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# How The Washington Group Was Born, Died

By BILL BECK  
And WHITNEY SHAW  
News Business Writers

Just under five years ago, James R. Gilley and Reynolds tobacco heir Smith Bagley merged a company of their own with Washington Mills Inc., to form a holding company that would become widely engaged in retailing and textile manufacture.

But soon the two were accused of fooling the stockholders of Washington Mills into financing the takeover of their own company.

And as of yesterday:

- The holding company, The Washington Group Inc., with gross revenues last year of \$100 million, was in federal bankruptcy court.

- Gilley, who had bought out Bagley's interest, was explaining to a bankruptcy judge the company's decline and, in particular, the still-standing promise of millions in fees to consultants.

- Bagley, it was revealed, had moved from being a principal owner of the troubled company to being a member of its payroll — as a \$60,000-a-year consultant.

Bagley's consulting arrangement, along with the others, has been ended by the bankruptcy court. The

loan through which he and Gilley financed their venture remains in part unpaid.

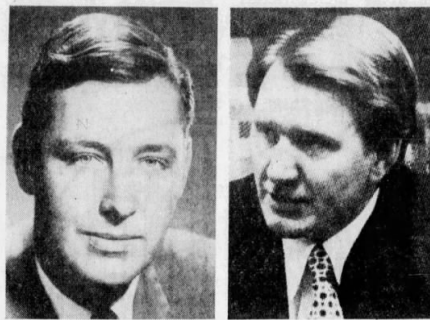
And the story of The Washington Group, which owned Mayberry Ice Cream Shops and Johnston Mills here in Charlotte, continues to unravel.

With the help of a \$2.5 million line of credit from United Virginia Bank in Richmond, Gilley and Bagley used their convenience store and ice cream chain, Convenient Systems Inc. (CSI), to purchase a controlling interest in Washington Mills in the spring of 1972.

They achieved controlling interest mainly through the purchase of 53,000 Washington Mills shares being held in trust by Wachovia Bank and Trust Co. of Winston-Salem. The stock was bought from Wachovia for \$37.50 a share, \$15.50 over its market value at the time.

CSI then owned about 30 per cent of Washington Mills' outstanding shares. No other stockholder beneficially owned as much as 10 per cent of the outstanding shares.

Notified that CSI had obtained control, the Washington Mills board of directors elected Bagley president and Gilley secretary of the company. Long-time president Walter A. Blackwood resigned and was named board chairman. Robert H. Vaughan resigned as secretary.



SMITH BAGLEY

JAMES R. GILLEY

... accused of fooling stockholders

Directors Albert L. Butler Jr., and F. F. Willingham, who had sold their shares to CSI, resigned to make room for Bagley and Gilley. Director S. R. Bason resigned about a month later. He was replaced by James W. Featherstone III, a partner in the law firm of Hutton, Williams, Gay and Gibson of Richmond. The firm was CSI's counsel.

On Oct. 12, 1972, preliminary agreement was reached to merge CSI and Washington Mills, with an exchange of three shares of CSI common stock for each share of Washington Mills.

The merger was ratified at a special stockholders' meeting in Winston-Salem in December 1972. CSI owned 74 per cent of the new

company, named The Washington Group Inc. Bagley controlled 32.5 per cent, Gilley 33.1 per cent.

Despite overwhelming shareholder approval of the merger, the new company found itself in court just over a month after the agreement was ratified. In January 1973, seven Washington Mills stockholders filed a suit seeking to force dissolution of the merger.

The suit alleged that events leading to the merger were a "scheme and conspiracy" to defraud the stockholders in violation of federal statute, North Carolina statute and common law.

In effect, the suit charged Washington Mills stockholders would have to pay for their own company, since the \$2.5 million Virginia loan had become a debt of Washington Mills.

A 1974 Washington Group proxy statement says, "As a result of the merger, by operation of law, Washington Mills-Retail Inc., (a subsidiary of The Washington Group) assumed the primary obligation to pay the Convenient Systems Inc. loan from United Virginia Bank."

