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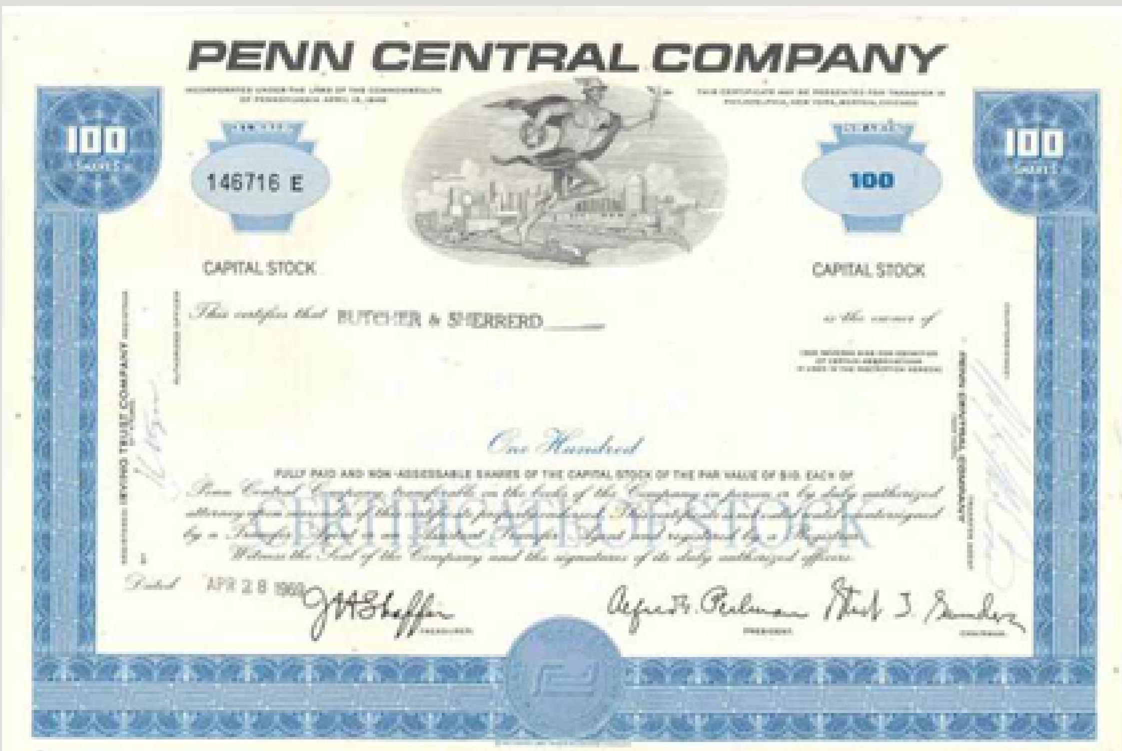

DONALD PRELL

The Untold Story of the Survival of the Penn Central Company

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Foreword

The story you are about to read is factual from start to finish. The people are real, their names are given in full. You could question the ethics of what transpired. Did the means justify the end? You will decide. It is titled an '*Untold Story*' because, other than a few numbered copies previously published, how the Penn Central Company was saved from having to be liquidated has not been known. Now through the medium of eBook publishing the story is no longer the sole provenance of a few collectors of Penn Central memorabilia.

Merge then Collapse

Even on Wall Street one's memory can be short-lived. ENRON and WorldCom have been described as America's largest bankruptcies. But few can name another, which in current dollars, was almost as large as the ENRON and WorldCom debacles.

Players of MONOPOLY will recall the value of controlling the railroads, with The Pennsylvania Railroad one of the historic four. (An interesting footnote is: in depression-ridden 1935, the firm of Parker Brothers was itself near bankruptcy, when it reluctantly acquired then marketed MONOPOLY. The board game became an instant bestseller, both in America and abroad.)

Almost four decades ago, in 1968, the management of the New York Central Railroad Company were playing real life MONOPOLY with their repeated and ultimately successful attempt to merge with The Pennsylvania Company. In

1971 two top-notch reporters on the editorial staff of the Philadelphia *Bulletin*, Joseph R. Daughen and Peter Binzen, wrote a best-seller called *The Wreck of the Penn Central*. The book jacket describes it thus:

> *"One cold winter's day, after more than ten years of fighting, bargaining, and negotiating, the New York Central and Pennsylvania railroads merged to form the most monumental single railroad in the history of the United States: the Penn Central, a railroad worth $4.5 billion with over 20,000 miles of track, 95,000 employees, and an annual payroll of over $1 billion. The date of this merger: February 1,1968.*
>
> *On June 21, 1970, only 867 days later, with a sickening crash that jarred not only Wall Street but the government and the whole national economy, the Penn Central went broke. The largest single railroad became the largest single bankruptcy in the history of the United States*

The directors of Penn Central Company, after being informed there was insufficient cash to operate the railroad, chose to file a petition for reorganization under Section 77 of the Bankruptcy Act, and thereby put its wholly owned subsidiary, the Penn Central Transportation Company, into bankruptcy. Section 77 of the Bankruptcy Act permitted a railroad to suspend most of its debts. The Section, adopted by Congress in 1933, was drawn specifically to cover railroads that found themselves in bankruptcy situations. Unlike ordinary bankruptcies, Section 77 did not provide for liquidation. It was a means for railroads to reorganize while the trains kept running.

The share price of the Penn Central Company – just as in the case of ENRON - had been in free-fall, dropping from a high of $86.50 to a low of $6.50, on the day the bankruptcy was announced. The next day the stock closed at $4.50. Authors Daughen and Binzen concluded their story with the bankruptcy of the Transportation Company. Yet the holding company continued operating.

Putting its major subsidiary into bankruptcy preserved the major asset of the Penn Central, but now, working capital was needed to pay expenses in order to maintain the value of the parent company's publicly traded shares.

Through the Swiss based investment-banking firm of Pressprich & Co. the Penn Central Company sold $24,000,000 of short-term notes (12% rate) to a number of banks and individuals in Switzerland and the United States.

At the time, it looked to be a “low-risk” investment, as the holding company had a number of valuable assets, apart from the railroads, which would eventually provide more than enough cash to retire the notes.

If everything had proceeded as planned there would be little more of interest to relate. Because it didn’t evolve that way, there is another story, which begins on a Wednesday afternoon in December of 1971.

The Phone Call

Harry Volk, President and CEO of the Union Bank of California summoned me to his office on the 10th floor of the Union Bank Building in downtown Los Angeles.

"Don, do you remember those Penn Central Notes Warner purchased for the bank last year; the short-term ones with the high yield?"

"Yes" I replied, "the 3 million Pressprich sold us yielding 12%."

"Well" Volk continued, "There is a problem with them, and I need your help. Let me get Warner up here, and we can discuss it together. And, er, what are you doing this Christmas?"

What else would I be doing, I mused, but the traditional festivities with my family? What I said was, "Just the usual, Mr. Volk." Invariably addressed as 'Mr. Volk" by everyone, even the management team, he was one of the old-fashioned stalwarts of complete separation of business from personal family concerns. Company parties did not happen. He was a shrewd, capable businessman *par excellence* who was much admired.

At age 47, I was now a senior officer and a member of Union Bank's Management Committee. Because of past achievements, Volk often called on me to resolve ticklish credit or personnel problems. His inquiry about my plans for Christmas was the tip-off that a crucial situation was about to be revealed.

Warner Heineman entered and reported he had been informed the notes were in default as the Penn Central Company didn't have the funds to pay either interest or the principal. They were offering to restructure the debt with new notes, which included free warrants to purchase shares at $4.00 per share. Not a bad deal if you believed the company would survive. Heineman, who was head of Union Bank's International Division, had recommended to the investment committee that they accept the offer.

"So.....exactly what is the problem?" I asked.

Volk replied: "An hour ago I had a phone call from an attorney, a Lloyd Cutler, who is with a Washington D.C. law firm. He is representing a group of the note-holders, and wants our help."

He continued: "There are about 20 holders of the notes – banks and individuals. The agent for the notes, Schroders Bank, insists that 100% of note-holders sign off on the restructure. Should any single one not agree, then Schroders would be obliged to bring an action to collect the notes, which would precipitate the filing of bankruptcy by the Penn Central itself. The railroad is already bankrupt, and they don't want that to happen to the holding company. Cutler said the entire group of note-holders, except for two individuals, have accepted the exchange offer. Of those two, the 'ringleader,' a Dr. Lauder, holds $300,000 of the Notes. The other fellow has $150,000."

"Now <u>here</u> is the problem, the Penn Central's board of directors desperately want to effect the restructuring. They will do almost anything to get the holdouts to sign, but can't allow the rest of the note-holders to know what they plan to do. Each of those banks that own notes - excluding us, of course - has a conflict of interest. Either they have loans to subsidiaries of the company or officers of the bank are also directors of the company. We are the only bank owning notes that does not have a conflict. Cutler would like one of our people to go to Zurich and convince the holdouts it is in their best interest to sign off on the deal"

"What I'd like, Don, is for you to fly to Washington D.C tomorrow, meet with Lloyd Cutler, then arrange to go on to Zurich to meet with the holdouts – can you do it, please?"

