FINANCE DOCKET No. 11681

# NEW YORK, SUSQUEHANNA & WESTERN RAILROAD COMPANY REORGANIZATION

*Submitted November 18, 1943. Decided July 19, 1944*

Plan for the reorganization of the New York, Susquehanna & Western Railroad Company pursuant to section 77 of the Bankruptcy Act approved.[1]

*M. C. Smith, Jr.*, for debtor.

*Ralph E. Lum* for trustee of the debtor's property.

*R. M. D. Richardson, Lyman M. Tondel, Jr., Raymond A. Coleman, A. M. Lewis, McCready Sykes, Langford E. Morris, J. Harlin O'Connell, Arthur Frank, Edwards S. Sanford, John H. Schmid, Coleman Burke, Walter T. Margetts, Jr., Leo J. McLaughlin, William M. Smith, Robert D. Brooks, Jacob Aronson, R. S. Buell,* and *Morton D. Frederick* for interveners. *Edith A. Merritt* and *Ira W. Hirschfield* for themselves.

REPORT OF THE COMMISSION

DIVISION 4. COMMISSIONERS PORTER, MAHAFFIE, AND MILLER

BY DIVISION 4:

Exceptions to the report proposed by the examiner were filed, and the case was argued orally before us on November 18, 1943. Our conclusions differ in certain particulars from those of the examiner.

## I. GENERAL

### A. NATURE OF PROCEEDINGS; INTERVENER; HEARINGS

The New York, Susquehanna and Western Railroad Company, hereinafter called the debtor or the Susquehanna, on June 1, 1937, filed in the District Court of the United States for the District of New Jersey, in proceeding No. 26175, a petition stating that it was unable to meet its debts as they matured and that it desired to effect a plan of reorganization under section 77 of the Bankruptcy Act, 11 U. S. C. 205. On the same date the court approved the petition as property filed.[2]

[1] For previous reports see 249 I. C. C. 621 and 252 I. C. C. 819.

[2] By the same order the court continued the debtor in possession of its property pending the appointment of trustees. On June 29, 1937, the court appointed Walter Kidde and Hudson J. Bordwell as trustees of the debtor's property, both of which appointments were ratified by the Interstate Commerce Commission, hereinafter called the Commission. Bordwell died November 15, 1937, and on December 6, 1937, the court appointed Kidde

On November 13, 1942, a plan for the reorganization of the debtor,[3] hereinafter referred to as the plan or the proposed plan, was filed with the Commission and with the court by the New York Life Insurance Company, Prudential Insurance Company of America, and Mutual Benefit Life Insurance Company of New Jersey, interveners,[4] hereinafter referred to as the insurance group [5] or the proponents of the plan. Hearings upon the plan were held on February 23–26, 1943. Briefs have been filed.

B. CLASSIFICATION OF CREDITORS AND STOCKHOLDERS

For the purposes of a plan for the reorganization of the debtor and its acceptance, and in accordance with the provisions of section 77 (c) (7), the creditors and stockholders of the debtor were divided, by order of the court dated January 26, 1943, into the following classes according to the nature of their respective claims and interests:

*Class 1.*—Claims against the debtor which would have been entitled to priority over existing mortgages if a receiver in equity of the property of the debtor had been appointed by the court at the date of the approval of the petition.

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sole trustee, which appointment was ratified. Kidde died on February 9, 1943. The court on February 10, 1943, appointed Henry K. Norton agent of the court and executive officer of the debtor's railroad and business, pending the appointment of a substitute trustee. On March 22, 1943, the court appointed Norton as sole trustee, which appointment was ratified. Norton had been employed in 1937 by the trustees as an analyst of the problems of the railroad. Later he became executive officer of the railroad for Kidde, the then sole trustee, and at the same time continued his duties as an analyst. Inasmuch as he is now trustee and at the time of the hearing on the plan, in substance and effect, was performing the duties of a trustee and had supervised the preparation of the documentary evidence presented by him, the testimony and evidence presented by him at the hearing will be referred to herein as that of the trustee.

[3] The debtor, on April 20, 1938, filed with the court and on April 21, 1938, filed with us, a plan for its reorganization. At the request of parties, this plan was not set for hearing because of its assumption of the priority of mortgage liens at variance with the contentions of other parties and later found to be at variance with the determinations of the courts, and because of other matters hereinafter described. On June 4, 1942, the debtor filed with us its statement that, in view of changed conditions, it could no longer support the plan and that it desired to withdraw it.

[4] Other interveners are the trustees or successor trustees under the several mortgages upon the debtor's properties, the trustees of the property of the Erie Railroad Company, hereinafter called the Erie (heretofore in proceedings for reorganization under section 77 in the District Court of the United States for the Northern District of Ohio, Eastern Division), a committee for the protection of the debtor's first and refunding mortgage bonds, a committee for the protection of the debtor's general-mortgage bonds, a group of holders of bonds of the Paterson Extension Railroad Company, the trustee under the first mortgage of the Wilkes-Barre & Eastern Railroad Company representing the holders of bonds issued thereunder claiming under a guaranty of such bonds by the debtor, a group of Wilkes-Barre & Eastern bondholders, the New York Central Railroad Company, the New Jersey Junction Railroad Company, a group of holders of the debtor's general-mortgage bonds, Edith A. Merritt, Central Holding Company, Lillie Mock, Blanche Oster, and Leonard Oster, the last five being individual bondholders.

[5] This group, informally associated to protect their respective interests, owns 23.1 percent of the principal amount of the debtor's terminal first-mortgage bonds, 44.5 percent of the principal amount of the first-mortgage bonds of the Midland Railroad Company of New Jersey, and 21.1 percent of the principal amount of the debtor's first and refunding mortgage bonds, or 30.4 percent of the principal amount of the bonds of those three issues outstanding.

*Class 2.*—Claims for personal injuries to employees of the debtor and claims of personal representatives of deceased employees of the debtor arising under State or Federal law.

*Class 3.*—Claims, other than those of the United States, for taxes and assessments accrued and unpaid.

*Class 4.*—Claims of the United States for taxes or customs duties, if any.

*Class 5.*—Terminal-mortgage bonds, in the principal amount of $2,000,000 with interest at 5 percent from May 1, 1937, to January 1, 1944.

*Class 6.*—Midland-mortgage bonds, in the principal amount of $3,489,000 with interest at 5 percent from April 1, 1937, to January 1, 1944.

*Class 7.*—Refunding-mortgage bonds, in the principal amount of $3,744,000, with interest at 5 percent from June 1, 1937, to January 1, 1944, plus interest at 6 percent from January 1, 1937, to June 1, 1937.

*Class 8.*—Second-mortgage bonds, in the principal amount of $448,000 (including one $1,000 scrip certificate), with interest at 4½ percent from June 1, 1937, to January 1, 1944, plus interest at 6 percent from February 1, 1937, to June 1, 1937.

*Class 9.*—General-mortgage bonds, in the principal amount of $2,551,000 with interest at 5 percent from February 1, 1937, to January 1, 1944.

*Class 10.*—Paterson Extension mortgage bonds, in the principal amount of $200,000 with interest at 5 percent from December 1, 1936, to January 1, 1944.

*Class 11.*—Unsecured claims without right of priority.

*Class 12.*—Preferred stock.

*Class 13.*—Common stock.

The court reserved the power to rescind, revise, alter, amend, supplement, or otherwise modify, the foregoing classification.

### C. DESCRIPTION OF DEBTOR'S PROPERTY

At the institution of the proceeding the debtor's lines extended from West End, in Jersey City, N. J., through Little Ferry, Passaic Junction, Hackensack, and Beaver Lake, to Hanford, at the New York-New Jersey State line, about 71 miles, and from Beaver Lake, through Hainesburg Junction, to Stroudsburg, Pa., about 48 miles, with a branch, 3.05 miles, from Little Ferry to the Edgewater terminal, at Edgewater, and a spur, 0.75 mile, at Paterson, totaling about 123 miles, all in the State of New Jersey, except about 4.7 miles from the Delaware River to Stroudsburg. At the last-named point it connected with the line of its wholly owned subsidiary, the Wilkes-Barre & Eastern

Railroad Company,[6] hereinafter called the Wilkes-Barre. On December 20, 1940, division 4 authorized the abandonment[7] of that portion of the line from Hainesburg Junction to Stroudsburg, about 11.79 miles. In addition, it owned detached mine branches having a total mileage of about 9.69 miles in the Lackawanna Valley in Pennsylvania.[8]

It also owned all the capital stock of the companies owning the following branch lines, (1) the Hackensack and Lodi Railroad, extending toward Lodi 1.4 miles from a junction with the main line near Hackensack; (2) the Lodi Branch Railroad, 0.4 mile, connecting with the Hackensack and Lodi near Lodi; (3) the Passaic and New York Railroad, 3.05 miles, from Passaic Junction to Passaic; and (4) the Susquehanna Connecting Railroad 6.55 miles,[9] in the Lackawanna Valley in Pennsylvania.

During the pendency of the proceedings, the trustee acquired[10] from the Erie Terminals Railroad Company (of which th debtor had owned 12 percent of the capital stock) 1.61 miles of tracks extending north and south along the Hudson River from Edgewater, hereinafter called the northern extension and the southern extension, respectively.

The debtor's trustee operated all of the foregoing lines not abandoned, including the Edgewater terminal, except the detached mine branches[11] and the Susquehanna Connecting Railroad[12] in Pennsylvania.

Effective December 30, 1941, the trustee on behalf of the debtor acquired trackage rights over the Middletown & Unionville Railroad between Unionville, N. Y., and its connection with the New York, Ontario & Western at Middletown, N. Y., a distance of 14.30 miles. Effective the same date, trackage rights over the New York, Ontario & Western between Middletown and its connection with the debtor's Winton-Priceville branch at Riverside Junction, Pa., a distance of 127.4 miles, were acquired. *New York, S. & W. Trustee Operation*, 249 I. C. C. 758.

As of December 31, 1942, the debtor owned 494 freight cars, 10 cabooses, 32 passenger cars (including 2 gas-electric motor cars and

[6] The Wilkes-Barre's properties have since been liquidated in a proceeding under section 77 of the Bankruptcy Act in the District Court of the United States for the Middle District of Pennsylvania.

[7] *New York, S. & W. R. Co. Trustee Abandonment*, 242 I. C. C. 758.

[8] The Winton-Priceville branch, 4.41 miles, the Johnson No. 2 Breaker branch, 1.04 miles, the Spencer branch, 0.55 mile, the Spencer Breaker Connection, 0.87 mile, the Murray branch, 0.46 mile, the Jermyn No. 2 Breaker branch, 1.46 miles, and the Dolph branch, 0.90 mile. The last two were abandoned pursuant to authority in *Susquehanna Connecting R. Co. Abandonment*, 247 I. C. C. 317.

[9] In *Susquehanna Connecting R. Co. Abandonment, supra*, abandonment of approximately 2.29 miles of this line was authorized.

[10] Acquisition authorized in *New York, S. & W. R. Co. Trustee Purchase*, 249 I. C. C. 777.

[11] The Spencer Breaker Connection is not operated. Over the four remaining branches either the Erie, the New York, Ontario & Western, or the Delaware, Lackawanna & Western, or more than one of them, operate under trackage arrangements.

[12] The Erie operates this line under trackage arrangements.

2 semi-Diesel streamlined motor cars), 6 1,000-horsepower Diesel switching engines,[18] and 11 units of work equipment. Thirty steam locomotives, 4 passenger cars, and 1 gas-electric car were leased from the Erie. The 10 cabooses, all the passenger cars, the Diesel switching engines, and an inspection car were acquired by the trustee during these proceedings, and all sums paid on account of their purchase were paid out of reorganization earnings.

The principal facilities of the Susquehanna include a classification yard, roundhouses, and repair shops at Little Ferry, a mile-long tunnel between Edgewater and Little Ferry, and a terminal yard, coal dock and dumper, and coal heating houses at Edgewater.

### D. TREATMENT OF PRELIMINARY MATTERS

Early in these proceedings, it appeared that there were some major problems which would have to be resolved before an acceptable plan of reorganization could be proposed. The most important of these concerned (1) the relations between the debtor and the Erie, which had controlled the debtor through stock ownership since 1898, including a claim of the Erie against the debtor and the question of their respective rights in the northern extension and the southern extension; (2) the debtor's liability, if any, to the holders of the Wilkes-Barre bonds; (3) the extent and priority of the liens of the debtor's principal mortgages, particularly as they related to the Edgewater Terminal; (4) the determination of the earning power of the several mortgage and leased-line divisions; and (5) the disputed claim of the State of New Jersey for unpaid taxes and penalties and the method of railroad taxation in New Jersey.

(1) The Erie filed a proof of claim against the debtor for $8,756,-032.95, including interest, of which amount $441,998.13 was alleged to be entitled to a preference under the "six-months rule." The trustee of the debtor filed set-offs and counter claims to the Erie's claim. He also filed a petition seeking a transfer from the Erie Terminals Railroad Company, controlled by the Erie, of the described northern extension and southern extension to him as trustee. These led to a general settlement in 1941 between the Erie trustees and the Susequehanna trustee, approved by both courts, the principal terms of which were, that the Erie trustees were to cause the transfer of the northern extension and the southern extension to the trustee of the debtor; the trustee of the debtor was to pay to the Erie trustees $250,000 in settlement of claims and $36,503.07 representing moneys advanced by the Erie toward the cost of the northern and southern extensions; the trustee of the debtor was to transfer to the Erie all stock held by him

[18] Two additional Diesel switching engines were purchased during 1942, but were requisitioned by the United States in October 1942. The trustee is endeavoring to replace them.

in Erie Terminals Railroad Company; the debtor's claims against Erie Terminals Railroad Company were to be canceled; and all the aforementioned claims and counterclaims were to be released. Erie Terminals Railroad Company thereafter would have no interest in property operated by the debtor. The terms of the settlement have been performed.

(2) As of October 1, 1937, the trustee of the debtor disaffirmed its lease of the railroad of the Wilkes-Barre, and, as of a somewhat later date, disaffirmed the debtor's guarantee of the Wilkes-Barre bonds. On April 3, 1940, the District Court of the United States for the Middle District of Pennsylvania (which had approved the Wilkes-Barre's petition under section 77 on September 30, 1937), and on April 24, 1940, the District Court of the United States for the District of New Jersey approved a proposed settlement of the claims of the Wilkes-Barre bondholders and of the Wilkes-Barre Company against the debtor. The principal provision of the settlement was that the Wilkes-Barre bondholders should have a nonpreferred unsecured claim against the debtor as of June 1, 1937, in the amount of $2,250,000. Also pursuant to the settlement, the entire capital stock of the Wilkes-Barre was tendered by the trustee of the debtor to The Commercial National Bank and Trust Company of New York, trustee under the Wilkes-Barre mortgage. The tender was accepted by the mortgage trustee.

Meanwhile, on January 17, 1939, the Commission had authorized the trustee of the Wilkes-Barre to abandon its line from Suscon, Pa., to Stroudsburg, Pa., 230 I. C. C. 537, and on March 26, 1939, operations had been discontinued on the 54 miles of track of the Wilkes-Barre between the afore-mentioned points. The trustee of the Wilkes-Barre has since been authorized to sell the entire balance of its road, which has been done. *Wilkes-Barre Connecting R. Co. Purchase*, 240 I. C. C. 173, and *Moosic Mountain & C. R. Co. Purchase and Operation*, 247 I. C. C. 241. As a result of the foregoing events, the trustee of the debtor no longer has any material interest in the Wilkes-Barre. Moreover, the trustee of the Wilkes-Barre disaffirmed its lease of the line of the Susquehanna Connecting Railroad Company (including the debtor's mine branches), and ceased operations thereon, and the trustee of the debtor has made other operating arrangements with respect thereto as hereinbefore described.

(3) As previously indicated herein, the plan filed by the debtor on April 21, 1938, (which the debtor later stated that, in view of changed conditions, it could not support and desired to withdraw) was not set for hearing because of representations of the parties that it would be futile to do so, on account, among other things, of pending litigation relative to the priorities of mortgage liens. The plan itself stated that it was based on the understanding that the terminal first mortgage was

the only lien on the terminal property. These lien controversies were determined by the district court's findings and order of May 25, 1939, and opinion of November 20, 1939, 30 Fed. Supp. 257, as modified by the opinion of the United States Circuit Court of Appeals for the Third Circuit filed on January 19, 1940, as corrected by its order of March 18, 1940, *In re New York, S. & W. R. Co.*, 109 Fed. (2d) 988. A petition for a writ of certiorari was denied by the Supreme Court on May 20, 1940, 310 U. S. 633.

(4) The Commission, division 4, on December 14, 1939, 236 I. C. C. 425, recommended a formula for the segregation of the debtor's revenues and expenses by and between the mortgage and leased-line divisions. Further reference to the formula will be made hereinafter.

(5) When disposition had been made of the foregoing matters, the only major questions which remained were those which had to do with (*a*) the method by which the State of New Jersey was to tax the debtor for the year 1941 and years subsequent thereto; and (*b*) the claim of the State of New Jersey for taxes levied against the property of the debtor for the years 1933 through 1940, but still unpaid, in the principal amount of approximately $1,216,000. The principal issues in connection with these questions were respectively (*a*) whether the taxes payable to the State of New Jersey by the debtor for the year 1941 and subsequent years would be, as applied to current earnings, approximately $270,000 per annum, as in 1940, or whether because of the legislation passed in 1941, such taxes would be approximately $430,000 per annum; and (*b*) whether the debtor would have to pay penalties which might run as high as $735,000 (to June 25, 1942), in addition to principal amount of taxes of $1,216,000.

By the enactment of Chapter 240 of the Laws of 1942, on May 8, 1942, the basis of the debtor's State tax liabilities for 1941 and subsequent years became settled at approximately the 1940 level.

The back taxes for the years 1933 through 1940 had been contested in both the State and the Federal courts by the debtor and most of the other major railroad companies which operate in New Jersey. Chapter 290 of the Laws of 1941 was intended to provide for the settlement of these taxes by the payment in full of principal only ($$1,216,000 in the case of the debtor) with interest on unpaid balances at the rate of 3 percent per annum from December 1, 1940. Chapter 290, however, was believed by some to have failed to apply to all tax claims it was intended to cover and, further, its application was blocked by litigation, so that it still remained undetermined whether the trustee of the debtor would have to pay only the $1,216,000 in settlement of back taxes plus the aforementioned interest from December 1, 1940, or, in addition, penalties which might amount to as much

as $735,000 (to June 25, 1942). On May 21, 1942, Chapter 241 of the Laws of 1942 became law. This chapter was designed to amend and cure the defects of Chapter 290 of the Laws of 1941, while still providing for the settlement of railroad back taxes by the payment in full of the principal amount of the claims, without so-called "interest penalties," and with interest only from December 1, 1940, as aforesaid. On June 10 and 25, 1942, the trustee of the debtor tendered to the State Treasurer payments in full settlement of all back taxes, including interest from December 1, 1940. Litigation has been instituted by the Attorney General of the State of New Jersey to challenge the constitutionality of Chapter 290, as so amended, and the State Treasurer was temporarily enjoined from accepting the aforesaid payments as well as similar payments tendered by other railroad companies. On July 20, 1943, in *Wilentz* v. *Hendrickson*, 33 A. (2d) 366, Vice Chancellor Jayne, of the Court of Chancery of New Jersey, continued until final hearing the temporary injunction referred to, and in an elaborate opinion expressed the view that the interrelated statutes (Chapter 290 and Chapter 241) are in purpose and effect violative of article I, paragraph 20 of the State constitution. However, if Chapter 290, as amended, were finally held to be unconstitutional and the claim for penalties were revived, the question would still remain as to the extent to which such claim would be allowable in these proceedings.

At the hearing a suggestion was made that it be stipulated that the debtor's plan be treated as withdrawn. One bondholder objected to such a stipulation. In view of what has been stated hereinbefore in regard to that plan, we will treat it as having been withdrawn.

The liens[14] of the several mortgages upon the roadway properties, as described in court orders No. 129 (as amended by order No. 235) and 198, are as follows:

(*a*) The Terminal, Midland, first and refunding (hereinafter called the refunding), second, and general mortgages are valid and subsisting liens, with priority in the order in which named in this paragraph, upon the Edgewater terminal properties, the line of the debtor's railroad, approximately 3 miles, extending through the Edgewater tunnel and connecting the Edgewater terminal properties with Little Ferry,[15] and part of the properties and yards at Little Ferry, as more particularly described in the court orders.

(*b*) The Midland mortgage is a first lien, followed as to priority, in order, by the refunding, second, and general, upon (1) the por-

[14] See court orders Nos. 129 (as amended by order No. 235 pursuant to the mandate and opinion of the Circuit Court of Appeals, Third Circuit) and order No. 198, adjudicating priorities of liens as to certain properties.

[15] Sometimes called Little Ferry Yard, Little Ferry Junction, and Undercliff Junction.

tion of the debtor's line from West End, in Jersey City through Little Ferry, Hackensack, Passaic Junction, and Beaver Lake to Hanford, including portions of the properties and yard at Little Ferry, and (2) the northern and southern extensions, extending north and south along the Hudson River from the terminal properties at Edgewater, as hereinbefore described. The terminal is also a lien subordinate to the other four mortgages named, upon the northern and southern extensions and upon certain portions of the properties and yard at Little Ferry, as more particularly described in the court orders.

(*c*) The refunding mortgage is a first lien, followed, in order, by the second and general mortgages, upon what remains (approximately 36 miles from Beaver Lake to Hainesburg Junction) of that portion of the debtor's line from Beaver Lake to Stroudsburg, Pa., and upon the mine branches, hereinbefore described, in Pennsylvania.

(*d*) The first mortgage dated June 1, 1881, of the Paterson Extension Railroad Company, the refunding, second, and general mortgages are valid and subsisting, first, second, third, and fourth liens, respectively, and are the only mortgage liens on the property of the former Paterson Extension Railroad Company.

(*e*) The first mortgage of the Passaic & New York Railroad Company is the only mortgage on the 3.05 miles of line of that wholly owned subsidiary extending from Passaic Junction to Passaic. There are no mortgage liens upon the properties of the wholly owned subsidiaries, the Hackensack & Lodi Railroad, the Lodi Branch Railroad, and the Susquehanna Connecting Railroad.

### E. PRESENT CAPITALIZATION AND OTHER LIABILITIES

The debtor's capitalization, as of December 31, 1942, exclusive of interest on funded debt, was $38,213,163, composed of the following:

| | | |
|---|---|---|
| Capital stock: | | |
| Common, $100 a share par value[16] | $12,816,319 | |
| Preferred $100 a share par value[16] | 12,964,844 | |
| Total capital stock | | $25,781,163 |
| Funded debt unmatured: | | |
| Terminal first-mortgage 5 percent bonds, due May 1, 1943[17] | 2,000,000 | |
| First-mortgage 5 percent bonds of Paterson Extension Railroad Co., due June 1, 1950 | 200,000 | |
| Total funded debt unmatured | | 2,200,000 |

[16] In addition, the debtor holds $183,681, par value, of common stock and $35,156, par value, of preferred stock, in respect of its liability for conversion of securities of predecessor companies.

[17] Now matured.

| | | |
|---|---|---|
| Long-term debt matured unpaid: | | |
| First-mortgage 5 percent bonds of Midland Railroad Co. of N. J., matured April 1, 1940 | [18] $3,489,000 | |
| Refunding mortgage 5 percent bonds, matured January 1, 1937 | 3,744,000 | |
| Second-mortgage 4½ percent bonds, matured February 1, 1937 | [19] 448,000 | |
| General-mortgage 5 percent, matured August 1, 1940 | 2,551,000 | |
| Total long-term debt matured unpaid | | $10,232,000 |
| Total Capitalization | | 38,213,163 |

[18] This includes one $500 bond which matured April 1, 1910, not presented for extension.
[19] Includes $1,000 of scrip. In addition, $552,000, principal amount, of second-mortgage bonds are pledged under the general mortgage.

Equipment obligations under lease-purchase agreements on the same date were $525,340.

On December 31, 1942, matured bond interest unpaid, for which no provision was made for current settlement, amounted to $3,066,341 and accrued tax liability to $165,252. Unsecured claims, partly allowed by the court and partly estimated, with a priority status to that of operating expenses, amount to $7,989.

Unsecured claims without priority allowed by the court are:

| | *Amount* |
|---|---|
| Claim based on settlement with the bondholders of the Wilkes-Barre (court order No. 158 of April 24, 1940) | $2,250,000 |
| Claim of Lehigh and New England Railroad Company (court order No. 67, of March 31, 1938 | 116,517 |
| Others | 21,741 |
| Total | 2,388,258 |

F. PROPOSED PLAN OF REORGANIZATION

1. *Capitalization and new securities.*—Under the group's plan the equipment obligations would be left undisturbed. There would be created and issued in exchange for the other securities of the debtor outstanding in the hands of the public new securities approximately as follows:

| | *Amount* | |
|---|---|---|
| Terminal first-mortgage 4-percent bonds | $2,000,000 | |
| First and consolidated mortgage 4-percent bonds | 3,000,000 | |
| General-mortgage 4½-percent income bonds | 4,000,000 | |
| Preferred stock, 5 percent, par amount | 3,000,000 | |
| Common stock, no par, taken at $100 a share | 4,250,000 | (42,500 shares) |
| Total, approximately | 16,250,000 | |

Under that plan, all, or substantially all, the properties held by the trustee of the debtor and all moneys held by the trustees under the Terminal, Midland, refunding, second, general, and Paterson Exten-

sion mortgages would be conveyed to the reorganized company, which, in the discretion of the reorganization managers might be either the debtor, with its articles of incorporation appropriately amended, or a new company (herein, in either event, called the reorganized company). Any such conveyance would be made free of the lien of any mortgage and of any equipment obligation except the rights of American Locomotive Company and its assignees under equipment obligations, and except, in the discretion of the reorganization managers, the rights of any vendor or lessor of equipment hereafter acquired by the trustee of the debtor.

In the discretion of the reorganization managers, all or substantially all, the properties now held by any of the following subsidiaries of the debtor would be either retained by the present owner thereof or conveyed to any other of such subsidiaries or to the reorganized company or to any newly formed subsidiary of the reorganized company: The Hackensack and Lodi Railroad Company; The Lodi Branch Railroad Company; Passaic and New York Railroad Company; and Susquehanna Connecting Railroad Company.

In addition to their above-mentioned powers with respect to all, or substantially all, the properties now held by the trustee of the debtor or by any of the afore-mentioned subsidiaries, the reorganization managers would have authority, in their discretion, to cause any part or parts of said properties to be retained by or conveyed to any of such subsidiaries or be conveyed to the reorganized company or to any newly formed subsidiary of the reorganized company. The reorganization managers would have authority, in their discretion, to dissolve any subsidiary of the debtor or the debtor itself, and if any subsidiary be not dissolved the reorganized company would hold all the stock therein now held by the debtor.

