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IRWIN S. ROSENBAUM
DAVID E. LILIENTHAL

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ISSUANCE OF SECURITIES BY PUBLIC SERVICE CORPORATIONS*

IRWIN S. ROSENBAUM AND DAVID E. LILIENTHAL

DISCHARGE AND REFUNDING OF OBLIGATIONS

The "discharge or lawful refunding of its obligations" are two closely related purposes for which public service companies may be authorized to issue securities. The provisions of all three sections of the Act are the same on this subject.

It has been pointed out that the inquiry of the Commission in passing on issues for discharging or refunding purposes should be directed to the following three considerations:

"1. Whether the proposed issue is reasonably required for the refunding purpose.
"2. Whether the expenditure to be refunded is a capital, as distinct from an operating or income charge.
"3. If the expenditure to be refunded is an operating or income charge, whether such refunding should, nevertheless, be permitted under the exception clause of the statute which reads: 'Except as otherwise permitted in the order in the case of bonds'."

It is incumbent on the applicant to prove by evidence that the issue is to be used for the refunding of obligations which are properly chargeable to capital, rather than to income or operating account. The mere allegation of a petition to that effect is

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The Supreme Court in People ex rel. Dry Dock, East Broadway and Battery R. R. v. Pub. Ser. Comm., 1st Dist., supra, as a matter of dictum said that in refunding cases the Commission has no authority to include the value of the property acquired by the proceeds of the securities sought to be refunded. The Commission in the later case disapproved of this ruling but felt that it was bound by the Court's decision to disregard the question of value. In re Dry Dock, East Broadway and Battery R. R. (No. 1715) 7 N. Y. Pub. Ser. Comm., 1st Dist., Rep. of Decisions 69 (1916).

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insufficient; affirmative proof must be offered. And though there be uncontradicted testimony that the issue is properly chargeable to capital account, the Commission, if it is not satisfied therewith, will make an independent investigation covering a large percentage of the property or expenditure under investigation.

The obligation to prove that the proceeds of securities to be refunded were invested in capital assets applies to those issued both before and after the creation of the Commission. In fact, so strict is the duty that the Commission will not accept the determination of a federal court having jurisdiction over a receiver that the investment was a capital expenditure.

But once a refunding issue has been put out with the approval of the Commission itself or its predecessors, in a subsequent proceeding to refund that issue, proof need not be made that the original expenditure was for capital purposes. Where the refunding operation includes the retirement of existing securities at a premium, the issue may cover the amount necessary for the premium. But the charge is not for a capital purpose and must be amortized by deductions from earnings during the life of the issue approved.

"It is apparent that obligations may be issued for other than proper corporate purposes, and also for purposes which are not the proper subjects of capitalization. The mere fact that obligations exist is not of itself sufficient to justify their capitalization. The purposes for which the indebtedness was incurred, or to express the idea with greater exactness, the uses made of the funds or property acquired or services rendered as the consideration of such obligations, are material subjects of inquiry. It is not intended at this time to point out what indebtedness may and what may not be capitalized. The dividing line should be established after careful and exhaustive inquiry into the governing principles."

For a case typifying the difficulty of proving the nature of expenditures made over a long period in the past where the books and accounts were partially kept, see In re Dry Dock, East Broadway and Battery R. R. Co., supra note 1. See also discussion supra note 1.

1 In re Richmond Light & R. R. Co., supra note 2.
2 In re Astoria Light, Heat & Power Co. (No. 1717) 5 N. Y. Pub. Ser. Comm., 1st Dist., Rep. of Decisions 122, 225 (1914). In this case the commissioners disagreed among themselves whether or not examination of seventy per cent. of the items of property acquired by expenditures sought to be refunded was sufficient.
6 See supra note 5.
8 In re Bronx Gas & Elec. Co. (No. 1160) 2 N. Y. PUB. SER. COMM., 1st Dist., Rep. of Decisions 150, 161 (1909); 2 N. Y. PUB. SER. COMM., 1st Dist., ANNUAL REP. FOR 1909, 10, 17 (10 per cent); In re Edison Co., 1
Improvement and Maintenance of Service

Operating charges. One of the primary duties of the Commission in passing upon the issuance of securities is to determine if an attempt is being made to capitalize amounts properly chargeable to operating expense or income. True it is that one of the purposes for which securities may be issued is the maintenance and improvement of service, and that under this provision items of operating expense and replacement may form the basis of an issue. But the Commission will allow such a procedure only in exceptional cases and it will not allow the capitalization to be permanent. It will require that the amount capitalized be amortized within a reasonable time by the creation of a sinking fund through deductions from income.

The Commission has held that floating indebtedness incurred in the ordinary running expenses of the corporation must be paid out of earnings.\(^9\) Fuel, materials consumed from day to day and labor incurred in daily maintenance came within this category;\(^10\) similarly, fees for annual meetings,\(^11\) legal expenses incurred in defending an injunction suit,\(^12\) uncollectible debts,\(^13\) deficiencies in earnings,\(^14\) and retirements and replacements.\(^15\)


\(^12\) Ibid.

\(^13\) In re Interborough Rapid Transit Co. (No. 1615) 4 N. Y. Pub. Ser. Comm., 1st Dist., Rep. of Decisions 105 (1913). See also dissenting opinion of Commissioner Maltbie. Ibid. 132. This case involved interest or advances forwarded to a construction company.

\(^14\) In re Manhattan & Queens Traction Corp., supra note 9.
Unpaid interest during early years also falls within this class provided it is not shown to be a proper charge to the cost of developing the business.\(^\text{16}\)

**Retirements and replacements.** Expenditures for retirements and replacements do not in general constitute a proper basis for the issuance of securities.\(^\text{37}\) They are properly chargeable to operating account and as such can be capitalized only under the power of the Commission, in exceptional cases, to allow an issue based on operating charges.\(^\text{18}\)

The charging of retirements and replacements to capital account results in an increase in capitalization without a corresponding increase in property. It has been said to have been ruinous to companies which have done so in the past, and is detrimental to the public interest.\(^\text{19}\) The Commission will generally

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\(^{15}\) See page 911.

\(^{16}\) In re Manhattan & Queens Traction Corp., *supra* note 9.


It was said in People ex rel. Binghamton Light, Heat and Power Co. v. Stevens, *supra* note 1, that, even though the Act as originally enacted in 1907 did not specifically prohibit the capitalization of renewals and replacements as were permanent in character might be capitalized within the meaning of the phrases “construction, completion or improvement of its plant” and “improvement of its service.”

“Soon after its inception the Commission found that the most difficult matters to regulate in connection with the capitalization of public service corporations were the tendencies on the part of some corporations to capitalize, or their failure to make allowances for, replacements and retirements of property used in the public service, with the resultant effects on service and rates.” 1 N. Y. Pub. Ser. Comm., 2d Dist., Annual Rep. for 1913, p. 102.

\(^{18}\) “The Public Service Commissions Law permits corporations, with the consent of the Commission, to issue securities to pay for replacements, but this provision was designed to take care of extraordinary cases; and it is obligatory on the part of such corporations to pay off securities issued for such purposes from earnings, or by such means acquire assets to make good the investment of such securities.” 1 N. Y. Pub. Ser. Comm., 2d Dist., Annual Rep. for 1915, p. 102. See below page 912.

