon invitation of Governor Harrison, which was attended by about twenty representatives of banks and investment bankers.<sup>245</sup> Mr. Stevens addressed the meeting, outlining the proposal to form a central bondholders' council and at or shortly after the meeting received assurance of financial support from many of those present. Subsequently Mr. Jay addressed a meeting in New York of the Investment Bankers Association called by Ralph T. Crane, then chairman of the foreign securities committee of the association.<sup>246</sup> This meeting likewise resulted in a number of investment bankers contributing to the Council.<sup>247</sup>

Contributions were also solicited outside of New York. Of a total sum of \$100,000 which was hoped to be raised against the Council's expenses for its first year, the New York quota was \$60,000, later increased to \$75,000, Chicago \$10,000 and Philadelphia \$6,000; the balance was to be raised elsewhere.<sup>248</sup> It was found that some feeling existed outside of New York that the large New York investment bankers should shoulder the financial burden involved as these firms had been responsible for originating most of the foreign issues.<sup>249</sup> Nevertheless, the contributions of these large New York houses were limited to \$5,000 each, as it was considered from the "political angle" that larger contributions from such sources would invite prejudice and criticism.<sup>250</sup>

Contributions were solicited on a basis of one, two, and three years, but, with some exceptions, pledges were made for the full period of three years.<sup>251</sup> Large and small contributors were not treated alike.

<sup>243</sup> *Op. cit. supra* note 50, Commission's Exhibit No. 19, at 17-18.

<sup>244</sup> *Op. cit. supra* note 27, at 1241.

<sup>245</sup> *Id.*, at 176-177, 1229-1230.

<sup>246</sup> *Id.*, at 1230.

<sup>247</sup> *Id.*, at 1231.

<sup>248</sup> *Id.*, at 1232-1233; Commission's Exhibits Nos. 274, 279. The Chase National Bank made its contribution conditional upon the raising of the New York quota of \$75,000 by New York City banks. The actual amount received by the Council in 1934 from all New York City sources was \$61,560. The Chase National Bank, however, waived its condition. *Id.*, at 1248-1249. The Chicago and Philadelphia quotas also were not met. 1934 Chicago contributions amounted to \$8,000; Philadelphia contributions to \$3,000. *Op. cit. supra* note 56, Commission's Exhibit No. 25.

<sup>249</sup> *Op. cit. supra* note 27, at 1234-1235.

<sup>250</sup> *Id.*, at 1234.

<sup>251</sup> *Op. cit. supra* note 56, at 158.

Payments to the Council of less than \$100 were considered "dues", i. e., outright donations. As to subscriptions exceeding this amount, the first \$100, or 20 percent of the amount exceeding \$500, was (with a few exceptions) considered "dues" and the balance an "advance." This advance was "repayable, in whole or in part, without interest, if and when, in the judgment of the board of directors of the Council, its finances permit repayment."<sup>243</sup> Thus, in the case of a \$5,000 subscription, \$1,000 consisted of "dues" and \$4,000 of an "advance."

With financial support assured from large banks and houses of issue, the Council was formally organized as related above. As it was felt desirable to "spread the support over the entire country,"<sup>244</sup> an effort was made to obtain subscriptions from the various groups listed in the report of the organizing committee as those who would benefit from the Council's work.<sup>245</sup> Banks, whether or not holders of foreign bonds, were solicited on the basis of the amount of the bank's deposits.<sup>246</sup> Attempts to obtain contributions from individual bondholders met with little success. In 1934 a total of only \$785 was received from 10 individual bondholders.<sup>247</sup> Similar lack of success followed efforts to obtain financial support from the fourth class to benefit from the Council's work, "manufacturers or merchants engaged in exporting or importing as well as producers of staple exports, such as cotton, wheat, corn, live stock, copper, etc." Contributions totalling \$2,500 were received from three members so classified.<sup>248</sup> Directors contributed \$1,275, while the seven founders contributed \$500 apiece, or \$3,500.<sup>249</sup> The aggregate number of members contributing to the Council in 1934 was 189, and their total contributions (both dues and "advances") aggregated \$90,238.75.<sup>250</sup> A list of those contributing \$500 or over follows:

\$1,500	Bancamerica-Blair Corporation, New York, N. Y.
500	Bank of New York and Trust Company, New York, N. Y.
2,500	Bank of the Manhattan Company, New York, N. Y.
5,000	Bankers Trust Company, New York, N. Y.
1,000	Becker, A. G., & Co., Chicago, Ill.
2,500	Brown Brothers Harriman & Co., New York, N. Y.

<sup>243</sup> *Id.*, at 186-187.

<sup>244</sup> *Id.*, Commission's Exhibit No. 274.

<sup>245</sup> Quoted *supra* in the text.

<sup>246</sup> The amounts solicited of banks varied according to the following schedule of deposits:

Deposits	Rate
\$4,000,000 or under	\$10.00
\$4,000,000 to \$10,000,000	\$2.50 per \$1,000,000 of deposits
\$10,000,000 and over	\$5.00 per \$1,000,000 of deposits

<sup>247</sup> *Op. cit.* *supra* note 26, Commission's Exhibit No. 26.

<sup>248</sup> *Op. cit.* *supra* note 27, Commission's Exhibit No. 282. One individual bondholder contributing \$500 was also a "founder" member.

<sup>249</sup> *Ibid.*

<sup>250</sup> *Ibid.* In *id.*, Commission's Exhibit No. 282, one founder member is classified as a "holder of foreign bonds."

<sup>251</sup> *Ibid.* In addition, nonmembers contributed the sum of \$148 in 1934. See Appendix D.

1,000	Central Hanover Bank and Trust Company, New York, N. Y.
5,000	Chase National Bank, New York, N. Y.
500	*Chubb, Hendon
500	City National Bank and Trust Company, Chicago, Ill.
500	*Clark, Greenville
2,000	Continental Illinois National Bank & Trust Co., Chicago, Ill.
1,000	Corn Exchange Bank Trust Company, New York, N. Y.
5,000	Dillon, Read & Co., New York, N. Y.
500	Drexel & Co., Philadelphia, Pa.
500	Electric Bond and Share Company, New York, N. Y.
500	Fidelity-Philadelphia Trust Company, Philadelphia, Pa.
500	Field, Gore & Co., Chicago, Ill.
500	Field, Gore & Co., New York, N. Y.
500	First Bank Stock Corporation, St. Paul, Minn.
1,000	First National Bank, New York, N. Y.
2,500	First National Bank of Boston, The, Boston, Mass.
2,000	First National Bank of Chicago, Chicago, Ill.
1,000	General Motors Export Company, New York, N. Y.
500	Girard Trust Company, Philadelphia, Pa.
5,000	Guaranty Company of New York, N. Y.
1,500	Hallgarten & Co., New York, N. Y.
2,000	Halsey, Stuart & Co., Incorporated, New York, N. Y.
1,000	Harris Trust & Savings Bank, Chicago, Ill.
500	Hornblower & Weeks, New York, N. Y.
500	*Houghton, Alanson B.
750	Iselin, A., & Co., New York, N. Y.
1,000	Kidder, Peabody & Co., New York, N. Y.
5,000	Kuhn, Loeb & Co., New York, N. Y.
500	*Lowden, F. O., Oregon, Ill.
500	*Mellon, Andrew W.
500	Mellon National Bank, Pittsburgh, Pa.
5,000	Morgan, J. P., & Co., New York, N. Y.
5,000	National City Bank of New York, The, New York, N. Y.
1,000	New York Trust Company, The, New York, N. Y.
1,000	Northern Trust Company, The, Chicago, Ill.
500	Northwest Bancorporation, Minneapolis, Minn.
1,000	Pennsylvania Company for Insurances on Lives and Granting Annuities, The, Philadelphia, Pa.
1,000	Philadelphia National Bank, The, Philadelphia, Pa.
1,000	Schroder, J. Henry, Banking Corporation, New York, N. Y.
2,500	Seligman, J. & W., & Co., New York, N. Y.
500	*Simson, Henry L.
500	Thacher, Thomas D.
1,000	Union Trust Company, The, of Pittsburgh, Pa.
1,000	United States Steel Corporation, New York, N. Y.
1,500	White, Weld & Co., New York, N. Y. <sup>251</sup>

\* Founder.

