BOSTON AND MAINE CORPORATION

134th ANNUAL REPORT 1966

Boston and Maine Corporation

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Executive Committee—Chairman: MR. STACK; Vice Chairman: MR. RESNIC; Members: MESSRS. CATALDO, COHEN, LERVICK, MULHERN, PICKARD and REARDON

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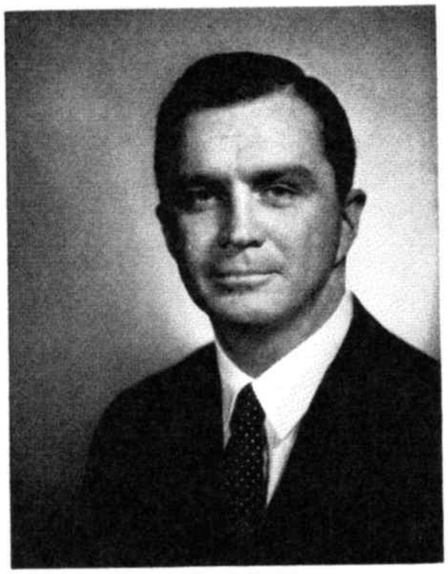
RICHARD J. MULHERN, President and Chief Executive Officer
RALPH W. PICKARD, First Vice President
WILFRED H. HOLLAND, Vice President-Operations
RICHARD J. SULLIVAN, Vice President-Traffic
WILLIAM A. KIRK, Vice President-Industrial Development
WHITCOMB HAYNES, General Manager
PAUL C. DUNN, Assistant Vice President-Equipment
CHARLES F. YARDLEY, General Manager-Piggyback
THOROLD S. CURTIS, Treasurer
JOHN J. NEE, General Attorney
W. FREDERICK WILSON, Assistant to the President
HARRY BLAKE, Secretary

TRANSFER AGENTS

Old Colony Trust Company, 45 Milk Street, Boston, Mass.
Manufacturers Hanover Trust Company, One Whitehall Street, New York, N. Y.

As of March 6, 1967



RICHARD J. MULHERN

President's Report

This Annual Report is being submitted to the Stockholders of the Boston and Maine Corporation by a Management that took office late in November, 1966.

The executive and supervisory structure of the Corporation is currently being surveyed so that every available opportunity for improving and streamlining the Railroad's performance—department by department—will be fully and vigorously pursued. Management's goals for the coming year have been clearly defined, are thoroughly understood by all departments and are being aggressively carried out, as will be noted in the ensuing sections of this Report.

For the year as a whole, the financial results of the Boston and Maine were significantly affected by extraordinary items that merit the particular attention of our Stockholders. For the 12-month period ending December 31, 1966, the consolidated net loss of the Corporation and its consolidated subsidiaries was $1,701,704. The major factors contributing to this figure were:

- A $700,000 settlement of the Mystic Terminal Company leases that will relieve the Boston and Maine from rental obligations of $1,200,000 and ancillary costs of another $200,000 for maintenance, insurance and other items, an aggregate of $1,400,000, or a net saving of $700,000. The leases, running to 1972 in one case and 1975 in the other, had been entered into by a prior management of the Boston and Maine in the year 1948. They were burdening the Mystic Terminal Company with annual operating losses of about $120,000. The settlement, recently concluded by your Management, will be payable in six annual installments. Rail freight business handled at the Mystic pier will be preserved. The $700,000 cost of the settlement has been reflected as an extraordinary charge against income in 1966, with the result that the Corporation's income in 1967, and income for each year thereafter, will reflect the benefit from elimination of the Mystic Terminal Company net loss of about $120,000 annually.

• Expenses of $478,000 principally in connection with merger proceedings relative to the Boston and Maine's application for inclusion in the Norfolk and Western system. Because of its crucial importance to the interests of B&M Stockholders, the status of these proceedings is dealt with at considerable length later in this Report.

• A decline of some $400,000 in revenues derived from potato traffic because of price and market conditions that drastically affected shipper decisions both as to the volume and timing of potato shipments. A marked recovery in potato movements is anticipated in the early days of 1967.

In 1966, too, the Boston and Maine had to assume heavy additional costs as a result of national wage and fringe benefit settlements. Substantial portions of these expenses were offset in 1966 by increased attention to budget controls. A major goal for 1967, now being given special emphasis, is a further cost control program, compatible with maintenance of the railroad at maximum efficiency, that will compensate for these increases, together with additional increases effective at the beginning of 1967.

In late 1966 and the first weeks of 1967, your Management brought to a successful conclusion efforts aimed at total elimination of losses from passenger service. The details are reviewed elsewhere in this Report.

B&M's contract with the Massachusetts Bay Transportation Authority was due to expire December 31, 1967. As this Report was being prepared, the Massachusetts legislature appropriated $5,000,000 to continue support of rail service through June 30, 1968. A portion of this appropriation will be applied to continuation of the Boston and Maine's commuter service.

