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WRIT OF CERTIORARI.

NEW JERSEY, to wit:

State of New Jersey to Board of Public Utility Commissioners of New Jersey, GREETING,

(L. s.) We being willing, for certain reasons, to be certified of an order made by the Board of Public Utility Commissioners of the State of New Jersey on January 7, 1926, directing the Passaic Consolidated Water Company, a corporation of New Jersey, to reform and rewrite its books of account, to modify its charges for depreciation, and to submit to the said Board an amended annual report for the year 1924. 10

We do command you, that the said order so made by the Board of Public Utility Commissioners, together with all things touching and concerning the same, as fully and entirely as before you they remain, to our Justices of our Supreme Court of Judicature at Trenton on the first Tuesday of May next, you certify and send, together with this writ, that therein may be done what of right and according to the laws of this State should be done. 20

WITNESS, WILLIAM S. GUMMERE, Chief Justice of our Supreme Court at Trenton, this 23rd day of February, nineteen hundred and twenty-six. 30

EDWARD J. KELLEHER,
Clerk.

OSBORNE, CORNISH & SCHECK,
Attorneys.

WM. S. GUMMERE,
C. J. 40

RETURN TO WRIT.

To the Honorable the Justices of the Supreme Court of Judicature of New Jersey:

10 The Board of Public Utility Commissioners herewith sends to the Supreme Court of Judicature of the State of New Jersey a certain Decision and Order made by said Board the seventh day of January, Nineteen Hundred and Twenty-six, together with all proceedings and matters touching and concerning the same, as fully and entirely as before said Board they remain, as it is within commanded.

IN WITNESS WHEREOF the seal of said Board is hereto affixed, and certified by the subscriber.

20 A. N. BARBER,
Secretary of the Board of
Public Utility Commissioners of New Jersey.

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Return to Writ.

STATE OF NEW JERSEY.

BOARD OF PUBLIC UTILITY COMMISSIONERS.

INSPECTOR'S REPORT.

HSL
HDW 10

Board of Public Utility Commissioners. Received April 4, 1925.

Date April 2nd, 1925.

Company: Passaic Consolidated Water Company.

Nature: Fixed capital accounts set up on company's books.

Place: Paterson, N. J. 20

REMARKS.

The Passaic Consolidated Water Company was incorporated on October 30th, 1923, being a consolidation of The Acquackanonk Water Company, The East Jersey Water Company, The Kearny Water Company, The Montclair Water Company, and The Passaic Water Company, which consolidation was approved by the Board under date of October 26th, 1923.

In the Board's decision approving the consolidation it was shown that the valuation of all the properties of the constituent companies, namely, \$11,500,000, found by the Board in its decision of March 27th, 1923, fixing the rates to be charged by these companies for water services, was sufficient to support the capitalization of the company resulting from the merger and consolidation. This decision further stated that in view of the fact that the companies had appealed to the courts for a review of the Board's 30 40

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value of used and useful property, it appeared preferable that the books of the consolidated company should be opened on the basis of the consolidated book figures (presumably the historical costs) with any proper necessary adjustments, "and that the books be so continued
10 until the legal proceedings are concluded, at which time any adjustment may be submitted to the Board for approval."

As indicated by the company's annual report for the year 1923, its books were opened up on the basis above stated. Several months after the close of that year the Court of Errors and Appeals handed down a decision sustaining the Board's valuation of the company's property above given, and in a letter dated June 2nd, 1924,
20 from the Board's Chief Inspector, Bureau of Utilities, in connection with the company's application for approval of an issue of bonds, it was suggested to the company that before its application was granted it should make the necessary adjustments on its books to bring same into conformity with the Board's valuation of its property and the balance sheets be submitted reflecting said adjustments. In reply
30 to that letter balance sheets were submitted showing the net worth of the company's property on three different bases, the last being the reproduction estimate at current prices, the letter accompanying the balance sheets stating that the latter basis is the one "which the company has a right to insist shall be used in Federal tax questions and in condemnation suits, and perhaps in other controversies involving values."

At that time there was no intimation that the
40 company intended to use its estimate of the

Return to Writ.

present reproduction value as the basis for adjusting the entries in its fixed capital accounts, which adjustments it was understood would later be submitted to the Board for its approval in accordance with its decision of October 26th, 1923. Nothing further was heard from the company in this matter until it recently filed its
10 annual report for the year 1924, in which is contained a corrected balance sheet as of December 31st, 1923, showing total fixed capital on that date of more than twice the value of the company's property found by the Board in its decisions above mentioned. On this balance sheet is the following note:

"After filing our report for two months ending Dec. 31, 1923, an appraisal was made of the properties as of Nov. 1, 1923 and book
20 entries made giving effect to this appraisal, and an audit was also made as of Jan. 1, 1924. After giving effect to appraisal and audit the following is a corrected Balance Sheet as of Jan. 1, 1924 and net changes shown for 1924 are based on these figures."

From this it clearly appears that the company, without the Board's approval, has adjusted its fixed capital accounts in accordance with a valuation of its property more than twice
30 that found by the Board, completely ignoring the Board's recommendation in this matter given in its decision approving the consolidation by which the company was formed. In setting up its fixed capital accounts in the manner indicated in the company's 1924 report, it has also disregarded the instructions in this matter given in the uniform system of accounts prescribed by the Board for water utilities, which became effective on January 1st, 1913, and remained in
40

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effect until January 1, 1925, when it was superseded by a new system of accounts, effective on the latter date, under both of which systems of accounts it is specifically required that "all charges made to fixed capital or other property accounts with respect to any property acquired on or after January 1st, 1913, shall be the actual cost of the property."

Respectfully submitted,
PHILANDER BETTS,
Chief Inspector, Bureau of Utilities.

Investigation made by,
HENRY S. LYON,
Statistician & Accountant.

A true copy
EDWARD J. KELLEHER,
Clerk.

April 8, 1925.

In re—Fixed capital accounts set up on books of the Passaic Cons. Water Company.

Mr. Walter W. Corrigan, Secy.,
Passaic Cons. Water Co.
158 Ellison St.,
Paterson, New Jersey.

Dear Sir:

I send you herewith copy of report of the Board's Statistician and Accountant, which refers to the above. This has been given consideration by the Board and the Board instructs me to inform you that it desires a representative of the Passaic Consolidated Water Com-

Return to Writ.

pany to appear before it at its meeting to be held on Thursday, April 23rd, at its rooms in the Globe Indemnity Building, 22 Washington Place, Newark, at 10:45 A. M., at which time the matters referred to in the inspector's report will be heard.

Very truly yours,
A. N. Barber,
Secretary.

B:R
Enc.
A true copy.
EDWARD J. KELLEHER,
Clerk.

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Return to Writ.

PASSAIC CONSOLIDATED WATER COMPANY.

General Office: 158 Ellison St.
Paterson, N. J.

10 Edmund Leb. Gardner,
Chairman of the Board.
Wm. R. Edwards, Genl. Supt.
John H. Cook, President.
A. W. Cuddeback, Vice-Prest. & Treas.
Walter W. Corrigan, Sec. & Asst. Treas.
Telephone: Sherwood 2424
Board of Public Utility Commissioners. Re-
ceived April 13, 1925.

April 11, 1925.

20 Board of Public Utility Commissioners,
Mr. A. N. Barber, Secretary,
Trenton, N. J.

Dear Sir:

This will acknowledge the receipt of your communication of the 8th instant, in the matter of

Fixed Capital Accounts set up on the books of the Passaic Consolidated Water Company.

30 We note that you have appointed Thursday, April 23d, 1925 at 10:45 A. M., at the Board's rooms in Newark for a hearing on this matter, and wish to advise you that this Company will have a representative present at the said hearing.

Yours very truly,
WALTER W. CORRIGAN,
Secretary.

40 A true copy,
EDWARD J. KELLEHER,
Clerk.

Opening.

BOARD OF PUBLIC UTILITY COMMISSIONERS.

Newark, N. J., Thursday, April 23rd, 1925.

PASSAIC CONSOLIDATED WATER COMPANY. Fixed Capital accounts set up on company's books. 10

PASSAIC CONSOLIDATED WATER COMPANY. Application for approval of issuance of \$750,000, bonds. 10

20 Before Commissioner J. F. Autenreith, Esq., President. P. Betts, Esq., Senior Inspector. H. S. Lyon, Esq., Statistician.

For petitioner appears Frederic J. Faulks, Esq.

30 Mr. Faulks: We are here on two matters; one on notice from the Board raising some question as to the manner in which we keep our capital accounts. When the calendar was called this morning I suggested that we would like to have that matter laid over because I think that we will get a long way to reaching a solution by discussing it with Mr. Lyon and Colonel Betts and perhaps work it out without bothering the Board if we can take it up with the Board informally.

40 Commissioner Autenreith: Mr. Lyon suggests if we take the testimony on the security issue we could dispose of the other by putting it off to a day or no day, whichever was thought best.

Opening.

Mr. Faulks: Yes. The other matter is this, and there is one part we are quite anxious to have disposed of today, if possible; this second matter is the application for leave to issue \$750,000 more of our consolidated six per cent. mortgage bonds. The mortgage itself is authorized and was approved by the Board sometime ago. Under that authority we have heretofore issued \$1,505,000 of those bonds out of a total of fifty million dollars provided for by the mortgage. We want to issue \$750,000 more of them to take care of our actual capital expenditures for 1924, which, after due allowance for depreciation, came to \$162,647.98. Then we want to issue an additional amount to take care of certain capital expenditures for 1925, a further sum of \$558,000.

20 Commissioner Autenreith: Anticipated capital improvements?

Mr. Faulks: Yes; in part. I can explain just what they are, or the witness better do that, but among them are expenditures of \$145,000 for the purchase of lands for a reservoir site and \$275,000 for the actual construction of the reservoir now in construction on that site.

The situation is this: That among the other municipalities that the applicant supplies in Paterson and Passaic, Clifton and Garfield, our pumping station and filtering plant is located at Little Falls above Paterson and we have, of course, large mains running to those various municipalities. The situation is such that neither of those lines of mains (there being two in number) are sufficient to take care of this entire territory and if anything should happen to either one of them the situation might, therefore, be rather serious. There is at present no reservoir or storage supply for any of those important municipalities.

Opening.

We have entered into a contract with the Highland Water Company to purchase a tract of land of one hundred thirty-five acres located almost entirely in the Borough of West Paterson, a small part of it being in the City of Paterson proper, and have agreed to pay them for that property \$145,000. There is an additional term of the purchase that we shall furnish the Highland Water Company with certain water.

The reason for that is this: They only have on this site a reservoir which, of course, they will no longer be able to use, if and when this sale goes through. We have below that reservoir and below the property we are buying from them, another reservoir which is fed from this upper reservoir. This upper reservoir is neither properly located nor sufficiently large for our large needs. We are proposing to build and in fact, have already, although we haven't taken title to this property, started the construction of the reservoir on the property that will hold sixty million gallons and that will be a supply for approximately three days for these municipalities in case anything should ever happen to our present pumping or distributing service.

You can readily see the importance of that. We feel that cities the size of Paterson and Passaic, to say nothing of these other cities, should not be left without a reservoir storage or supply facilities.

Mr. Cook, the president of our company, has been familiar with this property a long while and knows its value, knows that the Highland Water Company has no need for it and our need for it is great; that the price we are proposing to pay for it is the full, fair price. I would like to call him to testify to the details of that proposed purchase.

John H. Cook, direct.

We have given the Highland Water Company notice of this hearing today and I think they are not represented.

JOHN H. COOK, sworn on behalf of Passaic Consolidated Water Company.

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Direct examination by Mr. Faulks.

Q Where do you reside, Mr. Cook? A Passaic, New Jersey.

Q Are you connected with the Passaic Consolidated Water Company, the applicant in this matter? A I am the president of it.

Q You devote your entire business time to the affairs of this company? A Not all of it, no, sir; but a great part of it.

20

Q How familiar are you with its business matters and the customers it supplies with water? A I have been familiar with the affairs of the Passaic Consolidated Water Company ever since the consolidation and I have been familiar with the affairs of its predecessors for, oh, at least twenty or twenty-five years last past.

Q When was this Passaic Consolidated Water Company formed? A In, I think, October 30, 1923.

30

Q How was it formed? A It was formed by the consolidation of five water companies, the Passaic, the Acquackanonk, the East Jersey, Montclair and Kearny Water Companies.

Q Was such a consolidation approved by the Board? A It was.

Q I show you what purports to be a consolidation agreement or charter of the Passaic Consolidated Water Company (handing witness paper) and ask you if that is a copy of the com-

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John H. Cook, direct.

pany's charter? A That is a copy of an agreement between the companies in respect to the consolidation of the company.

Mr. Faulks: That being on file I don't suppose you care to have it marked.

Commissioner Autenreith: No; we have a copy of that.

10

Q The companies named in this charter, other than the Passaic Consolidated Water Company, are those you have just mentioned and which were merged into it? A Yes, sir.

Q What territories does this Passaic Consolidated Water Company supply? A It supplies about a dozen municipalities in northern New Jersey; Paterson, Passaic, the Town of Bloomfield, Kearny, Harrison, East Newark, Nutley and occasionally supplies some water to Montclair under a standby agreement and is supplying some water to the City of Garfield and supplies water to the City of Bayonne and the Borough of Totowa; I think I have mentioned them all now.

20

Q Does it furnish all the water that is supplied in Passaic, Paterson, Clifton and Garfield? A It does. Garfield has a supply of its own but it has been insufficient for its needs for a considerable period. We have supplied them a greater or less quantity of water for, I should say, possibly the last two years.

30

Q From where does the supply come that is furnished to these last-mentioned municipalities and how does it reach them? A There are two lines of pipe that proceed from the Little Falls filter plant and pumping station. One is a forty-two-inch pipe that goes down what was formerly known as the Little Falls Turnpike directly from

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John H. Cook, direct.

Paterson and the fifty-one-inch pipe that goes from the Little Falls plant and proceeds down through to the south and east and supplies the towns of, or the communities, rather, of Paterson, Passaic and Clifton from the fifty-one-inch pipe at a place in the Town of Bloomfield. This connection is a thirty-inch pipe that proceeds over through Clifton and joins the distribution system in the City of Passaic.

For example, under ordinary circumstances the water flows down through the forty-two-inch pipe to Paterson and is supplemented at Passaic, which is the lower end, so to speak, by this thirty-inch pipe and there is a connection into the lower end of Passaic. So if something happened in Paterson water may come up from the thirty-inch high-pressure pipe connecting with the fifty-one-inch in turn from the lower end. Or in the event of trouble in the other direction water may come down the forty-two-inch pipe from Little Falls.

The situation has been in the last few years that their production during the time where there was draught in Paterson, Passaic and Clifton was so great that we were compelled to pass water across between the fifty-one-inch and the present pipe close or nearby the Little Falls pumping station and Little Falls Turnpike and supplement the supply into the forty-two-inch pipe from the fifty-one-inch pipe. We had no storage directly in connection with the City of Paterson, Passaic or Clifton. The only possible storage we had was to take water from our Great Notch reservoir from the fifty-one-inch pipe and pass it over, as I said before, to the forty-two-inch pipe at Little Falls Turnpike at the place we call the cross-over, which just means a connection between those pipes.

John H. Cook, direct.

Q If anything should happen to any of these large pipes you have mentioned, what effect would that have on the supply of a sufficient amount of water? A Well, at the present time, if any serious accident happened to the forty-two-inch Paterson pipe it would cripple the whole situation there; or in the event of an accident happening to the thirty-inch connection with the fifty-one-inch pipe at the lower end it would have the same effect, although probably not in such a great degree. This proposed reservoir is close to Paterson and is on what is ordinarily known as Garrett Mountain which, as most people know, is a high spot or cliff that overlooks Paterson.

Q Then, as I understand your evidence, neither one of these large mains which you refer to is in itself sufficient to take care of the needs of that locality if the other main should be out of commission? A That is right.

Q What storage or reservoir supply have you now to these municipalities? A Well, we have about a hundred fifty-two million gallons of water stored in what we call the Great Notch reservoir, and then we are fortunately connected in such a way with Newark pipes that there are times when Newark could assist us in the case of a calamity and we could assist Newark, because the water in both of those pipes is just about the same pressure, about the same elevation. This reservoir which we hope to build, propose to build, will add about sixty million gallons of water which will be directly, you may say, in Paterson itself and will enable us to operate much more satisfactorily than we now do because there are times during the day when the draught is very heavy from the Little Falls pumping station and then periods during the

John H. Cook, direct.

night when the draught is comparatively light; that causes an irregular operation of the filter plant and pump.

Commissioner Autenreith: In your opinion that reservoir is necessary in the future to render a reasonably safe and adequate service to these municipalities?

Witness: It is so, yes, sir.

Q Is this allegation of the application correct; that the present system of approach through Passaic at the present there is no reserve supply for that territory and the proposed reservoir will be sufficient for practically three days' supply for this territory and will in addition equalize the pumping and effect a considerable saving in that respect? A It will, yes, sir.

Q Are those allegations correct? A Yes, sir.

Q Having that situation in mind and the necessity for meeting it, what has the company done? A The company availed itself of the services of a prominent and well known hydraulic engineer, Mr. Wiggins, and he in collaboration with our Mr. Cuddeback, who is the engineer and superintendent, as well as the vice-president of the company, gave this matter a great deal of study some months ago and looked over the territory that was in any way available for the building of a reservoir such as was needed for this section. And they finally selected this property of the Highland Water Company on Garrett Mountain as being the most desirable location for a reservoir and the most economical reservoir for the company to build that was anywhere in the vicinity.

John H. Cook, direct.

Q As a result of such investigations did they reach a conclusion? A We made a conclusion to purchase this property which is shown on the blue-print before you of the Highland Water Company.

Q Is this paper between the Highland Water Company and the Passaic Consolidated Water Company entitled "Contract for sale of upper reservoir property" the contract to which you refer? A Yes, sir.

Q Is there a true copy of it attached to the petition in this matter? A Yes, sir.

Q That contract I note, Mr. Cook, is dated January 29th, 1925, and calls for the transfer and closing of title on February 2nd, 1925. Has the title actually been closed? A It has not, due to the difficulties that arose in respect to the search of the property, which I believe now has all been cleared up.

Q Is the consideration that the Passaic Company proposes to pay the Highland Water Company for this property correctly set forth in this petition? A It is.

Q I mean, in this contract? A It is.

Q Is it contained in the 3rd and 4th sections of that contract? A It is.

Q Now, I show you a blue-print (handing witness blue-print) and ask you to point to the Board where the property described in that contract is located and the necessity for its acquisition by this company as well as the bearing its sale will have on the Highland Water Company. A This area that is shown in the lighter color on this blue-print, which is marked H. W. Company and front a part of it, on New street; it is in the Borough of West Paterson, almost of all of it, and is on the top of Garrett Mountain and is, a part of the property is on the edge of the

John H. Cook, direct.

bluff which runs along parallel with Valley Road to Montclair; contains about one hundred thirty-five acres and is a part of the property of the Highland Water Company that is shown on this map.

10 Q The part they have contracted to sell to you is all that is shown in the shaded color on the map. A South and east of New street. This is New street (indicating on map); this is south and east of New street.

Q Down at the extreme left-hand corner of the map are two parallel lines shown in shaded color; are they part of the property? A They are part of the property.

20 Q So you, in fact, get all of the property that is shown in the lighter shaded color on the map, do you not? A We do, except that part that is north of New street. We have acquired some property north of New street but only a small area that we needed for our dam or some change of the roadways.

30 Q What is at present located on the property that is proposed to be acquired by your company? A There is, I think, perhaps one or two small houses and the principal thing is a small reservoir, that belongs or did belong in fact to the Highland Water Company. That reservoir was a storage reservoir and supplied water through a plug, which is shown on the map by an irregular line, to another reservoir on the property which still belongs to them, which is north of New street. And they used that upper reservoir, so called, in the summer season to replenish water to the lower reservoir.

40 Q Where do you propose to construct this reservoir on this property that is acquired by your company? A Off this tract that is south

John H. Cook, direct.

and east of New street and is below this small reservoir that is shown as the Highland Water Company.

10 Q Why don't you use the site of this old and small reservoir? A For this reason, that in order to utilize that reservoir we would have to reinforce it to some extent and the elevation would be about twenty-five or thirty feet higher than is necessary or desirable for our purposes, which would put a constant burden on the pumping plant at Little Falls to push that water to twenty-five or thirty feet.

20 Q Is that present small reservoir sufficient for storage purposes for your company, in any event? A No. It is too small anyway. It is about one-tenth of the size of the reservoir which we propose.

Q What would be the capacity of this proposed reservoir? A Sixty million gallons of water.

30 Q When that reservoir has been built how will the water which rises and flows on this property continue to reach the lower reservoir of the Highland Water Company? A We are at the present time building what we call diversion ditches which will carry water from this upper reservoir of the Highland Water Company and pass it around our reservoir. We will be compelled to protect our reservoir from any possible surface water that comes on to this Barber property and this water that comes on this territory will pass around the reservoir which we will build and proceed down the plug below our reservoir, just as it did before, to the lower reservoir of the Highland Water Company.

40 Q So that most of that surface water will reach your new reservoir? A Will reach our new reservoir, will get into our new reservoir.

John H. Cook, direct.

Q What do you know about the value of this property, Mr. Cook? A When we began to negotiate for it the Highland Water Company had a proposition and a partial contract to sell that property to some pleasure company or some parties of that kind and the City of Paterson was also considering the purchase of it for a playground or pleasure park, something of that kind. The price which was, in a sense, when agreed upon between the Highland Water Company and the proposed purchaser, was the price which they named to us when we interviewed them in respect to this purchase.

Q Are you familiar with the values of property in that vicinity as a result of the properties that your company has acquired at other sales?

A I am not particularly familiar with the value of property in that vicinity but I do know that some of the purchases we have made, the cost per acre was quite like the cost per acre for this property. This property was held by the Highland Water Company as a valuable property because the city had talked about purchasing it for this pleasure park and these men had a sort of contract to purchase it from the Highland Water Company. The way I know that is we had to wait, when they made their agreement with us, until the time elapsed when the other party was going to purchase property.

Q From your knowledge of this property are you or not able to state whether the consideration which is to be received for it by the Highland Water Company is the full and fair value of the property? A I believe it is. I believe under all these circumstances I would say it was a good and sufficient sum to pay them for this property.

John H. Cook, direct.

Q You have said for reasonable necessities of the municipalities to which this company supplies water in that part of New Jersey the acquisition of this property and the construction of the proposed reservoir is necessary and to their interest. A It is.

Q Have you actually started the construction of that reservoir? A We have, and we have already spent about forty thousand dollars, which includes the five thousand dollars that we paid down on this agreement to buy the property.

Q You have paid five thousand dollars of the agreed purchase price? A We have.

Q Will you or will Mr. Cuddeback testify as to the cost of the construction of this reservoir when completed? A Why, Mr. Cuddeback has followed that thing up very closely and he can better testify in respect to the cost of the construction of the reservoir that I can.

Q Then I will ask you to deal with the capital expenditures made by the company during 1924 and which you now ask to have capitalized; are you familiar with those? A I am.

Q Show on schedule 1 of the petition. A They are shown there and the details are given rather completely in the annual report to the Public Utility Commission, which has already been filed, and the inspector of the Commission has visited our works and had observed to a greater or less extent and assisted in checking up these expenditures.

Q Have they or not in fact all actually been made? A They have been.

Q Were they made during 1924? A They were.

Q Were they all for capital expenditures? A They were.

John H. Cook, direct.

Q Without taking too much time state the nature of them by reference to this schedule 1.

A These water diversion rights were part of a tag-end of some condemnation proceedings which we were compelled to bring against the Weidmann and National Silk Dyeing Companies in Paterson for diversion rights against their properties along the river. That involved some—

Q That amount received and the actual amount paid them in such condemnation proceedings? A It does. That sum of \$984 is in connection with the filters for grading about the filter plant. When this addition to our filter plant was made in 1918 we were burning coal at that time and the accumulation of ashes on the embankments about that addition to the filter plant were left with the idea that we should fill up that embankment from our ashes from the plant. And that thing dragged along to some degree because for the last two years or so we have burned oil almost exclusively in that plant and we have had less ashes for these embankments and the grading has sort of dragged along. But we do from time to time grade with our men and teams, to keep them employed and to finally complete this grading, which I think is now pretty nearly completed.

In this chemical treatment at the plant, we put in some new cross cells that manufacture chlorine from a solution of common salt. We make a great deal of our own chlorine there, which is used in the sterilization of the water. We have also chlorine we purchase, but we make a good part of our chlorine there and this involves some cells for that manufacture.

Around the ground to the pumping station—

John H. Cook, direct.

Commissioner Autenreith: You needn't go into all the items in detail.

Witness: I shouldn't say so.

Commissioner Autenreith: The money was actually expended.

Witness: Yes, sir.

Q In your opinion it is all necessary for the proper and ordinary conduct of the business of the company? A They were.

Q Shall I take up with you the matter of the proposed expenditures for 1925, actual or proposed? A You better take them up with Mr. Cuddeback because he has been in close touch with it and helped to make up these figures.

Q Will you be good enough to tell us what disposition you can make of the bonds which are sought to be authorized under this petition if the application is granted by the Board? A I have a sales arrangement with the New Jersey General Securities Company whereby they will agree to take these bonds at par if their issuance is approved by the Commission.

Q They are six per cent. bonds? A They are six per cent. bonds.

Q They will take them at par? A They will take them at par.

Mr. Faulks: I don't think there is anything else.

Commissioner Autenreith: There is a criticism in the report made by the inspector. I think we might as well clear it up. I think Mr. Cook will probably know about it. Your outstanding capital stock is three and a half million?

Witness: Yes.

John H. Cook, direct.

Commissioner Autenreith: Your bonds are \$7,939,000?

Witness: Well, that is just about the figure; almost eight million.

Commissioner Autenreith: Almost eight million?

10

Witness: Yes, sir.

Commissioner Autenreith: I understand from this memoranda here that you took the Board's valuation of \$11,500,00 in the consolidation of the companies as the value of the properties.

20

Witness: Well, I don't think that—what I mean is this: When we effected that consolidation or when it was finally effected we started with a new set of books and we had a valuation of the properties made by Mr. Nicholas S. Hill in order that we might start our books with the proper figure representing the value of our property. We considered that the figure that had been placed on it by the Commission did not include all our property and was made purely for the purpose of fixing rates.

30

Commissioner Autenreith: I understood at the previous application for a security issue before this Board you adopted for the purpose of that issue the eleven and a half million dollar valuation.

Witness: When we asked for the issuance of those securities I think the total amount of stock and bonds that were issued was based on that eleven and a half million of which you spoke.

40

Commissioner Autenreith: You see, the point I am getting at is this: Since then

John H. Cook, direct.

you, of course, have a certain amount of capital investment but you have sold the Montclair property, unless something happened to make up those adjustments apparently there would be no assets to issue any more securities against.

10

Witness: The way I see it is this: We are asking the Board to approve the issuance of bonds to take care of expenditures, capital expenditures that have already been made and capital expenditures that we propose to make within the next year; as I understand it, or within this year, as I understand it; we may not, unless with the Board's permission, issue these bonds until we need some money for this purpose.

20

Commissioner Autenreith: You would still be overcapitalized by this amount, perhaps more than this amount, unless some adjustment was made to take care of the Montclair property; for the same reason, I suppose, that you did not retire a certain amount of securities against that.

Witness: What might be the fact—

Commissioner Autenreith: I think the proof ought to be offered to justify what the situation is.

30

Mr. Faulks: You mean, in regard to present value?

Commissioner Autenreith: So that I can see if this issue which you now ask for is granted that the total property now on hand would reasonably represent the value of the total amount of securities outstanding.

Mr. Betts: I think the testimony ought to include information as to the disposal of

40

John H. Cook, direct.

the proceeds obtained from the Montclair property. That is the point.

Mr. Faulks: There is no reason why that shouldn't appear on the record; if you know it.

10 Witness: It does appear to a certain extent here on page five, at the bottom of the page. It distinctly states that dividends of thirty-four and twenty-eight five seventy-one was declared from the proceeds of the sale of the property formerly of the Montclair Water Company.

Mr. Betts: Were all the proceeds distributed?

20 Witness: No. For that purpose we got one million seven hundred thousand dollars which was, I think, almost twice what the valuation that had been placed on that property, as near as we could determine it, that had been placed on that property by the Board. Of that one million seven hundred thousand dollars the town assumed five hundred thousand dollars of bonds, which left with us one million two hundred thousand dollars in cash. We finally declared that out
30 as a dividend to the stockholders of the Passaic Consolidated Water Company.

Mr. Betts: How much stock was there of the Montclair Water Company?

40 Witness: That stock of the Montclair Water Company went into the consolidation and it has never been distributed, of course because the Montclair Water Company has gone out of existence and there is no more stock of the Montclair Water Company.

John H. Cook, direct.

Mr. Betts: But the equivalent is now outstanding as the stock of the Passaic Consolidated Water Company?

Witness: The mortgage, or at least, the amount of stock issued and bonds issued I think just about represented eleven and a half million dollars at the time the Board
10 approved the issuance of the stock and bonds at the time of the consolidation.

Commissioner Autenreith: Now, if you take out of your valuation the approximate value the Board found on the Montclair property it would still leave outstanding the securities that were then outstanding and you will run over the line in this issue.

20 Witness: We had about five hundred thousand dollars, as I remember, of capital of the Montclair Water Company, although I am not quite sure; the capital stock of the old Montclair Water Company was five hundred thousand dollars.

Mr. Betts: It is just about that amount. The capital account was not readjusted and the one million two hundred thousand dollars came into the treasury of the Consolidated Water Company.
30

Witness: I see what you mean.

Mr. Faulks: Isn't this the situation: The Board fixed for rate purposes, and perhaps for purposes of approving this mortgage and the earlier issuance of bonds thereunder, a valuation of eleven million five hundred thousand dollars. It is my recollection (I may be wrong about this) in that valuation the property of the Montclair Water Company was included at one million one hun-
40

John H. Cook, direct.

dred thousand dollars. Is that not more than that amount?

Witness: Somewhat less than that I think.

10 Mr. Faulks: Somewhat less than that. We realized, as Mr. Cook has said, nearly twice the value placed by the Board on that property. And therefore, after having distributed to our stockholders one million two hundred thousand dollars we still have left ample capital for the purpose of this application. If we had only realized from the Montclair sale the amount that the Board valued that property under the rate case and distributed all of the amount realized to our stockholders, it would seem to me there might be some question about it. But where
20 we have one million seven hundred thousand dollars and only distributed one million two hundred thousand dollars it seems to me there is ample property left to justify the issuance of these proposed bonds. Certainly, up to the amount that is needed to pay for this property.