The Council has relied heavily for financial support on the investment bankers which had issued foreign bonds. In the following

<sup>251</sup> *Op. cit.* *supra* note 27, Commission's Exhibit No. 282.

table, prepared by the Council, the contributions of its members for 1934 are classified:

	Members		Contributions	
	Number	Percent	Amount	Percent
Class No. 1: Holders of foreign bonds, whether individuals, corporations or banks.....	87	48.0	\$58,840.00	63.0
Class No. 2: Banks and bankers who issued or distributed foreign bonds.....	18	10.0	20,050.00	22.2
Class No. 3: Banks which are not holders of foreign bonds.....	55	29.1	8,363.75	7.1
Class No. 4: Manufacturers or merchants engaged in foreign trade as well as producers of staple exports such as cotton, wheat, corn, livestock, copper, etc.....	3	1.6	2,500.00	2.8
Others: Directors.....	15	8.5	1,275.00	1.4
Founders.....	5	3.2	3,000.00	3.3
Miscellaneous.....	2	1.1	190.00	.2
Total.....	189	100.0	\$90,238.75	100.0

This table indicates that of the \$90,238.75 contributed to the Council in 1934, \$20,050.00, or 22.2 percent, was contributed by the houses of issue. But these figures hardly tell the full story. For among the 87 members listed in Class No. 1, "Holders of foreign bonds", are Bankers Trust Company, Guaranty Co., Halsey, Stuart & Co., Lee, Higginson Corp., J. P. Morgan & Co., and J. & W. Seligman & Co. as contributors of the aggregate sum of \$18,600. These firms admittedly were houses of issue as well as holders of foreign bonds. Then again there were included in Class No. 1 five banking institutions such as the Chase National Bank, which formerly, through a securities affiliate or a predecessor company, had underwritten foreign bond issues. These five banks contributed \$15,500 to the Council. Adding these sums of \$18,600 and \$15,500 to the Council's figure of \$20,050, we find that of total 1934 contributions of \$90,238.75, houses of issue had contributed \$54,150, or 60 percent.<sup>251</sup> And this figure represents contributions by the originating houses only; no attempt was made to ascertain the contributions made by members of selling groups or by secondary distributors of foreign bond issues. While the houses of issue contributed 60 percent of the total amount, in number they constituted only 16 percent (30 of 189) of the total contributing members.<sup>252</sup>

The Council has been the subject of severe criticism for soliciting and accepting financial support from the houses of issue. This subject will be explored in Section V of this report.

<sup>251</sup> *Ibid.*

<sup>252</sup> *Id.*, at 1256-1257.

<sup>253</sup> *Ibid.*

Paralleling the policy of the British Council of Foreign Bondholders, the American Council has endeavored to obtain payments from foreign governments with which it has concluded debt settlements. To the present time sums have been received from foreign governments as follows:

Brazil.....	\$16,150.00
Dominican Republic.....	20,000.00
Germany.....	30,200.00
Costa Rica.....	8,160.00
Province of Buenos Aires.....	20,000.00
Total.....	\$94,500.00

The sums paid by foreign obligors to the Council follow no fixed standard but are the result of negotiations between the Council and the debtor. The sums paid by Brazil and Germany were based on the Council's out-of-pocket expenses allocated to the particular negotiation.<sup>254</sup> In the case of the Dominican Republic, the payment represented a "flat sum to cover those expenses and the work of the Council."<sup>255</sup> It is the Council's policy, where possible, to obtain a sum from the foreign debtor which will represent a fee for its work over and above its expenses. With respect to such payments, J. Reuben Clark, Jr., testified before this Commission:

"Q. Well, now, what kind of funds have been received from the foreign governments? What has been the occasion for that?"

A. Those funds have been received at the conclusion of negotiations.

Q. Covering expenses of the Council?

A. Sometimes they have been estimated on that basis, and other times the element of fee has perhaps entered into it. The Council has gone on the principle that the debtor should pay some of the expenses of an arrangement for the resumption of service \* \* \*<sup>256</sup>

As we shall hereafter develop, the Council's practice of taking payments from foreign governments has been the subject of criticism.<sup>257</sup>

In connection with the debt settlement negotiated with the Province of Buenos Aires, the Council requested voluntary contributions from bondholders assenting to the plan in the amount of one-eighth of 1 percent of the face amount of bonds held.<sup>258</sup> Pursuant to this request the holders of the dollar bonds of the Province had agreed to con-

<sup>254</sup> *Id.*, at 1256-1257; *op. cit. supra* note 50, Commission's Exhibit No. 26; Letter, Foreign Bondholders Protective Council, Inc. to Securities and Exchange Commission, Dec. 11, 1936.

<sup>255</sup> *Op. cit. supra* note 27, at 1258.

<sup>256</sup> *Id.*, at 1259-1259.

<sup>257</sup> *Op. cit. supra* note 56, at 163.

<sup>258</sup> *Infra* sec. V, C, 2, 1.

<sup>259</sup> Foreign Bondholders Protective Council, Inc., Annual Report 1935, at 20-21. A similar contribution was recently requested of the holders of the bonds of the Dominican Republic, N. Y. Times, Dec. 23, 1936.

tribute \$54,932.08 to the Council as of November 30, 1936.<sup>200</sup> We shall subsequently refer to these contributions in more detail.<sup>201</sup>

It is the policy of the Council that payments from foreign debtors and from bondholders, together with such non-recurring items as the founders' contributions, formed a reserve fund, the earnings from which will supplement current income from members' contributions and which as the fund increases will tend more and more to make the Council self-supporting.<sup>202</sup> It is the hope of the Council that current income would be sufficient to meet current expenses and that the principal of the reserve fund can be kept intact. Inasmuch, however, as the Council's income in 1934 was insufficient to meet expenses, it was necessary in that year to draw upon the reserve fund in the amount of \$14,173.90.<sup>203</sup> No withdrawals have been made from this fund in 1935 or 1936.

The Council retains no regular attorneys.<sup>204</sup> The firm of Simpson, Thacher & Bartlett drafted its certificate of incorporation and by-laws and has attended to the legal aspects of its routine corporate activities such as the preparation of minutes of meetings,

<sup>200</sup>Letter, Foreign Bondholders Protective Council, Inc., to Securities and Exchange Commission, Jan. 8, 1937. In connection with the contributions from the bondholders and the Province a question arose as to whether their receipt would destroy the exemption of the Province of Buenos Aires from registration under the Securities Act of 1933, otherwise existing by virtue of sec. 3 (a) (9). This section provides an exemption as to "any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange." In response to a request for a legal opinion, the General Counsel of this Commission wrote the Foreign Bondholders Protective Council, Inc., on Jan. 31, 1936, as follows:

"I understand that upon the completion of negotiations between the Council and the representatives of the Province, the plan was agreed upon and the Council, in accordance with its authorizations previously given, recommended the plan to the favorable consideration of the holders of the outstanding Provincial bonds. I understand further that following the adoption of the plan by the Province the Council requested the bondholders and the Province to make certain voluntary contributions to the Council. You inquire whether the new securities to be issued must be registered with the Commission.

"As you are doubtless aware, Section 3 (a) (9) of the Securities Act of 1933, as amended, exempts from the registration provisions of the Act securities exchanged by an issuer with its existing security holders exclusively where no commission or other remuneration is paid or given, directly or indirectly, for soliciting the exchange.

"As previously indicated in my letter of December 23, it is my opinion that the making of voluntary contributions by the bondholders to the Council, under the circumstances outlined in your letter, does not operate to destroy the exemption from registration provided for by Section 3 (a) (9) of the Act. The question whether the making of the proposed contribution by the Province is of a character such as to destroy the exemption depends upon whether the amount thus paid to the Council is in fact paid or given directly or indirectly for soliciting the exchange of securities called for by the plan. In view of the various circumstances which must be taken into account in determining the exact nature of the arrangement under which any such contribution by the Province is made, I feel that I am not in a position to determine whether or not the payment of the requested contribution would in fact be a payment made or given for the solicitation of the exchange, and that this is properly a question of fact to be determined by the parties involved.