To assure that the B&M is fully reimbursed for passenger service provided under the MBTA contract, your Management recently completed negotiations with the Authority to compensate for increases in operating costs. These adjustments will be reflected in the extension of the contract through the first half of 1968 so that passenger service for the account of the MBTA will remain fully compensatory to the Boston and Maine.

Extensive changes have been introduced in the direction and structure of the Traffic Department. Freight sales offices in B&M's principal market areas have come under the supervision of tested, successful younger men who have come up through the B&M ranks, who enjoy the confidence of B&M's present customers and have the drive and know-how needed to meet Management's goals of new business development.

This team is being directed by aggressive marketing-oriented leadership. The department is conducting an extensive and continuing direct mail promotion campaign. A companion effort, involving widespread distribution of specially designed sales promotion materials, is under way by the Piggyback Department.

Initial results of these efforts have been gratifyingly evident at the close of 1966 and the beginning of 1967.

Your Management believes it important to note the contributions of the Industrial Development Department to rail-borne traffic.

In 1965, this Department estimated that its land sales program for that year would result in new or increased traffic for the Boston and Maine amounting to 8,015 cars in 1966. We are pleased to report that actual 1966 results showed a gain of 7,950 cars for such traffic, realizing more than 99% of the predicted increase.

Continuing and substantial progress was made in 1966 in reaching settlements with other railroads on disputed liabilities for freight car rentals. The results are contained in this Report.

Further improvement in the Corporation's working capital position was achieved in 1966. With minor exceptions, past due trade bills were substantially eliminated at the end of 1966.

Past due real estate taxes at the end of 1966 amounted to approximately $3,100,000. Your Management has begun negotiations with municipal officials with a view towards achieving tax settlements on terms comparable to the favorable results obtained in 1965.

Long-term debt continued in 1966 the marked reduction evident in recent years, with the result that fixed charges were further reduced. A net reduction of approximately $4,700,000 of debt was achieved in the past year.

There follows a review of developments of the past year and comment on the outlook for the coming year:

MERGER PROCEEDINGS

Hearings on the Boston and Maine's application for inclusion in the Norfolk and Western system began on April 20, 1966. One week later, on April 27, the Interstate Commerce Commission issued an Order approving the merger of the Pennsylvania and New York Central Railroads. Two provisions of this Order, in particular, had a direct and very important bearing on the Boston and Maine's position in the Eastern railroad merger movement.

The Commission ruled that if inclusion of the Boston and Maine could not be accomplished on terms fair and equitable to the parties, B&M would have a period of one year to seek inclusion in the Penn-Central system. The Commission also provided that B&M was to be afforded the benefit of certain protective traffic conditions and to be indemnified for any losses of freight revenue below a specified level from the time the Penn-Central merger took effect until a final determination was reached in B&M's application for inclusion in N&W. In subsequent proceedings, B&M has sought improvement in the protective and indemnification conditions and a decision by the Commission is pending.

Presentation of the B&M's case for inclusion in N&W ended on August 10, 1966. Meanwhile, consummation of the Penn-Central merger had begun to encounter delays. The ICC Order was challenged in the Federal Courts and ultimately came before the Supreme Court of the United States.

On December 22, 1966, a report in the B&M case for inclusion in N&W was issued by Commissioner Charles A. Webb, who had presided over the hearings. The report recommended that N&W be authorized, but not directed, to include B&M in the N&W system. The report also recommended financial terms that should apply in the event N&W elected to include B&M in its system.

Commissioner Webb's conclusions and recommendations will be the subject of final argument by B&M and other parties on April 13, 1967, before the full Interstate Commerce Commission. Thereafter, the Commission will make its final determination in the case and is expected to issue its Order later in the year.

B&M's Management has stated emphatically that Commissioner Webb's recommendations have failed to take adequate or realistic account of the contributions B&M can make to the N&W system. As for the recommended financial terms, they parallel the share exchange ratios outlined by the Norfolk and Western and Chesapeake and Ohio Railroads in their proposal for merger and establishment of a subsidiary to be known as "Dereco," which would accept B&M and other railroads under certain carefully qualified conditions. The "Dereco" proposal was flatly rejected by the prior B&M Management. Now, as your President, I want to make it absolutely clear that your present Management is unalterably opposed to the "Dereco" proposal as first announced by the N&W and the C&O, and you—the owners of this Corporation—are so advised.

Commissioner Webb's findings were qualified by recognition that B&M has a greater value to other railroad systems than it would have to N&W alone. Accordingly, in Exceptions filed with the Interstate Commerce Commission on February 28, 1967, B&M urged prompt action by the Interstate Commerce Commission to either:

- direct B&M's inclusion in the present N&W system in accordance with terms that are fair and equitable, or, if this cannot be accomplished
- free B&M to move at once for inclusion in another system.