(Discussion.)

30 Witness: The only reason we have gone ahead and worked on this reservoir is that we hope to complete it this season. In order to do that we must make hay while the sun shines.

Commissioner Autenreith: The approval of the sale of the Highland Water Company need not necessarily wait on the rest of this issue.

40 Mr. Lyon calls my attention to the fact that the amount involved in the sale of the Highland Water Company could be ap-

A. W. Cuddeback, direct.

proved, in any event, because it would still leave sufficient to dispose of the other question involved in the balance of the issue. I thought you might complete your proof on that and then we will take it up afterwards.

10

A. W. CUDDEBACK, sworn on behalf of petitioner.

Direct examination by Mr. Faulks.

Q Where do you live? A Paterson.

Q What position do you hold with the Passaic Consolidated Water Company? A I am its vice-president and engineer.
20

Q How long have you been connected with the company and its predecessors that were merged into it on October, 1923? A About twenty-seven years.

Q You are familiar with the company's properties? A I am very familiar with them.

Q Without going into details, what is the situation with regard to the necessity for the proposed storage reservoir with a capacity of approximately sixty million gallons on the property contracted to be bought from the Highland Water Company? A Formerly the Passaic Water Company had a service, a so called service reservoir within the city limits of Paterson up to a capacity of about thirty million gallons; but the constant demands for increased pressure have put these reservoirs out of commission; they are too low to supply the territory. It is not safe to operate a water supply to communities like Paterson, Passaic and Clifton un-
30
40

A. W. Cuddeback, direct.

less the continuity of service is guaranteed, within reason.

Commissioner Autenreith: I don't think you need any more proof on the necessity for this.

10

Q Are you familiar with the property that is covered by this contract? A I am, yes, sir.

Q Is it necessary for the purpose of the construction of that reservoir? A It is necessary, yes.

Q What have you to say as to whether or not if this contract is consummated the Highland Water Company is receiving the full and fair price? A They will receive a full, fair price in my opinion.

20

Q Turning to your capital expenditures. In the first place, what have you to say of the probable or certain cost of the reservoir now in process of construction on this property there. A I estimated it at two hundred seventy-five thousand dollars beyond the cost of the land. A very careful estimate has been made of that.

Q Are you familiar with the amounts that were expended during 1924, as shown in schedule one and testified to by Mr. Cook? A I am. I have been in charge of the expenditures.

Q Were they all actually expended as shown? A They were.

Q Turn to schedule two, please, which is the one that has to do with this effected or proposed capital expenditures during 1924. A The first item, thirty-eight thousand dollars, is our pipe inventory as of January 1st.

Q Actually on hand at that time. A Actually on hand at that time.

40

A. W. Cuddeback, direct.

Q Has the fifty thousand dollars mentioned as being under contract to purchase been actually ordered on the contract? A Yes, and part of the pipe delivered. The item of seventy-five thousand dollars is an estimate of the cost of laying the pipes, included in the two items above, and which will be laid during the coming year. The items following are estimates of the amount we will spend on those items, setting meters, service pipe and hydrants.

10

In miscellaneous construction we take care of various items that usually occur, always occur, as a matter of fact, and they are illustrated in the previous years' experience.

Q What is your last item, cost of office building, Prospect street? A That is a building we purchased recently in Passaic which we have occupied as an office for a number of years and which we could not secure for less.

20

Q All the items shown in both of these schedules are necessary and proper expenditures of the company? A They are.

Q And for the purposes that are indicated? A Yes.

Mr. Faulks: I think that is all.

Commissioner Autenreith: There is Colonel Betts' report (handing counsel report); you might read that over. Mr. Lyon has some criticism in regard to the question of capitalization.

30

(Matter taken into conference.)

40

Proceedings of November 20, 1925.

BOARD OF PUBLIC UTILITY
COMMISSIONERS.

Newark, N. J., Thursday, Nov. 20th, 1925.

10 Further hearing in the matter
of fixed capital accounts on
the books of the Passaic Con-
solidated Water Company.

Before the following Commissioners: Jos. F. Autenreith, Esq., President. F. W. Gnichtel, Esq., and Charles Browne, Esq.

For petitioner appear: Harry V. Osborne, Esq., and Frederic J. Faulks, Esq.

20 Mr. Osborne: We expected to be ready today, in fact, if it was really necessary we could be, but Mr. Faulks has been away three weeks for his health and just arrived this morning. I had a very short interview with him. If there is no objection I would like now to ask that this go over one more week.

Commissioner Autenreith: That is Thanksgiving.

30 Mr. Osborne: Whatever day you say.

Commissioner Autenreith: December 3d. This hearing is largely on the Board's request to comply with its rules.

Mr. Faulks: I think we can put in our proof in a very short time that day.

Mr. Osborne: It is just because of our inability to get together because of Mr. Faulks' absence.

40 A true copy.

EDWARD J. KELLEHER,
Clerk.

Nathaniel Sofman, direct.

Commissioner Autenreith: There is no objection to the adjournment.

Mr. Osborne: Two weeks?

Commissioner Autenreith: December 3d.

(Adjourned until Thursday, December 3d, 1925, at the Globe Indemnity Bldg., Newark, 10 N. J., at 11 o'clock A. M.)

A true copy.

EDWARD J. KELLEHER,
Clerk.

Newark, N. J., Thursday, December 10, 1925.

NATHANIEL SOFMAN, sworn on behalf of 20
Board of Public Utility Commissioners.

Direct examination by Mr. Queen.

Q Are you connected with the Board of Public Utility Commissioners? A Yes, sir.

Q In what capacity? A Chief statistician and accountant.

Q How long have you been connected with the Board? A Since 1911. 30

Q And how long in the capacity in which you are now employed? A I was assistant until August 1, 1925, and since that time I have been chief of the department.

Q Will you state briefly your qualifications for the duties which you are now performing? A Graduate of Barringer High School; attended New York University School of Finance and Accounts, New York University Law School; certified public accountant; registered municipal ac- 40

Nathaniel Sofman, direct.

countant; and I have been engaged in this kind of work for fifteen years.

Q Has the Board of Public Utility Commissioners adopted a uniform system of accounts for water utilities? A Yes, sir.

10 Q When was that uniform system of accounts effected, when did it become effective? A The first system went into effect January 1, 1913, and has since been revised as of January 1, 1925.

Q Have you the pamphlets showing those uniform systems of accounts? A Yes, sir.

Q Will you produce them please. A (Complies.)

Q Is this pamphlet which I show you the uniform system of accounts?

20 Mr. Osborne: May we shorten this by admitting that there is a uniform system of accounts effective January 1, 1925, and that certain paragraphs of it are pertinent to this issue, and if you will indicate what paragraphs they are we won't have to encumber this record with a lot of testimony.

30 Mr. Queen: I want to have the uniform system of accounts effective January 1, 1913, marked in evidence, and also the uniform system of accounts effective January 1, 1925, marked in evidence, in order that we may refer to them later in the examination.

Mr. Osborne: What is the pertinency of the old one? It is superseded by the later one, is it not?

40 Mr. Queen: The first one was effective at the time of the consolidation of these companies, and the one in effect January 1, 1925, was not then effective.

Nathaniel Sofman, direct.

Commissioner Autenreith: There is no objection to admitting them, I suppose, so far as those portions of them that may be pertinent to this inquiry?

10 Mr. Faulks: I think it ought to be understood, prior to the admission, that counsel will call the attention of the Board to such parts of these pamphlets as he claims are pertinent to any issue involved, and that those should be the only parts that will be printed in case of an appeal.

Commissioner Autenreith: I think there is no objection to that.

Mr. Queen: No objection, no, sir.

20 Commissioner Autenreith: Of course, any matters contained in these pamphlets that are not material to this question, are immaterial, so far as this record is concerned.

Mr. Queen: I offer such parts of the uniform system of accounts as may be pertinent to this question.

Mr. Faulks: And brought to the attention of the Board.

Mr. Queen: That will develop as we go through the examination.

30 Commissioner Autenreith: The witness may indicate the sections, and the sections not indicated by the witness, so far as their contents are concerned, will not be pertinent.

Q (By Mr. Queen.) Mr. Sofman, does the uniform system of accounts for water utilities conform in any respect to the system adopted or approved by the Interstate Commerce Commission of the United States? A In a general way, yes.

Nathaniel Sofman, direct.

Mr. Faulks: I don't think that is a proper question. It calls for an opinion of the witness.

Commissioner Autenreith: It doesn't appear that the witness has any knowledge as yet of the Interstate Commerce Commission's system of accounts. 10

Mr. Faulks: No.

Mr. Osborne: Why can't we put in the uniform system of accounts and then leave it for the Board to determine the extent of the conformation and whether it does conform?

Commissioner Autenreith: Are we going to have any evidence of the uniform system of accounts of the Interstate Commerce Commission? 20

Mr. Osborne: I assume they must follow it up by that, if this is competent. This would only be competent in the event of that going in, in any case. This is only the witness' opinion.

Commissioner Autenreith: No doubt about that, except that we think the witness is qualified as an expert to express some opinion on the subject. 30

Mr. Osborne: I think the mixing of the uniform system here and in the Interstate Commerce Commission has no basis. All they have to do is to offer certain sections.

Commissioner Autenreith: Don't you think that this witness is qualified as an expert to state that in his opinion one conforms to the other?

Mr. Osborne: He may be qualified, but I can't see that it is competent to this issue. 40

Nathaniel Sofman, direct.

Commissioner Autenreith: I think your objection is well taken as to the fact that there is no evidence as yet that he is acquainted with the Interstate Commerce Commission system.

Mr. Queen: That was merely an introductory question. I am going to ask the witness to produce the uniform system of accounts as adopted by the Interstate Commerce Commission. 10

Q (By Mr. Queen.) Have you that system of accounts, Mr. Sofman? A Yes, sir.

Commissioner Autenreith: Let me ask you, as to the uniform system of accounts of the Interstate Commerce Commission, are they pertinent only in relation to certain portions? 20

Mr. Queen: Yes.

Commissioner Autenreith: Then the same ruling with respect to the pertinent parts of the Interstate Commerce Commission system of accounts may apply, as well as to the rules and regulations maintained by the Board.

Mr. Queen: Yes, and they will be referred to in my examination. 30

Mr. Osborne: The witness produces the uniform system of accounts adopted by the Interstate Commerce Commission.

Mr. Queen: I offer the uniform system of accounts for telephone companies, as prescribed by the Interstate Commerce Commission in accordance with Section 20 of the Act to Regulate Commerce, the issue of January 1, 1913. 40

Nathaniel Sofman, direct.

Mr. Osborne: On its face that doesn't seem to be pertinent.

Q (By Mr. Queen.) I ask you this question, Mr. Sofman: Has the Interstate Commerce Commission, to your knowledge, adopted a uniform system of accounts for water utilities? A
10 The Interstate Commerce Commission has no water companies under its jurisdiction; therefore, no system has been adopted.

Mr. Osborne: Now I think it is the proper time to object to the admission of the uniform system of accounts for telephone companies as prescribed by the Interstate Commerce Commission.

20 Commissioner Autenreith: I will allow it to go in because there may be a question of how any system might or might not be—

Mr. Faulks: How can it be proper to pick out one kind of company that is under the jurisdiction of the Interstate Commerce Commission? If this is offered as its uniform system of accounts, then the evidence should include that system.

30 Commissioner Autenreith: Should be general?

Mr. Faulks: Yes. It might be that it would be something quite to the contrary with regard to a railroad company.

Commissioner Autenreith: That might be one reason for not allowing it to go in, but I will admit it subject to your objection.

40 (Pamphlet entitled "Uniform System of Accounts for Telephone Companies, as Prescribed by the Interstate Commerce Commission in accordance with Section

Nathaniel Sofman, direct.

20 of the Act to Regulate Commerce, First Issue, Effective on January 1st, 1913," received and marked Exhibit C. 3.)

Q Referring to this pamphlet which has just been marked in evidence, I want to ask you now to read the first paragraph, Section 9, defining fixed capital. A Page 32, Section 9, "Fixed Capital Defined"—
10

Mr. Faulks: Just a moment. We object on the ground that there is nothing to indicate that the pamphlet containing the uniform system of accounts for telephone companies as prescribed by the Interstate Commerce Commission, is or is representative of any uniform system of accounts the Interstate Commerce Commission may have adopted.
20

Commissioner Autenreith: I will accept the testimony subject to your objection and assume your objection will relate to all questions that may arise concerning the exhibit of the Interstate Commerce Commission in its entirety.

Mr. Queen: I call the Board's attention to paragraph 17, Section D, of the Public Utility Act, which says that "such system shall conform"—referring to the system of accounts—"insofar as in the judgment of the Board is practicable, to any system adopted or approved by the Interstate Commerce Commission of the United States of America."
30

Commissioner Autenreith: As I say, it may be a matter of construction as to just what the statute means with relation to this class of accounts as we determine it.
40

Nathaniel Sofman, direct.

Q (Last question read.) A "Fixed Capital Defined. By the fixed capital of a company (frequently termed the Construction Account) is meant the property, both tangible and intangible, which is devoted to the accomplishment of the principal purposes of its business, and which
10 has an expectation of life in service of more than one year from date of installation in service—exception being made in the case of hand tools and other small portable tools that may be lost or stolen."

Q Now, will you read Section 10 on page 33 of this pamphlet? A "Costs to be actual money costs—"

Mr. Osborne: Pardon me. What can we
20 understand to be the reason for the introduction of this Section 9? It is merely a definition. It has nothing to do with the system of accounts.

Mr. Queen: Because these sections which the witness is now reading are practically the sections of the Interstate Commerce Commission's Uniform System of Accounts which have been adopted by the Board.

Commissioner Autenreith: I can tell you
30 better what they are after I see them. You might put them in the record.

Mr. Osborne: This is entitled, "Instructions Pertaining to Fixed Capital Accounts." It goes in subject to the same objection, as I understand it.

Commissioner Autenreith: It is all subject to the objection made originally.

Mr. Osborne: What section did you ask for next?

40 Mr. Queen: Section 10, Page 33.

Nathaniel Sofman, direct.

A "Costs to be actual money costs. All charges made to fixed capital or other property accounts with respect to any property acquired on or after January 1, 1913, should be the actual money costs of the property. When the consideration actually given for anything with respect to which
10 a charge is made to any fixed capital or other property account is anything other than money, the actual consideration should be described in the entry with sufficient fullness and particularity to identify it, and the amount charged should be the actual money value of such consideration at the time of the transaction."

Mr. Osborne: That is practically the same clause as is in the Board's classification.
20

Mr. Queen: Yes.

Q Now, will you turn to page 33 again, Mr. Sofman, the same page that you have been reading from, and read Section 12? A "Costs of labor, materials and supplies.—The term cost as used in the fixed capital (or construction) accounts means the actual cost in money of labor and materials used in construction, or the actual cost in money of property acquired after construction, or if the consideration given is other
30 than money, the actual money value of such other consideration at the time of the purchase. Cost of labor includes not only wages, salaries, and fees paid employees, but also the personal expenses of such employees when borne by the company. Cost of material and supplies consumed in construction is the cost at the places where they enter into construction, including cost of transportation and inspection when spe-
40

Nathaniel Sofman, direct.

cifically assignable. If such materials and supplies are passed through storehouses, their cost entered in the account may include a suitable proportion of store expense."

10 Q Now, will you refer to the uniform system of accounts adopted by the Board and to the sections covering the same subject matter?

Mr. Faulks: The issue of 1913 or the issue of 1925?

Mr. Queen: The issue of 1913. The issue of January 1, 1913, was admitted in evidence, but was not marked.

20 (Pamphlet entitled, "State of New Jersey, Board of Public Utility Commissioners, Uniform System of Accounts for Water Utilities, First Issue, Effective January 1, 1913," received and marked Exhibit C. 1.)

Mr. Queen: I also offer the 1925 issue.

30 (Pamphlet entitled, "State of New Jersey, Board of Public Utility Commissioners, Uniform System of Accounts for Water Utilities, First Revised Issue, Effective January 1, 1925," received and marked Exhibit C. 2.)

Q (Last question read.) In Exhibits C. 1 and C. 2.

Commissioner Autenreith: The same subject matter that is in Exhibit C. 3?

Mr. Queen: As in Exhibit C. 3, yes.

A I have them.

40 Q Will you read them, please?

Nathaniel Sofman, direct.

Commissioner Autenreith: Are they identical?

Mr. Queen: I think they are.

Commissioner Autenreith: They have the copies. There is no objection to that, I take it; they speak for themselves. 10

Mr. Osborne: Will you tell us the paragraph in Exhibit C. 1?

Witness: In Exhibit C. 1, page 8, paragraph 10, and page 9, paragraph 12. In Exhibit C. 2, page 32, paragraph 3 and paragraph 4.

Mr. Queen: I request that those paragraphs be incorporated in the record, without actually reading them now, so that we will have them in consecutive form. 20

Commissioner Autenreith: They are in your exhibits, aren't they?

Mr. Queen: Yes.

Mr. Osborne: We understand, from what you said a few moments ago, that the only one that is pertinent to this issue is the one effective January 1, 1913.

I should think the whole situation could be summed up in a nutshell by a stipulation and thus avoid all this talk on the record, by a stipulation that the statute governing the situation is so and so—I have forgotten the paragraph—and that pursuant to the statute the Board promulgated this system of accounts as of such and such a date, and containing that paragraph, and later revised it, and that it is still in effect. That is all there is to it. 30

Commissioner Autenreith: And the Interstate Commerce Commission regulations, 40 as they are applicable.

Nathaniel Sofman, direct.

Mr. Osborne: Yes.

Mr. Queen: That is practically all on the record now.

10 Mr. Osborne: It is all on the record, but it is on the record in several pages and I was merely suggesting that it be condensed in a few lines.

Commissioner Autenreith: Well, we have got it now. Proceed with your further questions.

Q What was the date of the consolidation of several companies into the Passaic Consolidated Water Company? A They were consolidated under a decision of the Board dated October 26, 1923.

20 Mr. Faulks: Just a moment. I would like to know what paper the witness is using. He seems to have before him a series of questions and answers.

Commissioner Autenreith: There is no objection to your knowing what it is.

30 Q (By Commissioner Autenreith.) What is it, Mr. Sofman? A It is a list of questions and my answers to them. Of course, the answers were all prepared by myself.

Q (By Mr. Faulks.) You have a list of questions there, together with the answers to them as prepared by you? A The answers were all prepared by me.

Mr. Queen: You may throw that aside, if you desire.

40 Mr. Faulks: His counsel has one copy of them and the witness has the other. The

Nathaniel Sofman, direct.

answers seem to be agreed upon in advance. That is an extraordinary procedure, I should think.

10 Commissioner Autenreith: I take it that the information is taken from the records of the Board and it is just for handy use and nothing else. If you object to the witness referring to it, I will sustain your objection.

Mr. Faulks: I certainly do.

Commissioner Autenreith: Very well then, Mr. Sofman, just discard that list.

Q (By Mr. Queen.) Where is that decision of the Board reported, Mr. Sofman? A It is reported on page 259 of Volume XI, reports of the Public Utility Commissioners.

20 Q Is it page 253 or page 259? A Well, it begins at page 253 and runs through to that page.

Mr. Queen: I offer that decision in evidence.

Q What are the names of the companies that were consolidated?

30 Mr. Osborne: Doesn't the report speak for itself in that respect?

Commissioner Autenreith: Yes, I think it does, Judge. The report has all the names in it.

Mr. Queen: I also offer in evidence the Board's decision in the rate case of the Acquackanonk Water Company and other companies, as reported in Volume XI of the reports of the Public Utility Commissioners, page 11.

40

Nathaniel Sofman, direct.

Mr. Osborne: Was that prior to the consolidation?

Commissioner Autenreith: Yes.

Mr. Faulks: That is the decision in the rate case?

10 Commissioner Autenreith: Yes.

Mr. Faulks: I suppose the purpose of that offer is merely to show the valuation that was fixed on certain parts of the companies' property in the rate case?

Mr. Osborne: And used subsequently in the consolidation.

Commissioner Autenreith: And used subsequently in the consolidation, yes.

20 Mr. Queen: I now offer in evidence the annual reports of the Passaic Consolidated Water Company, filed with the Board for a part of the year 1923 and also for the year 1924.

Q Have you those reports, Mr. Sofman? A Yes, sir.

30 Q Will you refer to the pages in the books which you have just produced, or is it all one report of the company? A No, sir, there are two books.

Mr. Faulks: Are there pages, Judge, that might be said to be pertinent to the question here?

40 Q Are there any pages to which you desire to refer, Mr. Sofman? A In the 1923 report I would like to refer to pages 8 and 9, which show the balance sheet of the Passaic Consolidated Water Company as of December 31, 1923.

Nathaniel Sofman, direct.

Q (By Commissioner Autenreith.) What facts are there on pages 8 and 9 of the 1923 report that are of importance? A It indicates the book value of the Passaic Consolidated Water Company as of December 31, 1923.

10 Q And what is that value indicated? A The book value, \$13,283,817.14, from which should be deducted the depreciation reserve of \$1,537,454.48.

Mr. Osborne: The witness says "from which should be deducted;" does he mean to say "which is deducted" in that report or "which should be deducted," in his opinion?

Witness: No, it is deducted in the report.

Mr. Osborne: I see. I just wanted to make it clear on the record. 20

Q Do you know whether that part of the report conforms to the decision of the Board as found on page 259?

Commissioner Autenreith: In which case?

Mr. Queen: In the merger case.

30 Q I suggest that you read that part of the report so as to get it on the record.

Mr. Osborne: Isn't that a matter which appears on its face?

Mr. Queen: Yes, but it doesn't appear unless you get it in the record.

Commissioner Autenreith: You have the certificate of approval of the merger and you have the annual report. If they conform I suppose it appears so from a comparison of the two exhibits, doesn't it? 40

Nathaniel Sofman, direct.

Mr. Osborne: He is asking the witness to express an opinion on something which speaks for itself.

Commissioner Autenreith: Does it appear by comparison that they do conform?

10 Mr. Queen: It does, but I wanted the figures as read from the report and the decision of the Board so as to show that a conclusion can be reached by the Board.

Mr. Faulks: The note ought to be put in the record at the same place.

Commissioner Autenreith: In the report of 1923 there is this notation at the bottom—

Mr. Osborne: What page?

20 Commissioner Autenreith: Page 8: "These are consolidated book figures of constituent companies to carry out suggestion made in decision of Board dated October 26th, 1923, without prejudice to the company's rights to claim, use and prove true values of its properties in any proceeding, matter or transaction."

It at least indicates that they are one and the same thing by the report of 1923. That ties them together, doesn't it?

30 Mr. Queen: Yes.

Mr. Faulks: Well, of course, the reserve—

Commissioner Autenreith: The reserve is something else, but the reference indicates that it is one and the same thing.

40 Q (By Mr. Queen.) Do you know what was the basis for the opening of the books of the company, Mr. Sofman? A The basis ordered was the book costs as shown by the books.

Nathaniel Sofman, direct.

Q (By Commissioner Autenreith.) At what time?

Mr. Queen: At the time of the consolidation.

A At the time of the consolidation. 10

Mr. Osborne: That comes right out of a clear sky, "the basis ordered." What do you mean?

Q Does it appear in the order? A Yes, sir, it appears in the order.

Mr. Osborne: Which order?

Commissioner Autenreith: The Board's order concerning the consolidation petition. 20

Q Now, go on from there and we will know just what you are talking about. A The order states: "In view of the fact that the companies have appealed to the court for a review of the Board's value of used and useful property, it appears preferable that the books of the consolidated company should be opened on the basis of the consolidated book figures as shown in Exhibit P. 2 (Exhibit A) with any proper adjustments which may become necessary and that the books be so continued, until the legal proceedings are concluded, at which time any adjustment may be submitted to the Board for approval." 30

Q (By Mr. Queen.) Do you know whether any report was submitted, outside of the annual reports of the company, for approval of the Board? A There was an accountant's report submitted, the accountant being Mr. H. R. Gore. 40

Nathaniel Sofman, direct.

Q That was in the merger case, was it not?

A That was in the merger case, yes, sir.

Q Has any report been submitted subsequent to the merger case, other than the annual reports? A None that I know of, other than that report.

10 Mr. Faulks: I don't think it is quite fair to have the record left in that shape. There was a letter sent to the Board.

Commissioner Autenreith: You may produce that, of course.

Mr. Faulks: Yes. While perhaps it was informal, the company undertook to bring to the attention of the Board what it desired to do and felt that there was no objection on the part of the Board.

20 Commissioner Autenreith: You may offer that letter.

Mr. Faulks: All we wish to do is to have this issue presented and to have it understood that there has been no intention or action on the part of the company to depart from the Board's order.

30 Commissioner Autenreith: There is no question about that. I will settle that now. We understand there was no such intention on the part of the company.

Mr. Faulks: We have meant to comply with the Board's order in every respect.

40 Commissioner Autenreith: We understand that. May I ask counsel at this point whether they can stipulate that, subject to the Board's order in the consolidation matter, that the legal proceedings were terminated by a decision of the Court of Errors and Appeals ultimately, in which the

Nathaniel Sofman, direct.

values of the properties fixed in the rate cases were not changed?

Mr. Faulks: That is quite true. That is, they were not changed for rate making purposes.

10 There is no question, if your Honor please, that both the Supreme Court and the Court of Errors ratified the Board's figures of value for rate making purposes.

Commissioner Autenreith: Of course, we all understand that. I just wanted to get the stipulation in the record.

Q (By Mr. Queen.) Has the company filed an annual report covering its operations for the year 1924? A Yes, sir.

Q Have you that report there? A Yes, sir. 20

Q Will you refer to the report of 1924, pages 8 and 9, and the insert between pages 8 and 9, and read that insert, if you will? A Pages 8 and 9 of the 1924 report are the balance sheet of the company as of December 31, 1924. The insert is the balance sheet of the company as of December 31, 1923, and is given for the purposes of comparison between the two dates.

30 Q (By Mr. Osborne.) Is that last statement your conclusion, sir? A No, sir; our annual report requires the comparative figures.

Q You are stating the purpose of that insert now? A I assume that was the purpose of it.

Q The question asked you related to a question of facts; I just wanted to separate your answer so we can tell which is the fact and which is your conclusion. A I will say that the insert shows the December 31, 1923, balance sheet, and pages 8 and 9 are the 1924 balance sheet.

40 Q (By Mr. Queen.) Is that the same as the report of 1923? A No, sir; there is a decided

Nathaniel Sofman, direct.

difference between the balance sheet furnished December 31, 1924, and the previous balance sheet furnished.

10 Q What is that difference? A The fixed capital accounts of the company have been written up from \$13,325,512.20 to \$23,311,306.95, each of these figures being subject to a depreciation reserve respectively of \$1,537,454.48 and \$2,960,684.63, leaving the net book figures, after depreciation, of \$11,788,057.72, as compared with \$20,350,622.32, or a write-up of \$8,562,564.60.

Q Do you know what the basis of the fixed capital of 1924 was, as shown by the annual report of that date? Was that on the basis of the Board's valuation? A No, sir.

20 Q What was the Board's valuation, as shown by the insert in that report. A The insert doesn't show the valuation, but the two comparable figures, if you want it that way—the December 31, 1923, balance sheet shows a figure of \$23,170,397.95, as compared with the Board's valuation in the merger decision of \$11,200,000.

Q Is there any statement in that report beginning with \$11,200,000?

30 Commissioner Autenreith: Which report are you referring to now, what year?

Mr. Queen: 1924.

A There is an insert between pages 20 and 21 of 1924 report which starts off with the Board's valuation of December 31, 1920, of \$11,200,000.

40 Q Shouldn't that date be 1922 instead of 1920? A Yes, sir, there is an error there; it should be 1922, and it works down to December 31, 1924, showing the additions to the property and deductions on account of the Montclair

Nathaniel Sofman, direct.

sale, and it works down to the value of plant property as of December 31, 1924, of \$10,905,340.99.

Q How do those figures compare with the figures set up on the balance sheet? A That figure of \$10,905,000 compares with \$23,311,306.95. 10

Q Less depreciation? A Less depreciation of \$2,960,684.63, leaving a net depreciated book figure of \$20,350,622.32.

Q Can you explain the difference between those two figures, the \$11,200,000 figure and the figure of \$23,000,00 and some odd dollars? A The lower figure of eleven million dollars represents the valuation found by the Board in its merger decision. 20

Q And what does the larger figure represent, do you know? A I believe it to be the valuation placed by the company, after appraisal.

Q After appraisal by whom.

Commissioner Autenreith: If he knows.

Q Do you know? A I believe it to be by Mr. Nicholas S. Hill, Jr.

Q (By Commissioner Autenreith.) In any event it represents somebody else's valuation? 30
A Yes, sir.

Q (By Mr. Queen.) Will you refer to page 24 of the annual report of 1924, line 21, and give us the amount set up for depreciation or amortization and charged to expenses? What is that amount? A The amount set up is \$285,361.29.

Q Did the Board indicate in its decision in Volume XI, page 29, the amount that should be set up? 40

Nathaniel Sofman, direct.

Commissioner Autenreith: This referring to volume and page doesn't mean a whole lot. Is that the decision which approves the merger?

Mr. Queen: No, the rates.

10 A It indicates that a rate of one and a half per cent. should be set up for depreciation.

Q What is the amount in figures? A It indicates that approximately \$130,000 per year should be set up.

Q As against the \$285,361.29? A Yes, sir.

Q Does that \$130,000 include the Montclair property, which has now been sold? A It does. There should be an adjustment with that of approximately four or five thousand dollars a year.

20 Q What will be the effect of increasing the percentage of depreciation in a rate case?

Mr. Faulks: Objected to as immaterial.

Commissioner Autenreith: What is the materiality of that, judge? Isn't it argumentative?

Mr. Faulks: We don't make any claim that these figures are used or usable in a rate case.

30 Mr. Queen: I withdraw the question.

Q What would be the effect on the return in any particular year?

Mr. Faulks: Objected to for the same reason.

Commissioner Autenreith: What do you mean?

Mr. Queen: On the return on the fair value of the property.

40

Nathaniel Sofman, cross—re-direct.

Commissioner Autenreith: Isn't that argumentative? If you have all the facts in evidence what effect it may have are reasons why or why not the Board has or has not the power.

Mr. Faulks: Absolutely. The Board has no right to penalize the company in its business methods. 10

Commissioner Autenreith: If you have sufficient facts in evidence now on which the Board can act, if it chooses to act, the effect of all these things is a matter of argument.

