

Excerpts from Testimony of John F. Thompson

Q. You have indicated to my satisfaction that you regard my paraphrase as a fair statement of your view expressed here. I ask you only if your view expressed here was shared by other members of the financial community?

The Court: As you stated it.

The Witness: Yes, I think the financial community realized how little of the net [235] revenues of the Port Authority might conceivably be made available for mass transit if something like that were put through and also therefore extremely concerned about statements of one-hundred-million dollars a year and other things which are entirely out of context of the Port Authority's actual finances.

The Port Authority's net revenues are good for an enterprise the size of the Port Authority, but compared to the mass transit problem, they are peanuts.

Q. There is no legislation pending or gubernatorial proposal to have the Port Authority take over all mass transit, is that, Mr. Thompson? A. Frankly, counsel, nobody in the investment community can tell what the proposals are of those who want repeal. That is one of the unfortunate uncertainties of all of this. It is just destructive and not constructive. T 234-9 to 235-20.

* * *

[239] Q. Tell me now, Mr. Thompson, whether you think a municipal bond could be sold if it was sold with an explicit stipulation in the official statement stating that the State of which the municipal agency is a part reserves the right to modify covenants and provisions affecting the operation of that agency if sufficient public need required? T 239-4 to 239-9.

* * *

Excerpts from Testimony of John F. Thompson

【240】 A. Yes, I think it would be difficult to sell such an issue.

Q. You would have to pay a premium for floating such an issue, I suppose. A. If it were saleable it would carry a very high interest cost. Premium is a different word in market parlance. It involves the price factor.

Q. I understand. Thank you. If that is the case why weren't investors paying something more for New York Port Authority bonds when according to your testimony they were under the impression that its covenants could not be modified, whereas an informed investor would have to know that the Massachusetts Port Authority bonds covenants could be modified? T 240-2 to 240-15.

* * *

【241】 The Witness: At what point in time?

Mr. Sovern: In April 1974.

The Court: Or prior thereto.

Mr. Sovern: Or prior thereto.

A. I would think that the question never arose in an investor's minds as to the Massachusetts Port Authority. As I said yesterday there was a set of circumstances there which made entirely impractical the sort of drive to get money for mass transit which we have seen here. So the question just does not arise and it is not a real question. T 241-16 to 241-25.

* * *

【244】 Q. I'd like to call your attention **【245】** now, Mr. Thompson, to plaintiff's exhibit 5, your letter. T 244-25 to 245-2.

* * *

Q. That is your letter to Norman Hurd of June 10th, 1974. I call your attention particularly to the final para-

Excerpts from Testimony of John F. Thompson

graph on page 1. What did you have in mind there when you said that there would be a continued effort in the investment community working with the Port Authority to further [246] its involvement in mass transit within the covenant including the possible request for bondholders consent to a change? A. I think the sentence should be read in connection with the sentence which follows which was if the repeal bill is signed, if the repeal bill is signed. However, all of this potential effort will unfortunately have to be channeled into the mobilization of investors to uphold the covenant in the long constitutional court battle which will ensue. T 245-20 to 246-11.

* * *

[247] A. If you wish me to answer further as to what efforts were going on, I think some efforts were indicated in some of the things we went through yesterday, and some of the memos I wrote, there had been discussion that I knew of with a good many people in the investment community as to how something could be worked out. There has been discussion with Port Authority people. The Port Authority itself presented to the two governors and the governors adopted it, a program involving further involvement in mass transit within the covenant. All of that is now stymied just as I've said it would be.

The Court: What sort of a change in the covenant would you have anticipated the bondholders would consent to?

The Witness: The bondholders [248] might consent to a change which would permit funds that flow to the final reserve fund a consolidated reserve fund to be devoted to this in return for an increase in the interest rate which would be substantial.

Excerpts from Testimony of John F. Thompson

Now, I said in one of the memos that quotes were taken from yesterday, that a moderate increase would probably not attract bondholders. And this would not be an easy thing to do, your Honor, but in the long run my opinion was that an attempt in that direction, first an attempt in the direction of doing as much as possible within the covenant. Secondly, if it were then necessary to look for a change agreed to by the bondholders because on that basis, there would be specific proposals. There would be something that would be measurable. There would not be this feeling—just an outright repeal of the covenant—there is an attempt to get money way high on the operating revenues of the Port Authority, which would really impair it. An approach to the bondholders [249] would be in terms of specifics for so much of an application of surplus funds for mass transit might be allowed. But, as I say, that would be the second choice in my mind.

By Mr. Sovern:

Q. It would be fair, would it not, Mr. Thompson, to say that you regard the obtaining of bondholder consent under the conditions set forth in your memorandum as an exceedingly difficult undertaking? A. It would be an exceedingly difficult undertaking and it would have to be, to have any hope of success, it would have to carry substantial benefits to the bondholder in the way of additional interest.

Q. Now, you referred to other plans going forward at the Port Authority to help mass transit within the covenant. A. Yes, sir.

Q. Can you be more particular, more specific? A. The program to extend PATH to the Newark Airport and on

Excerpts from Testimony of John F. Thompson

to Plainfield, and the program to—that involves a number of railroad connections, so, I think, in this area, which I can't draw a [250] map of, but there were several of them permitting the flow of mass transit into Penn Station, which is not now possible, and the connection to Kennedy Airport in New York from Penn Station.

[251] Q. Do you have any idea how long those plans have been under consideration by the Port Authority? A. For several years, I don't know exactly.

Q. Do you know whether the Port Authority has certified within the meaning of section 7 that it would not impair the obligations to the bondholders to undertake that enterprise? A. The program calls, as I understand it, for assistance from both state government and from the federal government. These have not all been received. I believe it has been said that there was an expectation of such help from New Jersey which was later denied, so, now, the Commissioners have not yet certified the program.

Q. Do you know what fare levels would have to be set in order to meet the terms of the covenant in order to have those plans go forward? A. No, I don't think any study has ever been presented that brings it down to fares.

Q. Are you familiar with an occasion on which the Port Authority Commissioners refused to go forward with the Plainfield project unless a [PATH] fare increase was approved? A. I don't think I am specifically, no.

[252] Q. It occurred on February 19th in an effort to refresh your recollection, if it is the case, the time involved would have been February 19, 1974? A. I probably was aware of it at the time. It seems a perfectly logical arrangement. I presume the extra fare was needed to obtain the degree of self-support required. T 247-10 to 252-8.

* * *

Excerpts from Testimony of John F. Thompson

[253] Q. I call your particular attention **[254]** to the paragraph [of Exhibit S-5] beginning with the bottom of column one of the letter in which Mr. Ronan says—he is referring to the time when he approved the—he stated the repeal would be welcome.

“I have also stressed that the lifting of the statutory covenant, per se, does not mean that bondholders’ security would be eroded. The two states have not determined and the Commissioners have not acted to impose deficit burdens on the Port Authority in rail or other fields, which could impair revenue coverage or reserve requirements established in our indentures.

“Additionally, the Board of Commissioners is committed to preserve the credit of the Port Authority which is vital to the present and in any future undertakings of the agency.

“Governor Byrne on signing the New Jersey bill expressed his own determination to avoid impairing the Port Authority’s credit.”

Would you indicate for us which, if any, portions of that paragraph with which you disagree. A. May I request if another letter that was put in evidence yesterday which was my private reply to Commissioner Ronan which incorporates my then **[255]** views and I am sure will also incorporate my answer to this question.

The Court: Well, I think the question really is do you agree as you are sitting here today with the statements made by Mr. Ronan’s letter?

The Witness: Your Honor, the letter I wrote to him was one in which I had given that question a great deal of thought.

The Court: What number was that?

The Witness: P-14. And I think the first paragraph of this letter is appropriate as an answer to

Excerpts from Testimony of John F. Thompson

your question, leaving out the sentence about the conciliatory tone, “Your personal assurances about the Commissioners’ intent to maintain Port Authority credit standing were well-stated. However, the best of intentions are not apt to be persuasive to investors who have just experienced unilateral revocation of an important part of their bond contract.

“Furthermore, if the assurances are to be accepted at face value, it is [256] difficult to understand what is to be gained for mass transit by repeal of this covenant.”