In these Exceptions, your Management stressed that if B&M were given adequate credit for the contributions it can make to the existing N&W system then the ICC could properly direct N&W to include B&M at the exchange ratio proposed in the B&M petition for inclusion in N&W.

Your Management believes it important to recall to the Stockholders that the terms referred to in the foregoing paragraph called for B&M Stockholders to receive .41849 shares of N&W common for each share of B&M common.

No issue is of greater importance to your investment in Boston and Maine than the efforts of your Management to achieve inclusion in a major Eastern railroad system on terms that will fully protect your interests. This objective will be pursued aggressively and with every means at our disposal, and this Management will see to it that the Stockholders are kept informed of all important developments affecting their interests.

FREIGHT SERVICE

Consolidated freight revenues in 1966 were $53,805,000, an increase of $242,000 over 1965. Gains were achieved despite a walkout by the Brotherhood of Locomotive Firemen and Enginemen from March 31 to April 4, 1966.

The improvement in freight income resulted from increased emphasis on the use of advanced marketing techniques to expand existing business and attract new customers to the Railroad.

Forecasts of economic trends in the New England area served by the Boston and Maine point to encouraging increases in demands for materials and products that can best be moved by rail. A summary of current and future economic prospects, issued in August, 1966, by the Federal Reserve Bank of Boston, noted that "Construction of highways, new homes, commercial and industrial buildings and urban renewal projects is on the rise in New England, generating demand for all types of construction materials and equipment."

The activity predicted last summer is now under way and is showing a pattern of vigorous and continuing growth. The Boston and Maine is participating in substantial movements of building materials and further increases are expected as construction activity rises and the results of aggressive Traffic Department sales programs are realized.

Additionally encouraging factors for the year ahead are these:

- National per capita consumption of paper products continues to rise and has stimulated a continuing expansion of the paper industry in New England. This growth is taking place on the lines of the Boston and Maine's connections. It is also in evidence in plants served directly by the B&M. The results, as a whole, are being reflected in both increased inbound movements of raw materials and outbound movements of finished products.
- Plant expansion of the Public Service Company of New Hampshire at Bow, N. H., is proceeding on schedule. Geared to continuing use of coal, the expanded facilities are expected to consume an additional 750,000 tons of bituminous coal. This utility has been served by Boston and Maine movements of unit trains. To meet the plant's increased needs, B&M expects to begin additional movements of shuttle-type unit trains in September, 1967.
- Expanding markets for plastic products are being reflected in the growth of production facilities in Boston and Maine territory in New England. The Railroad is hauling both inbound shipments of raw materials and outbound movements of finished products.

• Potato traffic, which showed unusual declines in 1966 because of decisions by shippers to hold back shipments until more favorable market and pricing conditions could materialize, is expected to show substantial recovery in the year ahead.

PIGGYBACK SERVICE

Trailer-on-flat-car volume and revenue maintained in 1966 the growth trend that has marked this service since its inception on the Boston and Maine, as shown in the following table:

Year	*B&M Gross Piggyback Revenue*
1966	$3,421,000
1965	3,090,000*
1964	2,651,000*
1963	2,238,000*
1962	1,928,000*

*Does not include new automobiles handled for American Motors in Plan I piggyback service. Because of a decision to revise its New England distribution procedures, American Motors re-located a distribution facility that had been directly served by B&M Plan I piggyback.

B&M is the only railroad in New England that offers all of the basic piggyback methods and plans to its customers, affording a selection, in terms of economy and service, of various means by which freight can be moved in complete door-to-door service. The range of these services was an important factor in enabling B&M to absorb the loss of the American Motors business and continue the growth trend of prior years.

PER DIEM

Because the Boston and Maine terminates more than three cars of freight for every one car it originates, the rentals it is required to pay other railroads whose freight cars move on the B&M have always made up one of the most substantial items of expense in its operations.

Since 1953, B&M has been in litigation with other railroads as to the levels of car rental costs. As noted in the Annual Report for 1965, B&M in that year made its first significant gains in this vitally important area through successful negotiation of compromise settlements resulting in a net reduction of more than $516,000 in amounts claimed from the B&M by other roads.

Your Management is gratified to report that this trend continued on an accelerated scale in 1966, with a net reduction of $575,000 in amounts claimed by other railroads. It is additionally encouraging to report continuing successes in the reduction of these claims in 1967, with settlements up to this point having effected further net savings of more than $400,000.

PASSENGER OPERATIONS

During 1966 steps were taken to eliminate remaining segments of passenger service operated by the Boston and Maine outside the fully compensatory contract with the Massachusetts Bay Transportation Authority.

The Interstate Commerce Commission approved a B&M petition for discontinuance of four trains operating on the Connecticut River line between Springfield, Mass., and White River Junction, Vt. The ICC Order was contested in the Courts by the State of Vermont, but the B&M petition was sustained and the trains were discontinued on September 4,

1966. After reconsideration by the ICC, the authority for discontinuance of the service was reaffirmed and a final Order to that effect was issued February 3, 1967. This successful effort by the B&M will result in an annual saving of $185,000.

A net saving of $20,000 annually will result from a successful application to discontinue operation of passenger service between Greenfield and Springfield, Mass.

In another proceeding, B&M applied to the Massachusetts Department of Public Utilities for permission to discontinue one daily round trip, six days each week, of passenger service between Boston and Newburyport, Mass. The B&M application was approved and will result in a net annual saving of $49,000 to the Railroad.

Under an agreement with the State of New Hampshire, four trains now providing daily round trip service between Boston, Mass., and the cities of Concord and Dover in New Hampshire will be discontinued by mid-1967, unless the New Hampshire legislature votes funds to continue the service on a basis that will fully reimburse the B&M.

Accordingly, as of July 1, 1967, except for fully compensatory contract passenger service, the Boston and Maine will become an exclusively freight-carrying railroad.

IMPROVEMENTS

Capital expenditures for road property and equipment in 1966 were $2,372,000.

Twenty new 100-ton covered hopper cars were purchased for feed service, and 45 secondhand 70-ton open-top hopper cars were obtained to augment our fleet of cars in the growing sand and gravel service.

A capital investment of more than $250,000 was made in additional units of work equipment and machinery expected to contribute materially to productivity in the maintenance of track and fixed properties.

Other substantial investments included centralized traffic control permitting the retirement of thirteen miles of second track, a new car repair shop at Boston Engine Terminal, extensive additions to radio communication facilities, and a new engine inspection pit at Mechanicville.

Plant maintenance included resurfacing of 302 single track miles of main line, installation of 3,333 tons of new and relay rail, and 45,800 new and relay cross ties.

INDUSTRIAL DEVELOPMENT

In 1966 construction of new and expanded industrial plants in Boston and Maine territory exceeded earlier expectations, totaling 1,422,000 square feet of building and resulting in the installation of some 23,600 feet of track and 31 connections. These new facilities are expected to produce additional rail movement at the rate of 7,300 cars per year.

The outlook for the coming year appears favorable. Approximately 1,565,000 square feet of buildings are under construction or scheduled for completion during the year. Plants programmed for completion in 1967 are expected to increase rail volume by another 5,000 cars annually.

MBTA

Long range plans of the Massachusetts Bay Transportation Authority call for extension of Boston's rapid transit system over existing lines of the Boston and Maine. To this end, Management has been in negotiation with the MBTA relative to purchase or lease of the requisite sections of the Boston and Maine's right-of-way. Pending completion of appraisals being made by both parties, negotiations have not as yet proceeded to discussion of the financial terms of such a transaction.

MORTGAGE BONDS EXTENSION

Discussions have been initiated with major institutional holders of the Boston and Maine's First Mortgage Bonds, Series TT, in the amount of $46,339,000 due August 1, 1967, with a view towards extension of this maturity.

EMPLOYEE RELATIONS

The year 1966 was marked by a new round of requests from unions representing employees for wage and fringe benefit increases. In settlement of these demands, contracts have been signed on a national basis with representatives of approximately 70 percent of the company's employees. They provide for an increase of 5 percent in wage rates (effective August 12, 1966, for operating personnel, and January 1, 1967, for non-operating employees) and for improvement beginning in 1967 of vacation rules. National negotiations are continuing with representatives of the balance of employees.

In the course of the year the Congress enacted legislation substantially increasing payroll taxes to finance benefits for retiring employees.

A work stoppage, called without warning by the Brotherhood of Locomotive Firemen and Enginemen, suspended all operations of the company and six other railroads from March 31 to April 4, 1966. The issues were national in scope. Appropriate legal action has been instituted for recovery of losses.

LONG-TERM DEBT CHANGES

The Boston and Maine met substantial obligations for equipment and road property in 1966. This resulted in a net reduction in long-term debt of $4,698,065 as reflected in the following table:

Balance at beginning of year	$ 85,726,008
Increases:	
Equipment and Road Property obligations for new acquisitions	174,081
Collateral Note	1,000,000
	86,900,089
Decreases:	
Equipment and Road Property obligations paid	3,213,554
Principal payments made on Collateral Trust Indentures and Collateral Notes	2,480,868
First Mortgage Bonds retired	177,724
	5,872,146
Balance at end of year	81,027,943

A FINAL NOTE

The Boston and Maine Corporation is grateful to all employees for their cooperation during the year.

OPINION OF INDEPENDENT ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF THE
BOSTON AND MAINE CORPORATION

We have examined the balance sheet of the Boston and Maine Corporation and its consolidated subsidiaries at December 31, 1966 and the related statement of income and retained earnings 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.

The company records depreciation of roadway and structures, replacements of rails, ties, etc. and disposition of these assets in accordance with accounting practices prescribed by the Interstate Commerce Commission, as briefly explained in Note 3 of the notes to financial statements. The accumulated reserves for roadways and structures generally have been substantially less than the related costs of those properties which have been disposed of in prior years. The deficiency of these reserves, the amount of which is presently indeterminable, has been increased by the fact that the reserves which have been provided have been substantially reduced or, for certain classes of assets, eliminated entirely by charges for losses on retirements which have been unusually large in recent years. We have concluded that the railroad's reserves are inadequate and that neither the depreciation accounting method nor the replacement accounting method, described in Note 3, provide for, or would have provided for, the retirement losses or obsolescence of the magnitude experienced by this railroad.

In our opinion, except for the inadequacy of reserves and provisions for depreciation and obsolescence, discussed in the preceding paragraph, the financial statements referred to above present fairly the financial position of the Boston and Maine Corporation and its consolidated subsidiaries at December 31, 1966 and the results of their operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year after giving retroactive effect to the restatement, which we approve, of the transactions described in Note 1 of the notes to financial statements.

PRICE WATERHOUSE & CO.

Boston, Massachusetts
March 3, 1967

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES

STATEMENT OF INCOME AND RETAINED EARNINGS (Note 1)

	Year ended December 31 1966	1965
OPERATING REVENUES:		
Freight	$ 53,804,961	$ 53,562,697
Passenger	4,082,652	4,046,463
Other (including passenger service contract payments—$2,932,917 in 1966, $3,072,764 in 1965) (Note 11)	6,186,423	7,216,635
	64,074,036	64,825,795
OPERATING EXPENSES:		
Transportation	28,674,249	28,166,703
Maintenance of way and structures	8,491,951	8,039,559
Maintenance of equipment	9,024,791	8,711,048
Traffic, general and miscellaneous expenses	4,899,171	4,892,827
	51,090,162	49,810,137
NET REVENUE FROM OPERATIONS	12,983,874	15,015,658
OTHER OPERATING CHARGES:		
Payroll, property and state excise taxes, etc.	4,832,742	4,912,491
Net rents for equipment and joint facilities (Note 8)	5,283,450	5,441,212
	10,116,192	10,353,703
OPERATING INCOME	2,867,682	4,661,955
NONOPERATING INCOME (EXPENSE), NET—including net gain on recurring disposals of land, $384,970 in 1966 and $113,606 in 1965	680,557	(133,315)
INCOME (LOSS) BEFORE FIXED CHARGES, CONTINGENT INTEREST AND EXTRAORDINARY ITEMS	3,548,239	4,528,640
FIXED CHARGES:		
Rent for leased lines, etc.	450,609	452,374
Interest:		
First mortgage bonds	2,786,601	2,765,262
Equipment trust certificates	323,485	386,095
Conditional sale contracts	267,714	362,505
Guaranteed notes and other	325,546	364,980
Amortization of long-term debt expense	237,884	156,115
	4,391,839	4,487,331
INCOME (LOSS) BEFORE CONTINGENT INTEREST AND EXTRAORDINARY ITEMS	(843,600)	41,309
CONTINGENT INTEREST	748,140	748,140
LOSS BEFORE EXTRAORDINARY ITEMS	(1,591,740)	(706,831)
EXTRAORDINARY ITEMS:		
Net gain on disposal of Yard 9 land in 1966, North Station land in 1965	493,077	1,495,242
Merger proceeding expenses (Note 4)	(478,306)	(58,826)
Settlement of disputed per diem charges, less related legal fees (Note 8)	575,265	516,309
Mystic Terminal lease settlement (Note 5)	(700,000)	—
Abatement of property taxes and related interest	—	678,338
	(109,964)	2,631,063
NET INCOME (LOSS)	(1,701,704)	1,924,232
RETAINED EARNINGS AT BEGINNING OF YEAR	4,335,570	2,411,338
RETAINED EARNINGS AT END OF YEAR	$ 2,633,866	$ 4,335,570

ASSETS

	December 31 1966	December 31 1965
CURRENT ASSETS:		
Cash	$ 2,914,093	$ 2,154,309
Marketable securities, at cost (approximate market)	1,105,627	1,131,557
Special deposits	181,550	794,544
Accounts and notes receivable	5,636,296	4,951,410
Inventories of materials and supplies, at cost or less	2,813,438	3,111,952
Prepayments and other current assets	386,813	425,644
TOTAL CURRENT ASSETS	13,037,817	12,569,416
PROPERTIES (NOTE 3):		
Roadway and structures, including improvements to leased properties—$13,989,332 in 1966, $14,715,651 in 1965	173,522,256	175,395,035
Equipment	66,372,038	69,716,472
	239,894,294	245,111,507
LESS:		
Depreciation of roadway and structures	(5,741,774)	(5,588,911)
Depreciation of equipment	(26,245,021)	(26,728,342)
	207,907,499	212,794,254
Miscellaneous physical properties, less depreciation—$38,848 in 1966, $112,158 in 1965	3,573,742	3,623,571
	211,481,241	216,417,825
INVESTMENTS AND OTHER ASSETS:		
Investments in leased lines (Page 14 and Note 2)	3,611,790	3,588,349
Other investments (Page 14)	1,247,194	1,372,842
Deposits with trustees for first mortgage bonds and equipment obligations	1,930,293	2,266,104
Other assets and deferred charges	2,395,947	2,840,264
	9,185,224	10,067,559
	$233,704,282	$239,054,800

BALANCE SHEET

LIABILITIES AND CAPITAL

	December 31 1966	December 31 1965
Current liabilities:		
Accounts payable	$ 8,304,156	$ 8,148,857
Accrued vacation pay	1,962,993	1,642,748
Accrued interest	1,401,257	1,407,946
State and local taxes	3,224,261	2,903,342
Estimated current portion of injury and damage claims	1,346,173	1,336,309
Total current liabilities (excluding long-term debt due within one year)	16,238,840	15,439,202
Long-term debt due within one year (Page 14)	3,917,409	5,214,631
Long-term debt (Page 14):		
First mortgage bonds, due in 1967 (Note 6)	46,339,356	46,341,804
Income mortgage bonds	18,703,500	18,703,500
Equipment and other obligations	12,067,678	15,466,073
	77,110,534	80,511,377
Other liabilities and deferred credits:		
Provision for disputed per diem charges (Note 8)	10,946,958	10,849,210
Provision for injury and damage claims	1,091,212	1,186,656
Accrued depreciation on leased property and liabilities to leased lines	3,517,586	4,185,869
Unearned interest accrued on income mortgage bonds	6,733,260	5,985,120
Other	2,419,254	2,386,342
	24,708,270	24,593,197
Capital and retained earnings:		
Capital stock (Note 9):		
5% Preferred stock $100 par value:		
Authorized and issued—152,987 shares in 1966, 179,458 shares in 1965	15,298,700	17,945,800
Common stock, $1 par value:		
Authorized—4,000,000 shares		
Issued—763,679 shares in 1966, 704,518 shares in 1965	763,679	704,518
Additional capital (Note 9)	93,032,984	90,310,505
Retained earnings (Note 10)	2,633,866	4,335,570
	111,729,229	113,296,393
Contingent obligations and commitments (Note 12)		
	$233,704,282	$239,054,800

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES
STATEMENT OF INVESTMENTS IN LEASED LINES
DECEMBER 31, 1966

	No. of shares owned	*% owned*	*Cost*	*Boston and Maine equity in book value of underlying net assets*	*Approximate value based on current market quotations*
Northern Railroad	20,903	68.1	$2,140,898	$2,150,042	$1,567,725
Stony Brook Railroad	1,829	61.0	151,015	192,062	129,859
Vermont & Massachusetts Railroad	11,647	36.5	1,319,877	2,044,566	989,995
			$3,611,790	$4,386,670	$2,687,579

The shares in leased line companies have been acquired over the period from 1937 to 1966. At December 31, 1966 all of the shares were pledged to secure long-term debt. Annual rentals of the leased lines, under long-term leases, amount to approximately $405,000 plus certain federal and state taxes of the leased line companies which currently aggregate about $190,000 per year. Dividends received from the leased line companies amounted to $200,000 in 1966 and 1965. The leased line companies distribute on a current basis substantially all of their net income as dividends. The book value of the underlying net assets of each company has remained approximately the same during the period Boston and Maine has owned shares in the respective companies.

STATEMENT OF LONG-TERM DEBT
DECEMBER 31, 1966

	Portion due	
	Within one year (a)	*After one year (a)*
FIRST MORTGAGE BONDS, Series TT, 6% due August 1, 1967 (b)		$46,339,356
INCOME MORTGAGE BONDS, Series A, 4½% (4% cumulative), due July 1970 (c)		18,703,500
EQUIPMENT AND OTHER OBLIGATIONS:		
Equipment Trust Certificates, Series 1, 4½% to 6% due March 1971 secured by equipment of an aggregate original cost of $22,364,000 ..	$1,234,000(d)	4,935,000
Guaranteed notes 5% due to 1977 secured by $1,752,600 principal amount of Series TT bonds, capital stock of leased lines, capital stock and notes of certain wholly-owned subsidiary companies and "other investments", carried at cost of $128,320	566,667	4,366,666(e)
Conditional sale contracts and mortgage notes maturing at various dates from 1967 to 1990 secured by equipment and real estate of an aggregate original cost of $15,215,000 and "other investments" carried at cost of $715,058	2,116,742	2,766,012(e)
		12,067,678
	$3,917,409	$77,110,534

(a) Amounts outstanding are exclusive of bonds owned by the companies—$1,752,600 of Series TT bonds pledged against guaranteed notes and $559,000 of income mortgage bonds which are unpledged and $1,000 of equipment trust certificates owned by the company.