Mr. Queen: Yes; I think it is. Take the witness.

Cross examination by Mr. Osborne. 20

Q The company did file, as a part of its annual report for the year ending December 31, 1924, a set-up showing the figures found by and as directed by the Board, did it not? A Yes.

Commissioner Autenreith: Will you identify the page, please?

Q Those appear on page 20 of the report as an insert and between pages 8 and 9, do they not? A Yes, sir. 30

Mr. Osborne: That is all.

Re-direct examination by Mr. Queen.

Q Was that carried into the balance sheet of that year? A It appears there merely as a note or as an explanation. Those figures are not used for the purpose of— 40

Nicholas S. Hill, Jr., direct.

Mr. Faulks: I object to that.

Q (By Commissioner Autenreith.) You were asked the question whether it was carried into the balance sheet; it either was or was not. A It was not.

10

Mr. Osborne: We don't know what balance sheet he is talking about.

Q (By Mr. Osborne.) Aren't there two balance sheets? A There are two balance sheets, but neither one uses the figure shown in the insert between pages 20 and 21.

Q One of these balance sheets is book cost; is that right? A No, sir; neither one is book cost.

20

Q Which is book cost? A Neither is.

Mr. Queen: That is all the evidence we have to offer.

Recess from 1:00 to 2:00 P. M.

—————
AFTER RECESS.

30 NICHOLAS S. HILL, JR., sworn on behalf of Passaic Consolidated Water Company.

Direct examination by Mr. Osborne.

Q Will you give us your name and address, please, Mr. Hill? A Nicholas S. Hill, Jr., 1122 Nineteenth street, New York City.

Q And what is your business? A Consulting engineer.

40 Q How long have you been an engineer? A Between twenty-five and thirty years.

Nicholas S. Hill, Jr., direct.

Q Just state very briefly for the record, because the Board, of course, is aware of your qualifications, what your qualifications are. A I have at various times been chief engineer of the Water Department of Baltimore, Maryland; chief engineer of the Water Department of the City of New York; President of the Water Board of East Orange, New Jersey; President of the Consolidated Water Company in suburban New York; and I have been retained as consulting engineer on water works problems by New York City, Baltimore, Maryland; Albany, New York; New Orleans, Louisiana; Tampa, Florida; Matanzas, Cuba; Dallas, Texas; Florence, Ohio, and a number of other places; and I have been connected with appraisals and valuations of water works properties, possibly some seventy-odd water works systems in all. 10

Q You have made appraisals and valuations of water works properties? A Yes, sir, as I say, of some seventy-odd, I think; about that.

Q And you are familiar with prices as of different dates? A Yes, we have maintained records of prices and price trends in the office.

Q You are familiar with values, both new and depreciated? A Yes, sir. 20

Q Did you, at the request of the Passaic Consolidated Water Company, make a valuation of its property and plant as of October 31, 1923? A I did. 30

Q What was that valuation based upon? A That valuation was based upon pricing of the inventory of the plant and property as installed as of December 31, 1920, plus the actual cost of additions from January 1, 1921, to October 31, 1923. In other words, I took the inventory which was used in the rate case and priced it at prices current in 1923. 40

Nicholas S. Hill, Jr., direct.

Q Then that valuation represents what it would cost to reproduce this property as of that date? A It represents what it would cost to reproduce the property as of October, 1923.

Q In its then condition; that is to say, as depreciated? A Yes, and of course, after deducting depreciations. 10

Q I show you a book containing very many pages and ask you if that contains the valuation made by you, which you have just referred to? A It does.

Q What was the valuation reached by you? A The reproduction cost—

Mr. Osborne: Pardon me. We would like to offer this in evidence, or so much of it as may be material. 20

Mr. Queen: Let me ask the question before that is received.

Q (By Mr. Queen.) Was this appraisal made in any proceeding before the Board of Public Utility Commissioners or in any other proceeding, any court proceeding? A No, sir.

(Booklet entitled, "Valuation of Property and plant of the Passaic Consolidated Water Company as of October 31, 1923, based on current prices for property in place, December 31, 1920, plus actual cost of net additions from January 1st, 1921, to October 31st, 1923, inclusive," received and marked Exhibit R. 1.) 30

Mr. Osborne: There should be the same understanding with regard to this bulky exhibit as there was to the others, that only such parts of it need to be printed in case 40

Nicholas S. Hill, Jr., cross.

of appeal as either of the parties may designate.

Commissioner Autenreith: Of course, I don't want to decide now what is or is not necessary on appeal.

Mr. Osborne: I was going to ask a question which would dispose of that, and that was this: 10

Q (By Mr. Osborne.) Will you state what the result of that was in figures, Mr. Hill? A The total cost of reproduction new at prices current as of October, 1923, was \$23,117,267, and less depreciation, \$20,217,832.

Q And you placed this, when finished and when you had arrived at that result, in the hands of the company? A Yes, sir. 20

Mr. Osborne: Cross examine.

Mr. Queen: I would prefer that the cross examination take place at some other time, so that I may have an opportunity to look into these figures.

Commissioner Autenreith: Isn't there some of the cross examination that might take place now, because you may decide, after examination of this volume that has been offered in evidence, that you might not desire to cross examine further; that is, you might exhaust your preliminary examination and then if you have anything further you will be given an opportunity to cross examine on it at some future time. 30

Cross examination by Mr. Queen.

Q Mr. Hill, you testified before the Board of Public Utility Commissioners in a rate case in- 40

Nicholas S. Hill, Jr., cross.

volving the valuation of this property, did you not? A Yes, sir.

Q When was that testimony offered, about what year, do you recall? A I think it was some time in 1921 or 1922. I don't remember the date of the Board's decision.

10

Mr. Faulks: March 27, 1923.

Witness: It must have been in 1922, then.

Commissioner Autenreith: The summer and fall of 1922, I think it was.

Witness: Yes.

Q And in that testimony you said, did you not, that the value of the company's property was thirteen million dollars? A Yes, sir; I did.

20

Q And that was shown by Exhibit P. 23, Table D, of testimony offered by you on behalf of the company, was it not? A I don't remember the exhibit number, but I did testify to that effect.

Q What is the value you gave to the property by the appraisal which you have now made? A Based on current prices, as of October, 1923, the net depreciated reproduction cost was \$20,-

30

217,832.
Q (By Commissioner Autenreith.) I was under the impression in your direct examination that you said you adopted prices as of 1920; am I wrong about that? A 1923.

Q Prevailing prices of 1923? A Prevailing prices of 1923, yes.

Q Then this present exhibit that you offer is based upon 1923 prices? A The inventory up to January 1, 1921, which was the inventory used in the rate case, was priced on current prices

40

Nicholas S. Hill, Jr., cross.

in 1923, and to that was added the actual cost of plant installed subsequently.

Q At prevailing prices? A Yes.

Q So that a large part of this valuation then is on the basis of 1920 prices? A It is substantially 1923 prices.

Q I say, a large part of the property is valued at 1920 prices then. A No, the inventory as of January 1, 1921, was priced at prices current in 1923.

10

Q Prices current in 1923? A Yes, sir.

Q (By Mr. Osborne.) So that the majority of the property was valued at 1923 prices? A Yes, sir, substantially based on 1923 prices.

Q (By Mr. Queen.) How do the 1923 prices compare with the prices which prevailed at the time you testified in this case? A As I recall, prices in 1921 and 1922 were substantially fifty per cent. lower than in 1923. They were also lower by about seventy-five per cent. than they were in 1920.

20

Q (By Commissioner Autenreith.) In other words, 1920 represented the peak prices? A That was the highest point that was reached. They dropped down during 1921 and 1922, and there was a secondary peak in 1923 and the early part of 1924.

30

Q (By Mr. Queen.) You say that the prices in 1921 and 1922 were lower than 1923, is that correct? A Yes, sir.

Q How much lower? A About fifty per cent.

Q And prices in 1921 and 1922 were seventy-five per cent. lower than in 1923, is that correct? A Than in 1920.

Q Than in 1920, yes. When did you say the peak commenced to go up? A When did it commence?

40

H. R. Gore, direct.

Q Yes. The peak prices, as I understand it, were in 1920, about; is that correct? A Water works materials and labor commenced to advance in the latter part of 1915 and there was a very steady increase, which reached its maximum in 1920, and then there was a drop until the beginning of 1922, when prices commenced to rise again, and reached a secondary peak about the middle of 1923 and that secondary peak lasted over into the early part of 1924, from which time there has been a slight decline.

Q And in the appraisal which you have submitted here are the prevailing prices as of what time? A 1923.

Mr. Queen: That is all I feel I can do today, until the appraisal has been examined.

Commissioner Autenreith: You reserve any further cross examination then?

Mr. Queen: Yes.

Commissioner Autenreith: And I suppose you reserve any further re-direct?

Mr. Faulks: Yes.

Q (By Commissioner Autenreith.) Mr. Hill, did you testify in the application for consolidation and merger, as to value, before the Board? A No, sir.

H. R. GORE, sworn on behalf of Passaic Consolidated Water Company.

Direct examination by Mr. Osborne.

Q Mr. Gore, what is your profession? A Certified public accountant.

H. R. Gore, direct.

Q Where do you live? A I live in Mt. Vernon, New York.

Q And you are in business in New York City? A In New York City, yes, sir.

Q Under the firm name of Watterston & Gore? A Formerly, I was, but I have severed my connection with Mr. Watterston.

Q At the time you did some work for the East Jersey and associated water companies, contained in this volume (indicating) your firm name was Watterston & Gore, was it not? A It was.

Q Are you what they call a certified public accountant? A I am.

Mr. Osborne: I assume that that is a sufficient qualification?

Commissioner Autenreith: That is up to you. You are making your end of the record.

Q Have you had any experience or anything to do with the accounts of water companies? A Considerable.

Q To what extent? A I installed a system for the City of Mount Vernon Water Works Department.

Q You mean a system of accounts? A A system of accounts and I gathered together the figures for the merger of the Elizabethtown and subsidiary associated companies, and for the East Jersey and associated companies; I did the accounting work in connection with the Plainfield rate case; and I installed a class system of accounts for the City of Tampa, Florida, and other smaller installations.

Q On behalf of the Passaic Consolidated Water Company did you, on or about May, 1924,

H. R. Gore, direct.

make an audit of the books of the Acquackanonk Water Company, the East Jersey Water Company, the Kearny Water Company, the Montclair Water Company and the Passaic Water Company for the purposes of consolidation? A I did.

10 Q And did you determine plant values? A I didn't determine the values, no, sir.

Commissioner Autenreith: Set up the value.

Q In that statement did you set up plant values on the basis of an appraisal made by Mr. Hill? A I did.

20 Q I show you Exhibit R. 1 and ask you whether that is the appraisal which you used? A Yes, sir.

Q And did you furnish the result of your work to the company? A I did.

Q For the purpose of setting up its books? A Yes, sir.

Q Do you know whether the books were set up on that basis? A I do. They were set up on that basis.

30 Q Were the books then set up under your supervision and direction? A Yes, sir.

Q Using figures furnished by you for that purpose? A Using figures furnished by me.

Q And taken by you from Mr. Hill's appraisal? A To a great extent.

Q Insofar as they were applicable? A Insofar as the property was concerned, yes, sir.

40 Q I show you a report and ask you if that contains the data which you furnished the company as a result of your investigation. A It does.

H. R. Gore, cross.

Q Was that report followed in the setting up of the books of the company? A It was.

Mr. Osborne: I would like to offer that in evidence, or so much of it as may be material to this case.

(Booklet entitled "East Jersey and Associated Water Companies, report on audit, and exhibits, October 31st, 1923," received and marked Exhibit R. 2.) 10

Cross examination by Mr. Queen.

Q All you did was to take the books of the company and put together the figures on the appraisal which was furnished you; is that correct? A Using that as a basis. 20

Q Using the appraisal which had been given to you as a basis for setting up these figures? A For setting up the plant property, yes, sir.

Q You didn't determine any values at all, did you? A No, sir.

Q Did you have anything to do with fixing the amount for annual depreciation? A Which amount do you mean?

30 Q I think the amount is \$285,000, or thereabouts. A I may have assisted in the calculation of that; I don't recall.

Q But you didn't determine that figure, or any figure for depreciation, did you? A I worked out some depreciation figures at one time; I don't remember whether that was the figures I arrived at or not.

Q But on the data given you by somebody else; is that correct? A Yes, it was all based on the data furnished in that report.

40 Q In other words, all your report shows, the report which has been presented here, is the

H. R. Gore, cross.

compilation of figures, taken from the appraisal of somebody else and from the books of the company; is that correct? A Yes.

Q Did you prepare the figures for the annual report of the company in 1924? A I did not.

Q (By Commissioner Autenreith.) Mr. Gore, you testified in the merger case, too, didn't you? A Yes.

Q And in that merger case didn't you offer an exhibit of properties and values of the Passaic Consolidated Water Company? A On a certain basis, yes, sir. I think I furnished two sets of figures, one on the basis of book cost and one on the basis of appraisal, as determined by the Board in the rate case.

Q Didn't you set up in the exhibit in that case, pursuant to the appraisal made by Mr. Nicholas S. Hill, Jr., as of December 31, 1922, the value of plant property at \$12,817,605.12? A Of course, I don't recall the exact figure.

Q Well, the figure is in your exhibit, whatever it is? A Whatever is in the report, yes, sir.

Q In that instance in your testimony before your Board you merely set up figures that had been taken from an appraisal of someone else, did you not? A That is correct.

Q You used two bases for setting up plant value in this exhibit in the merger case? A One was on book cost and the other was on Mr. Hill's appraisal.

Q And the figures, whatever they may be, are set up in the exhibit? A Yes, sir.

Gustave Leimbacher, direct.

GUSTAVE LEIMBACHER, sworn on behalf of Passaic Consolidated Water Company.

Direct examination by Mr. Osborne.

Q What is your name and address? A Gustave Leimbacher, 88 East 1st street, Clifton, New Jersey. 10

Q What is your business? A I am an employee of the Passaic Consolidated Water Company.

Q What are your duties? A I am accountant in control.

Q You have charge of the books of the company? A Yes, sir.

Q After Mr. Gore set up the books of the company, the figures of the company, in accordance with Exhibit R. 2, did you make the entries? A I made the entries, yes, sir. 20

Q In the books? A In the books.

Q Under his direction and supervision? A Well, he furnished me with a report, and it was merely a matter of copying that report.

Q I show you Exhibit R. 2 and ask you whether you set up the figures in the books in accordance with the figures in that report furnished by Mr. Gore? A I did. 30

Q And the books have been kept in accordance therewith since? A Yes, sir.

Q Is it part of your duty to prepare the annual reports of the company? A It is.

Q And did you do so? A I did.

Q Did you prepare the 1923 and 1924 reports? A I did.

Q In the 1924 report I observe certain inserts or explanatory addenda; did you make those? A I did.

Q Can you indicate the purpose of them? 40

Gustave Leimbacher, direct.

Mr. Osborne: Hadn't he better have those reports before him?

Commissioner Autenreith: Yes, I guess he had.

10 Q I show you the 1923 and 1924 reports referred to by me and ask you whether they are the reports which you made out? A Yes, sir; they are.

20 Q The inserts which I have referred to, will you kindly turn to them and explain the purpose of them? A In the 1923 report the only insert that is in there that I am aware of is an insert in this report to the Board, a copy of which we have, because of the fact that this report, before it was filed and sent out to the Board, was turned over to our counsel who made the insert in ink on the report which was sent to the Board here.

Q (By Mr. Faulks.) The one appearing on page 8, which has already been read into the record? A Yes, sir, that insert was made under the direction of our counsel and was put in by him, in the report that was sent to the Board.

30 Q (By Commissioner Autenreith.) And the reservation expressed on page 8? A On page 8, yes, sir.

40 Q (By Mr. Osborne.) Now, turn to the 1924 report. A In the 1924 report, due to the fact—partially at least—that there is a column in the balance sheet which says, "Net Changes during Year," because of the fact that in the 1923 report we subsequently substituted the appraised figures, which, of course, were different than what appeared in the 1923 report to the Board, I made this insert, showing the corrected balance sheet, so that they would be better able to tell

Gustave Leimbacher, direct.

just what the decreases and increases were without a whole lot of explanatory remarks, and the insert opposite the income, page 20— This was data which was gotten up for the purpose of testing the rates, due to the fact that we had, of course, put this larger valuation on our books, the appraisal, we showed the amount of the plant property at the time it was fixed by the Board, plus additions and reductions to the date of the report, December 31, 1924. 10

Q (By Commissioner Autenreith.) Then you agree that the set up that you have in on the Hill appraisal that is now offered in evidence would be of no value to the Board to test rates. A Yes, sir, it would.

20 Q In what respect? A In this respect: This value which we show here for the purpose of testing rates, gives you the basis upon which to figure the possible return on the value.

Q I am speaking of the value that you set up on Mr. Hill's 1923 report. That, unexplained, would not be of any assistance to the Board in fixing the return, would it? A No.

30 Q So that you added this exhibit, which you now speak of, for the Board's benefit in ascertaining the status of the rates. A Exactly, and as far as I understand, that was the purpose of inserting this, so that it would enable the Board—

Q That was the purpose of putting it in there? A Yes, sir, showing the depreciation on the Board's valuation.

40 Q Have the books been since then kept on the basis of Mr. Hill's appraisal, as set up by Mr. Gore and in accordance with the uniform system of accounts? A Yes, sir.

Gustave Leimbacher, direct.

Q That is, you adopted the uniform system after you set up Mr. Hill's appraisal? A Yes, sir. As a matter of fact, we always kept a uniform system of accounts, and when we changed over into the other company we simply changed over to the appraised figure.

10 Q (By Mr. Osborne.) Then you have always kept them in accordance with the uniform system, the only difference being in the figures, making the figures conform to your appraisal? A Yes, sir.

Q (By Commissioner Autenreith.) Any changes you made in your books of accounts were made on your own initiative, without authority from the Board heretofore, or don't you know that?

20 Mr. Faulks: I think "at the direction of the Board" would be perhaps a fairer question.

Commissioner Autenreith: Leave the word "authority" out then; no objection to that.

30 Q (By Commissioner Autenreith.) Any changes made in your books of accounts were not made at the direction of the Board, were they? A I cannot say as to that; our counsel was handling that.

Q Then you don't know? A I don't know.

Commissioner Autenreith: I guess there is no dispute about that.

Mr. Faulks: We don't claim it was made at the direction of the Board. We are anxious to have the record show that it wasn't made or wasn't intended to be made against the direction of the Board.

40

Gustave Leimbacher, direct.

Commissioner Autenreith: You assumed that you had the authority to do it and you made them accordingly?

Mr. Faulks: Yes.

Mr. Osborne: May we ask the Board's staff to furnish us with a copy of a letter which was written to the Board, accompanying the balance sheets? 10

(Copy of following letter received in evidence and marked Exhibit R. 3.)

"Passaic Consolidated Water Company,
Paterson, N. J., June 23, 1924.

Philander Betts, Esq.,
Chief Inspector, Bureau of Utilities,
N. J. Board of Public Utility Commissioners, 20
Newark, N. J.

Dear Sir:

Replying to your letter of June 2nd, 1924, Mr. Wherry has filed with the Board today an exhibit prepared to show the net worth of the property of the Company on three bases, namely: (1) using the rate base as a basis; (2) using the book entries of the predecessor companies as a basis; and (3) using the reproduction estimate at current prices. 30

The latter is the basis which the Company has a right to insist shall be used in Federal tax questions and in condemnation suits, and perhaps in other controversies involving values.

We have explained these exhibits to Mr. Lyon and Mr. Petty, and trust that they will be sufficient for the purposes of the decision of the application now pending for approval of the bond issue. 40

Gustave Leimbacher, cross.

We will be glad to furnish you with any additional information.

Yours very truly,

(Signed) John H. Cook,
President."

10 *Cross examination by Mr. Queen.*

Q Referring to this insert between pages 20 and 21 of the annual report dated December 31, 1924, the figures read "Board's Valuation, December 31, 1920, \$11,500,000." A Yes.

Q Is that a correct date or is not the date December 31, 1922? A I couldn't quite tell you that. It is a date which was apparently fixed by our accountant and presumably by our counsel as being the date on which the appraisal was checked.

Q Aren't those the figures of the valuation of December 31, 1922, contained in the rate case? A Yes, I would say they are.

Q Then that date is December 31, 1922, is it not? A I couldn't tell you.

Q You don't know? A I don't know. There seems to be a question on the part of counsel or accountant as to just what date that was that the eleven and a half million started from; that is the figure they used.

Commissioner Autenreith: I guess we can all agree that December 31, 1920, has no relation to any particular value.

Mr. Faulks: Yes, I guess it must be 1922.

Commissioner Autenreith: Yes.

Mr. Osborne: There seems to be some confusion about it.

Mr. Faulks: Apparently it is a typographical error.

Gustave Leimbacher, cross.

Q Now, referring to page 24 of the annual report of 1924, I call your attention to "General Amorization \$285,361.29." Where did you get those figures? A By taking the depreciable property contained in Mr. Hill's appraisal, the new appraisal as of the date of the consolidation, plus depreciation, of course, on the additions since that date.

Q (By Mr. Faulks.) And applying what rate? A Oh, various rates. Mr. Hill in his appraisal showed various rates for different classes of property, anywhere from one to ten per cent., ten per cent. on special machinery and one per cent. on buildings and pipe lines, something like that.

Q (By Mr. Queen.) Now, the insert shows the depreciation at \$132,207.83, does it not? A I believe it does; whatever the figures there are.

Q (Hands witness exhibit.) A Yes, that is correct.

Q How do you explain the difference between the latter figures I have given you and the former ones? A The hundred and thirty-two-odd thousand dollars is an appreciation which would have been set up or would accrue by using the valuation fixed by the Board, and which we would naturally use for ratemaking purposes. We could apply those figures in place of the figures which appear in the operating statement and in that manner arrive at the return which we would have gotten had we used their appraised figures.

Q Then aren't the expenses of operation increased by the difference between \$132,207.83 and \$285,361.29? A They are, but not by applying the other figures, which are for ratemaking purposes. The figures which we show

Gustave Leimbacher, cross.

there and are using are just for income tax purposes.

Q (By Commissioner Autenreith.) Does the same rate of depreciation apply in arriving at both figures? A Yes, sir.

Q The same rate as to various classes of property? A In the data for taking the rates we just use one and a half per cent. on appreciable property.

Q You don't use the same rates then? A No, sir.

Q Are the rates of depreciation in the smaller figure those prescribed by the Board or found by the Board in the rate case, do you know? A I couldn't say. As I understand it, in the rate case the figure was apparently about one and one-half per cent. and that is what I am using for the data for testing the rates.

Q Then you used the same figure as the Board indicated in the rate case for this \$132,000 figure? A Yes, sir.

Q (By Mr. Queen.) And that figure of \$132,000 at that time included the Montclair depreciation, which was \$15,300; isn't that so? A You mean in the rate case?

Q In the decision in the rate case? A Yes.

Q (By Commissioner Autenreith.) The Montclair distribution system has since been disposed of by the company, that is, since the rate case, has it not? A Yes, sir.

Q (By Mr. Queen.) You didn't have anything to do with the fixing of the values in the appraisal, did you? A No, sir.

Q You didn't have anything to do with the fixing of the values in the appraisal, did you? A No, sir.

Q Your method was a method of controlling and bookkeeping? A Yes, sir.

John H. Cook, direct.

Q (By Mr. Osborne.) Do you know, reduced to a composite percentage, whether or not the results of the method which you used, based upon Mr. Hill's figures, reached practically the same results as the Board's? A I would say, yes.

10

JOHN H. COOK, sworn on behalf of Passaic Consolidated Water Company.

Direct examination by Mr. Faulks.

Q Mr. Cook, are you the president of the Passaic Consolidated Water Company? A I am.

Q Have you been such since the time of its formation in October, 1923, through the consolidation of various other companies? A I have.

20

Q Prior to that time were you connected in an official capacity with each of the companies that were then so consolidated? A I was.

Q Did you have anything to do with the sale of the Montclair distributing system which was referred to a moment or two ago? A I made it.

Q To whom was that property sold? A It was sold to the Town of Montclair, through its commissioners.

30

Q As a result of open negotiations between the municipality and the company? A Yes, sir.

Q When did that sale take place? A Why, as I remember it, it was in September, 1923.

Q When was it consummated? A In March, 1924, about the 10th of March.

Q That is when the title actually passed? A That is when the title was actually passed and the water was turned off from us.

40

John H. Cook, direct.

Q Turned off by you? A Turned off by us and turned on from the Newark system.

Q What price did the company receive from the Town of Montclair for the property so agreed to be sold to it in 1923, and actually sold to it in March, 1924? A \$1,700,000, which was
10 made up from their assuming \$500,000 of bonds that were on the property and paying us in cash \$1,200,000.

Q And at what price was the property so sold valued by the Board of Public Utility Commissioners in the rate case for rate purposes? A About \$1,047,000, as I recall it now.

Q Was the sale thus made by the company to the Town of Montclair approved by an order of this Board? A It was.

20 Mr. Faulks: I offer that order in evidence. I don't remember the exact date of it.

Commissioner Autenreith: It may be received.

Q Now, Mr. Cook, will you tell the Board the reason or reasons why, in the interest of the company and its consumers, the company desires to carry upon its books a property and plant account based upon a different valuation than the one found by the Board for rate purposes in the rate case that was concluded in March, 1923? A
30 Well, for certain business reasons. I might say for the effect that it has upon the Federal income tax, and also, as no doubt the Board knows, at the present time we are in the throes of a valuation being made with the idea that certain communities in our territory will purchase our property and we feel that it is more desirable to have figures shown on the books
40

John H. Cook, direct.

which, from our point of view, represent the proper value of the property.

Q In case a sale were effected, either to the municipalities as a result of the appraisals now being made, or to anyone else, would the fact that the books showed the property to be of a value higher than the one placed upon it by the Board for rate purposes and one which the company believed to be correct, have any bearing upon the Federal income or profits taxes which the company might have to pay as a result of such sale? A I believe it would. 10

Q Is there any desire on the part of the company or any of its officials to have the figures which it thus has placed upon its books have any effect whatsoever, either upon any rate matters, or upon the issuance of any securities? A I understand those matters are in the hands of the Commission who may, in their judgment, permit or deny the issuance of such securities. 20

Q And who have the power to fix rates. A And who have the power to fix rates.

Q Now, I want to know whether the purpose or the effect of the use of other valuations made by the company for its ordinary and proper business purposes has any relation whatsoever, either to the rates which it may be allowed to charge or to the securities which it may be allowed to issue. 30

Commissioner Autenreith: I think, Mr. Faulks, if you strike out the word "effect" and leave it just only the "purpose" on the company's part—

Mr. Faulks: I will accept your suggestion and then explain to you why I think it is proper. 40

John H. Cook, cross.

Q As to the purpose then, Mr. Cook?

Witness: Will you read the question, please?

(Question read as follows: Now, I want to know whether the purpose of the use of other valuations made by the company for its ordinary and proper business purposes has any relation whatsoever, either to the rates which it may be allowed to charge or to the securities which it may be allowed to issue?")

A No, not necessarily at all.

Q Is that in anywise the purpose? A It is not the purpose, no, sir.

Q Why do you do it? A As I said before—
Of course I myself feel it is desirable in every corporation that the figures as shown by the books should represent approximately and as closely as possible the values of the property. I myself, if it were possible, believe that it might even be desirable from time to time to have a revaluation made of the property in order that the stockholders of the company, the owners of the property, might know really what the property was worth, so that when they looked at the books they would see what it was worth in the minds of people who were qualified to place a value on the property. I have always felt that way.

Q You think that ought to be the practice in the case of public utilities as well as in the case of ordinary business corporations? A I do.

Cross examination by Mr. Queen.

Q The value which you speak of, Mr. Cook, is a value determined by the company or somebody

John H. Cook, cross.

employed by the company, isn't it? A Somebody employed by the company who is qualified in their opinion, by their experience and so on, to place such a value on the property.

Q In other words it is the company's valuation. A It is the company's valuation, yes, sir.

Q And the general amortization in the report of 1924, \$285,361.29 was the amount placed there upon the valuation of the property determined by the company, was it not? A I believe it was.

Q Then that is a part of the expense account, isn't it? A I believe so.

Q And that goes into rates, doesn't it? It is an element of rates, isn't it? A No, I don't understand it so, for this reason, that when an application for rates is made, the Commission doesn't take our book values; it forms its own opinion in respect to what the value of the property that should be used for rate-making purposes is; they are not made, as I understand it, by us, but by their own investigation in connection with the property at the time.

Q (By Commissioner Autenreith.) They would, as to operating expenses, be guided by your books? A Yes.

Q (By Mr. Queen.) And your operating expenses, as shown by the report of 1924, is the amount which I have stated?

Commissioner Autenreith: That is depreciation.

Q Or depreciation, and that is a part of the operating expenses, is it not? A I believe so.

Mr. Faulks: Is it true that a reserve for depreciation is an operating expense?

Mr. Petty: Not the reserve, but the charge.

John H. Cook, cross.

Q (By Mr. Faulks.) As a matter of fact, Mr. Cook, the \$132,000 figure shown by the report for depreciation is all that enters into the rates charged by the company to any of its consumers, is it not? A At the present time, yes.

10 Q (By Mr. Queen.) Suppose anyone not acquainted with this report should examine it and see the general amortization figure of \$285,361.29, it would show, would it not, that that is a part of the expenses which would be considered in the rates?

Mr. Faulks: I don't think that is a proper question, certainly to put to Mr. Cook, who is not an accountant, it wouldn't indicate that to me. It would indicate to me that the figure which was used, so far as rates were concerned was one of \$132,000.

Commissioner Autenreith: If he is not an accountant he will probably say he is not able to answer the question because he is not qualified to answer it.

Mr. Faulks: It doesn't seem to me to be a fair question to put to Mr. Cook.

30 A I would say it was within the province of the Commission to consider whether it was a proper charge or not.

Q (By Commissioner Autenreith.) If the Commission could find out what the background was to establish it. A That is the idea.

Q Then if you chose not to insert these figures based upon the Board's valuation, it would be a matter of investigation by the Board into your annual reports to adjust them to your own figures, would it not? A I suppose it would.

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Nicholas S. Hill, Jr., cross.

Mr. Queen: That is all.

Mr. Faulks: That is all we have.

Mr. Osborne: We understand that they may desire to have an opportunity to further cross examine Mr. Hill.

Mr. Queen: Yes, after his appraisal has been examined. 10

(Informal discussion as to adjournment.)