That would be my answer to your question.

Q. You left out the first sentence, “The conciliatory tone of your May 9th response to my letter of May 7th, *New York Times*, is welcome.”

Do you recall your testimony yesterday in which you indicated on page 91 of the transcript—the Court had asked you was the investment community equally shocked, the equal being to Governor Byrne’s—was the investment community equally shocked [when] the then Governor of New York—this is on page 90, line 24, “advocated repeal and the New York Legislature actually voted the repeal?”

Your answer, “I think to say ‘equal shock’ would be unfair, your Honor. Let me see if I could explain it. When Rockefeller signed the repeal in 1972, he issued a statement which in its terms was very conciliatory. It had words, ‘If it is, like I should be conferring with the Governor of New Jersey to try to work out something here that would not impair the credit of the Port [257] Authority.’ It was a less final thing.” A. And your question is?

Q. Well, the conciliatory Rockefeller message is regarded as quite important; the conciliatory Ronan message is regarded as worthless. Is that correct? A. The concili-

Excerpts from Testimony of John F. Thompson

atory Rockefeller message was issued along the way while the process of repeal was uncompleted. It had to be adopted by New Jersey. It indicated that steps might be taken to do something modifying—more moderate than the repeal.

Conciliatory, there is a word that looks forward to constructive action. Conciliatory here is simply that the tone of his letter which happened after the repeal had been finally concluded or was about to be.

Q. In other words, your answer on page 91 says, "It had words in it like, 'I shall be conferring with the Governor of New Jersey to try to work out something here that will not impair the credit of the Port Authority.'"

When you said that, do you mean that you thought Governor Rockefeller was going to try to induce Governor Cahill not to go along with the repeal? [258] A. No, I thought he was going to talk to Governor Cahill probably sensing that Governor Cahill was opposed to repeal and try to work something out, perhaps along the line of what eventuated, which was the repeal of the covenant applying only to future issues.

Q. And that is why he signed repeal of a wholly different statute in New York? A. Well, he had other reasons. His statement is much longer than that, to be sure.

Q. But he did sign the repeal? A. He did sign the repeal, yes.

Q. You were not troubled after that because he was conciliatory after signing? A. I would never say that. I hoped—I was not troubled by it.

Q. It was less shocking? A. I think I tried to explain the matter as I said yesterday, of shock. I thought I made the point. The shock came from the time that this was an action by a Governor of New Jersey whereas on the

Excerpts from Testimony of John F. Thompson

previous occasion, the then Governor of New Jersey had been the bulwark who stopped repeal.

That was the basis of my use of the word "shocked."

[259] Q. Let's see then, you were shocked, tell me if I correctly capture of essence of your testimony: You were less shocked by the Rockefeller signing of the repeal because he wrote a conciliatory statement upon approving repeal and because the process of repeal was not yet concluded, the New Jersey Legislation having not yet been enacted, indeed never been enacted. That is correct.

All right. Now, we are in 1974, Mr. Ronan has written a conciliatory letter and the Governor of New York has not yet approved repeal, but you and your colleagues in the bond market, I think it is fair to say, are behaving in a way that regards him open to persuasion on veto.

Why was not this Ronan conciliatory letter important?
A. Because, conciliatory there applied only to tone. It did not apply to anything that suggested Commissioner Ronan would change his position.

Commissioner Ronan had taken a position in favor of repeal.

Q. Governor Rockefeller had not? A. Governor Rockefeller had taken a position favorable to repeal. Governor Wilson had not yet, although it was beginning to be widely believed, **[260]** would sign the repeal and we were doing everything we could to dissuade him.

Q. I would like to return to that same paragraph, the first sentence says—

The Court: This is S-5?

Mr. Sovern: Yes.

The Court: Do you have S-5?

The Witness: Yes.

Excerpts from Testimony of John F. Thompson

Q. This is Mr. Ronan:

“I also stressed the lifting of the statutory covenant, *per se*, does not mean that bondholders’ security would be eroded.”

Do you agree with that statement? A. No, sir.

Q. The next sentence says, “The two states have not yet determined and the Commissioners have not acted to impose deficit burdens on the Port in the rail or other fields which could impair revenue coverage or the reserve requirements established in our indentures.” A. They have not acted because they could not under the covenant. The covenant was then still in force.

Q. Could they act now? A. Your Honor, that calls for a legal opinion, [261] I am afraid.

The Court: No, it is based upon your understanding of the consolidated bond resolution reserve requirements, the statutory reserve requirements, all of which I assume were matters of your personal knowledge prior to the enactment of the covenant because you were dealing with these bonds before the covenant was ever enacted.

The Witness: I think if they acted now to impose deficit funds on the Port Authority in the rail or other fields which could impair revenue coverage—

The Court: Or reserve requirements?

The Witness: —or reserve requirements, there would be an additional lawsuit filed on the same ground that are present in this suit. This would be my understanding.

The Court: But there were still protections which the bondholders had without the covenant if the Commissioners of the Port Authority acted in such a manner [262] as to impair the revenue coverage or

Excerpts from Testimony of John F. Thompson

the reserve requirements pursuant to which the bonds had been issued?

Mr. Landis. I do not think that was the context of the question. My recollection was the question was asked in the context of repeal and this covenant.

The Court: I am saying—

Mr. Landis: After it had been repealed, whether now they could do it? The witness answered he does not know what the legal situation is.

The Court: Mr. Landis, please, if that is an objection, it is overruled.

Now, the covenant has been repealed, presumably the bondholders are back to where they were prior to the enactment of the covenant in 1962.

You are dealing with those bonds in the period prior to the enactment of the covenant and I assume you were familiar with what the protections were that the bondholders had before the enactment of the covenant and I think the question was could the Commissioners have, or do you [263] agree with the statement of Mr. Ronan that, in effect, the Commissioners could not impair the reserve requirements or the revenue coverage under the statutes and resolutions in effect without the covenant if they would do so today or attempted to do so?

The Witness: As I read Mr. Ronan's statement, your Honor, it is to the effect that the Commissioners had not acted and I think the question directed to me was whether I agreed with Mr. Ronan's statement.

[264] Mr. Sovern: There was another question following it.

The Court: There was another question which followed it. Could they?

Excerpts from Testimony of John F. Thompson

Q. You said they could not because of the covenant, and I asked you whether they could today? A. My answer was that they could try, but I think that they would be brought into Court under the covenant.

The Court: Under the covenant?

The Witness: Yes.

The Court: Which covenant are you referring to?

The Witness: The 1962 covenant forbidding taking on a deficit rail mass transit on the grounds that repeal would impair the constitutional rights of the bondholders.

The Court: Let's forget about mass transit for the moment. Let's say the Port Authority decided it was going to build another World Trade Center, maybe the Moon Center, and they projected a cost of one billion dollars and knowing what the market conditions are today, and certainly there is nothing in the covenant which precluded them from undertaking such a venture, is that correct?

【265】 The Witness: Nothing in the Section 7.

The Court: So all the bondholders would have as protection would be the Consolidated Bond Resolution requirements, the Certification, the 1.3 test and the general refunding bond statutory reserve requirements.

Mr. Meyner: I think you omitted something your Honor, must have State legislation of both States.

The Court: Yes, we are assuming the States have concurred in permitting them to go ahead with the venture; and let's assume that the bondholders decided that it would impair the credit of the Port Authority and impair the reserve requirements and the revenue coverage requirements; wouldn't the

Excerpts from Testimony of John F. Thompson

bondholders be able to go into Court to enjoin such action by the Commissioners and the State?

The Witness: I am not sure whether the hypothesis includes the Commissioners having adopted this.

The Court: Yes, that the Commissioners have adopted this.

The Witness: And they have certified it?

The Court: They made the certification.

[266] The Witness: Under Section 7 and whatever certification they need to do on the 1.3 test.

The Court: Yes.

The Witness: Well, the question that would arise I believe under the 1.3 test, and it might arise under the very extreme example which you have given—that is a lot of money.

The Court: If they built one, they can build another one.

The Witness: Under the very extreme example you have given the 1.3 question might arise, and it might be that the Port Authority would be unable to get bond Counsel to give an opinion that bonds could be legally issued at that time.

The Court: Well, that was not the question. Wouldn't the bondholders be able to go into court to challenge the certifications made by the Commissioners as to the various requirements that must be met before they could proceed with such a project?

Mr. Landis: With all due respect, your Honor, I object to the form of the question. I think it asks the witness whether some people can bring a suit. We all know that anybody can bring a suit at any time. If it asks him whether **[267]** the suit will be successful or not, I think it clearly asks for a legal opinion.

Excerpts from Testimony of John F. Thompson

The Court: I want to try to find out what his understanding is of the protections which the bondholders had under the terms of the covenant and the prior statutes.

The Witness: Under the—

The Court: Under the Consolidated Bond resolution—

The Witness: Section 7.

The Court: That is right, and the prior statutes.

The Witness: Your Honor, I don't believe a legal question could be raised under Section 7. If the Commissioners certify that the project will not substantially or whatever—

The Court: Impair the credit.

The Witness: —impair the credit of the Authority, I doubt—here again, I am afraid I am expressing a legal opinion—I doubt that that could be contested. I would presume that their finding would be final in that respect.

As far as the 1.3 is concerned, the answer I gave you is the way I think a legal problem would arise. And I am very serious about that [268] because one of the most important facts at issue regarding the issuance of municipal bonds of any kind is getting a proper legal opinion from a recognized firm that these bonds can be legally issued. And if they could not indeed comply with the 1.3 coverage test, then as I understand the consolidated bond resolution the new bonds would not be legally issued. And I don't believe—if I may go further, I don't believe that existing bondholders would have any other way to get at it that I know of.

The Court: Is it your understanding that bondholders could never go into Court with respect to

Excerpts from Testimony of John F. Thompson

any undertaking of the Port Authority, to challenge the validity of the statistics or figures relied upon by the Commissioners as the basis for the issuance of bonds for new facilities?

The Witness: It seems to me sir that the Section 7 findings by the Commissioners would be final. Again I am not a lawyer.

The Court: No.

The Witness: I am not sure of my answers here. And I think the legal problem on the other arises in a different manner. It might be then that—

【269】 The Court: Let's say the Commissioners got a set of figures from a consultant. All right?

The Witness: That's right.

The Court: And that is before them when they act to approve the project and the issuance of the bonds; and the Bond Counsel then issues his opinion that the bonds are legal issues. All I am asking you is what your understanding is of the 1.3 test. Let's bring it down to that.

The Witness: The legal opinion has been issued?

The Court: Yes, the legal opinion has been issued based upon the statistics and the projections which the Commissioners have in front of them when they approve the issue; is it your understanding that the bondholders could never in any forum challenge the validity of the projections which were made.

The Witness: Yes sir, that is my understanding.

The Court: Then let me go to the next step. If that is the case, now supposing the Commissioners have before them a mass transit project with a set of figures prepared by Joe Doaks, whom they recognize that the investment 【270】 community would never

Excerpts from Testimony of John F. Thompson

accept as a qualified statistician, and they approve a mass transit facility and they certify that it is self-sustaining—all right?

The Witness: Yes.

The Court: —and again they made the certification; are you saying that the bondholders—now we are operating within the covenant—are precluded from coming into Court and challenging the validity of the statistics which formed the basis for the Port Authority's actions?

Mr. Landis: For the record, your Honor, I know what your feeling is, but I wanted to note that I would object to this line of questioning. This clearly is asking the witness for a legal opinion.

The Court: No. I want to know what his understanding of the covenant is now.

Mr. Landis: I think in the context of the way the question is asked, it clearly asks for a legal opinion. I do not press the point because I know what your position is.

【271】 The Witness: Your Honor, on that point I'm not sure at this point. I would think there would be more chance of a contest there, bringing a suit there than there would be on any of the others.

The Court: Well, we are dealing with objective facts now.

The Witness: Yes, yes, that's true.

The Court: There is the 1.3 test, the mathematical test that must be applied based upon the criteria which are set forth in the resolution, and in the covenant you are dealing with a certification that the project is going to be self-supporting. Well, again, we are dealing with a mathematical test, the pro-

Excerpts from Testimony of John F. Thompson

jections which are made, do they show that the project will be self-supporting.

Mr. Landis: Your Honor, do I understand that you are saying that the tests are the same, the 1.3—

The Court: No, I'm saying they are both objective tests.

Mr. Landis: But they are entirely [272] different tests. I think the record indicates that already.

The Court: They are different tests, I understand, but both are based upon projections of revenues.

Mr. Landis: Now, the 1.3—

The Court: And costs.

Mr. Landis: Now, the 1.3 test is historical revenues, in the first instance is historical revenues.

The Witness: Your Honor, I feel that this is a legal problem, and I certainly don't have a conclusive opinion on it.

The Court: Okay. What I am leading up to is this: Doesn't the investment community with respect to the acceptance of an Authority's bonds as proper investments really look to the integrity of the management of the particular Authority? And to the past performance record of the issuing Authority, the expertise of its staff, and so forth, as much as they do to a specific covenant or undertaking? Isn't that just as equally as important, if not [273] even more important?

The Witness: It certainly is very important and an exact equation, I would—

The Court: You may not be able to weigh them one against the other.

The Witness: But both are very important, and certainly the record of management, and I might say

Excerpts from Testimony of John F. Thompson

that the record of management can become a very broad thing in a bi-state agency of this sort, including the appointive powers of the Commissioners, the influence of the governors and the Legislatures of the two states, all these things become part of the way of the record of management.

The Court: Yes, without any question.
All right, I'm sorry.

By Mr. Sovern:

Q. To be sure I caught the full import of your response to the series of the Judge's questions, is it accurate to say that of the protective covenants we have been talking about, to wit, Section 7 certification and the 1.3 tests and the mass transit covenant, of those three, the [274] mass transit covenant is the only one you feel confident entitles the bondholders to suit?

Mr. Landis: Your Honor, I have an objection.
I don't think that was his testimony at all.

Mr. Sovern: If it isn't he can say so.
Excuse me, your Honor.

A. Feel confident is too strong.

The Court: Yes.

A. (Continuing) It is the only one where I think there is some possibility. Not being a lawyer and not being sure there is, I think, some possibility of bondholder action.

The Court: A better possibility than with respect to the others?

The Witness: A better possibility than with respect to the others.

Excerpts from Testimony of John F. Thompson

By Mr. Sovern:

Q. And that would be a major reason for attaching importance to it, is that correct? A. A major reason?

Q. For attaching high importance to it. A. Yes, that would be an important reason.

【275】 Q. Now, I'd like to come back—

The Court: Well, I take it that the reason for that is that if the covenant as such is not enforceable in a court, aside from the action of the marketplace, then it is really meaningless, it is worthless?

The Witness: Yes, it was certainly sold to investors as a legally enforceable contract.

Q. Now, I come back to my question with respect to S-5, the paragraph under discussion, the second sentence: The two states have not determined, and the two Commissioners have not acted, et cetera, and I asked you whether they could, and you said they could not so act because of the covenant. The covenant has now been repealed. And I ask you whether they could so act today? A. I think that gets into this question of—I think they could not—if the covenant is a legally enforceable matter—***

Q. I take it you are assuming that if such actions were attempted, the plaintiffs here would ask [Judge] Gelman to enjoin the Port Authority from doing that under the covenant? 【276】 A. Yes, I'm fully familiar with all the legal—T 253-25 to 276-2.

* * *

Q. You will see that Mr. Landis asked, "Now, let us assume at this point in time, a 100 million dollar bond issue, the purposing being to finance an investment of the Port Authority in mass transit that would not be self-supporting and a sale of a competitive bidding, what is your opinion as to what those bids would be," and that you thought that the issue would be more costly. T 276-10 to 276-17.

Excerpts from Testimony of John F. Thompson

* * *

[277] The Witness: Yes, yes. I think the situation you hypothecate there would be in the market the equivalent of the situation in which the Port Authority announced today on a 100 million dollar issue two weeks from now for whatever purpose, and this is a question that I have reviewed with our market people to considerable effect, and the general opinion that I get is that in this market it would cost the **[278]** Port Authority an interest cost of some 8½ percent. The quotations currently on outstanding Port Authority bonds indicate yields, interest rates to the investor of something like 6.50, 6.80. This indicates to me that such an issue coming to market would immediately drop the secondary market for all other Port issues. And we calculated it by some 6 to 10 points. T 277-17 to 278-11.

* * *

[279] The Court: And Mr. Sovern has said, as I understand in giving the answer which you ultimately did, did you assume that the bondholders were in court challenging the validity of the repeal of the covenant?

Mr. Landis: I don't see any point in asking him if he assumed something that we all know is true.

The Court: Well, let him answer.

The Witness: I understood the question states what is your opinion as to what those bids would be. That assumes that the sale of the issue would go forward to the date of receiving bids without **[280]** court action. The question of court action did not enter my mind in answering that question.

Mr. Sovern: Now, your Honor, Mr. Landis has just said we are all assuming the court action.

Excerpts from Testimony of John F. Thompson

The Court: No, no, no, the witness has said—you asked him—

Mr. Sovern: Yes.

The Court: You asked him specifically whether he assumed when he gave his answer that there was a bondholder action challenging the validity of repeal.

And he said he did not.

Mr. Sovern: He did not assume that.

The Witness: No.

Mr. Landis: So your Honor, that is not my understanding of his question. What he said is he did not assume a decision.

The Witness: I did not —

The Court: All right. He did not assume a decision.

The Witness: I did not assume [281] either way. I assumed that I was asked where such an issue would sell, what bids it would receive, and I tried to simply answer that question without that—at that time, we were talking markets and not covenant. T 279-12 to 281-6.

* * *

[284] Q. The next sentence of that paragraph under consideration is, “The Board of Commissioners is committed to preserve the credit of the Port Authority which is vital to the present and any future undertaking of the agency.” Do you agree with that statement? A. I certainly agree with it as what would be their statement of preference. That obviously is what they would say, and this was one of the things I was responding to in my reply to Commissioner Ronan.

Q. Do you agree with the final sentence of the paragraph?

Excerpts from Testimony of John F. Thompson

The Court: I thought that was the final sentence.

Mr. Landis: It is.

Mr. Sovern: No, the final sentence is, "Governor Byrne—"

The Witness: Governor Byrne—I wasn't there. I don't recall seeing his statement. I presume he said that. This is what I would say if I were in his place doing what he did.

Q. Would you regard it as conciliatory? **[285]** A. Oh, it's in a sense, yes, but I would also regard it as saying, "We're taking a drastic action here, but hold still, it won't really hurt."

Q. How does that differ from what Governor Rockefeller did? A. I think Governor Rockefeller spelled out the possibility of compromise on the issue much more fully. T 284-1 to 285-9.

* * *

[287] Q. Now, it is suggested in the brief of Counsel for the Plaintiff that one of the virtues of the covenant is that it would prevent the States from foisting a white elephant upon the Port Authority—that is to say, that if no bonds were issued, the Section 7 and 1.3 tests would not come into play and that therefore there is a risk that they just might make a gift here, and I don't attribute all the details of it, but in your opinion, if the covenant's repeal is upheld, do you understand that the States would then be free to avoid the protections of the 1.3 tests and the Section 7 certification by simply giving the Port Authority some deficit generating facility? T 287-5 to 287-16.

* * *

[288] The Witness: I think there is a very real possibility of this. It is again, a legal question in considerable part.

Excerpts from Testimony of John F. Thompson

Q. And so that is one of the safeguards afforded in your opinion by the covenant that is not otherwise vouchsafed to the bondholders? A. I would think those circumstances would—

Q. Are you familiar with Section 7 of the Resolution establishing each of the series of bonds? A. Yes, I think we went over that yesterday. T 288-15 to 288-24.

* * *

[293] Q. May the General Reserve Fund be used to pay the operating expenses for a facility for which bonds have not been issued? A. No, the General Reserve Fund may be used to pay for all operating expenses for a facility on which bonds—

Q. May the Consolidated Bond Reserve Fund be used to pay the operating expenses of a facility for which bonds have not been issued? A. I would think not, no.

The Court: You have answered the question.

Q. Now, you also testified yesterday that you regard the Section 6 covenant, the mass transit covenant as more exact, I believe, that was your phrase, but if it was **[294]** not, please correct me, than the 1.3 [and] Section 7 reassurances.

Is that your testimony? A. Yes, I used the word “precise” rather than exact, I think. I guess they are synonyms.

Q. At that time, the Court asked you about the definition of self-supporting. Do you recall that? A. Yes, you are now referring to the Section 6 covenant.

[295] Q. And you regard that as a precise definition? A. Precise in the sense that it must be referring solely to the expectations of this one facility.

Q. As you read that, could the states of New York and New Jersey agree that they would give all of their mass

Excerpts from Testimony of John F. Thompson

transit enterprises to the Port Authority with a pledge of tax support for those facilities for the ensuing ten years and then get the necessary certification that the facility was self-supporting? A. There is other language in here that deals, I believe, with recurring debt from some other sources. T 293-12 to 295-14.

* * *

【296】 Q. You do not see anything in this covenant that would prevent the kind of public action 【297】 that I have indicated in my question earlier? A. Which the states would pick up for ten years and then run?

Q. And then Whammo. That's right. They don't say what they will do.

* * *

The Court: They don't say.

* * *

Q. They simply make a ten-year commitment. A. It looks as though it might technically comply.

Q. Why do you say technically comply? It would be possible, would it not, as far as you can tell? A. As far as I can tell at the moment. I would want to study the matter a good deal further before giving an informed opinion on it.

Q. If that is a permissible reading of the covenant, is that a subject for bondholder concern? A. The situation is very hypothetical. It would require all the bodies to be in on the deal, as it were. I think it is too hypothetical for me to pass judgment on it at this point.

The Court: Have you ever given any consideration to that possibility?

【298】 The Witness: No. I think that whatever consideration has been given to that possibility has

Excerpts from Testimony of John F. Thompson

been on the basis of the states would act in a matter like that in good faith; having started it, it is very hard to stop a subsidy once you have started it.

Q. The basic assurance here is that the states and the Authority would behave in a responsible way. A. No, the basic assurance is that it would be for ten years self-supporting.

Q. And the bondholders are not concerned with the eleventh year? A. I think that gets into a sort of never-never land. It is pretty theoretical. I would not want to answer that, yes or no.

Q. I think I must press you, Mr. Thompson. As I read the covenant, it seems to me to permit exactly what I have suggested to you. You do not read it contrary. You have testified that you give a great deal of advice based on the covenant, and I ask you whether that advice is based on the assumption that this is not going to happen and that it is not going to happen because the basic [299] premise of bondholder reliance is that neither the states nor the Port Authority are going to engage in suicidal pacts and are going to conduct their affairs in a way that will enable them to continue as a viable entity. A. Which means in this case that they would have put their name on the line for a pledge of revenues, the estimates of revenues and debt service to satisfy the self-supporting requirements.

Q. I am assuming that those estimates are impeccable, not only in the sense that everybody behaved with honor at the point at which he made them out, but that unlike all other estimates they prove to be accurate and that the states did indeed keep that as a self-supporting facility for the entire decade. No one has made any promises for the eleventh year. It would not be dishonorable by any measure of good faith, would it, to refuse to renew a commit-

Excerpts from Testimony of John F. Thompson

ment when you made no commitment that you would renew the commitment? A. I did not understand you to say that the states made a commitment limited to ten years.

The Court: That was the assumption.

The Witness: They made a commitment to do it is what I understood you to [300] say.

Q. For ten years and no longer. A. Then I think you would have some trouble in the market.

Q. You think that would cause the Port Authority to have difficulty marketing its bonds now or in the eleventh year? T 296-24 to 300-8.

* * *

[304] The Court: Make that assumption, that both states [305] have adopted a referendum which enables the Legislature to pledge for a ten-year period their revenues to pay the deficits. All right?

The Witness: Yes.

The Court: Now go on with your question.

Q. Would anyone who bought bonds with such a covenant in them—and by such a covenant, I mean the 1962 covenant—be relying on the covenant or on other protections for his security? A. The question assumes that someone would buy bonds. And if they were ten-year bonds, somebody would.

Q. I ask you to assume that they are Port Authority bonds marketed in the period between 1962 and 1973 is the last—1973. The 1962 covenant was in the 20th and to the 39th series. You have testified at great length and in great detail about relying on that covenant. You may have observed that we think that perhaps people relied on something else.

Excerpts from Testimony of John F. Thompson

And I am asking you now whether if that covenant permits that kind of behavior people were relying on that covenant or the other protections **[306]** which include the integrity of the operation both of the Port Authority itself and of the governments of the two states. A. I simply do not think that the Port Authority would go along with the projection of such a situation or that the states would do such a foolish thing as to vote a commitment for a half or a third of the life of a bond if they were doing something. You know, covenants and laws operate in a real world and deal with real situations; and this is not one.

Q. You are not concerned about the states of New York and New Jersey dumping their mass transit on the Port Authority? A. Now you are asking me a different question. I am not concerned about the hypothetical situation that you raised.

Q. What aspect of my hypothetical situation do you regard as unreal—academic, as you prefer to call them? A. I regard the notion that any responsible person in the Governor's offices or the Legislatures or the Port Authority staff or Commissioners would put together a device involving a ten-year covenant of support or something in order to sell 30-year bonds.

[307] Q. If that were the only way that you could both finance mass transit, as you put it, to meet the problems of energy and urban matters, if that were the only way or adjudged to be the best way to meet the problems with mass transit, why wouldn't they do it? What is there magical about a ten-year commitment or a thirty-year commitment if there is nothing wrong with it? A. I would like you to go sometime through the procedure of assessing a bond issue and looking down the road where the revenue comes from. Your Honor, this is just so unreal that it is silly. T 304-25 to 307-13.

Excerpts from Testimony of John F. Thompson

* * *

Q. Isn't the reason that you are not concerned about this possibility that you have confidence [that] the states and the Port Authority, all 3 [308] as you noted, will not get together to adopt a plan that would obviously destroy the fiscal integrity of the Port Authority? A. I certainly think they won't get together to do anything as foolish as you have suggested, if that answers your question. T 307-23 to 308-6.

* * *

[309] Q. I'd like to come back to the covenant for just a brief while longer.

Mr. Thompson, in stating that you relied on the protections afforded by the 1962 covenant did you rely on the pledge that neither the States nor the Port Authority will use any of the Port Authority's revenues for mass transit except insofar as the facility is self-supporting or its deficits fall in conjunction with those of the Hudson and Manhattan within the 1/10th of the General Reserve Fund limitation? Did you rely on that? A. Yes, certainly.

Q. Did you rely on anything else in the covenant? A. In the covenant?

The Court: Within the covenant?

Mr. Sovern: Yes.

Q. Was there anything else of importance in the covenant to you?

The Court: I assume when you say "covenant" you mean the legislation in 1962.

Mr. Sovern: To be precise Subsection B. As I say I'm excluding now for purposes of [310] simplification the first part which is not [in] issue. A. Subsection A has not been repealed.

Excerpts from Testimony of John F. Thompson

Q. Exactly. A. I think that summarizes the covenant, what we relied on.

Q. Yes. I'd like to come back to something else we talked about a while ago. Did I understand you to testify earlier this morning that if the Port Authority were given a white elephant that all of the revenues of the Port Authority operation, operating revenue would be pooled in order to support that before debt service would be paid? A. That's the way I understand it. It's under the net revenues that are placed the debt. T 309-4 to 310-13.

* * *

[312] The Court: If no Consolidated Bond has ever been issued for the establishment, acquisition, effectuation, construction, rehabilitation or improvement of a white elephant, can the deficits of the white elephant be a charge upon the net revenue of these facilities that are enumerated in the preceding paragraph prior to the payment of the debt service requirement and all the rest?

Mr. Sovern: Thank you, your Honor.

The Witness: I don't see anything here which prevents it. This is a pledge of revenues to Consolidated Bonds. It tells where Consolidated Bonds get their revenues. It doesn't say how the Port Authority shall operate its projects or keep its accounts otherwise.

Now, I think you said yesterday that **[313]** Newark Airport is operating at a deficit. Its about the only operating expenses there come from the other airports.

Q. So one of the reasons for your believing that the Section 6 covenant is important is that you believe that the

Excerpts from Testimony of John F. Thompson

pledged revenues of all of the other Port facilities may be diverted to carry their losses even before that debt service requirements are met? A. No, sir, I do not believe that the pledged revenues may be diverted because the pledged revenues are net revenues.

【314】 Q. All right. Thank you.

You believe then that in determining the net revenues of the Port Authority for the purposes of the Consolidated Bond resolution, that the Port Authority is entitled to pool both facilities for which Consolidated Bonds had been issued and other facilities for which no bonds had been issued? A. So far as I know, their accounting and their method of operating pools their revenues from all their facilities and there must be some for which Consolidated Bonds were not issued.

Q. I gather that it is because you believe that such pooling is possible that you regard the covenant as an especially important protection? T 312-10 to 314-13.

* * *

【315】 A. No, I won't have those words put in my mouth. I believe that this is one situation that might arise that makes the covenant important.

Q. Thank you.

At page 14 of Plaintiff's trial brief, it is said and I quote, "While Plaintiff concedes that in rare instances a State's contract can be constitutionally abrogated by a proper exercise of the State's never abdicated police powers," and it goes on, what I want to ask you is whether you are aware of the proposition contained in the language which I just read to you? T 315-2 to 315-12.

* * *

The Witness: Your Honor, a day or two ago, I read a brief prepared by someone on this subject

Excerpts from Testimony of John F. Thompson

which cited some cases pro and con and came to the conclusion that this case was in the class of those where the police power would not [316] prevail.

The Court: That is not the question which he asked you.

The Witness: I am aware.

The Court: You are aware?

The Witness: I am aware that there have been these cases and a number have been adjudicated.

Q. When did you first become aware of them? A. I think in a general way I have been aware of that sort of thing since graduate school days, probably. T 315-21 to 316-10.

* * *

[317] Q. Did you know anything about inter-State compacts, the need for Congressional consent thereto? A. Since a suit was raised in this regard, I have become aware of this contention. I think I testified yesterday that it was not a contention which I took seriously, namely that any covenant must be approved by Congress because [318] there have been a number of past covenants, and I cited one yesterday, regarding the distance within which the States would not build any competing bridge and to my knowledge, that was not approved by Congress, nor was it considered necessary, and looking at it in the practical way, that, your Honor has suggested I do, this seemed to support the validity and the enforceability of the covenant that we are here concerned with.

Q. So your testimony is that you first learned that there might even be an issue as to the need for Congressional consent for the '62 covenant sometime after the Plaintiff instituted this action against the State of New Jersey? A. No, this other suit that the young man was here on.

Excerpts from Testimony of John F. Thompson

The Court: He means the *Gaby* case.

Q. The *Gaby* case? A. And its predecessor in New York State.

The Court: There was a prior New York litigation.

Mr. Sovern: The State will now mark for identification a story from the Daily Bond Buyer, Monday, June 24, 1974. It will be S-7. It came from the files, here is a copy for the witness.

I call your attention to column two. The second full paragraph.

[319] Did you see this story at the time it was published?

A. Yes.

Q. And you noticed that the Daily Bond Buyer says, "Repudiations of Solemn Pledges are Not Unique."

Do you agree with that? A. Well, I think it is in relation to what follows.

The Court: No, he is asking you whether you agree with that statement, not what the writer intended.

The Witness: Well, there have been other repudiations of solemn pledges granted. Some of them have been taken to Court and beaten down too.

Q. All right. A. This article, by the way, is a sort of editorial that John Winders does every week. To say that this is what the Bond Buyer says is not quite descriptive of the type of thing it is.

Q. Would you give the witness P-11, please?

P-11 is Moody Bond Survey, June 11, 1974.

Excerpts from Testimony of John F. Thompson

I call your attention to the final paragraph in column one.

In particular, the second sentence, "Both States have the right to alter corporate charter rights under constitutional provisions enacted following the famous case [320] of the *Trustees of Dartmouth College against Woodward*."

Did you see that assertion when it was published? A. Yes, and I did not fully-understand it.

The Court: I concur. T 317-20 to 320-4.

* * *

[322] Q. Mr. Thompson, does the institution of a lawsuit affect the value of a bond? A. Under what circumstances?

Q. Have you ever bought any bonds that were involved in a law suit? A. Where the validity of the bonds was involved in a lawsuit.

Q. I will start with that. A. If it was a new issue, my good friends in the bond legal firms would give an opinion on it, so I would not [323] be confronted with the question.

Q. And I am not referring to this case now. Have you ever been in a situation where you had to make a decision as to whether to participate in an offering or advise a client to purchase bonds that were involved in litigation in any way? A. This is a matter of such varied degree—

The Court: He is saying any form of litigation, for openers.

The Witness: We were involved not too long ago in an attempt to revive part of an issue down in Texas where there was some litigation started about the ownership of the property to be taken over for a generating plant.

Relying on the attorneys in Texas, we felt that the litigation was really part of the bargaining process over the price of the land, did not involve the

Excerpts from Testimony of John F. Thompson

validity of the bonds and we were willing to try to proceed. We were unsuccessful because our partners did not go along.

I know that is not a whole answer to your question, but your question covers so many different possible situations. T 322-16 to 323-23.

* * *

[325] Mr. Sovern: I'd like to ask the witness next about P-11. Will you give him a copy, please?

The Court: Yes. P-11. You already referred to that.

Mr. Sovern: I am referring to a different entry now, your Honor, the same paragraph, however.

By Mr. Sovern:

Q. At this time the final sentence at the end of column one, what is suggested is a considerable period of uncertainty and, perhaps, time lies ahead of these matters are litigated.

Uncertainty is not the bondholder's friend. Do you agree with that? A. Yes, certainly.

Q. And would that apply to this case? A. I think that's what he's talking about, isn't it?

Q. And you agree with the assertion with respect to this case? A. That a long period of uncertainty lies ahead, yes.

Q. And that it is not a bondholder's friend? **[326]** A. Uncertainty is not a bondholder's friend.

Q. And would presumably affect—strike presumably. And would affect the price of the bonds in the secondary market? A. Yes, it would affect them somewhat. T 325-1 to 326-5.

* * *

Excerpts from Testimony of John F. Thompson

By Mr. Sovern:

Q. I would like next to call the witness's attention to P-10, news release, Securities Industry Association, dated 5/15/74? A. Yes.

Q. I call your attention to the final sentence of the release. You think bond prices are affected by assertions that say "measures such as the proposed repeal are destructive of investor confidence and thus of public credit; the most certain [327] effect is to impair the ability to finance future public projects"? A. What is your question about it?

The Court: Do you agree with that statement?
It is the last—

Mr. Sovern: Well, I am sorry.

Q. It is, do you think that statement would affect the price of Port bonds?

The Court: Oh.

A. Well, this statement was, I believe, one of several dealing with the Governor of New York when some of us were attempting to affect his decision.

The Court: That doesn't answer his question.

The Witness: I don't think it had any market impact, your Honor.

Q. Because it was a private document given only to the Governor? A. It may well have been published somewhere.

Q. Look at the top of the page on the left-hand side, it says "news release" on one-half of the page and on the other side its says, "for immediate release." It was a press

Excerpts from Testimony of John F. Thompson

release, wasn't it? A. I don't remember that it was very widely [328] published, but it was a press release. You are quite right.

Q. Very good. Now that you know it was a press release, do you think it affected the price of the bonds? A. No, no, because what it says in that last sentence was the obvious to any investor.

Q. I'd like the witness to look next at P-12, that is, an article from Barron's dated 6/3/74. Do you have that article before you, Mr. Thompson? A. May I speak off the record.

(Discussion off the record.)

Q. Do you recognize that article? A. Yes, I think so.

Q. Did you have anything to do with its preparation? A. I think Miss or Mrs. Pacey came in for an interview about it at one time. I've forgotten whether she agreed not to quote me directly, or, perhaps you know. You read it more recently.

Q. I have a very bad copy. As nearly as I can tell she did not quote you. But how would you describe the circumstances of her interviewing you? [329] A. Well, she called up and said she wanted to do an article on this subject and someone had given her my name as somebody who might inform her on some of the considerations involved. At that time I was able to grant her an interview.

Q. Do you think this article had any effect on the price of Port bonds? A. The date isn't indicated and I have forgotten.

Q. This is the way it was produced for us. Oh, it's June 3, 1974? A. I wouldn't have thought of it as something having any effect on the market, no.

Q. Nothing in it would give bondholders concern? A. Well, it mentions the repeal of the covenant, but that was

Excerpts from Testimony of John F. Thompson

covered in other news items that people already knew. I don't think this was the first information they had about repeal of the covenant. T 326-17 to 329-20.

* * *

[330] Q. There is nothing else in that article that would be troublesome to bondholders? A. Well, the overall question it raises is about moral obligations certainly would confirm something that's troublesome to bondholders, yes. T 330-3 to 330-7.

* * *

[331] Mr. Sovern: S-9 is a *New York Times* story headed, "Port Authority Abandons Mass Transit Opposition." T 331-2 to 331-4.

* * *

Mr. Sovern: There is no dateline on that story, your Honor, but from its content it plainly was on May 1, the day following repeal in New Jersey and the holding of a press conference. T 331-11 to 331-15.

* * *

[332] Q. I call your attention to the bottom of the column where it is said that the: United States Trust Company contended that repealing the covenant would jeopardize the agency's—meaning the Port Authority—the agency's financial capacity to back its bonds and impair its credit rating for future issues.

Do you think that would affect the price of bonds? A. That the United States Trust Company suit said that, no.

Q. I did not ask you that the United States Trust Company suit said that. I asked if the fact that they said this would affect the price of the bonds. A. No. I think they were just stating a truism in the investment world.

Excerpts from Testimony of John F. Thompson

Q. You think a public announcement by the largest holder of Port Authority bonds whose decision to dump on the market, you said, to dump any large number of bonds, you said would drive prices way down—the announcement by that largest holder and the trustee both, that the agency's financial capacity was being jeopardized and its credit was being impaired would affect the price of the bonds? T 332-4 to 332-24.

* * *

[333] The Court: Would the making of the statement itself and its being reported in the press as reflected in S-9 affect the price of the bonds in your judgment?

A. Not considering the fact that the event had already been fully reported, the event of repeal.

Q. So that the price was as low as it was going to go?

A. I am not going to try to predict what the price would be that day or that week. T 333-7 to 333-15.

* * *

Q. You say that the Trust Company's assertions about the impaired capacity of the Port Authority had no effect on the price of Port bonds in the secondary market, because people already knew about the repeal of the covenant? A. Yes.

Q. Is that your testimony? A. Yes, I will go with that.

Q. And so the assertions of assessments **[334]** of a security by its largest holder do not affect the secondary marketprice of that security? A. Not when they are statements of things that are generally and fully recognized in the investment community.

Q. Have you ever bought a bond about which it was said—a bond or any other security about which it was said

Excerpts from Testimony of John F. Thompson

that its financial capacity was jeopardized and its credit rating impaired?

The court: By whom?

Mr. Sovern: By the largest holder of that security.

The Court: If it was, you know—

Q. If the largest holder of the security made those assertions would you go out and buy the bond? A. It would depend entirely on my own independent judgment of the situation.

Q. Have you ever used your independent judgment to buy such a bond? A. I have used my independent judgment to buy bonds when others thought that there were difficulties and would not do so, yes. T 333-18 to 334-21.

* * *

[335] Q. Yesterday you testified about the Port Authority's facilities and the breaking of a common thread with the acquisition of the H & M. How was that common thread broken? A. The facilities acquired or constructed up to then had all been expected eventually to become self-supporting. H & M was not.

Q. Self-supporting at what point in the future? **[336]**
A. Within a reasonable time, within three, four, or five years.

