FINANCE DOCKET No. 11662

NEW YORK, ONTARIO & WESTERN RAILWAY COMPANY REORGANIZATION

Decided August 16, 1956

After hearing on plans of reorganization proposed separately by debtor's trustee and a group of refunding mortgage bondholders, approval of any plan of reorganization of the New York, Ontario and Western Railway Company, principal debtor, and its wholly owned subsidiaries, Ontario, Carbondale and Scranton Railway Company, Ellenville and Kingston Railroad Company, Port Jervis, Monticello and Summitville Railroad Company, and Pecksport Connecting Railway Company, secondary debtors, pursuant to the provisions of section 77 of the Bankruptcy Act, refused, and dismissal of proceedings thereunder recommended.[1]

Elbert N. Oakes for debtor's trustee.

Anthony J. Armore, Peter Campbell Brown, Walter H. Brown, Jr., Parker Brownell, Richard E. Costello, James Randall Creel, G. Clark Cummings, Francis E. Curry, R. Granville Curry, Russell B. Day, Mahlon Dickerson, Frederick M. Dolan, Gerald E. Dwyer, William H. Fitzgerald, W. Meade Fletcher, Adolph Friedel, Leonard Gaines, Walter T. Gieselman, Jacob I. Goodstein, Covington Hardee, Lowell Hastings, Harold C. Heiss, Edward J. Hickey, Jr., James L. Highsaw, Jr., Herbert F. July, Henry Kaiser, Richard R. Lyman, William G. Mahoney, Leland J. Markley, Robert J. McLean, James L. More, Carrol A. Muccia, Raymond J. Otis, Charles D. Peet, Charles W. Phillips, Samuel A. Reinach, Jr., Cornelius F. Roche, Bernard H. Sherris, Jacob G. Smith, Nathaniel M. Sokolski, F. O. Steadry, Wayland K. Sullivan, Robert E. Tingsley, William St. John Tozer, Nelson Trottman, Abe Wagman, Jesse E. Waid, Jeremiah C. Waterman, Clarence E. Weisell, Harry E. Wilmarth, and *Samuel Zirn* for interveners.

REPORT OF THE COMMISSION

DIVISION 4, COMMISSIONERS MITCHELL, CLARKE, AND HUTCHINSON

BY DIVISION 4:

No exceptions were filed to the examiner's proposed report.

On May 20, 1937, the New York, Ontario and Western Railway Company, hereinafter called the principal debtor, the debtor, or the

[1] Previous reports: 221 I. C. C. 577, 224 I. C. C. 129, 240 I. C. C. 156, 275 I. C. C. 802 (not printed in full), 282 I. C. C. 801 (not printed in full); mimeographed report dated March 4, 1954.

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Ontario, filed in the District Court of the United States for the Southern District of New York a petition for the purpose of effecting a reorganization in accordance with the provisions of section 77 of the act of July 1, 1898, entitled "An Act To Establish a Uniform System of Bankruptcy Throughout the United States," as amended (11 U. S. C. 205). On the same day, the court approved the petition as properly filed under the statute, and proceedings designated as No. 68276 for reorganization of the debtor thereunder were begun and have continued to date. Pursuant to orders of the court, the debtor, on January 11, 1939, filed a proposed plan of reorganization. A hearing thereon was held by us, and by report and order of May 14, 1940, we refused to approve a plan for the reorganization of this debtor "unless and until further operations of the property disclose the possibility of more profitable operation than is at present apparent." *New York, O. & W. Ry. Co. Reorganization*, 240 I. C. C. 156. That conclusion was without prejudice to continuation of the reorganization proceedings.

The court, by order of July 7, 1948, approved the action of the principal debtor's trustees in disaffirming and rejecting the leases of the properties of the Ontario, Carbondale and Scranton Railway Company, the Ellenville and Kingston Railroad Company, and the Port Jervis, Monticello and Summitville Railroad Company, hereinafter referred to as the Carbondale, the Ellenville, and the Port Jervis, respectively, whose outstanding securities are owned by the principal debtor and pledged as collateral to its mortgage indebtedness. By the same order, the court directed the trustees of the principal debtor to continue the operation of each of these subsidiaries, until further order of the court, for the respective account of each of them. As of November 4, 1948, by orders of the court, these three subsidiaries, upon their respective petitions, were brought into the proceedings for reorganization of the principal debtor in connection with or as part of its reorganization, and by orders of December 6, 1948, the court appointed the trustees of the principal debtor as the trustees of each of these secondary debtors. On November 18, 1953, the Pecksport Connecting Railway Company, hereinafter referred to as the Pecksport, also a wholly owned subsidiary of the principal debtor, instituted a similar proceeding for its reorganization in connection with that of the principal debtor, and by order of February 1, 1954, the trustee of the latter was appointed trustee of the Pecksport.[2]

From the date of our refusal to approve a plan of reorganization for the debtor, in May 1940, until late in 1952, no plan was proposed by any party to the proceedings. As of January 6, 1953, E. Frederick Uhrbrock and others, constituting a protective committee for

[2] At this time there was a single trustee, whereas previously there had been two trustees.