Commissioner Autenreith: I will set this down tentatively then for a week from today and if in the meantime they find that more time is required we will take a longer adjournment.

Mr. Osborne: Then they will let us know by the end of the week, or Monday or Tuesday of next week, whether they desire to go on next Thursday. 20

Commissioner Autenreith: Yes, you may communicate with Judge Osborne and let him know what the situation is.

Mr. Osborne: If you are not going to be ready, let us know.

(Adjourned to Thursday, December 17, 1925, at the Globe Building, Newark, N. J., at 11:00 A. M.) 30

Newark, N. J., Thursday, December 17, 1925.

NICHOLAS S. HILL, JR., recalled on behalf of company, for further

Cross examination by Mr. Queen.

Q Mr. Hill, you have stated that you testified in the rate case in this matter? A Yes. 40

Nicholas S. Hill, Jr., cross.

Q In that case you submitted valuations of the property of the company on different bases, did you not? A Yes.

Q And you submitted a basis of the value on historical cost, what you called historical cost? A Yes, sir; I did.

10 Q And that value was \$10,823,573, as shown by the record, is that correct? A I think it is. I have not that data here with me.

Commissioner Autenreith: It is, if the record shows it.

Mr. Queen: Found on page 40 of Volume 11 of the reports of the Public Utility Commission.

20 Witness: As I remember, I submitted no historical cost, because of the lack of records to go back to the beginning of the company.

Q Well, at the foot of that exhibit, Appendix B, it is called, it says, approximate total valuation of capitalization of all five companies, \$10,823,573. A Yes.

Q That was your valuation? A No. That was the capitalization. That was not my valuation.

30 Q That was the capitalization on the historical basis? A No. That was the capitalization that the company had outstanding at the time the appraisal of the property was made, which, as I recall, was of December 31, 1920.

Q You then submitted what you call the book cost, did you not, and the value on the book cost was \$12,961,559? A Yes; that is right, \$12,961,559.

40 Q Then you also submitted the value of the cost of reproduction on the basis of the 1912 ap-

Nicholas S. Hill, Jr., cross.

praisal plus actual cost of additions since that date, depreciated, of \$10,240,784, did you not? A Yes; that was on the basis of the old appraisal of the Appraisal Board appointed by the old New Jersey Water Supply Commission, plus the cost of additions since.

Q Then you also submitted a valuation on the basis of cost of reproduction at pre war prices? A Yes.

Q Amounting to \$9,449,488, is that correct? A Yes.

Q Then a valuation on the cost of reproduction on the basis of average prices from 1911 to 1920, of \$13,595,632? A That is correct.

Q Then a valuation on the basis of cost of reproduction at current prices, of \$16,471,836? A Yes.

Q And by current prices I suppose was meant the prices of 1922? A The prices current as of 1920 about at the time of the appraisal.

Commissioner Autenreith: 1920?

Mr. Faulks: Yes; the appraisal was made as of December 31, 1920.

Commissioner Autenreith: I thought he had another appraisal in there as of 1920 prices, which was different from that figure.

Q Would that be 1922, Mr. Hill? A Yes, that was 1922; yes, that is correct.

Commissioner Autenreith: He has another appraisal in there of 1920 prices.

Q Then you also submitted the cost of reproduction at the 1920 peak prices? A Yes, sir.

Q The valuation being \$21,224,748? A Yes.

Nicholas S. Hill, Jr., re-direct.

Q Then having submitted all of those valuations on different bases, you then said, did you not, that the valuation of the property at fair value was \$13,000,000? A My appraisal of the property, the fair value of the property as of December 31, 1920, was \$13,000,000.

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Re-direct examination by Mr. Faulks.

Q Without taking any time to establish either your qualifications or your knowledge of the properties of the Passaic Consolidated Water Company, which I think will be conceded by everyone, what have you to say as to whether or not the properties of that company used and useful in its water business, are now worth substantially more than the value placed upon them by this Board in the rate case? A I then thought and I still think that the property of the Passaic Consolidated Water Company is worth substantially more than the value placed upon it by the Board.

20

Q Then, whether reproduction less depreciation, or whether any other particular method of valuation is the correct one, I understand you to say that in your opinion the present value of the properties referred to is substantially in excess of the values fixed upon it by the Commission in 1923 for rate making purposes? A I do.

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By Mr. Queen.

Q There have been some additions to the property, have there not, since that time? A Yes. But I mean, taking the Commission's basis and adding additions, subtracting withdrawals and making proper allowance for depreciation, bringing the valuation up to date, the valuation

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Nicholas S. Hill, Jr., re-direct.

of the property at this time on that basis is substantially less than I believe is the true value of the property.

Q (By Mr. Faulks.) Was that true of the date of your last appraisal, being the one that has been placed upon the books of the company? A Yes.

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By Commissioner Autenreith.

Q Mr. Hill, am I correct in saying that you testified in the rate case that value was a matter of sound judgment after considering the various bases of arriving at value? A Yes.

Q Then the value given by you in the rate case was a matter of your judgment after giving consideration to the various bases submitted? A Yes.

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(Discussion off the record.)

Mr. Osborne: They asked us for a copy of a letter written by Colonel Betts, referred to in the exhibit which we put in.

Mr. Queen: Exhibit R. 3, dated June 23, 1924.

Mr. Osborne: On page 46 of the testimony R. 3 was introduced by us. It was found in the files of the Board after the hearing, and by consent put into the record. That letter which was signed by Mr. Cook refers to a letter of June 2nd by Colonel Betts. We have not been able at the moment to locate that letter of June 2nd. Have you a copy of it?

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Mr. Queen: Yes. I have asked Judge Osborne to produce the original letter. He now says he cannot find it, but I have a

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John H. Cook, cross.

carbon copy, what purports to be a carbon copy.

Mr. Osborne: There will be no objection to taking this upon the assumption that it is a carbon copy of the paper in question. We will search our files.

10 Commissioner Autenreith: You can verify that by looking for the original.

Mr. Queen: Exhibit R. 3 is a reply in response to that letter of June 2nd.

Commissioner Autenreith: I suppose the purpose of it is to make the picture complete.

Mr. Queen: That is it.

20 Mr. Osborne: I do not think there can be any doubt but that that is a correct copy.

Mr. Queen: I offer it subject to correction if you find the original.

(Copy of letter of June 2, 1924, addressed to John H. Cook, president, Passaic Consolidated Water Company, received and marked Exhibit C. 4.)

Mr. Queen: In this letter, Exhibit R. 3, you say that—

30 Mr. Osborne: Who says?

Mr. Queen: Mr. Cook. I suppose Mr. Cook ought to be recalled.

JOHN H. COOK, recalled on behalf of the company, for further

Cross examination by Mr. Queen.

40 Q In this letter, R. 3, of June 2, 1924, you say that Mr. Wherry has filed with the Board today

John H. Cook, cross.

an exhibit prepared to show the net worth of the property of the company on three bases; namely, one, using the rate base as the basis, two, using the book entries of the predecessor companies as the basis, and three, using the reproduction estimate at current prices. I am informed that the files of the Board do not show that document. 10
A You mean that was filed by Mr. Wherry?

Q Yes. That was filed by Mr. Wherry. Do you know whether you have a copy of it? A Presumably we have a copy, but I do not know about that. Presumably we have a copy and if we have, if I can make a note of it, if required I can produce it, I suppose.

Mr. Osborne: We will look it up and if we have a copy it will be filed. 20

Mr. Queen: If it can be located it may be considered in evidence.

Mr. Osborne: Oh, yes, assuming it is subject to any objection as to its materiality, of course, which we cannot pass on without seeing it.

Matter Taken to Conference.

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Exhibit C. 1.BOARD OF
PUBLIC UTILITY COMMISSIONERS

UNIFORM SYSTEM OF ACCOUNTS

FOR

WATER UTILITIES

FIRST ISSUE

EFFECTIVE JANUARY 1, 1913

10

Page 8.

10. **Costs to be Actual Money Costs.**—All charges made to fixed capital or other property accounts with respect to any property acquired on or after January 1st, 1913, shall be the actual money cost of the property. When the consideration actually given for anything with respect to which a charge is made to any fixed capital or other property account is anything other than money, the actual consideration shall be described in the entry with sufficient fullness and particularly to identify it, and the amount charged shall be the actual money value of such consideration at the time of the transaction.

20

30 Page 9.

12. **Costs of Labor, Materials and Supplies**—Cost of labor (employed in construction) includes not only wages, salaries and fees paid employees, but also such personal expenses of employees as are borne by the company. Cost of materials and supplies consumed in construction is the cost at the places where they enter into construction, including cost of transportation and inspection when specifically assignable. If

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Exhibit C. 2.

such materials and supplies are passed through storehouses, their cost entered in the account may include a suitable proportion of store expense. The term "cost" as used herein means the actual cost in money of labor and materials used in construction, or the actual cost in money of property acquired after construction, or if the consideration given is other than money, the actual money value of such other consideration at the time of the purchase.

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Exhibit C. 2.BOARD OF
PUBLIC UTILITY COMMISSIONERS

UNIFORM SYSTEM OF ACCOUNTS

FOR

WATER UTILITIES

FIRST REVISED ISSUE

EFFECTIVE JANUARY 1, 1925

20

Page 32.

3. **Cost to be Actual Money Costs.**—All charges to fixed capital accounts shall be the actual cost of the property acquired. When the actual consideration given for same is anything other than money, it shall be described in the entry with sufficient fullness and particularity to identify it and the amount charged shall be the actual money value of such consideration at the time of the transaction. Discounts upon securities and other commercial paper is-

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Exhibit C. 2.

sued must in no case be included as a part of the cost of any property acquired.

10 Cost of labor (employed in construction) includes not only wages of employees but also such of their personal expenses as are borne by the utility. Cost of materials and supplies consumed in construction is the cost at the places where they enter into construction, including cost of transportation and inspection when specifically assignable. As a part of the cost of fixed capital should also be included such portion of engineering and plant supervision expenditures and of general expenses as may be chargeable to construction under an equitable plan for the apportionment of such expenses. The latter should not be interpreted, however, as permitting the addition to fixed capital accounts of arbitrary percentages to cover assumed overhead costs. Only the actual and necessary expenses incurred that are properly assignable to construction may enter into the cost of fixed capital.

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40 4. **Withdrawals or Retirements.**—When anything (not including minor parts the renewal of which is considered a repair) is withdrawn or retired from service, the amount at which it stood charged in any fixed capital account shall be credited to that account at the time of withdrawal, and the entry of such credit shall cite by name and page of book or other record the original entry of cost of the thing withdrawn. If such amount is not known, it shall be estimated, the facts upon which the estimate is based and the name of the

Exhibit C. 2.

person by whom estimated shall be shown, and the amount thus estimated to be the ledger value of such thing withdrawn shall be credited.

Credits for property retired should include such part of overhead costs as is equitably assignable thereto. 10

The amounts credited to fixed capital accounts for the retirement of property shall concurrently be charged (less salvage and insurance) to the Amortization Reserve as per the text of that account, and also the cost of dismantling, tearing down, or removing any discarded plant or equipment. When any replacement takes the form of reconstructing or converting existing property in such a way that the cost of the entire project cannot be accurately assigned as between the cost of putting in the new property, and the cost of taking out the old, no greater proportion of the cost of the project shall be charged to fixed capital accounts than would equal the cost of new plant or equipment having equivalent capacity and expectation of serviceable life. 20 30

Exhibit C. 3.

UNIFORM SYSTEM OF ACCOUNTS

FOR

TELEPHONE COMPANIES

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AS PRESCRIBED BY THE

INTERSTATE COMMERCE COMMISSION

IN ACCORDANCE WITH SECTION 20 OF THE
ACT TO REGULATE COMMERCE

FIRST ISSUE

Effective on January 1, 1913

20

WASHINGTON

1915

INSTRUCTIONS PERTAINING TO FIXED
CAPITAL ACCOUNTS.

Page 32.

30 9. **Fixed capital defined.**—By the fixed capital of a company (frequently termed the *construction account*) is meant the property, both tangible and intangible, which is devoted to the accomplishment of the principal purposes of its business, and which has an expectation of life in service of more than one year from date of installation in service (exception being made in the case of hand tools and other small portable tools that may be lost or stolen).

40 Fixed capital consists of *original capital*, *additions*, *betterments*, and *replacements*, and the cost thereof should be charged as directed below.

Exhibit C. 3.

10 *Original capital* is the fixed capital installed or acquired prior to the beginning of regular operations by the company. As applied to a telephone company it includes the acquisition or construction of the plant necessary to begin the regular operation of an exchange or toll system. The cost of original capital should be charged to the appropriate subaccounts under account No. 100, "Fixed Capital Installed Prior to January 1, 1913," or under account No. 101, "Fixed Capital Installed Since December 31, 1912."

20 *Additions* are structures, facilities, equipment, and other properties added to those in service at the beginning of operations, and not taking the place of any property of like purpose previously held by the company. The cost of additions should be charged to the appropriate subaccounts under account No. 101, "Fixed Capital Installed Since December 31, 1912."

30 *Betterments* are mechanical changes in structures, facilities, or equipment which have as their primary aim and result the making of the properties affected more useful or of greater capacity than they were at the time of their installation or acquisition. The cost of such portion only of the changes incident to betterments as will when added to the original cost of the property bettered, give the cost of replacement or reconstruction in present condition of the property as bettered should be charged to the appropriate subaccounts under account No. 101, "Fixed Capital Installed Since December 31, 1912." The remainder of the cost of the change should be classed as a repair and be charged to the appropriate operating expense accounts.

40 *Replacements* are those installations of fixed capital which have for their purpose the sub-

Exhibit C. 3.

stitution of one building, structure, piece of equipment, or machinery for another which it has become necessary to retire, the substitute having substantially no greater capacity than the property replaced; also the extension of life period of franchises, patents and other intangible fixed capital.

The cost of the fixed capital retired should be credited to the fixed capital accounts in which it is carried and the cost of the fixed capital installed in place of fixed capital so retired should be charged to the appropriate subaccounts under account No. 101, "Fixed Capital Installed Since December 31, 1912."

Page 33.

10 10. Costs to be actual money costs.—All charges made to fixed capital or other property accounts with respect to any property acquired on or after January 1, 1913, should be the actual money costs of the property. When the consideration actually given for anything with respect to which a charge is made to any fixed capital or other property account is anything other than money, the actual consideration should be described in the entry with sufficient fullness and particularity to identify it, and the amount charged should be the actual money value of such consideration at the time of the transaction.

* * * * *

12. Costs of labor, materials and supplies.—The term *cost* as used in the fixed capital (or construction) accounts means the actual cost in money of labor and materials used in construction, or the actual cost in money of property acquired after construction, or if the consideration

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Exhibit C. 3.

given is other than money, the actual money value of such other consideration at the time of the purchase. Cost of labor includes not only wages, salaries, and fees paid employees, but also the personal expenses of such employees when borne by the company. Cost of material and supplies consumed in construction is the cost at the places where they enter into construction, including cost of transportation and inspection when specifically assignable. If such materials and supplies are passed through storehouses, their cost entered in the account may include a suitable proportion of store expense.

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Exhibit.

REPORTS OF BOARD OF PUBLIC UTILITY COMMISSIONERS.

Vol. XI, page 253.

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No. 1123.

IN THE MATTER OF THE APPLICATION OF THE ACQUACKANONK WATER COMPANY, EAST JERSEY WATER COMPANY, KEARNY WATER COMPANY, MONTCLAIR WATER COMPANY AND PASSAIC WATER COMPANY FOR APPROVAL OF CONSOLIDATION AGREEMENT FORMING PASSAIC CONSOLIDATED WATER COMPANY.

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IN THE MATTER OF THE APPLICATION OF THE ACQUACKANONK WATER COMPANY, EAST JERSEY WATER COMPANY, KEARNY WATER COMPANY, MONTCLAIR WATER COMPANY AND PASSAIC WATER COMPANY FOR APPROVAL OF THE ISSUANCE OF CAPITAL STOCK OF PASSAIC CONSOLIDATED WATER COMPANY FOR THE PURPOSE OF SAID CONSOLIDATED TO THE AMOUNT OF THIRTY-FIVE THOUSAND SHARES AT THE PAR VALUE OF ONE HUNDRED DOLLARS (\$100) A SHARE.

30

Approval is given to the consolidation of five water companies and to the issuance of capital stock by the consolidated company, it appearing

1. That the assets behind the securities of the consolidated company are sufficient to conform to the requirements imposed by the State on newly incorporated companies;

2. That the consolidation does not by any of its terms subject any security holder in any of the companies to any unfair condition or arrangement;

40

Decision of Board Reported in Vol. XI of Reports.

3. That every statutory requirement applicable to the premises has been complied with.

William M. Wherry, for the Petitioners.

Edward F. Merrey, for the Cities of Paterson, Passaic and Clifton.

Theodore J. Badgley, for the Town of Montclair. 10

The petition in this matter alleges, among other things, that:

The above corporations were organized for the purpose of carrying on business of the same nature, namely, the supplying of water for domestic and public uses, in said State and comprising one system.

The respective Boards of Directors of the said corporations have approved a plan of consolidation of the said corporations, for the purpose of greater efficiency and economy of management, and in order more efficiency to carry on their business and discharge their public duties. 20

The books of the said companies have been balanced as of December 31st, 1922, and the value of the property of the companies has been ascertained as of that date. The value of the property, including all assets, as of December 31st, 1922, is more than \$13,000,000. The consolidation agreement provides for the capitalization of \$11,500,000 thereof, of which \$8,000,000 is to be bond and \$3,500,000 stock. 30

The property of the consolidated companies is subject to the following liabilities:

Bonds secured by mortgage.....	\$7,092,000.00
Debt to the New Jersey General Security Company	1,331,546.84
Current Liabilities, approximately.....	240,000.00

The consolidation agreement provides for the issuance of shares of the consolidated corpora- 40

Decision of Board Reported in Vol. XI of Reports.

tion to stockholders of the respective companies in the following proportions:

	No. of Shares Outstand- ing	Par Value Issued of New Stock to be for Each Share of Old Stock	Total Shares to be Issued
10	Acquackanonk Water Company	4,000	2.27375 sh. 9,095
	East Jersey Water Company..	1,000	5.74 sh. 5,740
	Kearny Water Company.....	1,000	2.84 sh. 2,840
	Montclair Water Company....	5,000	1.51 sh. 7,550
	Passaic Water Company.....	30,000	.1925 sh. 5,775
	Total shares		31,000
	Total in dollars, par value.....	\$3,100,000	

It is proposed to issue stock of the new company of a par value of \$400,000 and later bonds in the par value of \$908,000 bearing interest at six per cent. in consideration of the cancellation of an equal amount of indebtedness of the companies to the New Jersey General Security Company.

Article V of the consolidation agreement provides that "the present indebtedness, and all legal obligations and duties, of each of the said corporations shall be assumed in full by the consolidated," and Article VI provides that "upon consummation of this consolidation, all property, real, personal and mixed, of the said corporations * * * shall vest in the said consolidated corporation."

The companies have therefore petitioned the Board for:

1. A certificate of approval, in writing, of a consolidation agreement dated the 10th day of May, 1923.

2. The approval of the issuance of the stock of Passaic Consolidated Water Company for the purpose of said consolidation to the extent of thirty-one thousand shares.

Decision of Board Reported in Vol. XI of Reports.

3. The issuance of the stock of Passaic Consolidated Water Company, for the purpose of cancelling four hundred thousand dollars (\$400,000) of indebtedness to the New Jersey General Security Company, to the extent of four thousand shares.

The value of the properties of the applicants used and useful in furnishing water service was fixed by the Board in its decision dated March 27th, 1923; this decision also gives historical data concerning these companies.

This Board enunciated its policy with respect to the requirements in cases of mergers in the matter of the application of American Malt Corporation and American Malting Company for approval of agreement of merger and consolidation (R. B. P. U. C. Vol. II, p. 401). In its decision in this matter it stated that:

"In general, therefore, the Board is of opinion that, inasmuch as formal approval by a State tribunal is now, of necessity, a requirement in the case of every merger, the company resulting from such merger may properly be required to show at the time of merger, (1) assets behind its securities in amount sufficient to conform with the requirements imposed by the State upon companies newly incorporating under its laws; (2) that such a merger must not by any of its terms subject any security holder in any of the consolidating or merging companies to an unfair or inequitable condition or arrangement; (3) that in the carrying out of such merger it must be affirmatively shown that each and every statutory requirement applicable in the premises has been complied with."

The assets and liabilities of the consolidated corporation as of December 31st, 1922, condensed and rearranged, are shown in the following Table I on two bases as presented in Exhibit P-2, namely:

10 1. With the value of the plant and property both used and useful and other non-operative property taken at the combined book cost as shown in Mr. Gore's Exhibit A (Exhibit P-2).

20 2. With the value of plant and property used and useful based on Mr. Hill's fair value of \$13,000,000 including therein working capital of \$300,000 adjusted by Mr. Gore in Exhibit B (Exhibit P-2) to \$12,817,605.12 for all fixed capital.

For comparison, in column (3) is shown a similar balance sheet based on the Board's valuation of \$11,500,000.

30 3. With the value of plant and property used and useful taken as \$11,200,000 (that is, \$11,500,000 total value less \$300,000 working capital as taken in 2), this being the total value of used and useful property as shown in the Board's decision of March 27th, 1923.

TABLE I.

Condensed and re-arranged balance sheets on three bases for plant and property—both used and useful for water purposes and all other property—all as of December 31st, 1922.

Balance Sheets after giving effect to proposed issues of securities	(1) On Basis of Book Costs	(2) On Basis of Hill's Appraisal as Ad- justed in Gore's Exhibit B	(3) Board's Value of On Basis of \$11,500,000
Assets			
Plant and Property (all property).....	\$13,053,181.99		
Less Depreciation Reserve.....	1,398,341.64		
	<hr/>		
Depreciated Book Cost (all property)			
Depreciated Valuation of Used Water Property.....		(1) \$12,721,600.12	(1) \$11,200,000.00
Add Valuation of Excluded Property.....		(3) 96,005.00	(3) 73,000.00
		<hr/>	<hr/>
Depreciated Cost or Value of all Property.....	\$11,654,840.35	\$12,817,605.12	\$11,273,000.00
Current Assets and Deferred Items.....	786,926.14	786,926.14	786,926.14
	<hr/>	<hr/>	<hr/>
Total Assets Adjusted (less depreciation).....	\$12,441,766.49	\$13,604,531.26	\$12,059,926.14
Liabilities			
Current and Deferred Liabilities.....	\$ 241,498.96	\$ 241,498.96	\$ 241,498.96
N. J. General Security Company (2).....	23,546.84	23,546.84	23,546.84
Stock issue proposed:			
To N. J. General Security Company.....	400,000.00	400,000.00	400,000.00
To Shareholders of Consolidating Companies.....	3,100,000.00	3,100,000.00	3,100,000.00
Bond issue proposed:			
To N. J. General Security Company.....	908,000.00	908,000.00	908,000.00
For refunding.....	7,092,000.00	7,092,000.00	7,092,000.00
Surplus After Consolidation.....	676,720.69	1,839,485.46	294,880.34
	<hr/>	<hr/>	<hr/>
Total Liabilities (less depreciation).....	\$12,441,766.49	\$13,604,531.26	\$12,059,926.14

(1) Less working capital of \$300,000 as deducted in (2) by Mr. Gore.

(2) Open account after issuing to this company \$400,000 capital stock and \$908,000 bonds as proposed.

(3) After sale of Split Rock property.

Decision of Board Reported in Vol. XI of Reports.

In column (3) it will be noted that a surplus of nearly \$295,000 will remain after the issue of the securities as contemplated in the consolidation agreement. This is the minimum amount of surplus shown on any of the three bases.

10 The condensed and rearranged balance sheets on the three bases, then, each affirmatively indicate that (1) the assets behind the securities of the consolidated corporation are in amount sufficient to conform with the requirements imposed by the State upon companies newly incorporating under its laws. It is the Board's opinion that (2) the consolidation does not by any of its terms subject any security holder in any of the consolidating companies to an unfair or inequitable condition or arrangement and that in
20 carrying out such consolidation it has been affirmatively shown (3) that each and every statutory requirement applicable in the premises has been complied with, and that the Board should therefore approve the consolidation.

Counsel for the City of Paterson and also for the City of Passaic objected to the consolidation in general on the ground that it may become necessary at some future time for each of these municipalities to acquire by condemnation or
30 otherwise the distribution system in each of the respective municipalities for the purpose of operating municipally owned water supply departments and that it would be much easier to ascertain the value of the property of a company serving only within the areas of such city than to condemn part of the property of a very much larger system. As now operated, however, each of these water companies serves water outside the area of a single municipality and the main
40 source of supply is owned jointly by the ap-

Decision of Board Reported in Vol. XI of Reports.

10 applicants in this case. So in any event it will be necessary to segregate and value the part of the property which the municipality desires to purchase. The Board is of the opinion that each of these protesting municipalities will have the same rights and the same opportunity of condemnation of the necessary parts of the distribution system within their own territory after consolidation as before and the allegation that the municipalities may at some future time institute condemnation proceedings for the acquisition of this property would not justify the Board, on such a contingency alone, in withholding its approval of the consolidation and merger in this case in view of the fact that all legal requirements set forth by the Board in the American Malt Corporation case hereinabove cited have
20 been complied with. Moreover, the values of the constituent parts of the property of the consolidating companies have been estimated by various witnesses in great detail and on many bases and the relation that the value of the distribution systems bear to other elements of value may be estimated on any of these bases as fully after consolidation as without consolidation.

BASIS FOR OPENING BOOKS AFTER CONSOLIDATION 30

In the condensed balance sheets hereinabove set forth in the value of \$11,500,000 which was heretofore found by the Board does not include the value of non-operating property. The books of the existing companies show definite figures (presumably the historical costs) with respect to the assets and liabilities of the respective companies as now shown in their annual reports to the Board and there can be no prejudice resulting from the setting up of the combined balance
40

Decision of Board Reported in Vol. XI of Reports.

sheet on the basis of the combined book costs of the respective companies after eliminating inter-company items. In view of the fact that the companies have appealed to the court for a review of the Board's value of used and useful property, it appears preferable that the books of the consolidated company should be opened on the basis of the consolidated book figures as shown in Exhibit P-2 (Exhibit A) with any proper adjustments which may become necessary and that the books be so continued until the legal proceedings are concluded, at which time any adjustment may be submitted to the Board for approval. In the instant petition the Board's approval is asked for a capitalization of but \$3,500,000 of stock but it is indicated that the consolidated company will later ask for the approval of \$8,000,000 of six per cent. mortgage bonds.

CONCLUSIONS

The Board therefore finds and determines:

1. That the consolidation agreement is hereby approved.
2. That the books of Passaic Consolidated Water Company shall be opened on the basis of consolidated book costs as shown in Exhibit P-2 (Exhibit A) with any necessary and proper adjustments to be made therein.
3. That the Board hereby approves the issues of thirty-one thousand shares of stock of Passaic Consolidated Water Company at the par value of \$100 each per share in the amounts assigned to the shareholders of each company as shown in paragraph (7) of the petition herein-above cited.

Decision of Board Reported in Vol. XI of Reports.

4. That the Board hereby approves the issue of \$400,000 par value of stock of Passaic Consolidated Water Company for the purpose of cancelling an equal amount of indebtedness of the consolidating companies to the New Jersey General Security Company.

5. That all books of account and other records of the consolidating companies shall be turned over to the consolidated company.

Certificates in accordance with these findings will issue.

Dated, October 26, 1923.

Annual Report, December 31, 1923.

1923 Report
ANNUAL REPORT
OF
PASSAIC CONSOLIDATED WATER CO.
TO THE
BOARD OF
PUBLIC UTILITY COMMISSIONERS
OF THE
STATE OF NEW JERSEY
For the Two Months Ending Dec. 31, 1923

Page 8.

GENERAL BALANCE SHEET—ASSET SIDE

Line No.	Item. (a)	Balance at Close of Year. (b)	Net change During Year. (Increase in Black, De- crease in Red Ink.) (c)
1	100. Fixed Capital Installed Prior to January 1, 1913—Page 10	\$ 9,690,029.69	
2	101-42. Fixed Capital Installed since December 31, 1912—Page 11	3,593,787.45	
3	Total Fixed Capital in Water Department	13,283,817.14	
5	151. Construction Work in Progress—Page 12	943.06	
6	152. Materials and Supplies.....	170,681.26	
7	153. Cash	47,465.55	
9	155(a). Consumers' Accounts Receivable.....	602,146.43	
10	155(b). Other Accounts Receivable.....	50,706.85	
12	157. Other Current Assets (Specify in foot-note)..	167,969.68	
14	160. Investments—Page 14	40,752.00	
17	164. Prepayments (Specify in foot-note).....	2,400.92	
20	167. Other Suspense—Page 15	22,695.34	
21	Total	\$14,389,578.23	
	Other Current Assets—Accrued Water Rates.....		167,969.68
	Prepayments—Insurance	2,170.25	
	Rents	230.67	2,400.92

Note:

These are consolidated book figures of constituent companies to carry out suggestions made in decision of the Board, dated October 26, 1923; without prejudice to the Company's right to claim, use and prove true values of its properties in any proceeding, matter or transaction.

Annual Report, December 31, 1923.

Page 9.

GENERAL BALANCE SHEET—LIABILITY SIDE.

Line No.	Item. (a)	Balance at Close of Year. (b)	Net change During Year. (Increase in Black, De- crease in Red Ink.) (c)
1	200. Funded Debt—Page 16.. * * *	\$7,091,000.00	
5	204. Interest Accrued	\$4,776.67	4,776.67
9	208. Advances from Other Corporations, *	1,340,515.20	
10	209. Consumers' Deposits	47,745.19	
11	210. Other Accounts Payable	65,591.03	
12	211. Unearned Revenue	28,156.14	
16	216. Accrued Amortization of Capital—Page 18....	1,537,454.48	
19	221. Capital Stock—Page 17	3,500,000.00	
20	222 or 168. Corporate Surplus or Deficit—Page 21	774,339.52	
21	Total	\$14,389,578.23	
	Advances from Other Corporations—from New Jer- sey General Security Co.—Parent Co....		1,340,515.20

* Specify in foot-note.

Annual Report, December 31, 1924.

1924 Report
ANNUAL REPORT
OF
PASSAIC CONSOLIDATED WATER CO.
TO THE
BOARD OF
PUBLIC UTILITY COMMISSIONERS
OF THE
STATE OF NEW JERSEY
For the Year Ending Dec. 31, 1924

Page 8.

GENERAL BALANCE SHEET—ASSET SIDE.
Close of Year 1924.