The proposed new terminal first mortgage would constitute a lien on substantially the same property as is now subject to the lien of the existing terminal mortgage, with substantially the same priorities, and with substantially the same after-acquired property provisions. It would mature January 1, 1974, or 30 years from the date as of which issued, in the discretion of the reorganization managers.[20] It would be permissible, at the option of the reorganization

[20] Other provisions of the proposed mortgage are: That the bonds issuable under it would be limited to the issue of $2,000,000, principal amount, fully registered or in coupon form registerable as to the principal, or both, as determined by the reorganization managers; interest would be payable January 1 and July 1, beginning on July 1, 1944; the bonds would be redeemable in whole or in part at any time, on 60 days' notice by publication, at their principal amount plus accrued and unpaid interest, plus a premium of 3 percent if redeemed on or before January 1, 1954, at 2 percent thereafter and on or before January 1, 1964, at 1 percent thereafter and on or before January 1, 1972, and no premium if redeemed after January 1, 1972; the bonds would be convertible, at the option of the holder, at any time (in case of redemption, at any time prior to the date fixed for redemption) into an equal principal amount of first and consolidated mortgage 4 percent

managers, that an extension agreement be executed whereby the existing terminal mortgage, as modified by the extension agreement, would be assumed by the reorganized company, the maturity of the existing bonds would be extended to January 1, 1974, the interest rate would be reduced to 4 percent, and such other changes would be made in conformity with the herein-described provisions of the plan with respect to the mortgages as to the reorganization managers would appear appropriate.

The first and consolidated mortgage would authorize the issue of $7,000,000 principal amount of bonds, in series, of which approximately $3,000,000 principal amount, series A, would be issuable under the reorganization. Series A bonds would mature January 1, 1984, or 40 years from the date as of which issued, in the discretion of the reorganization managers; subsequent series would mature on such date or dates as fixed by the board of directors, subject to such limitations as are set forth in the plan. The mortgage would constitute a first lien, subject only to the lien of the new Terminal mortgage and the rights of American Locomotive Company and its assignees under equipment obligations, and in the discretion of the reorganization managers the rights of any vendor or lessor of equipment acquired by the trustee of the debtor, on all property of the debtor or its trustee, as such, at the time of the effectuation of the plan, except such cash, accounts

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bonds, series A; the after-acquired property clause would contain such provisions as the reorganization managers would determine, to safeguard or clarify it in the event of consolidation, merger, sale, or lease.

It would also contain appropriate provisions as to the additions and betterments fund hereinafter described, and the following so-called miscellaneous covenants: (1) Such provisions, if any, as would be necessary or proper in the judgement of the reorganization managers, with due regard for the rights of the holders of new terminal bonds, in order to enable the board of directors to dispose of property in connection with coordination and pooling arrangements with other carriers; (2) that no consolidation or merger, and no sale or lease of substantially all the properties as an entirety would be made except on the condition that the corporation which would thereafter operate the properties would assume said mortgage and all covenants thereof and all the debts, obligations and duties of the reorganized company with respect to the new terminal bonds; (3) provision, with conditions and limitations to be prescribed in the mortgage, for the modification or alteration of the mortgage and of the rights of the holders of the bonds, by the concurrent action of the reorganized company and of the holders of not less than two-thirds in aggregate principal amount of the terminal bonds then outstanding; and that, in the event that the reorganized company be unified with any other corporation by consolidation, merger, sale, lease, or otherwise, such modification or alteration could specifically include provision for the modification or elimination of the provisions in the mortgage relating to the additions and betterments fund and/or procedural provisions for ascertaining available net income without the maintenance of separate books of account, provided that no such modification or alteration would (*a*) alter or impair the obligation of the reorganized company to pay the principal of, or interest on, any new terminal bond at the time and place and at the rate and in the currency provided therein without the consent of the holder of such bond, or (*b*) permit the creation of any mortgage or lien in the nature of a mortgage ranking prior to or *pari passu* with the lien of the new terminal mortgage, except as would be in the new terminal mortgage otherwise expressly provided, unless the creation of such mortgage or lien be consented to by the holders of all outstanding bonds, or (*c*) modify or alter such other provisions of the mortgage as would be prescribed by the reorganization managers; and (4) the usual additional provisions regarding maintenance, replacements, releases, insurance, payment of taxes and the like. The mortgage would have no sinking-fund provisions.

receivable, and other current assets as customarily are not subject to the lien of a railroad first mortgage, and such properties or assets not necessary for the operation of the railroad as the reorganization managers may determine should not be so subject.[21]

[21] Other provisions of the mortgage: That it would also constitute a first lien, in such manner and with such exceptions as the reorganization managers should determine, upon all property acquired by the reorganized company after the effectuation of the plan, subject only to the lien of the new terminal mortgage by virtue of its after-acquired property clause and to such encumbrances or purchase-money liens as would exist or be created at the time of acquisition, with such provisions as the reorganization managers determine, to safeguard or clarify the after-acquired property clause in the event of consolidation, merger, sales or lease.

It would further provide that the denominations of series A bonds would be in the discretion of the reorganization managers and the denominations of subsequent series would be in the discretion of the board of directors; the bonds would be fully registered or in coupon form registerable as to principal, or both, as determined by the reorganization managers in the case of series A, and as determined by the board of directors in the case of subsequent series; the interest on series A bonds would be payable on January 1st and July 1st, beginning on July 1, 1944, and that of subsequent series at such rate and at such times as determined by the board of directors; series A bonds would be redeemable in whole or in part at any time, on 60 days' notice by publication, at their principal amount plus accrued and unpaid interest plus a premium of 4 percent if redeemed on or before January 1, 1954, 3 percent if thereafter and on or before January 1, 1964, 2 percent if thereafter and on or before January 1, 1974, 1 percent if thereafter and on or before January 1, 1982, and no premium if after January 1, 1982; subsequent series would be redeemable as determined by the board of directors; appropriate provisions similar to those in the new terminal mortgage with respect to the additions and betterments fund and the four so-called miscellaneous convenants described in connection with that mortgage; and a convenant substantially to the effect that the aggregate principal amount of all bonds issued under this mortgage which at any time may be under pledge would not exceed the amount of all indebtedness so secured by more than 10 percent of the aggregate principal amount of first and consolidated bonds then authenticated and not canceled.

The mortgage would further provide that, subject to the provisions of the plan elsewhere herein described with respect to the reduction of debt prior to the consummation of the plan, there would be issued at the time of the effectuation of the reorganization approximately $3,000,000 of series A bonds, and subject to the same provisions with respect to the reduction of debt, prior to consummation of the plan, an additional principal amount of approximately $2,000,000 of series A bonds would be reserved for the conversion of new terminal bonds, except that to the extent that the principal amount of the terminal bonds outstanding is reduced by refunding as provided in the following provisions hereof or by redemption or otherwise, the aforesaid approximately $2,000,000 of series A bonds reserved would be reduced and the approximately $2,000,000 principal amount of first and consolidated bonds described in the following provision herein described would be increased.

The remaining approximately $2,000,000 principal amount of authorized first and consolidated bonds would be issued as additional series A bonds, or in such other series, subject to such limitations and restrictions, as would be specified in the mortgage, to mature on such date or dates (not earlier than the maturity of series A bonds except where issued to cover the cost of equipment or for emergency purposes as provided in the mortgage), to bear such rates of interest and to contain such provisions regarding redemption, conversion, sinking funds, and other matters as determined by the board of directors but with respect to the lien of the first and consolidated mortgage all equally secured, such bonds would be issued only for the following purposes and subject to the following conditions: (*a*) To refund any new terminal bonds or any first and consolidated bonds or any obligations which at any time might constitute a line on any part of the system prior to the lien of the first and consolidated mortgage; (*b*) to cover the cost of additions and betterments, or the acquisition of additional property, including fixed property as defined below, or equipment, or substantially all the securities of corporations owning the same, to the extent of 75 percent of such cost, excluding the amount of existing and continuing prior liens on the property being acquired except to the extent of the actual cost of acquisition of any such liens, provided, that (*i*) no first and consolidated bonds would be issued to cover the cost of equipment or to refund equipment-trust obligations or any obligations for the deferred or serial payment of the purchase price of equipment unless the term of such bonds would not exceed the expected remaining efficient service life of the equipment, in

The general mortgage securing the 4½-percent income bonds would provide no limitation upon the amount of bonds issuable under it. It would provide for the issue of approximately $4,000,000 principal amount of series A bonds in connection with the reorganization, which would mature January 1, 1994, or 50 years from the date as of which issued, in the discretion of the reorganization managers. Subsequent series would mature on such dates as may be fixed by the board of directors, subject to limitations as described in the mortgage. It would constitute a lien upon all property from time to time subject to the lien of the first and consolidated mortgage, subject only to the liens of that mortgage and the Terminal mortgage and any liens prior to either of them.[22]

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any case not more than 15 years, unless a sinking fund be created with payments at an annual rate sufficient to retire such bonds in full at or prior to their respective maturities and unless, in the event of such a refunding, the entire issue of any equipment obligations being refunded be retired; and (*ii*) no first and consolidated bonds would be issued for the purpose of acquiring equipment which would also be under equipment-trust obligations or under any obligations for the deferred or serial payment of the purchase price of equipment; and (*iii*) no application would be made to the Commission for authority to issue first and consolidated bonds for any purpose specified in this clause (*b*) in respect of any item of cost more than 18 months after the close of the calendar year in which the reorganized company would have paid such cost. All such bonds which would be authorized by the Commission to be issued for any such purpose not sold or pledged within 36 months after the close of the calendar year in which the reorganized company would have paid such cost would be canceled, and no other first and consolidated bonds would be issued in lieu thereof or for any items of cost in respect of which the same were authorized.

Fixed property would include all lands, buildings, roadbeds, tracks, structures, machinery attached to and forming part of real property, switches, signal towers, and bridges and the like, which have a life expectancy of at least 25 years with reasonable maintenance, replacements, and repairs, but would not include property with a lesser life expectancy, or movables such as office furniture and office equipment, hand tools and the like.

(*c*) First and consolidated bonds would not be issued on the basis of additional property or additions and betterments acquired to the extent that such additional property or additions and betterments would be acquired by the use of the additions and betterments fund, except as in the mortgage otherwise provided.

(*d*) Upon requisite authorization by the Commission, first and consolidated bonds would be issuable from time to time, up to a principal amount of $500,000 at any one time outstanding, without regard to the restrictions on the issue of additional first and consolidated bonds previously stated in the mortgage, if the reorganized company would have contracted forthwith to sell or pledge such bonds and the board of directors by resolution adopted by two-thirds of the entire number of directors, would have determined that an emergency, which term may be defined in the mortgage, exists requiring such issue. The fact that such bonds theretofore have been issued for emergency purposes and thereafter canceled would not at any given time affect the right of the reorganized company then to issue first and consolidated bonds for emergency purposes up to the aforementioned maximum principal amount of $500,000 at any one time outstanding. The amount of first and consolidated bonds issuable for other than emergency purposes would be reduced by the aggregate principal amount of bonds theretofore issued for emergency purposes less the principal amount thereof which theretofore had been canceled. First and consolidated bonds would be issuable for emergency purposes on such other terms and conditions as determined by the reorganization managers and set forth in the mortgage.

The mortgage would provide no sinking fund for series A bonds, but subsequent series might have the benefit of sinking funds, in the discretion of the board of directors except as otherwise provided in the mortgage with regard to bonds issued to cover the cost of equipment or for emergency purposes.

[22] Other provisions of the general mortgage: The denominations of series A bonds would be in the discretion of the reorganization managers and those of subsequent series in the discretion of the board of directors; the bonds would be fully registered or in coupon form registerable as to principal, or both, as determined by the reorganization managers in the case of series A and as determined by the board of directors in the case of subsequent series,

Approximately 30,000 shares of preferred stock, having a par value of $100 a share would be authorized, approximately all of which would be issued in the reorganization. It would be entitled to receive dividends out of available net income, as defined by the plan and herein described, when and as declared by the board of directors, at the rate of 5 percent a year before any dividends would be paid, declared, or set

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but all series A income bonds would have to be registered as a condition precedent to the exercise of voting rights thereon; contingent interest on series A bonds would be at the rate of 4½ percent, payable on the first day of May in each year beginning with May 1, 1945; said interest, so long as payment thereof be contingent, would be paid if covered by available net income (as defined by the plan and presumably to be incorporated in, or appropriately referred to, by the mortgage), and if not fully covered thereby, to the extent so covered, in multiples of one-eighth of 1 percent, except that if the amount so available be less than one-fourth of 1 percent, such amount would not be payable until the amount thereof, together with interest payable in respect of said series A income bonds in any succeeding year, would equal or exceed one-fourth of 1 percent; to the extent that interest at the rate of 4½ percent for any income period would not be paid, the deficiency would be cumulative to a maximum amount at any on time of 13½ percent of the principal amount of the series A income bonds then outstanding; accumulations of interest would not bear interest; interest on the series A income bonds accruing for each calendar year would, up to a maximum amount at any one time accruing for prior years of 13½ percent of the principal amount of the series A income bonds then outstanding plus interest on such bonds for the current calendar year to the extent payable out of available net income, become owing as a debt on December 31, of each year but would be payable as in the mortgage provided; such interest (unless and until commuted to fixed interest as in the mortgage provided) would be mandatorily payable only out of available net income, defined as aforesaid, in respect of the preceding calendar year, or (in the case of accumulations of interest) out of available net income in respect of such preceding calendar year or subsequent calendar years; for the purpose of the immediately preceding provision, payment of interest would be considered as applied to interest accrued for the last preceding year before being applied to accumulations; the board of directors would have authority, in its discretion, to cause the payments of interest on said series A income bonds out of any fund whatever that would be lawfully available therefor and permitted under the terms of the income mortgage.

When the principal of any of the series A income bonds would become payable, whether at maturity or upon redemption or by acceleration, or in any other manner, or a permanent or confirmed appointment made of any trustee or receiver for the reorganized company or its property, or the contingent interest on the series A income bonds commuted to fixed interest, (*a*) interest on such bonds at the rate of 4½ percent for the next preceding calendar year, to the extent unpaid, and (*b*) any other interest accumulated on the next preceding May 1 to the extent unpaid, and (*c*) interest at the rate of 4½ percent from the last preceding December 31 would become immediately and absolutely payable regardless of earnings; the interest on said series A income bonds, payment of which is contingent upon earnings as hereinbefore described, would nevertheless by appropriate provision in said income mortgage be made commutable into fixed interest which would commence to accrue on May 1 next succeeding the occurrence of either of the following events: (*i*) The sale of 51 percent or more of the preferred stock and common stock pursuant to the provisions of the preferred-stock voting trust and the common-stock voting trust in the mortgage elsewhere referred to; or (*ii*) The consolidation or merger of the reorganized company or the sale or lease of substantially all of the properties of the reorganized company as an entirety.

Interest on series A income bonds would not be so commutable on the occurrence of either of the events described above, if such event occurred pursuant to an agreement consented to by the holders of not less than a majority in aggregate principal amount of series A income bonds then outstanding that said interest would not be so commutable; in the event of such commutation to fixed interest the same would be payable semiannually, the first such semiannual payment to be made on November 1st of the year in which such fixed interest would commence to accrue as above provided; interest provisions applicable to subsequent series would be as determined by the booard of directors, except that interest on subsequent series of income bonds would not be made commutable into fixed interest, and fixed-interest bonds would not be issuable under the income mortgage.

Series A bonds would be redeemable in whole or in part at any time, on 60 days' notice by publication, (1) so long as the interest had not been commuted to fixed interest, at

apart for payment on the common stock. Such dividends would be noncumulative, except that after a period of 3 years following the effective date of the plan, they would be cumulative to the extent earned in any calendar year but not paid until the dividend accumulations would total 15 percent of the par value of the then outstanding preferred stock. Such dividends would be deemed to have been earned to the extent covered by available net income after the deductions provided prior to the authority of the board of directors to apply it to general corporate purposes or to dividends. In the event of unification with any other corporation by consolidation, merger, sale, lease, or otherwise, the holders of the preferred stock would be author-

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their principal amount plus (*a*) interest at the rate of 4½ percent for the next preceding calendar year to the extent unpaid on the redemption date, and (*b*) any other interest accumulated on the next preceding May 1 to the extent unpaid on the redemption date, and (*c*) interest at the rate of 4½ percent from the last preceding December 31 to the redemption date; (2) if and when the interest had been commuted to fixed interest, at their principal amount plus accrued and unpaid interest plus a premium of 5 percent if redeemed on or before January 1, 1954, 4 percent if redeemed thereafter and on or before January 1, 1964, 3 percent if redeemed thereafter and on or before January 1, 1974, 2 percent if redeemed thereafter and on or before January 1, 1984, 1 percent if redeemed thereafter and on or before January 1, 1992, and no premium if redeemed thereafter; and subsequent series of bonds would be redeemable as determined by the board of directors.

On May 1 in each year, beginning with May 1, 1945, the reorganized company would pay to the income-mortgage trustee an amount equal to one-half of 1 percent of the maximum principal amount of series A income bonds outstanding at any one time. Such annual payment, would be payable only out of available net income after payment, or setting aside for payment, of all accumulations of interest and of the full interest requirements at the rate of 4½ percent accruing for the preceding calendar year on said series A income bonds outstanding in the hands of the public, and of all other items payable prior thereto out of available net income. If, during the said preceding calendar year, the reorganized company had made any charges for depreciation of roadway and structures, the amounts so charged would be used to make said annual payments for the sinking fund to the extent permitted by law or by applicable government regulation and to the extent said amounts would exceed the amounts to be applied to the additions and betterments fund, and the charge out of available net income for the sinking fund would be reduced accordingly. Annual payments for the sinking fund would not be cumulative. Moneys in the sinking fund would be applied by the mortgage trustee to the purchase or redemption at public or private sale or upon calls for tenders of series A income bonds. Bonds so purchased or redeemed would be canceled. In making provision in the income mortgage for a sinking fund on the series A income bonds after the interest thereon had been commuted to fixed interest, the reorganization managers would have authority to make such changes in the foregoing as they deem advisable in view of the possibility of such commutation. Sinking-fund provisions applicable to subsequent series would be as determined by the board of directors.

There would be no conversion rights in respect of the series A bonds; conversion rights as to subsequent series would be in the discretion of the board of directors.

Appropriate provisions, similar to those in the new Terminal mortgage in respect of the additions and betterments fund would be provided in this mortgage.

Provisions similar to the four so-called miscellaneous covenants hereinbefore described in connection with the new terminal mortgage and to the one hereinbefore described in connection with the first and consolidated mortgage relative to the proportion of bonds which could at any time be under pledge would be contained in this mortgage. It would also contain a provision that the series A income bonds issued at the time of the effectuation of the reorganization, and no others, would be entitled to elect or designate, in such manner as lawfully would be provided in the income mortgage, one director of the reorganized company and that such director would likewise be a member of any executive committee and of any other committee exercising general or financial powers of the board of directors.

Series A income bonds would be issued at the time of the effectuation of the reorganization in the principal amount of approximately $4,000,000. Additional series A income

ized, by vote on consent of at least two-thirds in par value, to give authorization, binding on all of the holders of preferred stock, for ascertaining available net income without the maintenance of separate books of account.

The preferred stock would be redeemable in whole or in part at any time, on 60 days' notice by publication, at $105 a share plus any accumulated unpaid dividends. In liquidation its value would be par plus any accumulated and unpaid dividends. Its holders would not have any preemptive rights to subscribe to any additional issues of stock or of securities convertible into stock.

Holders of the preferred stock would be entitled to one vote per share upon all matters except to the extent that provision is made in the

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bonds would be issuable, subject to such limitations and restrictions as specified in the income mortgage.

Additional income bonds of other series would be issuable, subject to the limitations and restrictions set forth in the mortgage provisions here described or as specified in the income mortgage, to mature on such date or dates (not earlier than the maturity of series A income bonds except where issued to cover the cost of equipment or for emergency purposes as hereinbefore described), to bear such rates of interest and to contain such provisions regarding accumulations of interest, redemption, conversion, sinking funds, and other matters as would be determined by the board of directors, but with respect to the lien of the income mortgage all equally secured. Such additional income bonds of series A or of other series would be issuable only for the following purposes and subject to the following conditions:

(*a*) To refund any new new terminal bonds or any first and consolidated bonds or any series A income bonds or any obligations at any time constituting a lien on any part of the system prior to the lien of the income mortgage.

(*b*) To cover the cost of additions and betterments, or the acquisition of additional property, in a manner similar to that to be provided in the first and consolidated mortgage with respect to the issue of additional first and consolidated bonds and subject to the limitations that would therein be set forth.

(*c*) Income bonds would not be issuable on the basis of additional property or additions and betterments acquired to the extent that such additional property or additions and betterments were acquired by the use of the additions and betterments fund, except as otherwise stated in the provisions herein described.

(*d*) No income bonds (except additional series A income bonds or income bonds of any series issued for emergency purposes as permitted by the provisions hereinafter described) would be issuable with interest ranking prior to interest on series A income bonds, and no income bonds (except additional series A income bonds or income bonds of any series issued for emergency purposes or to cover the cost of equipment as would be authorized by the provisions hereinafter described) would be issued with a sinking fund ranking prior to the sinking fund for the series A income bonds. No interest would be mandatorily payable on income bonds of any series (except at maturity, or upon redemption, or upon the commutation of the contingent interest on series A income bonds to fixed interest, or otherwise as stated in the provisions hereinabove provided in the description of interest rate on the income bonds) except out of available net income.

(*e*) Upon requisite authorization by the Commission, income bonds would be issuable from time to time, up to a principal amount of $500,000 at any time outstanding, without regard to the restrictions on the issue of additional income bonds set forth in the provisions hereinbefore described, if the reorganized company had contracted forthwith to sell or pledge such bonds and the board of directors by resolution adopted by two-thirds of the entire number of directors had determined that an emergency, which term would be defined in the income mortgage, exists requiring such issue. The fact that income bonds had previously been issued for emergency purposes, and thereafter canceled, would not at any given time affect the right of the reorganized company then to issue income bonds for emergency purposes up to the afore-mentioned maximum principal amount of $500,000 at any one time outstanding. Income bonds would be issuable for emergency purposes on such other terms and conditions as determined by the reorganization managers and set forth in the income mortgage.

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plan for the election of one director by holders of income bonds and except as otherwise limited by the plan as hereinafter described. Voting separately as a class, the holders of the preferred stock would be entitled to elect one-half of the board of directors less one, and one of the directors so elected would be a member of any executive committee and of any other committee exercising general or financial powers of the board.

Approximately 42,500 shares of common stock, without par value, would be authorized and issued in the reorganization. This stock would be entitled to 1 vote for each share upon all matters except to the extent that provision is made in the plan for the election of certain directors by holders of income bonds and preferred stock. The holders of this stock would not have any preemptive right to subscribe to any additional issues of stock or securities convertible into stock.

(*a*) *Voting trusts.*—All shares of preferred stock would be deposited under a voting-trust [23] agreement and voting-trust certificates would be issued to the persons otherwise entitled to receive the stock.

The terms of the voting-trust agreement would be determined by the reorganization managers and approved by the court but would include appropriate provisions to effect the purposes listed in the footnote.[24]

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[23] There would be three voting trustees, E. G. Herendeen, Richard K. Paynter, Jr., and Norvin H. Green. In the event of a vacancy in the trusteeship that would be held by Herendeen, he would be succeeded by Frank Wolfe. In the event neither could serve, the trustee under the new general mortgage would fill the position. In the event of a vacancy in the trusteeship held by Paynter, he would be succeeded by Frank A. Byrnes, and in the event neither could serve, the position would be filled by the holders of preferred-stock voting-trust certificates which are not so owned, controlled, or held that instructions as to voting would have to be disregarded pursuant to provisions hereinafter described. In the event of a vacancy in the trusteeship held by Green, he would be succeeded by Ogden B. Hewitt, and in the event neither could serve, the position would be filled by the holders of the common-stock voting-trust certificates (provided for in the plan and hereinafter described) not so owned, controlled or held that instructions as to voting would have to be disregarded pursuant to the provisions of the plan hereinafter described.

[24] (*i*) The period of the trust would be 10 years, but it would terminate upon the sale in accordance with the terms of the trust of at least 51 percent of the stock held in the trust, and would be terminable at any time by the voting trustees with the consent of the holders of a majority in interest of the preferred-stock voting-trust certificates then outstanding and with the consent of the voting trustees under the common-stock voting trust.

(*ii*) The voting trustees would have power in their sole discretion (but only with the approval of the Commission and the consent of the holders of a majority in interest of the preferred stock voting-trust certificates then outstanding and the consent of the voting trustees under the common-stock voting trust hereinafter referred to) to sell 51 percent or more (but not less than 51 percent) of the stock held in the trust at any time prior to the termination of the trust for such consideration as they would deem expedient (as part of which consideration they would have authority to take into account any agreements which the purchaser or purchasers would make by way of traffic agreements, guaranties, offers of exchange of securities, or otherwise, which in the judgment of the voting trustees would be of value to the holders of bonds issued in reorganization or of the preferred-stock voting-trust certificates; provided, however, that the purchaser or purchasers would be required for a reasonable period after the termination of the preferred-stock voting trust, to purchase such additional shares of preferred stock theretofore held under the trust as would be tendered at the same "price per share of preferred stock" as would have been paid in respect of said 51 percent or more of said preferred stock (the phrase "price per share of preferred stock" as used in these provisions defining the terms of new securities being intended to relate only to that part of the aforesaid consideration which reasonably might

All shares of common stock would be deposited under a voting trust-agreement and voting-trust certificates would be issued to the persons otherwise entitled to receive the stock.[25]

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be and would be intended to be divided and distributed among the holders of preferred-stock voting-trust certificates, including in particular, but without limiting the generality of the foregoing, cash and securities); and provided further, that the purchaser or purchasers would be required, as a part of the same transaction to buy 51 percent or more (but not less than 51 percent) of the common stock of the reorganized company and to make an offer to buy all of said common stock as hereinafter set forth; and holders of all preferred-stock voting-trust certificates would be bound by the terms of sale.

(*iii*) In the event that the sale of 51 percent or more of said trusteed preferred stock would be effected prior to the termination of the trust, that part of the consideration which would be the basis for determining the price per share of preferred stock, as defined in (*ii*) *supra*, and the balance of the trusteed stock, if any, would be distributed pro rata to the holders of preferred-stock voting-trust certificates against the surrender of said certificates.

(*iv*) The voting trustees would possess and would be entitled to exercise all rights and powers of absolute owners of the preferred stock held in the trust, including the right (*a*) to vote in respect thereof for every purpose and to consent to any corporate act of the reorganized company, it would be expressly stipulated that, except as in the voting trust specified, no voting right would pass by or under the preferred-stock voting-trust certificates or by or under any agreement express or implied, and (*b*) to sell, exchange, or otherwise dispose of such preferred stock, all subject to the provisions of the voting-trust agreement.

The voting-trust agreement would provide in substance that a copy of every notice of a stockholders' meeting be mailed to each registered holder of a preferred-stock voting-trust certificate, and that in case the voting trustees would receive from the holder of a preferred-stock voting-trust certificate within such reasonable number of days prior to the date of the meeting as would be set forth in such notice, a written request to vote in the manner stated in such request at any such meeting upon any matter to come before such meeting, the voting trustees would vote at such meeting in accordance with such request in respect of the number of full shares of preferred stock represented by said certificate, except that the voting trustees would disregard any instructions as to voting the shares of preferred stock represented by the certificate, if the written request to vote did not expressly state that the certificate be not owned or controlled by, or held for the benefit of, a person, firm, association, or corporation which owns or operates, or controls a corporation which owns or operates, or is controlled by a corporation which owns or operates, or is in any way, directly or indirectly, affiliated with a corporation which owns or operates a line or lines of railroad, or by two or more such persons, firms, associations, and/or corporations acting jointly.

The voting trustees, in determining whether or not they were authorized by the consent of the holders of a given percentage in interest of the certificates then outstanding, in any case where such consent would be required, (*a*) would treat as not outstanding certificates so owned, controlled, or held that instructions as to voting-trusteed stock represented thereby would have to be disregarded pursuant to the next preceding paragraph, and (*b*) would disregard any such consent by the holder of such certificates.