"If any payment which is made in fact is a voluntary contribution and does not, in any way partake of the nature of a commission or remuneration paid or given for the solicitation of the exchange of new bonds for old, then the new bonds are exempt from registration by reason of the provisions of Section 3 (a) (9) of the Act, referred to above."

<sup>201</sup>Intro sec. IV, B, 2, d. The Council, in connection with its negotiations with the Dominican Republic and with the Republic of China, each resulting in an offer of debt readjustment, has recently requested similar contributions from bondholders in the amount of \$1.25 per \$1,000 bond. N. Y. Times, Dec. 23, 1936 (Dominican Republic dollar bonds) and N. Y. Herald Tribune, April 12, 1937 (Republic of China, treasury notes of 1916).

<sup>202</sup>Op. cit. supra note 56, at 162-163; Commission's Exhibit No. 21, at 8-5.

<sup>203</sup>Ibid. See Appendix D.

<sup>204</sup>Op. cit. supra note 56, at 217.

income tax matters, etc. For such services from the inception of the Council to December 31, 1936, the Council has paid Simpson, Thacher & Bartlett the sum of \$1,130, and has paid the firm's disbursements of \$408.29.<sup>205</sup> The Council in only two cases has retained attorneys in connection with negotiations with foreign governments. The firm of Covington, Burling, Rublee, Acheson & Shorb, of Washington, D. C., represented the Council in connection with the German negotiations in the winter and spring of 1934. Their fee was \$2,500 together with disbursements of \$31.08.<sup>206</sup> The firm of Sullivan & Cromwell, New York City, represented the Council during the period of December 19, 1933, to April 25, 1934, in connection with the Council's negotiations with Brazil. This firm was paid a fee of \$3,500 and received reimbursement for expenses in the amount of \$1,039.89.<sup>207</sup> In summary the Council during the 3 years of its existence to December 31, 1936, incurred legal fees (exclusive of disbursements) in connection with its purely corporate activities of \$1,130 and in connection with debt negotiations of \$8,000, or an aggregate of \$7,130.

Special representatives of the Council have occasionally gone to foreign countries to negotiate with debtors. The names of these representatives and the amounts paid them by the Council from its inception to December 31, 1936, are as follows:

Brazil:

J. Reuben Clark, Jr. (Nov., 1933, Jan., 1934, incurred before becoming a salaried officer of the Council)..... \$5,000.00

Cuba:

Dana G. Muncó (Aug.-Sept., 1936)..... 2,500.00

Germany:

Laird Bell (two trips, Jan., April-May, 1934)..... 6,000.00

Pierre Jay (April-May, 1934)..... 5,000.00

C. J. Dieckman (April-May, 1934)..... 500.00

Total.....<sup>208</sup> \$19,000.00

As we have developed in the foregoing pages, the Council was created as a permanent central agency to defend and protect the interests of all holders of defaulted foreign governmental bonds. Hence, the total defaults included within its sphere of action aggre-

<sup>205</sup>Information supplied this Commission by the Foreign Bondholders Protective Council, Inc., under date of January 30, 1937. Part of the payment to Simpson, Thacher & Bartlett was made in January 1937 and hence is not reflected in the general account of the Council which is set forth in Appendix D. The submission of the bills of Simpson, Thacher & Bartlett was accompanied by a letter stating that no charge had been made for services of members of the firm.

<sup>206</sup>Op. cit. supra note 27, at 1236-1237; op. cit. supra note 56, at 218.

<sup>207</sup>Op. cit. supra note 66, Commission's Exhibit No. 28.

<sup>208</sup>Ibid., at 212-216 and Commission's Exhibit No. 28, as supplemented by information furnished this Commission by the Council under date of Jan. 30, 1937.

gate over \$1,700,000,000.<sup>209</sup> While it was not created to be the exclusive agency in the field, it has, as we shall later develop, acquired a virtual monopoly in the readjustment of foreign governmental defaults. No other agency in the foreign field at the present time purports to be the champion of the interests of all holders of defaulted foreign bonds, and no protective agency in the domestic field approaches it in the amount of defaulted securities with which it is concerned.<sup>210</sup> A bare recital of these facts affords a clear indication of the importance of the Foreign Bondholders Protective Council, Inc., to the holders of foreign bonds and to the country as a whole. Needless to say, it is incumbent upon an organization of this importance to act with the greatest integrity and with an eye single to the interests of those whom it was created to protect. We have heretofore developed the genesis, organization, and financing of the Council. We shall hereafter explore its general procedure and its techniques in negotiating debt settlement and shall appraise the manner in which it has fulfilled the important duties which have been placed upon it with the view of determining whether or not it has measured up to the exacting standards of its stewardship. But the purpose of such an analysis is not merely to make an appraisal of the present Council but to determine whether any such agency is preferable to the kind of quasi-governmental agency contemplated by Title II of the Securities Act of 1933. In this connection it is necessary to consider not only the central agency but also the protective committee as a mechanism of adjusting defaulted foreign bonds. In many foreign bond situations these committees have been conspicuous. To a consideration of the role which they have played and the manner in which they have been constituted we now turn.

<sup>209</sup> See *supra* sec. I, A.

<sup>210</sup> Perhaps the nearest approach in the domestic field in amount of securities represented by one agency was the case of H. W. Straus & Co. As developed in Part III of this report, Committees for the Holders of Real Estate Bonds (1930), at 1-2, the Straus organization formed its own committees for a substantial part of all real estate bonds underwritten by it and which subsequently defaulted. These reached the total of some \$450,000,000.

### SECTION III PROTECTIVE COMMITTEES

Thirteen protective committees for the holders of defaulted foreign bonds were made the subject of detailed investigation by and of public hearings before this Commission. The names of these committees, the foreign bond issues for which they acted, and the amount of such issues outstanding are shown in the following table:

Name of original committee	Chairman	Date of formation	Aggregate of bonds for which committee organized to act*	Device used to evidence bondholders' support
<b>El Salvador:</b> Bondholders Protective Committee for Republic of El Salvador. <sup>†</sup>	F. J. Litzman.....	Mar. 28, 1932	\$17,088,450	Deposits.
Protective Committee for Republic of El Salvador. <sup>‡</sup>	Montgomery Schuyler	Mar. 24, 1932	\$17,088,450	Do.
<b>Colombia:</b> Committee for the Holders of Colombian Dollar Bonds. Bondholders Committee for Republic of Colombia External Dollar Bonds. <sup>§</sup>	Thomas H. Healy.....	June 10, 1935	143,630,900	Registry.
Independent Bondholders Committee for Republic of Colombia. <sup>¶</sup>	Richard Washburn Child (succeeded by Fred Lewis). Robert L. Owen.....	Nov. 1, 1932 Nov. 15, 1932	143,630,900 82,138,900	Deposits. Do.
<b>Chile:</b> Chilean Bondholders Committee. Committee of Bondholders for the Republic of Chile Bonds. <sup>‡</sup>	No chairman named... John W. Greenman...	June 20, 1935 June 25, 1935	263,634,000 175,404,000	Registry. Do.
Committee of Bondholders for the Mortgage Bank of Chile Bonds. <sup>¶</sup>	Cesar J. Bertheau....	Do.	68,050,800	Do.
<b>Cuba:</b> Bondholders Committee for Republic of Cuba Bonds. Committee of Bondholders for the Republic of Cuba Public Works Gold Bonds Due 1945	Bronson Cutting (succeeded by Gerald P. Nye). George Burdham.....	July 25, 1934 Oct. 10, 1934	40,000,000 40,000,000	Deposits. Registry.

\* Figures taken from 1935 Report of Foreign Bondholders Protective Council, Inc.

† These committees up June 20, 1932, assumed identical membership, with F. J. Litzman at a later date becoming chairman.

‡ Includes Sterling bonds in amount of £263,830 converted at \$5.

§ These committees agreed to coordinate their activities on Oct. 1, 1934. In January 1935, the two committees assumed identical membership, with Robert L. Owen as chairman.

¶ This committee was organized to act for the bond issues of the Colombian departments and municipalities only. Shortly after its formation, however, it extended its authority to include bonds of the Republic of Colombia and of the mortgage banks.