Line No.	Item. (a)	Balance at Close of Year 1924. (b)	Net change During Year. (Increase in Black, Decrease in Red Ink.) (c)
3	Total Fixed in Water Department.....	\$21,089,745.90	\$2,080,652.05
4	150. Fixed Capital in Other Departments—Page 12,	140,609.00	300.00
5	151. Construction Work in Progress—Page 12.....	8,850.02	8,850.02
6	152. Materials and Supplies.....	179,547.33	8,866.07
7	153. Cash	67,951.47	20,485.92
9	155 (a). Consumers' Accounts Receivable.....	888,052.01	285,905.58
10	155 (b). Other Accounts Receivable.....	47,646.92	3,059.93
12	157. Other Current Assets (Specify in foot-note)...	146,115.01	21,854.67
14	160. Investments—Page 14	2,100.00	2,100.00
17	164. Prepayments (Specify in foot-note).....	4,116.01	1,715.09
18	165. Unamortized Debt Discount and Expense— Page 15.....	140,569.70	140,569.70
20	167. Other Suspense—Page 15.....	18,090.91	4,486.06
	Total	\$22,733,394.28	\$1,641,860.33
<i>Other Current Assets</i>			
	Water Rates Accrued		146,115.01
	Prepayments—Insurance		4,116.01

Figures in Italics Type appear in red ink.

Annual Report, December 31, 1924.

Page 9.

GENERAL BALANCE SHEET—LIABILITY SIDE.
Close of Year 1924.

Line No.	Item. (a)	Balance at Close of Year 1924. (b)	Net change During Year. (Increase in Black, Decrease in Red Ink.) (c)
1	200. Funded Debt—Page 16.. * * *	\$7,939,000.00	\$848,000.00
5	204. Interest Accrued	32,566.67	27,790.00
9	208. Advances from Other Corporations*.....	485,153.31	855,361.89
10	209. Consumers' Deposits	36,930.22	10,814.97
11	210. Other Accounts Payable.....	132,275.05	66,684.02
12	211. Unearned Revenue	41,525.83	13,369.69
16	216. Accrued Amortization of Capital—Page 18....	2,906,900.02	53,784.61
17	217 and 218. Other Required Reserves—Page 18..		65,294.21
19	221. Capital Stock—Page 17	3,500,000.00	
20	222 or 168. Corporate Surplus or Deficit—Page 21	7,659,043.18	1,612,448.36
21	Total	\$22,733,394.28	\$1,641,860.33
	Loans from New Jersey General Security Co.— Parent Co.		485,153.31

Figures in Italics Type appear in red ink.

Annual Report, December 31, 1924.

Insert between pages 8 and 9.

GENERAL BALANCE SHEET—ASSET SIDE.
Close of Year 1923.

After filing our report for 2 months ending Dec. 31/1923, an appraisal was made of the properties as of Nov 1/1923 and book entries made giving effect to this appraisal, and an audit was also made as of Jan 1/1924. After giving effect to appraisal and audit the following is a corrected Balance Sheet as of Jan. 1/1924 & net changes shown for 1924 are based on these figures.

Line No.	Item. (a)	Balance at Close of Year. 1923.	
3	Total Fixed Capital in Water Department..	\$23,170,397.95	
4	150. Fixed Capital in Other Departments—Page 12	140,909.00	
6	152. Materials and Supplies.....	170,681.26	
7	153. Cash	47,465.55	
9	155 (a). Consumers' Accounts Receivable.....	602,146.43	
10	155 (b). Other Accounts Receivable.....	50,706.85	
12	157. Other Current Assets (Specify in foot-note)...	167,969.68	
17	164. Prepayments (Specify in foot-note).....	2,400.92	
20	167. Other Suspense—Page 15.....	22,576.97	
21	Total	\$24,375,254.61	
	Other Current Assets—Accrued Water Rates..		\$167,969.68
	Prepayments—Insurance	2,170.25	
	Rents	230.67	
			\$2,400.92

Annual Report, December 31, 1924.

GENERAL BALANCE SHEET—LIABILITY SIDE.
Close of Year 1923.

Line No.	Item. (a)	Due and Unpaid.	Not Yet Due.	Balance at Close of Year 1923.	
1	200. Funded Debt—Page 16..			\$7,091,000.00	
5	204. Interest Accrued.....		\$4,776.67	4,776.67	
9	208. Advances from Other Corporations.....			1,340,515.20	
10	209. Consumers' Deposits			47,745.19	
11	210. Other Accounts Payable			65,591.03	
12	211. Unearned Revenue			28,156.14	
16	216. Accrued Amortization of Capital—Page 18....			2,960,684.63	
18	219 and 220. Optional Reserves—Page 18. Federal Income Tax			65,294.21	
19	221. Capital Stock—Page 17			3,500,000.00	
20	222 or 168. Corporate Surplus or Deficit—Page 21			9,271,491.54	
21	Total			\$24,375,254.61	
	Advances from Other Corporations—from New Jersey General Security Co.....				\$1,340,515.20

Annual Report, December 31, 1924.

Insert between pages 20 and 21.

PASSAIC CONSOLIDATED WATER COMPANY.

Plant Property, Depreciable and Non Depreciable with Values as Set by Board of Public Utility Commissioners, for Rate Purposes Only, and Depreciation for Four Years Ended December 31, 1924

	Total	Non-Depreciable	Depreciable	Depreciation 1-1/2% Year	
Board's Valuation, December 31, 1920...	\$11,500,000.00				
Working Capital	300,000.00				
Valuation of Plant Property, December 31, 1920	\$11,200,000.00	\$2,049,000.00	\$9,151,000.00	\$137,265.00	1921
1921 Additions	180,791.35		180,791.35		
Value of Plant Property, December 31, 1921	\$11,380,791.35	\$2,049,000.00	\$9,331,791.35	\$139,976.87	1922
1922 Additions	128,446.35	1,533.46	126,912.89		
Value of Plant Property, December 31, 1922	\$11,509,237.70	\$2,050,533.46	\$9,458,704.24	\$141,880.57	1923
1923 Additions (Ten Months)	226,417.05	5,131.69	231,548.74		
1923 Additions (Two Months)	53,130.95		53,130.95		
Value of Plant Property, December 31, 1923	\$11,788,785.70	\$2,045,401.77	\$9,743,383.93	\$ 2,711.12	2-1/3 months to Mch. 10, 1924 for Montclair only.
1924 Additions—Montclair only.....	8,541.07		8,541.07		
Deduct a/c Sale of Montclair Plant March 10, 1924	1,171,857.55	233,788.00	938,069.55	42,238.16	
Value After Montclair Sale.....	\$10,625,469.22	\$1,811,613.77	\$8,813,855.45	\$379,595.40	1924
1924 Additions (Exclusive of Montclair) Net	279,871.75	3,434.58	283,306.33		
Value of Plant Property, December 31, 1924	\$10,905,340.99	\$1,808,179.19	\$9,097,161.78	\$511,803.23	

Figures in Italics Type appear in red ink.

Annual Report, December 31, 1924.

Insert between pages 20 and 21 of the 1924 Report corrected to conform with the corrections made by the testimony (See State of Case, page 52, lines 30 to 40).

PASSAIC CONSOLIDATED WATER COMPANY

Plant Property, Depreciable and Non-Depreciable with Values as Set by Board of Public Utility Commissioners, for Rate Purposes Only, and Depreciation for Two Years Ended December 31, 1924

	Total	Non-Depreciable	Depreciable	Depreciation 1-1/2% Year	
Board's Valuation, December 31, 1922...	\$11,500,000.00				
Working Capital	300,000.00				
Valuation of Plant Property, December 31, 1922	\$11,200,000.00	\$2,049,000.00	\$9,151,000.00		
1923 Additions (10 months).....	226,417.05	5,131.69	231,548.74		
1923 Additions (2 months).....	53,130.95		53,130.95		
Value of Plant Property, December 31, 1923	\$11,479,548.00	\$2,043,868.31	\$9,435,679.69	\$137,265.00	1923
1924 Additions (Montclair Only)....	8,551.07		8,551.07	3,031.12	2-1/3 months Montclair to 3/10/24
Value of Plant Property, December 31, 1924	\$11,488,099.07	\$2,043,868.31	\$9,444,230.76	\$140,296.12	
Deduct a/c of Sale of Montclair Plant Mar. 10, 1924	1,078,458.31	30,000.00	1,048,458.31	18,286.12	
Value After Montclair Sale.....	\$10,409,640.76	\$2,013,868.31	\$8,395,772.45	\$122,010.00	
1924 Addition (Exclusive of Montclair)	279,871.75	3,434.58	283,306.33	125,935.58	1924
Value of Plant Property, December 31, 1924	\$10,689,512.51	\$2,010,433.73	\$8,679,078.78	\$247,945.58	

Figures in Italics Type appear in red ink.

Line No.	Account. (a)	Items. (b)	Totals. (c)
OPERATING EXPENSES.			
1	1. WATER SUPPLY EXPENSES.	* * * *	* * * *
2	401. COLLECTING SYSTEM EXPENSES: Diver- sion State-S. U. M.-Dyers	\$ 26,119.11	* * * *
3	(a) Water Purchased	14,701.64	* * * *
4	(b)—(i) Other Collecting System Expenses.	5,017.15	* * * *
5	Total		\$ 45,837.90
6	402. PURIFICATION SYSTEM EXPENSES.....		85,343.91
7	403. PUMPING SYSTEM EXPENSES:		
8	(a) Operating Labor	46,783.22	* * * *
9	(b) Fuel	190,023.62	* * * *
10	(c) Power Purchased		* * * *
11	(d) Miscellaneous Supplies and Expenses...	5,628.07	* * * *
12	Total		242,434.91
13	404. DISTRIBUTION EXPENSES		54,474.41
14	Total Water Supply Expenses.....		428,091.13
15	11. MAINTENANCE EXPENSES.	* * * *	* * * *
16	405. REPAIRS OF WATER COLLECTING SYS- TEM	606.63	* * * *
17	406. REPAIRS OF PURIFICATION SYSTEM.....	9,011.26	* * * *
18	407. REPAIRS OF PUMPING SYSTEM.....	28,248.48	* * * *
19	408. REPAIRS OF DISTRIBUTION SYSTEM....	46,582.21	* * * *
20	409. GENERAL REPAIRS	5,746.23	* * * *
21	410. GENERAL AMORTIZATION	285,361.29	* * * *
22	Total Maintenance Expenses		375,556.10
23	111. GENERAL AND MISCELLANEOUS EXPENSES.	* * * *	* * * *
24	411. ADMINISTRATION EXPENSES	53,784.40	* * * *
25	412. ACCOUNTING AND COMMERCIAL EX- PENSES	81,968.16	* * * *
26	413. BUSINESS PROMOTION EXPENSES.....	1,588.26	* * * *
27	414. LEGAL EXPENSES	27,907.10	* * * *
28	415. INJURIES AND DAMAGES.....	6,211.12	* * * *
29	416. INSURANCE	2,904.72	* * * *
30	417. RELIEF DEPARTMENT AND PENSIONS...	4,775.60	* * * *
34	421. MISCELLANEOUS GENERAL EXPENSES..	53,943.42	* * * *
35	Total General and Miscellaneous Ex- penses		233,082.78
36	Total Operating Expenses		1,036,730.01
37	422. TAXES, Page 25, Line 10, Col. (c).....		262,359.09
39	Total Revenue Deductions		1,299,089.10

Miscellaneous General Expense includes \$46,856.57 pro rata for year 1924 of expenses incident to rate case, consolidation &c.

ORDER OF BOARD.

STATE OF NEW JERSEY.
BOARD OF PUBLIC UTILITY
COMMISSIONERS.

10

In the matter of the fixed capital accounts on the books of the Passaic Consolidated Water Company.

This case having been duly submitted and full investigation of the matters and things involved having been had, and the Board having on the date hereof made and filed a decision containing its findings of fact and conclusions thereon, which said decision is hereby referred to and made a part hereof.

20

The Board of Public Utility Commissioners, after hearing, upon notice, by virtue of the power and authority conferred upon it by statute now ORDERS:

1. That the Passaic Consolidated Water Company shall reform and rewrite its books of account to conform with the Board's decision of October 26, 1923, approving the consolidation, starting with December 31, 1922, with the said item of \$11,200,000 shown in column (3) of table I of its decision approving the consolidation (P. U. R. N. J. Vol. XI, p. 257) and making subsequent additions and retirements and all other book entries in accordance with the provisions of the Board's Uniform System of Accounts for Water Utilities.

30

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Decision of Board.

the respondent company (P. U. C. N. J. Vol. XI, p. 253). As of December 31, 1922, the Board fixed the value of the used and useful property of these five companies at \$11,500,000, of which \$11,200,000 was fixed capital (that is, plant). In arriving at this value the Board considered many indicia of value. The Company's witnesses (P. U. C. N. J. Vol. XI, p. 11, *et seq.*, Appendices A and B) submitted various figures for cost or value varying from about \$9,450,000 to upwards of \$21,000,000; the municipalities submitted a reconstructed historical cost less depreciation in the amount of \$7,725,000 and also submitted a continuation of the 1912 appraisal (adjusted by the Board) in the amount of about \$10,250,000. There was also submitted in evidence in that case (Exhibit R. 7) an offer of the Company to sell its property to the municipalities served for \$10,594,538.

These five companies submitted a petition to the Board asking it to approve a consolidation of the above-named five companies into a new company to be called Passaic Consolidated Water Company. While in this case the Company's Exhibit P. 2 submitted balance sheets showing the combined fixed capital of the five companies on the basis of the consolidated book costs and on the basis of the \$13,000,000 valuation submitted in the rate case by their expert, Nicholas S. Hill, Jr. (P. U. C. of N. J. Vol. XI, p. 257) they specifically limited the amount of securities, the approval of which was asked by the Board, to the Board's value of \$11,500,000. In discussing a basis for opening the books of the new company after consolidation, the Board said in part:

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Decision of Board.

"Basis for opening books after consolidation.

"In the condensed balance sheets hereinabove set forth the value of \$11,500,000 which was heretofore found by the Board does not include the value of non-operating property. The books of the existing companies show definite figures (presumably the historical costs) with respect to the assets and liabilities of the respective companies as now shown in their annual reports to the Board and there can be no prejudice resulting from the setting up of the combined balance sheet on the basis of the combined book costs of the respective companies after eliminating inter-company items. In view of the fact that the companies have appealed to the court for a review of the Board's value of used and useful property, it appears preferable that the books of the consolidated company should be opened on the basis of the consolidated book figures as shown in Exhibit P. 2 (Exhibit A) with any proper adjustments which may become necessary and that the books be so continued until the legal proceedings are concluded, at which time any adjustment may be submitted to the Board for approval. In the instant petition the Board's approval is asked for a capitalization of but \$3,500,000 of stock but it is indicated that the consolidated company will later ask for the approval of \$8,000,000 of six per cent. mortgage bonds." page 259, Vol. XI.

And in its conclusions the Board found and determined:

"2. That the books of Passaic Consolidated Water Company shall be opened on the basis of consolidated book costs as shown in Exhibit P. 2 (Exhibit A) with any necessary and proper adjustments to be made therein."

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Decision of Board.

It is perfectly clear from these quotations that the Board approved the consolidation on the condition that consideration to be paid for fixed capital transferred to the new company should be based on the valuation thereof (adjusted for operative changes) made by the Board confirmed or modified by the pending Court decision and that in the interim consolidated book costs should be used for fixed capital account.

The merger was effective as of November 1, 1923, four days subsequent to the date of the Board's decision approving the merger.

The Board's decision in the rate case had been certioraried and on November 16, 1923, the Supreme Court of the State sustained the Board's valuation of \$11,500,000, which Court's decision was subsequently confirmed by the Court of Errors and Appeals. If the Court's decision had been handed down prior to the issuing of the Board's decision approving the merger, the basis for opening the books would have been the value of \$11,200,000 for fixed capital used and useful in the water business and \$300,000 for working capital, exclusive of non-operating property, and this would be the cost of the said property to the consolidated company.

The newly consolidated company opened its books as ordered by the Board on the basis of the consolidated book costs as of December 31, 1922, continued to the date of the merger, November 1, 1923, and early in 1924 rendered its report to the Board covering its operations from November 1, 1923, to December 31, 1923, on the basis indicated by the Board's decision. In this report the total fixed capital cost new December 31, 1923, amounted to \$13,282,817 and the cost new less depreciation amounted to \$11,746,363. But in its annual report for the year ending

Decision of Board.

December 31, 1924, the Company swept aside these figures prescribed by the Board's report and substituted therefor, without any authority from or previous notice to the Board, a different set of figures. The amount of fixed capital new as of December 31, 1923, was increased nearly \$10,000,000 to \$23,170,398 and the net amount after deducting depreciation reserve set up as a liability was \$20,209,714. In an explanatory footnote the Company's report states that this higher figure gave effect to an appraisal made by Mr. Hill, its expert, whose valuations on a number of bases had been considered by the Board in arriving at its value of \$11,500,000, which value, as has been stated, was confirmed by the highest court in the State. The cost to the consolidated company was the value of the property of the consolidating companies, and that value, as appears from what has gone before, was the value fixed by the Board and was the price paid by the consolidated company for the used and useful property of the consolidating companies as of December 31, 1922, and, when fixed by the court of competent authority, should have been set up on the books of account of the company in accordance with the Board's uniform system of accounts for water utilities (p. 8, Sec. 10) and additions to this cost should be entered in the books of account of the Company as prescribed by the said system of accounts. This Uniform System of Accounts for Water Utilities was directly authorized by the statute creating the Board (P. L. 1911, Chap. 195), the pertinent sections thereof reading as follows:

"17. The Board shall have power, after hearing, upon notice by order in writing, to require every public utility as herein defined: * * *

Decision of Board.

10 “(d) To keep its books, records and accounts so as to afford an *intelligent understanding* of the conduct of its business and to that end to require every such public utility of the same class to adopt a uniform system of accounting. Such system shall conform, in so far as in the judgment of the Board is practicable, to any system adopted or approved by the interstate commerce commission of the United States of America.

“(e) To furnish annually a detailed report of finances and operations, in such form and containing such matters as the Board may from time to time by order prescribe.”

20 The testimony in the case clearly shows that the provisions and rules with respect to the system of accounting for fixed capital as prescribed by the Interstate Commerce Commission is also prescribed in the Board's Uniform System of Accounts for Water Utilities so far as pertinent. The general principles governing the keeping of such accounts are identical in the uniform system of accounts of the two Commissions. As hereinabove stated, the actual cost of the property to the consolidated company was the \$11,500,000 as found by the Board to be the value of its used and useful property as of December 31, 1922, plus net capital additions to same down to November 1, 1923, plus non-operating property not included in such valuation.

30 The books of a utility, in the opinion of the Board, should record its financial history. With respect to fixed capital accounts, these should show the investment of the owners in such property and not varying, inconclusive estimates. If the directors, for the information of stockholders, consider it desirable to have made estimates of the cost of the property on other basis than the investment cost, there is no objection
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Decision of Board.

to so doing if they are not entered upon the books of account of the utility in place of actual investment costs. The Board's position is illustrated by the practice of conservative institutions (such as banking and insurance companies) in the makeup of their annual reports with respect to securities owned. Many of these companies publish the par value, the book value or cost and the market value of each security owned. If they followed the practice inaugurated by the respondent, this book value or cost would be entirely lost, to the detriment of all interested parties.

10 The position taken by the Company's counsel is that the book costs may be changed by the Board of Directors at any time they may see fit to do so and that they directed that the books of the Company with respect to fixed capital be changed as of January 1, 1924, nearly doubling the amount indicated by the value found by the Board and confirmed by the courts of the State. In justification of its action the Company offered a valuation by Nicholas S. Hill, Jr., as expert who testified that the value of the Company's property as of November 1, 1923, was \$23,117,267 and the same cost new less depreciation was \$20,217,832. The latter figure is to be contrasted with the same witness' value of \$13,000,000 submitted by him in the rate case of the same five companies merged into the respondent. In the rate case Mr. Hill offered a number of valuations or costs on varying bases, certain of the values exceeding \$20,000,000, notwithstanding which he stated that the fair value of the property was but \$13,000,000. Since this value was testified to by Mr. Hill, the Montclair water system has been sold to that municipality and the remaining capital is decreased by a pro-
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Decision of Board.

portionate amount. Net additions to capital account since the date of the merger are not clearly stated in the reports of the Company to the Board by reason of the fact that they are confused with the estimates of value of the witness Hill and do not clearly without considerable labor show the actual gross and net cost of additions less the cost of the retirements. This is a clear indication that the Company does not keep its books, records and accounts so as to afford to the Board an intelligent understanding of the conduct of its business, as required by the statute.

In this proceeding, however, the Board is not dealing with the question of valuation or of a new value for the Company's property. It is dealing with the cost of the property of the Passaic Consolidated Water Company and with its requirements that the Company follow the rules incorporated in the Board's Uniform System of Accounts for Water Utilities requiring this cost modified by subsequent changes be set up in fixed capital account. The valuation now offered by Mr. Hill showing the property capitalization for the Company is at such variance with the various values offered by him and by others that it could not be accepted by the Board in this proceeding even though value of such were an issue. The rules of the Board incorporated in the Uniform System of Accounts for Water Utilities respecting fixed capital accounts have been hereinabove set forth.

The arbitrary changing of the figures set up for fixed capital account by the Company does not enable the Board to ascertain from time to time the original cost of the Company as required by numerous decisions of the Supreme Court beginning with *Smyth v. Ames* (169 U. S. 466, 18

Decision of Board.

Sup. Ct. 418.), which requires that original cost new and original cost new less depreciation shall be considered as an element of value by the Board when determining value for the purpose of fixing just and reasonable rates.

Again, the arbitrary increase in the amount of fixed capital as claimed by the Company results in setting up of an excessive expense of depreciation for its property for the year 1924 in the amount of \$285,361.29. (Company's annual report for the year 1924, page 24, line 21, General Amortization.) This charge for depreciation relates to the water system of the five companies less about nine per cent. thereof sold to the Town of Montclair, but in its decision fixing just and reasonable rates for the five consolidated companies (P. U. R. N. J. Vol. XI, p. 29, Table I, l. 5) the Board indicated that the annual expense of depreciation for the entire property in place on December 31, 1922, should be \$130,000, of which \$13,300 was applicable to the Montclair property. It is therefore apparent that the Company's practice of writing up its fixed capital and applying a percentage thereto for amortization of depreciation has resulted in increasing its annual charge to expenses to provide for depreciation of plant and property from about \$120,000 up to \$285,000, thus decreasing its apparent net earnings by about \$165,000 and increasing its reserve for depreciation improperly to the same amount. In view of this the Board is of the opinion that it should now take action to have the proper amount of depreciation expense as indicated by its decision carried into the expense accounts of this Company. The arbitrary action of the Company in changing its fixed capital balances renders it more difficult for

Decision of Board.

the Board to readily ascertain the correct figures from time to time.

A further evil resulting from the Company's improper practice is that by the amount of the write-up it creates an unearned increment in the shape of an apparently free surplus which is solely in the nature of an inflation of its capital account and is not earned surplus out of which dividends may be paid. If the Company's contention that it can change the amount of fixed capital at its own volition should be sustained, this would also result in permitting an outside appraiser without official regulatory status to render an opinion which would convert a deficit into a surplus, a proceeding distinctly not in the public interest nor in the interest of the creditors of the Company.

The Board therefore finds and determines:

1. That the money cost of the operating property subsequently acquired by the Passaic Consolidated Water Company on November 1, 1923, was the same as the value of the operating property of the five companies on said date consolidated into said company as fixed by the Board as of December 31, 1922, adjusted to reflect operating changes through additions to and retirements from such value, but increased by non-operating assets as of November 1, 1923, and that as of December 31, 1922, the value of such operating property for the five merging companies was \$11,200,000 for fixed capital and which value of fixed capital continued as above indicated to November 1, 1923, constitutes the original money cost of said fixed capital to the respondent on said latter date.

2. That the Passaic Consolidated Water Company shall reform and rewrite its books of ac-

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count to conform with the Board's decision of October 26, 1923, approving the consolidation, starting with December 31, 1922, with the said item of \$11,200,000 shown in column (3) of Table I of its decision approving the consolidation (P. U. R. N. J. Vol. XI, p. 257) and making subsequent additions and retirements and all other book entries in accordance with the provisions of the Board's Uniform System of Accounts for Water Utilities.

3. That conclusion numbered (2) in its decision in reconsolidation (P. U. R. N. J. Vol. XI, p. 259) is to be modified to conform hereto.

4. That the respondent Company shall modify its charges heretofore made for depreciation under Account No. 410, General Amortization since November 1, 1923, to be consistent with the Board's finding of \$130,000 per annum for the annual depreciation of the operating property in being December 31, 1923, shown in P. U. C. N. J. Vol. XI, p. 29, Table I, line 5, column 1 (of figures).

5. That upon rewriting its books of account on the basis set forth in the foregoing decision, it shall on or before March 1, 1926, submit to the Board for approval a new verified annual report for the year 1924.

6. That upon approval of such amended annual report being had, the Company shall set up no other or different basis of fixed capital than that so approved.

An order will issue accordingly.

Dated: January 7, 1926.

BOARD OF PUBLIC UTILITY
COMMISSIONERS.

(SEAL) By (Signed) JOS. F. AUTENREITH,
President.

Decision of Board.

Attest:

(Signed) ALFRED N. BARBER,
Secretary.

10 I HEREBY CERTIFY the foregoing to
(SEAL) be a true copy of a decision rendered
by the Board of Public Utility Com-
missioners and ordered filed by said
Board.

ALFRED N. BARBER,
Secretary.

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REASONS.

Filed May 13, 1926.

NEW JERSEY SUPREME COURT.

PASSAIC CONSOLIDATED WATER COMPANY, <i>Prosecutor,</i> <i>vs.</i> BOARD OF PUBLIC UTILITY COM- MISSIONERS OF NEW JERSEY, <i>Defendant.</i>	}	10 <i>On</i> <i>Certiorari.</i> <i>Reasons.</i>
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Passaic Consolidated Water Company, prose-
 cutor of the above writ of certiorari, by Fred- 20
 eric J. Faulks and Harry V. Osborne, its attor-
 neys, comes and prays that the order of the
 Board of Public Utility Commissioners of New
 Jersey, made on the seventh day of January,
 1926, wherein the prosecutor was among other
 things directed to reform and rewrite its books
 of accounts, etc., and to modify its charges for
 depreciation, etc., and upon rewriting its books
 of account on the basis set forth in said order,
 to submit, on or before March 1, 1926, to the 30
 said Board, for approval, an amended annual
 report for 1924, and was prohibited from there-
 after setting up any other or different basis of
 fixed capital than that in said order approved
 by said Board, as by reference to the said order
 will more fully appear, may be declared null and
 void, set aside and for nothing holden, in so far
 as the same applies to this prosecutor, for the
 following reasons, namely:

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Reasons.

1. The annual report of the prosecutor heretofore filed with the said Board of Public Utility Commissioners of New Jersey for the year 1924 is a correct and true report of the prosecutor's assets, liabilities and receipts, disbursements, charges and business for the year 1924, and the
10 said Board has no jurisdiction nor authority to require a further nor an amended annual report for the year 1924, to be submitted to it for approval or otherwise.

2. The said report complies with the law and with all lawful rules and regulations of the said Board and the said Board has no jurisdiction or authority to require a further nor an amended annual report for the year 1924 to be submitted to it for approval or otherwise.

20 3. The charges for depreciation made by the prosecutor are in conformity with the law and the lawful rules and regulations of said Board and the said Board has no jurisdiction nor authority to require the prosecutor to modify its charges for depreciation.

30 4. The books of account of the prosecutor represent a true and correct statement of its assets and liabilities, as determined by its Board of Directors, and of its business, and the said Board of Public Utility Commissioners have no jurisdiction nor authority to require the prosecutor to reform and rewrite its books of account nor to require prosecutor to set up in its books of account the value of its assets at any other amount than that determined by its Board of Directors.

40 5. The said Board of Public Utility Commissioners have no jurisdiction nor authority to require the prosecutor to reform and rewrite its

Reasons.

books of account to conform with the Board's decision of October 26, 1923, approving the consolidation, starting with December 31, 1922, with the item of \$11,200,000 shown in column (3) of Table I of its decision approving the consolidation (P. U. R. N. J. Vol. XI, page 257) and making subsequent additions and retirements
10 and other book entries in accordance with the revisions of the Board's Uniform System of Accounts for Water Utilities.

6. The said order of the Board constitutes an unlawful interference with the management of the prosecutor's affairs.

7. The Board has no jurisdiction or authority to order that the prosecutor shall set up no other or different basis of fixed capital than that
20 approved by said order.

8. The prosecutor has the right to set up and maintain on its books of accounts and records its capital accounts at such valuation and its charges for depreciation in such amounts as are from time to time determined by its Board of Directors in the exercise of a fair and honest business judgment, for all other purposes than the fixing of the rates to be charged for the service rendered by it and for the issuance of securities by it; and said order of January 7, 1926,
30 seeks to deprive the prosecutor of this right to its injury, interferes with its property and vested rights and attempts to take the property of the prosecutor without due process of law.

FREDERIC J. FAULKS,
HARRY V. OSBORNE,
Attorneys for Prosecutor.

OPINION OF SUPREME COURT.

No. 201 May Term, 1927.

NEW JERSEY SUPREME COURT.

10 PASSAIC CONSOLIDATED WATER
COMPANY,

Prosecutor,

vs.

BOARD OF PUBLIC UTILITY COM-
MISSIONERS OF NEW JERSEY,
Respondent.

20 Argued May 4th, 1927; decided November 11,
1927.

On writ of certiorari.

For the prosecutor; Lindabury, Depue &
Faulks, Esqs., and Osborne, Cornish & Scheck,
Esqs.

For the respondent: John W. Queen, Esq., and
Thomas Brown, Esq.

Before Justices Trenchard and Katzenbach.

30 PER CURIAM.

40 This case is before this Court on a writ of
certiorari. The writ brings up for review an
order of the Board of Public Utility Commis-
sioners dated January 7, 1926, affecting the ac-
counts of the Passaic Consolidated Water Com-
pany, the prosecutor. The contents of the order
will later be particularly mentioned. In order
to understand the situation with reference to the
making of the order it is necessary to review
briefly certain matters relating to the prosecutor

Opinion of Supreme Court.

which occurred prior to the making of the said
order of January 7, 1926.