(*v*) The preferred stock held in the trust would not be voted in favor of the merger or consolidation with or into any other corporation or the sale or lease of all or substantially all of the assets of the reorganized company, before obtaining the consent thereto of the holders of a majority in interest of the preferred-stock voting-trust certificates then outstanding, and of the voting trustees under the common stock voting trust.

(*vi*) Whenever the consent of the voting trustees under the preferred-stock voting-trust would be required under the plan as a condition precedent to action by the voting trustees under the common-stock voting trust hereinafter described, such consent would be given only with the favorable vote or consent of the holders of a majority in interest of the preferred-stock voting-trust certificates then outstanding.

(*vii*) The reasonable expenses of such voting trustees, including counsel fees, would be paid by the reorganized company.

(*viii*) The voting trustees would act in accordance with the vote of a majority of said trustees.

[25] The initial three trustees under the common-stock voting trust and their respective alternates would be the same persons as in the case of the preferred-stock voting trust, and the successors of such persons for the respective trusteeships would be selected by the same interests and in the same manner as in the case of the preferred-stock voting trust.

The terms of the voting-trust agreement for the common stock would be determined by the reorganization managers and approved by the court, but would include appropriate provisions to effect the purposes stated in the footnote.[26]

2. *Additions and betterments fund.*—The plan, as amended on brief, in respect of this fund provides that all the new mortgages would contain appropriate provisions to require the board of directors on or before May 1 of each year beginning with 1945, to set aside from the available net income of the preceding calendar year, and prior to interest and sinking-fund payments upon the general-mortgage income bonds an amount which would be equal to 2 percent of the total railway operating revenues in such preceding calendar year, or $65,000, whichever would be greater, plus, through May 1, 1950, $20,000 a year, provided that amounts properly charged for depreciation of roadway and structures would be applied to such fund to the extent permitted by law or by applicable government regulation, and the charge out of available net income for such fund would be reduced accordingly. If, and to the extent that the available net income of any calendar year would not be sufficient to set aside for the fund $85,000 through May 1, 1950, or $65,000 thereafter, such deficiency would be made up in subsequent years before the payment of contingent or accumulated contingent interest, sinking-fund installments, or dividends, provided that the total of such deficiencies to be made up on May 1 of any year, exclusive of deficiencies made up in previous years and exclusive of the amount to be set aside in respect of the preceding year, would never exceed $150,000, and no deficiency would be made up on any May 1 which was incurred more than 28 months prior thereto.

The fund would be applied to provide for, or to reimburse the treasury of the company for, all or any part of the cost in any calendar year of capital investments[27] remaining after deducting from such cost all retirements of roadway and structures charges against income for such year, with proper adjustments for donations and other items not involving a cash outlay. The company would not have the right to issue any securities to capitalize the capital investments paid for out of the fund, but such investments, if for purposes for which first

[26] These purposes are stated substantially as in the case of the above-described preferred-stock voting trust, the essential differences being in the substitution of terms as between the common-stock voting trust, the common stock and related terms, on the one hand, and the preferred-stock voting trust, the preferred stock, and related terms, on the other hand.

[27] Such capital investments would be as defined by the Commission's classification of income, profit and loss, and general balance sheet accounts for steam roads, accounts Nos. 701, investment in road and equipment, 702, improvements on leased property, and 705, miscellaneous physical property, or advances to subsidiaries for expenditures which, if made directly by the reorganized company in respect of its owned and leased property, would be charged to said accounts, or such substituted accounts of the Commission as would at the time be in effect.

and consolidated bonds or income bonds would be issuable, would be usable, within such limits, if any, as would be specified in those two mortgages, to supply in whole or in part the excess of capital expenditures required to be certified under either of such mortgages over the principal amount of bonds that would be issuable under the terms thereof.[28]

3. *Determination and application of available net income.*—Available net income would be "income after fixed charges" (determined in accordance with the accounting rules of the Commission or, to the extent not governed by such accounting rules, in accordance with sound accounting practice).

Available net income would be determined for each calendar year within 4 months after the termination thereof, beginning with the calendar year 1944 and continuing thereafter so long as any funded debt would remain outstanding.[29]

Available net income for each calendar year would, subject to the following provisions, and subject to such modifications thereof (including rearrangement of the priority of payment) as the reorganization managers deemed desirable in connection with sinking funds created for bonds issued to cover the cost of equipment or for emergency purposes, be applied during the next succeeding calendar year to the following purposes and in the following order:

[28] Other provisions relative to the fund are the following: To the extent that the fund was not required for such capital investments, it or any part thereof would be usable for the payment of interest on fixed-interest debt, and, to the extent so applied it would be reimbursed out of available net income of subsequent years before payment of any contingent or accumulated contingent interest, sinking-fund installments, or dividends.

Whenever, prior to 1951, the amount in the fund exceeded $120,000 or whenever, in 1951 or thereafter, such amount exceeded $100,000, such excess would be usable in the purchase or redemption at public or private sale or upon calls for tenders of any new Terminal, first and consolidated, or income bonds, and bonds so purchased or redeemed would be canceled.

Any moneys in the fund not applied under the provisions above described during the calendar year in which credited, would be carried over in the fund to the next calendar year, in addition to the regular annual credit to the fund. If on May 1 in any year the fund were equal to or in excess of $200,000, no contribution would be made to it in such year, and the "then remaining available net income" to which reference is made in paragraph (*c*) of the provisions hereinafter described defining the proposed order of application of available net income, would, for the preceding year, be deemed to have been increased by the amount which would otherwise have been payable into the fund on said May 1.

[29] Provided (1) if in any calendar year the company should fail to earn its fixed charges, such deficit would be added to the fixed charges in the next succeeding year or years, and (2) adjustments necessary to correct the income or expense accounts of any prior year (but not any year prior to 1944) would be made by appropriate entries, either in the accounts of the current year, or (unless such adjustment would be in violation of applicable orders, rules, and regulations of the Commission), in the discretion of the board of directors, in whole or in part in the accounts of any subsequent year or years. Any such adjusting entries made in the accounts of any year to adjust the income or expense accounts of prior years would be treated, for the purpose of the provisions relating to the determination and application of available net income, as income or expense items for the year in which entered on the books, whether cleared through income or profit and loss accounts.

(*a*) Available net income would be set aside on May 1 to the extent, but only to the extent, required (when added to the credit, if any, for roadway and structures depreciation reserve as set forth in the provisions relative to the mortgages and the additions and betterments fund hereinbefore described) for the additions and betterments fund as hereinabove described.

(*b*) Any then remaining available net income would be set aside on May 1 to make up any deficiency not exceeding $150,000 in the amounts credited in the preceding 28 months to the additions and betterments fund, and to reimburse said fund for moneys that would have been taken from said fund and used for the payment of interest on fixed-interest debt.

(*c*) Any then remaining availabe net income would be applied on May 1 to provide any amount necessary to service any sinking funds which would be created in connection with any future issue of first and consolidated bonds.

(*d*) Any then remaining available net income would be applied on May 1 to the payment of any contingent interest on income bonds accrued during the last preceding calendar year, and of any accumulated unpaid interest thereon.

(*e*) Any then remaining available net income would be applied on May 1 to provide any amount which would be necessary (when added to the credit, if any, from roadway and structures depreciation reserve as herein elsewhere described) to service the sinking funds for the benefit of income bonds.

(*f*) Any then remaining available net income would be applied, as the board of directors would determine, to general corporate purposes or dividends on the several classes of stock in the order of their priority.

4. *Miscellaneous provisions relative to new securities.*—The effective date of the plan, which would be January 1, 1944, would determine the extent to which the claims of present creditors would be capitalized in new securities, but the plan would not affect creditors' claims until the new securities were actually issued (or existing securities actually extended) by the reorganized company under the plan, and the carrying out of the plan, even though after January 1, 1944, would not require any retroactive change in the operations of the trustee of the debtor or in his accounts, or in the reports made to the Commission, or in any other reports or returns for the period prior to the date when such new securities were issued or existing securities extended. Subject to the approval of the court, the reorganization managers would have authority to cause any issue of new securities to be dated, or the existing terminal bonds to be extended, as of another date than January 1, 1944, but only if the creditors who would receive such issue of new securities, or whose existing terminal bonds would be extended, would

receive through payments in respect of the old securities, or otherwise, the same amounts in cash and the same rights in respect of accruals of interest and accumulations of interest and dividends as if such issue of new securities had been dated, or the existing Terminal bonds had been extended, as of January 1, 1944.[30]

5. *Allocation of new securities.*—Under the plan, the holders of the Terminal bonds would receive in satisfaction of the principal amount of their claims a like amount of new Terminal-mortgage bonds after first having received payment in full in cash of their claims for interest accrued and unpaid at the rate fixed in the Terminal mortgage up to the effective date of the plan. As hereinbefore stated, the reorganization managers would have the option of providing for the extension and modification of the existing Terminal mortgage and bonds, in lieu of the creation of a new Terminal mortgage and the issue of new bonds thereunder.

Holders of the Midland bonds would receive, in respect of the principal amount of their bonds and accrued and unpaid interest to the effective date of the plan, new first and consolidated bonds in the amount of $1,771,641 and new general-mortgage income bonds in the amount of $2,894,897, and holders of refunding bonds would receive, in respect of the principal amount of their bonds and accrued and unpaid interest to the effective date of the plan, $1,228,359 of first and consolidated bonds, $1,105,103 of general-mortgage income bonds, and $2,736,538 par amount of preferred stock.

Holders of second-mortgage bonds not pledged, in respect of the principal thereof and interest accruing and unpaid to the effective date of the plan, would receive $118,031 par amount of new preferred stock and $471,649 in new common stock (4,716.49 shares without par value, stated at $100 a share), and holders of the general-mortgage bonds would receive, in respect of principal and interest accruing as aforesaid, $145,431 par amount of preferred stock and approximately $3,268,692 of common stock,[31] stated as aforesaid. The $145,431 of preferred stock and $581,139 of the common stock would be in recognition

[30] Other such provisions are: That subject to the approval of the court, the new securities would be in such form as would be determined by the reorganization managers, provided that they would include, in addition to provisions usual under the circumstances, appropriate provisions to effect the aims described in the plan; that the new securities would be issuable in temporary form in the first instance or interim certificates therefor would be issuable; that scrip would be issuable and distributable in lieu of fractional bonds or shares of stock; that such scrip would not entitle the holder to any interest or dividend payments or to any voting rights but would be exchangeable, on or before January 2, 1949, for the new securities (and for such interest and dividends in respect thereto as would be determined by the reorganization managers), when presented in proper multiples on terms and conditions approved by the reorganization managers; that after January 2, 1949, such scrip would be void; and that such adjustments as would be necessary to avoid the issuance of scrip in too small fractions would be made by the reorganization managers as they in their discretion would determine.

[31] This amount would be increased after certain of the stock initially allocated to the Paterson Extension bonds was made available, so that the total stock on the basis stated would equal the total claim.

of the $552,000 of second-mortgage bonds pledged under the general mortgage. Holders of Paterson Extension bonds would receive an initial allocation of $270,833 of common stock, stated on the basis per share as aforesaid, which would equal the principal amount of the outstanding bonds plus interest to the effective date of the plan. This amount of stock would be decreased after appraisals of certain non-carrier land subject to that mortgage would be made and credit therefor applied on the claim. Holders of unsecured claims would receive an initial allocation of approximately $238,826 of common stock, stated as aforesaid, which amount would be increased by the residue of available common stock after the release of certain of the stock initially allocated to the Paterson Extension bonds and after filling out, on the basis stated, the face amount of the claims of the general mortgage bondholders.

In the event that part or all of any claim in respect of which new securities are to be issued under the plan, including interest to the effective date, is satisfied prior to the consummation of the plan, the capitalization would remain unchanged, and the additional securities thereby made available for distribution, in respect of other claims, would be distributed in accordance with a reapplication of the methods prescribed in the plan, except, that to the extent that the principal amount of Terminal bonds outstanding would be reduced prior to the consummation of the plan, the total principal amount of new Terminal bonds and the total principal amount of new first and consolidated bonds, series A, to be reserved for the conversion of the new Terminal bonds would each be reduced, and the total principal amount of new first and consolidated bonds, series A, to be issued at the time of the effectuation of the reorganization would be increased to the same extent. Additional new common stock made available for distribution would be allocated to the holders of general-mortgage bonds until their claims were satisfied in full, and thereafter any additional new common stock made available for distribution would be allocated to unsecured creditors to the extent that the amount of common stock so made available makes such allocation practicable in the opinion of the reorganization managers.

6. *Provisions for execution of the plan.*—There would be three reorganization managers [32] who would supervise the carrying out of the

[32] They would be the same persons, with provision for the same alternates, as is provided in the plan, as hereinbefore described, to act as trustees under the stock-voting trusts, except, that in case for any reason neither Hernedeen nor Wolfe would serve, that position would be filled by the Central Hanover Bank & Trust Company, as trustee under the Midland mortgage, that in case for any reason neither Paynter, Jr., nor Byrnes would serve, that position would be filled by the Commercial Trust Company of New Jersey, as successor trustee under the refunding mortgage, and in case for any reason neither Green nor Hewitt would serve, that position would be filled by The New York Trust Company, as successor trustee under the existing general mortgage.

plan. They would serve without compensation, would act through a majority either at a meeting or by actions in writing without a meeting, would not be liable for any action taken by them in good faith or by any person employed by them in good faith, except that each would be liable for his individual malfeasance or willful neglect, and they would incur no personal liability for any of the expenses incurred in carrying out of the plan. They would exercise, in their discretion the powers listed in the footnote,[33] in addition to those granted to them under the plan, as hereinbefore described, in order to carry out the purposes of the plan, subject to the approval by the Commission or by the court where such approval is required by law or is desired by the managers. Any reorganization manager would be removable by the court for cause shown.

If deemed desirable and so ordered by the court, the plan, after being found fair and equitable by the court, could be executed by the sale or sales, at not less than fair upset prices to be fixed by the court, of all or any part of the property of the debtor and its subsidiaries, all on such conditions and in such manner as the court would direct. Upon any such sale the reorganization managers would have authority under the plan to purchase for the benefit of the reorganized company the property and assets offered for sale, and in the event they would

[33] 1. To cause the debtor or the reorganized company to make such agreements and arrangements as they would deem necessary or desirable in order to carry out the plan.

2. To pass upon and determine the amendments to be made to the articles of consolidation and bylaws of the debtor and the changes to be made in its corporate structure, if they should decide that it be the reorganized company, or to cause a new corporation to be organized as the reorganized company, and to pass upon and determine the form and provisions of its charter and bylaws; in either case to determine the number, which must be an odd number, and terms of office of the directors, and to select the individuals who would constitute the directors to be in office until the first annual meeting after the consummation of the plan.

3. To pass upon and determine the manner of carrying out, and to supervise, the transfer of the properties of the debtor and its subsidiaries and of any other property as provided for in the plan, and to incorporate such other corporations as they would deem advisable.

4. To pass upon and determine the form and provisions of the new mortgages, bonds, coupons, stock certificates, scrip, voting-trust agreements, voting-trust certificates, agreements, acceptances, assents, and any other documents they would deem necessary or appropriate in connection with the carrying out of the plan.

5. From time to time, whether before or after the acceptance of the plan by any holders of securities or creditors, to supplement or modify the plan or adopt a substitute plan, subject to the provisions of section 77 of the Bankruptcy Act, or to abandon entirely the plan or any supplemental or modified or substitute plan by filing a written notice to that effect with the Commission.

6. To employ counsel and agents and such other persons as they would deem necessary in the carrying out of their functions and to delegate to them any powers given to the reorganization managers hereunder; and to fix the compesation of the persons so employed, subject to the approval of the court, and if required by law, subject to the approval of the Commission.

7. After confirmation of the plan by the court, to pass upon and determine the method by which creditors would participate in the plan and exchange their present securities for those provided in the plan.

8. To take or cause the reorganized company to take any action which they would deem necessary or desirable in order to carry out the plan, including the making of financial and other arrangements and the making of any application to the court or the Commission or any other public authority.

purchase them, there would be applied on account of the purchase price the distributive share of the proceeds of such sale of all securities the holders of which had assented to the plan, and of all securities (although the particular holders thereof had not assented to the plan) of all classes which had accepted the plan or had become bound thereby. If physical properties of the debtor used in the service of transportation so offered for sale would be sold to others than the reorganization managers, the court would determine the extent, if any, to which the plan would be deemed inoperative.

In the event of a sale or any of the properties of the debtor to the reorganization managers, they would have authority in their discretion to sell all or any portion of the new securities distributable under the plan to holders of existing securities, if neither such security holders nor the class to which such security holders belong had accepted, or become bound by, the plan, provided that security holders in a class which had not accepted, or become bound by, the plan, and who themselves had not accepted the plan, would have the right, if they so notify the reorganization managers within a period of 30 days after the confirmation of such sale, to assent to the plan and receive the securities allocated to them under the plan in lieu of their aliquot share of proceeds of such sale of the properties. The proceeds of any such sale of securities, and, with the approval of the court, any other funds which, in the judgment of the reorganization managers, would be available among the assets of the debtor's estate or of the reorganized company and would not be necessary for the working capital requirements of the reorganized company or to pay any of the obligations under the plan would be usable to pay the portion of the purchase price of property acquired payable in cash on any such sale.

Claims in classes 1, 2, and 3 of the court's classification of claims to the extent filed and allowed would, in the discretion of the reorganization managers, either be paid in cash in connection with the reorganization or, to the extent unpaid at the date of the consummation of the plan, be assumed by the reorganized company and paid in the usual course of business with the same relative priority as they now have with respect to other obligations of the debtor. The proponents of the plan state that it is not anticipated that the total amount of allowed claims in classes 1 and 2 will exceed $12,000. The status of the tax claim of the State of New Jersey was hereinbefore discussed and it is not expected that any further payment would be required in connection therewith that would materially affect the working out of the plan. No other tax or assessment claim was filed against the debtor by any State or by any subdivision. No claim in class 4 has been filed.

The reorganized company would be deemed to have assumed the obligations under existing executory contracts and leases which by their terms do not terminate at or prior to the conclusion of these proceedings and which had not been disaffirmed by the trustee of the debtor prior to the confirmation of the plan, and the reorganized company would also assume any executory contracts and leases made by the trustee of the debtor, with the approval or authorization of the court, which by their terms do not terminate at or prior to his discharge; however,[34] the plan would reject, and the reorganized company would not be deemed to have assumed, the agreement dated April 6, 1904, between The Edgewater and Fort Lee Railroad Company and the New Jersey Shore Line Railroad Company, or any agreement supplemental thereto.

Claims, other than those of the United States, for taxes levied, assessed, or accrued against the trustee of the debtor, when determined, and liabilities and obligations incurred by the trustee during these proceedings, to the extent unpaid at the date of the consummation of the plan, would be assumed by the reorganized company and paid in the usual course of business with the same relative priority as they now have with respect to obligations of the debtor and other obligations of the trustee. The reorganized company would assume the liability for, and pay in full in due course, any and all taxes due to the United States from the debtor or its trustee for any taxable period prior to the date of his discharge without requiring proof thereof in this proceeding, and without prejudice by reason of not having been proved herein, subject, however, to the statute of limitations normally applicable to the assessment and collection of such taxes; provided, that the liability of the reorganized company for any taxes, whether to the United States or to a State or to any subdivision of a State, which might be the subject of litigation on the date of the confirmation of the plan, or which might become the subject of litigation on any date thereafter, and prior to the expiration of the applicable statute of limitations, would be determined pursuant to law, and provided further that nothing in the plan would be deemed to preclude either the debtor, its trustee, the reorganized company, or any other party from contesting the merits of any such taxes in the manner provided by law.

The amounts required to discharge the claims of the mortgage trustees for compensation and expenses, all costs of administration, and all other allowances made or to be made by the judge in the reorganization proceedings, including allowances provided for in section 77 (c) (12) of the Bankruptcy Act, within maximum limits approved

[34] This word and the words following to the end of the sentence added by an amendment set forth in the insurance companies' brief.

by the Commission where such approval is necessary, would be assumed by the reorganized company as prior liabilities and promptly paid in full in cash, in any event not later than 3 months after the date of the final decree in the proceedings. Unpaid amounts which became due on coupons prior to June 1, 1937, aggregating about $8,287.50, would be paid in cash at reorganization or by the reorganized company. Refunding bond scrip certificates in the principal amount of $533 and coupon obligations of first-mortgage bonds due in 1895 in the amount of $30 are outstanding. Claims in respect of these have not been filed. To the extent filed and allowed, claims on these obligations would be classified in accordance with the court's classification and would be satisfied in cash or new securities in the same class or be disposed of otherwise as the court would direct.

The construction of the plan by the court would be final and conclusive. The court would be authorized to correct any defect, supply any omission, or reconcile any inconsistency in such manner and to such extent as would be necessary or expedient in order to carry out the plan effectively. Certain other miscellaneous provisions relative to carrying out of the plan are stated in the footnote.[35]

The examiner's proposed report recommended for our approval the major portions of the plan proposed by the insurance group. It recommended, however, that the capitalization be fixed at $14,000,000, taking the no-par-value common stock at $100 a share, as compared with $16,250,000 as proposed by the insurance group, exclusive in each

[35] No inaccuracy contained in the plan or omission therefrom would constitute the basis for any claim for rescission of any new securities or for damages. Acceptance of the plan would include acceptance of the provisions of the new bonds, mortgages, stock certificates, scrip, voting-trust agreements, voting-trust certificates, and all instruments necessary and appropriate to the carrying out of the plan, other than orders of the court and of the Commission, with the same effect as though the terms of such instruments were set forth in the plan in full.

The proponents of the plan reserve the right not only to supplement but also to amend it. Furthermore, each element of the plan is dependent to a greater or lesser extent on all other elements. The suggestions made as to each element of the plan are therefore subject to reconsideration and possible change if other elements are changed.

Nothing contained in the plan would be construed to prevent its consummation in case of the amendment of section 77, under such amendment, or, in case of the enactment of other applicable provisions of law, under such provisions.

In case of any changes in the law applicable to the plan, any approvals which would become unnecessary under such new law would be dispensed with.

A court finding, after the submission of the plan to creditors, that for any reason any one or more of its provisions be invalid would not prevent its consummation without resubmission to creditors, with such modification on account of such invalidity as the reorganization managers would determine, provided such resubmission be not required by law.

Nothing contained in the plan with respect to limitations on total authorized issues of new securities or total capitalization, or otherwise, would prohibit the issue of equipment-trust obligations upon the purchase of equipment, pursuant to appropriate approval by the Commission where required.

Unless otherwise provided in any order or orders of the court, whenever notice would be required or permitted to be given under or pursuant to the plan, such notice would be deemed to have been duly and properly given if a copy thereof be published once in each week, on any secular day in each such week, for 2 successive weeks in one newspaper published and of general circulation in the Borough of Manhattan, city of New York, and in one newspaper published and of general circulation in the city of Newark, N. J.

instance of equipment obligations. This recommended reduction in total capitalization is reflected in the reduction from $4,000,000 to $2,500,000 of the amount of new general-mortgage income bonds to be issued and the reduction from $4,250,000 to $3,500,000 the amount of common stock to be issued. The proposed report followed the general method used by the insurance group in the distribution of new securities, but the above-stated reductions in the amounts of new securities to be issued had the effect of providing no new securities having a mortgage lien for allotment to the holders of the existing general-mortgage bonds. The existing general-mortgage bonds, however, would receive some new securities in respect of the second-mortgage bonds pledged under the existing general mortgage and in respect of the distribution of free assets. The proposed report also included recommendations that the sinking fund of $20,000 a year provided by the insurance group for the benefit of the new income bonds should be applied to the benefit of the new Terminal bonds and that the free assets should be represented by $400,000 of new common stock instead of $275,362 as proposed by the group.

7. *Objections to the plan and to the recommendations of the proposed report.*—The insurance group excepts to the reduction of the total capitalization and to the reduction of the amount of income bonds and common stock recommended in the proposed report. The trustee under the Midland mortgage, the trustee under the refunding mortgage, the protective committee for the refunding bonds, and parties representing the general-mortgage interests take similar exceptions. The insurance group also excepts to certain recommended changes in the terms of the plan which are hereinafter specifically referred to.

The trustee under the Terminal mortgage opposed the plan to the extent that it does not provide that the new Terminal mortgage bonds would mature within 10 years and would be protected by a sinking fund. It stated, however, that it is satisfied with the plan recommended in the proposed report.

The successor trustee under the second mortgage opposes as unfair the allocation of new securities to the holders and pledgees of the second-mortgage bonds.

The trustee under the general mortgage requests that the plan proposed by the insurance group be modified in the following respects: (*a*) That the rate of interest on the first and consolidated mortgage bonds be reduced to 3 or to 3½ percent; (*b*) that the interest rate on the new general-mortgage bonds be reduced to 4 percent; (*c*) that no premium be allowed on redemption of the new Terminal, first and consolidated, and general-mortgage bonds; (*d*) that interest on the new general-mortgage bonds be noncumulative or, in the alternative,

cumulative to the extent it is available and unpaid; (*e*) that dividends on the preferred stock be noncumulative; (*f*) that no premium be allowed on redemption of the preferred stock; (*g*) that the preferred and common stock voting trusts continue until 5 years from the date the plan be confirmed by the court or until such earlier time as dividends on the preferred stock have been paid in full for each of three consecutive periods of 12 months; (*h*) that provision be made for an issue of series B 4 or 5 percent income bonds in the principal amount of not less than $1,000,000 or more than $3,000,000 junior to the lien of the series A general-mortgage income bonds and the preferred stock be eliminated from the plan or reduced accordingly, any such series B bonds to be allocated to the refunding, second, and general-mortgage bondholders in the same manner as the preferred stock is allocated by the plan to those three classes of security holders; and (*i*) that no new securities be issued to unsecured creditors. It excepts to the recommendations of the proposed report with respect to the total capitalization and the amount of income bonds and common stock, the probable future earnings of the properties, the basis of allocation of common stock to the refunding bonds, the allocation of $215,199 of common stock to the Paterson Extension bondholders, the allocation of $400,000 of common stock in respect of the unmortgaged assets, the elimination of interest on the general-mortgage bonds in the distribution of securities representing unmortgaged assets, the failure to eliminate premiums on the redemption of income bonds and preferred stock, failure to provide that interest on the income bonds would be noncumulative (or only to the extent earned), and the failure to make dividends on the preferred stock noncumulative.

The protective committee for holders of general-mortgage bonds requests that the plan be modified so as to provide (*a*) for the issue of $5,000,000 instead of $4,000,000 general-mortgage 4½-percent bonds with a like reduction of the amount of the common stock; (*b*) that the voting trusts terminate at the end of 3 years; and (*c*) that the redemption premiums and cumulative rights of the proposed new securities be eliminated.

The committee excepts to the proposed report insofar as it fails to recommend these modifications, and, in addition, excepts to the reduction in capitalization, the allocation of $400,000 of common stock in respect of the unmortgaged assets, and the distribution of $226,271 thereof to the unsecured creditors, the allocation of $215,199 of common stock to the Paterson Extension bondholders, the basis of allocation of common stock to the refunding bondholders, the making of dividends on the preferred stock fully cumulative to the extent earned, and the finding that the plan would comply with section 77 (b) and (e), all as recommended in the proposed report.

The group of less than 25 bondholders of the Paterson Extension requests modification of the plan as follows: That the Paterson Extension properties be treated as an integral part of the Midland division and the Paterson Extension bondholders treated *pari passu* with the Midland bondholders in the distribution of new securities after deducting from the claim of the Paterson Extension bonds the value of noncarrier properties as provided in the plan; or that the Paterson Extension properties, both carrier and noncarrier be either sold or leased to the reorganized company. It excepts to the allocation of new common stock to those bondholders recommended in the proposed report, which is more favorable to them, prior securities considered, than the treatment accorded them in the plan as filed.

