

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT

REPORT

of

THE TRUSTEE

on the

ADMINISTRATION OF THE ESTATE

of

THE NEW YORK, NEW HAVEN AND HARTFORD
RAILROAD COMPANY
FOR THE YEAR 1971

to

THE HONORABLE ROBERT P. ANDERSON
UNITED STATES CIRCUIT JUDGE
SITTING BY DESIGNATION

Filed : May 4, 1972

(8989)

In The
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT
IN PROCEEDINGS FOR THE REORGANIZATION
OF A RAILROAD

REPORT OF THE TRUSTEE COVERING THE
YEAR ENDED DECEMBER 31, 1971

In the Matter of

THE NEW YORK, NEW HAVEN AND
HARTFORD RAILROAD COMPANY,
Debtor.

No. 30226

This report covers the activities of the New Haven Trustee during the year ended December 31, 1971 and sets forth additional developments during the first four months of 1972 which have an important bearing on the reorganization of the New Haven Railroad.

Since the initiation of Section 77 reorganization proceedings for the Penn Central Transportation Company ("Penn Central") on June 21, 1970, it has been clear that the success of the New Haven Reorganization Plan would depend upon the recognition given to the New Haven Trustee's claims against the Penn Central Estate. This was made clear by the Supreme Court of the United States on June 29, 1970 when, in the light of the intervening bankruptcy of Penn Central, it remanded the New Haven Reorganization Plan to this Court for further proceedings before it and the Interstate Commerce Commission (the "Commission") to insure that the New Haven Trustee would receive the full liquidation value of \$174.6 million, as found by

this Court and approved by the Supreme Court, for the New Haven property which had been conveyed to, and had been used as part of, the merged Penn Central system since December 31, 1968. (See New Haven Trustee's Report for 1970, pp. 8447-8472.)

In accordance with the mandate thus received from the Supreme Court, this Court conducted proceedings commencing in August, 1970, and on June 22, 1971 remanded the New Haven Plan to the Commission with a declaration and finding that the New Haven Trustee had the benefit of an equitable lien on tangible property conveyed to Penn Central, for which the full purchase price had not been received, and of a constructive trust in the amount of \$28,438,000 on so-called excess income from the Grand Central Terminal properties, to cover the interest of the New Haven Railroad in those properties conveyed on December 31, 1968, for which payment had not yet been made.

The trustees of Penn Central and certain other parties appealed that decision to the United States Court of Appeals for the Second Circuit which on March 17, 1972 reversed the decision and remanded the matter to the Commission on the sole ground that "the Connecticut Reorganization Court is not the proper body to grant whatever protection is required because it has no jurisdiction and we remand the case to the Interstate Commerce Commission with directions to consider, in the light of the Penn Central reorganization, the form of consideration the New Haven Estate should receive."

I have been advised by my Counsel, Professor James Wm. Moore of the Yale Law School and Joseph Auerbach, Esq. of the law firm of Messrs. Sullivan and Worcester, Boston, Massachusetts, that in their opinion the decision of the Court of Appeals for the Second Circuit is contrary to the intent of the decision of the Supreme Court in the *New Haven Inclusion Cases* and that Court's mandate to this Court. On the basis of my own analysis I concurred in their opinion and therefore authorized them to file on my behalf a petition to the Supreme Court for a writ of certiorari to review the decision of the Court of

Appeals. Pending the Supreme Court's action on that petition, pursuant to motion filed on my behalf, the Court of Appeals on April 6, 1972 stayed its mandate, and thus continued for the time the protection provided for the Estate by this Court's order.

Comments on Report of Penn Central Trustees on Reorganization Planning

The Penn Central Reorganization Court (United States District Court for the Eastern District of Pennsylvania, Fullam, D.J.) issued an order on November 3, 1971 requiring the Penn Central trustees to submit a plan of reorganization for Penn Central by April 1, 1972 and to file with that Court by February 15, 1972 a report on the prospects for reorganization. The Court also directed that comments on the Penn Central trustees' report, by any of the parties to the proceeding, should be submitted to it by March 15, 1972.

In accordance with that directive, my counsel filed my comments dated March 10, 1972. As set forth in detail in the filed document, my general conclusions were that the Penn Central trustees had failed to establish their conclusion that Penn Central can be successfully reorganized as a transportation company. I expressed the view that it was unrealistic to base a conclusion that reorganization was feasible by 1976 upon the achievement of conditions largely outside their control, i.e., drastic reduction in the size of Penn Central's railroad system, broad changes in labor conditions and in the reduction of work force, and new and substantially increased compensation for passenger service, together with increased traffic and revenues. The Penn Central trustees' conclusion depended upon the conversion of a deficit in net income of \$275,000,000 in 1971 into annual income available for fixed charges of between \$220 million and \$290 million by 1976.

While rejecting the Penn Central trustees' conclusions, I proposed an alternative course which, in my opinion, would offer a basis for a feasible reorganization, would protect to the great-

est possible extent under existing circumstances the constitutional rights of creditors, and would provide a method under Section 77 for maintaining the quantum of transportation services to which the public is entitled. Contrary to the announced policy of the Penn Central trustees to abandon diversification, liquidate non-transportation operations and investments and seek to reorganize the Penn Central enterprise as a truncated railroad, my proposed alternative is to continue the Penn Central business primarily as a holding company owning those non-transportation assets presently consisting of vast and various real estate holdings, a highly profitable pipe line and important other investments. Railroad operations and assets would be sold to other railroads or public authorities. After the achievement of carefully planned steps for discontinuance of transportation services as a proprietary function, the continuation of transportation operations by Penn Central would be limited to the employment of its operating staff, personnel and expertise together with its administrative facilities solely in the conduct of transportation services for the account of others.

This alternative is believed to carry with it substantial income tax advantages and, in any event, is in my view a preferable course, at least as a working hypothesis for a successful reorganization, compared to the program of the Penn Central trustees.

Several trustees under the Penn Central mortgage indentures and the group of institutional owners of Penn Central bonds, in their comments on the Penn Central trustees' report of February 15, 1972, questioned the feasibility of the Penn Central trustees' plan to reorganize Penn Central as a transportation company, and expressed fear of a steady and substantial erosion of the value of the property pledged as security for their bonds. One trustee went so far as to suggest immediate dismissal of the Penn Central reorganization and a complete liquidation of its business. It is my view that any such drastic action should be deferred for the present while the feasibility of my proposed alternative course is being explored. Meanwhile however, I have instructed counsel to propose to the Penn Central Reorganization Court a postponement of projected sales of substantial amounts

of non-operating property, particularly the Grand Central Terminal properties.

On April 3, 1972, the Penn Central trustees filed with the Penn Central Reorganization Court a document entitled "Trustees' Plan for Reorganization (April 1, 1972)". The proposed "Plan" is based upon the four conditions for reorganization set forth in the report of the Penn Central trustees on prospects for reorganization filed on February 15, 1972, viz.:

A. The Debtor will secure relief from the burden of continued employment of train service employees unnecessary for safe and efficient operation.

B. The Debtor will secure relief from the financial burden of operating freight service on uneconomic lines.

C. The Debtor will secure relief from the financial burden of operating all passenger service, both inter-city and commuter, for which it is not fully compensated.

D. The volume of freight traffic handled by the Debtor will increase substantially to the levels forecast by Temple, Barker & Sloane adjusted to take into account the effect of the relief described in B above.

The Plan would become effective on January 30 of the year which follows the calendar year during which all administrative claims other than Trustees' certificates shall have been substantially discharged and the Debtor shall have earned income available for fixed charges not materially less than \$275 million, and prospective income is reasonably estimated at that level.

The Plan also provides that if the stipulated level of annual income is not reached by 1976 the plan will be withdrawn and alternative proposals made by the trustees. Meanwhile the trustees will report periodically to the Penn Central Reorganization Court on progress in realizing the "Conditions for Reorganization".

The Plan gives a skeletonized version of the proposed treatment of creditors according to their priorities, sets forth proposed

abandonments of uneconomic route miles of railroad line, and provides for the termination of any passenger service for which it is not fully compensated.

Study of the Penn Central Plan leads to the conclusion that while subject to all the infirmities set forth in my Statement of Position dated March 15, 1972, and while contrary to my basic proposal for reorganizing Penn Central, the Plan does represent a crystallized choice and commitment by the Penn Central trustees and, as such, should be promptly filed with the Interstate Commerce Commission which has the statutory duty to formulate a Reorganization Plan for Penn Central on the basis of evidence presented in a record of hearings before it. Since this procedure necessarily will involve a long period of preparation and presentation and since, while the Commission carries on its hearings and deliberations, the erosion of Penn Central property values will continue, involving heavy sacrifice for Penn Central creditors, the task of ascertaining the basis, if any, for a Penn Central Reorganization Plan by the Interstate Commerce Commission should not be longer deferred.

This view was expressed to the Penn Central Reorganization Court by my counsel, Mr. Auerbach, on April 5, 1972, in stating my opposition, except as to expenditures required for safety or preservation of the Trust Estate, to a \$44.6 million capital budget proposed by the Penn Central trustees for 1972, and was reiterated in subsequent proceedings for the approval of a proposal to sell six segments of the Grand Central properties.