‡ These committees combined on Apr. 15, 1935, with C. J. Bertheau as chairman. The combined committee now represent the municipal issues in addition to the national and mortgage bank issues.

## SECTION VI

## CONCLUSIONS AND RECOMMENDATIONS

Regulation and control of committees and other agencies representing holders of defaulted foreign governmental bonds are necessary in the public interest and for the protection of investors. At present no supervision exists, except the registration requirements of the Securities Act of 1933, as amended. These apply for the most part only to committees seeking the deposit of bonds. Thus committees seeking only powers of attorney or proxies are by and large exempt, except as they may be subjected to the rules of the Commission governing the solicitation of proxies in respect of securities registered on a national securities exchange.

Even in case of committees which are required to register under the Securities Act, they are forced only to disclose the truth as to their organization, their affiliations, and their plans. There is no power to refuse to qualify as committees those who have even palpably conflicting or adverse interests. There is no power to supervise the conduct and activities of these committees during their life. There is no power to curtail or delimit in the public interest and for protection of investors the powers which committees may take unto themselves. As we have concluded in another part of this report, mere disclosure in these situations does not secure that degree of protection of investors which seems both desirable and feasible. On default, investors, unorganized and largely helpless to help themselves, have little freedom of choice but to go along with those who, self-constituted and self-appointed, announce themselves as their protectors. Disclosure of the facts regarding these protectors is not sufficient for the protection of investors. Prospective purchasers of securities have by and large a real choice—to buy or not, as their judgment dictates. To them disclosure of the pertinent facts surrounding the offering is of great value. But with respect to these default situations the case is quite different. An investor with defaulted foreign bonds already holds the securities; his investment has already been made; his choice is thus drastically limited. He feels impelled to do something to protect his interests, and the only avenue seemingly (or actually) open to him is the particular committee that may be in the field.

In addition, disclosures in the registration statement present the facts as of the time of filing. That date is usually far in advance

of the negotiation of a plan. When the committee subsequently negotiates a plan, the investor usually has no alternative but to go along with it regardless of the fact that it may be unsound or unfair. The price of going along will be submission to such terms and conditions as the committee in its uncontrolled discretion may impose. As we have seen, committees may exact heavy tribute from depositors. But the latter are faced with the choice either of not depositing (or of withdrawing their securities on payment of a penalty or assessment) with the result that they get little or nothing; or of going along with the committee and paying the committee such toll as the committee may dictate. In other words, though the registration statement contains no misstatements or non-disclosures of material facts, committees may continue to operate under oppressive deposit agreements. The Commission is powerless to regulate or control their practices.

In many respects the condition in the foreign field is more acute than in the domestic field. In the latter, creditors usually have some form of legal redress against the debtor; some forum before which their claims can be pressed; some method for reaching, collectively or individually, the assets of the debtor. But as we have seen, these measures of self-protection are largely non-existent in the foreign field. Investors are largely dependent upon the ability of those who purport to represent them to negotiate plans of debt readjustment. Thus it becomes especially important that measures be adopted which will require high standards to be provided for those who undertake to represent investors in this field. This means that the basis for regulation must be broader than mere disclosure; it must be directed toward the elimination of material conflicts of interests and unconscionable practices. Furthermore, methods must be designed to bring under regulation and control committees and other agencies presently exempt and immune from any supervision.

In fashioning these regulatory measures, it will not be possible even to approximate the type of supervision and control which inheres in bankruptcy or receivership courts; since the assets of the debtor are not subject to process in this country and no power exists to subject them to such jurisdiction. By the same token there is no control over the debtor in any real or legalistic sense. Hence any system of control must fall short of assuring, to the degree possible in the domestic field, production of reorganization or readjustment plans which are fair and equitable. As we have said, assets cannot be collected; claims cannot be enforced; debtors cannot be restrained from wasteful or unconscionable practices; leverage cannot be placed in the hands of creditors; priorities of creditors cannot be enforced, as in domestic bankruptcies or receivership.

The domain for regulation and control is largely restricted to the actual or purported representatives of creditors. The control is accordingly for the most part unilateral, though we will suggest a measure which might be taken to curb one type of extravagant practice of debtors. It will thus of necessity fall short of the desirable objectives. Nevertheless it can represent an advance over the chaotic and oppressive condition which exists today. That program of control should be designed to deal separately with (1) committees or similar representatives; (2) a central authoritative agency such as the Foreign Bondholders Protective Council, Inc.; and (3) certain practices of the debtors which may in a measure be restrained.

#### A. COMMITTEES

It would be dubious wisdom to prevent or place undue restraint on the formation of all committees in this field. The vices and weaknesses of committees should be dealt with directly and thoroughly. But a place in the system should not be denied them. Despite obvious defects that have attended their operations they have served and can continue to serve useful functions; certainly in this stage of development of techniques for handling these default situations. Indeed committees composed of owners or representatives of owners of foreign bonds should be encouraged. As negotiators of plans, committees by and large cannot be expected to function as effectively as a central authoritative agency. In this respect their effectiveness usually is to be found in cooperation with such an agency as the Council. But limited as their role may be, they may usefully perform functions that may not be undertaken by any other agency. Among these are affording investors some measure of protection against loss of their fraud and rescission rights against houses of issue, and supplying some vigilance against excessive practices by short term creditors in receiving preferences of their claims. The first of these is an important and valuable service to individual bondholders. The second is a general service to the entire class or classes of bondholders. Though no committee or other agency has any real sanction or power to prevent preferential treatment to short term creditors, nevertheless the vigilance and determination of any such agency can carry weight and persuasion as deterrents to excessive practices. Admittedly a central authoritative agency if committed to such programs and actually vigilant in pursuing them could be more effective in view of its greater resources, skill, prestige and standing. But absent that, committees can to some extent perform the desired functions.

But the importance of committees transcends these matters of fraud and rescission claims and preferential treatment of short term

creditors. If truly independent, they will supply to an extent a valuable conditioning influence on other agencies operating in the field, *e. g.*, houses of issue, fiscal agents, trustees under indentures or perhaps even a central authoritative agency. No possible method exists for legislating competency, ability, honesty and integrity. The foreign field (like the domestic) abounds with examples of greed, overreaching and excessive practices. No matter how nicely adjusted is the system of control, it may be expected that many of these practices and conditions will recur. Whether it be a weakness in a central authoritative agency, excessive practices of fiscal agents or trustees, greed of houses of issue, an independent committee which exposes it will be serving a useful function. The inherent weakness in any complete monopoly in this field is that such matters might go unnoticed and unheralded. Investors would be helpless in face of such a condition, as there is no forum where their claims can be pressed and given sanction. Independent committees can thus serve as a balance in the system. Inferior though they undoubtedly will be in negotiating debt adjustments, they, like minorities in other reorganization situations, can supply a check on those in a dominant position.

That is not to say that they have been or are above reproach. On the contrary, frequently driven by the profit motive, they have too commonly presented the sorry spectacle of entrepreneurial fiduciaries bent more on personal gain than anything else. Likewise they have frequently been invested with powers which no fiduciaries should exercise unrestrained. And furthermore they have at times been in the extremely vulnerable position of representing materially adverse interests. Hence to make more certain that their proper functions will be adequately performed the following measures should be taken to govern all committees undertaking to represent bondholders in these foreign default situations:

#### 1. PERSONNEL OF COMMITTEES

a. Houses of issue should be disqualified from being represented on committees, not only by reason of their potential or actual liability for fraud or rescission claims but also because they frequently have other conflicting interests abroad or other relations with the debtor, which history and experience demonstrate will be served before the interests of bondholders. This is not to say that houses of issue should be freed from their "moral obligation" to afford security holders protection and service in times of default. This can be done at times by consultation with committees and others, such as a central authoritative agency like the Council; and by lending their good offices and by giving their expert advice in these default

situations to such representatives of the security holders. The disqualification to act should extend only to situations where the houses of issue move into a fiduciary or representative relation to the security holders by direct or indirect representation in committees. The experience and technical knowledge of the houses of issue could thus be effectively utilized and preserved rather than lost. But they would occupy a subservient instead of a dominant place in the system.

b. Fiscal agents of the debtor should be disqualified from being represented on committees.

c. All short term creditors; and holders of commercial credits, and others with property or commercial interests in the debtor country which, by reason of their nature or amount, conflict or are likely to conflict with the interests of bondholders, should be disqualified from being represented on committees.

d. The foregoing disqualifications should be sufficiently broad as to cover those who have been an officer or director, within a reasonable period preceding their membership on the committee, of any such person.

e. Attorneys, who, by reason of their prior or present connection with or relationship to the debtor, the fiscal agents, the houses of issue, short term creditors, or others with property or commercial interests in the debtor country, have or are likely to have conflicting loyalties, should be disqualified from representing committees for bondholders.

f. Committees should be barred from being financed by those who would be disqualified from serving on committees.