Independently of the foregoing alternative proposals, the group requests that, in the event the proposal of the plan that the noncarrier properties be segregated for the benefit of the bondholders becomes operative, the noncarrier properties be conveyed to a trustee appointed by the court, in lieu of a new corporation created to act as titleholder.

The group also contends that the Paterson Extension bondholders should be compensated to the extent of $11,000 in cash or in new bonds in respect of two parcels of noncarrier lands which the debtor's trustee thinks should be transferred to the new company. The Paterson Extension mortgage trustee suggests that the court should hold further hearings to determine whether or not the two parcels should be conveyed to the new company or for the benefit of the bondholders as in the case of certain other parcels as hereinafter explained.

Edith A. Merritt, a holder of three $1,000 general-mortgage bonds makes numerous objections to the proposed plan and files several exceptions to the proposed report.[36]

[36] She objects to the provisions of the plan making allocations to the several classes of creditors, particularly the allocations to the general-mortgage bondholders, requests further hearings on various matters, asks that we withhold action on the plan until after final judicial determination of the validity of the New Jersey tax legislation and the litigation with the New York Central interests, claims that the general mortgage is entitled to a lien on equipment superior to that of all other mortgages, claims that in the plan the interest on the second-mortgage bonds is erroneously computed, opposes certain miscellaneous provisions of the plan and the provision relative to the personnel of the reorganization managers and voting trustees, claims a possible first lien in favor of the refunding followed by the second and general mortgages, on certain plots of ground described in two unrecorded mortgages, and contends that the provision that the construction of the plan by the court should be final and conclusive is illegal.

She excepts to the capitalization recommended in the proposed report as being too low; also that the recommended provisions of the proposed report do not comply with section 77 (b) and (e), in that the allocations of securities are not fair and equitable, do not afford due consideration to the rights of the general-mortgage bondholders and discriminate unfairly in favor of all the bondholders (except the Terminals) and the unsecured creditors. She asks that the recommended allocations to the refunding bondholders be "scaled down" about 50 percent and that the securities representing such reduction be passed on to the second-mortgage and the general-mortgage bondholders, and that, in any event, sufficient stock be issued to fill out the claims of the general-mortgage bondholders (the common stock allotted to them to be at the rate of one share of stock to each $10 of claim) and that the general-mortgage bondholders are entitled to be paid in full even to the exclusion of the unsecured creditors in the unmortgaged assets.

Blanche Oster and Leonard Oster, holders of refunding bonds, and Central Holding Company and Lillie Mock, holders of general-mortgage bonds, filed numerous exceptions to the proposed report.[37] These exceptions are, in general, vague and meagerly supported by reasons or facts.

The New York Central Railroad Company and the New Jersey Junction Railroad Company, hereinafter collectively referred to as the New York Central, intervened in opposition to any provisions of a plan which would disturb the rights of the New York Central growing out of certain contracts hereinafter more particularly referred to. The Erie supported the New York Central in that position. Both the Central and the Erie except to the provisions of the proposed report which would disaffirm contracts with the Central interests relative to trackage rights over the northern and southern extensions.

All of these objections, suggestions, and exceptions have been considered by us in reaching our conclusions and are to a large extent hereinafter discussed.

## II. NEW CAPITALIZATION AND CHARGES

### A. ASSETS, CAPITALIZATION, TRAFFIC, REVENUES, ET CETERA

1. *Book assets and valuation figures.*—The debtor's balance sheet as of December 31, 1942, shows the following assets: Investment in road and equipment $36,749,333; improvements on leased property $11,127; acquisition adjustments, Erie Terminals Railroad, $2,501 (credit); deposits in lieu of mortgaged property sold $397; miscellaneous physical property $302,636; investments in affiliated companies $722,155, including $590,761 of stocks, $62,496 of bonds, and $68,898 representing investment advances; other investments $453; cash on hand $1,267,-

[37] These exceptions relate mainly to the permissible total debt of the new company, the interest rate on the new income bonds, the amount of new income bonds justified by earnings, the total capitalization, the amounts and character of the new securities, the method of allocation of new securities to the Midland and the refunding bondholders, respectively, the allocations of new securities to the unsecured creditors compared with the recommended treatment of general-mortgage bondholders, the lien position of the new first and consolidated mortgage compared with the lien positions of the refunding and Midland mortgages, omission of statement in terms of debt per mile of the second lien of the Midland bonds upon the Terminal property, the conclusion as to the control of the new company being lodged in securities exchangeable for the Midland and the refunding bonds, the effect of the voting trusts as elements of compensation for exchange rights, the conclusion and recommended findings that the refunding bondholders would be fully compensated for the rights which they would surrender, the effect of rights of the holders of voting-trust certificates to instruct trustees how to vote, the 10-year period of the voting trusts, the personnel of the voting trusts, the recommendation that income-bond interest be not commuted into fixed interest in case of a lease for a lesser term than the term of any of the new mortgages, and in the case of the sale of 51 percent or more of both classes of new stock, the recommendation for elimination of provision that the holders of series A income bonds elect a member of the board of directors, the recommendation that the plan, modified as recommended, be approved, and the recommendation that the plan as recommended for approval be found to comply with section 77 (b) and (e).

146; temporary cash investments $1,250,000; special deposits $241,902; net balance receivable from agents and conductors $379,307; miscellaneous accounts receivable $310,240; materials and supplies $255,868; interest and dividends receivable $65,902; other current assets $6,852; working-fund advances $385; other deferred assets $25,623; rents and insurance premiums paid in advance $9,448; other unadjusted debits $235,381; total assets $41,831,654.

Liabilities shown on the balance sheet as of the same date were as follows: Common stock $12,816,319; preferred stock $12,964,844; stock liability for conversion $223,237; grants in aid of construction $24,888; funded debt unmatured $2,200,000; long-term debt in default $10,345,608, including $3,489,000 of Midland bonds, $3,744,000 of refunding bonds, $447,000 of second-mortgage bonds, $2,551,000 of general-mortgage bonds, $933 of scrip and receipts, and $113,675 representing a construction obligation to the Lehigh & New England Railroad Company; loans and bills payable $800,000; traffic and car service balances $1,352,804; audited accounts and wages payable $688,450; miscellaneous accounts payable $237,680; interest matured unpaid $23,492; unmatured interest accrued $17,500; unmatured rents accrued $292; accrued tax liability $165,252; other current liabilities $24,509; matured interest in default $3,066,341; other deferred liabilities $547,135; maintenance reserves $46,000; accrued depreciation, equipment $330,358; other unadjusted credits $241,930; additions to property through income and surplus $152,110; funded debt retired through income and surplus $50,000; and profit and loss debit balance $4,487,095; total liabilities $41,831,654.

As of December 31, 1940, the original cost of the property of the debtor, except lands and rights, was $11,905,157 road and $1,058,751 equipment; the cost of reproduction new $14,141,459 road, and $1,252,681 equipment; the cost of reproduction less depreciation, $10,670,666 road, and $601,052 equipment; the value of lands and rights $2,999,853, divided $2,686,837 carrier and $313,016 noncarrier; and working capital $108,000.[38]

The record also contains similar valuation data as of December 31, 1940, as to the properties of the debtor's subsidiary companies,[39] as to

[38] The original cost, as of December 31, 1940, of the road property of the Erie Terminals Railroad Company used by the debtor (which property, being the so-called northern and southern extensions, the debtor's trustee subsequently acquired, as hereinbefore explained) was $90,980; the cost of reproduction new was $102,168; the cost of reproduction less depreciation $79,142; and the value of its lands and rights $156.954, composed of $151,485 carrier and $5,109 noncarrier.

[39] The original cost of the property of the Hackensack & Lodi, except lands and rights, was road $30,260, the cost of reproduction new, road $43,507, the cost of reproduction less depreciation, road $30,370, and the value of lands and rights, carrier $8,546.

the portions of the debtor's properties on which the Terminal, Midland, refunding, and Paterson Extension mortgages are first liens, and as to the debtor's property not allocated to any mortgage.

The original cost of the debtor's property upon which the Terminal mortgage is a first lien, except lands and rights, was $2,824,821, the cost of reproduction new $3,068,990, the cost of reproduction less depreciation $2,411,948, and the value of lands and rights $1,024,826, divided, carrier $984,262, and noncarrier $40,564.

The original cost of the debtor's property upon which the Midland mortgage is a first lien, except lands and rights, was $6,245,353, the cost of reproduction new $7,548,658, the cost of reproduction less depreciation $5,749,234, and the value of lands and rights $1,461,126, divided carrier $1,331,648 and noncarrier $129,478. See also the data as to the northern and southern extension referred to in footnote 38, to which properties the Midland mortgages attached as a first lien upon its acquisition by the debtor's trustee, as declared by the court's order.

The original cost of the debtor's property upon which the refunding mortgage is a first lien, except lands and rights was $2,591,538, the cost of reproduction new $3,228,797, the cost of reproduction less depreciation $2,312,491, and the value of lands and rights $184,899, divided, carrier $172,563 and noncarrier $12,336.

The original cost of the debtor's property upon which the Paterson Extension mortgage is a first lien, except lands and rights, was $213,828, the cost of reproduction new $258,825, the cost of reproduction less depreciation $170,650, and the value of lands and rights $223,425, divided, carrier $156,919 and noncarrier $66,506.

The original cost of the debtor's property not allocated to any mortgage, except lands, was road $29,617, equipment $1,058,741, the cost of reproduction new, road $36,189, equipment $1,252,681, and the cost of reproduction less depreciation, road $26,343 and equipment $601,052.[40]

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The original cost of the property of the Lodi Branch, except lands and rights, was road $11,500, the cost of reproduction new, road $16,675, the cost of reproduction less depreciation, road $11,137, and the value of lands and rights, carrier $11,828, noncarrier $3,551.

The original cost of the property of the Passaic & New York, except lands and rights, was road $137,759, the cost of reproduction new, road $174,293, the cost of reproduction less depreciation, road $124,833, and the value of lands and rights, carrier $119,114.

The original cost of the property of the Susquehanna Connecting, except lands and rights, was road $298,766, the cost of reproduction new, road $365,739, the cost of reproduction less depreciation, road $251,893, and the value of lands and rights, carrier $22,028, noncarrier $541.

[40] In addition there were the following: Noncarrier land at North Hawthorne, N. J. formerly of the Erie Land and Improvement Company, value $21,905: 15 lots, at Passaic, carrier $28,000, noncarrier $15,903; carrier land, at Edgewater $11,189; land in Pennsylvania along line formerly under lease to the Wilkes-Barre & Eastern, carrier $1,752, noncarrier $26,324; and land at Stroudsburg, Pa., formerly of the Erie Land and Improvement Company, $504.

The amounts shown in the valuation data were determined in accordance with methods frequently explained in the valuation reports of the Commission.

2. *Traffic and revenues.*—The debtor's railway operating revenues from passenger and other operations for the past 6 years were as follows:

| Operations | 1937 | 1938 | 1939 | 1940 | 1941 | 1942 |
|---|---|---|---|---|---|---|
| Freight | $2,796,741 | $2,575,281 | $2,651,164 | $2,805,115 | $3,179,220 | $3,775,243 |
| Passenger | 293,295 | 249,018 | 217,433 | 255,819 | 325,752 | 426,019 |
| Mail | 18,277 | 15,777 | 15,619 | 16,074 | 16,921 | 11,357 |
| Express | 11,922 | 8,749 | 5,485 | 11,631 | 13,192 | 18,578 |
| Miscellaneous | 114,701 | 110,070 | 115,913 | 110,063 | 157,591 | 199,564 |
| Total | 3,234,936 | 2,957,895 | 3,005,614 | 3,198,702 | 3,692,676 | 4,430,761 |

Anthracite coal furnishes by far the greatest tonnage of all commodities. In 1940, anthracite coal traffic amounted to about 52 percent of the total tonnage handled, and the gross revenues from it that year were $1,272,714. Other of the principal commodities handled that year produced gross revenues as follows: Bituminous coal $174,025, zinc ore and concentrates $16,747, all other products of mines $51,270, cement $92,914, automobiles and trucks $216,406, vegetable oils $108,444, linseed oil $36,007, and all other manufactures and miscellaneous $682,375.

3. *Earnings and expenses. Earnings available for interest.*—The debtor's railway operating revenues as reported to the Commission for the 16-year period 1927–42, exclusive of those of the Wilkes-Barre, averaged $3,817,833.[41] For the 10-year period 1933–42, these averaged $3,373,404 a year. The lowest of such revenues in the 16-year period was $2,957,895 in 1938, the first full year following the trusteeship.

The railway operating expenses, as reported, averaged, for the 16-year period 1927–42, $2,700,691 a year,[41] and for the 10-year period 1933–42, $2,252,340 a year. In 1938, the year of lowest revenues such expenses were $2,030,376. In 1939, they were $1,998,517, in 1940, $2,060,496, in 1941, $2,227,886, and in 1942, $2,541,351.

The debtor's income available for interest during the last 16 years, as reported to the Commission, before deducting losses from operations of the Wilkes-Barre & Eastern (but adjusted to reflect additional New Jersey taxes of $65,333, $64,930, and $62,733 for the years

[41] For the 10-year period 1927–36, the railway operating revenues averaged $4,056,484 a year, the railway operating expenses $3,018,975 a year, and the income available for interest $455,198 a year.

1933–35, respectively, which at the time were not fully accrued on account of litigation in regard thereto) was:

| | | | |
|---|---|---|---|
| Year 1927 | $204,780 | Year 1935 | $370,295 |
| Year 1928 | 500,848 | Year 1936 | 400,492 |
| Year 1929 | 698,811 | Year 1937 | 393,455 |
| Year 1930 | 676,527 | Year 1938 | 74,485 |
| Year 1931 | 517,320 | Year 1939 | 304,222 |
| Year 1932 | 510,581 | Year 1940 | 475,324 |
| Year 1933 | 335,117 | Year 1941 | 704,568 |
| Year 1934 | 337,214 | Year 1942 | 956,060 |

The average for the 16-year period was $466,256, and for the last 10 years $435,123.[42]

B. CONCLUSIONS AS TO NEW CAPITALIZATION AND CHARGES

The trustee prepared in detail and put in evidence an estimated income account in a prospective normal year. Total operating revenues of $3,430,000 were thus estimated, divided $1,453,500 for merchandise freight, $1,511,500 for coal and coke, $320,000 for passengers, $15,000 for mail, $10,000 for express, and $120,000 for miscellaneous traffic. The operating expenses were thus estimated at $1,818,000, allowing $266,000 for maintenance of way of structures, $276,000 maintenance of equipment, $42,000 traffic expenses, $1,084,000 for transportation, and $150,000 for general expenses.

The figures just given result in estimated net revenue from railway operations of $1,612,000. Deducting from that amount estimated railway tax accruals (other than Federal income taxes) of $409,000, net equipment rents of $320,000, and miscellaneous deductions from income of $7,000, and adding net joint-facility rents of $36,000 and other income of $31,000, results in the trustee's estimated income available for interest, before Federal income taxes, of $943,000, and, after deductions for estimated Federal income taxes, of $225,000, a final estimate of income available for interest of $718,000. These estimates are also before depreciation for roadway and structures, which the trustee estimated would require under the Commission's recent order effective January 1, 1943, about $70,000 a year. The charging of that amount to operating expenses would affect New Jersey taxes and Federal income taxes, and the net result of making

[42] The trustee indicates that adjustments other than those hereinafter referred to should be made in the low income available for bond interest in 1938 before using it even in an averaging with other years, for the reason that it was a bad year generally for railroads, that it was the first year of independent operation, that car hire due the Erie was changed from a formula basis to a regular A. A. R. basis as between two independent railroads, pending negotiations with the Erie on that and other matters, indicating that the car hire should be reduced by at least $92,780 for comparative purposes, that general expenses were $42,000 higher than in 1937 due in part to extraordinary reorganization expenses applicable to 1937 which were not determined until 1938, and that taxes, which increased $61,000 that year, were higher than in any year from 1937 to 1941. Adjustments in respect of the $92,780 and the $42,000 would produce $209,265.

the charge would be to modify the trustee's estimate of $879,000 as available for interest before Federal income taxes and $679,000 after such taxes.

The trustee states that his approach to the estimate was to arrive at figures which, in the light of past results and present and prospective practices and tendencies, would produce estimates which would be unassailable as being too high or too low. The estimates represent the combined judgment of the officers of the trustee's organization. In working up the estimates the trustee deemed the results for the year 1940, except for passenger traffic, as the most pertinent and reliable, rather than those of the 1927–36 period for the reason that by that year nearly all the operating changes initiated by the office of the trustee had been put into effect and it was still possible to appraise for that year what effect, if any, the war was causing to the several classes of traffic. However, the trustee's detailed sheets supporting the principal estimates in most instances compare the figures estimated with the results of all the years 1928 to 1941 as well as with the estimates contained in the debtor's plan filed in 1938 and subsequently withdrawn.[43]

The debtor's trustee points out several sources of income and of savings in operating expenses which were not realized during the 1928–37 period, in which the debtor's property was operated under Erie control and management. The first group relates to yearly net benefits to the debtor, estimated by the trustee at about $306,500, resulting from a revision, during the trusteeship, of relationships between the debtor's operations and those of the Erie. The major items of this include revision of operating agreements as of October 1, 1936, $112,000, elimination of a tug at Edgewater $22,000, elimination of excessive rentals

[43] The trustee referred to the following favorable and possible unfavorable matters which were not taken into account in his forecast for a prospective normal year:

(1) There is a very good chance of at least one more large shipper being established at Edgewater.

(2) Two additional profitable interchanges have been discussed, viz, an interchange with the Lackawanna near Hainesburg Junction which would give the debtor substantially larger divisions on some of its traffic, and a connection with the Pennsylvania over a viaduct across Croxton Yard which would permit the opening of new routes.

(3) There is pending litigation with New York Central Railroad Company and its subsidiary, New Jersey Junction Railroad Company, which can result in a net benefit to the debtor of from $200,000 to $250,000 a year.

(4) There is a possibility of a unification of Northern New Jersey railroad transportation with Susquehanna Transfer as the hub.

(5) There is a slight possibility that some of the bituminous coal which because of war conditions now is moving from the South to New England over the Edgewater dump may remain with the Susquehanna after the resumption of barge movements from Norfolk to New England.

(6) On the other hand, there are two adverse possibilities, viz, the unlikely one that the New Jersey tax settlement act may be held unconstitutional, and the possibility that the Erie may withhold from the Susquehanna some of the present tidewater anthracite coal traffic. The proposed reorganization could be put through even in the event of an adverse decision on the tax settlement act, and the trustee has pointed out methods of recoupment from possible losses due to the Erie's diverting anthracite tidewater coal.

for locomotives $10,000, change in method of computing clerical costs at Paterson and Passaic stations $10,000, change of method of allocating lighterage costs in New York harbor $50,000, rerouting of fuel coal $30,000, adjustment of divisions on oils and greases $20,000, and rerouting of coal originating on the New York, Ontario & Western $45,000.

Another group of operating improvements includes the abandonment of 11.79 miles of line between Hainesburg Junction, N. J., and Stroudsburg, the substitution of Diesel engines for steam locomotives, the maintaining of the railroad's own repair shops, and changes in passenger-train operations.

From the abandonment of 11.79 miles of line of the refunding-mortgage district the trustee estimates savings of approximately $18,000 a year, computed on the basis of 1939 traffic by deducting from the calculated loss of $25,731 on operation of the segment the calculated profit of $7,575 on handling the traffic of the segment over the rest of the debtor's property.

The trustee's estimated saving from the use of Diesel engines is $120,000 a year. This estimate is supported by deducting from the hourly cost of operating a steam switching locomotive for the year 1940, $6.03, the hourly cost of operating a Diesel from the dates of installation of the Diesel switching engines to November 1, 1942, $3.11, the difference, $2.92, being multiplied by 40,508 switching-hours used in 1940. Additional depreciation of $24,750 a year on Diesels over steam locomotives is recognized in the estimate. On March 1, 1940, the trustee discontinued having the Erie repair its equipment and reestablished the debtor's shops at Little Ferry. At the time the change was made the trustee's organization estimated that after the first year a saving of about $25,000 a year would result from the running of its own shops. The trustee's over-all maintenance of equipment costs for the last 3 years averaged $352,000 a year, as against an average of $485,000 a year for the previous 9 years. Due to the several changes in the character of the equipment, he does not claim, however, that the entire difference between those figures represents a net gain. As the only rents of leased lines now paid relate to properties of wholly owned subsidiaries intended to be merged into the new company, no rentals of leased lines are contemplated after execution of the plan.

At the beginning of the trusteeship, 20 steam-drawn passenger trains were operated each way on week days between Jersey City and Butler. Reductions in train operations were made in November 1937, and April 1938, which resulted in the operation on week days of 8 trains between Jersey City and Butler and 2 between Jersey City and North Hawthorne, 14.6 miles east of Butler.

In 1940, the trustee rehabilitated the Paterson Extension, which extends from State Street, near the center of Paterson, 0.75 miles to its junction with the main line at Broadway, Paterson. Since 1913, this spur had stood practically idle except for occasional freight movements. A station, now called Paterson City, was constructed at State Street and two semi-Diesel streamlined, air-conditioned passenger cars were installed in July 1940, to operate between Paterson City and Susquehanna Transfer, a new station 15.24 miles from Paterson City, which the trustee had established on the Midland division near the entrance to the Lincoln Tunnel. Bus service had been established from Susquehanna Transfer to Times Square, New York City, upon which a 15-cent fare had been charged. With the establishment of the motorcar service from Paterson City, the bus fare was reduced to 10 cents. The 10-cent fare does not pay the cost of the bus operations by from 2 to 2.5 cents per passenger, and the Susquehanna absorbs this deficiency out of its rail fares. The running time over these combined services to Times Square is about 35 minutes. About $188,654 [44] of funds earned during reorganization were spent in developing this motorcar passenger service. In December 1940, 55,268 passengers used the motorcar and steam-train [45] services to and from Susquehanna Transfer in connection with the bus service to and from New York City. In 1941, the number using the same services averaged 56,666 passengers a month; in 1942, the monthly average was 77,376, and by February 1943, it had exceeded 90,000 a month. The increase in the 1942–43 period was due in large measure to the restrictions on the use of gasoline, to the acute rubber situation, and to the travel of war workers. Paterson is experiencing a wartime boom because of the concentration of airplane production in that vicinity. The trustee believes that the popular appeal of this quick service to New York City will sustain the 1941 average in normal times, and his forecast of passenger-train revenues of $345,000 in the normal future years embodies that assumption.

In the following table are shown for the debtor's entire property, the number of passengers carried, passenger revenues, and other data for the years 1937 through 1941:

[44] The major items are $103,226 for the motorcars, $15,000 for spare parts for motorcars, $4,769 for one gasoline-electric motorcar, $13,000 for gas car, $5,650 for spare parts for gas car, $8,802 for station and parking space at Straight Street, Paterson, $9,701 for new switches, $4,201 for signal protection, $17,738 for station, roadway, signal protection, crossover, et cetera, at Susquehanna Transfer, and $6,050 for repair pit and service facilities at North Hawthorne.

[45] The proportion using the steam-drawn trains is not shown, but during the first 6 months of 1940, just prior to the establishment of the motor car service and while the bus fare was 15 cents, an average of 5,801 passengers a month used Susquehanna Transfer and the bus to New York City.

| Period | Number of passengers | Passenger-train revenues from— | | | | |
|---|---|---|---|---|---|---|
| | | Passengers | Mail | Express | Milk | Total |
| Year 1937 | 1,388,605 | $293,295 | $18,277 | $11,922 | $22,875 | $346,369 |
| Year 1938 | 1,188,359 | 249,018 | 15,778 | 8,749 | 21,135 | 294,680 |
| Year 1939 | 1,067,822 | 217,433 | 15,620 | 5,485 | 17,331 | 255,869 |
| Year 1940 | 1,262,535 | 255,819 | 16,074 | 11,631 | 14,890 | 283,524 |
| Year 1941 | 1,589,638 | 325,752 | 16,921 | 13,192 | 10,916 | 366,781 |

The above revenue figures omit certain revenues from services allied to passenger services under our rules, but those items are not shown of record and are not of consequential importance in this connection.

Since the establishment of the motorcar service, the revenues from the stations served only by steam trains has continued to decline. The revenue from the stations served by the motorcars has made up the decline and has produced the increase in revenue. There were 560,266 passengers carried on the motorcars in 1941.

The trustee estimated the "out of pocket expense" of operating the 20 trains each way early in the trusteeship at $825,000. On that basis, the loss from passenger-train operations in 1937 would have been around $478,631, about 34.5 cents a passenger compared with the average passenger-train revenue of about 25 cents a passenger. He estimates the corresponding losses in a normal future year at around $230,000, based upon estimated recent out-of-pocket expense of operations of around $575,000, less estimated revenues of $320,000 from passenger service and $25,000 from mail and express services, these revenues being approximately those of 1941. Based on the 1,589,638 passengers carried in 1941, losses of $230,000 for that year would be about 14.5 cents a passenger, compared with the average passenger-train revenue of 23.1 cents a passenger.

The trustee purchased a two-car semi-Diesel motor train to replace some of the steam trains operated on the Midland division, but at the time of the hearing this train had not been put into operation.

On the basis of the trustee's estimates of additional earnings due to improved operating arrangements, the proponents of the plan would adjust upward the reported earnings of the debtor available for interest during the 13-year period 1927–1939, to show its present earning power. They would apply the $306,500 of additional net ascribed to the first group of benefits outlined by the trustee as an upward adjustment for each of the years 1927 to 1935, and proportionate parts thereof, $278,500, $193,167, $152,631, and $116,667, respectively, for the years 1936 to 1939, inclusive, the period during which the improvements were being made. They would apply as similar adjustments $25,000 as estimated savings from the described equipment repair change to each of the 13 years. They would give retroactive effect

to the estimated savings resulting from the abandonment of the Hainesburg Junction-Stroudsburg segment by increasing the earnings for interest by $9,000, $9,000, $11,000, and $18,000, respectively, for the years 1936 to 1939, and would make a similar adjustment for each of the same 4 years of $120,000 as the estimated yearly savings from the substitution of Diesel for steam locomotives. For the years 1936 to 1939, that adjusted income would be $832,992, $740,622, $383,-116, and $683,889, respectively. These adjustments applied to the income available for interest, before deducting Wilkes-Barre & Eastern losses, for the 13 years, as shown in the table hereinbefore set forth, would result in an average yearly income available for interest of $751,970.

H. Everett Woodruff, a railroad analyst and statistician employed by one of the group of insurance companies followed the debtor's operations and problems since 1936, participated in the hearings before the Commission on the segregation formula, and, in cooperation with the trustee and his staff, made special studies of the debtor's principal operations and traffic movements and of its primary accounts. He prepared and presented in evidence a statement of the 1937 income adjusted to reflect his estimate of the effect thereon of subsequent changes and probable future traffic and expenses.

