PSF Interstate Commerce Commission 1943

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THE WHITE HOUSE
WASHINGTON

March 23, 1943.

MEMORANDUM FOR

MAC

Will you find out from the ICC whether competitive bidding is being used to sell the new issue of $14,000,000 of Erie Railroad bonds?

F. D. R.

Pres Rec
N/H M

CYRUS S. EATON
TERMINAL TOWER
CLEVELAND, OHIO

March 15, 1943

THE WHITE HOUSE
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Dear Mr. President:

Despite their promises to you, the Interstate Commerce Commission completely dodged the fundamental issues involved in the Erie Railroad case. While the Commission acted wisely in denying the Erie permission to issue the $14,000,000 of bonds that were to have been sold to Morgan Stanley & Co., their studied avoidance of any reference to competitive bidding for railroad securities indicates that, with them, the Wall Street banking fraternity comes first and the public interest last.

I hope you can take a minute away from your heavy international responsibilities to get out the big stick and wield it as only you know how.

Sincerely yours,

Cyrus Eaton

Hon. Franklin D. Roosevelt
President of the United States
Washington, D. C.

PSF ICC folder

Pres to file

~~THE WHITE HOUSE~~
~~WASHINGTON~~

File personal

March 23, 1943.

MEMORANDUM FOR

MAC

Will you find out from the ICC whether competitive bidding is being used to sell the new issue of $14,000,000 of Erie Railroad bonds?

F. D. R.

Memo attached

OFFICE OF CHAIRMAN ALLDREDGE

March 23, 1943

Mr. McIntyre:

This personal note to you:

The difficulty I see at the moment about the question of competitive bidding on railroad bond issues is the fact that it has not been brought before the Commission as a whole for its formal determination in a regular proceeding where a precedent might be set. Several new Commissioners, including myself, have never had an opportunity to vote on this question in a formal way. It may be that the request of Senator Wheeler for comments on the bill introduced by Senator Shipstead will furnish a satisfactory substitute for a formal case, if Otis & Company or Mr. Casey do not appeal the decision of Division Four.

I do not think it is improper for me to say that I am personally in favor of competitive bidding. It may be necessary to make certain exceptions as S.E.C. has done, but I have long believed the principle to be sound.

J.H.A.
Alldredge

Interstate Commerce Commission
Washington

OFFICE OF
J. HADEN ALLDREDGE
CHAIRMAN

March 23, 1943

Personal and Confidential

MEMORANDUM FOR THE PRESIDENT:

In response to a request by telephone from Secretary McIntyre this afternoon, I take pleasure in giving you on my own behalf the following information relative to the decision of March 10, 1943, by Division Four of the Commission under Finance Docket No. 14106, on an application of the Erie Railroad Company for the issuance of $14,000,000 of first consolidated mortgage bonds:

1. A copy of the report of Division Four is attached.

2. The matter of competitive bidding was brought into this proceeding specifically by certain interveners.

3. Since the rendition of this decision by Division Four the Commission has received a letter from Mr. Cyrus S. Eaton, of Cleveland, Ohio, on behalf of Otis & Company, complaining of the failure to establish by precedent a rule requiring competitive bidding in connection with railroad bond issues. He was advised that Otis & Company may bring the competitive bidding question up before the Commission as a whole for its determination by filing a

petition for reconsideration of the decision of Division Four. To date no such petition has been filed.

4. Another letter has been received by the Commission from Mr. Max Siskind, Attorney, of New York, on behalf of Mr. Bernard E. Casey, a party to the Division Four proceedings, seeking information as to the procedure necessary to bring the question of competitive bidding before the Commission as a whole, and he has also been advised that this may be done through the filing of a petition for reconsideration of the decision of Division Four.

5. Senator Shipstead of Minnesota has introduced in the Senate of the United States a bill (S. 874) to require competitive bidding in connection with the sale of any securities by any common carrier by railroad subject to the Interstate Commerce Act. This bill has been referred to the Interstate Commerce Commission by Chairman Wheeler of the Senate Committee on Interstate Commerce asking for its suggestions and comments. The Legislative Committee of the Commission now has Senator Wheeler's request under consideration.