## 2. PROXIES AND DEPOSIT AGREEMENTS

a. The use of deposit agreements in the foreign field should be greatly restricted, and allowed only on a showing of conditions which make their use desirable or necessary in the interests of investors. Such conditions will be rare. If used, these agreements should be drastically limited in purpose and effect. Powers of committees over depositors should be vastly curtailed; freedom of withdrawal should be permitted. In effect, extortionate and oppressive practices of committees made possible by the conventional deposit agreement should hereafter be eliminated.

b. Control over proxies and powers of attorney should be provided, so as to avoid oppressive powers and grants of authority both unnecessary and inappropriate in the public interest and for the protection of investors.

## 3. SUPERVISION OVER ACTIVITIES OF COMMITTEES

a. Fees and expenses of committees should be subject to independent scrutiny, review and determination.

b. Trading in the securities by committee members, secretaries, counsel, and their affiliated interests should be prohibited.

c. Committees should no longer be the sole arbiters of the time when bondholders may deposit or withdraw their bonds. Nor should they be allowed to determine the amount of assessments or penalties to be imposed on depositors for the privilege of withdrawing. Nor should they be allowed to determine arbitrarily who may and who may not share in the benefits of a plan. Control over deposit agreements and proxies should be sufficiently pervasive so as to provide independent review and determination of these matters. This is essential in the interests of minorities who, as we have seen, have been oppressed by unconscionable practices of those who control the committee.

Committees measuring up to these high fiduciary standards might then well receive the cooperation of a central authoritative agency like the Council under whose leadership negotiation of debt settlements can by and large more effectively be made.

### B. CENTRAL AUTHORITATIVE AGENCY

As we have indicated, there is a necessary and appropriate place in the foreign field for a central authoritative agency. The necessity for one not only finds support in the experience of other countries; it is amply borne out by the record of the last decade in this country. And, as we have stated, such an agency may be expected to carry the brunt of the burden of protecting American investors in these default situations. Its prestige and standing will at times give it a virtual monopoly in negotiation of debt settlements. Eventually it may even preempt the entire field. The necessities of that situation makes insistent that such an agency be above reproach, be freed from all likely conflicting loyalties, and be wholly and truly independent of those influences which would retard or deter it in being vigilant and aggressive in protection of the interests of American bondholders.

In our judgment the Corporation of Foreign Security Holders, envisioned by Title II of the Securities Act of 1933, would not be the most appropriate central agency. The reasons therefor are set forth above and need not be repeated here. In our opinion the appropriate permanent agency is found in the Foreign Bondholders Protective Council, Incorporated.

The Council was organized at the suggestion and on the initiative of the Government. During its existence it has shown a record of constructive endeavor despite limitations and handicaps. It has functioned economically; it has been free of entrepreneurial influences; and it has brought about a resumption of debt service on a number of defaulted issues. It has maintained a quasi-public character, and those who have served as directors and members of its executive committee have not been actuated by mercenary motives but by a sense of public service. It should be recalled that upon its organization the Council was faced with an overwhelming task. Defaults were so numerous, as a result of the severity of the world wide depression, that the skill and ingenuity of even a well established agency of this sort would have been taxed. The task confronting the Council was doubly difficult, not only because it was starting *de novo*, but also because this country was not rich in the experience necessary for deft and effective handling of such default situations. Furthermore, the Council's policies and activities have necessarily had to be consistent with the policies and requirements of our national Government as to our relations with foreign countries. It has not been part of that policy to employ armed forces for debt collection or to utilize other oppressive sanctions against the defaulting government. The sound reasons for that policy have been set forth in this report; there is no need to repeat them at this point. But it results that the Council has had to proceed by powers of persuasion and inducement, often informally encouraged and supported by the State Department, in its endeavor to induce defaulting debtors to treat American bondholders fairly and without discrimination. In a more normal period such powers might be wholly sufficient for handling defaulted loans with efficiency and dispatch. But the past few years have witnessed the breach of international covenants, both private and public, on a wide scale. Default on loan contracts has been one manifestation of an attitude among many nations that international agreements could easily be broken. The effect has been to create an atmosphere in which the difficulties of the Council in persuading foreign governments to readjust their defaults and to renew debt service have been increased.

The accomplishments of the Council, as well as certain aspects of the Council's organization and procedure which we believe require improvement, have been described in the foregoing pages. We believe that despite protests which unfriendly critics have made, the firm foundations of the Council should be enlarged in building constructively an organization which may serve the interests of American investors in a manner consistent with the highest traditions of public service. The changes in the operation and constitution of the

Council which, in our judgment, should be made toward that objective embrace the following:

1. One of the basic problems of the Council is its financing. It originally accepted contributions principally from houses of issue and short term creditors. About three-fifths of its funds have come from houses of issue. This is undesirable, for the reasons we have stated. Accordingly, methods should be found for immediate financing of the Council from wholly disinterested sources. It may be that funds can be found from wholly independent sources. Thus some private foundation might be interested in such financing. That course seems the desirable one provided the Council can be assured of its complete independence. Our suggestion is that the Council be given adequate opportunity to exhaust this possibility.

If within a reasonably short period such funds are not made available, funds from some governmental agency should then be provided. These funds should not be contributed as donations or gifts; they should be loaned on easy and convenient terms with the full expectation, as seems reasonable, that they will be repaid over a term of years. The annual budget of the Council approximates \$100,000. That agency should be authorized to advance to the Council, as a loan, a maximum of \$150,000 a year for the next four fiscal years and \$100,000 a year for four years thereafter. A larger annual budget for the years which lie immediately ahead would enable it to render a larger service to investors. These funds would make the Council financially independent of houses of issue, short term creditors and other similar influences. The Council would thus be freed from any actual or ostensible entangling alliances with those whose interests do not lie with the bondholders. Given a term of years not exceeding eight, the Council by virtue of contributions from bondholders under debt readjustment plans and of contributions by foreign debtors, should be able to accumulate a reserve fund adequate for its purposes and perhaps begin repayment of the loan.

There are other matters equally important from the viewpoint of the public interest, the interest of American investors and the Council itself. These relate to the constitution, practices, and policies of the Council.

2. We think that a more appropriate and effective organization will be provided if the Council amends its certificate of incorporation (or the Council reincorporates) so that its charter contains the following restrictions or limitations:

a. The board of directors should be reconstituted so as to provide a small working body of men who could act

truly as an advisory group to the executive committee and could supervise its activities. Individuals unable or unwilling to assume an active role in the life of the Council should not be elected to its directorate. If the Council needs a larger number of consultants, arrangements should be made other than by electing them members of the board.

b. Fiscal agents, houses of issue, short term creditors, holders of commercial credits or property interests abroad, and brokers and dealers, together with attorneys for these interests, should be disqualified from being, or from being represented directly or indirectly, on the board of executive committee or from being members of the Council. This would include disqualification of members, directors, or members of the executive committee who are employees, officers, directors, nominees or agents of anyone who is directly disqualified. The disqualification should be sufficiently broad as to cover those who, within a reasonable period preceding their election, had been an officer, director or partner of any such person.

c. Maximum salaries or fees payable to directors or officers of the Council should be set.

d. The Council should be required to publish at least annual financial statements disclosing its receipts, disbursements, assets and liabilities.

e. The amount of funds received by the Council from foreign countries or from bondholders in connection with a debt readjustment plan should be subjected to independent scrutiny and review.