In the preparation of the statement, which is fortified by numerous explanatory data, he used the 1937 actual traffic volume and rates, with such adjustments as he deemed appropriate, including adjustments in anthracite coal revenues to reflect increased divisions of rates on fuel coal, certain New England traffic, oils and greases, and a changed route and changed divisions on coal of New York, Ontario & Western origin. Passenger revenues were adjusted on the theory that had the passenger service which the trustee is installing been in operation in 1937, it would have attracted a sufficient number of additional passengers to produce an increase of $26,705 in passenger revenues at the 1937 rate level. The 1937 expenses were adjusted to reflect the effect of changes in relation with the Erie, revised time schedules, installation of Diesel equipment, other changes in equipment ownership, the new Paterson-Times Square passenger service, discontinuance of certain passenger trains, abandonments, and other changes. In many instances the trustee's estimate on individual items was used. The exhibit does not purport to assume that all of the changes would have been technically possible in 1937 or that the management at the time could have made all the changes. The net result of this study is to increase the income available for interest in 1937 from $393,455 to $801,450, an increase of $407,995. As previously stated, the hypothetical income available for interest in 1937 as computed by the proponents of the plan through adjustments relating backward the principal benefits from operating changes brought about

by the trustee was $740,622. Woodruff's study carries that method of approach somewhat further and enters into an analysis of the primary accounts, producing what amounts to a forecast of future results with respect thereto but using as his starting base the 1937 results just as the trustee used the 1940 results as his base for computations. Woodruff's study or estimate does not deal specifically with Federal income taxes by way of relating them back as it related back other favorable and unfavorable changes and prospective traffic results.

The treatment of the anthracite coal situation requires some detailed discussion, as this traffic produces approximately 40 percent of the revenues of the railroad. There has been a general decline in the shipments of this commodity over the Susquehanna in recent years, due in considerable measure to the substitution of other sources of heat, light, and power, although recent pressure from government sources to secure changes from oil to coal for heating purposes has temporarily checked the decline due to those causes. The yearly average of the Susquehanna's shipments of anthracite as reported to the Commission, for the 10-year period 1928–37 was 2,764,063 net tons and the yearly average for the 4-year period 1938–41 was 1,998,761.[46] Other war dislocations, such as the demand for shipments of anthracite to Canada, and the demand for such shipments in relief of threatened gas shortages at such markets as Buffalo, N. Y., have caused the Susquehanna's anthracite movements of tidewater shipments to decline materially. There were 978,236 tons of tidewater anthracite handled in 1941, compared with 1,273,540 tons in 1938, and about 1,100,000 tons in each of the years 1939 and 1940.

The debtor's trustee estimates revenues of $1,300,000 from this traffic in a normal future year, based upon a tonnage of 2,000,000. For the 10-year period 1928–37 such revenues averaged $1,579,438 a year and during the 4-year period 1938–41 the average was $1,218,959 a year.

Through the year 1939, more than 90 percent of the anthracite coal handled by the Susquehanna was interchanged from the Erie. This coal all originated in the Wyoming fields of Pennsylvania, either on the Erie, the Delaware & Hudson, the Delaware, Lackawanna & Western, or the New York, Ontario & Western. The remainder handled by the Susquehanna was interchanged from the Lehigh & New England at Hainesburg Junction and came from Lehigh & New England or

[46] There are some duplications of shipments represented in these figures because of the fact that certain shipments received from the Erie at Passaic Junction are switched and dumped for storage at Coleberg. This, in the reports to the Commission, is treated as one shipment, and when the coal is later moved to Edgewater the latter movement is treated as another shipment. Adjustments for this duplication would make the above yearly average for the 4-year period 1938–41, 1,869,735 tons. Adjustments for the earlier period have not been made.

Lehigh Valley origins. About 60 percent of the tonnage delivered to the Susquehanna was for tidewater and was dumped at Edgewater from which the water-front yards in the New York City area were served. To some extent it also moved from there by boats and barges to New England and Canada. Nearly one-third of the remaining 40 percent was destined to lines connecting with the Susquehanna and the remainder, amounting to 600,000 to 700,000 tons, was delivered to consignees on the line. In 1940, 308,000 tons moved over a newly established route over the New York, Ontario & Western and the Middletown & Unionville Railroad to Hanford, and the Susquehanna to destination. In March 1941, another route in connection with the Ontario & Western, by which the Susquehanna received the shipments at Little Ferry, was established, and in 1941, 149,987 tons moved over it.

The Erie recently notified the debtor's trustee of having received an offer from another railroad having a dumper in New York harbor to dump its tidewater coal at a division of rates slightly less than that heretofore paid to the Susquehanna, and the trustee has declined to meet that lower division. This would disturb a traffic relationship of long standing, and would call for efforts to build up traffic relations with other railroads and with shippers to compensate for the loss of the Erie's tidewater traffic. The trustee estimates that the Susquehanna would lose immediately not more than 28 percent of the tidewater coal heretofore received from the Erie should the Erie decide to complete its negotiations for having its tidewater coal dumped elsewhere. The remainder of such tidewater coal, the trustee believes, would continue to be dumped at Edgewater for business reasons of a varying character, although by degrees further reductions in the amount of such movements might be made by the Erie. During the years in which the Erie operated the Susquehanna as part of its system, it availed itself of the general practice of coal-originating roads of insisting upon a differential of 13 cents a ton on coal moving to Susquehanna destinations by other than Erie routes. The differential has continued to the present time. It has been in effect on routes from Delaware Lackawanna & Western origins and Lehigh Valley origins other than the comparatively small Lehigh Valley shipments from the Wyoming Valley fields, which move over the Erie to Passaic Junction. It was not in effect in the case of the Lehigh & New England. No routes were established, even with the differential, in connection with anthracite originated by the Reading Company.

Owing to the decline in the tidewater movements and the possible move of the Erie to divert its tidewater shipments to other lines, the trustee indicates that the time may have arrived when the differential should be removed so that all carriers may compete on equal terms in

the anthracite market served through the Susquehanna's facilities. A substantial movement of coal is received by the Susquehanna from the Delaware, Lackawanna & Western even with the differential. With the differential removed, shippers along its lines would be in a better position to extend their markets in the Susquehanna's territory. The same is true with respect to shippers on lines of the Lehigh Valley and the Reading Company. Shipments from these companies could be delivered to the Susquehanna at Hainesburg Junction, and shipments from the Lackawanna could be delivered to the Susquehanna & Hyper-Humus. The development of such new traffic would, of course, require solicitation and would be subject to competitive influences, the results of which are not easily predictable, but the trustee states that the divisions of through rates that would be received on it would be greater than on the coal it receives from the Erie. .

Woodruff, in compiling his estimate of freight revenues by adjusting those of 1937, adopted the total 1937 anthracite tonnage of 2,229,411 and the 1937 tidewater anthracite tonnage of 1,119,553 tons as applicable to the normal future year, and further assumed that such shipments would come to the Susquehanna from the Erie and the New York, Ontario & Western in the same relative proportions and with the same relative divisions of rates as prevailed in 1941. However, he applied the rates of 1937. These assumptions resulted in his increasing such revenues over those of 1937 by $66,837, making his total estimated revenues from anthracite coal $1,256,447, compared with the estimate of $1,300,000 made by the debtor's trustee.

All things considered, including the general decline in the anthracite industry in the recent years, the outlook for the transportation of anthracite coal over the debtor's line does not appear to be altogether bright, and we believe that the anthracite tonnage estimates for the normal future year of both the trustee and Woodruff are somewhat too high.

The insurance group, in connection with its exception to the examiner's recommended capitalization, and the other parties filing similar exceptions argue that the examiner in the proposed report without warrant discounted the estimates of record of future earnings in his recommended conclusions and in his comment that the probabilities are that a range of from $600,000 to $700,000 would approximately represent expectable earnings for interest in a normal future year. They argue that undisputed evidence of record warrants an assumption that earnings of at least $750,000 a year will be available for interest, dividends, and other corporate purposes in a normal future year. We are not willing to draw that conclusion. The trustee's estimate of future earnings of $718,000, after Federal income

taxes but without any charge to operating expenses for depreciation of roadway and structures, is only slightly above the range of probable earnings indicated by the examiner. With charges to operating expenses for such depreciation, the trustee's estimate of $679,000 is within the range indicate by the examiner, but above the medium ($650,000) of that range.

The $801,450 estimate for the future of Woodruff contains no charges to operating expenses for roadway and structures depreciation, or for Federal income taxes. The trustee's estimate of $225,000 and $200,000 for Federal income taxes for a normal future year (with or without, respectively, estimated roadway and structures depreciation of approximately $70,000) is based upon a tax of 40 percent of taxable net income. Even though but 75 percent of the trustee's estimates for such taxes, $168,750 and $150,000, respectively, were deducted from Woodruff's estimate of $801,450, the resulting amounts of $632,700 and $651,450 substantially approach the medium of the range of expectable future earnings indicated by the examiner. In general, the same lack of realistic approach to Federal income taxes of the future is implicit in the other estimate of $751,970 deduced, as above described, by adjustments in the actual results for the years 1927 to 1939, inclusive, to reflect retroactively many of the expense-saving items considered in making up the other estimates referred to. While adjustments were made to reflect the last-mentioned items, they were not made to reflect any substantial part of the changed Federal income tax situation. Furthermore, there is represented in the $751,970 greater revenues from movements of anthracite coal than either the trustee or Woodruff estimated for the normal future year.

In view of these factors and the anthracite coal situation above discussed, and based on the evidence of record, we find that the reorganized company's earnings available for interest in a normal year may be expected to be within the range of from $600,000 to $700,000. The average yearly income available for interest in the years 1940, 1941, and 1942, $711,983, does not greatly exceed that range of income. The insurance group states on brief that the $956,060 of earnings so available in 1942 was after $111,032 for income tax accruals and $163,980 for nonrecurring expenditures. Such nonrecurring expenditures would of course, partly reduce the actual earnings. The sum of $650,000 capitalized at 5 percent would produce a capitalization of $13,000,000, at 4.5 percent about $14,440,000, and at 4 percent $16,250,000. The average yearly earnings for interest of the debtor, before Wilkes-Barre & Eastern loss deductions, of $466,256 for the 16-year period 1927–42, capitalized at 5 percent would produce a capitalization of about $9,325,000, at 4.5 percent about $10,361,000, and at 4 percent

about $11,656,000. Some of those earnings, however, were influenced by the so-called "drag" of Erie management. Taking the average earnings for interest, for the 13-year period 1927–39, after the above-described adjustments proposed by the proponents of the plan to relate backward the principal estimated advantages to the estate through trustee management, and capitalizing that sum of $751,970 at 5 percent, would produce a capitalization of about $15,039,400, at 4.5 percent about $16,710,000, and at 4 percent about $18,799,000. But the sum of $751,970 as yearly earnings for interest is believed not sufficiently to reflect existing and probable future conditions as to be used as a primary guide in fixing capitalization.

As herein indicated the general-mortgage trustee requested that the plan be modified by providing for the issue of not less than $1,000,000 additional 4 or 5 percent general-mortgage income bonds of a series junior to those provided in the plan, with a corresponding reduction of the preferred stock. The second-mortgage bondholders protective committee requested modification to provide for $1,000,000 additional general-mortgage income bonds with a corresponding reduction in the amount of common stock. These proposals would increase the total debt of the new company to $10,000,000 or more. The proportion of debt to total capitalization, taking the no-par-value common stock at $100 a share and excluding equipment obligations to be assumed, would then be increased from about 55.4 percent, as under the proposed plan, to about 61.5 percent. For reasons hereinafter stated, the maximum amount of debt which we approve for the new company is much lower than the debt which these proposals would require, and we cannot approve them.

The general-mortgage trustee also proposed that the rate of interest on the new first and consolidated mortgage bonds be reduced from the 4 percent provided in the plan to 3 or 3.5 percent, and that the interest rate on the new general-mortgage bonds be reduced to 4 percent. Under the plan, the proposed first and consolidated bonds bearing 4-percent interest would be allocated to the holders of the existing 5-percent Midland and 5-percent refunding bonds. The proposed rate of 4 percent reflects the customary treatment of similar bonds in recent railroad reorganizations. It is our opinion that the debtor's size and importance are not such that it would ever reasonably be expected to sell a 3- or 3½-percent bond at par. We believe the proposed 4-percent interest rate is proper for the first and consolidated bonds of the nature here under consideration. Substantially the same reasons apply to the request that the interest rate on the proposed general-mortgage income bonds be made 4 percent instead of 4.5 percent. The 0.5 percent additional interest over that of fixed-interest securities is justified by the

inferior lien position and the greater uncertainty of income from income bonds.

The fixed-interest charges under the proposed plan would be 4 percent interest on the $2,000,000 proposed Terminal-mortgage bonds and on the $3,000,000 first and consolidated mortgage bonds, plus $9,623 on the $452,844 of equipment obligations outstanding January 1, 1944, a total of $209,623 fixed interest. This amount of interest was earned in every year since 1927, except in 1938, and would nearly have been earned in 1938 if the two adjustments described in footnote 42 were made. It was earned 2.08 times under an average of the 10 years 1933–42, and would be earned 2.86 times under earnings of $600,000 a year. We find that these charges would be adequately covered by the probable earnings available for the payment thereof.

The next charges under the plan would be, in order, $85,000 [47] for an additions and betterments fund, 4.5 percent interest on the proposed $4,000,000 general-mortgage income bonds, amounting to $180,000, and a $20,000 sinking fund, which charges, added to the fixed interest charges, make a total of fixed and contingent charges of $494,623. This amount was not reached in earnings available for interest in any of the years 1933 to 1940, inclusive. With earnings of $650,000 for interest, they would be earned about 1.31 times. It exceeds by about $59,000, the yearly average of earnings for interest in the 10-year period 1933–42. Considering the character of the debtor's property and all elements of earning power, including the prospects of ability to pay or refund the debt at maturity, it is our opinion that the contingent-interest debt in excess of $2,500,000, with annual charges at 4.5 percent amounting to $112,500 would not be justified. That amount added to the prior charges of $294,623 and an immediately following sinking fund of $20,000 would make $427,123 of charges prior to dividends on preferred stock. Deducting these charges from $650,000, which is the medium of the range of earnings that may be expected for interest in a prospective normal year, would leave $222,877 for dividends and other corporate purposes. The requirements for dividends on $3,000,000 of preferred stock would be $150,000. This would leave $72,877 as expectable dividends on common stock in a prospective normal year. Dividends of 5 percent on $3,500,000 of common stock,

[47] As hereinbefore stated, the amended provisions of the plan for this fund require a yearly contribution to it of $65,000, or 2 percent of gross operating revenues, whichever is greater, plus $20,000 a year on each May 1st through May 1, 1950. This temporary $20,000 a year, as elsewhere explained, would be used to finance equipment purchases. The trustee gave detailed estimates of the requirements for additions and betterments to roadway and structures through 1948, averaging $56,000 a year. Two percent of the trustee's forecast of railway operating revenues in a prospective normal year would be $68,600. This percentage is in line with that used in recent railroad reorganizations as an alternate to be used in determining the amount payable into such a fund in any 1 year in case it should exceed a fixed sum otherwise payable into the fund. As such it adds flexibility to the fund in case of unusual demands upon the property.

or $5 a share for 35,000 shares, would require $175,000. In order to make proper provision for flexibility of earning power in this company, in addition to $3,000,000 of preferred stock, the issue of 35,000 shares of common stock having no par value would be appropriate. Stated at $100 a share that common stock would amount to $3,500,000.

### III. PLAN APPROVED

#### A. CAPITALIZATION. FIXED CHARGES

Considering the entire record, and taking into account the elements of value of the debtor's property, its past and present earnings, present and future expenses of operation, its probable future earning power, and traffic prospects for the future, as well as all other pertinent factors of record, we find that total capitalization after reorganization should be about $14,452,844. For the reasons hereinbefore stated this capitalization should be represented by approximately the following securities:

| | *Amount* |
|---|---|
| Equipment obligations | $452,844 |
| Fixed-interest, 4-percent bonds | 5,000,000 |
| Contingent-interest 4½-percent bonds | 2,500,000 |
| Preferred stock, 5-percent, $100 par value | 3,000,000 |
| Common stock, no par, taken at $100 a share | 3,500,000 |
| Total | 14,452,844 |

The cash position of the estate appears to be sufficient to carry through the reorganization under the plan without borrowing additional funds.[48]

[48] Since this report was prepared, the New Jersey Court of Errors and Appeals on or about June 22, 1944, held unconstitutional the New Jersey tax settlement law which would have had the effect of relieving the Susquehanna of the payment of so-called interest penalties on taxes for the years 1933–40, inclusive, upon paying interest at 3 percent from December 1, 1940, to the date of payment. In June 1942, the trustee tendered the State checks totaling $1,191,577 in payment of the principal of the taxes, and checks which included about $54,000 for interest from December 1, 1940, and thereupon the trustee eliminated liabilities for those taxes from his books and deducted the amounts of the checks before stating his cash on hand in his balance sheets. The State Treasurer by court orders was restrained from accepting the money in settlement of the taxes, awaiting the outcome of the litigation. The $54,000 for interest, having been tendered pursuant to a law declared unconstitutional, in this footnote will be treated as a restored asset of the estate.

The interest penalties are computed at 1 percent a month and to June 1942, would amount to $683,048, and to July 1944, to a maximum of about $987,281. Back taxes for the years 1933–40, amounting to about $25,355 assessed against the northern and southern extensions at Edgewater were tendered to the State by the Erie. As the Susquehanna may ultimately have to pay them, this amount should be added to the above $987,281, making $1,012,636 as the approximate maximum amount which the debtor's estate may ultimately have to pay, exclusive of the $1,191,577 tendered and set aside in respect of the principal of the taxes through 1940.

Copies of the trustee's monthly balance sheets and income statements filed with the court through April 30, 1944, have been transmitted to us by the clerk of the court pursuant to order 49 of general orders in bankruptcy, and are filed in this proceeding. These

B. EFFECTIVE DATE OF PLAN

None of the parties questioned the appropriateness of January 1, 1944, as the effective date of the plan, as proposed, and as the trustee's cash situation at present points to the availability of an adequate supply to consummate the plan as of that date, no reason appears for fixing a different date. Accordingly, it should be adopted as the effective date.

C. PARTICIPATION IN REORGANIZATION

The road is in good physical condition. No new securities are needed to finance any rehabilitation work. All securities issued in accordance with the reduced capitalization will be available for distribution to present security holders and holders of unsecured claims.

1. *Rights of creditors.* (*a*) *Segregation of earnings.*—The formula for the segregation of earnings by mortgage and leased-line divisions recommended by division 4, *supra*, was first applied to the operating results for June 1940. As stated, the results of operations in 1940 are deemed by the trustee as the most appropriate in estimating future earnings. Because of the accounting methods employed with respect to shipments of coal for storage at Coalberg whereby the Midland division was credited with revenues derived from such shipments but not charged in June with the cost of handling them, on the advice of the trustee's accounting staff, the formula was applied for the month of December, when a large coal tonnage was moved out of storage at Coalberg and appropriate accounting charges made with respect to such coal which offset the distorted results derived from the record for the month of June. The results for the 2 months were then combined. The income available for fixed charges re-

papers are included in those which the parties stipulated should be treated as part of the record.

The excess of the trustee's current assets over current liabilities on April 30, 1944, was $1,797,554. The current assets included $1,441,710 cash and $336,969 of materials and supplies. Adding to the $1,797,554 representing said excess the $54,000 tendered the State for interest results in $1,851,554. Deducting from that amount the $1,012,636 maximum requirements relative to back taxes, $450,000 for working capital, and approximately $105,833 necessary to apply the plan herein approved, through income bond interest, from January 1 to May 1, 1944, after allowance for Terminal bond interest which the trustee paid since January 1, 1944, would leave $283,085. This amount is none too large a margin, as reorganization expenses remain to be taken care of. There is the possibility that the decision of the Court of Errors and Appeals may be construed as not invalidating all of the provisions of the Tax Settlement Act, such as the provisions for payment of the principal of the back taxes in installments and for the payment of interest on the principal from December 1, 1940 at 3 percent a year. In view of this, the possibility that the court may not allow all of the maximum amount above computed in respect of back taxes, the reduction of Federal income taxes that will result, the possibility that provision may be made by the State for spreading the period of payment of the interest penalties over a number of years, and the authorization under the plan that the expenses of reorganization may be assumed by the reorganized company and paid within 3 months after consummation of the plan, coupled with the present good earnings under war conditions and the allocation of $450,000 for working capital, we are of the opinion that no changes in the plan are required by reason of the tax decision referred to.

sulting from these applications of the formula, as applied and as adjusted, are shown below, the word "available" meaning income available for fixed charges and the letter "D" indicating deficit.

| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) |
|---|---|---|---|---|---|---|---|---|---|---|
| | Midland district | Refunding district | Terminal district | Northern and southern Extensions (Erie Terminals R.) | Passaic & N. Y. R. | Paterson Extension R. | Hackensack & Lodi R., Lodi Branch R. | All other unassignables [1] | Rev. & Exp. lost to System or eliminated | Totals |
| Available: | $23,535D | $4,248 | $83,628 | $7,996 | $796 | $4,004D | $609D | $27,722 | | $96,242 |
| As applied | 24,007D | 20,417 | 84,279 | 8,900 | 858 | 3,972D | 594D | [1] 2,190D | | 83,691 |
| Adjusted | | | | | | | | | ($12,551) | |

[1] The adjustments in this column eliminate all items other than those relating to passenger operations between Croxton and Jersey City.

The adjustments are rather extensive and only the net results thereof are shown above. They are mainly for the correction of certain errors made in the original application of the formula, for the purpose of making a more complete application of it so as to eliminate as many as possible of the unassignable items, and to reflect certain permanent changes in operations made subsequent to the application.[49]

The above tabulation of the results of the application of the formula shows that the Terminal bond interest is earned 5.06 times, that the refunding-bond interest, in respect of the property on which the refunding mortgage is a first lien, is earned 0.65 times, and that all other districts, except the northern and southern extensions and the Passaic & New York both of which have no outstanding bonded indebtedness, are deficit lines.

[49] One adjustment is the transferring of $10,931, representing joint-facility rents income from the unassignable column (originally placed there by reason of a typographical error in an advanced copy of the formula report) to the refunding district. Another is in increasing the earnings of the refunding district by $4,289 to reflect an estimated net saving to that district by reason of the abandonment of the Hainesburg Junction-Stroudsburg segment. The adjustments also, as column 9 in the above tabulation indicates, eliminate from the allocations revenues and expenses no longer applicable to the system. For example, there appears in column 8, "all other unassignables" in the original application exhibit the sum of $14.608, representing operating revenues on merchandise and coal accruing under trackage rights (unmortgaged) between Croxton and Jersey City. Of this, an estimated amount of $9,487 has been lost to the system through cancelation of the trackage rights as to freight. This amount has been entered in the details of column 9 as having been lost to the system and consequently not properly assignable even as to unmortgaged assets, and the remainder $5,121, has been distributed among other divisions of the system on bases deemed appropriate by the trustees' accounting staff. Thus, the sum of $12,551, representing net loss to the system, entered at the bottom of column 9 is the amount by which the total sum of $96,242 allocable, under the original application of the formula, shown in column 10, exceeds the sum of $83,691 of the adjusted total in the same column. The net deficit sum of $2,190 appearing as the adjusted amount in column 8, above, relates entirely to the "All other unassignables" in respect of passenger operations between Croxton and Jersey City under the unmortgaged traffic rights still in existence as to that class of traffic. Another adjustment of significance was in crediting to the refunding district earnings of $801.97 of the mine branches, which were not reflected in the application of the formula.

(*b*) *Undisturbed securities.*—The lease-purchase agreements by which the trustee has purchased equipment should not be disturbed by the reorganization. In 1942, the trustee, as stated, purchased 8 Diesel switching locomotives on lease-purchase agreements at the aggregate cost of $649,240, of which $64,924 was paid in cash, the balance to be paid in monthly installments amounting to about $72,000 a year. Assuming early replacement on the same basis of the 2 of these Diesels requisitioned by the Government, the installment requirements on this group of equipment would be $72,000 a year through 1949, with a final payment of a small balance to be made in 1950. The trustee estimates that the average yearly payments required on additional equipment through 1949 would be $22,668. The additional equipment includes 160 new freight cars in 1945, a Diesel locomotive crane in 1946, and other minor equipment. Thus, an average of about $94,668 a year would be required through 1949 for equipment payments, of which about $24,750 a year would come from depreciation on the 8 Diesels and about $49,546 as depreciation on the other equipment, a total from depreciation of $74,296. The balance of about $20,000 a year required to make equipment payments would come from the additions and betterments fund. The trustee believes that after May 1, 1950, there would be no need for drawing on that fund for any equipment payments and recommends that after that date the payments to the fund be reduced $20,000 as provided in the proposed plan.

2. *Distribution of new securities.*—The primary, but not in all respects the controlling, basis for distribution of the new securities is the earnings test as shown by the above-described adjusted application of the segregation formula.

(*a*) *Terminal first-mortgage 4-percent bonds.*—Most of the adjusted earnings are derived from the Terminal division, which, during the period of the application of the formula, earned the interest on the Terminal bonds more than five times. The Terminal bondholders should, therefore, receive satisfaction of the principal amount of their claims in full in fixed-interest bonds, after first having received payment in full in cash of their claims for interest accruing and unpaid at the rate fixed in the existing Terminal mortgage to the effective date of the plan. In order to avoid the possibility of any dilution of their security, a new Terminal first mortgage should be created to secure an issue of $2,000,000, principal amount, or bonds to be exchanged for the Terminal bonds outstanding or, at the option of the reorganization managers, an extension agreement should be executed whereby the existing Terminal mortgage, as modified by the extension agreement, would be assumed by the reorganized company, the maturity of the existing Terminal bonds to be extended for the same period as though a new mortgage were executed, the interest rate reduced to the same rate as though a new mortgage were executed, and such other changes

made as to the reorganization managers appears appropriate as provided in the proposed plan hereinbefore described. The making of the rate of interest 4 percent as the plan proposes, as compared with the existing rate of 5 percent, the insurance group states, is justified by the maturity of the Terminal bonds before the effective date of the plan, by the present general level of interest rates, by the fact that this Commission in several recent railroad reorganizations has found in effect that ordinarily 4 percent is the maximum rate compatible with the public interest that a first-lien, fixed-interest bond of a railroad undergoing reorganization can bear, and by the fact that the new Terminal bonds would maintain their lien position on the same property and would be the obligation of a stronger company than the existing company. They also stress in this connection the provisions of the plan for the creation and maintenance of an additions and betterments fund and the drastic reduction in fixed charges.

The Terminal mortgage trustee argues that there would be a lack of sufficient compensation to the Terminal bondholders for the reduction of the interest rate to 4 percent under a new mortgage for a term of 30 years and without a sinking-fund benefit, as proposed in the plan. It contends that the present general level of interest rates may not be used by way of supplying the sufficient compensation for the reduction, but suggests that the situation could be met by the issue of bonds maturing in not more than 10 years with a fair sinking fund. Such bonds, it states, would probably have a market value near enough to par to justify the deferring of the bondholders' rights to present payment of the debt. This early maturity for such bonds would present a financial hazard and would be out of line with the general framework of the plan. Such early maturity is not believed required by the circumstances of the case. The reasons advanced by the proponents of the plan in support of the proposed new interest rate are cogent. Furthermore, under the existing Terminal mortgage, its bonds would have no priority rights upon income for payment of interest as against other bonds having first-mortgage positions upon parts of the system. The yearly interest upon such bonds secured by first mortgages, including the Terminal, amounts to $471,650. Under the provisions of the new securities, the Terminal bonds, in connection with the first and consolidated bonds, would have prior rights upon the first $200,000 of earnings available for bond interest. We believe that, considering the amount of the debt of the new company, the proposed terms of all of the new bonds are too short, and that the term of the new Terminal bonds should be 50 instead of 30 years. With the issue of new 4-percent 50-year Terminal bonds, with a sinking fund of $20,000 a year for the benefit thereof serviced out of available net income prior to interest on the income bonds, adequate treatment will be accorded to the exist-

ing Terminal bondholders. We will provide in the plan that the term of these bonds shall be 50 years and that the sinking fund of $20,000 a year proposed for the new income bonds be applied to the Terminal bonds. The rate of premiums on redemption, except with moneys from the sinking fund, will be 3 percent if redeemed on or before January 1, 1952, with a reduction of one-half percent for each 8-year period thereafter to January 1, 1992, and no premium thereafter.

(*b*) *First and consolidated mortgage 4-percent bonds.*—After the Terminal bonds have been satisfied in full, principal and interest, the Midland and the refunding bonds have prior claims upon the mortgaged assets,[50] except the 0.75 mile of line subject to the Paterson Extension mortgage as a first lien later herein discussed. Accordingly, the $3,000,000 principal amount of new first and consolidated bonds, which is the principal amount of the 4-percent fixed-interest bonds remaining after satisfaction of the Terminal bonds, are divided between the Midland bondholders and the refunding bondholders in the manner shown in the succeeding paragraphs. The first and consolidated bonds will be secured by a first mortgage on the entire system, subject only to the lien securing the new Terminal bonds and to prior rights under agreements for the acquisition of equipment.

For the purpose of allocating securities as between the Midland bonds and the refunding bonds, and for that purpose only, the system is divided into two parts. To one part, hereinafter called the refunding part, upon the earnings of which the allotment to the refunding bonds is based, there are allocated the earnings of the refunding division. To the other part, herein called the Terminal and Midland part, upon the earnings of which the total distribution to the Terminal bonds and the Midland bonds is based, there are allocated, in addition to the earnings of the property on which the Midland mortgage is a first lien (which includes the northern and southern extensions), the adjusted earnings or deficits derived from operations over the following properties:[51] (1) The Terminal division; (2) the Passaic and New

[50] The $70,000 first-mortgage bonds of the Passaic & New York matured on December 1, 1940. The trustee under authority of the court continued to pay the interest on these bonds, and, pursuant to authority of the court, has purchased with the general funds of the estate all of the bonds at prices not exceeding 90 cents on the dollar plus interest accruals. The court approved the purchases and ordered that until the further order of the court the bonds be held by the trustee subject to a lien in favor of the trustees of the several mortgages of the debtor, reserving for future determination the allocation of the lien among the several mortgage trustees.

[51] For the purpose of allocation as between Midland bonds and refunding bonds, the earnings of the Susquehanna Connecting are disregarded, both in the earnings allocated to each part and in total system earnings. This was done because, owing to the manner in which the Susquehanna books have been kept, the earnings of the Susquehanna Connecting do not appear in the formula application and because neither the Terminal and Midland part nor the refunding part appears entitled to them. For the purpose of considering the treatment to which unsecured claims are entitled, however, the earnings of the Susquehanna Connecting are taken together with the earnings and deficits of other unmortgaged assets.

York division [52] (after deducting charges on the Passaic and New York bonds); (3) the Paterson Extension division; (4) the Hackensack and Lodi division; [52] and (5) the trackage rights for passenger operations between Croxton and Jersey City.[52]

The earnings and deficits of the afore-mentioned properties are allocated to the Terminal and Midland part for the following reasons:

The Midland mortgage is secured by a second lien on the Terminal division and by a first lien on the northern and southern extensions. As between the Terminal and Midland part of the refunding part, it is equitable that the former should bear the entire deficits of the unmortgaged passenger trackage between Croxton and Jersey City and of the Paterson Extension, which carry almost exclusively passenger traffic, inasmuch as the refunding part has no passenger traffic. Also, as between the two, it is equitable that the Terminal and Midland part should bear the deficit of the Hackensack and Lodi division and receive the earnings of the Passaic and New York division, after deducting charges on the Passaic and New York bonds, since both of these divisions are physically connected with, and in reality are short branches of, the Terminal and Midland part and move most of their traffic jointly with it.

The court in deciding the lien controversy stated that the debtor's rolling stock is subject to the liens of the six principal mortgages or one or more of them, but reserved for future determination all questions with reference to relative priority. The insurance group computed that a return of 4 percent on the depreciated value of the equipment owned when the reorganization proceedings began would be $2,923 for 2 months as compared with the system adjusted earnings under the formula of $83,691 for the months of June and December 1940. They concluded that an allocation of the $2,923 between the Midland and Terminal part and the refunding part, which would be principally interested on the basis of a decision as to their respective liens on the equipment, would not be likely to affect sufficiently their proportions of system adjusted earnings under the formula to warrant, even from the point of view of the holders of the Midland and the refunding bonds, the delay and expense which further litigation of the lien controversy would necessitate. Accordingly, they deemed it unnecessary to petition the court for a determination of relative rights in equipment, and a return on the value of the equipment was not included in determining the adjusted earnings of each mortgage division.

The foregoing method permits the determination of the percentages of total system earnings attributable to the Terminal and Midland

[52] These properties are unmortgaged (except for the Passaic and New York mortgage), and their earnings and deficits, after deducting charges on the Passaic and New York bonds, though shown separately in the formula application tabulation, *supra*, are included with the earnings of the unmortgaged assets.

part and the refunding part, which are 75.43282 percent and 24.56718 percent, respectively. The $5,000,000 of fixed-interest bonds issuable is then divided between the two parts in those percentages. All the bonds thus issuable to the refunding part are allocated to the refunding bonds. From the bonds thus issuable to the Terminal and Midland part, the Terminal bonds are first satisfied in full (through the issuance of new Terminal bonds as set forth above), and the balance is allocated to the Midland bonds.

Both the method and the result of dividing the fixed-interest bonds on the foregoing basis are shown on lines 1 to 3 on appendix A hereto. The resulting allocation of all the fixed-interest bonds to be issued, including the new Terminal bonds, is as follows:

| Old bonds | New bonds | Principal amount of new bonds |
|---|---|---|
| Terminal bonds | New Terminal bonds | $2,000,000 |
| Midland bonds | First and consolidated bonds | 1,771,641 |
| Refunding bonds | First and consolidated bonds | 1,228,359 |
| | | 5,000,000 |

(*c*) *New general-mortgage income bonds and preferred stock.*—The same method is used in the distribution of income bonds and preferred stock between the Midland and the refunding bonds, except that after the claim of the Midland has been filled out in preferred stock the remainder of the preferred stock is allocated to the refundings. The execution of this method as applied to income bonds and preferred stock is shown on lines 4 and 5 of appendix A. The resulting allocations are as follows:

| Old bonds | Income bonds | Preferred stock |
|---|---|---|
| Midland bonds | $1,885,820 | $1,009,077 |
| Refunding bonds | 614,180 | 1,990,923 |
| | 2,500,000 | 3,000,000 |

(*d*) *Common stock.*—The securities remaining for satisfaction of the remainder of the claims of the refunding bonds, amounting to $1,236,538 and other claims are the $3,500,000 of common stock (35,000 shares having no par value, stated at $100 a share). For convenience, this no-par stock when hereinafter stated in dollars is on the basis of $100 a share.

Provision should be made in the plan for the creation of a fund, to be known as the security-retirement fund, through payments equal to 50 percent of the dividends paid on the common stock and the ap-

plication thereof in the manner of a sinking fund (1) for the retirement of the general-mortgage income bonds and after all such bonds have been retired, (2) for the retirement of the preferred stock, and appropriate provisions to that effect should be incorporated in the new securities, including the provisions for the determination and application of available net income. In this manner, the holders of the securities to be retired would, if earnings permitted, receive the full amount of their claims, and at the same time the value of the common stock would be enhanced by the retirement of the prior securities. The public interest would also be served.

The passenger traffic of the system and the relation of the Paterson Extension thereto has been discussed. The plan should authorize the proposed conveyance, to a new company other than the reorganized company, or to a trustee, as the reorganization managers should determine, for sale and distribution of the proceeds ratably to the Paterson Extension bondholders, of the noncarrier lands subject to the Extension mortgage, designated by the trustee as of no use to the debtor for railroad purposes, and with the approval of the court heretofore appraised for purposes of the plan at $55,634.50. On the basis of such appraisal, the remaining claim of these bondholders would be $215,199. The proponents of the plan believe that there is sufficient value in the Extension to warrant 100-percent satisfaction of this balance of the claim in new no-par value common stock, taken at $100 a share, even though a deficit in respect of it was produced by application of the formula.[53]

The Paterson Extension bondholders' group contends that the Extension is the dominating factor in producing passenger revenues which have materially reduced the passenger losses of the system. It points out that the incompleteness of the record makes it difficult to determine that contribution and on brief asks for further hearings to secure data for that purpose. It objects to the use of the results of the application of the formula on the ground that the formula, having been formulated before passenger service was instituted on the Extension, is inadequate to deal justly with the special situation which the use of the Extension has presented and that, as applied, it produces unjust results to the Extension bondholders. The group objects par-

[53] As hereinbefore shown, the application of the formula after certain adjustments produced a deficit of $3,972 for the Extension. There were neither freight nor passenger movements over the Extension in June 1940, the first of the 2 months the formula was applied, and the trustee testified that only nominal expenses were assigned to the Extension for that month. Passenger revenues of $1,623.61 were assigned to the Extension on a mileage prorate basis (apparently 1 mile to the Extension to 14 miles on the Midland division). The principal expense items assigned to the Extension were: Maintenance of way and structures $2,233.31, maintenance of equipment $179.08, traffic $113.54, transportation $1,275.71, general $243.75, and railway tax accruals $1,523.10. No rent of passenger cars was assigned to the Extension.

ticularly to the mileage-prorate basis for the allocation of passenger revenues between the Extension and the Midland division and asks that an allowance be made to the Extension for origination of traffic.

The debtor's trustee pointed out that even though the revenues of $1,623.61 shown in the application of the formula were doubled, without an increase in the expenses, the result would still be a heavy deficit, over $2,300 for this spur. There is a margin of only $348 between the revenues assigned during the test period and the transportation expenses alone. Expenses for maintenance of equipment of $179.08 and general expenses of $243.75, both allocated to the Extension during the test period, would more than exceed that margin, leaving nothing for maintenance of way and structures, traffic expenses, railway tax accruals, rent of leased equipment, and other expenses. As previously stated, at the time the formula was applied to the Paterson Extension, December 1940, the number of passengers, both steam train and motorcar, interchanging monthly at Susquehanna Transfer with the busses to and from New York City had reached 55,268, only slightly less than the monthly average of 56,666 using the same service in 1941, the year the trustee used as the basis for his forecast of future passenger revenues.

While the formula we approved was silent as to the method of distribution of passenger revenues between mortgage divisions, for the reason that at that time passenger traffic was limited to the Midland district, the trustee used the mileage-prorate basis. That is an approved method. The formula which we approved in *Central of Georgia Ry. Co. Reorganization*, 252 I. C. C. 587, provided that "interdistrict" passenger revenues should be "apportioned to the districts on the basis of road mileage over which the traffic moves." In *New York, N. H. & H. R. Co. Reorganization*, 224 I. C. C. 723, we said, in respect of a formula "Fundamentally, passenger revenues differ from freight and other revenues in that the former are on a strict mileage basis." For reasons there stated we declined to modify the considered formula to reflect terminal costs in handling passenger traffic.

The extension group argues that the trustee, with court approval, would not have invited additional passenger traffic by the installation of the described service were such service not profitable to the debtor's system. It also argues that the insurance group's proposed allocation to the Extension bondholders of common stock, after the described disposition of the noncarrier properties, does not adequately recognize their lien position or justly compensate them for the Extension's earnings contribution. Under the capitalization here approved, with but $10,500,000 of new securities ahead of common stock, the allocation of common stock to these bondholders in respect to the remainder of their claims, after the described treatment of the noncarrier properties,

would represent considerably greater income possibilities than under the insurance group's plan, which provided for $12,000,000 of new securities ahead of common stock.

If further hearings are not held, the group urges that broad equitable principles should govern in preserving the relative rights of their bonds, and suggests the following alternate treatments: (1) That the Extension be treated as part of the Midland division and that the Extension bondholders share *pari passu* with the Midland division bondholders in the new securities; or (2) that these bondholders be paid in cash upon a valuation to be agreed upon by the interested parties, or failing that, to be fixed by us, subject to confirmation by the court; or (3) that both the carrier and noncarrier properties of the Extension be leased to the reorganized company, the rental to be the income on the noncarrier properties plus 5 percent on the Commissioner's valuation of the carrier properties with other terms and conditions not necessary to describe.

We do not approve the first of these proposals for the reason that the Midland mortgage is a second lien upon the Terminal properties whose value clearly exceeds the amount of the claim under the lien of the Terminal mortgage, whereas the Extension mortgage is a lien on the Extension properties only. We do not approve the second proposal for the reason that negotiations for such a cash payment as proposed might delay the progress of the plan and the problem of determining what would constitute an equitable cash payment would not appear to be any less difficult of solution than the allocation of new reorganization securities in respect of the claims. Nor do we approve the lease method proposed, for the reason that no adequate basis has been established for the terms proposed and it would unduly complicate, rather than simplify, the corporate structure or structures that would emerge from the reorganization, particularly since the title to the properties has for many years been held by the debtor, and the Paterson Extension Railroad which created the mortgage no longer exists.

The general-mortgage interests object to the treatment of the Paterson Extension bondholders as proposed by the insurance group as being too liberal. They urge also that this too liberal treatment is increased under the capitalization recommended by the examiner. This objection is founded on the relative treatment accorded the general-mortgage bondholders and upon the status of the Extension at the beginning of the trusteeship. They contend, in effect, that the Extension bondholders are entitled to no better treatment (i. e. no greater percentage of their claims in new securities) in respect of their first lien on this small piece of property than the generals are entitled to in respect of their junior lien on the entire system prop-

erties. We do not regard this contention, embracing as it does the consideration of numerous factors, as involving a controlling consideration. However, recognition of the rehabilitated status of the Extension must be in the light of expenditures of earnings of the entire property of the debtor which were necessary during bankruptcy to develop the property of the Extension so that the present service would be possible.

We recognize that the treatment of this 0.75-mile spur presents a difficult problem, but we agree with the Extension group that it can be solved by the application of broad equitable principles. The trustee has initiated and partly carried through a program for the curtailment of losses from passenger operations by the substitution of motorcars for the steam trains. By 1939, as stated, he had eliminated about one-half of the steam trains and had shortened the route of others. By 1941, motorcars carried about 35 percent of the total number of passengers carried. Plans for the elimination of more steam trains by the substitution of motorcar trains are in course of being carried out, although the trustee expresses no hope of the elimination of all passenger losses even after the complete motorization of passenger-car operations. The reasonable prospects are that the future contribution of the Extension will be almost entirely passenger traffic.

While we recognize that the use of this spur has contributed to the coordination of the motorization of the system's passenger traffic, we do not regard it as the dominating factor in the reduction of passenger losses. Passenger service to the city of Paterson was furnished by the Broadway station before the rehabilitation of the spur. The elimination of the several steam-drawn passenger trains on the main line, of course, contributed materially to the reduction of the losses. But the extension cannot be considered as essential to this reduction. We do not believe that the Extension bondholders should share in securities rated higher than common stock. This will not ignore the first-lien position of the Extension bondholders on the Extension, but it will, we believe, fit those bondholders into a position in the capital structure of the reorganized company which will be the equitable equivalent of the position they now occupy with respect to the debtor's properties and earnings. Their participation in new system securities in the form of common stock to the extent of their claims after allowance for the noncarrier property will afford them the equitable equivalent of the rights which they now hold. We find that such allocation should be made to them in respect of the remainder of their claim after the described deduction with respect to the noncarrier properties and that such allotment will constitute fair and equitable treatment for their claims. This treatment will represent all values

in the Extension properties and leave nothing therein for distribution to the holders of junior liens thereon.

The adjusted earnings of the Susquehanna's unmortgaged properties, taken as a whole, are also a deficit as hereinbefore shown. The unprofitable unmortgaged passenger trackage between Croxton and Jersey City has little to do with the streamlined passenger service and has no strategic value worthy of consideration. The Susquehanna Connecting, in Pennsylvania, during the 2 months in 1940 that the formula was applied to the other parts of the lines, produced earnings of $1,159. The Passaic & New York occupies a middle position as between mortgaged and unmortgaged assets, as the $70,000 of bonds outstanding under its mortgage at the beginning of the trusteeship were purchased by the debtor's trustee at prices not exceeding 90 cents on the dollar plus accrued interest. Inasmuch as this property, under the plan we approve, is to be conveyed free of mortgage liens to the reorganized company or held for the benefit of the reorganized company in such a manner as to cause the new mortgage liens to attach to it, we are treating the property to the extent of $70,000 as part of the mortgaged property as to which new securities are allocated as elsewhere herein described, and the remaining value as unmortgaged property. This property produced earnings of $275 for the 2 months of the formula application after deducting interest on the then outstanding bonds. The Hackensack & Lodi and the Lodi branch, together constituting a 1.8-mile spur, produced a deficit of $594 in the test period of the formula application. Obviously, its operating value is questionable and probably its main value is for scrap. As hereinbefore stated, our Bureau of Valuation reports the 15 lots at Passaic, held by the court not subject to any mortgage, as having a value of $43,903. It also reports noncarrier land at North Hawthorne of the value of $21,905, and $26,324 of noncarrier land in Pennsylvania. The proponents of the plan indicated that there is a possibility that the Susquehanna Connecting and the Passaic & New York might be sold as going concerns. Taking into account all the factors, including those relative to physical valuation shown herein, we find that the value in reorganization of the unmortgaged assets may, and should be, determined as the equivalent of $400,000 of new common stock. The plan should provide that as part of the consummation of the plan, the Passaic & New York bonds be canceled.

The common stock remaining for distribution, after deducting from the total of $3,500,000 the $215,199 to the Paterson Extension bonds and $400,000 to the unmortgaged assets, is $2,884,801. This is the only remaining security to be allotted to approximately 24.4 percent of the claims of the refundings, and the claims of the seconds and the generals, all secured by liens upon the same properties of the debtor in

the order named. The new common stock under the capital structure which we approve herein, in our opinion possesses sufficient earning power and the operation of the security-retirement fund and the sinking fund for the new senior bonds will so develop and augment its earning power, that the remaining $2,884,801 of the stock need not be so allotted that any of these mortgage bonds will be kept altogether from participating therein, although the lien position of the generals will not receive a very substantial participation. We think and find that allocating this stock to the refundings for the remainder of their claims on the basis of one share of stock for each $90 of claims and to the seconds (the outstanding bonds and those pledged) on the basis of one share for each $100 of claims will adequately recognize in the new capital structure the rights possessed under their existing securities. This treatment will require $1,373,931 of the stock for the refundings and $1,316,250 for the seconds, leaving $194,620 for the generals. This amount of stock will satisfy such a comparatively small portion of the claims of the generals that it is not necessary to determine on what basis they should take it, except that they will be entitled to share in the securities representing unmortgaged properties to the extent of the unsatisfied portion of the principal amount of their bonds. For this purpose we determine that the $194,620 of stock should be allotted to them on the basis of one share of stock for each $110 of claims. They will not be entitled to share in the unmortgaged assets in respect of interest on their bonds for the reason that there are sufficient securities representing unmortgaged assets to satisfy only a comparatively small percentage of the principal amount of all claims entitled to share therein. Compare *Group of Institutional Investors* v. *Chicago, M. St. P. & P. R. Co.*, 318 U. S. 523, 569. These allocations of the common stock, demonstrated also on lines 6 (a), (b), and (c) of appendix A, are summarized as follows:

| | *Amount* |
|---|---|
| Refunding bonds | $1,373,931 |
| Paterson Extension bonds | 215,199 |
| Second-mortgage bonds, outstanding | 589,680 |
| General-mortgage bonds, from pledged seconds | 726,570 |
| General-mortgage bonds, from mortgaged properties | 194,620 |
| General-mortgage bonds, share in unmortgaged properties | 161,091 |
| Unsecured creditors | 238,909 |
| Total | 3,500,000 |

The allocations of new securities to the full amount of each class of claim and on the basis of each $1,000 bond and the yearly charges against income are shown in appendix B.

Since the claims of the creditors cannot be satisfied in full within the scope of the total capitalization, the owners of the common and preferred stock, with a book value as of December 31, 1942, of $25,-

781,163, could have no equity and would be entitled to no new securities. The foregoing result is supported by a comparison of the total of the claims of creditors of approximately $18,418,530 with the total capitalization of $14,000,000, exclusive of obligations under equipment lease purchase agreements. Accordingly, we find that the equity of the existing classes of preferred and common stockholders has no value.

The new first and consolidated mortgage (in the bonds of which the Midland bondholders would share for about 38 percent of their claims and the refunding bondholders for about 24.2 percent of their claims) constituting a first lien upon the entire railroad, except the Terminal property upon which it would be a second lien, in general effect, would represent a translating to the property of the new company, with no substantial changes in lien positions, the first-mortgage lien of the refunding on the line west of Beaver Lake and the first-lien position of the Midland on the Midland division, and combining into a second lien upon the Terminal property the second lien of the existing Midland mortgage and the third lien of the refunding mortgage upon the Terminal property.

The Midland mortgage is a first lien on about 73 miles of road, including the recently acquired 1.61 miles of track known as the northern and southern extensions adjacent to the Terminal property. Bonds outstanding under it are equal in principal amount to $47,794 per mile of road upon which they have a first lien. The total debt, including interest, equals $63,925 per mile of first-lien road. As hereinbefore stated, these bonds have a second lien upon the Terminal properties, which are concentrated near the water front at Edgewater, except for part of the yards at Little Ferry and the 3.05 miles of line from Little Ferry to Edgewater.

The refunding mortgage is a first lien on about 43 miles of road, a second lien on about 73 miles (omitting the 0.75 mile of the Paterson Extension as inconsequential), and a third lien upon the Terminal property. The bonds outstanding under it are equal in principal amount and in principal amount plus interest, respectively, to $87,070 and $117,907 per mile of road upon which they have a first lien. The second lien of the refunding mortgage on the 73 miles of road is subject to the first lien on the Midland equal to $63,925 per mile.

The bonds issued under the Midland mortgage matured in 1940, and those issued under the refunding mortgage matured in 1937; and both bore interest at the rate of 5 percent. As the bonds have matured, it is not necessary for us to consider the old interest rate as an investment feature which must be equalized or compensated for in the new securities. It is sufficient, in our view, that the new securities provide a reasonable return from an investment standpoint in

the light of current market conditions, considering the nature of the new securities, and the size and importance of the reorganized company.

For approximately 38 percent of their claims, the holders of the Midland bonds would receive new first and consolidated 4-percent bonds maturing in 1984 and having a first lien upon about 128 miles of road (securing debt at the rate of $23,437 per mile) and a second lien upon the Terminal property. For about 24.2 percent of their claims, the refunding bondholders would receive bonds secured by the same liens. The bonds under this mortgage would, with the new Terminal bonds, have a first claim upon the first $200,000 of earnings available for bond interest, whereas under existing mortgages there is no provision as to priority in favor of a given mortgage for payment of interest out of earnings of the company as a going concern. These bonds are to be redeemable, except from the sinking fund, at graduated rates of premium, and would have the indirect benefit, through advancement of lien position upon the Terminal property, of the sinking-fund payments for the benefit of the Terminal bonds and the direct benefit of such sinking fund in case of retirement of the Terminal bonds. They would have the direct benefit of such provisions of the mortgage as those for facilitating a merger, sale, or consolidation, those providing for the determination and application of available net income, those providing for yearly payments out of earnings into an additions and betterments fund, and those limiting the amount of new issues of such bonds that may be pledged. Other provisions of the mortgage, aimed mainly at saving the reorganized company from financial crises and thus indirectly benefitting the bondholders, are those providing for the issue of additional bonds for specified purposes such as refunding the Terminal bonds, the first and consolidated bonds, and obligations prior thereto, for the acquisition of additional property, and for emergency purposes, the provision for limited modification of the terms of the mortgage with the consent of the holders of two-thirds in amount of the outstanding bonds, and the provision hereinafter described for limited extensions of maturities of interest and principal with the consent of the holders of three-fourths in amount of the outstanding bonds. The mortgage provisions just described are for the most part missing in the existing mortgages. Coupled with the reduced capitalization and charges and the prospective earnings hereinbefore described, the bonds to be issued under this mortgage will be far superior to those to be surrendered in exchange therefor.

The Midland bonds and the refundings would be the only classes to participate in the distribution of the $2,500,000 of general-mortgage 4½-percent income bonds maturing in 1994, the former to the extent

of about 40.4 percent of the claim and the latter for about 12.1 percent. This new mortgage secures a debt of about $19,531 per mile, subject to the prior lien of the first and consolidated of about $23,437 per mile. This is exclusive of its third lien, subject to prior liens of $5,000,000, upon the Terminal properties. Interest on the new bonds is cumulative to the extent of 13½ percent of the principal. This mortgage, next junior to the first and consolidated and upon the same property, contains provisions similar to those of the first and consolidated with respect to merger or consolidation, modification, extensions of maturities, the additions and betterments fund, determination and application of available net income, the issue of additional bonds, including a limited amount for emergency purposes, and limitation as to amount to be pledged. The application of the security-retirement fund, created by the required setting aside of amounts equal to 50 percent of dividends on the common stock, to the retirement of these bonds will add materially to their value. These bonds would also benefit, through advancement of lien position, by the sinking fund described. The lien position of these bonds and their claim upon income, coupled with the other rights described and the reasonable prospects of income sufficient to meet their requirements make these bonds only slightly less valuable than the first and consolidateds and definitely superior to those to be surrendered in exchange.

The Midland bonds and the refundings would be the only ones sharing in the $3,000,000 of 5-percent preferred stock, the new security next in rank to the income bonds. The balance of the Midland's claim, about 21.6 percent, would be satisfied out of this stock and the refundings would be satisfied thereby to about 39.3 percent, leaving about 24.4 percent of the refundings' claim to be satisfied. Under our findings herein, this stock has cumulative rights to earned dividends, has the right voting as a class as long as income bonds are outstanding to elect one-half of the board of directors less one, and, in case of default of the equivalent of six quarterly dividends, has the right to elect two directors. The probability of regular dividends on this preferred stock will be augmented by the reduction of charges prior thereto by the application of the security-retirement fund to the retirement of the income bonds, and the application of that fund to the retirement of the preferred stock after the retirement of the income bonds will further add to the value of this preferred stock. The earnings on the new securities allocated in respect of each $1,000 Midland bond are $20.31 on the $507.78 of first and consolidated mortgage bonds, $24.32 on the $540.50 of income bonds, and $14.46 on the $289.22 of preferred stock, a total of $59.09, which is equal to about 4.4 percent on the $1,337.50 of claim per bond which would be exchanged for the new securities. The earnings on the new securities,

to and including preferred stock, allocated to each $1,000 refunding bond are $13.12 on the $328.09 of first and consolidated mortgage bonds, $7.38 on the $164.04 of income bonds, and $26.58 on the $531.76 of preferred stock, total $47.08, which is equal to approximately 3.5 percent on the $1,354.16 of claim per bond.

As stated, common stock is allocated to the refundings for the remainder of their claims on the basis of 1 share for each $90 of claims in recognition of their lien position. This treatment results in their receiving $1,373,931 of the $3,500,000 of the stock. As previously indicated, the yearly charges ahead of common-stock dividends amount to $577,123, which includes the $20,000 sinking fund and the additions and betterments fund of $85,000, the latter amount to be reduced to $65,000 after May 1, 1950. Dividends upon the common stock at $2 per share plus the payments into the security-retirement fund could be paid at an earnings level of approximately $682,123. These are within the range of the expectable earnings of a normal future year hereinbefore indicated. Dividends of $2 on the 3.67 shares of common stock allocated to each $1,000 refunding bond plus the earnings on the prior securities above shown, would amount to $54.42 and would produce earnings of about 4 percent on the $1,354.16 of claim per bond.

