

# FINANCIAL CONDITION

OF THE

**New York, New Haven & Hartford Railroad Company**

AND OF THE

**Boston & Maine Railroad**

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By LOUIS D. BRANDEIS

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# The Proposed Merger.

Early in May, 1907, the public discovered that the New York, New Haven & Hartford Railroad Company had for some time been proceeding secretly, and without authority under the laws of Massachusetts, to acquire stock of the Boston & Maine Railroad. Many large holders of Boston & Maine 7 per cent. stock, being privately approached, had been led to exchange their stock for the New Haven 8 per cent. stock. Other Boston & Maine stock had been purchased for the New Haven Company in the market.

The proposed merger was considered by many a serious menace to the welfare of Massachusetts and Northern New England. It was believed that, if accomplished, it would inevitably result in giving the New Haven complete monopoly in New England of all existing methods of transportation — railroad, steamship and trolleys — and that from the evils attending such a monopoly, government ownership would appear to afford the only escape. A determined effort was therefore made to secure action by the Massachusetts Legislature which would effectually prevent the New Haven Company from acquiring control of the Boston & Maine.

It was then so late in the legislative session that the subject could not be adequately considered for final action. A statute was enacted, however, on June 28, 1907, by which the New Haven Company was prohibited until July 1, 1908, from acquiring any additional Boston & Maine stock or attempting to vote on stock already acquired, or otherwise exercising control.

Before this act was passed the New Haven Company had acquired more than one-third of the Boston & Maine stock outstanding in the hands of the public, to wit, 109,948 shares out of a total of 295,096 shares — a minority so large that it may be easily converted into a working majority. The struggle to prevent the New Haven from controlling the Boston & Maine must therefore be continued.

The arguments against the merger will be made elsewhere. The purpose of this paper is merely to point out the error underlying the main argument which has been urged in favor of the merger. That argument is, in brief, as follows:

“The Boston & Maine Railroad requires for its proper development the expenditure of large sums of money. Its management is unprogressive and its financial condition is weak; so that the money necessary for improvements cannot be raised. The

New Haven Company, on the other hand, is financially strong. Its management is progressive. If it acquires control of the Boston & Maine, it can and will raise the money necessary, and may be relied upon to expend it wisely in improving the Boston & Maine Railroad facilities."

It is undoubtedly true that the Boston & Maine Railroad has not met fully the proper transportation demands of Massachusetts and Northern New England; and that it does require for its proper development the expenditure of large sums of money. But the assumption as to the relative financial position of the two companies and of the advantages of "New Haven management" is grossly unfounded. The New Haven Company, instead of being strong, is financially weak. The Boston & Maine, instead of being hopelessly weak, has been growing steadily in financial strength. A review of the financial operations of the two companies during the past six years should convince the reader of these facts and also make it clear:

*First*, that "New Haven management" of the Boston & Maine would be disastrous to the public as well as to Boston & Maine stockholders.

*Second*, that the Boston & Maine, if allowed to maintain its independence, can be developed so as to provide for Massachusetts and Northern New England the important transportation improvements which the public is demanding.

### CAUSES OF MISAPPREHENSION.

The misapprehension in regard to the financial condition of the New Haven is to be explained by the fact that:

1. Its change from financial strength to weakness has been accomplished in an extraordinarily short period of time.
2. The published reports of the Company have been so framed as not to disclose its real condition.

The difficulty in ascertaining the actual financial condition and operations of the New York, New Haven & Hartford Railroad Company arises mainly from the fact that the transactions of that corporation are conducted in large part through subsidiary companies, and that the management refuses to publish reports of these companies giving the detailed information concerning their condition and operation; for instance:

(a.) The New Haven's transactions in Massachusetts street railways are concealed through the medium of three voluntary associations, namely: the New England Investment & Security Company, the Springfield Railways Company, and the Worcester Railways & Investment Company.

(b.) The New Haven's transactions in the Rhode Island street railways are concealed by reason of the intervening Providence Securities Company, the Rhode Island Securities Company, the Rhode Island Company, and the United Traction & Electric Company.

(c.) The transactions of the steamship lines are concealed, as they were acquired through the New England Navigation Company and are operated by the New England Steamship Company and the United States Transportation Company.

(d.) The New Haven Company has concealed the record of its financial operations by omitting from its last annual report the statement showing its financial transactions heretofore published annually of "Resources to account for" and "Resources accounted for."

A large part of the 79 or more companies to which the New York, New Haven & Hartford Railroad Company's interests extend publish no report accessible to the general public. Some of the data furnished in this paper are, therefore, necessarily approximate.