I may add to the foregoing items of information this further comment:

In its decision in <u>Western Maryland Equipment Trust</u>, 111 I.C.C. 434, entered June 23, 1926, Division Four of the Commission established a precedent for competitive bidding on equipment trust certificates of railroads. Since that date this practice has been followed in the sale of equipment trust certificates with very few exceptions. There has been no similar precedent established so far as I can find in the sale of railroad bond issues, apparently because of a feeling that bond issues do not readily lend themselves to such procedure.

In the Columbia Law Review for January 1943, Volume XLIII, No. 1, at page 89, is a discussion of the subject of competitive bidding with a comparison between the prevailing rules of the Security Exchange Commission and the Interstate Commerce Commission. This discussion concludes with the statement that "the benefits derived from competitive sales are such as to warrant extending the rule as far as feasible".

J. Haden Alldredge

J. Haden Alldredge

F. D. 14106

INTERSTATE COMMERCE COMMISSION

FINANCE DOCKET NO. 14106

ERIE RAILROAD COMPANY PROPOSED BONDS

Submitted March 4, 1943. Decided March 10, 1943

Proposed issue of $14,000,000 of first consolidated mortgage 3½-percent bonds, series D, found not to meet the requirements of section 20a of the Interstate Commerce Act. Application for authority to issue denied.

Edward W. Bourne, H. A. Taylor, and Paca Oberlin for applicant.

Charles W. Sellers, Earl P. Schneider, Walter L. Flory, Max Siskind, Harry Malter, Martin H. Miller, and J. G. Luhrsen for interveners.

Robert J. Bulkley, James A. Butler, and Herbert Pillen for Halsey, Stuart & Co., Inc., and Otis & Co.

REPORT OF THE COMMISSION

DIVISION 4, COMMISSIONERS PORTER, MAHAFFIE, AND MILLER

BY DIVISION 4:

The Erie Railroad Company on February 4, 1943, applied for authority to issue $14,000,000 of first-consolidated-mortgage 3½-percent bonds, series D. The Chesapeake & Ohio Railway Company and Bernard E. Casey, stockholders of the applicant, the Railway Labor Executives Association and the Brotherhood of Railroad Trainmen were granted leave to intervene herein. The petition of Halsey, Stuart and Co., Inc., and Otis and Co. for leave to intervene was denied but they were permitted to present evidence and examine and cross-examine witnesses, provided the issues presented by the application and the petition in intervention of Chesapeake & Ohio were not broadened. A hearing was held and at the close thereof oral argument was heard.

The applicant has outstanding $14,000,000 of collateral-trust 4-percent notes, due January 1, 1953, which were issued pursuant to our order of December 16, 1941, in Erie R. Co. Reorganization, 249 I.C.C. 673, to evidence a loan from the Reconstruction Finance Corporation for a like amount which was approved by our certificate of December 16, 1941, in Erie R. Co. Reconstruction Loan, 248 I.C.C. 715. These notes are secured by the pledge of $17,500,000 of applicant's first-consolidated-mortgage 4-percent bonds, series B, also authorized by the order of December 16, 1941, supra, and are redeemable after January 1, 1943, and prior to January 1, 1945, at 105 and accrued interest. Arrangements were made to purchase the notes from the Finance Corporation at 103 5/8 and accrued interest. Upon the acquisition of the collateral-trust notes and the release of the $17,500,000 of first-consolidated-mortgage bonds, series B, pledged as security therefor such bonds would be canceled. To procure part of the funds to redeem the notes the applicant proposes to issue $14,000,000 of first-consolidated-mortgage 3½-percent bonds, series D, and the remainder would be supplied by the applicant.

In lieu of the series-B bonds which are to be canceled, there has been created a new series of bonds designated as first-consolidated-mortgage 3½-percent bonds, series D. These bonds would be issued under and pursuant to a third supplement to be dated February 1, 1943, to applicant's first-consolidated-mortgage to the First National Bank of the City of New York, trustee, dated July 1, 1941, as supplemented July 29, 1942, and August 1, 1942. They would be issued as coupon bonds, registrable as to principal in the denomination of $1,000, dated February 1, 1943, and as registered bonds in denominations of $1,000, $5,000, and $10,000, and in larger denominations, dated as provided by section 4 of Article One of the mortgage, would bear interest at the rate of 3½ percent per annum payable semiannually on February 1 and August 1, would be redeemable at the option of the applicant as a whole or in part on any date before maturity at 102½ to and including February 1, 1946, thereafter the premium decreasing one-half of 1 percent for two three-year periods, and for two periods of two years each, to and including February 1, 1956, and thereafter at par with accrued interest in each case, and would mature on February 1, 1958.

As a sinking fund for the series-D bonds the applicant would agree, so long as any of them are outstanding, to pay to the trustee on February 1, 1944, and on each February 1 thereafter the sum of $140,000, such payments to be made in cash or in series-D bonds, or partly in cash and partly in bonds. All bonds so tendered would be accepted by the trustee at the applicable redemption price at the next interest date or at the cost to the applicant, exclusive of interest and brokerage, whichever is less. The moneys in the sinking fund would be used to purchase series-D bonds at a price or prices not exceeding the applicable redemption price. Within 60 days prior to the next interest date if the money remaining in the sinking fund is $25,000 or more, or if the amount is less than $25,000 and the applicant so requests, the trustee would apply the moneys to the redemption of series-D bonds as provided in the mortgage. Any unexpended balance would be added to the next sinking-fund installment. Any series-D bonds acquired through the sinking fund would be canceled and no bonds would be issued in lieu thereof.

Arrangements have been made to sell the bonds, subject to our approval, to Morgan Stanley & Company who may assign interest in the purchase to others, at 96 and accrued interest. On this basis the average annual cost of the proceeds to the applicant would be approximately 3.85 percent.

After being granted leave to intervene the Railway Labor Executives Association and the Brotherhood of Railroad Trainmen took no further part in the proceedings. The objections of the interveners to granting authority to issue and sell the bonds are substantially alike to wit: the offer of only one investment banker to purchase the bonds was considered and accepted while another group of investment bankers, upon learning of the proposed refinancing, sought but was not given an opportunity to make an offer; therefore, the sale as proposed is improvident inasmuch as a better price might have been obtained. The applicant's position is that when this endeavor to make an offer for the bonds was presented to it arrangements had by that time been completed for their sale to Morgan Stanley & Company.

Considerable testimony was presented by the applicant regarding the considerations leading up to this proposed refinancing. Conferences were had by its officers and meetings of the finance committee and of the board of directors were held; minutes of some such meeting were introduced in evidence. It appears that at the time of applicant's reorganization in December 1941, there was a desire to raise the new money required through a public offering but because of market conditions then obtaining it was not practicable to do so and the money was procured from the Reconstruction Finance Corporation for which the collateral-trust notes were issued. The applicant's officers have kept in mind, however, the refinancing of the collateral-trust notes whenever a favorable opportunity to do so occurred. About the middle of January 1943, they concluded that the time had arrived when such refinancing could be undertaken. Accordingly negotiations were had with the Finance Corporation which resulted in its finally agreeing to sell the notes to the applicant at 103.625 and accrued interest. In the course of these negotiations it developed other parties were interested in purchasing some or all the collateral-trust notes. The Finance Corporation thereafter fixed 5 p.m. January 29, 1943, as a time limit within which the applicant could purchase the notes. The applicant exercised its option within the specified limitation and paid for the notes on February 27, 1943, using funds in its treasury for that purpose. Such payment reduced the applicant's cash on hand March 1, 1943, to $5,053,000. The treasury would be reimbursed in part from the proceeds of the proposed sale of the first-consolidated-mortgage bonds, series D, heretofore described.

As just indicated the applicant's cash has been reduced $14,507,500 by the purchase of the collateral-trust notes. Until such time as the cash position is restored by earnings or refinancing it may decide to resort to short-term loans evidenced by notes issued under the provisions of section 20a(9) of the Interstate Commerce Act. The applicant's finance committee and its board of directors have anticipated this situation and have authorized loans up to $11,000,000 for a short period.

A witness for the applicant concedes that the amount of savings from the refinancing would not be large but he asserts that there would be some savings. This point will be considered hereinafter. This witness also testified that while the matter of effecting a saving was a consideration entering into the proposals it was not deemed to be of major importance and there were other factors having greater weight in determining to refinance. These were (1) the extension for five years from 1953 to 1958 of the indebtedness now represented by the collateral-trust notes, thereby affording a more widely distributed series of maturities. The applicant expects to be able to retire during the 15-year period to 1958 all indebtedness maturing therein, including the proposed series-D bonds, and thereafter, the next bond maturity would be September 1, 1971; (2) the simplification of the capital structure through the elimination of a collateral-trust issue; (3) a wider distribution of the applicant's securities thus facilitating the opportunity to purchase them for the sinking fund or for their retirement, thereby effecting debt reduction. The call price for the series-D bonds is also lower than for the collateral-trust notes.

Much testimony was presented as to the nature and effect of the obligation which may have existed between the applicant and Morgan Stanley & Company, arising out of applicant's agreeing to purchase the collateral-trust notes on the afternoon of January 29, 1943, because of the understanding that the bankers would pay not less than 95¼ for the series-D bonds to be issued in refunding the notes, and the executing thereafter of the written contract to purchase the series-D bonds about 3:30 p.m. on February 3, 1943. This testimony seems to have been adduced for the purpose of aiding in the determination of the question whether during this period the applicant was so situated that it could have accepted some other offer if it so elected.

Opinion testimony was given as to the effect on an issuing company's credit of receiving too high a price for its securities and of the subsequent sale of such securities to the public at a recession from the initial selling price, such as was said to have been the case of applicant's issue of $18,000,000 of Ohio division first-mortgage 3½-percent bonds authorized on October 27, 1941, Erie R. Co. Reorganization, 249 I.C.C. 413. Witnesses for the applicant were of the opinion that such a condition was detrimental to applicant's credit and had an effect on its future financing but did not venture to make an estimate as to the measure of such damages. On the other hand, witnesses for the opposition were of the opinion that an overpricing of an issue would have no effect on the applicant's credit or future financing.

In behalf of Halsey, Stuart & Co., Inc., and Otis & Co., it was testified that they would underwrite for 10 days the applicant's purchase of the collateral-trust notes from the Finance Corporation at cost to the applicant, the notes to be in merchantable form, or they would underwrite for 10 days the $14,000,000 of the proposed 15-year 3½ percent bonds, series D, at the proposed selling price of 96 and accrued interest. If either proposal were accepted the applicant was to advertise immediately for bids on the basis that the highest bid would be accepted. Halsey, Stuart & Co., Inc., and associate reserved the right to bid at such advertised sale, and if the series-D bonds were offered for sale they would agree to bid a higher price than 96 and accrued interest. There was also some further testimony given to explain the intent of these proposals, but these are matters for the consideration of the applicant if it desires to do so, and are pertinent here only as an indication of the opportunity the applicant has to sell the bonds for something above 96.

Other testimony was presented more or less cumulative in nature, some of which was not material to the issues herein involved. In view of the disposition to be made of this application, as hereinafter indicated, it is unnecessary to summarize such testimony in this report.

The purchase at 103 5/8 of $14,000,000 of collateral-trust 4-percent notes, due January 1, 1953, from the Finance Corporation involves the payment of a premium of $507,500. If the purchase at that price were made by any one as an investment, he would receive a 3.56 percent yield to maturity. The applicant expects to pay a substantial amount of excess profit taxes in 1943 and will pay a tax of 81 percent of such profit. As the premium will be deductible from the amount of excess profit tax payments, the applicant assumes that the net cost of the premium paid will be 19 percent of $507,500, or $96,425.

The applicant shows that the issue and sale of $14,000,000 of its first-consolidated-mortgage 3½-percent bonds, series D, maturing February 1, 1958, at 96 percent of par, will result in a discount of $560,000, to which should be added $12,000 for printing, legal expenses, etc.; that the annual charge for amortization of discount amounts to $38,000 per annum; that the annual interest charge at 3½ percent amounts to $490,000 per annum, or a total annual charge for amortization of discount and interest of $528,000, which may be compared with the present interest charge of 4 percent on the collateral-trust notes in the amount of $560,000 per annum, or a reduction of $32,000 in annual charges; and that the New York State mortgage tax of approximately $28,000 and the Federal original issuance tax of $15,400 are chargeable to income for the year in which paid.

As presented by the applicant the net premium to be paid and the cost of acquiring the collateral-trust notes would be on the basis of a 3.92-percent interest rate to maturity, whereas the sale of the series-D bonds at 96 would produce an effective rate of 3.85 percent to maturity, a saving of seven one-hundredths of 1 percent, or giving consideration to the New York State mortgage tax, Federal issuance tax, printing mortgages, bonds, legal expenses, etc., the effective annual charge would be 3.89 percent, an alleged saving from the proposed refinancing of three one-hundredths of 1 percent, or $4,200 per annum.

The evidence is in substantial agreement that there will be some slight slight saving from the proposed financing, provided consideration is given to an assumed reduction in the excess profit taxes which may be assessed on applicant's earnings for the year 1943, and the possibility of such taxes in all subsequent years is ignored. However, if applicant's earnings subsequent to 1943 should be subject to an excess profit levy, then the asserted saving would become a loss.

In giving consideration to the record as presented, we cannot undertake to indulge in speculation as to the effect of possible future taxes upon the proposed issue, which would commit us to the policy of approving an issue of securities merely because the expenses incurred in connection therewith would reduce the amount of applicant's lawful taxes. On reflection, we are not convinced that a speculative reduction in taxes is a satisfactory basis upon which to give our approval of this security issue.

The evidence shows (a) that the $14,000,000 of notes have been purchased from the Finance Corporation at 103 5/8 percent of par, or at a premium of $507,500, to which should be added accrued interest at 4 percent from January 1, 1943, to date of purchase on February 27, 1943; (b) that the $14,000,000 of bonds have been sold subject to our approval at 96 percent of par and accrued interest from February 1, 1943, to date of delivery. On this basis the proceeds from the sale will be $13,440,000, from which there should be deducted New York mortgage tax $28,000, United States original issuance tax $15,400, cost of printing, etc., $4,500, legal expenses $8,000, leaving $13,384,100 as the net proceeds from the proposed issue which, together with treasury cash in the amount of $1,123,400, will be used to meet the cost of $14,507,500 for retiring the $14,000,000 of collateral notes.

Exhibits presented at the hearing show computations of costs in respect to the proposed bond issue and present data from which it can be determined that as of January 1, 1953, the applicant would have paid $5,600,000 interest on the collateral-trust notes, whereas on the same date it will have paid $1,260,000 into the sinking fund, $4,420,174 of interest and $1,123,400 of discount, premium and expenses, or a total outlay of $6,803,574 in respect to the proposed bonds. Of this outlay the $1,260,000 paid into the sinking fund, at redemption rates, would reduce the principal amount of bonds outstanding from $14,000,000 to $12,765,000, a net reduction of $1,235,000 in debt.

The interest payable from January 1, 1943, to January 1, 1953, upon the 4-percent collateral notes is $5,600,000, equivalent to an annual expenditure of $560,000. The interest upon the 3½-percent bonds from February 1, 1943, (date of the proposed bonds) to February 1, 1958, giving effect to sinking-fund payments of $140,000 per annum at the redemption rates provided in the indenture, is $6,804,501, to which there is added premium in the amount of $507,500, discount in the amount of $560,000 and expenses assignable to the issue in the amount of $55,900, and sinking-fund payments in the amount of $2,100,000, or a total of $10,027,901, which is equivalent to an annual cost of $668,526.70, a part of which would be devoted to the retirement of debt.

Further, the total cost of the notes to maturity, including payment and discharge of the debt, on January 1, 1953, would be $19,600,000, whereas the total cost to maturity of the proposed bonds, including payment and discharge of the debt, giving effect to sinking-fund payments at the redemption rates stated in the indenture, will be $21,956,901, or an increased outlay of $2,356,901.

The issue of the proposed bonds and the cancelation of the collateral-trust notes will not result in any current reduction in applicant's funded debt. The bonds would mature in five years after the date of maturity of the outstanding notes; the premium to be paid on calling the notes and the discount at which the bonds are proposed to be sold necessitate expenditures which are not warranted by an extension of only five years in the debt and the reduction in coupon interest rate from 4 to 3¾ percent.

Without more convincing evidence than the present record affords of the danger that underwriters are likely to injure the Erie's credit by paying it too much for its bonds, we are unable to say that its managers were justified on that ground in declining to explore the possibility of getting a better price than 96. The evidence given to the effect that the managers considered themselves obligated to carry out arrangements made to sell at 96 because of the stage to which these had progressed when they learned of the possibility of a somewhat better price, is more impressive. And it is given added weight by proof that as of the time when the directors concluded finally to accept the underwriters' offer, 96 was a good price for the new 3¾-percent bonds.