Other Participations of the New Haven Trustee in the Penn Central Reorganization Proceedings

The New Haven Trustee is a party to the Penn Central reorganization proceedings and as such has been called upon to participate actively before the Penn Central Reorganization Court, in a wide range of matters affecting the interests of the New Haven Estate.

Perhaps the most important matter has been the question of insuring that proceeds of the sales of property subject to the \$34,025,800 Divisional First Mortgage held by the New Haven Trustee are properly deposited and segregated to be held for the benefit of the New Haven Trustee. This has entailed not only continuous collaboration with The Fidelity Bank of Philadelphia, which is the indenture trustee under the Divisional First Mortgage, to the end that deposits of proceeds are in fact made, but also protracted proceedings before the Penn Central Reorganization Court and the Court of Appeals for the Third Circuit on the proposal of the Penn Central trustees in effect to create a new and single depository for the proceeds of all property sales, irrespective of the terms and provisions of the numerous separate and individual indentures attached to properties throughout the Penn Central System. That matter has now been settled so that even though actually deposited in another bank, the proceeds of sales of property subject to the Divisional First Mortgage are properly segregated and subject to the control of the indenture trustee.

Akin to this question has been the question of price and value received by the Penn Central trustees for property and other interests sold. In one case the Court of Appeals held with regard to the disposition by the Penn Central trustees of property located in Boston, Massachusetts that the amount to be deposited with the indenture trustee was substantially less than the indicated fair market value. Similar questions have been raised by me as to the sale and lease of the old New Haven West End properties to transportation authorities of the States of New York and Connecticut, to the proposed sale of operating properties to the Massachusetts Bay Transportation Authority, and to the conveyance of highway bridges and approaches to the Commonwealth of Massachusetts. Protection of the interests of the New Haven Estate requires not only careful preliminary investigation of proposed sales of property by the Penn Central trustees, but also, where the investigation indicates substantial deficiencies in the proposed sale prices, careful and expensive gathering of evidence and preparation for trial. For these purposes it has been

necessary for me to retain Messrs. Meredith & Grew, Inc., real estate agents, and Messrs. Coverdale & Colpitts, engineering experts, to protect the estate.

The New Haven Trustee also has a vital interest in preserving the full value of all Penn Central properties, pending a crystallization of the basic form a feasible reorganization, if any, will take. For this reason I have engaged a financial expert to make an in-depth study of the Pennsylvania Company, Penn Central's subsidiary which holds most of the non-railroad assets, and I intend to oppose an arrangement by the Penn Central trustees to turn over the stock of the Pennsylvania Company to a consortium of banks in liquidation of most of \$300,000,000 of bank loans of the Penn Central.

In April of 1972, I also petitioned the Penn Central Reorganization Court for an order directing the sequestering and setting aside of one-half of that portion of the income from the Grand Central Terminal Property that exceeds the expenses of operating Grand Central Terminal and requiring payment to the New Haven Trustee in partial settlement of the obligations of Penn Central Transportation Company to the New Haven Estate or, alternatively, the deposit of such funds in an appropriate escrow account for the benefit of the New Haven Estate until there shall have been so paid or deposited an amount equal to \$28,438,000, with interest from December 31, 1968.

Current Administration of the Estate

As of December 31, 1971 funds and temporary cash investments held by the Trustee amounted to \$3,077,437. An additional amount of \$11,437,588 was held in the registry of the Court, including \$9,068,661 received from the Penn Central Transportation Company in January 1971 representing the division between the New Haven Trustee and the Penn Central trustees of funds on deposit with the indenture trustee under the mortgage securing the Penn Central Divisional Mortgage Bonds held by the New Haven Trustee. Thus, the New Haven

Estate on December 31, 1971 had on hand cash or equivalents totalling \$14,515,025, as compared with \$14,467,567 on February 1, 1971.

During the year ended December 31, 1971, the income of the Estate was derived from income received on temporary cash investment and reinvestment of Trustee and registry funds in United States Treasury bills, certificates of deposit in major city banks, and prime commercial paper, as authorized by this Court. Income received from this source amounted to \$775,881, representing an average annual return of almost $5\frac{1}{2}\%$. This income, supplemented with cash generated by the settlement of claims and other miscellaneous receipts, have made it possible in the year 1971 to meet all disbursements for operating expenses, including legal, accounting, and special consulting fees, together with a reduction of almost \$400,000 in outstanding tort claims, from these sources with no impairment of the Estate's capital funds. However, the press for lowered interest rates by the Federal Reserve System, which began in the last quarter of 1971, resulted in a sharp downward trend in the rates of short term investments, and will reflect lowered income from this source in 1972.

Unpaid interest on the Trustees' Certificates issued to provide cash for New Haven Railroad operations is accruing at the rate of \$656,250 per annum, with a total of \$1,045,625 accrued at December 31, 1971. The accrual of this interest resulted in a net loss for 1971 of \$674,696. This growing prior charge against the assets of the Estate is a direct result of the Penn Central bankruptcy, since interest on the Penn Central Divisional Mortgage held by the New Haven Estate was being paid at the rate of \$1,701,290 a year. Interest on the Penn Central Divisional Mortgage, of course, is accruing in favor of the New Haven Trustee and constitutes a prior charge on the property of the Penn Central Estate covered by the mortgage. Thus, while the New Haven Estate is showing an increased liability of \$656,250 annually, a much greater amount is accruing in favor of the New Haven Estate on the total amount of consideration due from Penn Central.

On December 1, 1971 request was made of this Court for an Order directing the turn-over by certain banks and others of funds held by them for payment of unclaimed interest, dividends and cash of the New Haven Estate. These funds relate principally to the 1947 Plan of Reorganization. Such order was granted and a total of \$143,757 was received by the Trustee to be subject until July 6, 1972 to any valid claim duly filed against any part of the amount deposited.

In connection with the consummation of the Boston and Providence Railroad, the New Haven Trustee has filed a petition for allowance by the Interstate Commerce Commission of reimbursement for disbursements in the amount of \$61,448.

On June 21, 1971 Manufacturers Hanover Trust Company and A. Frederick Keuthen filed their petition in this Court to be permitted to resign as Corporate Trustee and Individual Trustee, respectively, under the New Haven First and Refunding Mortgage, because of the status of Manufacturers Hanover as both an unsecured and a secured creditor of Penn Central Transportation Company, and as a Trustee under a number of mortgages on property owned by Penn Central and affiliates. By order of July 29, this Court granted the petition and appointed Lawrence W. Iannotti of Hamden, Connecticut, and a member of the law firm of Tyler, Cooper, Grant, Bowerman & Keefe, New Haven, Connecticut, as successor trustee. For similar reasons, early in 1972 The Chase Manhattan Bank, N.A. and Joseph R. Thompson, Corporate Trustee and Individual Trustee, respectively, under the General Income Mortgage, were also permitted to resign and this Court appointed Jacob D. Zeldes, of Fairfield, Connecticut, and a member of the law firm of Zeldes, Needle & Cooper, Bridgeport, Connecticut, as successor indenture trustee. In both instances, the banks have agreed to continue to perform administrative work in connection with the transfer of bonds.

During the period from July 7, 1961 to and including July 1, 1963, Manufacturers Hanover Trust Company, as indenture trustee, received various payments on certain purchase money mortgages and notes deposited with it as consideration for prop-

erty released prior to the date of bankruptcy. Subsequent to July 1, 1963, all further payments on these mortgages and notes were deposited in the registry of the Court pursuant to Order No. 74 of this Court. The amount of principal held by Manufacturers Hanover Trust Company was \$324,182. From February 1, 1962, the indenture trustee, upon advice of the New Haven Reorganization Trustee, had periodically invested these funds in its possession, so that the principal and the income earned thereon totalled \$557-698, at the time Manufacturers Hanover Trust Company resigned as indenture trustee, and with its consent these funds have been transferred to the registry of the Court to be held in a special account.

UNSETTLED FREIGHT CAR HIRE CHARGES

Subject to the moratorium on payments ordered by the Court on July 6, 1970, per diem claims of six railroads for periods subsequent to July 7, 1961, were liquidated in 1971 by settlement agreements. The amount of the agreed settlements are to be treated as administration expenses of the Debtor and subsequently dealt with by the Court as are other like administration expenses. These settlements were liquidated for an amount of \$244,444 in satisfaction of post-bankruptcy claims against the Debtor amounting to \$790,350.

On the other hand, my counsel and staff continued their efforts to compel payment of amounts due the New Haven Estate from other railroads. During 1971 such settlements were made with 51 railroads, for a total of \$211,583 (of which \$66,939 is collectible from Penn Central for interline freight divisions due the Fore River Railroad), in liquidation of pre-bankruptcy and post-bankruptcy claims of \$472,516 allegedly due the Debtor. It is expected that the collection of the balance of outstanding receivable claims of approximately \$74,000 will be consummated during the first half of 1972 to the extent that collectibility is feasible.

SETTLEMENT OF REAL ESTATE TAX CLAIMS

As part of the plan of reorganization of the Boston and Providence Railroad Corporation, consummated on February 23, 1971, the New Haven Estate was relieved by the Boston and Providence of any obligation to pay real estate taxes to various towns and cities in Massachusetts and Rhode Island, for the years 1964-1968 inclusive, in the amount of \$596,817.

CONDEMNATIONS

Condemnation proceeds received in 1971 amounted to \$164,696 for land takings made prior to December 31, 1968. Since 1968 a total of \$363,348 has been received from this source.

PERSONAL INJURY AND PROPERTY DAMAGE LITIGATION

Under the various statutes of limitations the time for filing on all tort claims, other than those of minors and a few property damage claims in Rhode Island, expired on December 31, 1971.

During 1971, 24 new tort actions were instituted and 108 cases were disposed of by settlement or judgment for a total amount of \$584,000, which is considered to be far short of the total liability if the cases settled had been tried and final judgments entered against the Estate.

It will be recalled that early in the reorganization proceedings the Court approved the payment of liquidated claims for personal injury or death on an installment basis. The payments thus authorized were continued until July, 1970 when, because of the loss of dividend and interest income from Penn Central securities, it became necessary to suspend all payments except those required to cover running expenses essential for the preservation of the Estate.

After several months it became clear to me that total suspension of the payment of tort claims was causing injured persons undue hardship. Accordingly in July 1971, after notice to all parties and a full hearing, I received authority from the Court

to resume partial payment of these claims to the extent of \$200,000 per quarter. Two such payments were made in 1971 and two have been made thus far in 1972. As of the date of this report the balance of unpaid liquidated claims was \$665,010.

On the basis of prior experience in disposing of litigated matters, it does not presently appear that the Estate would be subject to payment of any amount in excess of \$3,000,000 to dispose of all unliquidated tort claims presently pending in the courts of the four states in which the railroad had operated.

At the year's end, the tort cases having a preferred status under reorganization totalled 247. Specifically, there were 78 in Connecticut; 78 in New York; 87 in Massachusetts; and 4 in Rhode Island. In addition, there are a total of 68 cases of injured minors in New York, Massachusetts and Rhode Island, and 12 property damage claims in Rhode Island on which the statute of limitations has not run and on which no suits have been brought.

Certified financial statements for the year ended December 31, 1971, carrying extensive notes and auditor's report, are attached to this report.

Respectfully submitted,
 RICHARD JOYCE SMITH,
 Trustee

Dated: May 4, 1972

JAMES WM. MOORE
Counsel for the Trustee

JOSEPH AUERBACH
Special Counsel for the Trustee

SULLIVAN & WORCESTER
Of Counsel

THE NEW YORK, NEW HAVEN AND HARTFORD
RAILROAD COMPANY

STATEMENT OF OPERATIONS

For the year ended December 31, 1971

INCOME:

Interest:

Investment of funds on deposit with U. S. District Court	\$565,389	
Temporary cash investments	183,402	
Other	<u>27,090</u>	\$ 775,881

EXPENSES:

Compensation:

Trustee	56,167	
Counsel for Trustee	29,111	
Trustee's employees	147,067	
Payroll taxes	<u>11,095</u>	243,440

Attorneys, consultants, etc. 479,026

Services rendered by Penn Central 4,800

Special counsel for and appointed by U. S. District Court 11,569

Miscellaneous 55,492

794,327

Loss before fixed charge (18,446)

Interest on Trustees' Certificates (Note 3) 656,250

Net Loss \$ (674,696)

STATEMENT OF CAPITAL DEFICIT

YEAR ENDED DECEMBER 31, 1971

Capital deficit at December 31, 1970	\$ (88,607,227)
Net loss	(674,696)
Elimination of liabilities having no equity under the Plan of Reorganization (Note 1)	30,600,727
Provision for administration costs and expenses (Note 1)	(7,500,000)
Cancellation of assets and liabilities related to leased line (Note 4)	(391,788)
Adjustment of personal injury reserves	3,130,385
Cancellation of liability for real estate taxes accrued on B&P properties years 1964-1968	596,817
Adjustment of amount of consideration due from Penn Central (Note 2)	483,270
Excess of per diem accruals over settlements (Note 3)	563,289
Proceeds from insurance and condemnations	<u>219,165</u>
Capital deficit at December 31, 1971	<u><u>\$ (61,580,058)</u></u>

See accompanying notes

THE NEW YORK, NEW HAVEN

BALANCE SHEET—

ASSETS		(Note 1)
Current Assets:		
Cash	\$	105,079
Temporary cash investments.....		2,972,358
Special deposits		175,971
Other		98,484
		<u>3,351,892</u>
Funds on Deposit:		
U. S. District Court.....	\$11,437,588	
Mortgage trustees	<u>557,698</u>	11,995,286
Consideration due for assets transferred to Penn Central Transportation Company on December 31, 1968 (Note 2).....		132,696,058
Other items collectible from Penn Central Transportation Company.....		<u>223,830</u>
		<u>\$148,267,066</u>

See accompanying notes

AND HARTFORD RAILROAD COMPANY

DECEMBER 31, 1971

LIABILITIES AND CAPITAL DEFICIT		(Note 1)
Current Liabilities (Note 3):		
Accrued fees—attorneys, consultants, etc.	\$ 345,746	
Other accounts payable and accrued liabilities.....	145,378	
Current portion of injury and damage reserves (Note 3)	800,000	
		<u>1,291,124</u>
Debt in default:		
Trustees' certificates (Note 3).....	\$12,500,000	
Real estate tax installments—City of Boston (Note 3)....	3,648,813	
4% mortgage bonds due July 1, 2007.....	76,819,900	
4½% income bonds due July 1, 2022.....	<u>52,755,500</u>	145,724,213
Reserves:		
Injury and damage reserves (Note 3).....	2,200,000	
Reserve for administration costs and expenses (Note 1)....	<u>7,500,000</u>	9,700,000
Other liabilities:		
Real estate taxes deferred by Court order.....	13,415,039	
Interest in default:		
Trustees' certificates	1,045,625	
4% mortgage bonds.....	24,334,837	
Unsettled post-bankruptcy per diem charges.....	5,611,522	
Accrued contingent interest (Note 3).....	7,121,993	
Liquidated tort claims—subject to quarterly installment payments	973,482	
Liquidated per diem claims.....	244,444	
Other	<u>384,845</u>	53,131,787
Capital Deficit (Notes 1, 2, 3 and 4)	(61,580,058)	
	<u><u>\$148,267,066</u></u>	

See accompanying notes

THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY

Notes to Financial Statements — December 31, 1971

1. Basis of financial statements

The order in which the liabilities are shown in the balance sheet does not purport to state in any respect the priority of liabilities in the pending reorganization proceedings.

During 1971 the Reorganization Court remanded the Plan of Reorganization of The New York, New Haven and Hartford Railroad Company (New Haven) to the Interstate Commerce Commission to carry out and implement its order. As a result, liabilities determined in the Plan of Reorganization to have no equity in the Estate have been credited to capital deficit as follows:

Other loans (U. S. Government).....	\$12,372,100
Disaffirmed conditional sale agreements.....	974,744
Post bankruptcy interest accruals on real estate taxes deferred by Court order.....	2,943,705
Interest in default relating principally to other loans (U. S. Government).....	3,275,190
Pre-bankruptcy material and other vouchers payable.....	5,161,921
Pre-bankruptcy unsettled per diem charges.....	4,234,766
Pre-bankruptcy injury and damage reserves.....	1,389,392
Other	248,909
	<u>\$30,600,727</u>

In addition, pursuant to the Plan of Reorganization a provision of \$7,500,000 for administration costs and expenses resulting from the bankruptcy proceedings has been charged to capital deficit. This provision is an estimate only and is subject to further proceedings before the Commission and the Reorganization Court.

Based upon the terms of the Plan of Reorganization, where applicable, no accruals have been made for interest in the accompanying statement of operations, except for interest on the Trustees' Certificates.

The accompanying balance sheet and statement of operations do not reflect A) any other adjustments or the recapitalization proposed under the Plan of Reorganization or which may result from any modification thereto approved by the Interstate Commerce Commission, B) adjustments which may result from the pending proceedings related in Note 2 and C) interest as ordered by the Reorganization Court on the balance of the consideration unpaid by Penn Central Transportation Company since December 31, 1968, and one-half the excess income from the Grand Central Terminal property, which are the subject of appeals referred to in Note 2, below.

2. General

On July 7, 1961, New Haven filed a voluntary petition under Section 77 of the Bankruptcy Act in the United States District Court of Connecticut. The Trustees in reorganization assumed office on August 31, 1961. In accordance with a Plan of Reorganization approved by the Interstate Commerce Commission by order dated November 25, 1968, and Order No. 559, dated December 24, 1968, of the Reorganization Court:

- A. The Debtor was found to be insolvent within the meaning of Section 77 (e) of the Bankruptcy Act.

- B. The holders of New Haven preferred stock, common stock and certificates of beneficial interest were found to have no equity in the Estate and no participation is recognized for such holders.
- C. Substantially all of the assets of New Haven were transferred on December 31, 1968, to the corporate predecessor of Penn Central Transportation Company in exchange for capital stock and bonds of the latter, cash and the assumption of various obligations and liabilities of the New Haven.

On June 21, 1970, Penn Central Transportation Company, (hereinafter referred to as "Penn Central") the principal subsidiary of Penn Central Company (a holding company created in 1968 which exchanged its shares on a share for share basis for all the outstanding shares of Penn Central) filed a petition for reorganization under Section 77 of the Bankruptcy Act. On June 29, 1970, in the *New Haven Inclusion Cases* the Supreme Court of the United States determined that the total consideration to be paid by Penn Central for the assets transferred to it on December 31, 1968, by the Trustees of the New Haven, plus \$5 million for a share of New Haven's operating losses in 1968, aggregates \$174,635,899. Against this amount, Penn Central has been credited by the Reorganization Court with \$41,939,841, consisting of \$32,871,180, which includes a reduction of \$483,270 in 1971, for assumption of certain obligations of the New Haven, cancellation of Certificates issued by the Trustees of the New Haven and various cash payments, including \$9,068,661 received on January 28, 1971, which represented one-half of the proceeds then on deposit with an indenture trustee for Penn Central bonds held by the New Haven, which proceeds had been derived from sales of property conveyed by New Haven to Penn Central on December 31, 1968. Pursuant to orders of the Interstate Commerce Commission, the Reorganization Court and a three-judge court in the Southern District of New York, the Trustee of the New Haven also received \$34,025,800 principal amount of 5% Divisional First Mortgage Bonds due January 1, 1994, and 956,576 shares of common stock of Penn Central (which shares were exchanged for the same number of shares of stock of Penn Central Company), all of which was received prior to the decision of the Supreme Court. The Supreme Court stated in its decision of June 29, 1970 that it was requiring "a reassessment of the consideration that Penn Central is to give in exchange for" the New Haven's assets, stating that "further proceedings before the Commission and the appropriate federal courts will be necessary to determine the form that Penn Central's consideration to New Haven should properly take and the status of the New Haven estate as a shareholder or creditor of Penn Central."

Thereafter, the Reorganization Court on June 22, 1971, ordered that:

(1) The consideration be increased by interest on the balance of the consideration unpaid since December 31, 1968, until date of payment, less interest and dividends received by the New Haven from Penn Central.

(2) All tangible property transferred by New Haven to Penn Central except rolling stock and the portions of other tangible property which were sold by the Penn Central or its trustees, is subject to an equitable lien as of December 31, 1968, to secure the claims of the New Haven against the Penn Central.

(3) The Penn Central bonds and Penn Central Company common stock, as above described, be held by the Trustee of the New Haven as security for the obligations of Penn Central to the New Haven.

(4) All the right, title and interest of the New Haven in and to the Grand Central Terminal Property be held in trust by the Penn Central or its trustees for the benefit of the New Haven until the New Haven shall have received \$28,438,000 plus interest, from the Grand Central Terminal Property, or until the obligations of the Penn Central to the New Haven shall have been discharged.

(5) One-half the excess income from the Grand Central Terminal Property shall, commencing July 1, 1971, accrue to the account of the Trustee of the New Haven.

(6) The Reorganization Plan is remanded to the Interstate Commerce Commission.

The Penn Central trustees and others appealed this Order to the Court of Appeals for the Second Circuit which, on March 17, 1972, held that the Reorganization Court lacked jurisdiction to enter such Order. The Court of Appeals remanded the matter to the Interstate Commerce Commission for further proceedings while stating that it did not intend by its decision to imply disagreement with the fairness of the Order of June 22, 1971, or with the conclusion of the Reorganization Court that the Supreme Court's opinion in the *New Haven Inclusion Cases* requires that the New Haven Estate receive \$174.6 million as compensation for the taking of its property. Issuance of the mandate of the Court of Appeals has been stayed. On April 28, 1972 the Trustee petitioned the Supreme Court for certiorari to review the decision of the Court of Appeals.

Essentially the same issues have been raised in a proceeding before the Penn Central Reorganization Court in Philadelphia, over the opposition of the Trustee of the New Haven and were the subject of Opinion and Order No. 546, dated December 31, 1971, of that Court. In Order No. 546 the Penn Central Reorganization Court ordered that the New Haven Trustee shall be deemed to have "a lien, indeterminate in amount, indeterminate as to priority, upon all of the real property and readily identifiable, tangible personal property (exclusive of rolling stock) conveyed to Penn Central" as of December 31, 1968, and which were still in possession of the Penn Central estate on June 11, 1971. It was further provided that "the ultimate disposition of the claims asserted by the New Haven Trustee is deferred pending completion of the program for handling proof of claim in these proceedings and the receipt and consideration of objections in accordance with such program". The New Haven Trustee appealed this Order on January 28, 1972 to the Court of Appeals for the Third Circuit.