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holders of the principal debtor's refunding (first) mortgage bonds, filed a proposed plan which was predicated on the acquisition of the prospective reorganized company's first-mortgage bonds and a majority of its capital stock by The New York, New Haven & Hartford Railroad Company, hereinafter referred to as the New Haven, owner of 50.2 percent of the capital stock of the principal debtor. The New Haven failed to support that plan, and its proponents, by letter of November 10, 1953, to the Commission, requested leave to withdraw it. By order of February 8, 1955, we directed that this proposed plan be withdrawn and dismissed from further consideration in these proceedings.

As of October 29, 1953, another proposed plan was filed by a group of less than 25 holders of the debtor's refunding mortgage bonds. That plan was basically altered by amendments filed February 23, 1954. Prior thereto, petitions for dismissal of the original plan were filed separately by the debtor's trustee and the city of Middletown, N. Y., intervener, and answers to one or both of the petitions were filed by the Bankers Trust Company, trustee under the debtor's refunding mortgage, and the New York Trust Company, trustee under the debtor's general mortgage. By order of February 8, 1955, we denied the petitions for dismissal and, by order of the same date, assigned the group's amended plan for hearing on March 21, 1955, together with another proposed plan which had been filed by the debtor's trustee as of January 7, 1955. Hearings were held, commencing on the assigned date and continuing from time to time through June 10, 1955. Leave to intervene was granted, either prior to or during the course of the hearings, to numerous parties, several of whom participated actively in the proceedings.[3] Briefs were

[3] The following interveners appeared in the present proceedings: Oswego Dock and Land Company et al., owners of bonds assumed by the debtor and secured by a purchase money mortgage constituting a first lien on certain realty of the debtor in Oswego, N. Y.; protective committee for holders of debtor's refunding mortgage bonds; Bankers Trust Company, trustee under the debtor's refunding mortgage; Henry I. Cohen, refunding mortgage bondholder; Charles Bennett Marr and others, group of refunding mortgage bondholders; The New York Trust Company, trustee under debtor's general mortgage; James Randall Creel, owner of refunding mortgage and general mortgage bonds; Samuel Zirn, owner of refunding mortgage and general mortgage bonds; Myron Budd and others, claimants upon liquidated claims for property damage; city of Middletown, N. Y., a tax creditor; town of West New York, N. J., a tax creditor; the city of New York, a tax creditor; Railway Labor Executives' Association, representing nonoperating employees of the debtor; Brotherhood of Locomotive Firemen and Enginemen; Grand International Brotherhood of Locomotive Engineers; Order of Railway Conductors and Brakemen; Brotherhood of Railroad Trainmen; Samuel M. Pinsly Associates, Inc., party to agreement of purchase of debtor's property under trustee's plan; Midland Equities Corporation, intended purchaser under plan of refunding mortgage bondholders group; Unadilla Valley Railway Company, party to option agreement for purchase of portion of debtor's main line; and the following rail carriers to whom the principal debtor owes various amounts for traffic and per diem car-rental balances; Union Pacific Railroad Company; The Delaware, Lackawanna & Western Railroad Company; The New York Central Railroad Company; Southern Pacific Company; Texas & New Orleans Railroad Company; Pacific Electric Railway Company; Chicago & North Western Railway Company; Chicago, Milwaukee, St. Paul & Pacific Railroad Company; Chicago, Burlington & Quincy Railroad Company; Northern Pacific Railway Company; and Great Northern Railway Company.

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thereafter filed by the debtor's trustee and certain interveners.[4]

On February 21, 1956, the hearing examiner's proposed report was issued and service of it was made on all parties of record. In that report, the examiner recommended that the Commission find that (1) neither of the proposed plans of reorganization should be approved, (2) no plan of reorganization can be formulated and approved, either now or in the foreseeable future, and (3) recommendation should be made to the United States District Court that the proceeding pending therein for the reorganization of this debtor under section 77 of the Bankruptcy Act should be dismissed. Under the Administrative Procedure Act, the proposed report is a part of the Commission's record in this proceeding. The proposed plans, the relevant facts, and the contentions of the parties have been adequately discussed therein and will not be repeated in full herein. We adopt the statement of facts as set forth in the proposed report and we arrive at substantially the same conclusions as are found therein.