Gilley and Bagley replied in an affidavit that the debt was not, in fact, a debt of Washington Mills.

In an affidavit filed with the court Aug. 22, 1973, Gilley and Bagley said, "As a necessary result of such merger, and in keeping with the ap-

plication of standard accounting principles, the assets and debt of the company being acquired, Convenient Systems Inc., became the assets and debts of the surviving company, Washington Mills-Retail, wholly-owned subsidiary of Washington Mills Co. The debts of CSI not become and are not now the obligations of Washington Mills (now the Washington Group)."

Both sides agreed to a court-proved settlement in the summer of 1973.

Washington Group agreed to chase shares from pre-merger Washington Mills stockholders at a market value of \$19 a share. Gilley and Bagley, who by then had a controlling interest in the Washington Group Inc., secured a \$3.4 million line of credit from United Virginia Bank and North Carolina National Bank to purchase stock from shareholder desiring to sell under terms of the agreement. Only 8,143,158 shares that qualified were repurchased.

The court dismissed, with prejudice, all charges of fraud against Bagley, Gilley, Convenient Systems Inc. and other defendants. The defendants were required, however, to pay the plaintiffs' legal fees of approximately \$220,000.

A dismissal with prejudice means that the judgment is as conclusive as if the case had been prosecuted to final decision adverse to the plaintiffs, or in this case the dissatisfied shareholders' claims. Bagley later sold his roughly 33 per cent interest in the Washington Group to Gilley on Jan. 26, 1976.

He bought the 634,673 shares of stock for more than \$2.8 million. The transaction occurred shortly after Bagley resigned as president of the conglomerate. The tobacco company has since become prominent in Washington D.C. social circles after moving there from Winston-Salem.

The \$2 million loan from United Virginia, used for CSI's original purchase of Washington Mills stock, was based on the personal guarantees of Gilley and Bagley and was an annual interest rate of 7 1/2 per cent maturing on May 1, 1974. The maturity date was later renegotiated to allow deferral of quarterly payments of \$312,000 until August of this year. The quarterly payments were supposed to run through May 1979 with a final \$316,000 payment on that date.

Complete repayment of that loan has not been made.

## Firm's \$7 Million Debt Shocks Judge

By BILL BECK  
News Business Writer

WINSTON-SALEM — The Washington Group Inc. owes \$7 million in long-term employment contracts to former officers and directors of the Winston-Salem holding company and firms it has absorbed.

That's what Washington Group president and chief executive officer James R. Gilley told a federal bankruptcy judge in Winston-Salem during a meeting of creditors yesterday.

Included in the figure is \$5.75 million owed David Johnston, former chairman of Charlotte-based Johnston Mills, who sold his equity in the textile firm to the Washington Group in April 1973.

Gilley also said the Washington Group owed \$300,000 to Smith W. Bagley, grandson of tobacco magnate R. J. Reynolds and former chairman of Washington Group Inc.

"I was floored at all the consulting fees," Federal Bankruptcy Judge Rufus Reynolds told Gilley. "I ordered that stopped."

"In my opinion, this company could not operate and pay that much money out (in long-term employment contracts) which is pretty close to \$600,000 a year," Judge Reynolds told the approximately 50 creditors present for the 2 p.m. meeting, the first since the \$100 million-a-year textile conglomerate filed for reorganization under Chapter X of the Federal Bankruptcy Act late in June.

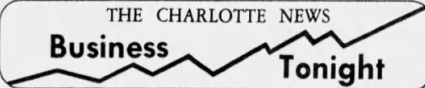
Reynolds told Gilley he was "quite shocked at your method of accounting for costs."

A source close to the bankruptcy proceedings said Judge Reynolds and court-appointed trustee Richard Gilbert have agreed to use the national accounting firm of Peat Marwick & Mitchell to establish a cost-accounting system and audit the books of the cash-short textile and retailing company.

Gilley was on the stand in Courtroom One of the new federal building in Winston-Salem for about an hour and fifteen minutes yesterday.

Judge Reynolds' line of questioning returned repeatedly to the long-term employment contracts.