The Passaic Consolidated Water Company is a
consolidation of five companies known as the
Acquackanonk Water Company, East Jersey
Water Company, Kearny Water Company, Mont-
clair Water Company, and Passaic Water Com- 10
pany. The approval of this consolidation was
made by the Board of Public Utility Commis-
sioners on October 26, 1923. On March 7, 1923,
the Board had filed a decision allowing an in-
crease in rates to the five companies. In the
consideration of the rate question the Board had
fixed the value of the used and useful property
of said companies at \$11,500,000, of which \$11-
200,000 was designated as fixed capital (that is,
plant) and \$300,000 was working capital. The 20
Board in its approval of the consolidation di-
rected that the books of the prosecutor should be
opened on the basis of consolidated book costs
as shown in an exhibit referred to in said pro-
ceedings as Exhibit P-2. This exhibit fixed the
valuations of plant and working capital at the
figures hereinbefore mentioned.

The prosecutor opened its books on the basis of
the consolidated book costs as of December 31,
1922, continued to the date of the merger, which 30
was November 1, 1923. In the early part of the
year 1924 the prosecutor rendered a report to
the Board covering its operations from November
1, 1923, to December 31, 1923, on the basis in-
dicated by the Board's decision. In its annual
report for the year ending December 31, 1924,
the prosecutor used a different set of figures. The
amount of fixed capital as of December 31, 1923,
was entered as \$23,170,398, and, after deducting
depreciation reserve set up as a liability, it set 40

Opinion of Supreme Court.

up a net amount as fixed capital of \$20,209,714. The prosecutor explained in its report that this higher figure was the result of an appraisal made by Nicholas S. Hill, Jr., an expert in the valuation of public utilities.

10 To these figures the Board objected. The result of its objections was embodied in the order dated January 7, 1926, which required the prosecutor (1) to reform and rewrite its books of account to conform with the Board's decision of October 26, 1923, approving the consolidation; (2) to modify its charges made for depreciation; (3) to rewrite its books of account on said basis and to submit to the Board for approval an amended annual report; (4) that upon approval of such amended annual report being had, the
20 prosecutor should set up no other or different basis of fixed capital than that so approved.

The writ of certiorari was allowed for the purpose of reviewing the validity of this order. The prosecutor contends that the issue is whether the Board can require a utility to enter on its records and accounts as the value of its fixed capital a sum arbitrarily determined by the Board without hearing or proofs and which sum is proven to be substantially less than the fair value
30 of such assets. The Board contends that the issue is whether the Board can require a utility to keep its books, records, and accounts according to the uniform system adopted by the Board so as to afford an intelligent understanding of the conduct of the business of the utility.

40 The prosecutor alleges that it has in no way sought to use the higher valuation in connection with the rates charged or properly chargeable by it, or as the basis for the issuance of securities, or in any other matters over which the

Opinion of Supreme Court.

Board has jurisdiction or supervision; that it claims the right to enter its assets on its records at their fair value; and that it cannot be lawfully compelled to enter them at a substantially less value arbitrarily fixed by the Board.

The Board contends that under the provisions of the Utility Act it has the power to make the order referred to and that said order is lawfully within the powers of the Board to enact. 10

The question presented seems to us to be somewhat academic. It nowhere appears in the record that the valuation placed upon its books by the prosecutor is sought to be used for any improper purpose. The Board defends its order not because the valuation which it has fixed for rate making purposes is likely to be lost either in its records or the records of the prosecutor, but because it feels, as evidenced by the argument of its counsel, that the prosecutor seeks to condemn its power and authority. 20

In disposing of this question we will start out with the premise that the power of the Board is that of regulation and not of asphyxiation. The right to regulate a utility does not destroy the right of private ownership. All the incidents of ownership, except in so far as it may be necessary to curtail them to properly exercise the power of regulation, remain with the corporation. If the order of the Board is arbitrary and unreasonable and beyond the powers given to it by the statute, it is void. It seems to us that one of the rights of private ownership is the keeping of accounts not solely for the purpose of establishing a basis for fixing rates but for such other matters as appertain to the ordinary business of a utility corporation. It owes to its stockholders certain rights that may require an
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Opinion of Supreme Court.

entry upon its books of what it determines to be the fair value of its property. It must be recognized that when a Board is fixing a basis for rates that it may perchance mistakenly undervalue the property of the utility or eliminate from the valuation elements which in the past
10 have required the expenditure of considerable funds.

In ascertaining the income and excess profits upon which taxes have to be paid to the Federal Government, for example, it is fair that the full value of the property should be used. To use it requires that such a valuation shall be entered on the books of account. In the event of the sale of any of the company's property for which it has no longer use there should be a record of the
20 true value of such property. These illustrations might be multiplied. They are only used for the purpose of showing that in the conduct of the affairs of a corporation questions regarding its property will arise which require that there be entered upon its books other entries than that of the valuation fixed by the Utilities Board for rate-making purposes.

It is well settled that when bodies are created for the regulation of utility companies the pre-
30 sumption is that the power of regulation conferred does not extend beyond the express terms of the grant. *State v. Paterson*, 129 Southwestern Reporter 892. In *Hackensack Water Co. v. Board of Public Utility Commissioners*, 96 N. J. L. 184, the Court of Errors and Appeals said: "It was the intent of the Legislature that the exercise of these powers should be controlled not only by the statute itself but by the settled rules and principles of the common law."

Opinion of Supreme Court.

The power which the statute gives to the Board and upon which the Board relies to sustain its order in the present case is found in Section 17 of P. L. 1911, page 378. It is in these words:

"The board shall have power, after hearing, upon notice, to require every public utility as herein defined:
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"(d) To keep its books, records and accounts so as to afford an intelligent understanding of the conduct of its business and to that end to require every such public utility of the same class to adopt a uniform system of accounting. Such system shall conform, in so far as in the judgment of the board is practicable, to any system adopted or approved by the interstate commerce commission of the United States of America.

"(e) To furnish annually a detailed report of the finances and operations, in such form and containing such matters as the board may from time to time by order prescribe.
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"(f) To carry, whenever in the judgment of the board it may reasonably be required, for the protection of stockholders, bondholders or creditors, a proper and adequate depreciation account in accordance with such rules, regulations and forms of account as the board may prescribe."
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We are of the opinion that the power given to the Board under these provisions of the statute is not sufficient to justify the order of January 7th, 1926. While there is ample authority to justify the provision that the prosecutor should adopt the uniform system of accounts prescribed by the Board, yet we are of the opinion that such a provision does not justify the provision of the order requiring the rewriting of the books of the company as to its capital account, or that por-
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Opinion of Supreme Court.

tion of the order which declares that no other
 or different basis of fixed capital shall be set up
 than that approved by the Board. It may well
 be that a Board could require an entry upon the
 books of a utility to the effect that on such and
 such a date the valuation for rate-making pur-
 10 poses was found by the Board to be a specific
 amount, but the order in the present case goes
 beyond that and is a prohibition that there shall
 not be set up on the books of the company for
 any purpose whatsoever any different basis of
 fixed capital than that which has been approved
 by the Board for rate-making purposes. This,
 we feel, transcends the power of the Board.

The order is, therefore, set aside with costs.

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JUDGMENT.

NEW JERSEY SUPREME COURT.

PASSAIC CONSOLIDATED WATER COMPANY, <i>Prosecutor,</i>	}	<i>On Certiorari.</i>	10
 <i>vs.</i> BOARD OF PUBLIC UTILITY COM- MISSIONERS OF NEW JERSEY, <i>Respondent.</i>		<i>Rule Setting Aside Order.</i>	

The Court having inspected the order made
 by the Board of Public Utility Commissioners of
 New Jersey, the respondent herein, dated Janu-
 ary 7, 1926, affecting the accounts of the Passaic
 Consolidated Water Company, the prosecutor
 herein, and the proceedings returned with the
 writ of certiorari in this cause, and having heard
 the arguments of counsel herein, and having duly
 considered the same,

It is, on this 1st day of December, 1927,

ORDERED, that the said order of the Board of
 Public Utility Commissioners of New Jersey be
 set aside, made void and for nothing holden,
 with costs.

Entered December 1, 1927.

On motion of

LINDABURY, DEPUE & FAULKS.
 OSBORNE, CORNISH & SCHECK,
 Attorneys of Prosecutor.

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NOTICE AND GROUNDS OF APPEAL.

NEW JERSEY SUPREME COURT.

10	PASSAIC CONSOLIDATED WATER COMPANY, <i>Prosecutor,</i>	}	<i>On Certiorari.</i> <i>Notice of</i> <i>Appeal.</i>
	<i>vs.</i>		
	BOARD OF PUBLIC UTILITY COM- MISSIONERS, <i>Defendant.</i>		

To Messrs. Osborne, Cornish & Scheck, attorneys for prosecutor:

20 TAKE NOTICE, that the Board of Public Utility Commissioners appeals to the New Jersey Court of Errors and Appeals from the judgment entered in this cause and that the following are the grounds of appeal:

1. That the New Jersey Supreme Court set aside and held for nothing the order of said Board, returned with the writ of certiorari.

30 2. That the New Jersey Supreme Court did not affirm said order and dismiss said writ.

JOHN O. BIGELOW,
Attorney for Board of Public
Utility Commissioners.

Service of the above notice of appeal is acknowledged December 5, 1927.

OSBORNE, CORNISH & SCHECK,
Attorneys for Prosecutor.

New Jersey Court of Errors and Appeals

PASSAIC CONSOLIDATED WATER COMPANY, <i>Respondent,</i>	}	<i>On Appeal.</i>
<i>vs.</i>		
BOARD OF PUBLIC UTILITY COM- MISSIONERS, <i>Appellant.</i>		

REPLY BRIEF FOR THE BOARD OF PUBLIC UTILITY COMMISSIONERS.

Either I have misunderstood the argument of the Company in the Supreme Court or it has now radically shifted its position, for by its brief on this appeal it distinctly asserts that it has complied with the Board's accounting rules and carried its plant on its books *at cost*. And the Company now allows its attack on the Board's accounting system to languish; it does not even argue that this system—including the requirement that assets be carried at cost—is not well adapted to the statutory purpose, namely, that the books of account may afford an intelligent understanding of the conduct of the business.

A.

Part I of the Company's brief urges that this appeal is unwarranted. To establish this contention, counsel at page 6 say of the Board's main brief,

“At page 29 it is admitted that, ‘By its order under review it (the Board) required the Company to reduce the book value of its water system \$381,840.35 too low,’ even

on the Board's theory that the Company can only carry its assets at cost, instead of at their actual value. No contention or pretense is made that the amount at which the Company was ordered to value its fixed capital assets equalled the cost thereof either as of December 31, 1922, or as of the date of the consolidation, or as of the date of the order under review, or represented any valuation thereof whatever except the earlier arbitrary one of \$11,200,000 made in the rate case as of December 31, 1922, by averaging appraisals as aforesaid."

The so-called admission in the Board's brief that the order under review required the Company to make too great a reduction is, in the Board's brief, clearly predicated on the hypothesis that the Company should carry the property on its books at the consolidated book costs of its predecessor companies. This was not the theory of the Board and this theory is emphatically rejected by the Company as may be noted at page 20 of its brief.

The second sentence above quoted, beginning "No contention or pretense is made" is contrary to the fact. Part III(2) of the Board's brief, pages 29 to 33, is devoted to showing that the amount which the Company was ordered to write into its account books was the cost of its assets as of the date of consolidation.

Counsel for the Company, in the passage above quoted and in half a dozen other places in their brief, characterize the valuation made in the rate case as "arbitrary." This also is contrary to the fact. That valuation was based upon the evidence. If it had been arbitrary, it would not have been sustained as it was by this Court.

B.

Part III (a) and (b) of the Company's brief urges that,

"The requirement of the Board's uniform system of accounts for water utilities that fixed capital assets shall be entered only at cost, is unauthorized and invalid."

Subdivision (a) asserts that such a requirement is beyond the power of the Legislature—is unconstitutional. The argument in support of this assertion seems to require no reply.

Subdivision (b) is the only part of the Company's brief which attempts to demonstrate that the requirement of the Board's accounting system that a utility shall carry its assets at cost, is beyond the scope of the legislative grant of authority. At the risk of emphasizing my opponents' argument, I quote this part of the Company's brief in full:

"The Legislature in enacting the Public Utilities Act of 1911 must be assumed to have known that Congress had at least as early as 1906 legislated as to interstate carriers in the way just recited. But the Legislature did not see fit to give these broad powers to the Public Utility Board it then created, nor power to adopt any Uniform System of Accounting conforming to those prescribed by the Interstate Commerce Commission under such powers except as far as this should be practicable. 'Practicable' must be regarded as meaning not only so far as reasonably usable, having in mind the difference in the kinds of business being transacted but also to the extent authorized by the Legislature, but not beyond that."

It will be observed that this argument rests upon a distinction between the authority given to the Interstate Commerce Commission by Congress and that given to the Board by the Legislature. The authority of the Interstate Commerce Commission over accounts is contained in the following passages from the Interstate Commerce Act, Section 20, as amended by the Hepburn Act:

“The Commission may, in its discretion, for the purpose of enabling it the better to carry out the purposes of this Act, prescribe a period of time within which all common carriers subject to the provisions of this Act, shall have as near as may be a uniform system of accounts and the manner in which such accounts shall be kept. * * * The Commission may, in its discretion, prescribe the forms of any and all accounts, records and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records and memoranda of the movement of traffic, as well as the receipts and expenditures of moneys. The Commission shall at all times have access to all accounts, records and memoranda kept by carriers subject to this Act and it shall be unlawful for such carriers to keep any other accounts, records or memoranda than those prescribed or approved by the Commission.”

It is difficult to see that this grant of power is broader than the grant by the Legislature to the Board in the respect that the one gives authority to the Commission to formulate a system requiring railroads to carry their assets at cost, while the other does not authorize a requirement that utilities carry their assets at cost.

Congress has, however, in one respect gone further than the Legislature in that it has for-

bidden interstate carriers to keep any accounts, records or memoranda other than those prescribed by the Commission. The Board does not attempt, although the contrary is alleged in the Company's brief, to prohibit the Company from keeping any records or accounts it may desire, in addition to those prescribed by the Board.

By books of account, the Board intends the ordinary journals and cash books and the ledgers made up by postings therefrom. The Board insists that the Company shall keep such a set of books in accordance with the accounting rules of the Board and that it shall therein carry its assets at cost. It has no objection to the Company keeping another set of books made up in such way as the Company may desire, or keeping such other records, including appraisals of its property, as its directors may deem wise.

The Legislature evidently intended that the accounts of all utilities of the same class should be kept in the same way, that is, according to a uniform system. The Legislature also intended that these accounts should be kept in such a way as to afford an intelligent understanding of the conduct of the business, and it understood or assumed that there might be several different accounting systems each of which would afford such an intelligent understanding. The Legislature gave to the Board authority to pick and choose among such systems and determine which one should be used by the utilities.

Nowhere in the Company's brief is there an attempt to show that the system prescribed by the Board, including the requirement that assets be carried at cost, is not well adapted to afford an intelligent understanding of the conduct of the Company's business.

C.

Parts II and IV and subdivision (c) of Part III of the Company's brief deal chiefly with questions of fact, namely, whether the Company has conformed with the Board's requirement that it carry its property at cost and whether the order of the Board under review required it to carry its property below cost. To rebut the argument contained in these parts of the Company's brief, I rely on the review of the evidence contained in Part III (1) and (2), pages 27 to 33 of the main brief for the Board. There is, however, one sentence at page 17 of the Company's brief to which attention should be directed:

"The sole complaint is that although its capital assets have been admittedly properly classified and entered at cost, they are also entered for the ordinary and proper purposes of the Company over which the Board is given no jurisdiction or control carried at their actual value."

I do not understand the meaning of this sentence unless it be that the Company in former times entered its assets at cost and later raised them to what the Company alleges is their actual value.

D.

Part V of the Company's brief urges that the public interest does not require that assets be carried at cost. It is a sufficient answer to say that the Board is the judge of public interest within the scope of the authority constitutionally delegated to it by the Legislature; and that since the Board's order was within the scope of its authority, no question of public interest arises.

In the course of this part of the Company's brief at page 23, it is said that the Board,

"Insists that nothing but costs shall be used for any purpose."

The Board makes no such insistent. The Board is not concerned with what records the Company keeps in addition to those required by the Board, nor is it interested in the uses or purposes to which the Company puts its records.

E.

The last part of the Company's brief urges that the order under review is injurious to the Company. The specifications of this injury are not impressive. But even were the Company injured by this order, such injury is not a ground for setting it aside. The lawful acts of government, whether of administrative bodies or of the courts, frequently affect adversely the interest of individuals.

There is nothing set forth in the Company's brief which should lead to an affirmance of the judgment of the Supreme Court.

Respectfully submitted,

J. O. BIGELOW,
Of Counsel with the Board
of Public Utility Commissioners.

New Jersey Court of Errors and Appeals

PASSAIC CONSOLIDATED WATER
COMPANY,

Respondent,

vs.

BOARD OF PUBLIC UTILITY COM-
MISSIONERS OF NEW JERSEY,

Appellant.

On Appeal.

BRIEF OF JOHN O. BIGELOW FOR BOARD OF PUBLIC UTILITY COMMISSIONERS.

The respondent, Passaic Consolidated Water Company (hereinafter called the Company), in 1924 wrote into its books of account items totaling \$9,886,580.81, in order to add that sum to the book figures of its water supply system and so raise the books from a cost basis to the amount of an appraisal just made.

These book entries did not represent additions to plant or other actual transaction. They were contrary to the uniform accounting system prescribed by the respondent Board of Public Utility Commissioners (hereinafter referred to as the Board).

The Board, upon learning of these entries and after notice and hearing, ordered the Company to erase the same and further to reduce the book value of the plant by the additional sum of \$381,840.35 for reasons hereafter explained.

On certiorari, the Supreme Court set aside this order of the Board. That judgment of the Supreme Court is the subject of this appeal.

It will be observed that there were two issues before the Supreme Court: First, was it lawful for the Company to write up the book value of its assets contrary to the accounting system adopted by the Board? Second, assuming that this action of the Company was unlawful, was the order of the Board a proper and legal order under the circumstances?

The Supreme Court decided the case on the first question and held that the Company had a right to make the book entries above-mentioned. *This decision, in effect, nullifies the uniform accounting system adopted by the Board, pursuant to the statute.*

The issue as I see it and as stated in the brief of Mr. Faulks and Judge Osborne for the Company in the Supreme Court is this:

"From this recital, it will be seen that the issue between the parties to this proceeding arises almost wholly, if not entirely, from the insistence of the Board that it has the right under its system of uniform accounts to require the prosecutor * * * to carry practically all of its property on its records only at the actual money cost to it thereof."

STATEMENT.

Section 17 of the Public Utility Act (P. L. 1911, p. 378) gives to the Board power,

"To require every public utility as herein defined,

* * *

"(d) To keep its books, records and accounts so as to afford an intelligent understanding of the conduct of its business and to that end to require every such public utility of the same class to adopt a uniform system of accounting. Such system shall conform, insofar as in the judgment of the Board is practicable, to any system adopted or ap-

proved by the Interstate Commerce Commission of the United States of America."

Pursuant to this authority, the Board in 1912 adopted and prescribed uniform systems of accounts and among them one for water utilities effective January 1, 1913. The fundamental rule of these systems was that the accounts should reflect *actual transactions* and should be based upon money expended or in case of a consideration other than money, then the actual money value of such consideration.

Rule 10 for water utilities is as follows:

"10. Costs to be Actual Money Costs.— All charges made to fixed capital or other property accounts with respect to any property acquired on or after January 1, 1913, shall be the actual money cost of the property. When the consideration actually given for anything with respect to which a charge is made to any fixed capital or other property account is anything other than money, the actual consideration shall be described in the entry with sufficient fullness and particularity to identify it, and the amount charged shall be the actual money value of such consideration at the time of the transaction" (Case, p. 88).

In 1923, the Acquackanonk Water Company and four other water utilities petitioned the Board for approval of a plan of consolidation into one corporation to be known as the Passaic Consolidated Water Company, the respondent in this cause. The consolidation was approved by the Board and went into effect November 1, 1923.

The consolidated company opened its books on the basis of the books of the consolidating companies that is on the basis of cost, and it closed its books on December 31, 1923, on the same basis and duly reported to the Board (Case, p. 106).

In May, 1924, Mr. Nicholas S. Hill, Jr., an engineer engaged by the Company to make an appraisal of the property, reported a valuation as of November 1, 1923. This valuation, was \$23,170,397.95, an increase of \$9,886,580.81 or approximately seventy-five per cent. over the book costs.

The Company, by certain entries in its books, increased the item of "Fixed capital in water department" to meet this appraisal and also made certain changes in the item "Fixed capital in other departments" and in "Investments," which need not be detailed. To offset these writeups, it made certain additions on the liability side of its ledger, increasing depreciation under the heading of "Accrued amortization of capital" by \$1,423,230.15, setting up a reserve for income tax of \$65,294.21 and increasing surplus account from \$774,339.52 to \$9,271,491.54.

These figures appear from a comparison of the two schedules (Case, pp. 106 and 110).

None of these book entries represented *actual transactions*. They did not state money which had been *spent on the plant* and which thereby increased its cost. They were intended merely to reflect the appraisal of Mr. Hill.

When the Company, in 1925, submitted its annual report to the Board, the Board set the matter down for hearing (Case, p. 6). After the taking of testimony and hearing counsel, the Board made its order as will be shortly set forth. But before doing so, it is necessary to advert to an earlier case involving the five companies which were consolidated into the Passaic Consolidated Water Company.

In 1922, these companies proposed a schedule for increased rates. The matter came on for hearing before the Board and the Board found it necessary to ascertain the value of the companies' property. By its decision dated March 27, 1923, it fixed the value of the water property of the Company at \$11,200,000, and of other property at \$73,000, as of December 31, 1922, or \$381,840.35 below the book values of the same date (Case, p. 101).

This order was removed into the Supreme Court by certiorari and was sustained by the Supreme Court November 15, 1923, and by this Court on May 19, 1924. *Acquackanonk Water Co. v. Board*, 100 N. J. L. 169, 125 Atl. 33. So when the Board made its decision in the accounting case—the decision now before this Court—it not only ordered the Company to expunge the write-up of \$9,886,580.81, but further ordered the Company to reduce on its books the value of its water plant by \$381,840.35, in order to bring its books into line with the value found by the Board in the rate case as of December 31, 1922, with adjustments for additions, etc., since that date, on the theory that this was the cost of the property to the consolidated Company (Case, p. 126).

ARGUMENT.

I.

The Board's uniform system of accounts applicable to this case is valid.

(1)

The Statute.

The Board's authority to prescribe the accounting rules in question is found in the Public Utility Act, P. L. 1911, p. 374.

"17. The Board shall have power, after hearing, upon notice by order in writing, to require every public utility as herein defined:

* * *

"(d) To keep its books, records and accounts so as to afford an intelligent understanding of the conduct of its business and to that end to require every such public utility of the same class to adopt a uniform system of accounting. Such system shall conform, insofar as in the judgment of the Board is practicable, to any system adopted or approved by the Interstate Commerce Commission of the United States of America."

A mere reading of this section without further argument would seem sufficient to sustain the power of the Board to prescribe and enforce a uniform system of accounting for water companies, whereby each company shall *keep its books in the usual manner*, namely on the basis of actual costs rather than on the basis of appraisals. But the decision of the Supreme Court to the contrary necessitates a more extended consideration.

(2)

The Statute is Constitutional.

The Company contended before the Supreme Court,

"If by such legislation it was intended to authorize the Board to require a public utility to carry its assets only at cost, such legislation is unconstitutional."

Under this head, counsel for the Company argued that the authority of the State was based solely on the fact that the business of a public utility is affected by a public interest and hence goes no further than this public interest reasonably requires.

This argument is not sound. A public utility as defined in Section 15 of the Public Utility Act operates,

"Under privileges granted or hereafter to be granted by the State of New Jersey or by any political subdivision thereof."

The respondent Company was created and exists solely by the grace of the Legislature of New Jersey, acting not only through the merger sections of the Corporation Act but also through Section 18(h) of the Public Utility Act prohibiting the merger of public utilities without the approval of the Board. The Company has its mains in the public highways of the State by the grace of the Legislature.

The right of the State to require the Company to carry its assets at cost is not based primarily on the fact that the Company's business is affected with a public interest but rather on the fact that the Company came into existence, continues to exist and to operate solely by virtue of franchises granted by the State. The Company has no rights except those granted it by the

State. The right to keep its account books as it sees fit was expressly withheld by the State. If the promoters of the Company did not like the statute, they should not have incorporated under its provisions. The constitutional power of thus limiting the Company's rights, cannot be seriously questioned.

(3)

The I. C. C. Rules of Accounting.

The reference in Section 17 (d) of the Public Utility Act to accounting systems adopted by the Interstate Commerce Commission, indicates that the Legislature intended that the Board should have authority to prescribe accounting systems similar to those of the Interstate Commerce Commission.

A brief history of railway accounting and the regulation thereof by the Interstate Commerce Commission is contained in an article by Frank Fay, "Uniform Methods of Railway Accounting" in the Journal of Political Economy for December, 1913, p. 881.

Promptly after the approval of the Hepburn Act, June 29, 1906, the Commission undertook the construction of a system of uniform accounts for steam roads.

On June 3, 1907, it prescribed a Classification of Expenditures for Road and Equipment effective July 1, 1907. At the head of the text is the following note:

"Special note covering all entries in the accounts included in this classification. Where the consideration in the transaction shown in any entry is anything other than money, the actual consideration must be

shown in the entry and the actual cash value shown in the various columns."

Section 36 of this classification deals with the purchase by a carrier of a railroad, as a going concern or otherwise. The text in part follows:

"To this account should be charged amounts paid for road purchased. In this connection, attention is specially directed to the note at the beginning of this classification. Where payment is made by an issue of the Company's securities or other commercial paper, the cash value thereof at the time of such payment should be charged. * * * When contracts are entered into for the construction of a completed road for a fixed amount whether payable in cash or in the Company's securities, the amount paid in cash or the cash value of the securities issued in payment should be charged to this account."

On June 21, 1909, the Commission promulgated a Classification of Expenditures for Additions and Betterments, and on May 31, 1910, revised the same. It was based, of course, on the actual expenditure of money.

On May 31, 1910, a form of General Balance Sheet Statement was approved with the classification of the accounts involved in such statement. The following excerpt from the explanatory text is pertinent to this case:

"PROPERTY INVESTMENT.

1. Road and Equipment.

B 1-a. Investment to June 30, 1907.

This account should include the balances carried in the General Ledger showing the book value of Road and Equipment as it stood on June 30, 1907, subdivided between (a) Road and (b) Equipment, when the subdivision can be accurately made.

B 1-b. Investment since June 30, 1907.

This account should include the cost of all property, classifiable as Road and Equipment or Additions and Betterments, acquired since June 30, 1907, less deductions for property abandoned. The amount included herein should be subdivided: (a) Road, (b) Equipment, (c) General Expenditures."

Without stating further in detail the accounting system adopted by the Interstate Commerce Commission and in force at the time of the passage by the Legislature of our Public Utility Act, it is enough to say that this system was carefully designed to require that the books of account of the carriers should set forth an accurate financial history beginning July 1, 1907; that each entry should represent an actual transaction and that the amounts set forth in the accounts should be the amounts actually spent and in case the expenditure should be anything except money, then the actual cash value thereof at the time of the transaction.

Henry C. Adams, who was in charge of Statistics and Accounts for the Interstate Commerce Commission when their uniform system was developed, wrote on this subject in the Quarterly Journal of Economics for May, 1908, p. 370:

"It is important, as bearing upon the influence likely to be exerted by this system of accounts, to know that the construction accounts promulgated by the Interstate Commerce Commission and adopted by most of the states, propose to open the balance sheet account with a cash statement of what it cost to create the property at one hundred cents on the dollar. A moment's consideration will show that this is a sound principle of accounting. The balance sheet statement of cost should be the book record of actual investment. The amount of securities issued

to obtain the money spent in construction has nothing to do with the statement of such cost, for it is the money spent that measures cost and not bonds or stocks issued. A correct statement of investments is the beginning of correct accounting, if for no other reason than that it is the basis from which to measure depreciation charges on the one hand and charges for additions and betterments on the other."

These were the rules in force at the time of the adoption of the Public Utility Act and they must be presumed to have been contemplated by the Legislature when it enacted that the systems to be adopted by the Board of Public Utility Commissioners should

"Conform insofar as in the judgment of the Board is practicable to any system adopted or approved by the Interstate Commerce Commission."

The system in controversy in this case is substantially the same as the system above referred to.

While there have been amendments to the accounting systems of the Interstate Commerce Commission from time to time since the enactment of the Public Utility Act, the underlying principle that accounts should represent actual transactions and should state costs and not appraisals, remains unchanged. There was admitted in evidence in this case before the Board as Exhibit C. 3, excerpts from the Interstate Commerce Commission's Uniform System of Accounts for Telephone Companies, effective January 1, 1913. Section 10 prescribes,

"Costs to be actual money costs. All charges made to fixed capital or other property accounts with respect to any property acquired on or after January 1, 1913, should be the actual money costs of the property." (Case, p. 94).

The leading decision on the power of the Interstate Commerce Commission over the accounts of carriers is *Kansas City Southern v. U. S.*, 231 U. S. 423, 34 S. C. 125. The authority of the Commission was fully upheld even though the bookkeeping requirements of the Commission tended to control the conduct of the carrier.

(4)

Statutory Requirements in Other Jurisdictions.

In Great Britain, as early as 1868, Parliament required railway companies to make semi-annual financial reports in great detail on forms prescribed by the statute, 12 *Chitty's Statutes*, 162. These reports were intended for the protection of the shareholders as well as for the information of the government. They were required to set forth among other things, a statement of the amount of capital expenditures to the beginning of the six-month accounting period and also of the capital expenditures during the period.

The pioneer state in regulation in this country was Massachusetts. In 1873 the General Court enacted:

"Every railroad corporation shall keep its books of account in a uniform manner upon the system heretofore prescribed by the Board." *Public Statutes of 1882*, p. 616.

By amendment in 1913, it was prescribed that,

"The forms shall conform as nearly as may be to those established by the Interstate Commerce Commission." *General Laws of 1921*, p. 1677.

Chapter 164, Section 81, of the General Laws, extended the control of accounting to gas and electric companies, and Chapter 164, Section 2, to water companies.

New York and Wisconsin, inspired by the Hepburn Act, revised their regulatory statutes in 1907. The New York Act was passed at the insistence of Governor Hughes and was, in part, drafted by him. It authorized the Public Service Commissions to establish uniform systems of accounts and directed that these systems should conform as near as might be to those from time to time prescribed by the Interstate Commerce Commission. Laws of 1907, Chap. 429, Sec. 52.