\(^{19}\) The Commission disapproved capitalization of replacements of property and equipment of a street railway in excess of the amount invested in the replacements over and above the cost of the retired property. It said:

“If new track of the same weight as the old were laid, and in the same manner substantially as the old, then the whole would be a replacement, but to such extent as the present track is heavier and laid in a better and more expensive manner, such excess over mere replacement should be treated as a betterment. The Commission is of the opinion that replacements should not, except possibly in extraordinary cases, be made with the authority of the Commission from the proceeds of bond issues, but that
not approve the practice even though it may result in improved service because of the benefit derived from new equipment. 20

But it has done so in certain extreme cases, especially in its early years when its accounting requirements were not of long enough standing to warrant the Commission in "penalizing" a company for failure to maintain a depreciation reserve in the past. The Commission found that the relaxation of its requirements in these early cases worked out beneficially to all parties concerned. 21

Where, however, replacements are made at a higher cost than the original cost of the property retired, the difference between the two may be charged to capital account. In such case, the retirements must be deducted from capital account at the same figure as they were put in. 22 The claim has been made that the depreciation in perishable structures and property should be provided for and made good out of the earnings of the venture. The result of providing for the replacement of worn out and perishable property by constant issues of new stock or new bonds of public service corporations has been shown to be a constantly increasing capitalization representing a constantly decreasing property and equipment, resulting in false statements by public service corporations as to their assets in public reports and in reports to stockholders, which have been misleading and damaging." In re Coney Island & Brooklyn R. R. (No. 1109) 2 N. Y. Pub. Ser. Comm., 1st Dist., Rep. of Decisions 130 (1909).

20 In re New York Rys., supra note 17.

21 The Commission in some of its early cases, especially those of electric power companies where the investment was subjected to a great risk, allowed the issuance of securities to cover the cost of replacements and retirements subject to amortization of the amount so allowed. In commenting upon this practice, it said:

"This attitude of the Commission has been justified. Corporations have been allowed to issue securities for replacements, but they have been required to adopt a programme which will result within a reasonable time in either paying off such securities from earnings or the acquisition from that source of assets sufficient to make good the investment of such securities. The beneficial results of this policy are manifold. It has enabled the corporations to continue to serve the public without interruptions uniformly attendant upon receiverships or reorganizations, which in many instances would no doubt have resulted if the securities petitioned for had been denied. It requires that the corporations shall conduct their affairs to the end that the securities outstanding shall be represented by an equivalent investment in property devoted to the service. The effect upon the financial standing of the public service corporations has been beneficial, as it makes them comparable to the industrials and other unregulated fields for investment so far as the possibilities attendant upon external development are concerned. It has enabled them to finance themselves at a minimum cost. All of this results in better service to the communities affected, since the service rendered by the corporation is very sensitive to any changes in its financial standing." 1 N. Y. Pub. Ser. Comm., 2d Dist., Annual Rep. for 1915, e. See also In re New York Rys., supra note 17.

difference between the present value and the original cost, rather than between the original cost of the old and the cost of the new property should be capitalized, but such a rule would result in the capitalization of the charges which should have been accumulated in the past for depreciation and replacement requirements. The Commission has refused to apply it.\textsuperscript{23}

The situation is somewhat complicated when a reorganized company seeks to issue securities in connection with the retirement and replacement of property which was involved in the reorganization. In such case should the retired property be written off at original cost to the predecessor company, at its capitalization at the time of the reorganization, or at its value at the date of the replacement? These questions have been passed on in several interesting cases.

The New York Railways Company had been formed by reorganization of the Metropolitan Street Railway Company.\textsuperscript{24} Under the Act as it then stood the Commission had no power to limit the capitalization of the reorganized company. As a matter of fact, it had been found by the Commission that the capitalization exceeded the fair value of the property by at least $16,500,000. The company then sought to issue securities to purchase cars which would replace old cars acquired at the time of the reorganization. The bondholders' reorganization committee had released the old cars at $3,700 per car, but the cars were not carried on the books of the company at any specific amount. The transportation engineer of the Commission had


testified in the reorganization case that the cars had a value of only $822 apiece. The company now claimed that it should be permitted to capitalize the difference between the present value of the old cars and the cost of the new. The Commission, however, ruled that only the difference between the original cost of the old cars to the Metropolitan Company and the cost of the new could be capitalized. In denying the use of present value as a standard, the Commission said:

“If the proposition of counsel is sound, a company could escape all obligations to provide for replacements or accrued depreciation for which no provision has been made by merely going through the form of reorganization, for then it would be obliged to provide only for the depreciation which had accrued from the date of reorganization. Prudent management unquestionably requires that, if provision has been made in past years for depreciation, it should be made up from earnings as rapidly as possible; but in no event may it properly be charged to capital account, and a mere change in corporate name or form does not remove this obligation.”

In *In re New York Edison Company*, property sought to be replaced was included in a reorganization wherein assets aggregating $26,743,666 were taken in the “Plant and Property” account of the reorganized company at $81,688,645. The reorganization had been effected prior to Commission control. The reorganized company now sought to issue securities representing expenditures for the replacement of property acquired prior to the reorganization. Two of the commissioners thought that the difference between original cost of the retirements to the old company, based principally on estimate, and the cost of the new property could be capitalized. They thought that the Commission had no control over prior overcapitalization and could not require that the applicant “write down its capital account.”

Two other commissioners held a contrary view and would allow capitalization of only the difference between the original cost of the retirements tripled to correspond with the inflation of capitalization on reorganization and the cost of the new property.

This problem does not, of course, arise under the present practice under which the Commission has authority to value property involved in a reorganization and require that securities issue only up to the amount of the company’s valuation.

In such cases, where the Commission capitalizes the property at a proper value at the time of the reorganization, it would seem proper that an issue for replacements cover the difference

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22 Supra note 22.
between the capitalized value and the cost of the new cars. As was said by the Commission in the New York Railways case:

"If the reorganization of the Metropolitan system had been carried through upon the basis of the appraisal of the expert for the Commission, and if these cars had been capitalized at $800 per car, the applicants might now claim consistently that the company should be allowed to capitalize the difference between the cost of the new car and the capitalized value of the old car. The net addition to capital account would be $5,200 per car, and so far as these cars are concerned, the capital of the company would be represented by physical property to the extent of the capitalization."

For the same reason that retirements and replacements may not be charged to capital account and form the basis of a permanent security issue, a depreciation reserve or a surplus fund may not be created by such issue, nor may the proceeds of an issue be used to reimburse for moneys spent from depreciation funds.

Bonds, etc. issued for operating expense and income charges. All three sections of the Act, however, provide for an exception to the general rule that securities may not be issued for purposes chargeable to operating expenses or to income. They provide that prior to issuance of securities an order must be obtained from the Commission stating the purpose of the issue, the reasonable necessity thereof and "except as otherwise provided in the order in the case of bonds, notes and other indebtedness, such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income."

The issuance of securities covering operating expenses and

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To the same effect see In re Ojai Power Co. (Dec. 9872) P. U. R. 1922B 793 (Cal. R. R. Comm. 1921).