3. The standards for qualification of members of the Council's committees should, of course, conform to those which from time to time may be required of all other committees in the foreign field. The prohibitions, limitations, and restrictions on the use of deposit agreements or proxies should likewise be applicable to the Council's committees, if these committees employ them at any time. In other words, the Council's committees should be subject to the same supervision and control as other committees in the foreign field.

4. In order to measure up to the exacting standards of a central authoritative agency, which is vigilant and aggressive in its representation of the interests of American bondholders, the Council should broaden its program of policy and action so as to bring within its sphere of activity and concern preservation to bondholders of all their rights, including protection of bondholders against preferences commonly obtained by short term creditors and a consideration of the enforcement (directly or through other means) of fraud and rescission claims. Elimination from the Council of houses of issue and short term creditors is a first (and necessary) step in this direction.

The foregoing matters do no more than to suggest in broad outline the manner in which such a central authoritative agency as the

Council should be organized and operated. They are no guarantee of future efficiency and vigilance. The Council will remain a self-perpetuating body with all the risks which that implies. But these changes will provide better assurance that the Council will develop in the strong tradition of vigorous and loyal prosecution of the interests of American bondholders. This of course will provide necessary minimum assurance to the Government (always an interested party) that the fate of its nationals is in proper hands. The Council under these safeguards and subject to the indirect and informal conditioning of the State Department should develop a tradition of loyal and efficient service which will bring deep respect and confidence at home and abroad.

### C. THE DEBTOR

As we have indicated, no jurisdiction over the debtor is available. Nevertheless certain practices of the debtor can be substantially curtailed.

1. Some measures can be taken to curb repatriation of defaulted bonds. As we have seen the practice of using funds available for debt service to repatriate defaulted bonds has been vicious from the viewpoint of American investors. No perfect system of prevention can probably be designed. But some sanctions can be applied against brokers, dealers and others who purchase or participate in the purchase, as principal, agent, delivering or forwarding agent, or otherwise, knowing or having reasonable cause to believe that such defaulted security is acquired, directly or indirectly by the foreign government, its agent, or any person domiciled or residing in its territory.

An effective sanction against such practices would make it less likely that a foreign debtor would default and use funds, otherwise available for debt service, to purchase the bonds at prices depressed as a consequence of its default.

2. The unilateral plan, with all of its unconscionable characteristics, cannot readily be outlawed or controlled at present. It may be feasible at a future time to apply sanctions against solicitation of assents to plans except and unless those plans are approved by duly qualified agencies in this country. But such a control necessarily awaits among other things the development of the comprehensive program recommended above.

### D. FUTURE FOREIGN LOANS

The national policy regarding the sale in this country of securities of foreign governmental issuers, the restrictions and conditions on

such sales, and the provisions of loan contracts, which are necessary and appropriate in the public interest and for protection of investors are not within the purview of this report. One aspect of that matter, however, has a rather direct bearing on the functioning and financing of a central authoritative agency which acts for American investors when these foreign loans default. It deserves special notice here.

No matter how free from fraud and overreaching foreign loans may be it is to be expected that there will be a certain percentage of defaults in years to come. That is but a normal consequence of depressions and of selfish interests of foreign debtors. Since that is predictable, consideration should be given towards making adequate provision in future loans for financing the cost of protecting American investors in the event of default. That is to say, the underwriters might be required in case of future loans to deduct from their gross fees and commissions and to pay over to a reserve fund in the government a sum which would be available to a qualified central authoritative agency for the purpose of defraying at least part of the cost of protecting that or other similar loans in periods of default. The amount to be paid on each issue cannot be accurately adjusted to the probable risk of default. But a step in that direction might be taken by fixing the amount at a stated percentage of the gross fees or commissions of the underwriters of the loan. Accordingly, in all future foreign loans the underwriters might be required to pay into such a reserve fund a sum equal to a small percentage of their gross fees and commissions. The amounts so paid into this reserve fund could be pooled for use in case of a default on the issue in question or on any other foreign issue. If this system were followed, funds would be provided in advance for the costs of readjusting future defaults. From the viewpoint of American investors this seems just and equitable. From the long range point of view it would provide the representatives of American bondholders with the funds necessary for their efficient and effective activity in times of default. Insofar as those funds would be available to the Council they would materially assist it in becoming financially independent.

## APPENDIX A

## THE BRITISH CORPORATION OF FOREIGN BONDHOLDERS

I. CORPORATION OF FOREIGN BONDHOLDERS ACT.  
[61 & 62 VICT.] *Corporation of* [Ch. cxlix.]  
*Foreign Bondholders Act, 1898.*



## CHAPTER cxlix.

An Act to reconstitute the Corporation of Foreign Bondholders. A.D. 1898.  
[25th July 1898.]

**W**HEREAS by licence dated the 1st day of August 1873 under the hand of the secretary of the Board of Trade after reciting that it had been proved to the Board of Trade that the Corporation of Foreign Bondholders which was about to be registered under the Companies Acts 1862 and 1867 as an association limited by guarantee was for the purpose of promoting the objects of the nature contemplated by the 23rd section of the last-mentioned Act and that it was the intention that the income and property of the association whencesoever derived should be applied solely towards the promotion of the objects of the association as set forth in the memorandum of association of the said Corporation and that no portion thereof should be paid or transferred directly or indirectly by way of dividend or bonus or otherwise howsoever by way of profit to the persons who at any time were or should have been members of the said Corporation or to any of them or to any person claiming through any of them the Board of Trade in pursuance of the powers in them vested and in consideration of the provisions and subject to the conditions contained in the memorandum of association of the said Corporation as subscribed by eight members thereof on the 30th day of July 1873 thereby directed the Corporation of Foreign Bondholders to be registered with limited liability without the addition of the word "Limited" to its name :

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And whereas the said Corporation of Foreign Bondholders was on the same 1st day of August 1873 duly incorporated under the Companies Acts 1862 and 1867 the word "Limited" being omitted pursuant to the said licence:

And whereas the objects of the said Corporation are by its memorandum of association declared to be (inter alia) (a) Watching over and protecting the rights of the holders of bonds obligations debentures and other securities of a similar character issued by or on behalf of foreign and colonial governments states provinces municipalities and public companies (c) Adopting measures in case of default of payment of any principal or interest or of any breach of any condition of any foreign loan for the protection and vindication of the rights of the bondholders (h) Giving support and rendering assistance to measures and enterprises calculated to maintain and promote public credit and benefit the holders of foreign bonds and (k) Doing all such other things as are incidental or conducive to the attainment of the above objects:

And whereas the said memorandum of association provides that the members of the Corporation should be of three classes viz. 1. Permanent members whose qualification was the payment to the Corporation of one hundred pounds 2. Life members and 3. Subscribing members and that the contributions of the permanent members should be treated as loans to the Corporation repayable with interest at the rate of five per cent. per annum but only when and as the Corporation should determine:

And whereas paragraph 5 of the said memorandum of association provides that the property and income of the Corporation from whatever source derived shall be applied solely towards the promotion of the objects of the Corporation as set forth in the memorandum of association and that no portion thereof shall be paid or transferred directly or indirectly by way of dividend bonus or otherwise howsoever by way of profit to the persons who at any time are or have been members of the Corporation or to any of them or to any person claiming through any of them But it shall nevertheless be competent to the Corporation to repay the contributions of the permanent members with interest at the

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rate of five per cent. per annum and also to remunerate any committees agents legal advisers officers and servants of the Corporation or any members of the Corporation or other persons for any services actually rendered to the Corporation and also to exercise powers of borrowing money And paragraph 6 declares that the fifth paragraph qualified as aforesaid was a condition on which the said licence was granted by the Board of Trade and that on breach thereof by the Corporation the liability of the members of the council of the Corporation and of every member of the Corporation receiving any such dividend bonus or other profit as aforesaid should be unlimited:

And whereas the management of the business and direction and control of the said Corporation was by its articles of association (Article 46) vested in a council consisting (Article 33) of not exceeding thirty members:

And whereas the capital fund of the Corporation was provided by various persons contributing sums of one hundred pounds each to the Corporation and becoming permanent members thereof:

And whereas the business and operations of the Corporation have been and are still being carried on with great advantage to the English holders of foreign securities and to the public at large:

And whereas the whole of the contributions of the permanent members of the Corporation have been repaid out of the accumulated funds of the Corporation either with interest at five per cent. per annum or in some cases without interest where the members have accepted less than the full amount in discharge thereof but no portion of the property or income of the Corporation has been paid or transferred directly or indirectly by way of dividend bonus or otherwise howsoever by way of profit to the persons who are or at any time have been members of the Corporation or to any of them or to any person claiming through any of them There are five life members but there are no subscribing members of the Corporation:

And whereas the accumulated funds and property of the Corporation (after repayment of the contributions of the permanent members) amounted in value at the 31st day of December 1896 to £100,000 or thereabouts as appears by the balance sheet of the Corporation at that date:

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And whereas the original capital fund of the Corporation was mainly subscribed and the Corporation was established by persons who were holders of or otherwise interested in foreign securities and such persons became the permanent members of the Corporation but by the lapse of time deaths of parties changes of interest and other causes the permanent membership of the Corporation has to a considerable extent passed into the hands of persons who are not now directly interested in foreign securities or in the work of the Corporation or the objects for which it was established :

And whereas it is desirable to secure that the Corporation should in the future more directly and exclusively represent the interests of the holders of foreign and other public securities and that the application of the accumulated funds and property of the Corporation to the public objects for which it was constituted should be further safeguarded and the possibility of the voluntary winding-up of the Corporation and the distribution of its surplus funds amongst its members prevented and that with these objects the existing Corporation should be dissolved and a new Corporation established and that the objects and scope of the Corporation should be enlarged :

And whereas these objects cannot be attained without the authority of Parliament :

May it therefore please Your Majesty that it may be enacted and be it enacted by the Queen's most Excellent Majesty by and with the advice and consent of the Lords Spiritual and Temporal and Commons in this present Parliament assembled and by the authority of the same as follows :—

Short title. 1. This Act may be cited as the Corporation of Foreign Bondholders Act 1898.

Dissolution of existing Corporation. 2. The Corporation of Foreign Bondholders (in this Act hereafter referred to as "the old Corporation") shall be and is hereby dissolved.

Incorporation of new Corporation of Foreign Bondholders. 3. The Right Honourable Sir John Lubbock Baronet The Right Honourable Sir Edward Thornton The Right Honourable Sir Mountstuart Elphinstone Grant Duff The Right Honourable William Lawrie Jackson The Honourable Sir Charles William Fremantle The Right Honourable William Lidderdale Sir Henry Whatley Tyler,

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General Sir John Luther Vaughan His Honour Judge Thomas William Snagge Admiral Edward Field Charles Edward Barnett William Henry Bishop Edward Oliver Pleydell Bouverie Walter Randolph Farquhar Henry Riversdale Grenfell William Rolle Malcolm Richard Biddulph Martin John Wynford Philipps Cornelius Sursey William Trotter and Andrew Kinsman Hichens and other the persons who shall for the time being constitute the council or governing body of the Corporation as in this Act provided shall be and are hereby incorporated by the name and designation of "The Corporation of Foreign Bondholders" with perpetual succession and a common seal with power to hold lands and to sue and be sued in its corporate name and with the further powers conferred and subject to the conditions imposed by this Act.

4.—(1) The objects and scope of the Corporation are—

- Objects and scope of Corporation.
- (a) To watch over and protect the rights and interests of holders of public securities wherever issued but especially of foreign and colonial securities issued in the United Kingdom :
  - (b) To collect and preserve documents statistics reports and information of all kinds in respect of public securities and publish circulate and render available the same in a readily accessible form :
  - (c) To adopt measures for the protection vindication and preservation or reservation of the rights and interests of holders of public securities either on any default in or on breach or contemplated breach of the conditions on which such public securities may have been issued or otherwise and to obtain for such holders such legal and other assistance and advice as the Corporation may deem expedient :
  - (d) To negotiate and carry out or assist in negotiating and carrying out arrangements for the resumption of payments in respect of any public securities in default or re-arranging the terms on which such securities may in future be held or for converting or exchanging the same for new securities or for any other object in relation

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- thereto and for the purpose of effectively representing the holders of public securities or otherwise to invite the deposit and undertake the custody of such public securities and to issue receipts or certificates of the Corporation in the place of securities so deposited :
- (e) To undertake and carry out or superintend assist and take part in the conversion or exchange of public securities under any arrangement made with regard thereto or otherwise :
- (f) To undertake superintend or take part in the collection and application of revenues and funds appropriated to the service of public securities and in relation thereto or otherwise to draw accept endorse and negotiate bills of exchange and negotiable instruments :
- (g) To convene meetings of holders of public securities for the purpose of concerting with them the requisite measures to be adopted and to appoint committees to act on their behalf in conjunction with the Corporation or otherwise :
- (h) To organise equip despatch and appoint missions delegates and representatives to and in any part of the world with a view to carrying out and effectuating any of the objects or purposes of the Corporation and to provide for or contribute towards the expenses of any missions agents or representatives appointed by the Corporation or others for the purposes aforesaid or otherwise :
- (i) Generally for the purposes aforesaid or otherwise to act in the name and on behalf of the holders of public securities the care or representation of whose interests shall be entrusted to the Corporation :
- (j) To take such steps as may be deemed expedient with the view of securing the adoption of clear and simple forms of public securities and just and sound principles in the conditions and terms thereof :
- (k) To render assistance to and support measures and enterprises calculated to maintain and promote public credit and to benefit the holders of public securities and promote or concur in the promotion of Bills for obtaining any statutory or

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- other enactment with that object and to oppose any Bills or measures which the Corporation may deem calculated to prejudice that object :
- (l) To subscribe to or take any share or interest in or lend money to any other company society or association whether for profit or not carrying on or intending to carry on any similar or analogous objects :
- (m) To employ retain and pay agents in any part of the world :
- (n) To invest the funds of the Corporation on any securities and vary the investments from time to time and to purchase take on lease or hire sell let and turn to account any real or leasehold property required or deemed expedient for the purposes of the Corporation :
- (o) To borrow or raise money for any of the purposes or objects of the Corporation and in any mode and to mortgage charge or pledge any of the property of the Corporation as security for the same :
- (p) To apply to Parliament for any variation or extension of the objects or constitution of the Corporation :
- (q) To do all such other things as are incidental or conducive to the attainment of the above objects and to employ or expend the funds and property of the Corporation in carrying out such objects.

(2) The expression " public securities " in this section and in the First Schedule to this Act includes bonds debentures obligations annuities rentes stock shares and other securities of all kinds of or issued or guaranteed by governments states colonies provinces cities municipalities public bodies local and other authorities commissioners boards corporations companies and associations whether incorporated or not.

Interpretation of " public securities."

5. All the assets property and rights of the old Corporation shall be and are hereby vested in the Corporation and such Corporation shall pay undertake and shall be bound by and be liable for all the debts liabilities engagements contracts and obligations of the Corporation.

Vesting in new Corporation assets and liabilities of old Corporation.

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A.D. 1898. — old Corporation in the place and in discharge of the old Corporation and may sue and be sued in respect thereof.

Management of Corporation vested in a council—Appointment &c. of members.

6.—(1) The control and management of the business and operations of the Corporation shall be vested in a council consisting of twenty-one members (with power to increase to not exceeding thirty as hereafter provided) seven of whom shall retire at the second quarterly meeting of the Council in 1899 and in each subsequent year but shall continue in office until the conclusion of the meeting at which the appointment of their successors shall be made or notified as the case may be as herein-after provided. The members to retire in each year shall be those who have been longest in office except in the case of the members of the first council whose order of retirement shall in default of agreement among themselves be determined by ballot.

(2) The places of the seven members of the council retiring in each year by rotation as aforesaid shall be filled up in the following manner:—

(a) Two members shall be appointed by the Central Association of Bankers of London:

(b) Two members shall be appointed by the London Chamber of Commerce:

(c) Three members shall be appointed by the said council and of such three members two at least shall be persons who at or before the time of their election shall have respectively proved to the satisfaction of the said council that they are the bonâ fide holders of foreign bonds to the nominal amount of five thousand pounds.

