

VOL. III

United States Circuit Court of Appeals For the First Circuit

OCTOBER TERM, 1942.

No. 3823.

AMERICAN POWER & LIGHT COMPANY, Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION, Respondent.

No. 3824.

ELECTRIC POWER & LIGHT CORPORATION v. SAME,

Supplemental Portions of TRANSCRIPT OF RECORD

Pages 681 to 866, inclusive.

The Legal Intelligencer, 222 N. 15th St, Phila.

[Text of stamp on document: U. S. Circuit Court of Appeals for the First Circuit;
Filed in Clerk's Office May 13, 1943]

COMMISSION'S EXHIBIT 389

[From Samuel W. Murphy, now president of Electric Bond and Share Company, but then a member of its legal department, to Frank A. Reid, the company's general attorney. This exhibit contains a series of handwritten marginal annotations made by Mr. A. D. Root, who is referred to in the exhibit (R. 11, 105-06). The annotations are printed here as footnotes.]

April 18, 1927.

Mr. Frank A. Reid, OFFICE

In Re: Pennsylvania Reorganization

In connection with the Pennsylvania reorganization proposed by Mr. Root I have the following comments to make :

First : As a general comment I suggest that as far as possible both reorganizations be run at the same time and in connection with each other; that

is all agreements and all plans of reorganization should be laid so that no one will be able to separate one part of the reorganization from the other part. My reason for this is that while in the Pennsylvania Power & Light reorganization the increase in the Plant Account is apparently not so large, the increase of the Plant Account in the so-called Susquehanna Power & Light reorganization is tremendous, and we must not forget that in Pennsylvania the Commission has the right to approve or disapprove the acquisition of utility properties by a public utility.

I suggest, therefore, so that the Commission will find it much more difficult to unravel the cost of the various properties, that we go before them with a plan that contemplates both the transfer of certain properties to Pennsylvania Power & Light Company, as well as the formation of a new utility company, and also the transfer to the Lehigh Valley Transit Company of the railway properties, so that it will be practically impossible for anyone to find out what the cost of any individual property was or the cost of any particular group of property. I believe that while you could get the Commission to approve your Pennsylvania Power & Light reorganization, they would not approve the Susquehanna Power & Light reorganization, but they might be willing to approve the reorganization of all your properties in Pennsylvania if it would be impossible for anyone to determine at what figure the various properties were going into the whole reorganization. [Footnote: Isn't this a matter of presentation only?]

Second : In addition to the above, I make the following specific comments on the various reorganization plans:

A. PENNSYLVANIA POWER & LIGHT REORGANIZATION

1. I suggest cancellation of all liens except East Penn Electric 6's, East Penn Electric 5's and Lykens Valley 6's. My reason for this is that if it can be done without too great a cost it will eliminate the trouble of funding property subject to prior liens under our Pennsylvania mortgage with its necessary allocation of property subject to prior liens and its confusion in the future. [Footnote: P.B.S. (P. B. Sawyer, vice president of National Power and Light Company) originally said no. He may change his mind now.]

2. I think a decision should be made as to whether we will call the East Penn Electric Preferred Stock still outstanding or whether we will sell assets and liquidate. I suggest you have the charter checked to determine whether the cost is more if the stock is called rather than to liquidate. I also suggest for your consideration the calling of the stock in any event so that an obstreperous stockholder could not raise the question of equity in selling to ourselves. [Footnote: This question already considered. Believed best to call.]

3. I suggest that it would be better to transfer the property and assets of the Williamsport Railway Company and the railway property of the East Penn Electric

Company to separate corporations and then transfer securities of the Lehigh Valley Transit Company rather than the railway assets above mentioned. My reason for this is an operating reason, namely that Mr. Sawyer might find it better to have a number of small operating railway companies rather than have the Lehigh Valley Transit Company enter into a new field of operation. This question, however, can be better answered by Mr. Sawyer. [Footnote: OK if P.B.S. prefers.]

4. I do not understand why \$2,500,000 of electric light property is transferred to the East Penn Electric Company in place of \$1,500,000 railway properties, although I believe that in the general mix-up we can transfer any amount of property to the East Penn Electric Company in place of the railway property and it will not make any difference. I am, however, not entirely clear as to this and suggest that you talk to Root about it. [Footnote: OK as is.]

5. I notice that Root has capitalized \$600,000 odd dollars of dividends which will be declared out just prior to the reorganization. This makes me wonder if perhaps some additional dividends have not been added to our cost of the property and have not been capitalized. I believe that if dividends have been capitalized we should not do so for the reason, not only that we are going before a Commission on this whole transaction and capitalization of a dividend, in my opinion, is a particularly vulnerable point of talk, but also Mr. Stebbins is having great difficulty in finding valuations equal to our cost and it looks to me as though the cost was two or three million dollars too high. [Footnote: This is up to P.B.S.]

6. I notice that there is an increase in the surplus of Pennsylvania Power & Light Company on this transaction which I don't understand and again I point out the fact that we will have to go before the Commission. In my opinion we should be careful not to have the surplus of the operating company increased by this transaction. [Footnote: Dividend from East Penn. Do it before the reorganization as contemplated in plan.] Otherwise we might have difficulty before the Commission.