27 People ex rel. Kings County Lighting Co. v. Strauss, 178 App. Div. 840, 844, 165 N. Y. Supp. 1106 (1st Dept. 1917). In this case, the Commission in authorizing an issue for reimbursement purposes found that part of the amount had been expended for depreciation reserves. It allowed, however, the full amount applied for but required that either the proceeds be used in part to build up the depreciation reserve to its former state, or that the total amount of bonds authorized for reimbursement be reduced by such amount. The order of the Commission was reversed on the ground that if the funds were expended for depreciation reserves, the issue to that amount should be refused, but the condition imposed was beyond the power of the Commission.

Depreciation reserves invested in extensions and additions may be the basis of capitalization. In re Dry Dock, East Broadway and Battery R. R., supra note 1.

28 Sections 55 and 69 of the Public Service Commission Law read as above. The clause in Section 101 of the Law dealing with this subject has inverted the phraseology quoted above.
income is by the Act left largely to the discretion of the Commission; the purpose, however, of the provision is clear. In certain unusual circumstances a company may, because of inadequate reserves or present income insufficient to cover an unusual happening, or because of poor financing in the past, be in need of funds for use for other than the usual capital purposes. For example, in the case of *In re Eighth Avenue Railroad Company*, a street railway was in a difficult position because of the pressure of short term obligations which it had issued in the past to an excessive amount and because of arrears of taxes. Under the circumstances, the Commission allowed the company to place a real estate mortgage and to borrow funds thereon by the issuance of long term notes.

The Commission has stated that it will exercise its power in this respect very sparingly and carefully. Necessarily, it must do so in order to prevent inflation of capitalization and to prevent the excessive capitalization of expenditures which should properly be borne out of income.

The securities issuable under these provisions are limited to "bonds, notes and other evidence of indebtedness." They do not include the issuance of capital stock.

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2 For discussion of these provisions, see Semple, *Issue of Securities by Public Service Corporations for Refunding of Debts and Reimbursement of Income Expenditures* (1915) 49 Am. L. Rev. 568.

Under the contracts entered into between the City of New York and the Interborough Rapid Transit Company for the operation of the subways, replacements were made the subject of the bond issue. The Commission allowed the issue because of the exceptional circumstances, but said that the case should not be considered a precedent. In *re Interborough Rapid Transit Co. (No. 2182)* 8 N.Y. Pub. Serv. Comm., 1st Dist., Rep. of Decisions 130 (1917); *ibid., supra* note 13. See dissent of Commissioner Maltbie on this holding on pages 132 and 133.

For an instance where unusual repairs to a railroad bridge were made the subject of a bond issue and amortized, see *In re Coney Island & Brooklyn R. R. (No. 420)* 2 N.Y. Pub. Serv. Comm., 1st Dist., Rep. of Decisions 336 (1910).

30 *Ibid.* 27: "In general, security issues are permitted only for capital expenditures and not for those 'reasonably chargeable to operating expenses or to income,' but in the case of bonds, notes or other evidence of indebtedness, the order authorizing the issue may permit the application of the proceeds to the latter class of expenditures. In other words, outstanding obligations for income expenditure may, under the authorization of the Commission, be refunded by a bond issue, but may not be capitalized as the basis of a stock issue . . . . It is obvious that to prevent inflation and the capitalization of expenditures which should properly be borne out of income, this power should be sparingly and carefully exercised."


32 *In re Richmond Light & R. R. Co., supra* note 2; *In re Eighth Avenue R. R., supra* note 30, at 27.
There is, under sections 55 and 69, a definite limitation upon the power of the Commission to authorize these issues. It cannot, under the wording of these provisions, allow reimbursement of the treasury in any case for maintenance of service or for replacements. Section 101, however, contains no such provision. This section contains merely a limitation that no order shall be granted for the reimbursement of such moneys expended from income for betterments or replacements unless the accounts and vouchers have been kept in such a manner that the Commission can ascertain the amount of moneys expended and the purposes of the expenditures. It seems, therefore, that telegraph or telephone corporations can issue securities for reimbursement of moneys expended from income or moneys in the treasury for maintenance of service and replacements. There does not appear to be any reason for the difference between the provisions; but the case would necessarily be an extreme one wherein the Commission would allow reimbursement of moneys for maintenance of service and that part of the cost of replacements not represented by new capital. The corporation could generally have little reason for asking for such an issue representing expenditure of past earnings because it would immediately be burdened with the necessity of amortizing the issue out of future earnings.

The section allowing these securities does not specifically provide that the amount of the issue should be amortized from income in the future. Such, however, is quite clearly its meaning. Accordingly, the Commission will not allow the issuance of bonds or notes to cover operating expenses without providing for a timely amortization of the amount of the issue or making some adequate provision for extinguishment of the charges.

REIMBURSEMENT OF THE TREASURY

Prior to 1910, the Commission had no jurisdiction to authorize the issuance of securities to reimburse the treasury for money previously expended therefrom for capital purposes. It might approve the issuance and sale of securities to provide funds for construction of an extension, or it might authorize issues for the

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34 Ibid. 179.
purpose of discharging or refunding obligations incurred for the purpose, but it could not authorize a company to replenish its treasury with the proceeds of an issue if the company should quite properly see fit to finance the construction by the use of funds lying in its treasury. This defect was cured in 1910 by amendment to section 55 of the Act and by addition of the other sections of the Act so that each contained a provision of similar import.36

The moneys to be reimbursed, under sections 55 and 69, must have been “actually expended from income or from any other moneys in the treasury of the corporation, not obtained by or from the issue of stocks, bonds, notes or other evidence of indebtedness of such corporation.” Section 101 differs from these provisions in that it applies to the reimbursement of moneys “actually expended from income from any source” and makes no mention of moneys obtained from security issues.

The difficulty of proving the source of the expenditure, the use it has been put to, and the character of the property acquired makes it necessary that a limit be put on the time within which a company may reimburse its treasury. Sections 55 and 101 provide that the expenditure for which reimbursement is sought must have been made within five years next prior to the filing with the Commission of the application for authority to issue the securities. Section 69 sets a similar time limit of ten years.

The expenditure for which it is sought to reimburse the treasury must have been made for the acquisition of property, the construction, completion, extension or improvement of its facilities, improvement of service, or discharge of obligations.37

36 See Rosenbaum and Lilienthal, Issuance of Securities By Public Service Corporations (1928) 37 YALE LAW JOURNAL 716, 719 n. 12.

37 Expenditures properly the subject of capitalization made in connection with a refunding operation might also form the basis of a reimbursement issue. Refunding of obligation is “one of the aforesaid purposes,” but except in the above instance, the refunding operation itself could not constitute an expenditure from the treasury.

For the right of a company to absorb a surplus by issuance of stock as a dividend see page 920 et seq.

In In re Central Hudson Gas & Elec. Co., supra note 35, it was held that a consolidated company could not issue securities to reimburse its treasury for expenditures made by its constituent companies prior to consolidation, because such an issue would amount to a capitalization of a contract for consolidation or of the effect of a consolidation. The consolidation agreement in this case provided that any capital stock unused in the exchange should be unused except for the needs of the company.

The fact that a company made temporary loans to discharge certificates of indebtedness the proceeds of which were used to acquire capital property and subsequently paid off the loans from income does not prevent the issuance of securities to reimburse it for the payments. In re Eighth Ave. R. R., supra note 7.
Expenditures for maintenance of service and replacements are expressly excluded by sections 55 and 69. As has been pointed out above, section 101 contains no such exception. In fact, by the following provision in the section, it authorizes the issuance of securities for such issues:

"... provided, however, that no order shall be granted authorizing such issue for reimbursement of moneys expended for income for betterments or replacements unless the applicant shall have kept its accounts and vouchers of such expenditures in such manner as to enable the commission to ascertain the amount of moneys so expended and the purpose for which such expenditures have been made."  

This provision could possibly refer solely to the difference between the original and replacement costs, which amount is in any case a proper basis of issue for any purpose other than reimbursement of the treasury; or it could in addition to this amount include also the original cost, which is a proper subject of issue only in exceptional cases and must be amortized in the future. In the absence of any express limitation, it would seem that the latter is the proper construction, and that it rests within the discretion of the Commission to allow reimbursement for the entire cost of a replacement, provided the amount of the original cost less increased replacement cost be amortized.  

All three of the sections further provide that the Commission may authorize reimbursement of money spent from income prior to the passage of the provisions, for any purpose for which an

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38 The limitation is restricted to reimbursement of treasury operations. In re Central Hudson Gas & Elec. Co., supra note 35, at 387. 

"This is the first appearance in section 69 of the words, 'except maintenance of service and except replacements,' and from the context it appears that their use in this connection was intended only to qualify to the extent mentioned the newly provided right to reimburse the treasury for money expended from income. Additional and, as it would seem, absolutely convincing evidence that this was the legislative intent appears in a further modification of section 69 by the amendment of 1910 ....... " In re Binghamton Light, Heat & Power Co., supra note 33, at 178.  

39 Another requirement is that the company must have kept its accounts and vouchers in such a manner that the Commission can ascertain the amount and purpose of the expenditure. Under the wording of sections 55 and 69, this requirement would apply to all expenditures; under section 101 only to those made from income for betterments or replacements. It would appear, however, that proof by accounts and vouchers would, as a practical matter, be necessary for all expenditures under any of these sections.  

39 Note that sections 55 and 69 left it discretionary with the Commission to allow the issue by insertion of the phrase "if in the judgment of the Commission such consent should be granted." Section 101 contained no such clause and probably made it mandatory for the Commission to approve issues falling within its terms.
original issue is allowable, except maintenance of service and replacements. The expenditures must have been made within five years prior to the filing of the application, which, in turn, was required to be filed prior to January 1, 1912.

DIVIDENDS AND STOCK DIVIDENDS

It is a fundamental proposition that dividends are not payable out of capital funds or earnings necessary for operating costs. Under sections 28 and 42 of the Stock Corporation Law, stock dividends are unlawful unless made from surplus funds. Public service corporations are more strictly limited than this; they may issue securities only for purposes enumerated in the Public Service Commission Law, and the issuance of stock dividends, be they in the form of capital stock, bonds, scrip or dividend warrants, is not one of such purposes.

But where funds available for dividends have been utilized to acquire property and it is proposed to repay the stockholder by direct issue instead of by reimbursing the treasury and then declaring a dividend, it would seem that the Commission has power to authorize the issue.

Prior to 1910, it was impossible to issue securities to reimburse the treasury, and the Commission held in several cases that securities could not be issued directly to stockholders for dividends even though they represented expenditures made from

40 Operating expenses and fixed charges must be paid prior to payment of either dividends upon stock or interest upon bonds. People ex rel. Binghamton Light, Heat & Power Co. v. Stevens, supra note 1; In re Brooklyn-Manhattan Transit Co., 3 N. Y. TRANSIT COMM., REP. OF DECISIONS 501 (1923).

To the same effect as to interest on bonds, see In re Richmond Light & R. R., supra note 2; In re New York Rys., supra note 17.

41 Williams v. Western Union Tel. Co., 93 N. Y. 162 (1883); Moritz v. Interior Conduit & Insulation Co., 87 Hun 430 (N. Y. 1895) (scrip dividends).

42 In re Babylon Electric Co., 1 N. Y. PUB. SER. COMM., 2d Dist., REP. OF DECISIONS 132 (1908); In re Erie Ry., ibid. 471 (1909); In re Central Hudson Gas & Elec. Co., supra note 35.

43 Another practical method of distribution is for the company to declare a dividend, offer stock for sale to stockholders, and then credit the declared dividend against the purchase price.

In Williams v. Western Union Telegraph Co., 9 Abb. N. C. 419 (N. Y. 1881), and in Hatch v. Western Union Telegraph Co., 9 Abb. N. C. 430 (N. Y. 1881), it was held that a telegraph company has no power to issue stock dividends representing surplus invested in its property, on the ground that the provisions which are now sections 28 and 43 of the Stock Corporation Law prohibited stock dividends. The contrary view, which is obviously correct, is expressed in Williams v. Western Union Telegraph Co., 9 Abb. N. C. 457 (N. Y. 1881) and in Howell v. Chicago & N. W. R. R., 51 Barb. 378 (N. Y. 1868).
funds otherwise usable for dividend purposes. The Commission pointed out that it could allow issues only for purposes enumerated in the statute and that a stock dividend, far from being an acquisition of capital property, was a distribution of such property, or a mere restatement of the distribution. And even after the Public Service Commission Law was amended so as to allow reimbursement of the treasury, the Commission adhered to its former view and maintained that, although the treasury might be reimbursed and a dividend declared from the proceeds of the security issue, no securities might be issued directly to the stockholder to represent the dividend.

In In re Central Hudson Gas & Electric Co., the Commission said:

"In this case, the applicant being without authority to issue stock for any purpose without the approval of the commission, may not declare a stock dividend. If we approve an issue of stock to reimburse the treasury of the company for moneys expended from income on improvements or betterments of its properties, such an issue of stock will be authorized for sale at not less than par in order actually to reimburse the treasury for the moneys so expended. When such moneys have been restored to the treasury of the company the board of directors may then determine whether or not such moneys may properly be used for dividend purposes. While it is true that stock authorized to be issued and sold for account of reimbursement may be sold to stockholders of the company and the proceeds immediately declared as a dividend to the stockholders of the company, and so amount in substance to the distribution of the stock so authorized among the stockholders, that would result from action taken in full accordance with law and because of the issuance of stock for a purpose prescribed in the law, namely reimbursement. For the reasons above stated it could not be in legal contemplation a stock dividend."  

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45 Supra note 35, at 242. To the same effect see In re Auto Transit Co. (Dec. 13813) P. U. R. 1925A 218 (Cal. R. R. Comm. 1924).

The California Commission, however, entertained a contrary view in In re Bell Water Co. (Dec. 14469) P. U. R. 1925D 1, 4 (Cal. R. R. Comm. 1925):

"When a utility applies to the Commission for permission to issue stock for the purpose of paying a dividend, it is incumbent upon such utility to show that it has had surplus profits from its business and that such surplus profits have been invested in its properties. In our opinion, neither assessments on stock, nor advances by consumers, nor reserve for accrued depreciation, nor donations, nor an increase in the asset accounts due to a revaluation of properties, results in surplus profits available for dividend purposes. Such items not being available for the purpose of declaring a dividend, they can not be used as a basis for the issue of stock to reimburse a utility's treasury, which stock in turn is to be used to pay a dividend."
Evidently the Commission did not have presented to it the New York Supreme Court case of *In re Watertown Gas Light Company.*<sup>46</sup> That case was decided under the act creating the Commission of Gas and Electricity.<sup>47</sup> Under this act, a certificate must issue from the Commission as to "amount of stock and bonds reasonably required." The purposes for which securities may be issued were not specified, and under the provision the Commission apparently allowed the reimbursement of the treasury for capital expenditures.

It appeared in the case that the stockholders of the company had drawn no dividends or profits for themselves, but had expended the net earnings of the company, to which they were entitled as stockholders, to pay off certain indebtedness against the company incurred for capital purposes. The court allowed an increase in capitalization and the issuance of stocks and bonds directly to the stockholders to the amount of the diverted funds. It said:

"... most of the old debt has been retired from the surplus earnings, but the surplus earnings belong to the stockholders who have received no dividends or profits from the company and the dividends which should have come to them have been used in payment of the debts of the company. As a matter of fairness there is no reason why they should not now receive the capital obligation of the company for the debts which they have thus paid."<sup>48</sup>

A recent opinion of the Transit Commission is in accord with this decision.<sup>49</sup> The Brooklyn City Railroad Company incorporated the Brooklyn City Development Corporation for the purpose of purchasing rolling stock for it. It purchased the stock of the latter company at par, using $4,000,000 of the funds which it had accumulated over a period of years and which might have been but were not used for dividend purposes. The Development Corporation then utilized the money thus procured to purchase the rolling stock. The Railroad Company, in its application to the Commission, sought to issue capital stock to the amount of $4,000,000 and to distribute it to its stockholders. The objection was raised that this procedure would amount to the unlawful issuance of a stock dividend. The Commission held otherwise. It was admitted by the objecting Corporation Counsel that the Railroad Company might issue $4,000,000 of its stock in exchange for the cars in the hands of the Development Corpora-

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<sup>46</sup> *Supra* note 35.
<sup>47</sup> N. Y. Laws 1905, c. 737, § 12.
<sup>48</sup> In *In re Watertown Gas Light Co., supra* note 35, at 467.
<sup>49</sup> In *re Brooklyn City R. R. (No. 2715) 4 N. Y. TRANSIT COMM., REP. OF DECISIONS 122 (1924).*
tion; that it could then because of its complete stock ownership dissolve the latter company and distribute among the stockholders the $4,000,000 of its own stock left in its hands. The Commission held that this formality was not necessary and that stock could be issued directly to the stockholders of the Railroad Company. It said:

“In fact and effect the fundamental and outstanding facts are that the petitioner has laid out or will lay out money applicable to dividends in purchasing rolling stock of commensurate value. It asks to be allowed to acquire title to these cars and thereafter intends to issue stock to its stockholders to reimburse them for the money which they would otherwise have got in dividends. I do not see where there is any question of reimbursing the treasury of the company. The assets of the company have been decreased by the price of the cars bought at the expense of dividends. Its assets will be increased by the value of the cars when it takes title to them. Its assets have been increased by the ownership of all stock of the Development Company. They will be decreased commensurately when the latter company dissolves. In effect, the stockholders have paid for these cars and if they choose to accept stock in payment for the dividends they have lost, I do not see how it affects the Commission.”

The position of the Transit Commission and Supreme Court on this question seems entirely justified. The securities authorized represent capital additions, and the purpose of reimbursing the treasury is substantially complied with. The objection that the treasury must first be reimbursed and then a dividend declared appears to be purely a formal one unsupported by reason or by necessary statutory construction.

GENERAL CONSIDERATIONS BY THE COMMISSION

The Commission must, in approving an issue, determine that it is “necessary” for the purpose sought, whether that purpose be acquisition of property, maintenance and improvement of service, reimbursement of the treasury, or refunding of obligations. In determining if the issue is necessary for the purpose, the Commission has a certain amount of discretionary power to disapprove issues even though they fall within the statutory purposes. But its discretion in this respect is limited to cases where the issue would be against public policy, or where the company has by its own action put itself beyond the scope of the statute.  

50 “The word ‘necessary’ as used in the statute, is not to be interpreted from the standpoint of some piratical corporation which might desire to exploit the public, or from the standpoint of some perverse commission which might conceive it to be public service to bait public utilities. ‘Necessary’ means needful under all conditions attending the enterprise.” Kansas City, K. V. & W. Ry. v. Public Utilities Comm., 101 Kan. 557, 563, 167 Pac. 1138, 1140 (1917).

51 “The prevailing view can be stated to be that a corporation will become
It cannot go so far as to substitute its own judgment for that of the directors and stockholders. It cannot, for example, refuse to allow the discharge or refunding of obligations incurred in a prior lawful transaction merely because it now disapproves the price or the terms and manner of financing the purchase. In People ex rel. Delaware & Hudson Co. v. Stevens, the Commission attempted to do just that.

The Delaware & Hudson Company owned and controlled all the stock of the Northern New York Development Company, the United Traction Company, and the Hudson Coal Company. Prior to the enactment of the Act it had entered into the following arrangements:

(1) It purchased coal land at the cost of over five million dollars, issued in payment therefor its one year notes and placed title to the land in the Hudson Coal Company. Approximately two and a half million dollars worth of notes were outstanding at the time of the proceeding.

(2) It forwarded approximately five million dollars to the Development Company for the purchase of the Hudson Valley Traction Company. The stock and securities were transferred by the Development Company to the United Traction Company for seven and a half million. The Delaware and Hudson Company entitled to the execution of a certificate, authorizing the issue of the proposed stock or bonds if that proposition is brought within the terms of the statute. The Commission must then execute such a certificate unless it can set forth facts which prove the proposed issue to be against public policy or which operate to estop the corporation from demanding the execution of a certificate as a matter of right. IGNATIUS, FINANCING OF PUBLIC SERVICE CORPORATIONS (1918) 294.

"The Commission stands firmly upon two propositions: First, that it has no power to authorize the issue of stocks, bonds, or other evidence of indebtedness except for one or more of the purposes enumerated in sections 55 and 69 of the Public Service Commissions Law; second, that within the limits of those purposes it has a very wide discretion as to the purposes and all of the details of the proposed issue: that this discretion is to be controlled by sound general principles of universal application. While no formal decision has been rendered as to the extent the Commission will undertake to control the discretion of boards of directors, its undeviating practice is not to interfere with that discretion unless its exercise is deemed to be clearly unwise and prejudicial to public interests by reason of its infringing upon some general principle essential to the public welfare. In other words, the denial of an application of this character imposes upon the Commission the burden of pointing out clearly and conclusively wherein the granting of the same would be improper or unwise." 1 N. Y. PUB. SER. COMM., 2D DIST., ANNUAL REP. FOR 1908, 17.

52 The court has intimated that if such were the case "a doubt might arise with reference to its constitutionality." People ex rel. Delaware & Hudson Co. v. Stevens, 197 N. Y. 1, 11, 90 N. E. 60, 63 (1909), aff'd 134 App. Div. 99, 118 N. Y. Supp. 969 (3d Dept. 1909).

53 Supra note 52.
had previously purchased the entire capital stock of the United Company, 50,000 shares, at $150 per share. The premium thus paid out was repaid the Delaware & Hudson Company in the form of two and a half millions of new stock of the United Company, and the company besides issued five million dollars of new stock on account of its purchase of the Hudson Valley property, all of which was turned over to the Delaware & Hudson Company. The Delaware & Hudson Company made payment by the issuance of its notes for not exceeding twelve months and renewable at five and six per cent interest.

In the present proceeding, the Delaware & Hudson Company sought to issue bonds on an existing mortgage of its property for the purpose of refunding or paying the short term notes. The Commission granted the validity of the purchase, but refused to allow the issuance on the ground that the purchase of securities was an unfortunate one for the Delaware & Hudson Company, the price being too high and the property not being included in the mortgage. It suggested that a mortgage might be issued by the United Traction Company to retire the obligations. As to the purchase of the coal land, it refused to allow the issue because it believed that the land should have been mortgaged to pay the obligations. The Court of Appeals, affirming the reversal of the Commission’s order, held that its action constituted an interference with the discretionary power of the directors and stockholders of the company and was unwarranted by law. It said that the purchase of stock of the one corporation by the other prior to the law was legal and that the Commission has no power to require a company to divest itself of title to such securities, or to refuse to allow issuance of securities to refund or repay obligations so incurred because it did not approve the terms on which the property was acquired. “This,” the court said, “we think would be substituting the judgment and discretion of the Commissioners for that of the directors and stockholders of the corporation.”

The inquiry by the Commission cannot go beyond investigation of the financial facts. Such matters as adequacy of service by other companies in the territory are left for determination in other types of proceedings and cannot be grounds for refusing approval of a proposed issue.54

One of the financial facts which the Commission will consider is the ability of the company to sustain the interest charges on the obligations sought to be issued. Where the net income after the deduction of operating expenses is insufficient to sustain

such charges, for example, as interest on an issue of bonds, the Commission will refuse to allow the issue. The approval of the Commission does not sanction the wisdom of the venture nor warrant that investment in the securities is advisable or profitable. But the public does and will inevitably put some reliance on the judgment of the Commission. The Commission should merely cull out those that are not feasible, and render the financial statements of the applicants a fit basis for judgment.

55 The Commission refused to allow the issue of bonds where the company was operating at a loss and the possibility of a small net income in the future was uncertain. It said:

"It would be absurd to authorize bonds to be issued in excess of the amount upon which the property will regularly and with reasonable certainty earn interest after paying all operating charges, including reserves for depreciation, etc., and amortization payments. To do so would be to invite foreclosure and reorganization. It is customary for banking houses of standing and repute to go further, and insist that interest payments shall not exceed one-half or two-thirds of the net earnings after paying the charges above mentioned." In re Mid-Crosstown Ry. (No. 1728) 5 N. Y. PUB. SER. COMM., 1ST DIST., REP. OF DECISIONS 22 (1914). In re Bronx Gas & Elec. Co., supra note 8; In re Long Acre Elec. Light & Power Co., 1 N. Y. PUB. SER. COMM., 2D DIST., ANNUAL REP. FOR 1911, 166.

56 "In passing upon the application for leave to issue additional capital stock, the Commission will consider:

"Whether there is reasonable prospect of fair return upon the investment proposed, to the end that securities having apparent worth but actually little or no value may not be issued with our sanction.

"We think that to a reasonable extent the interests of the investing public should be considered by us in passing upon these applications.

"The Commission should satisfy itself that, in a general way, the venture will be likely to prove commercially feasible, but it should not undertake to reach and announce a definite conclusion that the new construction or improvement actually constitutes a safe or attractive basis for investment. Commercial enterprises depend for their success upon so many conditions which cannot be foreseen or reckoned with in advance, that the duty of the Commission is discharged as to applications of this character when it has satisfied itself that the contemplated purpose is a fair business proposition." In re Hudson River Elec. Power Co., 1 N. Y. PUB. SER. COMM., 2D DIST., REP. OF DECISIONS 51, 67 (1907).

"While the Commission, as it has frequently stated in its opinions, does not in making authorizations of security in any way guarantee that the securities so authorized are a good or safe investment, yet its object is to render the company's financial statements and make its own conclusions constitute such basis that the investor will not be misled." 1 N. Y. PUB. SER. COMM., 2D DIST., ANNUAL REP. FOR 1913, 108.

"The Commission has also been of the opinion that it is for the public advantage to permit the companies to issue bonds or evidence of indebtedness only for capital purposes, so that the certificate of approval of the Commission would represent some assurance to investors. Securities would thus represent actual capital expenditures, and where this is the case, there would be less likelihood of foreclosure and of receiverships and that securities would sell below par." 1 N. Y. PUB. SER. COMM., 1ST DIST., ANNUAL REP. FOR 1908, 116.
The disastrous effect either upon the financial plans or continued operation of the company of refusal by the Commission to assent to the issue must, of course, as a practical matter, have some weight in the determination; but it is not a controlling consideration.

In authorizing security issues, the Commission must be assured that the company has the legal right to exercise the franchise or construct or acquire the property which will be the basis of the issue. As was said in People ex rel. New York Edison Co. v. Willcox:

"The purpose and interest of the law forbids the Commission to authorize the issue of stock and bonds under sections 69 or 55 when prescribed requirements and conditions precedent to the right of the applicant to construct and operate a plant and system or a railroad have not been fulfilled or complied with and when, perhaps, the property to be acquired or constructed may never be acquired or constructed and the bonds or stock, the issue of which is applied for, have no substantial security to rest upon. A contrary conclusion would make the authorization and avouchment of the commissions a bait and a trap for ensnaring the investing public." 58

In the case just quoted from, an electric light and power company operating in the city of New York petitioned the Commission for authorization to issue securities to acquire property upon which to construct power houses and sub-stations, to construct such houses and sub-stations, and to purchase and lay underground cables and ducts. The company had failed to obtain the consent of the Commission to begin construction as required by section 68 of the Public Service Commission Law. It

57 The knowledge on the part of the investors and others that the issuance of securities by public utilities corporations within this State has received Commission approval adds to their stability and increases their negotiability." 1 N. Y. Pub. Ser. Comm., 2d Dist., Annual Rep. for 1917, xx.

58 "The fact that the effect of such a refusal of a refunding plan in a single case may be disastrous, as it is very apt to prove in the present one, is not the controlling consideration, but rather that, under the settled policy of the law as now determined by the Legislature and interpreted by the Courts, the approval of the Commission to the issue of new securities, whether it be for refunding or other purposes, is notice to the public that the securities so authorized by it represent at least investments made by the company for capital account and not disbursements for mere temporary purposes." People ex rel. Dry Dock, East Broadway & Battery R. R. v. Pub. Ser. Comm., supra note 1.

was held that the Commission had no power under such circumstances to authorize the issuance of the securities.\textsuperscript{59}

The same necessity exists for the prior consent of the Commission "to exercise any right or privilege under any franchise,"\textsuperscript{60} unless such franchise had been granted and actually exercised prior to the necessity for Commission approval.\textsuperscript{61}

Similarly, consent to crossing and use of streets must be obtained by a railroad company from the municipality concerned prior to authorization of security issues to cover the cost of a terminal.\textsuperscript{62}

But the Commission will not pass on the question of the validity of the franchise or the limits of the franchise rights of a company. And even though proceedings may be pending in Court to determine the validity of the franchise of a merged company, the Commission may authorize the issuance of securities by it.\textsuperscript{63}

\textbf{DISPOSITION OF PROCEEDS}

The sections of the Act each provide that the company authorized to issue securities cannot without the consent of the Commission apply the issue or its proceeds to any purpose not specified in the order.\textsuperscript{64}

\begin{quote}
\textsuperscript{59} For a holding to the same effect see Wisconsin Southern R. R. v. Wisconsin R. R. Comm., 185 Wis. 313, 201 Pac. 244 (1924).