If the adequacy and fairness of the price were the only things to be considered we could, perhaps, approve the application. We are not convinced, however, that the probable cost to the applicant of changing creditors is justified, nor that if the Reconstruction Finance Corporation loan is paid off the entire $14,000,000 debt should be re-created. The evidence, we think, clearly shows that the costs immediately related to the proposed transactions will exceed any direct benefits therefrom, and it is our opinion that this fact outweighs the other considerations deemed by the applicant, as above stated, to be advantages resulting from the transaction. In its Annual Report to the Congress for the year 1941 the Commission said:

> * * * Moreover, so far as most of the railroads which are not in bankruptcy are concerned, it seems clear that it would be a mistake, in the present tide of apparently revived earning power, to ignore the fact that they have a very heavy burden of debt and that it may be a crippling

> burden in the future, if earnings should radically decline. We have noted with approval that many of the managements are avoiding this mistake and are using the favorable earnings of the present, in one way or another, to reduce fixed charges as rapidly as practicable. While stockholders may on first thought be disposed to object to such a policy, it is the stockholders who will suffer most in the event of future insolvency. They will, we believe, be shortsighted if, by insistence on immediate dividends, they jeopardize the continuance and possible expansion of a program of debt reduction. It is clearly the sane and sound policy to pursue.

That expression is applicable here. The present opportunity to reduce debt should be utilized While the reduction in cash incident to retiring the notes may justify replenishing the treasury of the company, it is not necessary to do so to the extent proposed. Furthermore, it seems somewhat doubtful if it is necessary to do so at all on any long-term basis. On that point, however, we need reach no conclusion at this time.

Upon consideration of the application and the evidence presented at the hearing, we are unable to make the required finding under Section 20a of the Interstate Commerce Act that the proposed issue (a) is for some lawful object within applicant's corporate purposes and compatible with the public interest which is necessary and appropriate for, or consistent with the proper performance by it of service to the public as a common carrier and which will not impair its ability to perform that service, and (b) is reasonably necessary and appropriate for such purpose.

An order denying the application will be entered.

ORDER

At a Session of the INTERSTATE COMMERCE COMMISSION, Division 4, held at its office in Washington, D. C., on the 10th day of March, A. D. 1943.

FINANCE DOCKET NO. 14106

ERIE RAILROAD COMPANY PROPOSED BONDS

Investigation of the matters and things involved in this proceeding having been made, a hearing having been held and oral argument having been heard, and said division having, on the date hereof, made and filed a report containing its findings of fact and conclusions thereon, which report is hereby referred to and made a part hereof:

It is ordered, That the application of the Erie Railroad Company for authority to issue $14,000,000 of first-consolidated-mortgage 3½-percent bonds, series D, be, and it is hereby, denied.

By the Commission, division 4.

W. P. BARTEL,

Secretary.

(SEAL.)

PSF I.C.C. folder 2-43

PRIVATE AND CONFIDENTIAL

October 18, 1943.

Dear Joe:-

It goes without saying that whether you like it or not you will be reappointed when your term expires!

As to Mr. Rogers, I have very little information about him. Do you want to give me a slant? If you do not want to put it in writing, give me a ring on the telephone.

Always sincerely,

Honorable Joseph B. Eastman,
Interstate Commerce Commission,
Twelfth Street and Constitution Ave.,
Washington, D. C.

The term of Eastman also expires on December 31st—

Grand Office
Brotherhood Locomotive Engineers
Cleveland, O.

EXECUTIVE DEPARTMENT
A. JOHNSTON
GRAND CHIEF ENGINEER

October 13th, 1943

The President
The White House
Washington, D C

Dear Mr President -

As you no doubt know, the term of office as a member of the Interstate Commerce Commission of Mr. John L. Rogers expires December 31, 1943; he having been appointed in 1937.

Prior to Mr. Rogers' appointment by you he served for many years as mechanical engineer with the Bureau of Locomotive Inspection, Interstate Commerce Commission, and in other capacities with the Commission and I am confident that his record justifies my wholehearted endorsement of him for reappointment.

Therefore, it will be considered as a personal favor, if you will continue Mr. John L. Rogers as a member of the Interstate Commerce Commission.

Very truly yours.

A. Johnston
Grand Chief Engineer