The security-retirement provision, while initially appearing to require sacrifices on the part of the common stock, should by degrees augment its earning power by removing the drain on income of the prior securities (partly held by the refundings) which it will be used to retire. The sinking fund also tends to the same purpose. Substantially all of the features of the new structure mentioned above in connection with the two new mortgages will enure to the benefit of the new stock. Another outstanding feature of the new company which should materially benefit and protect all new securities is the provision directing the order of application of available net income, with a view to avoiding defaults, maintaining the company's credit, and insuring the flow of earnings to the purposes normally required and to the persons entitled to rely thereon. With the existing debt of $16,483,-116,[54] including equipment obligations, secured on these properties, requiring annual fixed charges of $628,983, reduced to $7,500,000, with fixed and contingent annual charges (including the sinking fund and the additions and betterments fund) of $427,123, we believe and find that there is sufficient earning power in the stock, so that the securities allocated to the Midlands, the refundings, and the seconds will accord full recognition in the new capital structure for the existing securities which they will replace, and adequate compensation for the senior rights relinquished.

[54] This includes estimated interest accruing to January 1, 1944. In addition, there are unsecured claims amounting as of that date to approximately $2,388,258.

(*e*) *Conclusions as to other contentions.*—The successor trustee under the second mortgage introduced testimony and argued at some length concerning the amount of common stock the second-mortgage bondholders should receive in view of the fact that the proposed plan allocated preferred stock to them to the extent of only 20 percent of their claims. A considerably different situation is presented under the capitalization and distribution which we approve, where all of the preferred stock is exhausted before the refundings are satisfied. For the reasons hereinbefore stated, we believe that the allocations of the new common stock on the bases which we provide adequately and fairly deals with the claims of the refundings, the seconds, and the generals.

Request for the elimination from the plan of provisions for premiums on redemption of the new Terminal, first and consolidated, and general-mortgage bonds and the preferred stock was made by both the general-mortgage trustee and the protective committee for holders of general-mortgage bonds. The requirements for the payment of premiums in line with those contained in the proposed plan on redemption of the Terminal and first and consolidated mortgage bonds are so general as to bonds of those classes, and serve such a useful function in supporting investments in such securities that their elimination is not approved except as to the redemption of those bonds through operation of the sinking fund. Provision for premiums on the redemption of income bonds and preferred stock of the classes of those here proposed is not general as in the case of higher rated securities. As the retirement of these two securities is most likely to occur through operation of the security-retirement fund, we do not think that premiums on their redemption should be imposed, and we will so provide in the plan.

One of the general-mortgage bondholders requests that the plan be made to provide that the reorganization managers be appointed by the court. The proponents of the plan state that the managers named in the plan and the method of choosing their alternates were arrived at after a vigorous exchange of views among representatives of the various bond issues. We think that the interests of the creditors in the outcome of the proceedings is sufficient to require that they or their representatives designate the managers, and that the responsibility of the court is such that it should have the authority to approve or disapprove such designations. But we do not approve as part of the plan the naming of individuals for the respective positions, for approval of the plan by us would imply in some degree, at least, approval of the individuals named therein for the positions even though the plan did provide for their approval by the court, and the court

might feel justified or obligated in some degree to recognize such approval. The personnel of such bodies should be kept separate and distinct from the provisions of a plan. This obviously requires that the plan provide what interests shall be entitled to designate the managers for the court's approval. We think that the interests of the creditors will be adequately served by providing that the trustees under the existing Terminal and Midland mortgages shall appoint the manager for the first position, that the trustee under the existing refunding mortgage and the insurance group jointly shall appoint the manager for the second position, that the trustees under the existing second and general mortgages jointly shall appoint the manager for the third position, and that in case appointment for any of such positions is not made within such time as the court shall deem reasonable, the court shall appoint such manager. We will incorporate these provisions in the plan.

As stated, the general-mortgage bondholders protective committee requests modification of the plan so as to eliminate all the cumulative rights under the proposed new securities. Apparently this request is directed at the limited cumulative features of the income bonds and preferred stock. The general-mortgage trustee contends that interest on the new general-mortgage income bonds and on the new preferred stock should be made noncumulative. Under the provisions of the proposed plan, the interest upon the income bonds becomes payable as a debt if covered by net income available therefor, as defined by the plan. Then there is provision that when there is not income available therefor, it shall accumulate to the extent of the maximum of 13½ percent of the principal amount of the series A bonds outstanding and that, when income becomes available therefor, that percentage of accumulation shall become payable. This is a fair compromise between fully cumulative and noncumulative income bonds and tends to stabilize the income on, and the value of, such bonds between good and bad years of income. That provision of the proposed plan should not be disturbed. The situation is somewhat different as to dividends on preferred stock. The proposed plan provides that dividends earned (covered by income available therefor) and not declared and paid shall accumulate to the extent of 15 percent of the par value of the stock outstanding but not beyond. Thus, there is less reason for limiting the accumulation of earned and unpaid preferred stock dividends than for limiting the accumulation of unearned interest on income bonds. Permitting the unlimited accumulation of preferred-stock dividends which have been earned would stabilize the earnings on, and value of, that stock and would not deprive the common stock of anything to which it would be justly entitled. Accordingly, we will provide that the proposed plan be modified so as to provide that divi-



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dends on the preferred stock should be fully cumulative to the extent earned (covered by income available therefor) but not otherwise.

The trustee under this same mortgage requests that the preferred and common stock voting trusts should continue for only 5 years instead of 10 years as provided in the plan, or until such earlier time as dividends on the preferred stock would have been paid in full for each of three consecutive periods of 12 months. The protective committee for the general-mortgage bondholders requests that the trusts terminate at the end of 3 years. The insurance group, while indicating that it is a matter of prophecy as to whether the voting trusts should be terminated earlier than at the expiration of 10 years, states that the trusts are intended, not merely to bridge over a period of transition following the reorganization, but to protect the stockholders from exploitation of their securities in such a way that control of the railroad could be secured at a cost disproportionate to the investments in those securities. They state further that the past history of the debtor contributed to fixing the periods of the trusts the full time permitted by the law of New Jersey. Under the circumstances here presented, we believe that the period of the voting trusts should be 5 years, and we will so provide in the plan. In order to make definite the periods of the operation of the voting trusts, we will insert in the plan a provision that the voting trusts will begin as of the date of the order of the court directing consummation of the plan.

As in the case of the reorganization managers, we are of the opinion that the voting trustees should be subject to the approval of the court, and for the same reasons which we stated in connection with our discussion of the reorganization managers, the names in individuals for the positions should be eliminated from the plan. The proposed plan provides for the designations of voting trustees, respectively, by the trustee under the new general mortgage, the holders of the preferred stock voting-trust certificates and the holders of the common stock voting trust certificates (excluding those owned or controlled by railroad interests) in case those named in the plan cannot serve. This method of selecting the initial voting trustees does not appear to be workable, inasmuch as it will be necessary for the voting trustees to issue the voting trust certificates which would evidence the right of the holders to participate in the selection of the trustee. We think that the initial voting trustee should be selected by the same interests, and be subject to the same approval, as in the case of the reorganization managers, and that in case of a vacancy in any of the positions after the initial trustees have been approved by the court and the voting trust certificates issued, appointment for the first position should be made by the trustee under the new general mortgage, appointment for the second position should be made by

the holders of the preferred stock voting-trust certificates (exclusive of those owned or controlled by railroad interests), and appointment for the third position should be made by the holders of the common stock voting-trust certificates (exclusive of those owned or controlled by the railroad interests). Should any of the parties or interests fail to make appointment of a trustee, either the initial trustee or to fill a vacancy, within such time as the court shall consider reasonable, the court shall appoint such trustee. We will incorporate these provisions in the plan.

Edith A. Merritt in her brief raises questions on various phases of the proceeding. Discussion here obviously must be limited to matters pertinent to the consideration of a plan of reorganization. She contends that the division of the railroad into two parts, the so-called refunding part, and the Terminal and Midland part, as was done by the insurance group in the course of the development of the plan, unjustly deprives the second and the general-mortgage bondholders of valuable rights as lienors. This theoretical division of the railroad, as the explanatory text accompanying the plan states, was for the purpose of allocating securities "between the Midland bonds and the refunding bonds, and for that purpose only." Obviously, it was used as a device in aid of the presentation of a clear analysis of a rather complicated lien situation in connection with the use of the results of the application of the segregation formula in the allocation of securities to the Midland and the refunding bondholders. But after the allocations were made as between those two classes of security holders, the theoretical division of the railroad into the two parts dropped out of the picture and allocations were made as to the other bondholders without regard to that division. Consequently, the limited use of the division into parts could not have had the effect, as Miss Merritt appears in substance to assert, of diverting the equity of the general mortgage to the property subject to the first lien of the refunding mortgage and depriving it of its equity in the properties subject to the first liens of the Midland and Terminal mortgages. She requests that the idea of "dividing up the properties according to the formula be eliminated entirely," and that, except in the case of the Terminal mortgage, there be a gradual scaling down, on a basis which would be fair and equitable to all concerned, of the claims of the various mortgages according to their liens as adjudicated by the courts. In this connection, she indicates the necessity for further investigation of mortgage liens and mortgage releases without making any disclosure of what she expects further investigation would reveal. Her idea of eliminating entirely the use of the results of the application of the formula in making allocations of new securities is at variance with the emphasis put upon the earning-power test of value

for reorganization purposes in recent decisions of the Supreme Court and in the provisions of section 77. We see no merit in these contentions. Nor do we find any merit in her claim that the general mortgage is entitled to a lien superior to all other mortgages on the debtor's equipment.

Miss Merritt makes certain contentions, not altogether clear, as to a superior position which the general-mortgage bonds should occupy in the allocation of securities by reason of the $552,000 of second-mortgage bonds pledged under the general mortgage. The previous discussion herein and appendix A, show that under the plan allocations of new stock are made in respect of these pledged bonds on the same basis used in making allocations in respect of the outstanding second-mortgage bonds. This treatment is all that could be required.

Her objections to the personnel of the reorganization managers and voting trustees need not be discussed, as under the changes in the proposed plan which we are making we do not indicate our approval or disapproval of these officers.

She makes the general observation in the form of an exception that the plan should not provide that the "effectuation instruments can be put through without the careful supervision of the court and without submission to bondholders and their consent." The plan provides that, subject to the approval of the court, the new securities shall be in such form as shall be determined by the reorganization managers, provided that they include in addition to provisions usual under the circumstances, appropriate provisions to effect the provisions contained in the plan. A requirement that the forms of such securities be submitted to all bondholders and their consent secured would tend to cause indefinite delays and possibly render the execution of a plan impossible. We find no merit in this exception. On exceptions, she objects, without assigning reasons, to all of the miscellaneous provisions of the plan contained on pages 109 and 110 of the printed proposed plan filed of record. We have considered all of these provisions. Some of them we approve without comment, as they are customary provisions of plans. Certain others of them we disapprove or modify for reasons hereinafter stated.

She objects to the following matters stated on pages 108 and 109 of the printed proposed plan:

> The statements made in the plan and in the attached appendices are based upon information obtained from the record of the proceedings in the court and before the Interstate Commerce Commission, from the staff of the trustee of the debtor and from other sources believed to be reliable. Certain of such statements are necessarily based on estimates or assumptions, and none is to be considered a representation or warranty. None of the insurance companies nor any of their employees nor counsel for the insurance companies have any knowledge of their own concerning such information. No inaccuracy contained in the

plan or omission therefrom shall constitute the basis for any claim for rescission of any assent or approval to the plan or of acceptance of any new securities or for damages.

The first three sentences of the statements just quoted we do not regard as properly part of the plan which we approve, but as a protective statement which serves its purpose as notice to interested parties upon its being presented with the proposed plan. The last sentence, however, we regard as an appropriate part of the plan and so include it in the plan which we approve.

There were introduced in evidence, as coming from the files of the trustee under the refunding mortgage, two unrecorded supplemental mortgages. The first one, dated January 25, 1910, conveyed a mortgage lien to the Central Trust Company, then trustee under the refunding, the second, and the general mortgages, to a parcel of land, acquired by deed of the same date, containing 2.331 acres, abutting for 2,025 feet the debtor's right-of-way in Ridgefield Township, Bergen County, N. J., apparently near Little Ferry. The second one, dated June 12, 1917, conveys a mortgage lien to the same trustee to two parcels of land, acquired May 4, 1911, in the city of Paterson, Passaic County, N. J. One of these parcels, a 25-foot strip containing thirty-nine one-hundredths of an acre, abuts on the debtor's right-of-way for 685 feet and the other, a 40-foot strip containing sixty-three one-hundredths of an acre, abuts on the debtor's right-of-way for 690 feet. The exact location of these parcels of land, their value, and whether title to them is still in the debtor or its trustee, were not established of record. Nor was it established whether or not evidence was presented as to the mortgage liens on these parcels of land to the court at the time it had before it the determination of the matter of the liens of the several mortgages upon the several mortgage divisions of the debtor's property. Miss Merritt urges that the value and income from these parcels should be definitely established with a view to determining whether the several mortgages covering them are being given proper recognition in the allocation of new securities. In view of the record before us of the determination of the liens of the several mortgages by the courts, it is not understood why the liens of these mortgages should be presented to us in this vague form. Nor is it clear that we, in view of the adjudications by the courts, would be justified in making findings in regard thereto. Furthermore, upon the record, it would seem that we would not be justified in finding that the first liens of the Midland and Paterson Extension and possibly of the Terminal mortgages, respectively, did not attach to these parcels by virtue of the after-acquired property clauses of those mortgages. Compare in this connection the decision of the Circuit Court of Appeals, Third Circuit, in *In re New York, S. & W. R. Co., supra.*

The Paterson Extension bondholders' group requests, in the event the proposal of the plan that the Paterson Extension noncarrier properties be segregated for the benefit of the bondholders becomes operative, that such properties be placed in the hands of a trustee appointed by the court in lieu of creating a new corporation to act as a titleholder. The insurance group has no preference in this regard, but believes that the matter should be left to the discretion of the reorganization managers, and have amended the plan to that effect. This appears to deal adequately with the situation. The contention of the Extension group that these bondholders should be additionally compensated to the extent of $11,000 in cash or in new bonds in respect of the two parcels of land now used as sites for gasoline service stations and intended to be conveyed to the new company does not possess substantial merit. These parcels are corners of areas now used for team tracks and car deliveries and, while not now needed for railroad purposes, the testimony of the debtor's trustee shows that there is reasonable likelihood that the parcels may in the future be needed for the handling of team-track and car-delivery services. For these reasons the parcels were not designated by the debtor's trustee among those selected by him as not needed for railroad purposes. No sound reasons appear for not accepting the trustee's judgment in that regard. The values of such parcels are adequately recognized in the securities provided by the plan for these bondholders. For similar reasons the suggestion of the Paterson Extension mortgage trustee that the court be asked to pass upon the disposition to be made of these two parcels is not approved.

The situation in regard to the New York Central litigations, briefly, is as follows: The Erie and the Central each organized a subsidiary company for the purpose of building a railroad running north and south to serve the industrial districts on the west bank of the Hudson River. Through their respective subsidiaries the contract of April 6, 1904, was negotiated. It recited the previously contemplated railroads and stated that "in the opinion of the parties hereto, the interests of the public and of said parties will be better served by the building of one railroad, to be used jointly by the parties." The Central interests agreed to build the portion from Bull's Ferry, at or near Weehawken, north to the Hudson-Bergen County line and the Erie interests agreed to build from the county line north to the Susquehanna's Edgewater terminal, which portion is the described southern extension acquired by the Susquehanna's trustee. The agreement specifies that the railroad was to have a sufficient number of main tracks (not exceeding four) to handle the business of both parties with suitable and sufficient side track accommodations. Upon the failure of either party so to construct its portion, the other party upon completion of its section could enter and construct the portion the other party had agreed to

build. Each party built its described portion of road. Each party granted to the other, without any mention of time limitations, the right of trackage over the other party's section "for the operation thereon of cars and engines for the transportation of freight and passengers." Interest on the first cost of construction and on additions and betterments were to be borne equally by the parties and the cost of maintenance, including taxes, was to be borne by the parties on a use basis.

The agreement recited that the Erie's subsidiary was organized to build its railroad as far north as Fort Lee and that the Central's subsidiary was organized to build its railroad as far north as the New York-New Jersey State line. It then provided that "in case and whenever" the Erie interests or the Central interests should construct any additional portion of railroad north of the Susquehanna's terminal, the respective parties would have the option of having trackage rights thereon similar and under the same terms and conditions as in the case of the two sections south of the Susquehanna's terminal. The Erie interests constructed the described northern extension from the Susquehanna terminal north toward Fort Lee and the Central interests notified them of their election to have trackage rights thereon. There was no physical connection between the northern and southern extensions except the Susquehanna's tracks converging northwardly and southwardly from the Edgewater tunnel just west of the Edgewater terminal. The Susquehanna was not a party to the agreement and no provision was made in the agreement for operations between the northern and southern extensions.

On April 1, 1911, the Susquehanna, which operated on a rental basis over the tracks of the Erie Terminals Railroad Company (a nonoperating subsidiary of the Susquehanna and the Erie, then holding title to the northern and southern extensions) agreed with the Central interests to shift their cars between the northern and southern extensions "for a reasonable switching rate or charge," to be determined by arbitration in case of disagreement. By the same agreement the Susquehanna was given trackage rights over the portion of the railroad between Weehawken and the county line built by the Central interests. No time limit was specified in this agreement relative to the respective rights and promises. This agreement was among those as to which the trustee gave notice of disaffirmance.

Subsequent agreements, terminable on short notice, were made between the Erie interests and the Central interests covering switching movements between the northern extension and southern extension and between the Central's terminal at Weehawken and other points between that terminal and the Susquehanna's Edgewater terminal, on a cost basis (later made a fixed amount), but in those agree-

ments the company promising to do the actual switching was the Erie Terminals Railroad Company, and provision was made therein for the Central interests to pay to the Susquehanna stated amounts per car "as a trackage charge for each loaded car" of the Central and its affiliates moved across the Edgewater yard. The last of such supplemental agreements provided that the Erie Terminals Railroad would be paid by the Central and affiliates $4.30 for each loaded car switched to or from shippers on the northern extension and $6.65 for loaded cars switched to or from plants on those sections of railroad between the Edgewater terminal and the Central's terminal at Weehawken. These specified sums the debtor's trustee states are intended to cover the Susquehanna's costs. The Central, in its tariffs, publishes single-line rates to points on the extensions, and the Susquehanna has been making the actual movements in and out of the industries on the extensions from and to the southern end of the line, the Central's terminal at Weehawken, not at published switching rates but at the rates fixed under the terms of the agreements referred to.

The Susquehanna's trustee, in explanation of the trustee's steps to disaffirm the contracts, stated that if the Central's traffic, amounting to 10,000 to 13,000 carloads a year, which is handled as described, were handled as Susquehanna traffic instead of under the arrangements and at the charges described, the Susquehanna would receive divisions of the revenues. He states that on similar traffic received from the Erie and the Pennsylvania the Susquehanna receives in the neighborhood of $30 to $35 a car. He further said "the division on all the terminal lines, because of the work and the car-hire expense, usually take the form of arbitraries and minimum divisions, and the minimums I have mentioned would be similar to those we now get from other roads." The car hire which the Susquehanna in that event would have to bear he estimates at $5 a car.

The position of the Central is (1) that it has vested interests in the nature of perpetual easements in the extensions, that such extensions are joint railroad facilities which did not come into the debtor's estate by operation of law under the Bankruptcy Act, and that consequently such interests or servitudes previously impressed upon the properties cannot be divested in this section 77 proceeding; (2) that the agreements are those of the trustee and his predecessors in title, not those of the debtor, and therefore not subject to disaffirmance under section 77; and (3) that the agreements may not be disaffirmed in this proceeding for the reason that the trustee in taking title agreed on behalf of himself, his successors, and assigns to assume the duties and liabilities of his grantor under existing contracts and leases in connection with the extensions. The Erie argues substantially to the same effect. Both urge that the public interest is best served by having both the

Central and the Susquehanna serve the industries located on the extensions. Both request further hearings before we pass on the merits should we hold that the contracts may be legally disaffirmed by the plan, on the ground that the proposals that the plan disaffirms the contracts was made for the first time on brief after the close of the hearings.

The insurance group states that the Susquehanna's position in the court litigation is that the contracts are in substance the contracts of the Susquehanna. It requests that we insert in the plan, in lieu of the described provision which it previously requested, the following provision for conditional disaffirmance:

However, in the event that it is adjudicated by the highest court to which the question is presented, or it otherwise appears from the decision of such court that the agreement dated April 6, 1904, between the Edgewater and Fort Lee Railroad Company and the New Jersey Shore Railroad Company, or any agreement supplemental thereto, may not be rejected by the trustee of the debtor, but may be rejected in its plan of reorganization, the plan rejects any of said agreements as to which such a decision shall have been reached and the reorganized company shall not be deemed to have assumed them.

Obviously, the contest is as to the disaffirmance of the basic agreements establishing the reciprocal trackage rights over the respective sections of the railroad built in the interests of the two railroad systems and not as to the subsequently made operating arrangements, as the latter are covered by agreements terminable on short notice. Were it not for the fact that matters of public interest are involved, we might be justified in incorporating in the plan such a conditional disaffirmance of the contracts as the insurance group requests, but there is more to the subject than the legal right to have the contracts disaffirmed.

The historic basis for the building of one railroad adequate for the use of both railroad systems, instead of two railroads, in this much congested but strategically located narrow area of land cannot be casually ignored. It had its origin in the idea of avoiding the duplication of railroad facilities, the conserving of land for industrial purposes, and the contemplation of mutual benefits to be secured from the servicing by two carriers of a growing industrial area. Its purpose was akin to that of the provision of the Interstate Commerce Act authorizing us under certain conditions to require the common use of terminals and tracks leading to such terminals by two or more carriers. There has been no showing here that the tracks are inadequate to serve both railroads or that undue congestion of traffic has resulted from the use of the trackage rights.

The fact that there are considerably more Central carloads to be shifted to and from the northern and southern extensions than there are Susquehanna carloads to be shifted to and from the Central's por-

tion of the line is not of controlling importance and it is believed only partially indicative that the basic arrangements have been more favorable to the Central than to the Erie interests, for as suggested by counsel for the Central at the argument, it is possible and highly probable that industries have been established or expanded in this area by reason of the fact that both the Central interests and the Erie interests served the terriory. The Commission has found in a number of cases that service by a carrier under a trackage agreement is, in practical and legal effect, the substantial equivalent of an extension of its rails to the points served. The long standing period during which the railroads and the general public have acted under the basic arrangement here sought to be discontinued is an important element bearing on the public interest. That the public interest is much affected by a situation of this kind is indicated by the following excerpt from the opinion of the Supreme Court in *Union Pacific Ry. Co.* v. *Chicago, R. I. & P. Ry. Co.*, 163 U. S. 564:

> It is well said by Sanborn, J., speaking for the Circuit Court of Appeals: "Courts cannot be blind to the fact that every railroad company cannot have entrance to our great cities over tracks of its own, or to the fact that railroad companies do, and every public interest requires that they should, make proper contracts for terminal facilities over the roads of each other."

Considering all elements of the public interest, the interests of the particular railroads involved, and the interests of shippers in the immediate vicinity and of the public generally, we are of the opinion and find that the plan with the inclusion therein of the requested disaffirmance provision would not be compatible with the public interest. Accordingly we deny the insurance group's request that it be included.

3. *Discussion and conclusions as to other provisions of the plan.*— Certain provisions of the plan not specifically objected to and certain pertinent findings require consideration.

Among the powers of the reorganization managers to deal with the properties of the debtor and its four subsidiaries described in the plan is authority "in their discretion, to cause any part or parts of said properties to be retained by or conveyed to any of such subsidiaries or be conveyed to the reorganized company or any newly formed subsidiary of the reorganized company." The insurance group requests that this provision be clarified by inserting the following sentences immediately following the quoted provision:

> The foregoing sentence is intended to confer expressly upon the reorganization managers power to cause transfers of such parts of said properties to be made, to the extent which in their opinion may be necessary or desirable in effectuating the purposes of the plan. It is not intended to enable them to use the corporate entity of any of the afore-mentioned subsidiaries as the reorganized company.

We approve the provision as contained in the proposed plan with the above clarifying sentences added, and with the proviso that the liens of the new mortgages contemplated by the plan upon such properties shall be preserved.

The insurance group suggests that, in the event we make the sinking fund of $20,000 a year apply to the benefit of the new Terminal mortgage bonds (instead of to the new general-mortgage income bonds, series A, as proposed in the insurance group's plan), the sinking fund in the same amount per year should be applied to the benefit of the new first and consolidated mortgage bonds in the event that all of the $2,000,000 of new Terminal bonds are redeemed, refunded, converted, or otherwise retired. As hereinbefore stated, we have found that the sinking fund should be applied to the benefit of the new Terminal bonds, and we approve the foregoing suggested provision, with the explanation that, in the event stated, the sinking fund shall be applied to the first and consolidated bonds of series A.

As stated, the proposed plan provides that interest on series A income bonds, in the absence of an agreement to the contrary made by a majority of the holders of such bonds, would be made commutable into fixed interest upon either (*a*) the sale of 51 percent or more of the preferred and common stock pursuant to the provisions of the voting trusts, or (*b*) the consolidation or merger of the reorganized company or the sale or lease of substantially all of the properties of the company as an entirety.

The insurance group states that the purpose of the provision stated in (*a*) above is intended to protect the recipients of the income bonds from exploitation of their security by a purchaser of the stock. It expresses fear that, in the event such control should be acquired by a class I railroad, the acquiring railroad might operate the Susquehanna property for the benefit of the acquiring carrier's system as a whole without regard to the benefit of the Susquehanna's property, all to the detriment of the new income bonds. It believes that making the contingent interest fixed is an appropriate protection for these bonds and requests that its proposed plan be amended so as to provide that the contingent interest on series A bonds would become fixed, unless otherwise agreed to by a majority of such bondholders, in case of a sale of 51 percent or more of the preferred and common stock pursuant to the provisions of the voting trusts to a class I railroad or to interests controlling or controlled by such a railroad.

An essential feature of the plan which we shall approve herein is the provision that, in the interests of the future stability of the reorganized company and in the public interest, the payment of interest on the new general-mortgage bonds, series A, shall be contingent upon

earnings. The proponents of the plan have also placed emphasis upon the desirability of provision for contingent interest upon the junior bonds by including provisions in the proposed general mortgage that interest on series other than series A bonds may not be made commutable into fixed interest and that fixed-interest bonds may not be issued under the general mortgage. It also appears probable from the record that the reorganized company may become unified with a larger carrier. The provisions of the voting trusts look to that end. In all of the proposed mortgages, provision is to be made for a method of modifying, within limitations, the provisions of the mortgages so as to eliminate the provisions relating to the additions and betterments fund and the procedural provisions for ascertaining available net income without the maintenance of separate books of account in case of a unification of the reorganized company with another corporation.