7. Before we do anything check should be made to see that the authorized indebtedness of the Pennsylvania Power & Light Company is sufficient to take care of the funding operations that we desire to go through and if not that the indebtedness is properly increased. My recollection of the Pennsylvania law is that it takes 60 days to do this. [Footnote: OK.]

8. I think that in this Pennsylvania Power & Light reorganization we should try to work in the 1/2 of the Scranton or Stanton (I don't know which) power house. I am referring to the power house which has been built jointly by us and the American Gas & Electric Company. It may be that we can fit this in in some such way that we can get out some common stock without increasing our valuation for bonding purposes. [Footnote: Sawyer says no.]

B. SUSQUEHANNA POWER & LIGHT REORGANIZATION.

It is very difficult for me to give you intelligent comments on this reorganization as I have been unable to lay my hands on the corporate charter and I suggest that we set Priest at making a corporate charter before we finally give our approval to this reorganization. However, the following are my comments:

1. I think that we should not only figure out whether the 7% bonds are to be called but also whether the 6% or even 5 1/2% bonds should be called. I suggest also that a study be made as to the advisability of calling the 5% and the 4% bonds. I assume that this study will show it to be too expensive but I think we ought to know about it. [Footnote: P.B.S. originally said no.]

2. I notice that the Harrisburg and the Lancaster Companies have outstanding \$50 Preferred Stock which the plan calls for exchange in the merger. I assume that it is not contemplated to create a \$50 Preferred Stock of the new company but that the exchange will be made on a basis of one share of the new for two shares of the old. [Footnote: OK. No \$50 stock to be out.]

3. I think the increase in Plant Account through the medium of the X Company, when the X Company will merely get the assets of two little companies and in addition some stock, is very dangerous when you are going to appear before a Commission. [Footnote: S.W.M. (Samuel W. Murphy, the author of this exhibit) apparently didn't read plan very close. It provides for X Co. securing assets of United Elec., Lititz Gas, and Intercourse Elec. Co.] I believe that we should transfer to the X Company all the assets that we can possibly lay our hands on if we are going to increase the Plant Account. I suggest that all the companies whose stock we own 100% and which have no liens on their property be transferred to the X Company, and the security of only those companies where we have a part ownership or where there is a lien attached to the property be transferred to the X Company. Otherwise the increase in Plant Account is too obvious and can be traced too easily. I believe this to be a very dangerous part of the plan and I think before anything of this sort is done we should consider it very carefully. I particularly call your attention to the fact that we do not have in this case any property owned by any individuals but it is all owned by companies. It is the first reorganization that I have had anything to do with where a step-up in Plant Account was not made with property owned by individuals who could have no balance sheet, the net effect of which was to make it impossible to trace the increase. I simply call your attention to this as apparently the Plant Account has been increased from \$25,000,000 to \$61,000,000 on the basis of the transfer of the assets of the Lititz Gas Company and the Intercourse Electric Company. [Footnote: That is exactly what has been done in plan. S.W.M. missed part of it.]

4. I notice some water supply companies are to go into the reorganization and I think we should consider the question as to whether we want our new company to be also in the water supply business. [Footnote: Up to P.B.S.]

5. Inasmuch as under the Pennsylvania law there is a provision for the increase of the indebtedness upon a vote of the stockholders of a corporation, I suggest for your consideration that we agree as we did in Arkansas to have the new company issue the bonds and make the mortgage prior to the merger so that the merged company will take over not only the obligation but the property actually subject to the lien of the outstanding bonds.

I again desire to impress upon you the importance, in my opinion, of scrambling all these reorganizations together so that about the only thing the Pennsylvania Commission will be able to understand will be the result and not how the result was reached. [Footnote: This plan at its present stage is for home consumption only, and I tried to make it simple for that reason. Is not scrambling just a matter of presentation?] Root's reorganization, in my opinion, is too simple and too easy to follow, particularly the Plant Account of the Susquehanna reorganization from \$25,000,000 to \$61,000,000 through a merger. I also desire to call your attention to the fact that Mr. Sawyer desires to talk over this whole matter with Governor Fisher of Pennsylvania, and I believe that we do not want to put Mr. Sawyer in the embarrassing position of giving him a plan to submit to the Governor, which the Governor would approve if no figures were presented to him, and then have the Commission refuse to approve the transfer of the utility properties because of the tremendous increase in Plant Accounts. The net result of Root's plan as I see it is to have the whole Susquehanna situation cost Lehigh nothing, and while I believe that is a very salutary result in the ordinary case, I do not believe that we ought to risk obtaining this result by damaging our reputation before the Pennsylvania Commission. Such a result, in my opinion, might start an investigation into our whole rate and financial structure in Pennsylvania and lead to all sorts and kinds of consequences. [Footnote: Don't see how commission will see original costs, as they are all on Lehigh Books.]

I merely repeat this in order that you may know that I feel very strongly that in states where we have commissions on reorganizations we should not attempt to get too much of our cost repaid.

SAMUEL W. MURPHY

SWM*CCC