PROPOSED PLANS OF REORGANIZATION

Plan of refunding mortgage bondholders group.—This plan, initially filed October 29, 1953, was basically altered by amendments filed February 23, 1954, which, in turn, were wholly superseded by an amended plan dated June 6, 1955, and submitted 4 days later, on the last day of the hearing, by the chairman of the group. No attempt was made by its proponents to offer proof of the many assumptions, conclusions, and interpretations of fact on which this plan depends, and the only evidence presented in its support is found in the last-day testimony of the chairman,[5] whose experience has been primarily of a clerical, bookkeeping, and accounting nature in the banking and investment fields, and as a licensed real-estate broker, supplemented by attention in later years to his personal real-estate interests. He has no experience in the operation or management of railroads.

Under this late-developed version of the group's plan, a new company, the Ontario & Midland Railway Company, would be organized under the laws of the State of New York to acquire by assignment all of the assets of the debtor and its subsidiaries, free and clear of all liens and encumbrances, subject to the partial discharge or assumption by the new company of the debtor's and trustee's liabilities and obligations.

[4] Oswego Dock & Land Company; refunding mortgage bondholders committee; Bankers Trust Company; refunding mortgage bondholders group; The New York Trust Company; Samuel Zirn; Myron Budd, Anna Budd and others; city of Middletown and taxing municipalities in the State of New York; Railway Labor Executives' Association; Brotherhood of Locomotive Engineers and others; and Samuel M. Pinsly Associates, Inc.

[5] There was also brief testimony by the president of a newly formed corporation relative to its proposal to supply the cash capital required under this latest amended plan.

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The capitalization of the proposed new company would consist of 600,000 shares of common stock of $1 per value and $5,625,000, principal amount, of 50-year first-mortgage noncumulative 4-percent income bonds. Annual charges are stated as $35,000 for fixed interest and $225,000 for contingent interest.

"General creditors' claims," including bond interest in default ($25,497,561), stockholders' equity (58,114,043), back wages in dispute ($898,569), and other items, aggregating, according to the classification adopted in this plan, $88,259,554, would not be accorded any recognition whatsoever under it.

All of the new income bonds would be issued by the reorganized company in satisfaction of (*a*) claims listed as embracing those of 6-month creditors $244,233; (*b*) traffic and car-service balances owed to other railroads $2,574,096; (*c*) the principal amounts of the debtor's outstanding refunding and general mortgage bonds, $20,000,000 and $12,000,000, respectively; and (*d*) Inland Lakes-to-Sea Terminal Corporation mortgage indebtedness $125,000; totaling $34,943,329.

For each $1,000 outstanding refunding mortgage bond of the principal debtor, the holder thereof, upon exercising the "right to subscribe" and paying $10 in cash, would receive $150, principal amount of new income bonds and 10 shares of new common stock; and for each $1,000 outstanding general mortgage bond, the holder thereof, upon exercising the "right to subscribe" and paying $5 in cash, would receive $125, principal amount, of new income bonds and 5 shares of new common stock.

The new stock, of a par value of $1 per share, would be nonassessable and entitled to one vote per share. Cash at the par value would be paid for stock sold. Delivery of the new stock to debtor's bondholders on the basis above stated would require 260,000 shares. An additional 40,000 shares would be issued to the prospective purchaser (hereinafter described) of portions of the property in payment for "fees, commissions, expenses including underwriting costs, and other items in connection with the plan." The remaining 300,000 shares would be sold to such prospective purchaser at par. The sale of the stock to the bondholders, under their "right" to subscribe, and to the prospective purchaser, at par, would provide $560,000 cash, which with estimated cash proceeds of $3,300,000 from the sale of certain portions of the property would provide $3,860,000 cash required for the $3,000,000 partial payment of administration liabilities under the plan and $860,000 for working capital of the new company.

A total of $4,200,000 of certain designated assets would be acquired by a purchaser, known as the Midland Equities Corporation, and then resold by it to unknown parties, in order to obtain the cash required to pay the net purchase price of $4,200,000. This corporation

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was organized under the laws of the State of Delaware, only 5 or 6 weeks before the last amended plan was presented at the hearing, for the express purpose of providing a buyer under the plan. Although its president testified briefly concerning the corporation's offer of purchase and its "commitment" to supply the necessary cash capital, he was unable to state its capitalization or the amount of its assets, and did not reveal the financial responsibility either of himself, his associate half owner of the corporation's stock, or his assertedly able financial backers whom he did not identify.