The Channel F programmable sys-



"How much time has Johnston devoted to consulting?" Reynolds asked Gilley.

"I can't say," Gilley answered. "He was at the Johnston Building in Charlotte and I was in the Winston-Salem office. About every time I went to Charlotte I saw him."

Gilley said Bagley resigned as chairman of the Washington Group Inc. on Dec. 18, 1975. Gilley said Bagley sold him his 33 per cent share of stock in the company, except for "70,000-80,000 shares" in a trust for Bagley's children.

The Washington Group executive committee met on the day Bagley resigned and "issued a five-year contract that required he not compete" with the company in a similar business. According to Gilley, the contract called for Gilley to receive \$60,000 a year, an automobile and a secretary.

(Gilley's statement yesterday about the contract with Bagley, however, conflicts with what the company told stockholders in April, 1976. "Mr. Bagley resigned all offices and directorships with the company and its subsidiaries in December, 1975," stated the Washington Group Inc. Notice of Annual Meeting of Stockholders dated April 9, 1976.

"Since his resignation, he has been employed by the company as a con-

sultant under a ten-year agreement at \$60,000 annually."

"He (Bagley) was supposed to be available for consultation up to and including coming back to Winston-Salem as chief executive officer," Gilley said. "The last payment to him was through the month of May. We stopped payment to him the first of June."

Gilley admitted on the stand that the Washington Group assumed obligation for payment of long-term executive contracts to officials of companies that Washington Group absorbed, including Washington Mills Co., Diener Mills and Johnston Mills.

At times, Gilley told Judge Reynolds he was "not familiar" with names of some people Washington Group had on long-term contracts.

Gilley unraveled the skein of complicated financial dealings that have characterized the conglomerate since it was formed in 1972.

"When I took over (in late 1975), we owed the banks \$27 million and had lost \$9 million that year," Gilley said. The company owed 40 per cent of that total (\$10.8 million) to North Carolina National Bank; 40 per cent (\$10.8 million) to United Virginia Bank of Richmond; and 20 per cent (\$5.4 million) to American Bank & Trust Co. of Reading, Pa. At the

time, according to Gilley, the company also owned \$850,000 to The Northwestern Bank of North Wilkesboro.

"During that next 18 months, we disposed of the convenience stores, Washington Weaving Co., Worth Spinning Co., Park Yarn Co. and the Johnston Mill property in Charlotte and paid the banks \$15 million," the boyish-looking executive told Judge Reynolds. "During 1976, we reached a loan agreement which gave the three major banks most of the fixed assets (of the company) as collateral — all of the land buildings and equipment."

When the Washington Group filed for reorganization under the federal bankruptcy statutes in June, Gilley estimated the company owed about \$12 million to NCNB, United Virginia Bank, and American Bank and Trust; \$1 million to the Northwestern Bank; \$7 million in trade accounts; and about \$2 million to the company's factors, United Virginia Factors Inc.

(Factoring is a means of advancing credit whereby the factor purchases at a discount and without recourse the accounts receivable of a firm. The factor assumes complete responsibility for credit investigation and collection.)

Judge Reynolds asked Gilley about doing business with the factors.

Gilley replied that United Virginia Factors was a subsidiary of United Virginia Bank and hinted that problems with the factors had pressured the Washington Group to seek reorganization under the bankruptcy court.

## Entertainment System's Sales Brisk In Carolinas

By WHITNEY SHAW  
News Business Writer

Sales of Fairchild's Channel F video entertainment system, which was introduced in the Carolinas approximately two months ago by Charlotte's Allison-Erwin Co., are moving briskly.

The Channel F programmable sys-

tem has more than a dozen entertainment and educational cartridges that can be displayed in color on a television screen.

In its first 60 days on the market in the Carolinas, Allison-Erwin's Channel F sales were 28 per cent ahead of projections. Almost half of the company's projected August sales were achieved in the first eight days of the month.

Charlotte's Wray/Ward Advertis-

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in a Southeastern state about three months ago.

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