The Commission will not go so far as to refuse to allow the issuance of proper securities because the applicant has failed in the past to obtain Commission consent to another issue as it should have done. In re Consolidated Gas Co. (No. 1823) 5 N. Y. Pub. Ser. Comm., 1st Dist., Rep. of Decisions 339 (1914). But see dissent of Commissioner Maltbie.


Permission to exercise its franchise and privilege as a corporation under section 156 of the Transportation Corporation Law must be obtained prior to the issue. In re Erie Barge Freight Terminal Co. (No. 7966) (1921) N. Y. P. S. C., 26 N. Y. St. D. R. 136.

The Court of Appeals refused to consider the question of prior exercise of a franchise where the Commission did not make or base its final order upon a finding of fact in regard to it. People ex rel. New York Edison Co. v. Wilcox, supra note 58. The dissenting opinion of Chief Justice Cullen, \textit{ibid.} 112, 100 N. E. at 710, is to the contrary on this point.

\textsuperscript{62} In re Erie Barge Freight Terminal Co., supra note 61.


Discounts and expenses in connection with the sale of bonds should be distributed over the term of the bonds and should be amortized out of in-

In In re Nassau Electric R. R., commented on in 2 N. Y. Pub. Ser. Comm., 1st Dist., Annual Rep. for 1911, 609, a company sought to issue bonds to retire bonds of certain other companies of equal par value as part of plans for a consolidation. The bonds sought to be retired had been issued together with an equal amount of stock at a discount of approximately fifty per cent on the combined issues. The Commission, in the absence of any evidence of amounts actually realized for either the stocks or bonds, considered the bonds as issued at a fifty per cent discount, rather than the stocks issued as a bonus. It allowed the issuance of the entire amount of bonds, but required that half the amount be amortized out of income within the life of the bonds.

"It has been the consistent policy of the Commission in acting upon all applications for its consent to the issue of securities or the right to construct and operate, to prevent a recurrence of conditions such as have resulted in the present receiverships and to insure for the future a safe and conservative system of finance on the part of public service corporations. In the past the street railroad companies of this city quite frequently obtained the approval of the Board of Railroad Commissioners for the authorization of mortgages for perfectly proper purposes and then used the proceeds of the securities secured by the mortgage for purposes different from those for which the mortgage was authorized. The Metropolitan Street Railway Company obtained the consent of the Board for a large mortgage to raise sums to electrify various horse car lines which have not been electrified. The New York & Queens County Railroad Company, in 1906, secured the consent to the issuance of a $10,000,000 mortgage, a part of the proceeds of which were to be used for the double tracking of its line between Jamaica and Flushing to be completed not later than January 1, 1908, yet during the past year when complaints were made that the service on this line was inadequate, the company alleged that it could not run more cars because it did not have the double track road. In all its orders authorizing the issuance of securities the Commission has inserted provisions requiring that the proceeds of the sale of the securities shall actually be used for the purpose for which authorized, has required that companies account periodically for the sale and disposition thereof, such accounts to be subject to audit by an accountant of the Commission, and has in particular cases inserted additional provisos designed to prevent companies from issuing and using securities for any purpose except that for which the authorization was given." 1 N. Y. Pub. Ser. Comm., 1st Dist., Annual Rep. for 1908, 115.

"The statute requiring consent of the Commission to issues of stocks and bonds apparently assumes that once permission has been given the proceeds will be devoted to the uses for which they are certified by the Commission to be reasonably necessary. It does not provide any machinery by which the Commission may know that the proceeds are thus used, and it is entirely possible that moneys authorized for one purpose may by a corporation be diverted to another which would not have been authorized"
tain a statement as to the amount sold, exchanged or otherwise disposed of, the date of the transaction, to or with whom sold or exchanged, terms and conditions of the transaction, and use of the proceeds for the purposes allowed. The company is generally required to continue to file these reports until all of the securities are disposed of.65

Where the Commission has been unable to complete its survey of the properties and accounts of the applicant company so as to determine the correctness of the items of a refunding plan, it has frequently reserved a certain portion of the authorized issue for future adjustment in case that on completion of the check-up it should find that certain outstanding securities are not properly subject to refunding.67

Similarly, where it authorizes the issuance of securities for new construction, it bases the probable cost on estimates. And in some cases, the purchase price of property is estimated but not definitely determined. In such cases, the Commission will generally require the company to submit vouchers of actual cost

by the Commission. It is too much to assume that corporate operations are always conducted in good faith and with scrupulous regard to the provisions of law. It has, therefore, seemed wise to the Commission to make some provision whereby it may know what application is made of the proceeds of securities authorized by it; and it is believed that such provision is warranted by the general scope and tenor of the law.” 1 N. Y. PUB. SER. COMM., 2D DIST., ANNUAL REP. FOR 1907, 20.

65 “To afford a ready means for ascertaining the precise disposition of the proceeds of all such securities authorized by it, it has established an account with each corporation, in which in a suitable manner is kept a record of the application, its nature, the amount of securities authorized, the reports made thereon pursuant to the rule, and the disposition of the proceeds. Thus, either the Commission or any citizen or person interested can readily ascertain the disposition made of the moneys as reported by the corporation, and it is believed that any misapplication of the proceeds, in defiance of the terms of the order, would subject the corporation guilty of the same to forfeiture of the penalties described by section 56 of the act.” 1 N. Y. PUB. SER. COMM., 2D DIST., ANNUAL REP. FOR 1907, 21.

“Applications to issue securities with which to acquire property or make extensions and improvements in the future are, in the first instance, the most simple and direct of those submitted to the Commission. The orders of the Commission authorizing the issue of securities for these purposes necessarily merely show the amount to be issued, the minimum price, and the purposes for which the proceeds are to be issued, and require that verified reports shall be filed showing that the orders had been complied with. Owing to different points of view, lack of mutual understanding, and other reasons, it has been not infrequently necessary in such matters for the Commission to make examinations of the corporations' books, supplemented by engineering investigations to ascertain whether the Commission's orders have been fully complied with.” 1 N. Y. PUB. SER. COMM., 2D DIST., ANNUAL REP. FOR 1913, 103.

before withdrawing the money for these purposes, and it will require that the actual cost and not the estimated cost be entered on the books of account.\textsuperscript{68}

The Commission will not authorize the issuance of such an amount of securities for the purpose of reimbursement of the treasury or for any other purpose as, on the market, will net proceeds in excess of the amount required for the purpose.\textsuperscript{69} If the security will sell above par, it will limit the amount issuable, or the order authorizing the issue will provide that the excess received may not be expended except for purposes authorized by the Commission on supplemental order.\textsuperscript{70}

**REVISION OF ACCOUNTS AND OVERCAPITALIZATION**

Although the Commission cannot recast the financial structure of a company and completely wipe out abuses which have entered it in the past, it can go far to safeguard the interest of the investing public and to facilitate its own work by requiring that, as a condition to the issuance of securities, the capital account be made to reflect the true status of the company's property.\textsuperscript{71}

\textsuperscript{68} In re New York Dock Ry. (No. 1587) 4 N. Y. PUb. SER. CMm., 1ST DIST., REp. OF DECISIONS 94 (1913); In re Syracuse & Suburban R. R., supra note 64.