Q. Were those expectations fulfilled, to your knowledge? A. In what cases?

Q. I am asking you about your understanding about the Port Authority's experience with deficit facilities. Do you know of any cases in which their expectations were not fulfilled that the enterprise would become profitable within a reasonable period of time. I think you said three or four years. T 335-17 to 336-11.

Excerpts from Testimony of John F. Thompson

* * *

A. I am not sure that my facility knowledge of the Port operation is sufficient to give you a full and accurate answer. I have understood that one or two facilities from [337] time to time have not done as well as hoped, but on the whole the reverse is true. T 336-23 to 337-2.

* * *

Q. So your assumption that the Port Authority's moving from what had been almost entirely, with one or two exceptions, profitable enterprises to mass transit was a major factor in your concern about the acquisition of the Hudson and Manhattan? A. Yes, it was a factor of concern.

Q. And it continues to be a major concern down to today. That is to say, if the repeal of the covenant is upheld you are concerned that that pattern of profit making activity will be broken with the introduction of this deficit generating facility. A. I understand that is the purpose of the repeal.

Q. So the answer to my question is yes. A. That is a concern, yes.

Q. Now yesterday you gave as an example of the political pressures that are brought to bear on governors and the reason for bond holder fear, the fact that the governors vetoed the PATH fare increase. Is that correct? A. Yes. I understand that I mis-stated the exact procedure that took effect from lack of knowledge, that [338] actually the governors had already signed the minutes of the appropriate meeting when the fare request was approved, but that later on they persuaded the Commissioners to withdraw the application to the Interstate Commerce Commission for permission to raise the fare.

Q. Now, I believe it is accurate to say that you have throughout your time on the witness stand referred to the

Excerpts from Testimony of John F. Thompson

covenant as a bar to engagement of the Port Authority in mass transit. Is that correct? A. In deficit producing mass transit.

Q. Does it permit the Port Authority to operate bus lines that run at a deficit? A. The covenant, I believe, has the word rail in it. So bus lines are not included.

Q. Did most investors know that? A. I have not taken a poll. I don't believe I know the answer to that. T 337-6 to 338-17.

* * *

[339] Q. Are you familiar with the economics of the operations of the airport part of the Port Authority's business? T 339-6 to 339-8.

* * *

[340] Q. Are you familiar with it? A. I have not reviewed with the Port Authority a breakdown of their operation into airport and other things. I don't know the figures.

Q. Do you know whether the airports have been doing better or worse than they used to do? By used to, to take a time period, three years ago. A. I don't know. On the one hand there has been a lot of capital improvement at Newark. On the other hand there has been the effect of recession here on air traffic.

Q. So you don't know. A. I don't know.

Q. Do you know about the impact of energy developments on the traffic patterns at the bridges and tunnels? A. I received some overall information on that a year ago when the energy crisis was at its height; and it seems to me that for a time there was a decline of something like ten percent. But this taxes my memory as far as being exact is concerned.

Excerpts from Testimony of John F. Thompson

Q. But your recollection is there has been some deterioration in the revenues from the auto traffic? A. There was during that period. I think, and I am not sure I can cite a source for this, but I think it has pretty much come back to where it was. T 340-1 to 340-25.

【351】 By Mr. Landis:

Q. In discussions that led off with regard to a credit report issued in January of 1962 with regard to the 19th series of consolidated bonds of the Port Authority, Mr. Sovern asked you and it is at page 211, line 10, Mr. Sovern asked you, "Did the 19th series contain a covenant?"

And you responded, "No, because the covenant had not yet been passed by the two Legislatures."

Is it also true that there was no legislative power to take over the Hudson & Manhattan at that time? A. That is true, the legislation authorizing the takeover of the Hudson-Manhattan had also not been passed.

Q. I show you a copy of the Port of New York Authority official statement in connection with the issuance of the 19th series, the date of the official statement being December 22, 1961, and I ask you to read the last paragraph of the discussion on page 13 of that document, the discussion being entitled, "Hudson & Manhattan Railroad Acquisition and Improvements Study."

I ask you to read the last 【352】 paragraph. T 351-1 to 352-2.

* * *

【354】 The Witness: The paragraph reads, "The Port Authority has no present effective legislative power which would enable it to undertake the financing and implementation of this proposal."

Excerpts from Testimony of John F. Thompson

The status of the pending legislation on the subject is reported in the next subdivision.

Mr. Landis: Thank you, Mr. Thompson, we have previously had reference to the official statement that is contained in the stipulation, that official statement being the statement for the 41st series, which is the last series of bonds which had been commissioned by the Port Authority, a copy of which you have in front of you.

Would you refer to page 17 of that document and would you specifically [355] refer to the language that starts, "It is presently intended. . ." Just below the center of the page, and review that language over to the break in the middle of the next page.

A. I have read it.

Q. Do you recall having read that at the time that official statement was circulated? A. Yes, I did, sir.

Q. And in making recommendations with regard to the purchase of that series, did you rely on those statements?

A. Yes, sir. T 354-8 to 355-13.

* * *

The Court: Mr. Thompson, have you ever read a document which is exhibit 5 annexed to the stipulation of facts in this case which was a speech made by Mr. [356] Daniel Goldberg, the then general solicitor of the Port Authority, in October, 1964.

The Witness: Yes, I read it recently.

The Court: Do you recall having read it at the time or approximately at the time it was published in April of 1964.

The Witness: I don't recall specifically reading that at the time, sir. It was one of a series of

Excerpts from Testimony of John F. Thompson

lectures to a section of personnel of the Port Authority and I am not sure it was distributed to some of the rest of us at the time.

The Court: Do you recall ever having conversations with Mr. Goldberg concerning the financial structure of the Port Authority in its economic prospects and the state of the bonds and the consolidated bond resolution?

The Witness: Your Honor, I am quite sure that I have had. I have known Mr. Goldberg for many years and I have had conversations with him on a number of related subjects and I am sure this must [357] have come into it.

The Court: Because during the course of this talk, he does make reference to the concerns of the financial community, and I am sure you would be included in that group.

In the reading of this document which you say you did recently, did you take note of some of the statements that he made to the effect—and his speech was given prior to the adoption of the covenant—that in fact under the existing statutes and consolidated bond resolutions, there were no monies available within the Port Authority financial structure to finance any deficit rail transit operations.

The Witness: I remember that he made such statements, yes.

Q. Is that your understanding of what the effect of the statutes and consolidated bond resolution would be without the covenant?

The Witness: Would have been then or—

The Court: Now, irrespective of the covenant, is it

Excerpts from Testimony of John F. Thompson

your understanding [358] at the present time that under the statutes which were in effect and are still in effect and the terms of the consolidated bond resolution pursuant to which these bonds were issued, that there are no monies available within the Port Authority structure which could be used for mass transit that are not already pledged to existing bondholders?

The Witness: I am not sure that without the covenant some of the money in the bottom line would not be so useable, your Honor.

[359] The Court: When you say the bottom line, what is it?

The Witness: The consolidated bond reserves.

The Court: That would be the only possible source of monies then for the use, or to cover deficits resulting from mass transit operations, which the Port Authority might undertake?

The Witness: Well, your Honor, that would depend on how the project was integrated into the Port Authority. As I said yesterday, I have seen no specific proposals from advocates of repeal [as] to just what their intention is. And I have heard many comments about sums like 100 million dollars a year and so on that give rise to fears that they are looking at something much further up the scale.

Then I don't feel at all confident to answer what would in effect take place.

The Court: Now, I call your attention to page 23 in this same exhibit in which Mr. Goldberg discusses—T 355-22 to 359-25. * * * [360] his interpretation and the effect of the Section 7 certification which you had indicated was a subjective test which

Excerpts from Testimony of John F. Thompson

was not adequate to safeguard the interests of the bondholders. I would ask you to read it, because I am sure you would not recall the whole paragraph.

The Witness: No, I am reading it.

Yes, I have read it, sir.

The Court: Mr. Goldberg seems to view this Section 7 certification as being a very rigorous and precise one, and he ends up with the statement that this Section 7 certification has "helped to allay the fears of the financial communities."

I gather from the testimony which you gave us yesterday, particularly that [361] interpretation of Section 7, and also that you disagree with his conclusion that the financial community's fears were assuaged by the conclusion of this certification requirement.