(b) The first mortgage bonds are secured by substantially all the road properties and equipment of the company, its operating franchises, leases and agreements subject to the prior lien of equipment trust obligations and conditional sale contracts in the case of certain property and equipment as indicated in the statement above. Interest is payable semiannually at the indicated rate. The first mortgage bonds are entitled to the benefit of a sinking fund provision under which the company is required annually on or before May 1, to deposit with the trustee cash equal to the lesser of (a) 1% of the outstanding TT bonds or (b) net income of the railroad before contingent interest minus "net income deficit," as defined, subsequent to 1964. Under the terms of the sinking fund provision no sinking fund deposit is required in 1967. Negotiations for the extension of the maturity of these bonds are described in Note 6.

(c) The income mortgage bonds are secured by a second mortgage on the same properties as those securing the first mortgage bonds. Interest is payable at the rate of 4½% per annum if "available net income" is sufficient and, if not earned, is cumulative and payable not later than the maturity of the bonds at the rate of 4% per annum. The income mortgage bonds are entitled to the benefit of a sinking fund provision under which the company is required annually, on or before September 1, to deposit with the trustee $482,870 in cash or Series A bonds (at the lesser of their principal amount plus accrued interest, or their cost to the company) if "available net income" is sufficient. There has been no sinking fund obligation since 1958.

(d) The same amount matures each year to maturity.

(e) Payable at varying amounts each year to maturity.

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

NOTE 1—PRESENTATION OF CONSOLIDATED STATEMENT OF INCOME

The company is reporting its consolidated statement of income for 1966, and retroactively for 1965, in accordance with the accounting treatment promulgated in Opinion Number 9 of the Accounting Principles Board of the American Institute of Certified Public Accountants. These principles differ in certain respects from those presently required in annual reports to the Interstate Commerce Commission. For this and other reasons, the net loss for 1966 being reported to stockholders may differ from the net loss to be reflected in the parent company's 1966 annual report to the ICC. The transactions in those years that were extraordinary in nature have been set forth separately in the consolidated statement of income.

The following retroactive restatements have been made to adjust the 1965 statement to a basis comparable with 1966:

Net loss, as reported in 1965	($594,711)
Add (deduct) retroactive adjustments:	
Net gain on recurring disposals of land	113,606
Merger proceeding expenses	58,826
Legal fees related to per diem settlements	49,429
Losses on track retirements	(333,981)
Loss before extraordinary items, as restated for 1965	($706,831)

NOTE 2—BASIS OF CONSOLIDATION

The accompanying financial statements include the accounts of Boston and Maine Corporation and those of its wholly-owned subsidiary companies. The company's investments in unconsolidated leased line companies which are less than wholly owned are summarized on page 14.

NOTE 3—PROPERTIES

Amounts reflected for properties largely represent the aggregate of acquisitions and additions (by merger, purchase, construction or otherwise), less retirements, recorded under the system of accounting prescribed by the Interstate Commerce Commission. In accordance with such accounting requirements, the company commenced providing depreciation on roadway and structures, other than rail, ties, ballast and other track materials, on January 1, 1943. Equipment has been systematically depreciated since its acquisition. The recorded cost, less salvage, of all depreciable properties retired or sold is charged to the depreciation reserves. In 1966 this practice resulted in charging to the reserve a net loss of approximately $600,000 incurred upon the retirement of a major property which in accordance with generally accepted accounting principles would have been reflected in the company's consolidated statement of income.

Rails, ties, ballast and other track materials in the amount of approximately $41,300,000 at December 31, 1966 reflect "replacement" accounting, which has been considered an acceptable alternative in the railroad industry to the more widespread practice of depreciation accounting. Under this method replacements in kind are charged to maintenance expense and only improvements and additions are capitalized. The amounts capitalized are not depreciated. Retirements of such properties, less salvage, are also charged to maintenance expense. Until 1966 retirements which were considered abnormal had been charged directly to retained earnings, and gains and losses on disposals of land were credited or charged to retained earnings. In 1966, and retroactively for 1965, such transactions were reflected in the company's consolidated statement of income.

The accompanying statement of income includes charges for depreciation totaling $4,397,000 in 1966 and $4,611,000 in 1965.

NOTE 4—MERGER PROCEEDINGS

Reference is made to page 4 of the company's 1966 annual report to stockholders for a description of various merger possibilities presently being considered. Merger proceeding expenses reflected as an extraordinary charge in the consolidated statement of income are comprised principally of related legal and consulting costs.

NOTE 5—MYSTIC TERMINAL LEASE SETTLEMENT

In early 1967 Mystic Terminal Company, a wholly-owned subsidiary, terminated unprofitable operations at leased facilities. For a settlement of $700,000 to be paid over a six-year period to 1972, the company was relieved of future rental commitments aggregating $1,200,000 and the obligation to maintain the facilities. The $700,000 termination settlement has been reflected as an extraordinary charge in the 1966 consolidated statement of income.