The Wisconsin statute grants, in much detail to the Public Utility Commission, power to prescribe the form of all books, accounts and records of public utilities. Laws of 1907. Chap. 499.

All the states, except Delaware and Kentucky, have now established regulatory commissions and in most cases have given to the commissions power to prescribe uniform systems of accounts. These systems, I am informed, without exception require that the books shall be based upon actual costs and nothing else.

(5)

The Purpose of Uniform Rules of Accounting.

The Legislature has enacted in the section under consideration that the uniform system of accounting should be adopted to the end that the books of a utility might "afford an intelligent understanding of the conduct of its business." In order to make clear the meaning of this phrase, it is proper to consider the various uses of uniform accounts and reports based thereon.

A.

Uniformity itself is of the essence, so that the accounts may be easily examined and readily understood.

If the accounts of one company are based on actual costs and of another on appraisals; if the expenditures of one for relaying a water line go to operating expenses, and of another to betterments; if the discount on bonds is amortized by one company over the life of the bonds and is charged by another company as an expense incurred on the date of the issue of the bonds;—it is apparent that before the accounts of any company can be understood it is first necessary to ascertain on what system its accounts are kept. Annual reports with their balance sheets and statements of operations are meaningless until the reader first learns on what basis the books are kept.

Mr. Adams, in the paper above-mentioned deals with the necessity for uniformity in accounting:

“The balance sheets published at the present time are of slight value, except for those who are acquainted with the details of the supporting accounts upon which they rest. If, however, the supporting accounts are kept in a uniform manner by the carriers, and if, as the result of adequate supervision, the accumulation of these accounts in the balance sheet may be relied upon as correct, the balance sheet will prove to be in fact what it is in theory—the key to the financial and operating management of a carrier.”

A uniform method of keeping accounts is also necessary if the operating statement of one company is to be compared with the corresponding statement of another utility. Comparison without uniformity is impossible.

The value of uniform systems of accounting is emphasized by the fact that many trade associations have endeavored to secure uniformity by the voluntary action of their members. One of the most recent of these is the Petroleum Institute of America, which last year formulated a uniform system for that great industry. Bulletin of the Petroleum Institute, January 31, 1927.

It is suggested by the Supreme Court (Case p. 138) that the company may put in its books and in its report a note explaining its deviation from the uniform system. But if all or many companies, subject to the Board, should keep their accounts as they see fit and expect the Board to be satisfied by explanatory notes, then the time required to digest such notes and calculate the effect of the divergence would render the task of using the reports too tedious to be practicable.

B.

Section 14 of the Public Utility Act requires that,

“The Board shall report annually, on or before the first day of January, to the Governor, making such recommendations as it may deem proper, which report shall be laid before the next succeeding Legislature.”

The recommendations intended by this section clearly are not limited to the specific powers given to the Board by the act but properly embrace the whole field of public utilities to the end that the Board may call to the attention of the Governor and of the Legislature any need that may arise of further legislation on the subject.

The Board properly has in mind this duty of recommendation when it prescribes rules for accounting and forms of reports. The actual cost

of public utility property, the amounts invested therein from year to year, are certainly subjects which may influence the Board's recommendations and which the Board may require should be shown by the accounts of the utilities.

C.

Our Public Utility Act was adopted by the Legislature in 1911, in response to the recommendation of Governor Woodrow Wilson. In his inaugural message January 17, 1911 (Senate Journal for 1911, p. 58), he said, with reference to the Utility Commission:

"It is understood by everybody who knows anything of the common interest that it must have complete regulative powers: the power to regulate rates, *the power to learn and make public everything that should furnish a basis for the public judgment* with regard to the soundness, the efficiency, the economy of the business—the power, in brief, to adjust such service at every point and in every respect, whether of equipment or charges or methods of financing or means of service, to the general interest of the communities affected" (Italics ours).

The annual reports of utilities based on the uniform accounts and made pursuant to Section 17 (e) are open to the inspection of anyone interested. Excerpts from such reports of the more important public utility companies are published in the press of the State. A condensation of all these reports is annually printed and distributed at the expense of the State by authority of the Legislature. These reports are an important factor for advising the Legislature and for creating an informed public opinion on the subject of utilities. Showing as they do the enormous and continuing need for new capital and the modest return earned by most utilities on their actual in-

vestment, these reports have fostered in New Jersey a conservative temper in dealing with public utilities. They have done away with the old feeling which existed before 1911, that these companies as a class earned excessive returns and charged unreasonable rates and were therefore a proper field for radical action.

D.

Uniform accounts and reports based thereon are also of value in creating a stable market for the securities of public utility companies. Banking houses and investors rely upon the fact that the accounts of all utilities are kept in the same way and that their reports are reliable indices of the money invested in the properties.

That the protection of the investing public is to be considered by the Board is indicated by the decision of the Supreme Court in *Interstate Tel. & Tel. Co. v. Board*, 84 N. J. L. 184, 86 Atl. 363. In that case, the Board refused to authorize a new issue of bonds in substitution for an old issue then in default, on the ground that the utility would be unable to meet the principal and interest on the new bonds. The Court said:

"Who shall answer for the future of these bonds when they leave the hands of the present owners and seek the open market for investment? Such we conceive was the legislative inquiry when it reposed the power in, and imposed the duty upon, this administrative board to investigate, not only the legality, but practically the public policy and equity of a proposed bond issue, which in its far-reaching effects concerns not alone this prosecutor and its bondholders, but the welfare of the investing community, and the public conscience of the State, upon the approval of whose delegated agency the bonds will be offered for sale."

The confidence of the bond market in the securities of New Jersey public utility corporations is of immense importance to the State. New bonds are issued yearly for millions of dollars to finance needed extensions. Their good reputation and low interest rate rest not alone on the fact that the territory served is rapidly growing but also on the fact that the companies are regulated by a conservative public board which insists on sound financial and accounting practices. Balance sheets and statements of earnings are relied upon because they show actual investment and earnings and are not based on the idiosyncrasies of boards of directors.

The credit of all New Jersey utilities would suffer if the Board's power over accounts should be nullified by the decision of this Court.

E.

Uniform accounts are of value to the stockholders.

A stockholder has a right to examine the books of his corporation under the rule of such cases as *Feick v. Hill Bread Co.*, 92 N. J. L. 513, 105 Atl. 725. If the books are kept on a uniform system, this examination is comparatively simple. Otherwise, the examiner will have to search the journals to see what items make up the several ledger accounts—an impossible task when dealing with a corporation of any great size.

Furthermore, uniform accounts are a valuable guide to the directors in ascertaining the real earnings of the Company. Where accounts are unscientifically kept, the management fequently through ignorance of the real situation, declares dividends out of capital and permits the Company to drift into bankruptcy.

F.

A correct statement in the books of the capital invested in plant is a necessary basis for figuring depreciation and charges for betterments or renewals.

Depreciation is calculated on cost and not on value. It is designed to return to the corporation when its plant or any part thereof is exhausted, the same amount invested therein.

Section 17(f) of the Public Utility Act requires that every public utility,

“Shall set aside the sums so provided for out of earnings and carry the same in a depreciation fund. The income from investment of moneys in such fund shall likewise be carried in such fund. This fund shall not be expended otherwise than for depreciation, improvements, new construction, extensions or additions to the property of such public utility.”

When, as in this case, the Company writes up the value of its property, part of which value is the result of the investment of the depreciation fund in improvements and new construction, it is impossible to tell how much of the value appearing on the books represents the depreciation fund and how much represents the investment by the stockholders.

The cost of property is also the basis of allocating the cost of renewals between operating expenses and betterments. Take this example:

A company ten years ago laid a six-inch pipe line for \$10,000. Three per cent. annually has been reserved for depreciation, or \$3,000 in all. The line has become obsolete and is replaced with a twelve-inch line. Rising costs are such that to re-lay a six-inch line would cost \$15,000 and the twelve-inch line actually costs \$20,000.

The whole \$20,000 is charged to plant account and the cost of the old line, \$10,000, is credited that account. \$3,000 is charged to depreciation reserve and \$7,000 to current expenses.

But if the old line has been written up on the books to \$15,000, then the charge against current expenses will be \$12,000.

Capital accounts necessarily affect net operating revenues.

G.

The cost of the property is also one of the elements which must be considered by the Board in ascertaining its present value as a basis for rates.

Some of the early cases, such as *Dow v. Beidleman*, 125 U. S. 680, seemed to hold that an investor was protected by the Fourteenth Amendment to the extent that he must be allowed a reasonable return on his investment as distinguished from the value of his property. This rule was abandoned for two reasons. First, the period of great expansion of railroads, was the period of high prices after the Civil War; when prices declined in the early nineties the traffic was unable to bear rates which would bring a return on the original investment.

The other impelling reason for this change of rule was that the books of account did not show the amount actually invested. Bonus stock had been issued to contractors constructing the roads, and the cost of the roads had been charged at a figure including the par value of such stock. Franchises and merger values had been capitalized at immense sums. Operating expenses during lean years had been charged to betterments,

and so, practically, it was impossible to determine actual costs.

This was one of the major reasons impelling the courts to adopt present value instead of historical cost as the basis of rates. And it was also one of the major causes that impelled Congress and Legislature to provide for uniform accounting systems.

While present value is the rule enforced at the moment, few students of the subject believe that present value will continue indefinitely as the basis of rate making. When the next great slump in values comes, it will be found that a reasonable return on the then value of most utilities will be insufficient to meet the interest on debt. As the funded debts will have been incurred under governmental supervision and the proceeds honestly used for extending service, courts and legislatures alike will be impelled to fix rates on prudent investment or some modification thereof.

The amount of investment in public utilities in New Jersey since January 1, 1913, the date on which our uniform system of accounts became effective, already largely exceeds the investment prior thereto. In a few years, the book costs of property installed before January 1, 1913, will be so insignificant in comparison with the whole investment, that book costs may be accepted as a true statement of the amount invested.

Rate fixing under the present rule which necessitates a complete inventory and appraisal of the utility's property is so expensive and cumbersome, both to the utility and to the public, that it will be discarded in favor of the simple method of glancing at the balance sheet.

In preparation for that day, as well as for use under the present system of rate making, it is essential that the property accounts should set forth investment and not appraisals.

The fair value rule was laid down in *Smyth v. Ames*, 169 U. S. 466. The court held:

“And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stocks, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case.”

It will be observed that the basis for rates adopted was the present value of the property and that the court was endeavoring to find a measure for that value. Earning capacity alone could not be the measure because it was dependent upon the rates fixed. Market value could not be the sole basis because it, too, was dependent upon rates, and furthermore, railroads are not usually bought and sold in the market and so the court sought for other sources of evidence to ascertain present value.

The rule of *Smyth v. Ames* is still the law of the land. Some cases have given greater weight to prudent investment and others to reproduction cost as evidence of value, but no case has made either of these elements decisive.

In the *Minnesota Rate Cases*, 230 U. S. 352, the whole reproduction cost theory was rejected so far as it applied to railroad rights of way and lands.

In *Willcox v. Consolidated Gas Co.*, 212 U. S. 19, the court suggested that a return on present value might not be approved,

“Where the property may have increased so enormously in value as to render a rate permitting a reasonable return upon such increased value, unjust to the public.”

In *Des Moines Gas Company v. Des Moines*, 238 U. S. 153, the reproduction theory, insofar as it involved the tearing up and replacing of pavements, was rejected.

McCardle v. Indianapolis Water Co., 47 Sup. Ct. 144, put more emphasis on reproduction cost than any other decision of the U. S. Supreme Court, but even in that case the present value of the property was fixed at an amount several million dollars below the cost of reproduction. And the Court said that fair value,

“does not mean that the original cost or the present cost or some figure arbitrarily chosen between these two, is to be taken as the measure. * * * The weight to be given to such cost figures and other items or classes of evidence is to be determined in the light of the facts of the case in hand.”

Historical cost, the amount actually invested in the property, is still an important element in rate making and will probably become more important in the future. The record of this cost should be preserved in the books of account.

(6)

The Uniform System Adopted by the Board.

The Board's system applicable to water utilities, prescribes:

“10. Costs to be Actual Money Costs.— All charges made to fixed capital or other property accounts with respect to any prop-

erty acquired on or after January 1st, 1913, shall be the actual money cost of the property. When the consideration actually given for anything with respect to which a charge is made to any fixed capital or other property account is anything other than money, the actual consideration shall be described in the entry with sufficient fullness and particularity to identify it, and the amount charged shall be the actual money value of such consideration at the time of the transaction." (Case, p. 88, l. 16).

This requirement conforms closely to the system of the Interstate Commerce Commission in effect at the time our Public Utility law was adopted. It is *copied word for word* from the Interstate Commerce Commission's system for Telephone Companies (Case, p. 94, l. 20).

The provision in question is well designed to the end that the accounts of the utility may "afford an intelligent understanding of the conduct of its business."

The provision clearly comes within the scope of the purposes which the Legislature had in mind when it authorized the Board to adopt a uniform system.

It is, perhaps, true that the Board might have adopted some other uniform system, that it might have required every company under its jurisdiction to have made an appraisal in the spring of 1924 and periodically thereafter and to add to or subtract from its property accounts sums sufficient to meet such appraisals.

Such a system would have secured the uniformity intended by the statute but it would probably have brought to the Supreme Court applications for certioraries from every utility in the State.

It is not the province of the Court to determine whether the uniform system adopted by the Board is the best system which might have been adopted. The duty of adopting the system was conferred by the Legislature upon the Board and not on the Court.

In *Kansas City Southern v. U. S.*, 231 U. S. 423, the Court had under review a rule of the Interstate Commerce Commission relative to additions and betterments. The rule worked an undoubted hardship on the railroad and its stockholders and was of doubtful wisdom. The Court said:

"But, did we agree with appellant that the abandonments ought to be charged to surplus or to profit and loss, rather than to operating expenses, we still should not deem this a sufficient ground to declare that the Commission had abused its power. So long as it acts fairly and reasonably within the grant of power constitutionally conferred by Congress, its orders are not open to judicial review."

The uniform system of accounts prescribed by the Board pursuant to statutory authority, should be upheld and enforced by this Court.

II.

The Company, by the bookkeeping entries in question, violated the Board's accounting system.

It is unnecessary to argue this point since the Company admits that it has not complied with the uniform system of accounts insofar as that system requires the Company's property to be carried on its books at cost.

III.

The order of the Board under review is valid.

I will assume that it has been demonstrated above that the Board's uniform system was lawfully established and that the book entries in question violated that system. What power had the Board in the premises?

Section 17 of the statute gave the Board power by order to require the Company,

"(a) To comply with the laws of this State * * * and to conform to the duties imposed upon it thereby.

"(d) To keep its books, records and accounts so as to afford an intelligent understanding of the conduct of its business and to that end to require every such public utility of the same class to adopt a uniform system of accounting."

It is no answer to the Board's order to assert that the Company keeps its books so as to afford an intelligent understanding of the conduct of its business. The power of the Board goes further in that it may prescribe a uniform system.

Nor is the Board's power exhausted by merely ordering the Company in general terms to adopt the uniform system. If that were the end of the authority of the Board, the section under consideration would be a dead letter. In order to make it effective, in cases like the present where the Company fails or refuses to conform, the Board has power to order as specifically as is necessary the making of the proper entries in the books of account, so as to secure conformity with the duty to follow the uniform system imposed by the statute.

If the Company should buy 1,000 tons of cast iron pipe at \$35 a ton and enter the pipe on its

books at \$70,000, the Board would have power to order the erasure of this figure and the insertion of \$35,000, that the books might conform with the uniform system.

The power of the Board goes not merely to the form of accounts but to the substance, the figures inserted in the several accounts.

Kansas City Southern v. U. S., supra.

(1)

The consolidation viewed as such and not as a purchase.

The consolidation of the five companies was made pursuant to Section 18(h) of the Public Utility Act and to Sections 104 to 109 of the Corporation Act. 2 C. S. 1659. Section 104, as amended P. L. 1918, p. 1013, provides that two or more corporations,

"May merge or consolidate into a single corporation which may be either one of said merging or consolidating corporations * * * or a new corporation under the laws of this State to be formed by means of such merger and consolidation."

In the case under consideration, the companies consolidated into a new corporation formed by means of such consolidation, namely, the present Company.

Section 107 enacts that upon the consummation of the act of consolidation, all the property of the consolidating corporations shall be vested in the consolidated corporation. It was by operation of this statute and not by purchase that the new company acquired its property.

A purchase requires a meeting of minds of vendor and purchaser. But in this case there was no meeting of minds between the Passaic

Consolidated Water Company and the other five companies, for the former did not exist until the instant when the latter ceased to exist. The same act which created the new company, vested title in it and also extinguished its predecessors.

Section 105 of the Corporation Act requires the agreement of consolidation to set forth the number of shares of capital stock of the new company

“And the manner of converting the capital stock of each of said merging or consolidating corporations into the stock or obligations of such new or consolidated corporation.”

The stock of the new company issued to the stockholders of the old, was not issued in payment for the property acquired but was issued in lieu of the stock held by them in the old companies and in conversion thereof.

It follows since there was no purchase by the new company of the water system, that there was no “cost” to that company of that system. The new company stood exactly in the boots of its predecessors. Its liabilities were the same as theirs, dollar for dollar, and its assets were likewise the sum of their assets, and the only cost was what the property had cost them. It was therefore necessary that the account books of the new company should be opened with the same figures with which the account books of the old companies were closed; in other words, that they be opened on the basis of consolidated book costs. This is, in fact, what the new company did and it continued its books on this basis for six months, until it made the entries therein which occasioned the Board’s order.

If the foregoing is the correct interpretation of the transaction, then the Board should have directed the Company to expunge the writeup

and to restore its books to their original condition. By its order under review, it required the Company to reduce the book value of its water system \$381,840.35 too low. This figure is the difference between the consolidated book costs and the figure adopted by the Board. But the total consolidated book costs were \$12,441,766.49, so that the difference in question, namely, \$381,840.35, was a variance of only 3%. This difference is so unsubstantial relative to the total amount that it should not be made the basis for a reversal of the order.

(2)

The consolidation viewed as a purchase.

The consolidation can be viewed as a purchase: that the Company bought from the stockholders of its predecessors their net assets and paid for them by its capital stock of the par value of \$3,100,000. This was the theory of the Board’s order now under review. Its basis is that the promoters of a company to be formed by a consolidation, bargain with the stockholders of the existing companies for their property and that the transaction in substance, if not in form, is a sale of the net assets for stock in the new company.

The cost to the Company then, according to Section 10 of the uniform system of the Board, was the actual money value of this stock at the time it was issued, and this amount, the money value of the stock at the time of its issue, was the sum to be entered in its books as the cost of the property pursuant to the uniform system of accounts. It was, therefore, incumbent upon the Board to ascertain the money value of the stock.

The cash value of one share of stock, multiplied by the number of shares issued in payment for the property, is the cost of the property. That cost in turn determines the amount of surplus; that is, cost of property less debts and less the par value of the stock, equals surplus. To arrive at the same result by another route, the difference between the actual and par value of the stock is the paid-in surplus.

Now I must set down some figures:

1. If the cash value of the stock equaled its par value, then the cost of the property was \$3,100,000, and no surplus should have appeared on the books.
2. If the cash value of the stock was \$125 a share, then the cost was \$3,875,000 and a surplus resulted of \$775,000. This was approximately the basis on which the books were originally opened.
3. And if the stock was actually worth, at the time it was issued, \$399 a share, the cost was \$12,369,000 and there was a surplus of approximately \$9,271,491.54, and it was to this figure that the Company in 1924 wrote up its books as of the day of the consolidation.

Of course, it is generally difficult to say what is the cash value of stock of a new corporation, but in this case it appeared that at the time of the consolidation, the consolidating companies were indebted in the sum of \$400,000 and that contemporaneously with the consolidation 4,000 shares of the stock of the new company, of the par value of \$400,000, were issued in payment of this debt (Case, p. 105). This was most persuasive evidence that the stock was actually worth in money exactly its par value, \$100 a share.

Certainly it established that the cash value of the stock was not \$399 a share or anywhere near that amount and that the property did not cost the Company within millions of the amount set up on the books in May, 1924. If the stock had been, in fact, worth \$399 a share, the Company would have paid \$1,596,000 in settlement of a debt of \$400,000 and a gross fraud would have been done the stockholders.

The Board also had before it another line of evidence of the money value of the stock, namely, proof of the value of the property which the stock represented. While it is true that the money or market value of stock is seldom exactly the same as the value of the property it represents, but is sometimes greater and sometimes less, still the value of the property in the absence of proof of market value is a permissible guide to the value of the stock, especially in the case of a public utility whose earnings are limited by the value of its property.

Mr. Nicholas S. Hill, Jr., testified that he had made a valuation as of October 31, 1923, of property in place December 31, 1920, and had added thereto the actual cost of net additions from January 1, 1921, to October 31, 1923 (Case, p. 58, l. 29), and that the result was \$23,117,267 and after deducting depreciation, \$20,217,832 (Case, p. 59, l. 15).

Mr. Hill also admitted that he had testified a year earlier to the value of the same property as of December 31, 1922, or ten months earlier than the date of the consolidation. He had testified that the cost of reproduction on the basis of average prices from 1911 to 1920 was \$13,595,632 and on the basis of 1922 prices, was \$16,471,836 and that his final appraisal of the fair value was

\$13,000,000 (Case, pp. 83, 84 and p. 60, l. 27). He explained this difference by stating that as he recalled,

“Prices in 1921 and 1922 were substantially 50 per cent. lower than in 1923” (Case, p. 61, l. 20).

“Water works materials and labor commenced to advance in the latter part of 1915 and there was a very steady increase which reached its maximum in 1920, and then there was a drop until the beginning of 1922, when prices commenced to rise again and reached a secondary peak about the middle of 1923 and that secondary peak lasted over into the early part of 1924, from which time there has been a slight decline.” (Case, p. 62, l. 2).

This testimony, disclosing such violent changes in price levels and setting forth a 75 per cent. increase in the value of the company's property from January 1, 1923, to the middle of that year, was not persuasive evidence of the money value of the stock issued in payment for this property.

The Board also had before it, its conclusions in the rate case fixing a value of \$11,500,000 as of a date ten months before the consolidation. *This value had been unanimously approved by this Court. Acquackanonk Water Co. v. Board*, 100 N. J. L., 125 Atl. 33. That figure was adopted by the Board as the measure of the value of the stock after allowing for additions and betterments during the intervening ten months.

The Company contends that the Board has no right to value the Company's property for the purposes of accounting.

Section 16(b), however, gives the Board power to value the property whenever, in its judgment, such valuation is necessary for the purpose of carrying out any provision of the act. The valua-

tion in this case was incidental to the ascertainment of the cost of the property to the Company for the purpose of requiring the Company to conform to the uniform accounting system. The Board clearly had authority to consider value for this purpose.

The evidence before the Board—namely, the issuance of 4,000 shares to pay a debt of \$400,000—would have justified a finding that the cost of the property was to be determined by valuing the stock issued in payment thereof at \$100 a share. The Board made a finding more favorable to the Company and determined the cost of the property at about \$113 a share.

This finding, embodied in the order before the Court, was clearly supported by the evidence.

(3)

There are other details in the order of the Board under review besides the direction that the Company set up in its books as the cost of its property the sum above mentioned, namely, details relating to depreciation, amended annual report and conformance in the future to the uniform system of accounts. These matters, however, are subsidiary to the main question and seem to require no separate consideration. Depreciation, both under the system adopted by the Company and under the Board's system, is calculated on book values. The annual report is drawn from the books. Hence, an amendment of the property accounts properly carries with it an amendment of the depreciation account and an amended annual report.

The order of the Board was authorized by the statute and was supported by the evidence and should be sustained.

IV.

The per curiam opinion of the Supreme Court.

(1)

“The question presented seems to us to be somewhat academic. It nowhere appears in the record that the valuation placed upon its books by the prosecutor is sought to be used for any improper purpose.”

The Supreme Court evidently considered it unimportant how the Company kept its books, so long as it did not attempt to use the entries for an improper purpose. The Legislature, however, has considered the manner in which the books of utilities are kept is of sufficient importance to give specific authority to the Board to prescribe the manner in which books should be kept. Inasmuch as the Board has exercised this authority and prescribed a uniform system, the Board is under a positive duty to see that the Company keeps its books in the manner prescribed.

The Board is not concerned with the question whether the compliance of the Company in this individual case is important or not.

(2)

“In disposing of this question, we will start out with the premise that the power of the Board is that of regulation and not of asphyxiation.”

With this principle the Board is in hearty accord but the applicability of the principle to the case at bar does not appear.

If the asphyxiation consists of requiring the Passaic Consolidated Water Company to carry its property on its books at cost, then I would reply that this form of asphyxiation is voluntarily

adopted by most business concerns and is submitted to without objection by all other public utilities, not only in New Jersey but, so far as I am aware, throughout the United States.

(3)

“It seems to us that one of the rights of private ownership is the keeping of accounts not solely for the purpose of establishing a basis for fixing rates but for such other matters as appertain to the ordinary business of a utility corporation. It owes to its stockholders certain rights that may require an entry upon its books of what it determines to be the fair value of its property.”

This is the kernel of the decision. Of course, we agree that the sole purpose of keeping accounts is not to establish a basis for fixing rates. The Board did not attempt so to restrict the Company.

But the Supreme Court evidently meant by this pronouncement that the Company has a right to enter upon its books what it determines is the fair value of its property and *to keep its books on that basis*. But the Legislature, in creating the Company, did not give it this right; on the contrary, in the same statute which authorized the creation of the Company, it gave to the Board the right to determine how the books should be kept.

(4)

“In ascertaining the income and excess profits upon which taxes have to be paid to the Federal Government, for example, it is fair that the full value of the property should be used. To use it requires that such a valuation shall be entered on the books of account. In the event of the sale of any of

the company's property for which it has no longer use, there should be a record of the true value of such property."

These illustrations are not very apt. The last year in which excess profits were taxed, was 1921, pursuant to Title III of the Revenue Act of November 23, 1921. Even if excess profits taxes had been payable for the years when the consolidation was affected and the bookkeeping entries in question were made, the tax would have been calculated not on the value of the property but upon the *amount invested* in the business. Under Section 331 of the Revenue Act of 1921, or Section 330 of the Revenue Act of 1918, the cost of the property to the predecessor companies constituted the invested capital of the new company.

It is only too likely, however, that the Company did have in mind its income tax when it rewrote its books of account. It had just sold its distributing system in Montclair for \$1,700,000 and hoped to sell other parts of its system at equally attractive figures. It was liable for a tax of 12½% on the difference between the cost and the selling price. On this tax, the value of the property sold had no bearing. But as books generally reflect costs, it might be that the figures inserted by the Company would be taken as cost and in this way the Company might be able to evade its tax liability.

The taxable gain on such sales is the difference between sales price and cost to the Company's predecessors. Revenue Act of 1924, Section 204, Regulations 65, Section 1597.

In the event of a sale of property, the record of the true value of such property would be the selling price and would be entered on the books

under the uniform system or any other system of honest bookkeeping. No other book record of the true value would seem necessary.

(5)

"It may well be that the Board could require an entry upon the books of a utility to the effect that on such and such a date the valuation for rate making purposes was found by the Board to be a specific amount."

The Court seems to have contemplated a footnote to the books for the benefit of the Board. I would suggest that the books be kept in the usual manner and that the Board would have no objection to the Company writing in them a note that on such and such a date Mr. Hill appraised the property at a specific amount.

V.

Conclusion.

The Legislature empowered the Board to prescribe a uniform system of accounts and to require public utilities, including the Passaic Consolidated Water Company, to conform thereto. The Board did prescribe such a system including a provision that the property accounts must state costs and not appraisals. This system was not unreasonable, arbitrary or capricious, but conformed to approved and usual practice and to similar systems of the Interstate Commerce Commission. The Company disregarded the lawful accounting requirements of the Board and wrote up the amount at which it carried its water supply system by nearly \$10,000,000 in order to make its books conform to an appraisal of its property. The Board, by the order under review, has properly directed the Company to re-

write its books so as to conform with the uniform system of accounts.

The order of the Board should be sustained and the judgment of the Supreme Court should be reversed.

Respectfully submitted,

J. O. BIGELOW,
Of Counsel with the Board of
Public Utility Commissioners.

New Jersey Court of Errors and Appeals

PASSAIC CONSOLIDATED WATER
COMPANY,

Respondent,

vs.

BOARD OF PUBLIC UTILITY
COMMISSIONERS,

Appellant.

ON APPEAL
FROM
JUDGMENT
OF
SUPREME
COURT.

BRIEF FOR RESPONDENT.

This is an appeal from a judgment of the Supreme Court setting aside upon writ of certiorari an order made on January 7, 1926, by the Board of Public Utility Commissioners of the State of New Jersey, the appellant herein (hereinafter for brevity referred to as "the Board") against Passaic Consolidated Water Company, the respondent herein (hereinafter for brevity referred to as "the Company"). By such order the Board among other things directed the Company to reform and rewrite its books of account; to modify its depreciation charges accordingly, and to set up on its records no other or different basis of fixed capital than that the Board should approve. The Board's order and the decision on which it was based appear at pages 115 and 117 of the case. The opinion of the Supreme Court vacating such order will be found at page 132 and its judgment at page 139 of the case.

Statement of Issue.

The issue involved is a simple but important one. Briefly stated, it is whether the Board can as it has attempted to do by the order in question require a public utility to enter on the latter's records and accounts as the value of its fixed capital assets for all purposes a sum arbitrarily determined by the Board without hearing or proofs, which sum is substantially less than either the cost or the fair value of such assets, and to expunge therefrom all other entries as to the value thereof.

Statement of Facts.

The following independent statement of facts on behalf of the Company is required in the interest of clarity.

The order under review results from the three following proceedings before the Board relating to the value of the Company's property, although only the order made in the last thereof is involved in this appeal.

(1) In March, 1923, the Board in a proceeding to determine rates for water service, and as of December 31, 1922, fixed the value of the used and useful property of five public utilities thereafter merged into the Company at \$11,500,000., of which amount \$11,200,000. was fixed capital. It is conceded in the Board's brief that such valuation was \$381,840.35 less than the total cost of such capital assets to said utilities (Board's brief, bottom of page 3, top of page 5, top of page 29). Such valuation for rate making purposes was an arbitrary one and was arrived at

largely by averaging different appraisals of the capital assets of the interested companies submitted in the rate case which varied from about \$9,450,000. to upwards of \$21,000,000. (Record, pp. 82-83; pp. 118-119). *Acquackanonk Water Co., et al. v. Board of Public Utility Commissioners*, opinion of Supreme Court, 125 Atl. 33; 1 N. J. Misc. Rep. 575, not officially reported, aff'd 100 N. J. L. 169. It will be noted that this valuation was (1) made as of December 31, 1922, (2) for rate fixing purposes only, and (3) purely an arbitrary one representing neither the value nor cost of the capital assets, but a lesser sum than either thereof.