A provision requiring the commutation of contingent interest into fixed interest upon consolidation, merger, or sale of over 51 percent of the stock, or the sale or lease of substantially all the properties, as here proposed, even with the qualification that a majority in interest of the series A bonds could waive the requirement, would present obstacles to negotiations for a unification of the properties with a larger carrier. This seems to be particularly true in view of the fact that the amount of debt permitted reflects the consideration that it is in part debt-bearing contingent interest. In view of this, and the other reasons stated, the evident functions of the voting trustees,[55] and the settled policy that such unifications and the terms thereof be subject to the authorization of public regulatory bodies, we find that the circumstances of this case do not warrant the requirement at this time that the contingent interest on the series A income bonds be commuted into fixed interest as here proposed. Accordingly we do not approve the provisions of the proposed plan relating thereto.

Among the miscellaneous provisions contained in the plan for carrying it out is one to the effect that a court finding after the submission

[55] The proposed plan provides that the voting trustees, subject to our approval and to the consent of a majority in interest of the two classes of voting-trust certificates (and subject also to the disregarding of requests to vote such certificates held by a railroad or by railroad-controlled interests), may sell 51 percent or more of the two classes of stock for such consideration as they may deem expedient, and that as part of such consideration they may take into account any agreements which the purchaser may make by way of traffic agreements, guaranties, offers of exchange of securities, or otherwise which in the judgment of the voting trustees will be of value to the holders of bonds issued in reorganization or of the two classes of voting-trust certificates. The plan also provides that the new mortgages shall provide that no consolidation or merger, and no sale or lease of substantially all the properties of the reorganized company as an entirety, shall be made by the reorganized company, except on the condition that the corporation which will thereafter operate said properties shall assume the mortgages and all covenants thereof and all the debts, obligations, and duties of the reorganized company with respect to the bonds outstanding under the mortgages.

of the plan to creditors, that for any reason any one or more of its provisions are invalid would not prevent its consummation without resubmission to creditors, with such modification on account of such invalidity as the reorganization managers determined to be necessary, provided such resubmission is not required by law. It might be argued that authority of this nature by reason of its being part of the plan would not require the separate approval of the court. The provision should be modified so as to provide that such determination of the need for modification or for resubmission should be subject to the court's approval.

Among the provisions of the plan giving specific authority to the reorganization managers is one which authorized them from time to time, whether before or after the acceptance of the plan by any holders of securities or creditors, to supplement or modify the plan or adopt a substitute plan, subject to the provisions of section 77, or to abandon entirely the plan by filing a written notice to that effect with the Commission. This provision has no proper place by way of conferring authority upon reorganization managers whose functions do not come into being until the plan has been confirmed by the court. Accordingly, it is not approved.

Another provision of the proposed plan is that its proponents reserve the right to supplement and amend it, and that, on account of the interdependence of all elements of a plan, suggestions made as to each element are subject to reconsideration and possible change if other elements are changed. There is adequate provision in the law and practice in section 77 proceedings to meet the situations apparently intended to be met by this provision. As a part of the plan such a provision is vague, and might be misleading. It is not approved.

As hereinbefore stated, under the plan the following claims would be paid in cash or assumed by the reorganized company and paid in due course of business without change of priority: (*a*) Claims in classes 1, 2, and 3 of the court's classification of claims to the extent filed and allowed; (*b*) claims, other than those of the United States, for taxes levied, assessed or accrued against the trustee of the debtor, when determined, subject to contest of the merits thereof pursuant to law; (*c*) liabilities and obligations incurred by the trustee during the reorganization proceedings; (*d*) taxes due to the United States from the debtor or its trustee, subject to the statute of limitations and to the right to contest on the merits pursuant to law; and (*e*) amounts required to discharge the claims of mortgage trustees for compensation and expenses, all costs of administration, and all other allowances made or to be made by the judge in the reorganization proceedings, including allowances provided for in section 77 (c) (12) of the Bankruptcy Act. We think there is no necessity for including in (*e*) above,

the words "amounts required to discharge the claims of the mortgage trustees for compensation and expenses," as all charges properly payable to the mortgage trustees would be included in the remaining words of (*e*) above, "all costs of administration, and all other allowances made or to be made by the judge in the reorganization proceeding, including allowances provided for in section 77 (c) (12) of the Bankruptcy Act." See *Reconstruction Finance Corp.* v. *Bankers Trust Co.*, 318 U. S. 163. We approve the above provisions with the elimination of the words "amounts required to discharge the claims of the mortgage trustees for compensation and expenses," and find that the claims, treated as described, will not be materially and adversely affected by the plan.

There should be inserted in the plan the following provision:

> The debtor, as reorganized, or the transferee of the property of the debtor, in connection with any settlement of transportation accounts between the United States and the debtor or the reorganized company, shall be required to recognize and pay or allow for any and all sums, determined through audit, adjustment, compromise, or litigation, as due the United States by virtue of the provisions of section 322 of the Transportation Act of 1940, 54 Stat. L. 955, for overpayments made prior to the date of confirmation of a plan of reorganization, without requiring proof thereof in this reorganization proceeding and without prejudice by reason of such sums not having been proved herein, with the same relative priority as they now have with respect to other obligations of the debtor.

The proposed plan contains the following provision relative to the voting power of the preferred stock:

> Holders of the preferred stock shall be entitled to one vote per share upon all matters except to the extent that provision is made herein for the election of one director by holders of income bonds and except to the extent that the right of holders of preferred stock to vote for members of the board of directors of the reorganized company is limited as hereinafter provided. Voting separately as a class, the holders of the preferred stock shall be entitled to elect one-half of the membership of the board of directors of the reorganized company less one, and one of the directors so elected shall be a member of any executive committee and of any other committee exercising general or financial powers of the board of directors of the reorganized company.

After the income bonds have been retired through the operation of the hereinbefore-described security-retirement fund, that fund will be applied to the retirement of the preferred stock. By that time the preferred stock will hold such a favorable position that it should no longer be entitled to elect one-half of the board of directors less one. Accordingly we will provide in the plan that that right, as described in the last sentence of the last above-quoted provision of the proposed plan, will not operate after the income bonds have been retired through operation of the security-retirement fund or otherwise. We will also add a clarifying provision that if one-half of the membership of the board of directors involves a fraction, the factor of one-half should be ap-

plicable to the next larger whole number in computing the number of directors which the preferred stock may elect.

The proposed plan clearly provides that all retirements of roadway and structures charges against income of a calendar year with proper adjustments for donations and other items not involving a cash outlay by the reorganized company shall be used for payment for capital expenditures, before any sums shall be used for that purpose from the additions and betterments fund. By amendment to our accounting classification, effective January 1, 1943, the carriers are required to charge to operating expenses the ledger value, less value of salvage, of nondepreciable road property retired and not replaced. Prior to such amendment, such retirements were charged generally to profit and loss rather than to operating expenses and the effect of the change will be to increase materially in many years the charges to operating expenses. Under the circumstances and in view of the fact that the provision first referred to in this paragraph was prepared prior to the amendment to the accounting classification, it is our view that the provision should be eliminated and other arrangements made in the plan for the use of the cash represented by the charges to operating expenses for nondepreciable property retired and not replaced. We will insert in the plan a provision authorizing the exclusion from the computation of net income available for contingent interest and for the additions and betterments fund and the sinking-fund requirements provided for in the plan, of that part of the charges to operating expenses representing the service value (ledger value less value of salvage, if any) of nondepreciable roadway property retired and not replaced.

As previously indicated, in connection with the Terminal bonds, we are of the opinion that the proposed terms of the mortgage bonds should be lengthened. Accordingly we will provide in the plan that the term of the first and consolidated mortgage bonds to be issued at reorganization shall be 60 years and that of the general mortgage bonds issued at reorganization 75 years. The rate of premium on redemption of the first and consolidated bonds, except with money from the sinking fund, will be 4 percent if redeemed on or before January 1, 1951, with a reduction of one-half percent for each 7-year period thereafter until January 1, 2000, and no premium thereafter.

On our own motion we find that all of the new mortgages should contain provisions, in such form and substance as may be determined by the reorganization managers with the approval of the court, that each of the mortgages may at any time with the approval of the Commission or such other regulatory body as may at the time have jurisdiction in the premises, be modified by the concurrent action of the

reorganized company and of the holders of not less than 75 percent in principal amount of all bonds of the mortgage outstanding at the time of such vote so as to postpone the time or times of payment of any fixed interest or accumulations of contingent interest, either before or after the interest is due, or the principal of any or all series of bonds of the mortgage, either before or after maturity, whether bearing fixed or contingent interest, which at such time may be outstanding, provided that the payment of the principal of the bonds may not be postponed for a longer period than 20 years from the maturity date designated in the bonds and that the maturity of interest on the bonds may not be postponed for a longer period than 5 years but in no event beyond the maturity date of the principal of the bonds designated in the bonds unless such maturity be postponed, in which event the maturity of interest on the bonds may not be postponed beyond the extended maturity date of the principal.

The proposed plan provides for the use of excess moneys in the additions and betterments fund, in the discretion of the board of directors, to the purchase or redemption of the Terminal bonds, first and consolidated bonds, or income bonds. We think that the lien positions which are relinquished in exchange for these bonds require that such funds be applied in the board's discretion, to the purchase or redemption of the Terminal bonds and after all of such bonds have been retired or converted, to the purchase or redemption of first and consolidated bonds and income bonds, in the order named. We will so provide in the plan.

In order to meet the requirements of the New York Stock Exchange as to listing stocks the plan should provide that the preferred stock, voting as a class, shall have the right to elect not less than two directors after default of the equivalent of six quarterly dividends, and that the affirmative vote of at least two-thirds of the preferred stock would be required as a prerequisite to any charter or bylaw amendment altering materially any existing provision of such preferred stock. This provision as to electing not less than two directors appears somewhat to overlap the previously described provision that the preferred stock as a class shall be entitled to elect one-half of the directors less one, but as the latter provision will not operate after the income bonds have been retired, there will thereafter be no overlapping of provisions.

In the interest of simplicity and economy, the plan should contain provisions authorizing the reorganization managers to offer to the creditors who would receive small amounts of scrip entitling them to fractional amounts of new securities, the election to accept the proceeds of the sale of such scrip at the market price of the bonds and stock and if not listed on an exchange, at a price to be approved by the court. The managers should have power to appoint such agents

as would be necessary for the above purpose who would also be permitted to sell such scrip as would be desired by participating creditors.

The plan should also provide that interest paid on the existing Terminal bonds for any period or periods subsequent to the effective date of the plan shall be applied to and treated as payments of interest on the new Terminal bonds.

4. *Summary.*—The changes in the proposed plan which we have hereinbefore indicated should be made, together with findings in regard to certain matters, are summarized as follows:

1. That the capitalization of the new company, including the classes of new securities and charges thereunder and the allocation of new securities to the several classes of creditors be as herein stated in lieu of these proposed by the insurance group, as will appear in summary form in appendixes A and B hereto.

2. That the sinking fund of $20,000 a year, proposed in the insurance group's plan for the benefit of the general-mortgage income bonds be applied to the benefit of the new Terminal bonds, that this sinking fund be serviced out of available net income prior to interest on the income bonds, and that, in the event the new Terminal bonds are redeemed, refunded, converted, or otherwise retired, the sinking fund shall be applied to the benefit of the new first and consolidated mortgage bonds, series A.

3. Disapproving the provisions relating to the commutation of contingent interest on series A income bonds into fixed interest upon the sale of 51 percent or more of the preferred and common stock, or upon a consideration or merger of the reorganized company or the sale or lease of substantially all of the properties of the reorganized company as an entirety.

4. That dividends on the preferred stock be fully cumulative to the extent earned (covered by income available therefor), but not otherwise.

5. That no provision be contained in the plan relative to the disaffirmance or rejection of contracts relative to trackage rights on the northern and southern extensions.

6. Adding a provision that the right of the preferred stock to elect one-half of the directors less one and to have one director so elected be a member of any executive committee exercising general or financial control, shall not operate after the income bonds have been retired through operation of the security-retirement fund or otherwise, and providing that in computing the number of directors which the preferred stock may elect, if one-half of the membership of the board involves a fraction, the factor of one-half should be applicable to the next larger whole number.

7. Providing that interest paid on the existing Terminal bonds for periods subsequent to the effective date of the plan shall be applied to and treated as payments of interest on the new Terminal bonds.

8. Adding clarifying sentences to that provision of the proposed plan relative to the authority of the reorganization managers to cause any part or parts of the properties of the debtor and its four subsidiaries to be retained by or conveyed to any of such subsidiaries or be conveyed to the reorganized company or any newly formed subsidiary of the reorganized company, with a proviso that the liens of the new mortgages contemplated by the plan upon such properties shall be preserved.

9. That an amount equal to 50 percent of all dividends paid on the common stock be applied to the retirement of the general-mortgage income bonds and thereafter to the retirement of the preferred stock.

10. Providing that no premiums shall be paid on redemption of income bonds, series A, or preferred stock, and that no premiums shall be paid on the redemption of Terminal mortgage bonds and first and consolidated bonds out of the sinking fund.

11. Fixing a date for the beginning of the periods of the voting trusts; providing methods for the appointment of all voting trustees; providing that all voting trustees be subject to the approval of the court; and providing that the period of the voting trusts shall be 5 years.

12. Adding a provision requiring the debtor or the reorganized company to recognize and pay or allow for any and all sums due the United States for transportation overpayments made prior to the date of confirmation of the plan without requiring proof thereof in this reorganization proceeding.

13. Disapproving as part of the plan the provision giving to the reorganization managers authority, whether before or after the acceptance of the plan, to supplement or modify it or to abandon it entirely.

14. Disapproving as part of the plan the provision that the proponents of the plan reserve the right to supplement and amend it and making each element of the plan subject to reconsideration and possible change if other elements are changed.

15. Providing for the cancelation of the Passaic and New York bonds as part of the consummation of the plan.

16. Authorizing the exclusion from the computation of income available for fixed charges, for purposes of determining the amount of available net income for contingent interest and the additions and betterments fund and sinking-fund requirements of that part of the charges to operating expenses representing the service value of non-

depreciable roadway property retired and not replaced, and eliminating the provision of the plan that cash representing charges to income for retirements of roadway and structures be used in payment for capital expenditures before funds in the additions and betterments fund be so used.

17. Adding to the plan, in order to meet the requirements of the New York Stock Exchange as to listing stocks, provisions that the preferred stock, voting as a class, would have the right to elect not less than two directors after default of the equivalent of six quarterly dividends, and that the affirmative vote of at least two-thirds of the preferred stock be required to amend the charter and bylaws to the extent of making material changes in the preferred stock.

18. Adding to the plan provisions authorizing under certain conditions, the delivery to creditors of the proceeds from the sale of scrip in lieu of small amounts of scrip and authorizing the appointment of agents to carry out that provision.

19. Modification of the provision authorizing the reorganization managers, under certain conditions, to carry out the plan even though the court should find that one or more of its provisions be invalid, so as to require the court's approval of such action by the reorganization managers.

20. Requiring provisions in the new mortgages whereby under given conditions, the payments of the principal of, or interest on, any series of bonds may, within stated limitations, be postponed.

21. Disapproving as unnecessary the inclusion in the list of claims to be paid in cash or assumed by the reorganized company the words "amounts required to discharge the claims of the mortgage trustees for compensation and expenses."

22. Providing that excess moneys in the additions and betterments fund may be used for the purchase or redemption of Terminal bonds, first and consolidated bonds, and income bonds in the order named.

23. Providing methods for the appointment of all reorganization managers and providing that all such appointments be subject to the approval of the court.

24. Providing that the term of the new Terminal bonds be 50 years, that of the first and consolidated bonds issued at reorganization 60 years, and that of the general-mortgage bonds issued at reorganization 75 years; and fixing the rates of premiums on redemption of the Terminals and first and consolidated as hereinbefore described.

25. Finding that the interests of the holders of certain described claims (which under the plan would be paid in cash or assumed by the reorganized company and paid in due course of business without change of priority) would not, when so treated, be materially and adversely affected by the plan.

26. Finding that the equity of the holders of the existing preferred and common stock had no value.

5. *Further authorizations by the Commission.*—In view of the provisions of section 77 (f), we shall, when a plan is finally adopted, give consideration to the granting of such authorization for the issue of securities, assumption of obligations, transfer of any property, sale, consolidation or merger of the debtor's property, or pooling of traffic to the extent contemplated by the plan and not inconsistent with the provisions and purposes of the Interstate Commerce Act. Nothing contained in this report shall be considered or be construed as a grant of authority for the issue of new securities, assumption of obligations, transfer of any property, sale, consolidation or merger, or pooling of traffic, pursuant to either the Bankruptcy Act or the Interstate Commerce Act, until further appropriate action by the Commission upon confirmation of the plan by the court.

The authorization and approval granted herein are upon the condition that the journal entries covering the necessary accounting adjustments required in the execution of the plan should be submitted to us for approval before they are recorded on the books of the reorganized company under the plan of reorganization approved.

### D. CONCLUSIONS AS TO PLAN

We find that the proposed plan, modified as herein stated, will meet the requirements of section 77 (b) of the Bankruptcy Act, will be fair and equitable, will afford due recognition of the rights of each class of creditors and stockholders, will not discriminate unfairly in favor of any class of creditors or stockholders, will conform to the requirements of the law of the land regarding participation of the various classes of creditors and stockholders, and will otherwise meet the requirements of section 77 (e), will be compatible with the public interest, and should be approved.

An appropriate order will be entered.

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## APPENDIX A

| | Terminal and Midland part | | | | | | | Refunding part | | Bonds wholly junior | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Terminal and Midland part total [1] | Terminal bonds | Midland bonds (including Northern and Southern Extension) | Passaic and New York division | Paterson Extension bonds | Hackensack and Lodi division | Unmortgaged assets (unsecured claims) | Refunding part total [1] | Refunding bonds | Second-mortgage bonds | General bonds (to extent secured by pledge of second-mortgage bonds) | General bonds | System total |
| Amount of claims: | | | | | | | | | | | | | |
| Principal | | $2,000,000 | $3,489,000 | | $200,000 | | $2,388,258 | | $3,744,000 | $448,000 | $552,000 | $2,551,000 | |
| Interest to Jan. 1, 1944 on coupons due on or after June 1 1937 | | [2] | 1,177,538 | | 70,833 | | | | 1,326,000 | 141,680 | 174,570 | 882,221 | |
| Total claims | | 2,000,000 | 4,666,538 | | 270,833 | | 2,388,258 | | 5,070,000 | 589,680 | 726,570 | 3,433,221 | |
| 1. Adjusted income available, for fixed charges | $62,690.80 | 84,279.26 | 15,107.30(D) | [3] | 3,971.70(D) | [4] | [5] 2,509.37(D) | $20,417.35 | 20,417.35 | | | | [6]$83,108.24 |
| 2. Line 1 expressed as percent of system total | 75.43282% | | | | | | | 24.56718% | | | | | 100% |
| 3. New fixed interest bonds: | | | | | | | | | | | | | |
| (a) Distribution between two parts on percentage basis (see line 2) | $3,771,641 | | | | | | | $1,228,359 | | | | | $5,000,000 |
| (b) Distribution within parts | 3,771,641 | 2,000,000 | (37.97%) $1,771,641 | | | | | 1,228,359 | (24.23%) $1,228,359 | | | | 5,000,000 |
| 4. New income bonds: | | | | | | | | | | | | | |
| (a) Distribution between two parts on percentage basis (see line 2) | 1,885,820 | | | | | | | 614,180 | | | | | 2,500,000 |
| (b) Distribution within parts | | | (40.41%) 1,885,820 | | | | | | (12.11%) $614,180 | | | | 2,500,000 |
| 5. Distribution of new preferred stock | | | (21.62%) 1,009,077 | | | | | 1,990,923 | (39.27%) 1,990,923 | | | | 3,000,000 |
| 6. Distribution of common stock: (No-par shares, stated at $100 a share): | | | | | | | | | | | | | |
| (a) To fill out balance of first-lien claims | | | | | [7] 215,199 | | | | (27.10%) 1,373,831 | | | | 1,589,130 |
| (b) To mortgage claiments | | | | | | | | | | 589,680 | 726,570 | 194,620 | 1,510,870 |
| (c) To accord recognition of unmortgaged assets | | | | | | | 238,909 | | | | | 161,091 | 400,000 |
| (d) Total allocation of common stock | | | | | 215,199 | | 238,909 | | 1,373,931 | $589,680 | 726,570 | 355,711 | 3,500,000 |
| 7. Total new securities [8] | | $2,000,000 | $4,666,538 | | [7] $215,199 | | $238,909 | | $5,207,393 | $589,680 | $726,570 | $355,711 | 14,000,000 |
| 8. Percent of total claims satisfied | | 100% | 100% | | 100% | | 10% | | 102.71% | 100% | 100% | [9] 31.55% | |

See footnotes on following page.

[1] See discussion in the report for detailed explanation of the method used in computing the total adjusted earnings of the Terminal and Midland part and of the refunding part and of the use of these totals. Since the separation of the entire road into two parts was made solely for the purpose of allocating new fixed interest and income bonds pro rata as between the Terminal, the Midland and the refunding bonds, the computation of the totals for such parts has been continued only through line 4 of this appendix.

[2] Back interest to be paid in full in cash.

[3] The adjusted earnings of the Passaic and New York division total $857.79. This amount is combined with unmortgaged assets and included in the figure $2,509.37 on line 1, after first deducting charges on Passaic and New York bonds, $583.33 for the 2 months. The total so combined is $274.46. The bonds have been purchased by the trustee of the debtor. It would be improper to credit the unmortgaged assets with any earnings except the excess over total bond interest, since they were not entitled to any more before the bonds were purchased by the trustee, and the purchase was made with reorganization earnings subject to the system mortgage liens. For that reason, in this appendix the sum of $583.33 representing charges on the Passaic and New York bonds has been excluded both from the Passaic and New York division earnings attributed to the unmortgaged assets and as indicated in footnote 6 from the total system earnings used for purposes of distribution.

[4] The adjusted earnings of the Hackensack and Lodi Division is a deficit of $594.19. This amount is combined with the adjusted earnings of other unmortgaged assets and is included in the figure $2,509.37, on line 1.

[5] This includes the earnings referred to in footnote 3, the deficit referred to in footnote 4, and the adjusted deficit of $2,190 resulting from passenger operations between Croxton and Jersey City shown in column 8 of the table in the report under "Segregation of earnings," but is exclusive of the net earnings of the Susquehanna Connecting which totalled $1,159 for the 2 months of June and December, 1940. The actual revenue of Susquehanna Connecting for the 2 months studied was $1,253 (derived from the Erie, which has been operating the Susquehanna Connecting since 1938 at the rate of 1 cent per ton-mile). Its actual expenses for the year 1940 were $131.14 for maintenance of corporate organization and $432.84 for taxes levied or an average of $94 for each 2 months' period. The reasons for the exclusion of the Susquenhanna Connecting's earnings from both the Terminal and Midland part and the refunding part and from total system earnings, for purposes of distribution to the Terminal, Midland and refunding Bonds, are set forth in the report. For purposes of their allocation, the unmortgaged assets are entitled to credit for such earnings. The resulting deficit of the unmortgaged assets, including the Passaic and New York and Hackensack and Lodi divisions, for the 2 months' period of the formula application is $1,350.37.

[6] The reason for the $583.33 difference between this figure and the system adjusted earnings as shown in column (10) of the table in the report under "Segregation of earnings" is that this figure excludes charges on the Passaic and New York bonds for the reasons explained in footnote 3.

[7] Taken in connection with $55,634 of noncarrier assets explained in report.

[8] Exclusive of equipment obligations of $452,844.

[9] Percentage reflects allocation as to pledged second-mortgage bonds in preceding column.

(D) denotes deficit.

# APPENDIX B

*Present capital structure, distribution of new securities, summary of plan (including annual charges) and distribution of new securities per $1,000 principal of claim*

| Obligations | Principal amount as of Jan. 1, 1944 | Total claim including unpaid interest as of Jan. 1, 1944 | Assumed | Modified Terminal 4-percent bonds maturing Jan. 1, 1944 | First and Consolidated 4-percent bonds maturing Jan. 1, 2004 | General mortgage 4½-percent income bonds maturing Jan. 1, 2019 | Preferred stock 5 percent | Common stock no-par value stated at $100 a share | Total capitalization | Distribution of new securities per $1,000 principal of old claim | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | First and Consolidated mortgage bonds | General mortgage income bonds | Preferred stock shares | Common stock shares |
| Equipment Obligations | $452,844 | $452,844 | (100%) $452,844 | | | | | | $452,844 | | | | |
| Terminal 5 percent Bonds due May 1, 1943 | 2,000,000 | 2,000,000 | | (100%) $2,000,000 | | | | | 2,000,000 | | | | |
| Midland first 5's due April 1, 1940 | 3,489,000 | 4,666,538 | | | (37.97%) $1,771,641 (24.23%) | (40.41%) $1,885,820 (12.11%) | (21.62%) 1,009,077 (39.27%) | (27.10%) | 4,666,538 | $507.78 | $540.50 | 2.8922 | |
| First and refunding 5's due Jan. 1, 1937 | 3,744,000 | 5,070,000 | | | 1,228,359 | 614,180 | 1,990,923 | $1,373,931 (100%) | 5,207,393 | 328.09 | 164.04 | 5.3176 | 3.6697 |
| Second 4½'s due Feb. 1, 1937 | 448,000 | 589,680 | | | | | | 589,680 | 589,680 | | | | 13.1625 |
| General 5's due Aug. 1, 1940 | 2,551,000 | 3,433,221 | | | | | | [1] (31.55%) [2] 726,570 [3] 194,620 [4] 161,091 (80.50%) | 1,082,281 | | | | 4.2426 |
| Paterson extension first 5's due June 1, 1950 | 200,000 | 270,833 | | | | | | [5] 215,199 (9.96%) | 215,199 | | | | 10.7600 |
| Unsecured claims | 2,388,258 | 2,388,258 | | | | | | 238,909 | 238,909 | | | | 1.0003 |
| Preferred stock | 13,000,000 | 13,000,000 | Found to have no equity; does not participate | | | | | | | | | | |
| Common stock | 13,000,000 | 13,000,000 | Found to have no equity; does not participate | | | | | | | | | | |
| Total | 41,273,102 | 44,871,374 | 452,844 | 2,000,000 | 3,000,000 | 2,500,000 | 3,000,000 | 3,500,000 | 14,452,844 | | | | |

[1] This percentage represents the entire allotment of common stock from three sources shown below.
[2] This stock is allocated in respect of $552,000 principal amount pledged second mortgage bond.
[3] This stock is allocated in respect of the lien on mortgaged property.
[4] This stock is allocated in respect of deficiency claim against unmortgaged property.
[5] In addition these bondholders receive the beneficial interest in noncarrier property appraised at $55,634, which value added to the common stock produces 100 percent of claims.

*Summary of plan*

| | Principal amount | Annual charge |
|---|---|---|
| Fixed interest debt: | | |
| Equipment obligations | $452,844 | $9,623 |
| Modified terminal bonds | 2,000,000 | 80,000 |
| First and consol. bonds | 3,000,000 | 120,000 |
| Total fixed interest debt | $5,452,844 | $209,623 |
| Other obligations: | | |
| Additions and betterments fund | ---------- | [1] 85,000 |
| Sinking fund terminal bonds | ---------- | 20,000 |
| Contingent-interest bonds | 2,500,000 | 112,500 |
| Total debt and charges before dividends | 7,952,844 | 427,123 |
| Preferred stock | 3,000,000 | 150,000 |
| Common stock (stated at $100) | 3,500,000 | ---------- |
| Total capitalization and charges through preferred dividends | $14,452,844 | $577,123 |

[1] The additions and betterment fund will decrease by $20,000 beginning in 1951.

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