NOTE 6—EXTENSION OF MATURITY OF FIRST MORTGAGE BONDS

The company is currently negotiating for an extension of its 6% Series TT First Mortgage Bonds due August 1, 1967. Under the terms of the indenture, maturity of these bonds may be extended up to July 1, 1970 upon approval of holders of seventy-five per cent of the principal amount of the outstanding bonds.

NOTE 7—FEDERAL INCOME TAXES

As at December 31, 1966, the companies had loss carryovers for federal income tax purposes aggregating approximately $34,000,000 which would be available to apply against taxable income in varying amounts through the year 1973.

NOTE 8—PROVISION FOR DISPUTED PER DIEM CHARGES

The company is party to a dispute with other railroads over per diem rates for freight car rentals. For various reasons, including its situation as a so-called terminal line, the company incurs more rentals than it earns. Since August 1953, payment has been made to other railroads at rates which are less than the rates adopted by the Association of American Railroads, although full provision has been made by charges to income at the latter rates. In 1966 and 1965 the company and several other railroads settled their disputed liabilities of $1,027,279 and $922,124, respectively, which resulted in extraordinary credits, less related legal fees, of $575,265 and $516,309, respectively. Where settlements have been reached they provide that subsequent charges will be settled in full at lower than industry approved rates. The provision for per diem charges relating to open disputes amounted to $10,946,958 as of December 31, 1966. The excess of amounts accrued and related charges to income over payments, exclusive of the above settlements, amounted to $1,125,027 in 1966 and $1,059,008 in 1965.

NOTE 9—CAPITAL STOCK, STOCK OPTIONS AND ADDITIONAL CAPITAL

The 5% preferred stock is redeemable at any time at $100 per share plus accumulated unpaid dividends and is convertible at the option of the holder into common stock at the rate of 1¾ shares of common stock for each share of preferred stock. Additional capital was increased by $2,600,776 in 1966 in connection with the conversion of 26,471 shares of preferred stock into 46,324 shares of common stock.

Dividends on preferred stock, if not paid, are cumulative only if and to the extent (not exceeding 5% per annum) that earnings are available. On this basis there were no cumulative unpaid dividends at December 31, 1966. If earnings are sufficient, the company is required to set aside annually one half of one per cent of the par value of the authorized preferred stock as a sinking fund for redemption of preferred stock, before dividends are paid on the common stock. There was no cumulative sinking fund obligation as at December 31, 1966.

At December 31, 1965 there were outstanding options granted to certain employees to purchase 54,153 shares of common stock of the company at prices ranging from $6.00 to $19.38 per share or an aggregate of $803,000. During the year options for 12,837 shares were exercised. The $121,703 excess of the proceeds over the par value of such shares was credited to additional capital. No options were granted during the year. Options for 10,059 shares were terminated during the year. At December 31, 1966 there were outstanding options to purchase 31,257 shares at $6.00 to $19.38 per share or an aggregate of $507,000, of which options for 8,997 shares were then exercisable at an aggregate of $142,000. Under the present stock option plans, further options for 10,236 shares could be granted to key supervisory personnel at the fair market value at the time of the grant. Options generally become exercisable in instalments over a four year period beginning one year after the date of grant and remain exercisable during the fifth year after the date of the grant (until the tenth year for options granted prior to 1965).

NOTE 10—RESTRICTIONS ON DIVIDENDS AND ADDITIONAL BORROWINGS

The indentures securing the first mortgage bonds, the income mortgage bonds and the guaranteed notes contain various restrictive provisions under which, at December 31, 1966, the company could not pay dividends on or make purchases of any class of its capital stock. The indenture securing the first mortgage bonds also contains restrictions on additional borrowings.

NOTE 11—PASSENGER SERVICE

The company is obligated to continue certain passenger service within a twenty mile radius of Boston under a contract with Massachusetts Bay Transportation Authority expiring on December 31, 1967 but renewable by the MBTA for a period up to two years. The contract provides generally that the company will be reimbursed for the excess of passenger service expenses, as defined, over passenger service revenues and includes options for the Authority to lease or purchase passenger rights of way and passenger equipment at prices to be determined upon exercise of the options.

NOTE 12—CONTINGENT OBLIGATIONS AND COMMITMENTS

In addition to the matters referred to elsewhere in the financial statements and notes, the company had the following contingent obligations and commitments at December 31, 1966:

The company rents approximately 1,300 freight cars and 330 piggyback trailers under long-term leases which expire at various dates to 1976. Current annual rentals under the various leases amount to approximately $635,000. The company also rents its general offices under a lease expiring in 1972, renewable thereafter, which provides for a current annual rental of about $280,000.

The company is plaintiff or defendant in numerous lawsuits which, in the opinion of company officials and counsel, will not have a material effect on its financial position. Several pending proceedings are derivative stockholders' suits. Recovery, if any, in these actions would inure to the benefit of the company.