3. Liabilities

On July 6, 1970, following initiation of the Penn Central Reorganization, the Reorganization Court authorized the New Haven to suspend payment with respect to any and all claims, including, without limitation, claims for torts, taxes and per diem, which in the judgment of the Trustee, were not necessary to preserve the Estate of the New Haven and to keep it intact.

Liabilities normally subject to current settlement, the payment of which has been deferred because of bankruptcy, are not included in current liabilities.

The Trustees' Certificates consist of 5¼% notes and were due: \$5,000,000 on August 4, 1971, and \$7,500,000 on December 31, 1971. The U. S. Government now has the entire beneficial interest in the Trustees' Certificates as a consequence of its guarantee in connection with their issuance in 1961 and 1965, and the default by the New Haven Trustee following the Penn Central bankruptcy.

Pursuant to agreement between the Trustee and the City of Boston, which was approved by Court Order No. 596, \$4,505,505 was paid in cash, the balance of \$3,648,813 was to be paid in three equal annual installments in satisfaction of real estate taxes amounting to \$13,034,280. Because of Court Order No. 617, suspending the payment of claims, the amounts of \$1,216,271 due March 25, 1971 and March 25, 1972 were not paid.

The New Haven's 4¼% income bonds provide that unpaid interest is cumulative up to 13¼% of the principal amounts of bonds outstanding. Accordingly, during the three years ended December 31, 1959, an aggregate of \$7,121,993 of contingent interest not earned was accrued by charges against income.

During reorganization, the New Haven has negotiated settlements of per diem obligations with Reorganization Court approval, at less than the full amount claimed. In 1971, \$614,349 of net per diem accruals were settled for \$51,060; the balance of \$563,289 has been credited to capital deficit. Settlement of per diem receivables increased cash by \$144,644 in 1971.

The New Haven estimated the amount payable at December 31, 1971, under pending injury and damage claims incurred prior to January 1, 1969 to be \$3,000,000. The excess of injury and damage reserve accruals (\$3,130,385) over the amount estimated to be payable has been credited to capital deficit. Except for certain classes of claims, the statute of limitations prevents the filing of additional injury and damage claims incurred while the New Haven was an operating railroad.

On May 19, 1971 the Court authorized the resumption of personal injury payments not to exceed \$200,000 quarterly. During 1971 installments of \$387,296 were paid out on liquidated claims. At December 31, 1971 the amount to be paid on outstanding liquidated claims was \$973,482.

4. Leased line

As a result of the settlement of litigation involving a lease between the New Haven and the Providence and Worcester Railroad, improvement to leased line (disaffirmed)—\$1,984,339 and the related liabilities (\$1,592,551) were charged to capital deficit.

5. Federal Income Taxes

The New Haven has received a ruling from the Internal Revenue Service with respect to the Plan of Reorganization (see Note 1) that no loss would be recognized on the transfer of the operating assets to Penn Central and that the basis of the stock and securities of the Penn Central received by the New Haven would be equivalent to the basis of the operating assets transferred to the Penn Central decreased by the amount of money received and the amount of liabilities assumed by Penn Central.

The New Haven has filed with the Internal Revenue Service a request for a ruling to establish that the New Haven retains the net operating loss carryovers which existed at the time of the transfer of its assets. On present estimates, a favorable ruling would eliminate the likelihood of federal income taxes during the five year carryover period.

In addition the New Haven has sustained additional net operating losses for federal income tax purposes since the transfer of its assets, which may be used to eliminate taxable income during the respective carryover periods.

Report of Certified Public Accountants

Mr. Richard Joyce Smith, Trustee
The New York, New Haven and
Hartford Railroad Company

We have examined the accompanying balance sheet of The New York, New Haven and Hartford Railroad Company, at December 31, 1971, and the related statements of operations and capital deficit for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, (1) subject to such adjustments as may result from final determination of the uncertainties noted below, the accompanying balance sheet and statement of capital deficit present fairly at cost, the asset, liability and capital deficit accounts of The New York, New Haven and Hartford Railroad Company at December 31, 1971 and (2) the statement of operations presents fairly the results of operations for the year then ended, all in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. However in view of the uncertainties explained in Notes 1 and 2 as to:

- (1) the final determination of the form of consideration receivable from the Penn Central Transportation Company and the realizability of such consideration,
- (2) the recapitalization resulting from implementation of the proposed Plan of Reorganization,
- (3) the adequacy of the provision of \$7,500,000 for administrative costs and expenses,
- (4) adjustments resulting from court orders and appeals,

we do not express an opinion as to the overall financial position of The New York, New Haven and Hartford Railroad Company at December 31, 1971.

ARTHUR YOUNG & COMPANY

Hartford, Connecticut
January 28, 1972, except as to Notes 2 and 3 as to
which the date is April 28, 1972.