(2) On November 1, 1923, the five companies involved in the rate case were with the approval of the Board consolidated into the Company. By the consolidating order the Company was directed with "no prejudice" to temporarily open its capital account not with such rate valuation figure but on the basis of the "historical costs" of the merged companies, and the Company filed with the Board its annual report for the year 1923 on this basis (Case, p. 103, l. 30, p. 120, l. 29). Prior to the time for the filing of its annual report for 1924 the Company completed a thorough appraisal of its property as of the date of its incorporation and caused the values shown thereby to be entered on its books of account. This showed the value of its fixed capital assets, less proper depreciation, to be \$20,217,832. and in its 1924 report the Company included its said capital assets at this figure (Case, pp. 56-59; pp. 63-65; pp. 67-68). The Company both in its book entries and its annual report fully conformed with the requirements of the Board's Uniform System of Accounts for Water Utilities, which as hereinafter is explained, attempts to compel entries to be

made on a cost basis alone (Case, pp. 67-70). It included in its report to the Board all data needed or desired by the latter, and also showed the various amounts written off for depreciation (Record, pp. 51-53, p. 55, l. 20; pp. 68-69, p. 73, l. 1). In the taking of these steps, as well as in the proceedings before the Board resulting in the order here under review, the Company has always asserted that it in nowise sought to use such higher valuation in connection with the rates charged or properly chargeable by it, or as a basis for the issuance of securities, or in any other matter over which the Board had jurisdiction or supervision. It has, however, uniformly insisted, and still does, that for its other and ordinary and proper business purposes it has the right to enter its assets on its records at their fair value, and that lawfully it cannot be compelled to enter them therein either only at their original cost to its predecessors in title, or at the substantially less value arbitrarily determined by the Board in the order which the latter now seeks to have upheld (Case, p. 71, l. 15; p. 73, l. 23; p. 77, l. 15).

(3) Notwithstanding this, the Board in the proceedings now under review, and by its order dated January 7, 1926, directed the Company:

(1) To reform and rewrite its books of account * * * starting with December 31, 1922, with said item of \$11,200,000. * * * and to make subsequent additions and retirements and all other book entries in accordance with the Board's Uniform System of Accounts for Water Utilities;

(2) To modify its charges theretofore made for depreciation accordingly;

(3) After so rewriting its books of account to submit to the Board for approval an amended annual report for the year 1924;

(4) To set up no other or different basis of fixed capital than that so approved. (Case, pp. 115-116).

The Board made this order notwithstanding the undisputed evidence showed that between 1922, when its rate case valuation was made, and November 1, 1923, prices for water works, materials and labor had steadily increased and at the later date were 50% higher than they were at the date of such earlier valuation. It was largely as the result of these increased prices that the appraisal showed the then value of the Company's fixed assets, less depreciation, to be not \$11,200,000. but \$20,217,832. (Case, p. 61, l. 25; p. 62, l. 17). Upon the hearing resulting in the order under review no question was raised as to the actuality of such increased value or the validity or fairness of the method by which the new valuation was made. For all purposes of the proceeding the Company was shown to have had capital assets of a value in excess of \$20,000,000. as of the date the Board ordered it to treat them for all purposes as worth little more than one-half that amount.

The only attempted justification for the order under review is a requirement in the Uniform System of Accounts for Water Utilities theretofore promulgated by the Board, as it claims with Legislative sanction, requiring fixed capital assets to be entered only at the actual cost thereof. As will, however, be shown, there is no warrant in law for this requirement.

On behalf of the Company we respectfully submit that the Board was without authority to make its said order and that the judgment of the Su-

preme Court vacating it because it transcended the power of the Board should be affirmed for the following reasons:

ARGUMENT.

I.

This appeal from the judgment of the Supreme Court setting aside the Board's order is unwarranted.

At page 5 of the Board's brief it is conceded that by the order in question the Board "not only ordered the Company to expunge the write up of \$9,886,580,81, but further ordered it to reduce on its books the value of its water plant by \$381,840.35 in order to bring its books into line with the value found by the Board in the rate case as of December 31, 1922, with adjustments for additions, etc., since that date, on the theory that this was the cost of the property to the Consolidated Company." At page 29 it is admitted that, "By its order under review it (the Board) required the Company to reduce the book value of its water system \$381,840.35 too low," even on the Board's theory that the Company can only carry its assets at cost, instead of at their actual value. No contention or pretense is made that the amount at which the Company was ordered to value its fixed capital assets equalled the cost thereof either as of December 31, 1922, or as of the date of the consolidation, or as of the date of the order under review, or represented any valuation thereof whatever except the earlier arbitrary one of \$11,200,000. made in the rate case as of December 31, 1922, by averaging appraisals as aforesaid.

No warrant or justification for the pending appeal can be found, therefore, in the Board's Uniform System of Accounts for Water Utilities which it puts forward as the sole ground therefor. It is manifest that the appeal is taken solely in the hope that this Court may, contrary to the opinion of the Supreme Court, express the view that the Board has the power it craves to compel all public utilities to value their capital assets at cost regardless of their worth, and this for all purposes whether or not related to the matters over which the Legislature has given the Board regulatory powers. We submit, however, that this Court is not called upon to determine whether the Board has such a broad and devastating power in a case where the record discloses and the Board admits that its order rested not on such alleged power, but upon an arbitrary valuation of assets in which cost does not enter.

II.

The Board unjustly and without warrant ordered the Company to carry its assets not only below cost, but at an arbitrary valuation fixed for rate purposes alone which was obsolete and inadequate at the time the order under review was made.

The valuation imposed upon the Company's assets in the proceedings under review was made for rate purposes alone in a proceeding to which the Company was not a party. The manner in which it was arrived at as well as the fact that it resulted in a figure less than cost has already been shown. Even if it had been properly made for the intended purpose such a valuation cannot

be a proper one for all other purposes. A valuation of the property of a public utility may be necessary or advisable for one of several purposes growing out of its duty to the public, as for instance, the establishment of just and reasonable rates for service to be rendered or the issuance by it of securities. On the other hand, it may be necessary for one of several purposes relating solely to its internal affairs, such as local, State or Federal taxation, a private sale, or public purchase or condemnation.

The elements which enter into the value of such a property for some of these purposes are not necessarily to be given the same weight or considered at all in fixing a value for other purposes. Earnings, for instance, do not enter into the question of assessed value for local tax purposes nor for rate making, but are taken into account in assessments of capital stock and inheritance taxes, on private sale and condemnation purposes. Likewise franchises may not be taken into account for rate purposes but may for local taxation, for capital stock tax, and upon a sale or condemnation. Other illustrations of the varying elements entering into valuations for various purposes will no doubt occur to the Court. But all of these purposes affect the corporate owner in some of its activities, are of importance to its stockholders and must be dealt with by its Board of Directors. In this respect a public utility corporation is no different from any other business corporation, and, except as authorized by the Legislature, the Board has neither the right to value the Company's property nor to prevent it from so doing and using such valuation for any of its lawful, corporate purposes over which the Legislature has given the Board no control. Even if the rate valuation had been made concurrently with

the order under review, the Board could not properly insist that it bound the Company for all purposes.

While the Board's appraisal for rate purposes was made as of December 31, 1922, the Company did not acquire its property until November 1, 1923, during which time the value thereof had largely increased.

To the extent to and for any purpose for which the Board may have the right to fix the value of the assets of a public utility, it must do so as of the time the valuation is made. *McCardle v. Indianapolis Water Company*, 272 U. S. 400, 411 (1926). It may not adopt a value made at a different time, under different price conditions and for a different purpose. To do this, as the Board has in the instant case, is to determine values not only without any basis in fact, but contrary to all of the facts, and to attempt to impose its arbitrary will on the Company. In *Erie Railroad Co. v. Utility Board*, 85 N. J. L. 420, 423, our Supreme Court said:

“The statute does not justify merely arbitrary orders, and anyone who is injuriously affected by such an order may justly complain.”

In *Hackensack Water Co. v. Public Utility Commissioners*, 98 N. J. L. 41, 42, unanimously affirmed by this Court on the opinion below, 100 N. J. L. 177, Mr. Justice Swayze, speaking for the Supreme Court, said:

“The present value must be taken as the value of the property devoted to public use and an arbitrary date is as unlawful as an arbitrary rate.”

The Board's brief near the top of page 21 concedes that “present value is the rule en-

forced", and yet at pages 5 and 29 admits that the order sought to be sustained forbids the Company to carry fixed capital assets on its records at a sum equal to either their cost or present value.

III.

The requirement of the Board's uniform system of accounts for water utilities that fixed capital assets shall be entered only at cost is unauthorized and invalid.

The Board's claim to the contrary, constituting the sole basis of this appeal, rests upon Section 17 (d) of the Public Utilities Act of 1911, which confers on the Board power to require a public utility "to keep its books, records and accounts so as to afford an intelligent understanding of the conduct of its business, *and to that end* to require every such public utility of the same class to adopt a uniform system of accounting. This section further provides that "Such system shall conform, in so far as in the judgment of the Board is practicable, to any system adopted or approved by the Interstate Commerce Commission of the United States of America." (P. L. 1911, p. 379).

To this requirement the Company makes no objection. It does, however, question the interpretation placed by the Board upon this statutory provision, and the arbitrary power the Board insists is thereby conferred upon it.

Briefly stated, the Board's contention is—

(a) That this legislation authorizes it to require every public utility to adopt a uniform system of accounting, conforming to any system adopted or approved by the Interstate Commerce

Commission; (b) the Board has adopted a Uniform System of Accounting for Water Utilities which conforms to the one adopted for telephone companies by the Interstate Commerce Commission, and (c) such System of Accounts in addition to requiring certain prescribed classifications of the capital assets of water companies requires them to be entered and carried only *at cost*. (Case, p. 88, l. 15).

The Company contends that no law requires it to enter or carry such assets only at cost, and that even if all such contentions of the Board were correct the order under review is nevertheless invalid, and this because:

(a) If by such legislation it was intended to authorize the Board to require a public utility to carry its assets for all purposes only at cost such legislation is unconstitutional.

The source of authority for such a requirement in the case of a carrier engaged in interstate commerce and that of a state utility is entirely different, and even if the requirement is a valid one in the first of these instances, it is not in the second. Such authority over interstate carriers is based *primarily* upon a Constitutional grant to Congress to regulate commerce among the states, a grant subject to no limitations other than those prescribed by the Constitution itself, and *secondarily* upon the specific delegation by Congress to the Interstate Commerce Commission of the power to require every interstate carrier under its jurisdiction to report "the *cost and value* of the carrier's property, franchises and equipment", and further specific action by Congress making it "unlawful for any such carrier to keep any other accounts, records, or memoranda than those prescribed or approved by the Commission". (Sec.

20 of the Act to regulate commerce, U. S. Comp. Stat., Anno., Vol. 8, pp. 8592-8593). In the case of the Board the authority delegated to it rests wholly upon the exercise of the police power of the State to control *so far as reasonably necessary* intrastate business effected with a public interest. *Union Dry Goods Co. v. Georgia Pub. Serv. Corp.*, 248 U. S. 372; *Erie R. Co. v. Board*, 87 N. J. L. 438; *Phillipsburg v. Public Utility Board*, 85 N. J. L. 141; *Erie R. Co. v. Public Utility Com.*, 89 N. J. L. 57.

The argument in the Board's brief that the Board's control over the Company is complete and absolute and may be exercised in entire disregard of what are ordinarily treated as property rights because the Company obtained its charter from and is therefor a creature of the State, is unsound. The authority of the Board is conferred over a utility as a utility and not as a corporation. It is equally extensive over individuals, co-partnerships and corporations engaged in the public service. It is the character of the business and not the character of the operator that has justified the legislature in giving the Board whatever authority the latter has. All utilities, whether individual or corporate, are entitled to the same application of the law and to equal protection thereunder. No showing is made of the existence of any necessity in the public interest to require a utility to enter its capital assets on its records at only their actual cost. In the absence thereof such a requirement would be unconstitutional.

(b) Such legislation does not attempt to authorize the Public Utility Board to require a public utility of this State to carry its assets only at cost.

The Legislature in enacting the Public Utilities Act of 1911 must be assumed to have known that

Congress had at least as early as 1906 legislated as to interstate carriers in the way just recited. But the Legislature did not see fit to give these broad powers to the Public Utility Board it then created, nor power to adopt any Uniform System of Accounting conforming to those prescribed by the Interstate Commerce Commission under such powers except as far as this should be practicable. "Practicable" must be regarded as meaning not only so far as reasonably usable, having in mind the difference in the kinds of business being transacted but also to the extent authorized by the Legislature, but not beyond that.

(c) Quite apart from what has already been said, it is clear that the Legislature has not conferred upon the Board the unlimited power which it has sought to exercise by the order in question.

It is elementary, and the Board's brief admits (p. 6), that if the Board has the power it attempts to assert it must be found in the Public Utilities Act (P. L. 1911, p. 374). Nowhere in this legislation is authority vested in the Board to fix the value of the capital assets of a public utility either for every purpose of the utility itself, or for any purpose the Board may from time to time deem desirable. This will readily appear from an examination of Sections 15, 16, 17 and 18 of such Act, which will be found on pages 376 to 382 of the Laws of 1911, which is all the pertinent legislation there is. The control conferred upon the Board over public utilities, their property, property rights, equipment, facilities and franchises as appears by Section 15 is only granted "so far as may be necessary for the purpose of carrying out the provisions of this act." Its power to appraise and value the property is expressly limited to exactly the same extent. It is authorized to fix just

and reasonable rates; to require every utility to file complete schedules of rates; to fix just and reasonable standards; to require every utility to keep its books, records and accounts so as to afford an intelligent understanding of the conduct of its business, to furnish annually a detailed report of its finances and operations, and to carry a proper and adequate depreciation account. It may suspend increases of rates and hear and determine their reasonableness. Without the approval of the Board no utility can issue stocks, stock certificates, bonds or other evidences of indebtedness payable in more than one year, nor sell, lease, mortgage or otherwise dispose of or encumber its property, franchises, privileges or rights, or any part thereof, nor merge or consolidate with any other utility.

Nowhere in our law will there be found either express or implied authority in the Board to value the property of a public utility for any purpose that the Board may deem fit. It may do so only after a hearing "for the purpose of carrying out any of the provisions of this act." Nowhere in our legislation is there to be found any provision, express or implied that a utility may not value its own property for its ordinary business purposes unrelated to the service it renders, the rates it charges or the securities it issued same. Unlike Congress the Legislature has not made it unlawful for a utility "to keep any other accounts, records or memoranda than those prescribed by the commission."

As already stated, the Company does not question the jurisdiction of the Board to determine values for the purposes of fixing "just and reasonable rates," or in connection with the filing of "complete schedules * * * of rates," or in the fixing of "just and reasonable standards," or for

the "fixing of standards for measurement." or in "suspending increase of rates," or in the issuance of "any stocks, stock certificates, bonds or other evidences of indebtedness," or in passing upon any proposed disposal or encumbrance "of its property, franchises, privileges or rights, or any thereof," or any proposed "merger or consolidation." But conceding the authority of the Board to supervise, regulate and control it in all of these matters, it does challenge the power of the Board to prohibit it from valuing its property for other usual business purposes and from entering such valuation upon its books of account.

That it is justified in so doing is clear under the authorities of which *Atlantic Coastline v. North Carolina Corp. Commission*, 206 U. S. 20, is but one of many. The prevailing rule is there tersely and clearly stated by Mr. Justice White, thus:

"As the public power to regulate railways and the private right of ownership of such property co-exist and do not the one destroy the other, it has been settled that the right of ownership of railway property like other property rights finds protection in constitutional guarantees, and, therefore, wherever the power of regulation is exerted in such an arbitrary and unreasonable way as to cause it to be in effect not a regulation but an infringement upon the right of ownership, such an exertion of power is void because repugnant to the due process and equal protection clauses of the fourteenth amendment."

The same principle is vigorously repeated by the same high Court in *Missouri, ex rel. v. Public Service Commission*, 262 U. S. 276, 288 (1922), where it is said:

"There is nothing to indicate bad faith. So far as appears, plaintiff-in-error's board

of directors has exercised a proper discretion about this matter requiring business judgment. It must never be forgotten that while the State may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies and is not clothed with the general power of management incident to ownership. The applicable general rule is well expressed in State Public Utilities Commission, *ex rel. Springfield v. Springfield Gas & Electric Co.*, 291 Ill. 209, 234: 'The Commission is not the financial manager of the corporation and it is not empowered to substitute its judgment for that of the directors of the corporation * * *.'"

No further authorities need be cited to sustain the just principle for which the Company contends, namely, that in the absence of legislative authority the Board has no such general and far-reaching authority over it, its Board of Directors and the investment of its stockholders, as the Board has by the order under review sought to assert.

Nor is the argument of the Board on this point supported by any decisions. In *Kansas City Southern Railway Co. v. United States*, 231 U. S. 423, cited in the Board's brief (p. 25), the plaintiff carrier had abandoned certain of its property and insisted that it had the right to treat the loss so sustained as an operating expense rather than a capital charge. The Supreme Court defined the amount involved as "the cost or estimated replacement value of abandoned property." Neither the Commission nor any of the courts through which this case passed considered the question of whether the write-off should be on the basis of cost or value, and the sole question passed upon was one of proper classification of accounts.

The proofs show without contention to the contrary, that the Company has in all respects classified its accounts in accordance with the requirements of the Board's Uniform Accounting System for Water Utilities. The sole complaint is that although its capital assets have been admittedly properly classified and entered *at cost* they are also entered for the ordinary and proper purposes of the Company over which the Board is given no jurisdiction or control carried at their actual value. In insisting upon attempting to prevent this practice, the Board seeks to go far beyond anything which has been sanctioned by the courts in sustaining the broad powers granted to the Interstate Commerce Commission or state public utility boards. Certainly no court should uphold on the theory of required "bookkeeping" an order which unnecessarily injures a utility without in anywise benefiting or safeguarding the interests of the portion of the public it serves. This was the view expressed in the able opinion of the Supreme Court vacating the order in question, where it is said:

"It is well settled that when bodies are created for the regulation of utility companies the presumption is that the power of regulation does not extend beyond the express terms of the grant,"

and where in addition there is cited the holding of this Court in *Hackensack Water Company v. Board of Public Utility Commissioners*, 96 N. J. L. 184, that—

"It was the intent of the Legislature that the exercise of these powers should be controlled not only by the statute itself, but by the settled rules and principles of the common law."

(d) As is shown in the following Point IV hereof the assets in question are in fact carried on the Company's books at the cost thereof to it.

IV.

The method which the company adopted in the writing of its capital accounts in fact conforms to the system of uniform accounts prescribed by the Board and upon which its order was based.

An important provision of such System is as follows:

"All charges to fixed capital accounts shall be the actual cost of the property acquired. When the actual consideration given for same is anything other than money, it shall be described in the entry with sufficient fullness and particularity to identify it and the amount charged shall be the actual money value of such consideration at the time of the transaction" (Case, p. 89, l. 16).

The purpose and effect of this regulation in its application to the situation of the Company is that the consideration paid by it for the property of the five companies consolidated into it was the value of its capital stock and other obligations issued *at the time of its formation* with the express approval of the Board, as a result of the consolidation proceeding had before it. In other words, the actual cost to the Company of its capital assets as defined by this regulation was their net worth at the time of their acquisition by it. This worth was ascertained through an actual current valuation of these assets, which the Board refused to even consider in the proceeding resulting in the order under review. It is this worth—

this cost—that the Company entered on its accounts and which the Board ordered stricken therefrom and replaced by the arbitrary amount of \$11,200,000. arrived at by it as of December 31, 1922, in the rate case, changed only by the additions and retirements made to the Company's property between December 31, 1922, and the date of the consolidation order.

The Board both in the decision and finding upon which its order is rested placed upon this, its own, accounting regulation the same construction as the Company did in making the entries ordered stricken out and now does in contending that they should not be stricken out. It is said, in its decision:

"The cost to the consolidated company was the value of the property of the consolidating companies" (Case, p. 121, l. 18).

Its principal finding and determination was:

"That the money cost of the operating property subsequently acquired by the Passaic Consolidated Water Company on November 1, 1923, was the same as the value of the operating property of the five companies on said date consolidated into said company" (Decision, p. 113, ll. 22-27).

But though so finding the Board rejected the principle of its decision and undertook to completely nullify its own accounting regulation. With a few strokes of the pen it stated that the Company had complied with its regulation and also forbade it to do so. It sought to accomplish this curious result by the simple artifice of refusing to consider value "at the time of the transaction". As already shown, the amount it thus ordered the Company to enter on its records as the cost of its property represents nothing but the Board's own

judgment expressed on evidence submitted in another and earlier proceeding for another purpose and under different conditions as to elements constituting value, when both prices and values were materially lower. By its order it violated such regulation of its own Uniform System of Accounting and at the same time declared that it relied thereon.

On pages 29 and 31 of the Board's brief it is conceded that by "its order under review" it required the Company "to reduce the book value of its water system \$381,840.35 too low"; that "the consolidation can be viewed as a purchase" of the net assets of the five predecessor companies and that "this was the theory of the Board's order now under review". But notwithstanding this, and in an attempt to show that the Board did not by its own order violate the above quoted regulation of its Uniform System of Accounts, the argument is made in this Court for the first time that the consolidation could not have in effect resulted in a purchase by the Company of the property of the five predecessor companies because "a purchase requires the meeting of minds of vendor and purchaser", and that in this case there was no meeting of minds between the Pacific Consolidated Water Company and the five earlier companies, as the former did not exist until the instant when the latter ceased to exist. This specious argument, however, loses sight of the fact that the article referred to deals not merely with a purchase but with "the actual consideration given" for property acquired for "anything other than money", and requires the amount charged to be the actual money value of such consideration at the time of the transaction. No matter upon what theory the consolidation may be regarded the fact can not be gainsaid that the

actual consideration given for the property which the Company then acquired was its shares of stock and bonds, which represented and were worth the then value of the property it thus acquired, and not merely the cost thereof years before to its predecessors in title.

V.

There is nothing in the public interest requiring the Board to have the power over utilities which it has attempted to exercise by its order under review.

There is much in the Board's brief as to the necessity and theories of public utility regulation not germane to any issue raised on this appeal, but disclosing an intense desire to have this Court hold that the Board is authorized to act as the guardian of the public interest in matters over which the Legislature has given it no regulatory powers. The length to which the Board is prepared to go in the assertion of its alleged power is manifest.

On page 16 of its brief the view is expressed that one of its proper functions is "creating an informed public opinion on the subject of utilities."

On page 17 it is explained that other necessary functions of the Board are to make certain that there is "fostered in New Jersey a conservative temper in dealing with public utilities;" that "radical action" directed against utilities is prevented, and that a "staple market for the securities of public utility companies" is created.

On page 18 it is asserted that "the confidence of the bond market in the securities of New Jersey public utility corporations" and "the credit of all

New Jersey utilities" would suffer if the Board's power over accounts should be nullified by the decision of this Court.

On the same page it is argued that the order in question must be upheld for the protection of stockholders and as "a valuable guide to the directors in ascertaining the real earnings of the Company" and in order to prevent the frequent practice of management which "through ignorance of the real situation, declares dividends out of capital and permits the Company to drift into bankruptcy."

At the bottom of page 21 it is asserted that if the Board can be regarded as authorized to make up the balance sheet of every New Jersey utility the present methods of rate fixing "will be discarded in favor of the simple method of glancing at the balance sheet." To this prophecy is added the naive statement that "In preparation for that day, as well as for use under the present system of rate making, it is essential that the property accounts should set forth investments and not appraisals." And this notwithstanding that it is admitted that "present value is the rule enforced," under such decisions as *McCardle v. Indianapolis Water Company*, 272 U. S. 400 and *Hackensack v. Public Utility Commissioners*, 98 N. J. L. 41, affirmed 100 N. J. L. 177.

Following the citation of Section 14 of the Utilities Act, which requires the Board "to report annually to the Governor, making such recommendations as it may deem proper, which report shall be laid before the next succeeding Legislature," appears the following:

"The recommendations intended by this section clearly are not limited to the specific powers given to the Board by the Act but

properly embrace the whole field of public utilities to the end that the Board may call to the attention of the Governor and of the Legislature any need that may arise of further legislation on the subject. The Board properly has in mind this duty of recommendation when it prescribes rules for accounting and forms of reports."

The Company's records and annual reports in fact show *cost* as well as value and contain all of the information which the Board needs to make any recommendation to the Legislature.

The fallacy of the Board's argument as to all of these matters is that it insists that nothing but cost shall be used for any purpose and that it has power covering all of these matters which the Legislature has never expressly or impliedly given it.

While vesting in it great powers as to all of such matters as service, rates, issuance of securities, disposition or encumbering of property, mergers, and other matters directly affecting the public interest the legislation has, nevertheless, seen fit to leave with the utility itself the conduct of its own affairs in other matters, subject in the case of a corporation to the law governing corporations, and in all cases to the protection afforded by the courts. We repeat, that in all matters affecting its rates, its service, its usefulness to the portion of the public it serves, or the issuance of its securities by it, the Company willingly recognizes that the power of the Board is well-nigh supreme—and properly so. But there is nothing related to these matters which makes it advisable in the public interest that in the course of the ordinary and proper management of its other affairs the Company shall be prohibited from carrying its assets on its records at their fair value.

Furthermore, it clearly appears from Section 17 (d) of the Utilities Act (P. L. 1911, p. 374) that the sole legislative purpose of vesting power in the Board to require every public utility to adopt a Uniform System of Accounting was to provide that its books, records and accounts "should afford an intelligent understanding of the conduct of its business." This requirement the Company has complied with strictly and in its annual reports to the Board has included data showing the cost to its predecessors as well as the value it placed upon its capital assets. The showing thus made fully meets the statutory purpose and requirement, but is not satisfactory to the Board, the latter says, because if all or many companies followed the practice it would "render the task of using the reports too tedious to be practicable." This view, we submit, is insufficient to require the Court to uphold the Board's order.

The remaining ground urged in support of its validity is that Section 17 (f) of the Public Utilities Act requires every public utility to carry an adequate depreciation account in accordance with such rules, regulations and forms of account as the Board may prescribe (P. L. 1911, p. 379). But this Section further provides that the Board shall only have power "by order in writing after hearing (to) fix proper and adequate rates of depreciation of the property of every public utility, in accordance with such regulations or classifications, which rates shall be sufficient to provide the amounts required over and above the expense of maintenance to keep such property in a state of efficiency corresponding to the progress of the industry." The Board's contention is that as a result of increasing the amount of its fixed capital the Company has set up a depreciation expense for the year 1924 in an amount substantially in

excess of the sum that would be required if it carried its property only at the cost thereof to its predecessors in title. It is difficult to see how this can be urged as validating an order requiring the Company to reform and rewrite its fixed capital account so as to include as the aggregate value thereof only a sum resulting in a lesser amount of depreciation. For the Company has admittedly not taken, and has repeatedly disclaimed any intention of taking depreciation in excess of the amount approved by the Board in the determining of rates for its service, its depreciation account, exceeding as it does the amount required by the Board for the protection of the public it serves, is one over which the Board has no control. The Board has never, upon notice by order, after hearing, fixed rates of depreciation for the Company and its order directing the Company to modify its depreciation charges was in this respect clearly unlawful. On the other hand, it is a matter of importance to the Company not only in the determination of the income taxes properly payable by it but for the protection of its stockholders and the well-being of the Company itself, that its depreciation charges should be adequate.

VI.

The order under review is injurious to the Company, interferes with its property and vested rights, attempts to take its property without due process of law, and constitutes an unwarranted interference with the internal management of its affairs.

Save only to the extent that in the public interest its operations have been subjected by the legislature to the control and regulation of the Board, the Company is entitled to administer its affairs and business in compliance with the requirements of the Corporation Act of this State under which it is organized. This general law vests the administration of its ordinary business matters in its Board of Directors, not in the Public Utility Board. It confers upon its Directors certain rights and imposes upon them certain duties. Among such rights and duties is having the Company's Federal income taxes fairly determined; endeavoring to acquire upon a sale or condemnation of any of the Company's property the full value thereof; protecting the investment of its stockholders through the maintenance of proper depreciating reserves, and distributing to the stockholders such of the profits of their corporate enterprises as are not needed for the proper conduct of the business. With the exercise of these rights and duties the Board's order unjustifiably interferes, for it endeavors to compel the Company's Directors to value its property on its books at much less than its fair worth.

And with what result? None whatever as to the service rendered by the Company or the rates charged therefor, or the securities which it may

issue, for these are determined by previous orders of the Board made in appropriate proceedings for such purposes. But with injury to the property rights and interest of the company. If the Board's order is upheld the Company must carry its property at a value subjecting it to undue Federal taxation. Although threatened with being compelled to sell its property to or to submit to condemnation thereof by various municipalities it will be required to enter upon its records as the value thereof a sum equal to only about one-half of its fair value (Case, p. 76, l. 25). It will not be permitted to take as depreciation the amount that sound principles and proper business practices and precautions require. In the payment of dividends to its stockholders it must be governed not by its true surplus as directed by the Corporation Act but by a false surplus arbitrarily fixed by the Utility Board. The necessary result of all this would be to inflict injury upon the Company and to deprive it of its property contrary to law and unlawfully interfere with its internal management.

This was the view taken by the Supreme Court in its able opinion resulting in the judgment appealed from. That Court found, and we submit properly so that —

“The right to regulate a utility does not destroy the right of private ownership. All the incidents of ownership, except in so far as it may be necessary to curtail them to properly exercise the power of regulation, remain with the corporation. * * * One of the rights of private ownership is the keeping of accounts not solely for the purpose of establishing a basis for fixing rates but for such other matters as appertain to the ordinary business of a utility corporation. It owes to its stockholders certain rights that may require an entry upon its books of what it deter-

mines to be the fair value of its property.
* * * The order in the present case * * * is
a prohibition that there shall not be set up on
the books of the Company for any purpose
whatsoever any different basis of fixed capi-
tal than that which has been approved by the
Board for rate making purposes. This, (we
feel,) transcends the power of the Board.”

CONCLUSION.

For the reasons above stated, we respectfully
submit that the order of the Supreme Court
should be affirmed.

February Term, 1928.

Respectfully submitted,

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