We both knew what I would answer, but I appreciated his asking.

To Washington D.C.

Business travel was a frequent occurrence, to which my family was well accustomed. In those days, to fly First Class from Los Angeles to Washington D.C. on PanAm, was to know a degree of pleasure in air travel. How to justify my absence from the family at Christmas-time would not be a pleasant prospect; so for the moment I merely hinted at the possibility to my wife, then packed a bag and took off the next morning.

Cutler and Pickering was - and still is - a very prestigious law firm in the District of Columbia. Lloyd N. Cutler, Yale Law School, 1939, Editor of his law Journal, was already a prominent figure on the Washington scene. He wasted no time in filing me in on the details of the proposed venture, and emphasized the extremely sensitive nature of the assignment. He revealed that some members of the Penn Central's board had put funds into an account in a Bank in

Zurich and signing authority for these would be mine to do with as I saw fit.

Mentally I rolled this nugget of fiscal largesse around in my mind as he went on:

"The primary holdout is a Doctor Lauder. He bought the notes and now feels he was cheated by the company. The other holdout is a Herr Schneider, who says he will do whatever Lauder does. Schroders Bank have asked Lauder if he would meet with you on December 27th. He has agreed, but is telling them it will do no good, as he has made up his mind not to sign."

"Do realize, if any of the other note-holders were to discover that Lauder was being paid, it would no doubt produce chaos as they would all want to be paid. We dare not even let Schroders know what is being done. In fact, when you leave my office, I don't want to know what you plan to do."

Plan, I didn't have a plan, not yet anyway. However the tantalizing prospect of convincing a singularly reluctant note-holder to put pen-to-paper was as intriguing a challenge as I'd yet encountered. Only after I had taken the measure of this Dr. Lauder would I be able to create some sort of inducement. Perhaps.

Lloyd Cutler stood up. "Here are the papers for Lauder and Schneider to sign. After they have been executed, deliver them to Schroders and let me know it has been accomplished. Believe me, everyone appreciates your accepting this assignment. Good luck, and please give my thanks to Harry Volk."

To London

As I flew back to Los Angeles next morning at least a possible solution to the family Christmas dilemma began to take shape. Reaching the Union Bank building in downtown LA by mid-afternoon, I called Harry Volk to make my report.

"Mr. Volk, I'll do my best to accomplish this --- but I really don't want to be away from my family over Christmas. Since the bank has an apartment at the Grosvenor House in London, I'd like to use it, if it is available."

After a call to Lee Swett confirmed the apartment was indeed available through the first week of 1972, I drove home to tell my wife not to buy a tree -- just get out the suitcases and start packing.

"Darling, how would you like to spend Christmas and New Years in London? Owen and Erin will come with us too, of course." My English wife had lived and worked in London before we met, so I was fairly confident her response would be positive.

"When do we leave? Who is paying for this?" She said, with alacrity and practical British thrift.

"We leave just as soon as you're ready. The bank will be covering the cost, and we can use Swett & Crawford's apartment at the Grosvenor House." Two days later, we boarded a Pan Am flight to London, wearing winter clothing and ready for the chilly December weather ahead.

These events happened over thirty years ago, yet I can still recall as if it were yesterday.

While London has its share of fine hotels, the estimable Grosvenor House on Park Lane still reflected its earlier grand heyday. When Union Bank acquired a group of insurance companies, which included Swett & Crawford, one of the prize assets was an apartment in the Grosvenor House. These units are the height of luxury: a separate entrance from the street, room service around the clock, furnishings and décor which are the acme of quality. Initially downcast about leaving their friends at home at this time, our son and daughter soon laid claim to their own bedrooms (with six-inch-thick goose down comforters) and eagerly began devising their 'sees' and 'dos.' Quite sophisticated for their ages, Owen Trelawny had just-turned eleven and Erin Teleri nine-and-a-half, they had traveled abroad with us before.

Some good friends resided nearby on Mayfair's Green Street, within walking distance. We spent Christmas Eve there before a candlelight service at the American Church, then after a morning walk in Hyde Park, a memorable Christmas Dinner. I had reached a decision; one that would have a totally unanticipated result.

"Bette dear, I'm leaving tomorrow to try and resolve this thing, and I'd like to take Owen along. He'd appreciate seeing Zurich. You and Erin enjoy a few days together --- see some plays, go shopping, just enjoy yourselves."