This offer of purchase was made on the condition, among others, that the corporation would be accorded an opportunity to inspect the property and certain records and that the funds to be paid by it for the debtor's assets be placed in escrow and held for the sole purpose of making payment to creditors as provided in the plan. By letter of July 29, 1955, submitted by the corporation to the chairman of the bondholders' group after the close of the hearing, this conditional offer was made a "firm" one, with the offerer standing "ready to consummate the purchase of the said property of the debtor and to pay therefor at such times as your said proposed plan of reorganization as now submitted is approved by the Interstate Commerce Commission and by the United States District Court." From this it would appear that the offer is still conditional, payment of the proposed purchase price being contingent upon final approval of the bondholders' plan, without change. This condition would seem to mean that if any modification were made in the proposed plan the offer would be nullified. Furthermore, despite assertions to the contrary, there has not been made sufficient showing of financial responsibility to justify a finding, with respect to a plan dependent upon the described commitment, that adequate means for the execution of the plan have been provided.

Under this proposed plan, substantial changes would be made in the composition and operation of the debtor's system. The miles of railroad to be operated upon reorganization would be reduced from 541 to at least 274; the number of diesel units would be reduced from 46 to 26; the number of employees would be reduced from 1,312 to 706, 644, or some other number, and standard wages would be paid to "survivors" immediately upon reorganization, if possible; the number of cars handled in bridge traffic would be reduced from 49,616 to 25,000 annually; certain trackage rights would be surrendered; and joint operation of the diminished property (to the extent operated) would be effected with the New York, Susquehanna & Western Railroad Company. In substitution for lost traffic resulting from the abovementioned reductions and changes in methods of operation, the plan contemplates the acquisition of 5,000 carloads annually from the New York, Susquehanna & Western and 15,000 additional carloads in the

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movement, over the debtor's main line, of truck-trailers transferred from boat to rail at Cornwall and from rail to boat at Oswego. No definitive arrangements have been made for the acquisition of the anticipated new traffic.

Assumed increases in revenues and earnings over the present level, with projected annual earings of $1,063,000 after charges of $260,000, are predicated not only on the anticipated effect of the above-indicated changes in methods of operation and expected savings through abandonment of unprofitable portions of the system, but also on adjustments that it is hoped could be brought about in revenue divisions with connecting carriers. No substantial evidence was offered in support of the various assumptions underlying this traffic and earnings forecast.

The bondholders' plan has been repeatedly referred to by its proponents and supporters as providing for an internal reorganization, despite the fact that it either lacks or violates some of the requisites of a true internal reorganization and involves, as a vital part of the reorganization scheme, the sale to an outside party of a substantial portion of the debtor's property with likely prospects of discontinuance of operations thereof. The distinction perhaps is not important here, except that in the minds of the bondholder interests such a reorganization, when characterized as internal, appears to have merit over one involving an outright sale of all the property to an outside party for partial operation. The emphasis given this matter serves to point up the important question of the feasibility of any kind of internal reorganization, whether genuine or spurious.

Under the provisions of subsection (d) of section 77 of the Bankruptcy Act, the Commission is required to render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet the requirements of subsections (b) and (e) of the section and will be compatible with the public interest, or to render a report and order in which it shall refuse to approve any plan.

To meet the requirement of compatibility with the public interest, the proposed plan should provide a capitalization represented by securities having some prospect of yielding a reasonable return to their holders and having something more than mere speculative value. To meet this requirement under subsection (b), as well as other requirements of section 77, there must be adequate coverage of fixed charges by the probable earnings available for the payment thereof. Also, under subsection (b), the plan must provide adequate means for its execution. In these two essential respects at least, the bondholders' proposed plan is clearly deficient.

The debtor has not had earnings available for fixed charges during the trusteeship, and there is no convincing evidence that under the

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operation contemplated by the bondholders' plan there would be earnings available for that purpose. During each of the 18 years of trusteeship, from 1937 through 1954, the debtor failed to earn any income for payment of fixed charges, and the total deficit in income available therefor is in excess of $13,920,000, representing an annual average deficit of more than $770,000 (minimum $256,909 in 1943 and maximum $1,646,000 in 1946). It is obvious that, with annual fixed-interest charges of $35,000 and contingent-interest charges of $225,000, as proposed in the bondholders' plan, the debtor's probable earnings, in the light of the past 18 years' experience, would not afford any reasonable prospect of paying income-bond interest, even irregularly and only occasionally. And, with total annual charges of at least $260,000, it is apparent that there would be no hope of paying any dividends on the 600,000 shares of stock proposed to be issued under the plan. Under these circumstances, it is clear that the new securities would have, at best, a most speculative value and would afford wholly inadequate compensation to the debtor's bondholders and other creditors for the rights surrendered by them.

The proponents of this plan estimate that, with drastic changes in operations involving the discard of approximately half of the debtor's mileage and dismissal of nearly half of its employees, in conjunction with the inauguration of certain joint-operating and other conjectural traffic-producing arrangements hoped to be effected with other carriers upon reorganization, including the movement of truck-trailers in volume over the debtor's main line and the readjustment of freight-revenue divisions with connecting carriers, the annual earnings of the reorganized and reconstituted properties of the debtor would produce an annual income of $1,323,000 available for charges. All of these proposed methods of inducing more traffic and producing additional revenues are in the realm of speculation. There is no substantial evidence that any of them have got much beyond the stage of wishful thinking. There is no record proof that these matters have been seriously considered by anyone other than the proponents of the plan or that there have been any definite commitments by other parties necessary to give substance to their hopes.

The witness who presented the final amended version of the bondholders' plan also relies upon the conclusions of the Wyer report (offered on behalf of Samuel M. Pinsly Associates, Inc., in support of the trustee's plan, hereinafter discussed) to substantiate his own estimate of prospective earnings. However, that report contains no estimate or forecast of probable future earnings of the railroad as now operated, or as it would be operated upon reorganization, except that, in carrying out the primary purpose of the study to determine whether on the basis of the 1954 level of traffic the rail-

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road could be operated profitably, certain calculations were made on the basis of results of operation of that year adjusted to conform to the recommendations made in that report. The witness who was responsible for this study expressly disavowed any intention to present an earnings forecast, and his calculations were predicated on many assumptions as to changes in extent and method of operation in keeping with his recommendations with respect to ways for improving the railroad's earning power. The earnings figures contained in that report afford no probative support for the prospective earnings basis assumed under the bondholders' plan.

Nor does the flexible, blanket adoption by the spokesman for the bondholders' plan of the testimony and evidence presented by the trustee's witnesses suffice to support his conclusions as to the hypothetical earnings basis for this plan. The adoption of such evidence is subject to the same defects and infirmities as the record shows is inherent in that evidence. In this connection, it is noteworthy that some of the more cautious supporters of the basic principle of the bondholders' plan concede that the record is "scant" as to evidence of prospective earning power in relation to valuation for reorganization purposes, and suggest that, taken alone, the record of earnings since 1940 would evidently lead to another unfavorable conclusion by the Commission similar to that in its 1940 decision in this reorganization proceeding. Likewise, Pinsly Associates, supporting the trustee's plan, on brief concede that the "record does not contain a great deal in the way of precise estimate of the extent of the increase in revenues that might be expected to follow as a result of the emergence of the O & W from trusteeship."

The record convincingly shows that an internal reorganization of the debtor cannot be achieved under present circumstances. Even if it should be deemed probable that the reorganized company, in time, could successfully operate the severely truncated railroad remaining after sale or abandonment of portions of the debtor's properties, as proposed in the bondholders' plan, reorganization of the debtor would not be possible under this plan because of the necessity to provide for payment of certain claims and expenses which the plan does not purport to satisfy in full. Reorganization expenses, taxes and other administration expenses aggregating nearly $7,000,000 would be discharged by the payment of $3,000,000 in cash, although there is no evidence that discharge of these obligations could be accomplished in the manner proposed; but the plan would impose on the trustee the burden of effecting a compromise of these tax and other administration liabilities. Also, under this plan, the new company would assume equipment-trust obligations in the amount of approximately $2,000,000. Although immediate payment

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of this obligation might be required upon consummation of the plan, there is nothing in the plan or the supporting testimony which discloses either the purpose or the ability to effect such discharge. Furthermore, under this plan, the claims of 6-month creditors and of various railroads for large traffic balances and car hire would be discharged by delivery of income bonds in greatly reduced amounts, although there is no evidence to support the belief that these creditors would accept such treatment in full satisfaction of their claims.

The record shows that the plan and the testimony in support of it are vague and lacking in necessary factual detail or affirmative knowledge of proponents with respect to such important factors as (*a*) provisions for the continued operation of the main line of the debtor's railroad and the extent thereof, (*b*) the identities of the persons or corporations to whom portions of the system would be resold, and for what purpose, whether abandonment and scrapping or operation, (*c*) arrangements for the continued operation of portions of the property that, it is expected, will be sold by the prospective purchaser, (*d*) the provisions for acquiring needed new traffic, which is the indispensable factor of any internal reorganization in this case, and (*e*) the provisions for protection of employees and for payment of back wages claimed by them.

In view of the foregoing defects in the bondholders' plan and the patent deficiencies in the proof offered in support of it, we conclude and find that, entirely apart from and without regard to the question of priorities involved in the proposed treatment of creditors' claims, this plan is not feasible and fails to meet the requirements of section 77 of the Bankruptcy Act. We further find that an internal reorganization of the debtor's system in the manned or along the lines proposed in the bondholders' plan cannot be achieved at this time or within the foreseeable future.

Debtor trustee's plan.—This plan, dated December 1, 1954, as amended March 14 and June 8, 1955, provides for the sale of all properties of the principal and secondary debtors, free and clear of all liens, claims, encumbrances, agreements, and contracts (except as to outstanding equipment obligations), to Samuel M. Pinsly Associates, Inc., for an aggregate purchase price of $4,600,000, payable in cash, subject to reduction by the amount of equipment-trust obligations outstanding at the time of consummation of the sale.[6] The contract of purchase, dated December 1, 1954, which is a basic part of the plan, provides that, if at the expiration of 18 months from the time the plan is filed with the Commission,[7] a plan based substantially upon the

[6] As of the time of the hearing, these obligations amounted to approximately $2,000,000.

[7] The plan, in its initial form, was accepted by the Commission for filing as of January 7, 1955, by our order of that date.

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contract shall not have been consummated, the purchaser, or its nominee, shall at any time thereafter have the option to cancel the agreement.

The purchaser, subject to the jurisdictional powers of the Commission, agrees, with relation to the main line of railroad proposed to be acquired under the contract of purchase, extending from Cornwall to and including the dock property at Oswego, and to Scranton, Rome, and Utica, to operate the same for a period of not less than 10 consecutive years from the date of acquisition. There is no definite commitment on the part of the purchaser to operate various branch lines or lines of subsidiary debtors, and, in fact, the record shows that it is the intention of the purchaser either to dispose of or, subject to our authorization, to abandon such unspecified portions of the system as it does not choose to operate, including possibly some portion of the main line.

The trustee's plan provides, in effect, that the cash representing the purchase price is to be applied in such manner as shall be deemed consistent with the relative priorities of the creditors of the trustee and, should any cash remain after the payment in full of such creditors, then the residue shall be applied toward the payment of the creditors of the debtor. It is contemplated by the trustee's plan that the Commission will make determination of (*a*) all questions bearing on the rank and priority of claims, both prior and current, other than those of general creditors and stockholders, (*b*) the manner of legal and equitable distribution of the assets of the principal and the secondary debtors, (*c*) the respective values of their properties, and (*d*) a fair upset price for the properties of each company.

A basic objection offered by the bondholder interests generally to the trustee's plan is that it is not a true plan of reorganization but is simply an outright sale-and-liquidation proposal in contravention of the statute. They maintain that as such it is indistinguishable for practical purposes from a straight bankruptcy liquidation involving a distress sale of assets to a favored purchaser at a price so low that it would in all liklihood, leave nothing available for distribution to any bondholders, since the proceeds of the sale would be insufficient even to satisfy the obligations of the trusteeship. These parties contend that such a liquidation, as distinguished from reorganization, of an interstate railroad cannot be lawfully approved and effectuated, over objections by creditors, under the provisions of section 77 of the Bankruptcy Act. As our findings are based on other grounds, it is unnecessary that we decide this legal question.

A workable plan of reorganization requires *inter alia*, that substantial evidence of feasibility and of reasonable prospects of future successful operation be presented.

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The method of operation proposed by the prospective purchaser under this plan is vague and uncertain. The only definite information concerning the future operation of the railroad is found in the statement in the plan that the prospective purchaser "agrees with relation to the main lines of railroad so acquired, * * *, to operate the same for a period of not less than 10 consecutive years from the date of acquisition thereof." But the consultant Wyer, who was employed by the prospective purchaser to make a study of ways to improve the earning power of the debtor's property, reported that, in order to operate at a profit, it might be necessary to abandon some portion of the main line in addition to effecting substantial branch-line abandonments. Consequently, there is no guarantee of continued operation of the main line, but the prospective purchaser has issued a clear caveat that some part of it may be abandoned. Furthermore, as a practical matter, the above-quoted commitment to operate would be unenforceable in the event the purchaser finds that it cannot operate the railroad profitably and obtains appropriate authorization for abandonment. Thus, the record contains little definite information, and certainly no assurance, with respect to the type of service to be rendered or the extent of the operations to be conducted. Because of the uncertainty of the intentions of the prospective purchaser and the very likely probability of its deciding to abandon the railroad should circumstances dictate that course, the proposed plan amounts to little more than a sale of the debtor's properties, leaving to the purchaser the privilege of operating them or disposing of them as it sees fit. This is tantamount to a wide-open arrangement so far as future operation is concerned.

The feasibility of the trustee's plan, from the standpoint of whether the railroad can be profitably operated, on the basis of the recommendations made in the Wyer report, depends on the full "cooperation" of various groups and interests, but, first and most important of all, on that of labor. Few, if any, of the suggested economies could be effected immediately. In fact, savings that could be brought about immediately are estimated at only about $20,000. The report states: "The job cannot be done quickly. At best, it is a long-term proposition."