(3) On any member so appointed vacating office either at the expiration of his term of office or previously thereto his successor shall be appointed by the party with whom the original appointment rested. Any member appointed in the place of a member vacating office prior to the date fixed for his retirement shall as to retirement by rotation stand in the place of the vacating member.

(4) On any member of the council whose appointment does not rest with the council vacating office the secretary of the Corporation (and in case of the yearly appointments at least fourteen days before the date of the quarterly meeting of the council at which the

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vacating members are to retire) shall give notice in writing to the party with whom the appointment rests requesting such party to make the appointment and notify the same to the Corporation within fourteen days and if such appointment is not made or is not so notified within that time the council may at any time before such appointment shall be notified fill the vacancy by the appointment of a member who as to period of office and re-appointment shall be deemed to be the nominee of the party with whom the appointment originally rested.

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(5) A retiring member shall be eligible for re-election and if retiring by rotation shall be deemed to offer himself for re-election unless he gives to the council notice of a contrary intention.

(6) The first council shall consist of the persons named in section 3 of this Act seven of whom shall retire at the second quarterly meeting of the council in 1899 seven others at that in 1900 and the remaining seven at that in 1901 and on any such member vacating office prior to the date fixed for his retirement the council may fill the vacancy by the appointment of a member who as to retirement by rotation shall stand in the place of the vacating member.

(7) Whenever the number of the members of the council is below thirty the council may appoint any extraordinary or additional members up to that number and may determine the period for which they shall respectively hold office. All such extraordinary or additional members shall be subject to the general provisions of this Act applicable to ordinary members of the council.

7.—(1) A member of the council shall vacate his office—

Vacation of office &c.

(a) On the expiration of his term of office:

(b) If he resigns his office by notice in writing to the council:

(c) If being interested directly or indirectly in any contract or transaction with the Corporation he fails to declare such interest to the council (unless his name appears in connexion therewith) prior to or when such transaction is considered by the council and no member so

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interested shall in any case vote thereon but having declared such interest the member so interested shall not be bound to account for any profit accruing to him therefrom :

- (d) If he becomes bankrupt or enters into any arrangement or composition with or applies for protection against his creditors or is declared lunatic or becomes of unsound mind or is convicted of felony :
- (e) If he shall not attend any meeting of the council or any committee of the council for a consecutive period of six months and the council resolve that his office is vacated :
- (f) If the council shall at a meeting specially convened for that purpose by resolution passed by a majority of at least three fourths of the whole of the members of the council remove such member from office. The member whom it is proposed to remove shall have seven days clear notice sent to him of such meeting and he may attend the meeting but shall not be entitled to be present at the voting or take part in the proceedings otherwise than as the council may allow.

(2) Provided always that no resolution of the council shall be invalidated by reason of any disqualified members having taken part therein or voted thereon and all acts done in good faith by the council or by the persons acting as members thereof shall be valid for all purposes notwithstanding any invalidity in their appointment or any disability in acting on the council be afterwards discovered.

(3) The members of the council if constituting a quorum may act notwithstanding any vacancy in their number and if by any means the number of members should at any time be reduced below that required for a quorum of the council the remaining member or members may exercise the powers of filling up vacancies given to the council by subsections (3) and (4) of section 6.

Powers &c.  
of council.

8.—(1) The council may exercise all the powers of the Corporation within the objects and scope of the Corporation declared by this Act.

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Foreign Bondholders Act, 1898.

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(2) The council may out of the surplus funds and property of the Corporation after providing for its liabilities remunerate the members of the council for the conduct of the ordinary business of the Corporation in such manner as the council may determine. Provided that such remuneration shall not without the sanction of the Board of Trade exceed in any one year the sum of one thousand five hundred pounds in respect of the president or president and vice-president and one hundred pounds in respect of each member of the council exclusive of any remuneration for special missions undertaken or special services rendered and of any remuneration in which any such member may participate as a member of any special committee of the holders of public securities acting in conjunction with the council. The aggregate of the sums payable in respect of the ordinary remuneration of the council shall be divided amongst the members as the council may determine.

9. The regulations contained in the First Schedule to this Act or such other regulations varying or supplementing the same for like or analogous purposes as may from time to time be made by the council with the approval of the parties in whom a right of appointment of members of council is vested or in case of difference shall be settled by the Board of Trade shall govern and regulate the summoning of meetings of the council and the procedure thereat and the keeping and auditing of the accounts of the Corporation and other matters referred to in such schedule.

Regulations  
in First  
Schedule.

10. The Council shall in each year commencing in the year 1899 out of the available funds and property of the Corporation appropriate such a sum not being less than two thousand pounds as they think fit and apply the same in manner prescribed in the Second Schedule hereto. Such appropriation shall be made at the second quarterly meeting of the council in each year.

Appropriation for  
payments  
to members  
of old Corporation.

11.—(1) All the property and income of the Corporation from whatever source derived shall be applied solely towards the promotion of the objects and purposes of the Corporation and except as authorised by this Act no portion thereof shall be paid or transferred directly or indirectly to the persons who at any time are or have been members of the Corporation or of the

Property  
and income  
of Corporation to  
be applied  
exclusively  
as authorised  
by this Act.

[Ch. cxlix.] *Corporation of* [61 & 62 Vict.]  
*Foreign Bondholders Act, 1898.*

A.D. 1898. — old Corporation or to any of them or to any person claiming through any of them and any contravention or attempted or contemplated contravention of this section may be restrained at the suit of any member of the council or of any member of the old Corporation at the passing of this Act as well as any other person by law entitled to sue for such purpose.

(2) If the Corporation acts in contravention of the provisions of this section every member of the council of the Corporation who shall be party or privy to such contravention and every member of the Corporation or of the old Corporation who shall have received except as authorised by this Act any part of the property or income of the Corporation shall be liable to account for and return any property or income so received and further shall be responsible for the whole of the liabilities of the Corporation.

(3) Except in the case provided for by the last preceding subsection no member of the Corporation or of the old Corporation shall be in any way personally responsible for the debts liabilities or engagements of the Corporation.

Application of surplus funds on winding-up after payment of old members according to scheme sanctioned by Board of Trade.

12. On any winding-up of the Corporation the surplus assets of the Corporation after discharge of its liabilities shall be applied first in payment of fifty pounds to each permanent member of the old Corporation at the passing of this Act his representatives or assigns who shall not have received payment under the provisions of section 10 and subject thereto such surplus assets shall be devoted to the objects or some of them or to objects similar or analogous to those or some of those for which the Corporation is established by this Act in accordance with a scheme which shall be settled or sanctioned by the Board of Trade with power to such Board from time to time to vary or amend such scheme as such Board may deem expedient.

Expenses of Act.

13. The expenses of this Act shall be paid out of the funds of the Corporation.

II. RULES AND REGULATIONS OF THE COUNCIL OF THE CORPORATION.

FIRST SCHEDULE

REGULATIONS REFERRED TO IN SECTION 9 [OF THE ACT].

1.—MEETINGS AND PROCEEDINGS OF THE COUNCIL AND COMMITTEES OF THE COUNCIL, &c.

1.—Meetings of the Council shall be held at such time and place, and may be adjourned, and shall be regulated as the Council may from time to time determine. A quarterly Meeting of the Council shall be held in the months of January, April, July, and October in each year. No notice shall be necessary of Council Meetings fixed by resolution of the Council to be held on stated days.

2.—The Council shall elect a President, and may elect a Vice-President of the Corporation, and determine the period for which they shall respectively hold office.

3.—The President, or, if absent, the Vice-President, if any, shall preside at every Meeting of the Council. If neither is present the Members present shall elect a Chairman of the Meeting.

4.—The President or Vice-President may at any time summon a Meeting of the Council, to be held at the office of the Corporation or other usual place of meeting, on giving such notice to the Members by post or otherwise as he shall think fit. Any two other Members of the Council or the Secretary may convene a Meeting of the Council on three clear days' notice. The first Meeting of the first Council shall be held within one month after the passing of this Act, and may be summoned by the Right Hon. Sir John Lubbock, or in default of him during such month, by any two other Members of such Council.

5.—Notice to Members for the time being out of the United Kingdom shall not be necessary to constitute a valid Meeting of the Council for the transaction of business: