

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT

REPORT

of

THE TRUSTEE

on

ADMINISTRATION OF THE ESTATE

of

THE NEW YORK, NEW HAVEN AND HARTFORD
RAILROAD COMPANY
FOR THE NINE MONTHS ENDED
SEPTEMBER 30, 1969

to

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

Filed : October 31, 1969

(7847)

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

REPORT OF RICHARD JOYCE SMITH, TRUSTEE, FOR THE
NINE MONTHS ENDED SEPTEMBER 30, 1969

In the Matter of

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

No. 30226

This interim Report is respectfully submitted to the Court on the administration of the Estate of the New Haven for the nine months ended September 30, 1969. For the reasons hereinafter indicated, I feel that regular semi-annual narrative reports should be submitted to this Court on a calendar basis, commencing with the period beginning January 1, 1970. In light of the significant events which have occurred this year, however, and particularly those of recent months concerning the consideration required to be paid by Penn Central for the New Haven's assets and the pending Plan of Reorganization, it seemed to me to be important to submit this interim Report as of September 30, 1969, with a year-end report to follow.

This is the ninth Report to this Court filed by the Trustees in office from time to time. The eighth Report related to administration of the Estate during 1968 and was filed May 29, 1969 by the undersigned and William J. Kirk. Mr. Kirk

resigned as Trustee effective midnight, February 28, 1969, and the undersigned has acted as sole Trustee since that date. While this Report includes matters occurring during the first two months of 1969, it is devoted primarily to developments in the administration of the Estate since February.

The first Report to this Court which was filed by the three Trustees appointed in 1961, Mr. Kirk, Harry W. Dorigan, who died in 1966, and the undersigned, covered the first six months of the operations of the New Haven in reorganization. The next seven Reports were on an annual basis and covered the years 1962 through 1968.¹

The primary reorganization effort in the early years was to take every possible step to insure that the New Haven would be included in a merged Penn Central system. To that end, the Trustees directed their counsel to intervene in the merger proceedings before the Interstate Commerce Commission while concurrently the Trustees undertook direct negotiations with the Pennsylvania Railroad and New York Central Railroad managements. In our first seven Reports, we were not only concerned with these reorganization efforts but also with our day-to-day responsibility in carrying on the operations of the New Haven's railroad system. These latter functions, of course, terminated on December 31, 1968, and we were able to say that our eighth Report constituted "the final Report of the Trustees covering the Railroad operations put in their charge by this Court's Order No. 7, dated July 26, 1961." (p. 7529)

Under the pending Reorganization Plan, whose concept was developed by the Trustees and approved both by the Interstate Commerce Commission and this Court, as hereinafter discussed in detail, the New Haven will continue in business as an in-

¹The Reports heretofore filed by the Trustees appear in the printed records as follows: March 5, 1962, p. 700-(1); June 1, 1963, p. 1725; March 30, 1964, p. 2415; May 14, 1965, p. 3315; April 11, 1966, p. 4039; March 17, 1967, p. 4837; March 20, 1968, p. 5669; and May 29, 1969, p. 7525.

vestment company registered under the Investment Company Act of 1940. While the New Haven is not yet subject to that Act, I consider, nevertheless, that beginning with 1970 it would be appropriate to adopt as a regular, future course, pending consummation of the Plan, the filing of a semi-annual report.²

Through the submission of semi-annual reports, I would be frequently advising this Court with respect to my stewardship of a large trust *res*. In addition, public disclosures of material facts would be occurring periodically. While most enterprises are able to communicate directly with persons entitled to have business information deemed material, the Estate does not have adequate knowledge of the identity either of the persons in the classes heretofore found by this Court to have an equity in the Estate or of other persons who claim to have an interest. The most feasible way of disseminating material information under these circumstances is to file frequent reports with this Court, making service thereof to the customary service list, relying upon news media to disseminate information broadly concerning the existence of the report or particular items in it, and sending copies on request to interested persons.

Since December 31, 1968, as was anticipated by the eighth annual Report, I have been actively engaged in processing administration claims against the Estate, including various tort, tax, per diem (freight car hire) and other claims. A principal requirement during this period was the completion of staff work in preparation for a post closing settlement under Section 7 of the Agreement dated April 21, 1966 among the Trustees and what is now Penn Central Company. In addition, continuing management of the New Haven's cash and other holdings was required to achieve the greatest benefit for the Estate during this remaining interim reorganization period. Finally, litigation has continued throughout the period with respect to final determina-

²Under Section 30(d) of the Investment Company Act of 1940, it is provided that every registered investment company shall transmit semi-annual reports to its stockholders.

tion of the price to be paid by Penn Central, and the provisions of the Reorganization Plan other than those relating to price were presented to and ruled upon by this Court.³

To submit a Report fairly summarizing all material, relevant matters, but at the same time not overburdened by detail, I have had to develop a standard to aid in determining which matters merited inclusion. I feel that the most useful test under present circumstances in this unique railroad reorganization is to consider whether a particular matter or event could have a bearing upon the ultimate form of the Reorganization Plan. This test recognizes the significance of information needed by interested persons in appraising claims in the Estate.

In the instant Report, I have grouped the subject matter in the general categories of financial condition, current administration, status of the Reorganization Plan and factors which I consider may have a bearing on completion of the reorganization.

I.

FINANCIAL CONDITION

Apart from certain miscellaneous items, the Estate derived its income, during the nine months ended September 30, 1969, exclusively from interest and dividends. On the Penn Central bonds and stock delivered to me at the closing on December 31, 1968, the Estate received \$1,260,000 of interest and \$1,710,209 of dividends. In addition, it received interest of \$308,043 on temporary cash investments and \$298,720 from investment of funds in the Registry of the Court, together with \$22,908 of other interest. Miscellaneous items amounted to \$25,516, and total income for the nine-month period was \$3,625,396.

³I would be remiss if I failed to note in this respect Mr. Kirk's valuable contribution and the continuing significance for me of his views in financial matters given to me while he was still a Trustee.

Expenses during the same period aggregated \$1,044,745 and, accordingly, if interest on pre-bankruptcy long-term debt and on tax claims is disregarded, the New Haven had net income for this period of \$2,580,651. This was the first time since 1958 that the New Haven had income available for fixed charges.

The expenses included interest payments of \$492,188 on the outstanding \$12,500,000 principal amount of Trustees' Certificates; a \$25,000 fee for the services of the Special Master in connection with hearings on Grand Central Terminal matters; and miscellaneous expenses of \$38,907. Apart from these items, the expenses were compensation of \$200,069 for the internal staff of the New Haven and \$171,739 for its outside attorneys, accountants and consultants; and payments of \$116,842 for the services of Penn Central employees made available to the Estate at my request under the Agreement dated April 21, 1966. Under the Agreement, the New Haven continues to have adequate office quarters and facilities, without charge, in its former office building in **New Haven**.

It is important to note that the foregoing summary of income and expenses is not necessarily indicative of what may be expected during the balance of the period prior to termination of the reorganization. On the income side, interest on Penn Central bonds is expected to be increased in some degree by reason of the litigation hereinafter described. The number of shares of Penn Central common stock held by the New Haven would similarly be affected, but the aggregate future income from stock presently held and from any increase in the number of shares will depend upon the rate of future dividends. With respect to interest earned by the Estate through investment of the cash on hand and the funds in the Court's Registry, there are two factors which would have a bearing. The amount of cash available for investment may fluctuate greatly because of liquidation of claims, and variations in available yields on the type of short-term high-grade debt securities that are appropriate investment vehicles. At a later point in this Report, the cash situation will be discussed.

The principal item of expense, that is interest on the outstanding Trustees' Certificates, will run essentially unchanged until late in 1971. During that year, and in accordance with the views expressed by this Court, these Trustees' Certificates (constituting Class B under the Reorganization Plan) will be paid in cash in the amount of \$5,000,000 in August and \$7,500,000 in December. Payments for services of Penn Central personnel will decrease as it becomes less necessary to use experienced former New Haven personnel in completing the disposition of property damage and other railroad related claims outstanding against the New Haven at December 31, 1968 or related to operations then terminated. A reduction in monthly use of such personnel has already occurred and current use is at a level substantially less than that reflected in the first nine-month period. In my opinion, the cost of the services has been reasonable.

Turning to the balance sheet, at September 30, 1969, the New Haven had cash, temporary cash investments and other current assets which aggregated \$7,628,357. In addition, it had funds on deposit, principally in the Registry of this Court, but also with mortgage trustees, in the total amount of \$4,913,269. Accrued current liabilities at that date amounted to \$2,025,319. The current assets and liabilities on that balance sheet gave effect to the settlement of the Section 7 items under the Agreement, and some other items (including substantial credit items for the New Haven) as provided by Supplemental Order No. 572. This is subsequently discussed in connection both with the Grand Central Terminal excess income and the orders of both this Court and the three-judge court in the Southern District of New York dealing with the Commission's Fourth Supplemental Report.

In the September 30, 1969 balance sheet, the New Haven's holdings of the Penn Central stock and bonds received on December 31, 1968 were carried in the aggregate at \$112,335,150 in accordance with instructions from the Commission. These

values reflect a per share value of \$87.50⁴ for the stock and a discount of 13% from the principal amount of the Penn Central bonds.

II.

CURRENT ADMINISTRATION OF THE ESTATE

PERSONNEL

Both before the inclusion on December 31, 1968 and thereafter, studies were made of the New Haven's staff requirements during the interim prior to consummation of the Plan of Reorganization. The workload to be met includes regular day-to-day housekeeping and administrative functions; problems connected with final settlement with Penn Central; injury and damage (primarily personal injury) litigation and settlement of such claims arising prior to January 1, 1969; per diem litigation and settlements; and activities required in connection with formulation, prosecution and consummation of a reorganization plan. Petition for Order No. 579 dated June 13, 1969, subsequently approved by this Court by Order No. 579, dated July 1, 1969, sets forth the staffing of the New Haven which I have established.

Briefly summarized, the New Haven presently employs fifteen persons. Ten are located in New Haven and include the Treasurer and Comptroller, two counsel and four special assistants. A staff attorney and secretary are located in Boston, and two staff attorneys and a claims investigator⁵ are located in New York. The aggregate annual salary presently in effect for this entire staff is \$203,731. In addition, my annual com-

⁴The significance of this value is hereinafter discussed in connection with the decisions of this Court and the three-judge court.

⁵The claims investigator has been added to the staff subsequent to July 1, 1969.

pensation is currently fixed by the Commission and this Court at \$50,000 and that of James Wm. Moore, Counsel for Trustee, at \$25,000.

I have previously referred to the use of Penn Central employees for various tasks related to former railroad operations which are being run out. In addition, outside counsel have been appointed in Connecticut, Massachusetts, New York and Rhode Is'and to assist the staff attorneys in handling the presently large volume of personal injury and property damage claims. Other outside counsel previously appointed by the Court in connection with reorganization matters, per diem matters, the Boston and Providence Railroad reorganization, tax matters in Massachusetts and various general legal questions, continue to be called upon by me and Professor Moore.

As noted in the Petition for Order No. 579, employment of an additional staff accountant has been recommended by the independent auditors employed to review the Estate's system of internal controls. It is intended to put this into effect as soon as possible.

SECTION 7 SETTLEMENT

An important aspect of the Agreement dated April 21, 1966 was that the New Haven's operations would be transferred at the closing date without any hiatus and without inconveniencing either the public or the staff of the New Haven. The procedures for this purpose (set forth in Section 7 of the Agreement) provided that Penn Central would assume specified current liabilities of the New Haven at the closing and receive specified current assets. A settlement would be made five months thereafter in which an amount equal to the excess of current liabilities over current assets, as reflected on the New Haven's books, plus \$1,000,000, would be paid to Penn Central which was to have carried out all continuing day-to-day functions involved in the receipt, disbursement and processing of current assets and current liabilities.

The Section 7 procedures proved, in practice, to be an excellent mechanism, and it is believed that no sale of operating property of the New Haven's magnitude has been carried out more smoothly or at less cost.

With respect to the financial aspects of the settlement required under Section 7, a disagreement arose between the New Haven and Penn Central. The latter claimed that on various items I, as Trustee, was required to pay it a total of \$988,020 more than the amount I proposed to pay. In accordance with the provisions of the Agreement, the dispute was submitted to Arthur Young & Co. for determination, which decided that the New Haven owed Penn Central only \$189,159 more than I had submitted for final settlement.

As a result of the dispute and the time required for its submission and determination, the Section 7 settlement could not be carried out on the date fixed under the Agreement. Accordingly, it was agreed with Penn Central, and approved by this Court that an interim payment would be made to Penn Central on May 29, 1969 in the amount of \$4,872,730. Following determination of the dispute, the New Haven owed a balance to Penn Central under Section 7 of \$2,839,952. In connection with payment of this amount, the Court had a further hearing on June 24, 1969 and provided by Supplemental Order No. 572, that there should also be paid to Penn Central the amount of \$99,011, representing payments on so-called "recollectible costs" and to make further payments of similar items as might be received by the Trustee from time to time. As offsetting credits, the Court also found that Penn Central was obligated to the Trustee in the amount of \$275,000, representing a payment made by me to the United States, in liquidation of its secured claim, pursuant to Order No. 565; \$45,000 theretofore received by Penn Central as condemnation awards on account of takings prior to January 1, 1969; and \$3,377,903 on account of the New Haven's one-half share of excess income of the Grand Central Terminal properties for 1967 and 1968. In Supplemental Order No. 572, the Court ordered Penn Central to make a net payment of \$758,940 to the Trustee.

In accordance with a stay granted by this Court, Penn Central appealed the Order insofar as it required the payment with respect to excess income of the Grand Central Terminal properties. Subsequently, as described in connection with the Order dated September 11, 1969 of the three-judge court, the Commission adopted the findings of this Court with respect to such payment. A summary of the determination of the amount is hereinafter set forth.

Although the disputes with Penn Central in connection with the amounts required to be paid under Section 7 at the appointed closing were resolved by the determination made by Arthur Young & Co., other interpretative questions remain. These appear not to involve as basic questions whether the New Haven or Penn Central is obligated to the other, but whether either is obligated to third parties or entitled to receive particular payments from third parties by reason of the provisions of Section 7. A number of specific questions of this nature have arisen and are discussed later in this Report.

GRAND CENTRAL TERMINAL EXCESS INCOME

In connection with completion of the Section 7 settlement, a study was made of the Grand Central Terminal properties' "excess income" for the years 1967 and 1968. Based upon a New Haven participation of 50% of such "excess income", it was determined that, before adjustments, the New Haven was entitled to \$1,001,360 for 1967 and \$1,721,541 for 1968, or a total of \$2,722,901.

These computations were based upon the so-called "Terminal Account", which in the case of the hotels operated by the railroads, with the exception of the Hotel Biltmore, reflected the actual amounts paid by the hotels into the Terminal Account rather than the amounts which represented accrued earnings of the hotels for the particular period as reflected by their own books. I felt, and this position was taken in this Court, that in view of the termination of the Grand Central Terminal agreements as part of the conveyance on December 31, 1968, the "excess

income" for 1967 and 1968 should be adjusted to reflect the underlying earnings of each of the hotels involved. As a result of such an adjustment, "excess income" was increased to \$3,377,903 which was ordered by this Court to be paid by Penn Central and was subsequently adopted by the Commission as an amount to be paid by Penn Central in cash, outside the consideration to be paid for the New Haven's assets.

REQUEST FOR TAX RULING

By Petition for Order No. 581, dated July 1, 1969, I requested authorization to file an appropriate request on behalf of the New Haven with the United States Internal Revenue Service for such rulings as might be necessary or appropriate to establish that the New Haven's basis for tax purposes for the Penn Central securities received pursuant to Order No. 559, and any additional securities received as a consequence of the litigation and review proceedings, is equal to the New Haven's basis for the assets which it transferred to Penn Central on December 31, 1968, and that the New Haven retains the net operating loss carryovers which existed at the time of the transfer of its assets. This Court granted the Petition and a formal request for a ruling has been filed with the Internal Revenue Service.

The rulings which may be made on these questions could have considerable significance for the New Haven. The New Haven suffered net operating losses in the years 1964 to 1968 as follows: 1964 — \$12,103,825; 1965 — \$6,068,839; 1966 — \$8,306,083; 1967 — \$16,096,026; and 1968 — \$21,403,181. A favorable ruling as to the operating loss carryovers would have the effect of permitting their use as an offset to income earned during a five-year period beginning with the current year. On present estimates, this would eliminate the likelihood of any federal income taxes during that period.

The question of the tax basis relates essentially to the consequences of a disposition of the Penn Central securities received as consideration for the New Haven's assets. The ruling request

indicates that the New Haven's basis for such assets was approximately \$308,650,000. Since this basis is considerably higher than the valuation placed upon the assets by the Commission, a sale at some future time by the New Haven, or the proposed investment company, of such securities at a price higher than the value fixed by the Commission for the assets conveyed, but not in excess of the tax basis as requested, would not under present law result in the realization of taxable gain.

PERSONAL INJURY AND PROPERTY DAMAGE CLAIMS

A study has been made of the estimated aggregate liability of the New Haven for personal injuries and property damages accruing prior to January 1, 1969. At that date, there were a large number of claims in existence and a considerable amount of pending litigation related to the prior railroad operations. The railroad also has liability exposure subsequent to December 31, 1968 for actions brought in accordance with the provisions of the local statutes of limitations in the states in which it was operating. This Court was advised through testimony of staff counsel employed with respect to tort matters that it is now estimated that the potential aggregate liability of the Estate in this area is \$8,000,000. This estimate includes an appraisal of claims anticipated to be made and the payments which remain to be made on all existing settlements.

In contrast to this estimate, the New Haven's September 30, 1969 balance sheet reflected reserves or liabilities in the amount of \$10,174,022. This total was made up of a current liability in the amount of \$1,551,000, a reserve account in the amount of \$6,475,930, and a liability account of \$2,147,092.

While it is too early to assess the accuracy of the estimate of ultimate liability previously given to the Court, it is supported by current experience. With respect to current settlements, the formula for installment payment has been revised to increase the percentage of payment being made periodically.

UNSETTLED FREIGHT CAR HIRE CHARGES

At September 30, 1969, the New Haven's balance sheet reflected a net total liability of \$23,696,253 to more than 100 carriers for unsettled so-called per diem claims accrued at rates established by the Association of American Railroads. Of this amount, \$14,173,237 represented post-bankruptcy per diem. I am advised that the balance of such net liability would be entitled to participate in the reorganization only as an unsecured general claim. Under litigation which has already occurred in the so-called six-months claims case decided by this Court (278 Fed. Supp. 592, *aff'd* 405 F.2d 50, *cert. den.* April 28, 1969), these general claims would not be entitled in any respect to preferential treatment. In addition, since this Court found no equity for unsecured creditors, as hereinafter discussed, it is my position that the amount owed by the New Haven is limited to the unsettled post-bankruptcy charges. Since December 31, 1968, a number of settlements of these post-bankruptcy per diem charges have been the subject of petitions to and approval by this Court. During this period there have been approved settlements with Union Pacific Railroad; Nevada Northern Railway; Louisiana and North West Railway; Canadian Pacific Railroad; Ontario Northland Railway; Chicago and Illinois Midland Railway; Reading Company; Gulf, Mobile and Ohio Railroad; St. Louis-San Francisco Railway; Chicago, Rock Island Pacific Railroad; Pittsburgh and Shawmut Railroad; and Quanah, Acme and Pacific Railroad. These settlements were made by payment of \$519,887 in final satisfaction of net post-bankruptcy per diem claims against the Debtor amounting to \$2,360,569.⁶

⁶Subsequent to September 30, 1969, this Court has approved settlements with Canadian National Railway and its subsidiary companies, Atchison, Topeka and Santa Fe Railway, and Missouri-Kansas-Texas Railroad, which provide for payments of \$390,585 in settlement of per diem claims aggregating \$1,993,274 of which \$1,293,013 are post-bankruptcy claims.

On the other hand, the New Haven has claims against certain carriers for interline freight settlements that I consider were improperly offset against per diem claims against the New Haven. These claims amounted to \$1,584,576 at September 30, 1969.

The basic question of the amount of the New Haven's ultimate liability for unsettled per diem charges is still undecided. The per diem dispute has existed since 1953 and is in litigation before the United States District Court for the Southern District of New York, *Baltimore & Ohio Railroad Company, et al vs. New York, New Haven and Hartford Railroad Company and Boston and Maine Railroad*, 196 F. Supp. 724 (1961). The dispute is also the subject of a decision of the Commission in ICC Docket No. 31358. The New Haven and the Boston & Maine Railroad have sought judicial review of this decision before a three-judge United States District Court for the District of Massachusetts. The Court refused to set aside the decision of the Commission, and an appeal has been taken to the Supreme Court. *Boston & Maine R. R. vs. United States*, 297 F. Supp. 615 (D. Mass. 1969), appeal docketed, No. 343, July 15, 1969.

DEFERRED REAL ESTATE TAXES

Pursuant to the July 28, 1969 opinion of this Court, the New Haven's obligation for real estate taxes was fixed at \$25,758,614. This was made up of \$4,961,418 for pre-bankruptcy unpaid real estate taxes, plus interest thereon to July 7, 1961 in the amount of \$101,416 but without penalty, and post-bankruptcy real estate taxes, without interest or penalty, in the amount of \$20,695,780. In contrast, accruals for unpaid real estate taxes were reflected on the New Haven's September 30, 1969 balance sheet in the total amount of \$29,995,209. Since December 31, 1968, the New Haven has not owned any real estate.

PROVIDENCE AND WORCESTER RAILROAD LEASE TERMINATION

In accordance with the provisions of the Agreement dated April 21, 1966, the Trustees rejected the lease of the proper-

ties of the Providence and Worcester Railroad pursuant to Section 77(b) of the Bankruptcy Act. The Commission approved the rejection as part of the Reorganization Plan, and P&W has appealed this Court's Order No. 559, with regard thereto, to the Court of Appeals for the Second Circuit. The Commission also provided an alternative to P&W which would permit its inclusion in the Penn Central system. This order has been affirmed by a three-judge court in the Southern District of New York, and P&W has appealed to the Supreme Court.

P&W has claimed that the New Haven is liable to it as a consequence of the disaffirmance of the lease, and has instituted an action for damages before this Court. The Trustees have filed an answer in that case denying liability and have also filed a third-party complaint against Penn Central on the basis that, if there should be any liability, it is the responsibility of Penn Central.

BOSTON AND PROVIDENCE RAILROAD REORGANIZATION

The plan of reorganization for Boston and Providence Railroad was confirmed late in 1968 by the District Court for the District of Massachusetts. Attempts to prevent consummation of the plan have continued. It is hoped, however, that the plan may be carried out in the near future.

OTHER SIGNIFICANT MATTERS

There was a number of other significant matters which arose in the current administration of the Estate. In brief summary, these were as follows:

1. *Southern Divisions Case.* In April 1969, an order of the Commission with respect to joint inter-territorial rates between Official and Southern territories was set aside and the defendant railroads were ordered to resettle their accounts by July 23. In the case of the New Haven, the liability amounted to \$1,475,900 plus accounting charges of \$7,750. By Petition for Order No. 588, I asked this

Court to adjudge that Penn Central was required to make such payments on behalf of the New Haven. Thereafter, I reached a settlement with Penn Central covering various existing disputes under Section 7 of the Agreement dated April 21, 1966, pursuant to which Penn Central agreed to make the above payments. By Order No. 588, entered on August 11, 1969, the settlement was approved.

2. *Summer Street Bridge.* Pursuant to the settlement approved in Order No. 588, Penn Central agreed to assume all liability on the part of the New Haven in connection with the destruction of the Summer Street Bridge in Boston by fire in 1968. The New Haven's exposure was estimated to be as much as \$350,000.

3. *Proceeds of Condemnation.* Under Supplemental Order No. 572, Penn Central was directed to pay the Debtor \$45,000 in respect to two condemnation awards which related to takings from the New Haven prior to January 1, 1969. Under the settlement in connection with Order No. 588, Penn Central has agreed that the Estate is entitled to all additional condemnation awards related to takings that occurred prior to 1969. As of September 30, 1969, \$36,701 had been received.

4. *Proceeds of Insurance.* Various disputes which had existed with Penn Central were resolved in part by Arthur Young & Co. in its determination of the settlement under Section 7 of the Agreement dated April 21, 1966, and in connection with the settlement approved in Order No. 588.

5. *Anti-trust Litigation.* The settlement approved in Order No. 588 confirmed that any proceeds that might be received after December 31, 1968 from certain litigation previously instituted by the Trustees against suppliers of steel wheels and tickets should be delivered to Penn Central.

6. *State of Connecticut Gross Earnings Tax.* The State of Connecticut claimed that the New Haven was not entitled to relief from the State's gross earnings tax as

a railroad during 1968 since it had conveyed its assets before the end of the year. On June 5, 1969, pursuant to my petition, this Court barred and disallowed this claim.

7. *Disaffirmed Tugboat Leases.* The charterer of three tugboats made a claim for \$230,139 pursuant to the terms of the respective charters, in connection with the rejection of the charters by the Trustees. By Order No. 589, dated September 11, 1969, this Court approved a settlement in full of these claims by payment of \$165,966.

8. *Deed Taxes.* At the conveyance of the New Haven's real properties on December 31, 1968 to Penn Central, the Trustees were required to pay various deed excise taxes. These amounted to \$48,200 in Massachusetts, \$9,899 in Rhode Island and \$18,915 in the City of New York. The Trustees sought refunds in each case. Rhode Island has granted a refund; Massachusetts has denied the refund and I have taken an appeal; and various procedural steps remain before the City of New York can complete its processing of the protest made.

9. *Other State Matters.* In Massachusetts, there is an appeal pending in the Supreme Judicial Court from orders of the Department of Public Utilities denying tax relief to the New Haven for the years 1961 and 1962. It is hoped that this case can be progressed later this year. In addition, there are a number of pending cases for abatements of real estate taxes related to years prior to the bankruptcy, which I intend to press for disposition.

The bulk of the deferred real estate taxes previously referred to in this Report relates to claims of taxing authorities in Massachusetts and, particularly, to properties formerly owned in Boston. Discussions are currently being held with the taxing authorities to attempt to find an appropriate solution. If this can be accomplished, it would also terminate the tax litigation referred to.

The State of New York claims \$166,000 in connection with its grade crossing elimination program and has set off \$10,000 which it owed the New Haven for tax refunds. I consider the set-off to have been improper and also consider that the State may not be entitled to the balance which it claims.

III.

STATUS OF REORGANIZATION PLAN

Since filing the Trustees' eighth annual Report, the most significant developments relating to a plan of reorganization for the Debtor have been opinions of this Court on May 28 and July 28, 1969 and of the three-judge court in the Southern District of New York on June 18, 1969.

DECISION OF REORGANIZATION COURT ON PLAN OF REORGANIZATION

In its Memorandum of Decision, dated July 28, 1969, this Court considered the distributive portion (or second step) of the Reorganization Plan, as set forth in the Commission's Fourth Supplemental Report and Order, dated November 25, 1968. In addition, the Court considered the form of order which it should enter with respect to the price which Penn Central should pay for the New Haven's assets (the first step of the Reorganization Plan). In its Order dated July 28, 1969, this Court provided that Penn Central pay the New Haven \$29,035,899 in addition to the consideration which was received by the Trustees from Penn Central on December 31, 1968. The Court remanded the Plan to the Commission until the issue of price to be paid by Penn Central is finally judicially determined and stated that the Commission should reconsider the Plan at that time from the standpoint of determining how any additional consideration, that may be finally required, is to be paid by Penn Central and whether any modification in the structure of the Plan would be necessary. In addition, the Court provided that the stock of Penn Central received as

consideration for the sale would have the benefit of an "underwriting" by Penn Central so as to insure that between the date of final consummation of the Plan and February 1, 1978, the Estate would have the opportunity to receive in cash the \$83.1 million of the purchase price represented by the shares already received. The Court set forth various other provisions dealing with its intent in this regard.

With respect to the second step of the Reorganization Plan, the Court concluded that the disparity between the price which it found was required to be paid by Penn Central and the price found by the three-judge court, hereinafter summarized, made it unfeasible for the Reorganization Plan then to be approved. With respect to specific terms of the Reorganization Plan, the Court provided that Class A and Class B claims should be paid in cash; that pre-reorganization secured tax claims are entitled to interest only to July 7, 1961; that Class J claims (the First and Refunding Mortgage Bonds) are entitled to receive common stock (rather than warrants) of the reorganized company in discharge of claims for accrued interest; that Class K claims (General Income Mortgage Bonds) are entitled to payment of their contingent interest accrued for the years 1957, 1958 and 1959 in the same manner as provided for payment of principal; and that the Plan should provide for the settlement and liquidation of claims other than as set forth in the Plan, if so approved by the Reorganization Court, up to the time of consummation or any prior date fixed by the Commission.

The Commission and Penn Central subsequently appealed this Court's order of July 28, 1969, insofar as it dealt with the first step of the Plan, to the Court of Appeals for the Second Circuit. Appeals were also taken by Manufacturers Hanover Trust Company, as Trustee under the First and Refunding Mortgage, The Chase Manhattan Bank, N.A., as Trustee under the General Income Mortgage, and the First Mortgage 4% Bondholders Committee.

OTHER APPEALS FROM THE DECISIONS OF THE REORGANIZATION COURT

Apart from the five appeals from this Court's order of July 28, 1969, above referred to, there are also six other appeals pending in the Court of Appeals for the Second Circuit taken from this Court's Order dated August 10, 1968 (and entered August 13, 1968) in connection with the First Step of the Plan of Reorganization certified to this Court by the Commission in accordance with its Report and Order dated November 16, 1967. The appellants in these cases are Manufacturers Hanover Trust Company, The Chase Manhattan Bank, N.A., the First Mortgage 4% Bondholders Committee, Oscar Gruss & Son, United States Trust Company of New York, as Trustee under the New Haven's Harlem River Division Indenture, and Penn Central.

There are two additional appeals pending in the Court of Appeals for the Second Circuit from this Court's Order No. 559 dated and entered December 24, 1968, taken by Penn Central and P&W. This was the order pursuant to which the Trustees conveyed the New Haven's properties to Penn Central on December 31, 1968.

In addition, there are three appeals pending in the Court of Appeals for the Second Circuit which relate to the determination of this Court with respect to the treatment of Grand Central Terminal excess income for the years 1967 and 1968. As previously noted, by Order No. 572 and Supplemental Order No. 572, this Court ordered Penn Central to pay the Trustees in cash \$3.38 million, representing one-half of the excess income earned by the Grand Central Terminal properties in those years. Penn Central has taken separate appeals from Order No. 572 and Supplemental Order No. 572, and the First Mortgage 4% Bondholders Committee has appealed Supplemental Order No. 572, essentially as to claims for interest on the sum awarded.

Thus, there are now pending in the Court of Appeals for the Second Circuit sixteen appeals from various orders of this Court in proceedings dealing with the Reorganization Plan (treating the Commission and the United States as a single

party in the case of their appeal from the July 28, 1969 Order). By order dated October 7, 1969, all the above described appeals have been consolidated, except for the "issues relating to that portion of the plan of reorganization which involves the internal reorganization of the New Haven including the rights of creditors *inter se*". The appeals relating to these latter issues have been separately consolidated. Such consolidation on the basis of issues correlates that part of the litigation before the Court of Appeals involving price with the appellate litigation in connection with the decision of the three-judge court next discussed.

DECISION OF THREE-JUDGE COURT ON CONSIDERATION FOR NEW HAVEN'S ASSETS

In an opinion dated June 18, 1969, a three-judge court in the Southern District of New York determined the litigation brought by the First Mortgage 4% Bondholders Committee, The Chase Manhattan Bank, N.A., Manufacturers Hanover Trust Company, and Oscar Gruss & Son to review the Commission's Fourth Supplemental Report. These actions were wholly related to the Commission's findings under Section 5 (the merger section) of the Interstate Commerce Act with respect to the consideration to be paid by Penn Central for the New Haven's assets. In a decree dated September 11, 1969, the court provided that Penn Central increase the consideration theretofore paid to the New Haven by \$990,000 in the manner set forth in the Fifth Supplemental Report on Reconsideration, dated August 26, 1969, of the Commission. That Report provided that Penn Central deliver to the Trustee 6,460 shares of Penn Central stock, \$425,799 principal amount of the Penn Central 5% Divisional First Mortgage Bonds and \$54,450 in cash. The court also provided that the New Haven would have the right to dividends on such stock and interest on such bonds from December 31, 1968 and interest on the cash from that date at the rate of 6%.

In addition, the court concurred with this Court in requiring Penn Central to pay the Trustee \$3.38 million in cash on account of the Grand Central Terminal excess income for the years

1967 and 1968, confirming the Commission's findings to the same effect in the Fifth Supplemental Report on Reconsideration. As above noted, however, Penn Central has appealed to the Court of Appeals from this Court's order in that regard.

With respect to the so-called "underwriting" of the Penn Central stock at \$87.50 per share, the three-judge court adopted the same approach as this Court and went on to make findings with respect to detailed provisions thereof on matters adverted to by the Commission in its Fifth Supplemental Report on Reconsideration.

Appeals have been taken to the Supreme Court of the United States from the September 11, 1969 order of the three-judge court by Manufacturers Hanover Trust Company, The Chase Manhattan Bank, N.A., and the First Mortgage 4% Bondholders Committee. As above noted, P&W has taken an appeal to the Supreme Court from an earlier order dated April 28, 1969, in the same three-judge court proceedings with respect to the issues related solely to P&W.

STATUS OF PENDING LITIGATION

Insofar as the first step of the Reorganization Plan is concerned, issues determined by the three-judge court find a parallel, but essentially different result in this Court's July 28, 1969 Order. Thus, to a very large extent, the sixteen appeals now on file in the Court of Appeals for the Second Circuit and the three appeals from the Order, dated September 11, 1969, of the three-judge court involve common questions. As above noted, the appeals pending before the Court of Appeals have been consolidated into two distinct appeals so as to separate the issues under the first step from issues under the second step. It has been indicated that one or more of the parties intends to seek *certiorari* from the United States Supreme Court in advance of judgment by the Court of Appeals. If granted, it would insure that the first step issues raised in the various appeals from this Court's orders would reach the Supreme Court substantially concurrently with those raised by the

order of the three-judge court, which has been directly appealed to the Supreme Court. Even if *certiorari* is not so granted, it is possible that the Supreme Court may defer argument in the appeals from the three-judge court until the Court of Appeals has rendered a decision on the appeals from this Court's decision.

IV.

FACTORS CURRENTLY AFFECTING COMPLETION OF THE REORGANIZATION

Presently, there are two sets of factors which affect the reorganization. The first is continuance of the litigation heretofore summarized which it seems certain will not be resolved short of a Supreme Court determination. Apart from the litigation, but dependent in great measure upon its results and the time required for its disposition, there are a number of other matters which affect the value of the Estate and the claims of particular persons which will require constant review and which could involve changes in prior conclusions.

It is generally difficult to estimate the length of litigation, but the complexity and difficulty of the issues involved in this reorganization make such an estimate particularly difficult. The consideration issues involve a range of findings which could produce additional consideration of as much as some \$28 million, assuming that the range is confined solely to the difference between the opinions of the respective courts which have now passed upon these issues. Absent a settlement, it would appear that the litigation cannot reasonably be expected to be fully resolved before the middle of 1970, and it may well be that an additional period of as much as a year or more beyond that time would be required. This period is of great significance for persons interested in the Estate because, until such final determination, the Commission cannot make the review and determinations required by this Court's remand of July 28, 1969. Thus, it appears unlikely that this Court could receive a further certification of the Plan of Reorganization from the Commission before the fall of 1970. Recognizing

the procedures following certification that would be required, including notice and hearing by this Court before it could approve the Plan and then the voting, confirmation and consummation procedures set forth in the Bankruptcy Act, I have concluded for purposes of planning the functioning and staffing of the Estate that, even if there are no appeals, the reorganization probably will not be consummated earlier than the end of 1971. In fact, it may be more realistic to assume that termination of the reorganization will not occur until a much later date.

With respect to the effect of the July 28, 1969 Memorandum and Order of this Court on the Plan's second step, there are a number of important points to be noted. Under that Order, Class A and Class B claims estimated at approximately \$17.5 million, which were to be discharged by issues of notes, are now required to be paid in cash. Further, as above indicated, I have authorized counsel to explore the possibility of settling various of the deferred taxes in cash. In addition, I have been actively settling in cash accrued per diem claims and tort claims, each of which would be discharged under the Plan by the use of notes. Such use of cash, in the case of tax claims and per diem claims, in particular, is desirable for the benefits which it may produce for the Estate when priority claims are discharged at a discount. It is advantageous not only from the viewpoint of the Estate but also for the claimant for whom cash in hand in an amount less than his claim may be as valuable as the full amount of his claim at a much later date. At the same time, however, such cash as is now available is invested in high yield, short-term securities of a prime nature. If the total cash requirements for all the purposes enumerated were to be met in a short time, the cash now available to the Estate would be exceeded. This would make necessary either a sale of Penn Central securities or new borrowings, possibly collateralized by such securities. While the Estate's cash flow has thus far been adequate, it depends primarily upon the rate of the dividend on Penn Central stock.

The market price of the Penn Central stock in the period covered by this Report and up to the date of this writing has declined substantially more than the stock market as a whole, based upon general averages. The circumstances of the acquisition of the shares presently held, including the litigation and the theory of the purchase price requiring the consideration to be partially in the form of such shares, have seemed to me to make it necessary to continue to hold such shares at this time notwithstanding the decline in the market. Sale of any substantial amount of the shares would constitute a frustration of the Plan which this Court has approved in principle. The so-called underwriting, which is now embodied in the opinions of both Courts as well as having received specific acceptance by the Commission, support the concepts employed in the Plan, wholly apart from interim stock market fluctuation.

With respect to the claims against the Estate, the September 30, 1969 balance sheet reflected book liabilities which, pursuant to this Court's opinion of July 28, 1969, and the steps taken by the Trustees in the administration of the Estate, may be substantially reduced. These include the following: personal injury and property damage claims, for which there were reserves at that date of \$10,174,022, are presently estimated to require payments of approximately \$8 million; deferred real estate taxes, which at that date were shown as nearly \$30 million, have been reduced as claims in reorganization by this Court's opinion of July 28, 1969 to a total of \$25,758,614; the liability for unsettled per diem, which is reflected on the September 30, 1969 balance sheet in the total amount of \$23,696,253, is now recognized to be entitled to participate in the bankruptcy in the amount of \$14,173,237; a September 30, 1969 balance sheet liability of \$5,161,921 on account of pre-bankruptcy vouchers payable represents claims of general creditors found by this Court in the July 28, 1969 opinion not to have any equity; interest in default, which is included in the September 30, 1969 balance sheet at \$27,610,027, has a total claim, as provided by this Court's opinion of July 28, 1969, of \$24,326,000; and unsecured debt in default, which is reflected in the

September 30, 1969 balance sheet in the total amount of \$13,346, 844, has, in accordance with this Court's findings of July 28, 1969, no equity.

In addition to the adjustments in the value of the Estate which these items would entail, I expect that the Estate will continue to be able to make settlements of unpaid post-bankruptcy per diem on a favorable basis which would further reduce the adjusted per diem obligation downward from \$14,173,-237.⁷ I am also hopeful that negotiations with taxing authorities can produce a reasonable settlement for the Estate which the authorities will find advantageous.

It seems to me that the concept of the Reorganization Plan as approved by this Court remains sound. This Court has specifically provided that such provisions should be further reviewed by the Commission at the time that the litigation concerning the price to be paid by Penn Central has been finally resolved. I intend to continue to review the impact of all matters upon the distributive provisions of the Reorganization Plan as they come to pass and to bring them to public attention through semi-annual reports or special reports, if that should appear appropriate, to this Court. The September 30, 1969 financial statements are attached.

Respectfully submitted,
RICHARD JOYCE SMITH, *Trustee*

Dated : October 23, 1969

JAMES WM. MOORE, *Counsel for Trustee*

SULLIVAN & WORCESTER, *of Counsel*

⁷By virtue of the settlements approved subsequent to September 30, 1969, unpaid post-bankruptcy per diem has now been reduced to \$12,880,224.

THE NEW YORK, NEW HAVEN AND

BALANCE SHEET—

ASSETS**Current Assets:**

Cash	\$	925,581	
Temporary cash investments.....		5,276,317	
Special deposits		152,117	
Miscellaneous accounts receivable.....		10,042	
Accrued interest receivable.....		422,385	
Accrued accounts receivable.....		758,940	(B)
Working funds		22,300	
Other		60,675	
		<u>7,628,357</u>	

Funds on Deposit:

U. S. District Court.....	\$	4,415,250	
Mortgage Trustees		498,019	4,913,269

Investments, at Interstate Commerce**Commission valuation:**

Penn Central Company:

950,116 shares of capital stock at \$87½ per share.....	83,135,150	
\$33,600,000 principal amount of 5% Divisional First Mortgage Bonds due January 1, 1994.....	29,200,000	112,335,150

Other Assets:

Interline freight withheld by foreign railroads	1,584,576	
Recollectible costs (insurance claims).....	109,400	1,693,976
Additional consideration receivable from Penn Central.....		990,000(C)
Improvements to leased line (disaffirmed)— net of accumulated depreciation of \$1,478,710.....		1,984,339
		<u>\$129,545,091</u>

(B) Represents net balance receivable from Penn Central for one-half share of the excess income from Grand Central Terminal properties for the years 1967 and 1968, over Section 7 post-closing settlement amount payable, as provided in Court order 572 dated July 1, 1969. This order is under appeal by Penn Central.

(C) Pursuant to Order of the Interstate Commerce Commission approved by decree of the Three Judge Court on September 11, 1969. As part of this additional consideration 6,460 shares of Penn Central stock valued at \$87.50 per share has been delivered subject to its return in the event the decree is not sustained.

The Reorganization Court by its Memorandum of May 28, 1969 and Order of July 28, 1969 set a price approximately \$28,000,000 more than the aforesaid figure of \$990,000.

HARTFORD RAILROAD COMPANY

SEPTEMBER 30, 1969

LIABILITIES AND CAPITAL DEFICIT**Current Liabilities:**

Current portion of injury and damage reserves.....	\$	1,551,000	
Accrued interest payable.....		61,250	
Accrued fees—Consultants, Legal, etc.		178,430	
Other accounts payable and accrued liabilities.....		234,639	
			<u>2,025,319</u>

Long-Term Debt:

Trustees' certificates		12,500,000	
Debt in default:			
4% mortgage bonds due July 1, 2007.....	\$76,819,900		
4½% income bonds due July 1, 2022.....	52,755,500		
Other loans (U. S. Government).....	12,372,100		
Disaffirmed conditional sale agreements.....	974,744	142,922,244	
			<u>142,922,244</u>

Injury and damage reserves..... 6,475,930

Other Liabilities:

Real estate taxes deferred by Court order.....	29,995,209		
Interest in default.....	27,610,027		
Unsettled per diem charges.....	23,696,253		
Accrued contingent interest.....	7,121,992		
Pre-bankruptcy material and other vouchers payable	5,161,921		
Liabilities relating to leased line (disaffirmed).....	1,592,550		
Other	2,712,617	97,890,569	
			<u>97,890,569</u>

Capital deficit (net of capital stock of \$156,461,941)..... (A) (132,268,971)

\$129,545,091

(A) The Interstate Commerce Commission in its order of November 25, 1968 and the United States District Court for the District of Connecticut in its order of December 24, 1968 found that the holders of The New York, New Haven and Hartford Railroad Company's preferred stock, common stock and certificates of beneficial interest have no equity in the estate.

THE NEW YORK, NEW HAVEN AND HARTFORD
RAILROAD COMPANY

STATEMENT OF INCOME

For the nine months ended September 30, 1969

INCOME:

Interest:			
Penn Central bonds.....	\$1,260,000		
Investments of funds on deposit with			
U. S. District Court.....	298,720		
Temporary cash investments.....	308,043		
Other	22,908	\$	1,889,671
Dividends on Penn Central stock.....			1,710,209
Miscellaneous			25,516
			<u>3,625,396</u>

EXPENSES:

Compensation:			
Trustees	44,433		
Counsel for Trustees.....	18,871		
Trustees' employees	127,812		
Payroll taxes	8,953		200,069
Interest on Trustees' Certificates.....			492,188
Attorneys, consultants, etc.			171,739
Services of Penn Central employees.....			116,842
Special Master—Judge Van Voorhis.....			25,000
Miscellaneous			38,907
			<u>1,044,745</u>

Net Income		\$	2,580,651
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STATEMENT OF CAPITAL DEFICIT

Nine months ended September 30, 1969

Balance, January 1, 1969 (net of capital stock).....	(\$142,166,994)
Net income since December 31, 1968.....	2,580,651
Other credits:	
Condemnation proceeds	81,701
Grand Central Terminal Excess Income—	
years 1967 and 1968.....	3,377,903
Additional consideration receivable from Penn Central.....	990,000
Excess of Per Diem accruals over settlements.....	3,162,214
Miscellaneous items	50,660
Other debits:	
Arbitrators' decision of Section 7 settlement dispute.....	(179,140)
Settlement of disaffirmed tug boat leases.....	(165,966)
Capital deficit at September 30, 1969.....	<u>(\$132,268,971)</u>