## New York, New Haven & Hartford Railroad Co.

### SUMMARY.

#### I.

*The present company is a new Connecticut corporation. It is not strictly a railroad company. It is a general transportation, lighting, power, water and holding company.*

#### II.

*About one-half of its outstanding capitalization represents properties other than steam railroads, — properties purchased at exorbitant cost to secure a monopoly in transportation.*

#### III.

*Its securities are not proper investments for Massachusetts savings banks. Its stock is not tax exempt.*

#### IV.

*In six years the stock of the company increased 122.8 per cent., and its liabilities 366 per cent. With the additional \$39,029,600 bonds about to be issued, the increase of liabilities as compared with June 30, 1901, will be 434 per cent.*

#### V.

*In the six years the gross earnings of all its railroads (steam) operated increased only 38.5 per cent. The reported increase in net earnings from operation was 46.9 per cent. The actual increase (making up the accounts as heretofore) was only 18.88 per cent.*

#### VI.

*In the six years its "other income" from street railways, steamships, electric light, gas, water and power plants, and from securities owned, has increased largely, but such income is more precarious.*



## VII.

*In the aggregate \$10,096,605.01, expended to make good equipment depreciation which should have been charged to operating expenses, was charged to Profit and Loss, and was paid for out of premiums received from sale of stock and bonds.*

## VIII.

*Last year's reported gain on Profit and Loss transactions was merely a bookkeeping device.*

## IX.

*Last year if the company's customary charge for maintenance had been made, the net income from all sources would have failed by \$1,171,530.82 to provide a sum sufficient to pay the 8 per cent. dividend.*

## X.

*In the last three years the fixed and miscellaneous charges have about doubled. They will reach \$20,000,000 this year, and will exceed by at least \$3,000,000 the net earnings from the operation of the steam roads, even as the accounts were kept last year.*

## XI.

*This year's fixed and miscellaneous charges will reach \$20,000,000. They will be at least \$3,000,000 larger than last year's. They would exceed by at least \$6,000,000 the net earnings from operation of the steam roads if the accounts were kept as formerly.*

## XII.

*This year's net income will probably be less than last year's. If solvency is to be maintained*

**A LARGE REDUCTION IN THE DIVIDEND RATE IS INEVITABLE.**

## Part First.

### THE NEW YORK, NEW HAVEN & HARTFORD RAILROAD COMPANY

#### I. THE CHARACTER OF THE PRESENT COMPANY.

1. **A NEW COMPANY.**—The present New York, New Haven & Hartford Railroad Company is a *new* corporation. The *old* New York, New Haven & Hartford Railroad Company, which long deserved the reputation of being financially one of the strongest railroad companies of the world, was incorporated under the laws of both Massachusetts and Connecticut. The *old* company ceased to exist on May 31, 1907. On that day it became “merged with and in” the Consolidated Railway Company, a Connecticut corporation. The Consolidated Railway Company was incorporated by special act of the Connecticut Legislature on April 30, 1901, as The Thompson Tramway Company. On January 24, 1902, its name was changed to Worcester and Connecticut Eastern Railway Company. On May 18, 1904, its name was again changed to the Consolidated Railway Company. On May 31, 1907, when it absorbed the New York, New Haven & Hartford Railroad Company, it assumed, with that company’s other property, also its name.

By the agreement under which the *old* company became merged in The Consolidated Railway Company it was provided that the outstanding certificates of stock “of the consolidating corporations shall be and remain valid as certificates of stock” of the new consolidated corporation. The application of June 1, 1907, to the New York Stock Exchange that “\$91,878,100 of stock of the present merged New York, New Haven & Hartford Railroad Company” be substituted “for the same amount of stock of the old New York, New Haven & Hartford Railroad Company now on the list” was granted. The stockholders of the *old* company were thus left in ignorance of the transformation of their stock into stock of the *new* company.

2. **LARGELY A HOLDING COMPANY.**—The aggregate amount of bonds and stocks of the New York, New Haven & Hartford Railroad Company outstanding on June 30, 1907, was \$299,016,800. The stocks, bonds, notes and accounts receivable of other corporations, including its subsidiary lines, which it held on that day, had an aggregate book value of \$148,914,729.

3. **NOT STRICTLY A RAILROAD COMPANY.**—The *new* company, instead of being merely a railroad corporation, possesses other broad powers. It may, besides holding bonds and stocks of other corporations, own and operate directly anywhere not only steam railroads, but trolley lines and steamship lines. It may engage directly in the business of supplying electric

light or gas or power or water. It may enter upon still other fields of business. It utilizes these broad corporate powers, namely:

A. *Railroads Operated.* — It operates the 2,006 miles of railroad line owned or leased, formerly operated by the *old* New York, New Haven & Hartford Railroad Company.

B. *Railroads Controlled.* — (a) It holds a controlling interest in the bonds and stock of the Central New England Railroad Company, which has 256 miles of line. This company showed for the year ending June 30, 1907, an operating deficit of \$431,047.

(b) It holds a majority of the stock of the New York, Ontario and Western Railroad Company, with 546 miles of line. This company, burdened by indebtedness which now amounts to \$26,825,000, had not paid a dividend on its common stock for twenty-five years prior to its purchase by the New Haven. In the past year it paid dividends at the rate of 2 per cent. per annum.

C. *Trolley Lines Controlled.* — It holds the trolley systems of Connecticut and Rhode Island and of parts of Massachusetts, New York, and Vermont, — in all about 1,500 miles of trackage acquired at exorbitant prices. Its trolleys extend even beyond the territory served by its steam roads; for instance, the electric roads from North Adams, Massachusetts, to Bennington, Vermont, and from Bennington, Vermont, to Hoosick, New York.

D. *Steamship Lines Controlled.* — It owns and operates, besides nine steamship lines plying between New York, Connecticut, Rhode Island, and Massachusetts, lines between New York and Portland, Maine, and owns a half interest in steamship lines from Boston to Philadelphia, Baltimore, Newport News, Norfolk, and Savannah, acquired at huge cost.

E. *Electric Light, Gas, and Water Power Companies Controlled.* — It owns and operates electric light, gas, power, and water supply plants.

The combined capitalization of the steam railroads owned or leased and operated is less than the aggregate capitalization of its "other properties."

4. **SECURITIES NOT SAVINGS BANK INVESTMENTS.** — The bonds and notes of the *old* New York, New Haven & Hartford Railroad Company were expressly made by Massachusetts law savings bank investments, in spite of the fact that a part of the road was subject to mortgage. Its first mortgage bonds were savings bank investments as bonds of a "New England railroad which has earned and paid regular dividends of not less than 3 per cent. per annum on all its issues of capital stock for two years last preceding" the investment. The stock of the *old* company was good savings bank collateral as the stock of a New England railroad company which had "paid regular dividends of not less than 5 per cent. per annum on all its issues of capital stock for five years last preceding the date of such note."

The bonds and notes of the *new* company are not savings bank investments, and the stock cannot be accepted as savings bank collateral; because it is a *new* company, and the Massachusetts statute related to the *old* company. Even the first mortgage bonds are not savings bank investments under the general law; because the *new* company is not a "railroad company"

but a general transportation, lighting, power, water and holding company, and, furthermore, a company which, since it has acquired the railroads, has paid only two quarterly dividends.

5. **STOCK NOT TAX EXEMPT.** — The stock of the *old* company was exempt from taxation in Massachusetts because it was stock of a railroad company, a part of whose line was located within Massachusetts. The *new* company is not a railroad company but a general transportation, electric light, gas, water supply and holding company. The tax exemption does not apply to such company.

6. **LEGAL ENTANGLEMENTS.** — The grasping policy of the New York, New Haven & Hartford Railroad Company has resulted in investigations now pending by both Federal and State authorities into the legality of its acts. The United States Department of Justice is vigorously prosecuting its investigation to determine whether the acquisition by the New Haven Company of competing railroads, steamship and trolley lines was not in violation of the Sherman Anti-Trust Act. The Attorney General of Massachusetts has advanced far in litigation to determine whether the acquisition by the New Haven Company of Massachusetts trolley lines did not violate our State laws.

## II. CAPITALIZATION.

1. **STOCK.**—The outstanding capital stock of the *new* New York, New Haven & Hartford Railroad Company on June 30, 1907, was \$121,878,100. The *old* company had outstanding on May 31, 1907, prior to its absorption by the Consolidated Railway Company, only \$91,878,100. The Consolidated Railway Company had on that date outstanding \$30,000,000 of its capital stock. Up to April, 1907, it had only \$10,000,000 of capital stock, and during the eleven months ending May 31, 1907, failed by \$11,653.34 to earn the 2 per cent. dividend which it paid on that \$10,000,000. In April, 1907, the Consolidated Railway Company purchased for \$20,000,000 of its stock the steamship properties then held by the New England Navigation Company, another of the New Haven's subsidiary corporations. When the Consolidated Railway Company absorbed the *old* New York, New Haven & Hartford Railroad Company, and assumed the name of the latter, the *old* company's \$91,878,100 of stock (which was then selling at \$164 per share, and in January, 1902, had sold as high as \$254 per share) was treated as being of the same value per share as the \$30,000,000 Consolidated Railway Company stock. This illustrates how stock may be manipulated when its issue is not subject to effective anti-stock watering laws like those of Massachusetts.

The 247,977 shares of New York, New Haven & Hartford Railroad Company's "full paid stock" now held by its subsidiary companies, may, in the discretion of the management, be sold in the market without notice to the public from time to time, at any price — a serious menace to the market value of New Haven stock.

2. **BONDS.** — The outstanding funded indebtedness (including notes payable) of the *new* New York, New Haven & Hartford Railroad Company on June 30, 1907, including debt of subsidiary companies and of merged roads, as reported to stockholders was \$231,787,100, and its only contingent liability as reported to stockholders was a joint liability "with other roads for any deficiency on foreclosure of bonds of the Boston Terminal Company." As a matter of fact the liabilities of the New York, New Haven & Hartford Railroad Company on June 30, 1907, were \$35,032,477 greater, or in all \$266,819,577, as the following liabilities were not disclosed in the report to stockholders:

### UNDISCLOSED LIABILITIES.

A. There were then outstanding in the hands of the public at least \$4,000,000 of the New England Investment and Security Company 4 per cent. Preferred stock guaranteed as to dividends and in liquidation by the New York, New Haven & Hartford Railroad Company, on account of which it had paid out through subsidiary companies during the year ending June 30, 1907, \$184,106.48 to satisfy the guaranty.

B. There were outstanding in the hands of the public about \$3,387,950 of Springfield

Railways Company 4 per cent. Preferred stock guaranteed as to dividends and in liquidation by the New York, New Haven & Hartford Railroad Company.

C. There were then outstanding in the hands of the public about \$5,727,326.65 of the bonds of these Massachusetts trolley companies which the New Haven controlled through the New England Investment and Security Company.

D. There were then outstanding in the hands of the public about \$21,917,200 bonds and stocks of the Rhode Island street railway system underlying the \$19,898,000 Providence Securities Company 4 per cent. debentures guaranteed by the New York, New Haven & Hartford Railroad Company, which latter form a part of the \$231,787,100 of the admitted funded debt reported to stockholders.

**3. SIX YEARS INCREASE IN STOCK.** — The total amount of capital stock outstanding under the name of "New York, New Haven & Hartford Railroad Company" increased from \$54,685,400 on June 30, 1901, to \$121,878,100 on June 30, 1907, an increase of \$67,192,700, or 122.8 per cent. The total of such stock outstanding in the hands of the public increased from \$53,614,600 on June 30, 1901, to \$97,080,400, an increase of \$43,465,800 on June 30, 1907, or 81 per cent., \$24,797,700 of the stock being held by New Haven subsidiary companies.

The aggregate market value of the \$53,614,600 capital stock outstanding in the hands of the public on June 30, 1901, at the then market price of \$213 per share, was \$114,199,098. The aggregate market value of the \$97,080,400 capital stock on December 2, 1907, at \$132 per share was \$128,146,128, or only \$13,947,030 more.

**4. SIX YEARS INCREASE IN LIABILITIES.** — The funded liabilities of the New York, New Haven & Hartford Railroad Company outstanding in the hands of the public, including notes payable, the funded debt of companies controlled and operated, and the guaranteed shares and underlying securities of the Massachusetts and Rhode Island trolley systems, increased from \$57,176,700 on June 30, 1901, to \$266,819,577 on June 30, 1907. *That is an increase in six years of \$209,642,877, or 366 per cent.*

The gross earning of the railroads increased in the six years only 38.5 per cent.

**5. ADDITIONAL BONDED INDEBTEDNESS.** — Since June 30, 1907, the New Haven has issued at least \$1,929,000 additional mortgage bonds and has invited from its stockholders and convertible debenture holders, subscriptions at par for \$39,029,600 6 per cent. forty-year bonds convertible into stock at par after January 15, 1923.

**6. VALUE OF EQUITY.** — The aggregate funded indebtedness of the New Haven Company and companies controlled and operated outstanding in the hands of the public including notes payable, guaranteed stock and bonds, and the securities underlying them, on June 30, 1907, as above stated, was \$266,819,577.

The aggregate market value of its outstanding stock in the hands of the public at the market price December 2, 1907 (\$132 per share), was \$128,146,128, or less than one-half the amount of such liabilities.

### III. FIXED CHARGES.

1. **FIXED CHARGES, 1906-7.**—The total fixed charges and other deductions from income of the New York, New Haven & Hartford Railroad Company, and companies controlled and operated, as reported to stockholders, for the year ending June 30, 1907, was \$15,187,714.18. This sum does not include the sum of the \$1,079,463.52 of taxes, net rental, interest, and guaranteed dividends of its Massachusetts trolley system. Including these, but excluding steam railroads independently operated, the total fixed charges of the New Haven and its subsidiary companies for the year ending June 30, 1907, was at least \$16,267,177.70.

2. **SIX YEARS INCREASE IN FIXED CHARGES.**—The total fixed charges of the New Haven Company, including companies controlled and operated, as shown in the report to stockholders, supplemented by the addition of the estimated fixed charges of the Massachusetts trolley lines, increased from \$7,988,104.71 for the year ending June 30, 1901, to \$16,267,177.70 for the year ending June 30, 1907. That is an increase in six years of 103.61 per cent.

3. **FIXED CHARGES 1907-8.**—The estimated fixed charges for the current year of the New York, New Haven & Hartford Railroad Company including subsidiary companies (except steam railroads independently operated), for rental, interest, taxes, and sinking fund, but not including miscellaneous charges, are about \$19,200,000. With the addition of miscellaneous charges, the charges may safely be estimated at not less than \$20,000,000. The report of the New York, New Haven & Hartford Railroad Company to the Massachusetts Railroad Commissioners for the quarter ended September 30, 1907, gives the fixed charges and deductions from income for that quarter as \$4,718,235.74 — or at the rate of \$18,872,942.96 per year. This does not include the charges of subsidiary companies. The fixed charges and guaranties of the Massachusetts trolley system alone amounted, for the year ending September 30, 1907, to \$1,079,463.52. Adding these we have \$19,952,406.48 for the year without including the charges of other subsidiary companies.

#### IV. NET INCOME.

1. FROM STEAM RAILROAD OPERATION. — A. 1906-7 NET EARNINGS. — The net earnings of the New York, New Haven & Hartford Railroad Company from the operation of its steam roads owned and leased, for the year ending June 30, 1907, are reported as \$17,751,854.61. The percentage of operating expense is given as 68.073 per cent. of the gross earnings. This low operating percentage, as compared with the record of this company, requires explanation in view of the known heavy, general increase in operating expense of railroads throughout the United States in recent years. The explanation will be found in the fact that none of the reported improvements and betterments made during the year were charged to operating expense.

(a) *Maintenance of Way and Equipment.* — In spite of the great increase of cost of labor and material, and the great increase of traffic,\* the amount reported as expended for maintenance of way and equipment in the year ending June 30, 1907, was not substantially more than the average so expended in the four years preceding the administration of Mr. Mellen. That is, in the four years ending June 30, 1903, the average amount so expended was \$10,508,397.52; in the year ending June 30, 1907, it was \$11,117,873.27. If the total charges made to maintenance of way and equipment for the year 1906-7 had borne the same percentage to gross earnings as the average of the four years 1900-1903,† the net earnings from operation for the year 1906-7 would have been reduced to \$15,247,253.79 or to less than even the year's fixed charges which (including Massachusetts trolleys) aggregated \$16,264,677.70.

For detail see following schedule:

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\* The gross earnings increased in the six years ending June 30, 1907, \$15,469,624.95 or 38.5 per cent. The traffic increased in slightly greater proportion than the gross earnings, as the freight and passenger rates decreased slightly, to wit:

	1901.	1907.	Decrease.	
Average rate per ton mile . . . . .	1.479 cents	1.436 cents	0.043 cent	2.91%
Average rate of passenger fare per mile . . . . .	1.763 cents	1.623 cents	0.14 cent	7.94%

† Namely, 24.5 per cent. of the gross earnings.



1 Year Ending June 30,	2 Net Earnings from Operation as reported.	3 Maintenance of Way, Structures and Equipment as reported.	4 Per Cent. to Gross Earn- ings, of Expenditures for Maintenance as reported.	5 Increased Maintenance on Basis 1900-08 (24% Per Cent. Gross Earnings.)	6 Reduced Net Earnings after deducting Increased Maintenance on Basis of 24% Per Cent. of Gross Earnings.
1900 . . . . .	\$12,100,312.04	\$10,097,498.80	25		
1901 . . . . .	12,083,832.47	9,924,539.20	24.7		
1902 . . . . .	12,247,213.50	11,583,910.16	26.6		
1903 . . . . .	12,341,053.97	10,427,640.94	22		
			Average 24½		
1904 . . . . .	13,123,698.50	10,171,073.80	21	\$11,829,312.75	\$11,465,459.55
1905 . . . . .	14,148,925.16	10,206,674.86	20	12,245,577.21	12,160,022.82
1906 . . . . .	17,761,735.83	11,283,502.66	21	12,981,158.97	16,064,079.52
1907 . . . . .	17,751,854.61	11,117,873.57	19.9	13,622,474.39	15,247,253.79
			Average 20.5		

(b) *Betterment and Improvement Charge off.*—The average expenditure for betterments and improvements charged to operating during the four years ending June 30, 1903, was 6.09 per cent of the gross earnings. If the same percentage of expenditures for betterments and improvements had been charged to operating in 1906 and 1907, the operating percentage would have been increased to 74.16 per cent.; the net earnings from operation would have been decreased by \$3,386,157.92, and would have been reported as only \$14,365,696.69.

The necessity of making such a charge of expenditure for betterments and improvements in order to meet the requirements of maintenance and depreciation is fully recognized by the New Haven management. In the years 1903-4 and 1904-5 also similar charges were made, but the amount so charged is not disclosed in the published reports. In 1905-6 no charge of that nature was made to operating account of expenditures for betterments and improvements; but \$3,000,000 of such expenditures (that is, about 5.6 per cent. of gross earnings) was charged generally against the year's income from all sources and \$5,564,416.74 was charged to profit and loss for improvements, betterments, and equipment. In 1906-7 \$3,000,000 of the expenditures for betterments and improvements (amounting to 5.3 per cent. of the year's gross earnings) was again charged off; *but instead of being charged against the year's income it was charged to profit and loss.* If it had been charged to the year's income, as in the preceding year, the accounts for 1906-7 would have shown a deficit for the year of \$1,011,946.30 after paying dividends. If there had been charged against the year's income the same percentage of betterments and improvements as the average in the four years prior to the present management,\* the accounts for 1906-7 would have shown a deficit for the year of \$1,398,104.22 after paying dividends. The charge off would have amounted to \$3,386,157.92.

For details see following schedule:

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\* Namely 6.09 per cent. of the gross earnings.

1 Year Ending June 30,	2 Cost of Railroad and Equipment.	3 Gross Earnings.	4 Operating Expenses as reported.	5 Per Cent. Operating Expense to Gross Earnings as reported.	6 Cost of Improvements and Betterments charged to Operating Expenses as reported.	7 Per Cent. to Gross Earnings, of Improvements and Betterments charged to Operating Expenses.	8 Reduced Operating Expense after deducting Improvements and Betterments charged to Operating Expenses.	9 Per Cent. Reduced Operating Expenses to Gross Earnings after deducting Improvements and Betterments.
1900 . . . . .	\$57,251,529.87	\$40,325,151.88	\$28,224,839.84	69.99	\$2,745,952.02	6.8	\$25,479,187.82	63.18
1901 . . . . .	57,302,986.68	40,132,411.37	28,048,478.90	69.89	2,425,814.76	6.04	25,622,664.14	63.84
1902 . . . . .	57,301,714.69	43,521,087.11	31,273,873.61	71.86	3,403,708.09	7.8	27,870,165.52	64.03
1903 . . . . .	59,676,735.70	47,296,077.51	34,955,023.54	73.91	1,867,817.25	3.9	33,087,206.29	69.9
					\$10,442,992.12	Average 6.09		
1904 . . . . .	61,363,136.93	48,282,909.20	35,159,210.70	72.82	Described — cost not given.	. . . . .	See column 5.	See column 5.
1905 . . . . .	68,750,161.21	49,981,947.77	35,833,022.61	71.69	Described — cost not given.	. . . . .	" " " "	" " " "
1906 . . . . .	92,816,398.97	52,984,322.36	35,222,586.53	66.47	none.	none.	" " " "	" " " "
1907 . . . . .	111,171,551.64	55,601,936.32	37,850,081.71	68.073	none.	none.	" " " "	" " " "

**B. SIX YEARS INCREASE IN NET EARNINGS.** — The net earnings from operation, as reported, increased from \$12,083,832 for the year ending June 30, 1901, to \$17,751,854.61 for the year ended June 30, 1907, an increase of \$5,668,022.61 or 46.9 per cent.

If for the years 1906-7 the same method of accounting which prevailed in 1900-03 had been applied and the same pro rata of expenditure for betterment and improvement\* had been charged to operating, the net earnings for 1906-7, as above stated, would have been found to be \$14,365,696.69, and the increase in net earnings from operation during the six years only \$2,281,864.22 or 18.88 per cent.

**C. 1907-8 NET EARNINGS.** — In view of the fact that business depression will presumably reduce gross earnings, without an immediate corresponding reduction in operating expenses, it is probable that the net earnings from operation of the steam railroads of the New Haven Company for the current year will be less than in 1906-7. The result of the operations for the first three months of the current year point strongly to this conclusion.

For the first quarter ending September 30, 1907, the gross earnings increased \$1,080,878.11, and the net earnings decreased \$167,453.86, as compared with the corresponding quarter of the year 1906. In other words, the operating percentage for the first quarter of 1907-8 was 66.1 per cent., as compared with 62.4 per cent. in the preceding year. It should be noted, however, that the "car service balance" which in the year 1906-7 was charged as "operating expense" is, under recent rulings of the Interstate Commerce Commission, not so charged, but appears as a deduction from income. The item "hire of equipment," which appears for the first time in the report for the quarter ending September 30, 1907, of the New Haven Company, and which amounts to \$454,291.93 should be added to the 1907 reported operating expense if a comparison of operating cost with 1906 is intended. If so added the 1907-8 operating percentage for the first quarter of the current year would be 69.11 per cent.

## 2. NET INCOME FROM "OTHER PROPERTIES."

**A. 1906-7 OTHER NET INCOME.** — The aggregate net income for the year ending June 30, 1907, from sources other than steam railroads, was \$7,631,789.85, as follows:

(a.) *From Street Railway Lines:*

As reported to stockholders . . . . .	\$3,615,899.69	
Share net earnings Massachusetts street railways . . . . .	1,306,036.92	
	<u>                    </u>	\$4,921,936.61

(b.) *From Steamship Lines:*

As reported to stockholders . . . . .	\$635,127.22
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\* Namely, 6.09 per cent. of gross earnings.

(c) *From Bonds, Stock and Miscellaneous:*

As reported to stockholders . . . . .	\$2,077,874.36	
Less reported income from bonds and stock of Massachusetts street railways . . . . .		3,148.34
		<u>          </u>
		\$2,074,726.02
		<u>          </u>
		\$7,631,789.85

*B.* SIX YEARS' INCREASE IN OTHER NET INCOME. — The net income other than from operation of railroads (steam) increased in the six years ending June 30, 1907, from \$562,560.23 to \$7,631,789.85, an increase of \$7,069,229.62.

*C.* 1907-8 OTHER NET INCOME. — The estimated net income from property other than railroads (steam) for the current year is about \$7,500,000. In making this estimate the net earnings from operation of street railways, steamships, electric light, gas, power and water plants are assumed to be substantially the same as in the year 1906-7; and it is assumed that the dividend rate on stocks owned will be maintained.

## V. HOW DIVIDEND REQUIREMENTS MET.

Prior to the year beginning July 1, 1906, all dividends are reported as having been paid substantially from net earnings from operation. That is, the balance of reported net earnings of the railroads (steam) remaining after paying fixed and other charges was in each year substantially sufficient to pay the dividends declared. In 1906-7 the dividends paid amounted to \$6,904,988, but the balance of reported railroad net earnings remaining after the payment of fixed charges was only \$1,484,676.91. In other words, at least \$5,420,311.09 of the dividends was paid out of "other income."

In the current year the net earnings from operation of steam railroads must fall far short of meeting all fixed charges. In other words, *all of the dividends as well as a part of the fixed charges must be met from the income of "other properties."*

The gradual shrinkage of the surplus net earnings from operation of the steam railroads applicable to dividends over fixed charges, the increase of dividend requirements, and the inroad of dividends upon "other income" according to the reports to stockholders for the past seven years are as follows:

Year Ending June 30,	Operating Percentage.*	Net Earnings from Operation of Steam Railroad.	Fixed Charges.	Balance Applicable to Dividends.	Dividend Requirements.	Balance to be Provided from Other Income.	Surplus over Dividend Requirements.	Other Income.	Surplus Net Income as reported.
1901 . . .	69.89	\$12,083,832.47	\$7,988,104.71	\$4,095,727.76	\$4,294,738.00	\$199,010.24	. . . . .	\$562,560.23	\$363,549.99
1902 . . .	71.86	12,247,213.50	8,181,414.73	4,065,798.77	4,296,568.00	230,769.23	. . . . .	613,060.00	382,290.77
1903 . . .	73.91	12,341,053.97	8,079,900.17	4,261,153.80	4,618,438.00	357,284.20	. . . . .	565,817.99	208,533.79
1904 . . .	72.82	13,123,698.50	7,935,378.36	5,188,320.14	6,006,448.00	818,127.86	. . . . .	906,435.84	88,307.98
1905 . . .	71.69	14,148,925.16	8,664,324.51	5,484,600.65	6,400,000.00	915,399.35	. . . . .	1,223,451.79	308,052.44
1906 . . .	66.477	17,761,735.83	9,752,115.77	8,009,620.06	6,467,092.00	. . . . .	\$1,542,528.06	2,175,757.35	3,718,285.41†
1907 . . .	68.073	17,751,854.61	16,267,177.70	1,484,676.91	6,904,988.00	5,420,311.09	. . . . .	7,634,938.19	2,214,627.10‡

\* It should always be borne in mind that since June 30, 1905, the reported operating cost does not include any amount for improvements or betterment. For purposes of comparison with earlier years \$3,226,745.23 should be deducted in 1905-6 and \$3,386,157.92 in 1906-7 from the reported net earnings from operation of railroads (steam). See p. 14, *supra*.

† A charge of \$3,000,000 on account of expenditures for improvements and betterments was made against income, so that the surplus was reduced to \$718,285.41.

‡ A charge of \$3,000,000 was made on account of expenditures for improvements and betterments, but instead of being charged against surplus income, was charged wholly to Profit and Loss.

## VI. PROFIT AND LOSS MANIPULATION.

The Profit and Loss account in the report to stockholders for the year ending June 30, 1907, shows a gain of \$4,030,325.86 as arising substantially from the item "Premiums on Issues of Stock and Bonds less Discount and Commission on Debentures \$4,777,366.03." As a matter of fact, there was no actual gain. That is, no money was received from the public as premiums on stock. The item is a mere inter-company bookkeeping device which prevented the Profit and Loss account from showing an actual loss. But for this item of gain from premiums, the account would have shown a loss, because of the charge to this account (instead of to the year's income) of \$3,000,000 charged off to meet depreciation (see *supra*, p. 14) and the amount of \$3,147,564.32 paid for "discount, commissions and expenses" of the "European loan" negotiated in the year 1907, the facts in regard to which are not disclosed in the stockholders' report.

NOTE.—The alleged gain from Premiums, etc., arises, according to a statement made by Mr. Mellen under date of November 7, 1907, in answer to a special inquiry made through the Massachusetts Railroad Commissioners as follows:

" Premium on 85,210 shares of the capital stock of the N.Y., N.H. & H. R.R. issued . . . . .	\$8,521,000.00"	
Sundry premiums on sale of securities, etc. . . . .	222,171.77	
	<u>                    </u>	\$8,743,171.77
Less:		
Sundry premiums, discounts, etc. . . . .	\$15,811.36	
Discount on Debentures sold by the Consolidated . . . . .	650,357.52	
" Discount, Commissions and Expenses European loan . . . . .	3,147,564.32"	
	<u>                    </u>	3,813,733.20
		<u>\$4,929,438.57</u>

It appears from applications made to the New York Stock Exchange for the listing of additional stock under dates of March 22, 1906, November 8, 1906, April 19, 1907, and June 1, 1907, together with the facts appearing in the Annual and Quarterly Reports to the Massachusetts Railroad Commissioners that the 85,210 shares of stock were issued as follows:

	Shares.
From June 30, 1906, to September 30, 1906 . . . . .	1,805
" September 30, 1906, to November 8, 1906 . . . . .	470
" December 31, 1906, to February 28, 1907 . . . . .	8,870
" March 31, 1907, to April 19, 1907 . . . . .	49,065
" April 19, 1907, to May 31, 1907 . . . . .	25,000
	<u>85,210</u>

Mr. Mellen's statement indicates that the \$8,521,000 par value of stock was sold at a premium of \$100 per share, netting a profit of \$8,521,000. As a matter of fact, not a single share was sold to the public, no cash profit was received from the public for any of the stock, and none of it was actually sold for \$200 a share. Indeed, at no time during the year ending June 30, 1907, did the market value of New Haven stock rise to \$200 a share. During the period from March 31 to April 19, 1907, in which the 49,065 shares were issued, the price ranged between \$174 and \$180 per share; during the period from April 19 to May 31, 1907, when the 25,000 shares were issued, the price ranged between \$163½ and \$180.

What must actually have occurred was this: The 85,210 shares of stock were issued in exchange for \$17,042,000 4 per cent. Debenture Bonds of the Consolidated Railway Company, the New Haven subsidiary company through which it operated its Connecticut trolleys and of which it owned the entire capital stock.

These bonds were exchanged on the basis of \$200 in bonds for \$100 in New Haven stock; but at the time of the exchange at least \$14,813,000 of these bonds were held by the New Haven Company in its own treasury, or in that of some other of its subsidiary companies. In other words, to the extent of at least 74,065 out of a total of 85,210 shares issued, the New Haven Company simply exchanged its own stock for what were, in substance, its own bonds. The 74,065 shares were issued but a few days prior to the merger of the New York, New Haven & Hartford R.R. Co. into the Consolidated Railway Co. At the time of that merger, as above stated (page 9), \$30,000,000 par value of stock of the Consolidated Railway Co. (which was certainly not worth more than par and had not cost as much) was put into the consolidation upon the same basis as all of the New York, New Haven & Hartford R.R. Co. stock then outstanding.

If it was proper to record a gain by reason of the issue of the 74,065 shares of stock, so exchanged, then it should have recorded a loss of \$30,000,000 on account of placing the \$30,000,000 stock of the Consolidated Railway Co., worth at most par, on the same basis as the New Haven stock—alleged to be worth \$200 a share.

Of the remaining 11,145 shares out of the 85,210, 8,615 shares were issued in January, 1907, to the stockholders of South Bay Wharf and Terminal Company for \$1,723,000 par value of Consolidated Railway 4 per cent. bonds which they received at that time in payment for their property.



## VII. EQUIPMENT ACCOUNT ADJUSTMENTS.

The Equipment Account as shown by the Stockholders' Report for the year ending June 30, 1901, was \$5,261,793.72. The Equipment Account (steam) as shown by the Stockholders' Report for the year ending June 30, 1907, was \$32,792,939.81, an increase in the six years of \$27,531,146.09. The total amount expended during the six years charged to Capital Account was in fact only \$9,789,833.03. For details of this increase see Note.

In the years 1900, 1901, 1902, and 1903, the cost of certain new equipment appears to have been charged to operating expense, but the amount so charged is not given. In the years 1904, 1905, 1906 and 1907, there does not appear to have been any portion of the cost of new equipment charged either against operating expense or generally against the year's income. In other words, the inevitable depreciation in equipment during those four years does not appear to have been charged either against operation or the year's income. Consequently the reported net earnings from operation should be reduced by a further sum adequate to make good such depreciation.

The failure to make a proper depreciation charge becomes marked when the situation as to the leased line equipment is considered. By the terms of the leases the New Haven Company is obliged to keep up the equipment and at the end of the lease to deliver to the lessors equipment of equivalent value, or its cash equivalent.

The annual report to the Massachusetts Railroad Commissioners and answers made to special inquiries made by them disclose that on June 30, 1907, the appraised value of the leased line equipment (steam railroads) was \$3,038,241 less than the obligations to the lessees in respect thereto. This difference of \$3,038,241 represents the depreciation on the leased line equipment. Amounts aggregating it for new equipment should have been charged from time to time against the operating expenses of the company. It does not appear that during the four years ending June 30, 1907, any sum was so charged.

The accounts further disclose that during the last four years instead of charging

NOTE.		
Cost of equipment as per stockholders' report, June 30, 1901		\$5,261,793.72
Cash expenditures for new equipment (charged to capital):		
1903	\$2,328,593.07	
1905	3,564,522.01	
1907	4,062,560.84	
	\$9,955,675.92	
Less proceeds of old equipment sold	165,842.89	9,789,833.03
Adjustments:		
Sundry bookkeeping adjustments made in 1904, representing transfer from cost of road to cost of equipment	\$7,938,229.52	
Increase in valuation of equipment on appraisal in 1907	941,907.52	8,880,137.04
Equipment of Manufacturer's Railroad, merged in 1907		8,810.31
Appraised value of equipment of leased lines (1907)		8,852,365.71
		<u>\$32,792,939.81</u>

equipment depreciation to income it had been charged to Profit and Loss. One such charge was made June 30, 1904, of \$7,326,781.10, and another in the year ending June 30, 1906, \$3,711,731.43.\* Notwithstanding these large amounts charged to Profit and Loss to meet depreciation it appears that the valuation of the equipment of the New Haven, according to its own appraisal in 1907, was only \$941,907.52 in excess of its cost as appearing by the books of the company. The difference, to wit, \$10,096,605.01, therefore represents, according to the New Haven's statement, the depreciation in equipment which has been charged to capital instead of to operating expense. Over how many years this depreciation should be distributed cannot be definitely determined; but, as prior to Mr. Mellen's administration, it was customary to charge a portion of the cost of new equipment to the year's income, it is probable that a large part of this depreciation of \$10,096,605.01 should be charged against the operating expenses of the years 1904, 1905, 1906 and 1907, and the net earnings reduced to that extent. The appraisal of the New Haven equipment appears to be high, as compared with the Boston & Maine, even if full allowance is made for differences in the character of the equipment. The valuations and the amount of the equipment of the two roads are as follows :

	New Haven.	B. & M.
Valuation as appears by report to stockholders for year 1907 . . . . .	\$32,792,930.81	\$19,994,372.91†
Description of equipment:		
Locomotives . . . . .	1,176	1,073
Cars in passenger service . . . . .	2,202	1,654‡
Cars in freight service . . . . .	19,776	20,782
Miscellaneous cars in company's service . . . . .	1,056	529

\* The Profit and Loss Items against which these charges have been made appear to have been in each instance premiums on sale of capital stock and bonds, such premium aggregating \$7,397,531.03 in 1904, and \$3,376,703.26 in 1906.

† Of the above amount of \$19,994,372.91, \$12,699,266.04 represents the book value of the Boston & Maine's equipment on June 30, 1907, as shown in its trial balance. The remaining \$7,295,106.87 represents the inventory value of the equipment of the leased lines as follows :

Boston & Lowell Rd. . . . .	\$833,583.94
Fitchburg Rd. . . . .	4,089,588.11
Conn. & Pass. Rivers . . . . .	296,665.00
Worc., Nash. & Rock. Rd. . . . .	415,336.03
Manch. & Lawrence Rd. . . . .	19,839.00
Northern Rd. . . . .	205,759.64
Conn. River Rd. . . . .	455,977.66
Con. & Mont. Rd. . . . .	970,337.49
Franklin & Tilton Rd. . . . .	8,020.00
Total,	\$7,295,106.87

‡ Includes 10 Passenger and 4 Baggage Cars, in service between Boston and Montreal, 31.67 per cent. of which are owned by the Canadian Pacific Railway Co.