Ultimately, with the cooperation of labor, including an 86-man reduction in personnel, revision of existing labor contracts, and an arrangement as to future wage scales, plus the cooperation of city and State officials, involving substantial capital expenditures by the railroad to provide automatic crossing gates or warning devices instead of watchmen, thus reducing the present cost of highway crossing protection, plus savings that could be realized from branch-line abandonments, subject to approval by appropriate regulatory author-

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ity, plus additional revenue that might be derived from increased freight divisions, requiring concurrence of connecting lines or the successful prosecution of proceedings before the Commission, this report shows estimated savings of approximately $801,000. Improvements or changes in operations that depend upon the cooperation of labor organizations account for more than half of that sum. The possibility of securing the required cooperation must be considered in the light of the militant reaction of the various labor organizations in this case to the avowed intention of Pinsly Associates not to "buy" any labor contracts. But even with a total of approximately $821,000 savings estimated under all the hypotheses adopted in the Wyer report, there would have been a cash deficit of $400,000 on the basis of the 1954 level of operations, which was the measure of the traffic and earnings test applied for the purposes of the study.

In addition to the foregoing estimated economies, other potential savings of undetermined amount were suggested in the Wyer report as a means of putting the operations of the debtor's properties on a profitable basis, but these improvements either do not lend themselves to an evaluation in terms of dollars or would require much more time than was available to the proponents' consultant for proper study to support any definite recommendations. Because of the indefinite character of these suggestions, they do not merit serious consideration in determining whether, from the standpoint of profitable operation, the trustee's plan is feasible.

The concrete recommendations contained in the Wyer report contemplate the abandonment of certain branch lines, and possibly an undetermined portion of the main line, "in order to bring about a balancing of revenue and expense." But the witness could not say with certainty that even then the prospective purchaser would be able to operate the property at a profit. As hereinbefore indicated, this study was an objective one of possible ways to improve the earning power of the debtor, and the witness did not purport to make an earnings study as such, nor did he make a study to determine whether or not the proposed purchase price was a fair one. In fact, he made no recommendation as to the price at which Pinsly Associates should purchase the debtor's property, but on cross-examination stated that he personally, as a prudent business man, would not make any investment in this railroad unless and until the labor situation is cleared up.

Certain other factors having an important bearing on the question of the feasibility of the plan and the probability of successful operation of the railroad thereunder deserve brief attention.

Samuel M. Pinsly Associates, Inc., was created in December 1953 with a capitalization of $26,000, representing cash paid for 260 shares

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of stock issued equally to Samuel M. Pinsly and Raymond L. Morrison. At the time of the hearing, there was approximately half of the paid-in capital left in the corporation. Other than such cash residue, the corporation has no assets of any kind. No deposit under the contract was required of Pinsly Associates, and the corporation would not now make one, nor would either Pinsly or Morrison personally guarantee the performance by it of the terms and provisions of the contract. There is no underwriting commitment by any bank, investment banker, or financial institution as to the corporation's obligation to pay approximately $2,500,000 in cash under the contract of purchase.

Pinsly Associates, while recognizing that the Commission, in the exercise of its power under section 77 (d) to approve a plan "which may be different from any which has been proposed," may alter the terms or undertakings of the trustee's proposed plan, makes it clear that such alteration could not include a change in the proposed purchase price of $4,600,000 imposed by the purchase agreement and declares that, if the prospective purchaser were required to assume a larger obligation, the agreement would be nullified. Pinsly Associates also points out that, subject to its election, the agreement by its terms is cancellable, if a plan of reorganization based substantially on the agreement has not been consummated within 18 months from the filing of the trustee's plan with the Commission. Such period expired July 7, 1956.

While Mr. Pinsly, himself, in 1954, operated three separate short-line railroads with annual gross revenues of approximately $400,000 and about 120 employees, and in 1955 conducted a somewhat more extensive operation embracing a fourth short-line railroad, he has had no experience in operating a railroad of the size and character of the debtor's railroad system. Mr. Morrison, costockholder in Pinsly Associates, has had no experience of this kind whatever; his principal business is dealing in and reconditioning rail and other metal and rebuilding and leasing railway equipment. The record contains little definite information concerning the type of operation these parties would expect to adopt or their capacity to perform, should they be permitted to take over the debtor's property.

In view of all the foregoing facts and circumstances, we find that the trustee's proposed plan of reorganization is not feasible.

Earning power is the primary criterion of value for the purpose of reorganization under section 77. "The basic question in a valuation for reorganization purposes is how much the enterprise in all probability can earn." *Group of Institutional Investors* v. *Chicago, M. St. P. & P. R. Co.*, 318 U. S. 523 (1943). The trustee's plan proposes a sale price for which valuation findings complying with the

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requirements of the statute cannot be made on the basis of the record, because it contains little probative evidence of prospective earning power.

No attempt was made by either the trustee or the prospective purchaser to establish a value for the railroad as a going concern or on the basis of earnings, either present or prospective. The valuation efforts of the trustee were confined to the establishment of a salvage or scrap value for the property, on the hypothesis that it was no longer being operated as a railroad. No property valuation of any kind was made by the prospective purchaser or its consultant, who was not prepared to express an affirmative opinion as to the fairness of the proposed purchase price under the contract of sale.

The trustee contends that the price offered, because it is identical with price bid in open court by the same interests on January 6, 1954 (and thus became the basis for the purchase agreement executed on December 1, 1954), represents the value established by public bidding and sale and is therefore the best determination of value of the debtor's system. The validity of this view under the particular circumstances of this case is vigorously and unanimously challenged by the bondholder interests. They point out, and the record shows, that, while the bidding in question occured in open court, in a proceeding initiated by the court's order to show cause, the proposed price herein under consideration is embodied in a private contract of sale executed approximately 11 months later by the trustee and Pinsly Associates without benefit of competitive bidding, court action, or notice to interested parties. Other facts also tend to remove this proposed transaction from the category of a sale consummated by public bidding or under the guidance or the aegis of the court. Aside from a question of adequacy of notice and invitation to bid in open court on January 6, 1954, the price of $4,600,000 then bid by Pinsly Associates was topped by a bid of $4,605,000 made by another party, then in court, who expressed his willingness and readiness to go higher if necessary. However, the court stopped the bidding, and the trustee recommended the acceptance of the Pinsly bid. The court, holding that it lacked power to approve the proposed sale of the entire railroad system, did not adopt the trustee's recommendation. By formal oral opinion of February 11, 1954, the court said, in part:

> As I read section 77, the entire scheme of that section contemplates a reorganization and not liquidation, which this would be. * * *
>
> As I look at the section, it seems to me that the whole plan of the section means reorganization, or if not reorganization, not liquidation, but dismissal of the proceedings.

On the basis of the opinion, the court, by order of March 24, 1954, dismissed the trustee's proposed sale for lack of power in the court to approve it. No appeal was taken.

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The foregoing facts, considered in their entirety, refute the trustee's contention that the purchase price stated in the contract of purchase underlying his proposed plan represents the value established by public bidding and sale of the debtor's system.

Dismissal of the proceedings.—These reorganization proceedings were instituted by the debtor, and by compulsion of law the bondholders have been prevented from enforcing their rights and remedies under the liens of the mortgages securing the two issues of outstanding bonds. Meanwhile, the mortgaged properties have been and are continuing to be dissipated through accumulating operating deficits, which have been accruing since May 20, 1937. It is obvious that an indefinite continuation of the section 77 proceedings, with the resultant accretion of unpaid taxes and other administration expenses, will only serve further to jeopardize the bondholders' security. Since our report of May 14, 1940, there has been no improvement in the debtor's earnings; in fact, its situation has become steadily worse.

Under the statute, it is necessary that a plan, if it is to be approved, shall provide for the payment of all costs of administration in cash. As hereinbefore indicated, neither proposed plan, in terms or method of treatment, makes such provision, nor would it be possible under the reorganizations contemplated by them, to pay in cash, either presently or in the foreseeable future, substantial portions of the administration expenses, including large amounts of unpaid tax accruals, both Federal and local. Under these circumstances, in addition to other persuasive reasons, hereinabove discussed, why no feasible plan of reorganization can be approved, we are left with no practicable alternative but to recommend to the court that the pending section 77 proceedings for reorganization of this debtor be dismissed.

CONCLUSIONS AND FINDINGS

In view of the findings and conclusions hereinbefore made, it is unnecessary, and would be superfluous, to attempt to determine, as is contemplated under the trustee's plan in expection of its approval (*a*) the question of the adequacy of the proposed purchase price, (*b*) the value of the properties, separately, with relation to the principal debtor and each secondary debtor, for either reorganization or liquidation purposes, (*c*) a fair upset price for the properties of each company, (*d*) the validity, amounts, and relative priorities of claims against the debtors' estates, and (*e*) the manner of legal and equitable distribution of their assets. No findings or recommendations concerning these matters are intended to be made or suggested herein.

To summarize, we conclude and find that:

(1) The proposed plan of reorganization presented by the refunding mortgage bondholders' group should not be approved.

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(2) The proposed plan of reorganization presented by the debtor's trustee should not be approved.

(3) No plan of reorganization can be formulated and approved, either now or in the foreseeable future.

(4) Recommendation should be made to the District Court of the United States for the Southern District of New York that the proceedings pending therein for the reorganization of the New York, Ontario & Western Railway Company, principal debtor, and its secondary debtors, under section 77 of the Bankruptcy Act, should be dismissed.

An appropriate order will be entered.

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