\textsuperscript{69} Dissenting opinion of Commissioner Maltbie in In re Consolidated Gas Co., supra note 60.

\textsuperscript{70} In In re Coney Island & Brooklyn R. R., 2 N. Y. PUB. SER. CMm., 1ST DIST., ANNUAL REp. FOR 1908, 117, the Commission approved the issuance of bonds by a trustee under an equipment trust agreement, and provided that if the bonds should sell for more than par, which was the minimum sale price, the proceeds should go to the applicant company and not to the trustee.

To the same effect see In re Redondo Telephone Co. (Dec. 14,528) P. U R. 1925E 140 (Cal. R. R. CMm. 1925).

\textsuperscript{71} For a discussion of this subject see IGNATIUS, OP. CIT. SUPRA note 51, at 294-303.

The Commission has found it necessary to investigate and analyze plans of accounts of many companies which have been entered as lump sums prior to the accounting regulation of the Commission.

"These analyses automatically eliminate from the investment account amounts which represent property which has gone out of service, and indicate other amounts which are not properly representative of investment in the property devoted to the activities of the corporation.

"In effect, these inquiries amount to a retroactive application of the Commission's accounting orders to the earlier corporation life of the properties involved.

"The Commission has definitely aimed at a constructive program rather than the uncovering and revelation of past misdeeds of corporation mismanagement and financial juggling in the controlling agencies of the rapid transit and surface lines. In order to arrive at information which would make possible the prevention of such conditions in the future, the Commission has adopted a course in the prosecution of its examination which would throw the strongest light upon the financial activities of those who are
The accounts of the company as thus corrected may then be safely used to appraise its present financial condition and to furnish a basis for the computation of future replacements and retirements.\footnote{22}

Prior to the issuance of securities it is therefore the practice of the Commission to examine thoroughly the accounts, books and inventories of the applicant. The order granting the issuance, or the use of the proceeds, is then made conditional upon acceptance of the necessary corrections.\footnote{23}


\footnote{23}{For example see: In re Syracuse and Suburban R. R., supra note 64; In re Rochester Ry. & Light Co. (No. 6538) (1918) N. Y. P. S. C. 2d Dist. 17 N. Y. St. D. R. 389.

"The corporations which have been examined have had their entire capitalization reviewed by the Commission, and in connection with subsequent applications for authority to issue securities it will only be necessary for this division to bring these examinations up to date in order to verify for the Commission the financial statements submitted in support of such applications.

"The first examination which the division makes of the accounts and property of a corporation, as explained in the 1914 report, usually comprehends its entire history; in short, it resolves itself into an analysis and verification of the corporation's investment and capitalization." 1 N. Y. Pub. Ser. Comm., 2d Dist., Annual Rep. For 1915, xlvii.

"In making examinations of corporations the most important source of information, other than the accounts of the corporations themselves is the inventory of the physical property in service at the conclusion of the examination. This statement of so called physical data is taken from the sworn annual reports filed by the corporations with the Commission. When the examiner has concluded his work the report of the examination, together with the annual report of the Corporation to the Commission, is referred to the Commissioner's engineer to ascertain what, if any, property charged on the corporation's books is no longer in service. Conclusions drawn from the data as reported by the corporation are frequently found to be erroneous by reason of an utter lack of accuracy in the compilation}
The Commission may in its investigation find, aside from mere error in the keeping of the accounts, that the capital account exceeds the value of the capital properties. Under such conditions, the company is said to be “overcapitalized.”

But the Commission cannot refuse to allow an issue of securities representing the addition of new capital solely on the ground of such past overcapitalization, nor can it as a condition to the issuance of securities require the scaling down of a capital structure by amortization of amounts which it considers excessive capitalization. 74

The Commission of the First District required such reduction of capitalization in In re Brooklyn Borough Gas Co., supra note 72. The Commission found that the fixed capital account of the company in question was $1,778,100, whereas the present appraised value of the property was only $1,344,752. The company wished to issue $125,000 capital stock for purposes of extensions, additions, reimbursement, etc. The Commission required as a condition to its approval that the company charge off $178,428 to surplus, and carry the remaining $250,000 as a suspense account on the balance sheet under the title of “Franchise and other intangible assets in process of amortization.” The Company was required to reserve from earnings over and above reservation for depreciation five cents per 1,000 cubic feet of gas sold. The amount reserved was required to be invested in extensions and additions, “so that in the course of eight or ten years there will be physical property substituted for the intangible asset, and there will have been established a parity between the structural value and the nominal capitalization of the company.”

The same corrective method was used in the reorganization of the Third Avenue Railroad. Under the Act as it stood prior to 1910, the Commission had no power to prevent the gross overcapitalization of companies reorganized under Sections 9 and 10 of the Stock Corporation Law. It accordingly proceeded under its powers over accounts, and required an amortization of excess capitalization which the company had issued in its reorganization. It resorted to the same methods in In re Twenty-third St. Ry., supra note 1; In re New York Edison Co., supra note 22. The Commissioners split on the question whether it had power to require a company which had increased its capitalization three times over the value of its property to write off replacements at three times book cost so as to make it conform to the degree of capitalization that had entered into the company's structure. Commissioner McCall said: “I do not believe that the Commission has the power to impose as a condition, for authorizing issuance of securities for the purpose of refunding obligations . . . that the applicant company shall write down its capital account because of alleged capitalization of some of its intangible assets in the remote past.”

But the Commission of the 2d District and the Transit Commission are on record as opposed to the assumption of such jurisdiction. In re Watertown Light & Power Co., supra note 72; In re Brooklyn City R. R., supra note 49. The case of People ex rel. Binghamton Light, Heat and Power Co. v. Stevens, supra note 1, wherein it was held that the Commission could not permit the issuance of $195,000 of bonds on condition that the capital account of the company be reduced by writing off $100,000 of capital stock, indicates strongly that the Commission will not be allowed to
assume such jurisdiction. And in People ex rel. New York Rys. v. Pub. Ser. Comm., 223 N. Y. 373, 119 N. E. 437, rev'd 181 App. Div. 338, 168 N. Y. Supp. 760 (1st Dept. 1918), it was held that the Commission in approving a plan of reorganization and execution of a mortgage could not require a company, before paying dividends or interest, to expend monthly for depreciation and maintenance 30 per cent of its gross operating revenue and to credit the balance of "accrued amortization of capital account." It was pointed out that the power to require depreciation reserves was not expressly delegated to the Commission and could not be inferred. The case is analogous to our present consideration.

The case of Matter of Watertown Gas Light Co., supra note 35, is sometimes cited as approving the assumption of such jurisdiction by the Commission, but it would seem to have little bearing on the question.