The Witness: Yes, I think implicit in his statement at that time was the record of the Port Commissioners from the whole Authority up to that time of complete independence from political discussions. And I think that is implicit in what he says here. And since then there have been changes in that respect. Mr. Goldberg goes on later, as you know. In order to further allay the fears of the financial community he is forecasting the 1962 covenant.

The Court: He is advocating some form of covenant at the conclusion of his talk. That is certainly so.

The Witness: It pretty much outlines what the 1962 covenant became.

The Court: Now in order to perhaps help me in my understanding of what the financial structure of

Excerpts from Testimony of John F. Thompson

the [362] Authority's bonds are, if you take a look at the bottom of page 21, and continuing over on 22, right to the bottom of 22—

The Witness: Right.

The Court: I have read this I don't know how many times. But at the conclusion Mr. Goldberg says that in point of fact the Authority would not be in a position under its then financial structure to be given a deficit operation and be called upon to pay the operating deficit and any debt service requirements which it might entail, because all of the moneys, all revenues, are the Authority's and were pledged for existing facilities or to outstanding bond issues.

The Witness: I think that is the substance of what he is arguing.

The Court: Do you agree with that?

The Witness: I agree that the pledges that he describes are accurately described. I do not believe that the situation through the Section 7 certification that he describes was sufficient to [363] satisfy the investment community that these things would not take place.

The Court: Now I am not concerned with the Section 7 certification. But what I want to know is whether you agree with what he seems to be saying here, that the Authority's revenues are already pledged pursuant to the statutes or the consolidated bond resolution so that it could not pay or would have no monies left to pay for any deficit operation that might be handed to it, by the action of the States.

The Witness: I think first he indicates that they will not take the money outside the Port Authority.

Excerpts from Testimony of John F. Thompson

Then he goes on to document the fear that a group of deficit ridden railroads might be taken over, and that is what he reads into the Section 7 certification. The last paragraph on page 22 documents an additional fear that this might be done within the Port Authority. And then he goes on to speak of the Section 7 certification.

[364] The Court: Would you agree with his statement in that paragraph in the middle of page 22, that the Authority's revenues could not be used to subsidize the private railroads to the extent of their commuter operating deficits—estimates they were called in 1961?

The Witness: As matters then stood, I think that was probably correct, yes, sir.

The Court: Now if you could turn to that series 41 official statement—T 360-7 to 364-13.

* * *

The Court: Page 62, where Mr. Sovern was asking you to read, and following up some questions which he had; again, I just want to find out what your interpretation of this representation is in the official statement.

As I read this, could the states give to the Authority, let's say the Delaware & Lackawanna and the Susquehanna **[365]** and the Erie Railroad for nothing, having acquired them by whatever means they did; and could revenues of the Authority which are pledged as described here then be used to pay any deficit resulting from such rail operations?

The Witness: Your Honor, I have reread this section since my testimony of that this morning, and I have to say that I am simply uncertain on it and

Excerpts from Testimony of John F. Thompson

do not know what the legal outcome of such a controversy would be.

The Court: I am trying to isolate it. Assuming that they could not use any of these pledged revenues for such purposes, then the consolidated bondholders would really have nothing to fear, would they?

Because all of the revenues from all of these facilities as described there are pledged to the consolidated bonds.

And if you got down to Section 5 it is to pay the debt service on the consolidated bonds, and the balance is pledged as security for the consolidated **[366]** bonds, to be paid into the consolidated bond reserve fund, except such amounts as must be paid to the general reserves.

The Witness: Yes.

The Court: So assuming that the interpretation I think that Mr. Sovern was contending for this morning is correct, then none of the revenues of the Port Authority from any of the facilities which are mentioned in Section 4-i, could ever be used to finance a deficit transit operation, and that would be pursuant to the terms of the consolidated bond resolution.

The Witness: Your Honor, I am not certain that follows.

The Court: I realize you have some question in your mind. I have a question mark. We hope that it will be cleared up.

The Witness: If it does follow, I have no idea of why the effort was made to repeal the covenant. T 364-18 to 366-23.

[367] The Court: Again reading the same paragraph, and if you will make that same assumption,

Excerpts from Testimony of John F. Thompson

the only way that revenues from any of the Port Authority's existing facilities could be used to finance the mass transit operation would be if the Port Authority were able to issue a consolidated bond to either purchase or rehabilitate or improve that facility. Is that right?

The Witness: That would be a way to do it, yes.

The Court: Now really doesn't the financial community have control over that situation?

I mean, the financial community has a lot of concerns and fears and so forth for the integrity of the covenants and for the security it has for its bondholders. But doesn't the financial community and its ability to reject the [368] offering of any bond by the Port Authority have ultimate control whether the Port Authority or the states can ever engage in this kind of mass transit operation?

The Witness: Your Honor, implicit in your question is a concept of the financial community as a much more unified thing than it is. There are many competing firms that do things on a variety of bases.

There are firms who would not hold out, as you say, if they could get a 9½ percent bond to sell on the basis of this, they could very well try to do it. This would be quite contrary to the interests of other bondholders who had gone before them. I think that is the difficulty. The financial community is not a unified organization. T 367-5 to 368-19.

* * *

[369] Mr. Landis: Your Honor, may I have one question.

Excerpts from Testimony of John F. Thompson

By Mr. Landis:

Q. Assume, if you will, Mr. Thompson, Consolidated Bonds that the Judge referred to only need be one \$1,000 bond sold to anyone, the proceeds of which would purchase from the State of New Jersey all the deficit generating commuter railroads in New Jersey that are now privately owned, those railroads having been previously purchased for their market value by the State of New Jersey. T 369-2 to 369-11.

* * *

[370] The Court: Given your experience with the integrity of the Port Authority Commissioners and the manner in which they have conducted themselves over the last what, fifty odd years, would you consider that to be a realistic fear, that the Port Authority **[371]** would issue a \$1,000 bond of a consolidated—pursuant to a Consolidated Bond Resolution to bring into the pie the mass transit deficit operation? Do you think that they would ever do such a thing?

The Witness: Your Honor, ten years ago I would have answered certainly not. Today if you asked me about the Port Authority staff I would say certainly not.

We have noted from time to time that the Commissioners are under greater and greater political pressure in these matters. I cannot give you as strong an answer now as I would have before.

The Court: Would you say it would be unlikely?

The Witness: Your Honor, there has been so much going on in this thing that seemed unlikely to me from the start and unintelligent, the things that have been promoted in this field that it's somewhat unlikely. T 370-21 to 371-19

* * *

*Excerpts from Testimony of John F. Thompson**Recross-Examination by Mr. Sovern:*

Q. So one of the fears the covenant protects against is the issuance of a \$1,000 bond and the taking in of all the deficits. Is that correct? A. That is a hypothetical question which technically [372] I think fits into the provisions and would work.

Q. You say it would be somewhat unlikely that such a step would be taken, and, therefore, I take it, you believe that there is some risk that it will be taken. This morning you regarded as absolutely unthinkable that the States might make an arrangement with the Port Authority for a ten year support arrangement. Do you still regard that as absolutely unlikely, or is that somewhat unlikely? A. Now, this was a ten year voted covenant?

The Court: Right.

A. (Continuing) Yes, I still regard that as very unlikely because it doesn't fit together.

Q. That's more unlikely than that they would issue a \$1,000 bond for the assumption of all the mass transit facilities in the metropolitan area. Is that correct? A. I think we might not attach too much weight to the \$1,000. T 371-21 to 372-17.

* * *

[382] (Exhibit S-21, Official Statement, 19th Series, was admitted in evidence.) Q. This was the official statement for the 19th Series, was it not, Mr. Thompson? A. Yes, so I understand.

Q. And you testified earlier on your cross-examination, the 19th Series was sold [with] no special charges for fears

Excerpts from Testimony of John F. Thompson

of special mass transit. Is that correct? A. I believe that's correct. T 382-8 to 382-16.

The Court: Could I ask you one question? Has Moody's changed its rating of Port Authority bonds since back in 1971 or so?

The Witness: No.

The Court: It is still A today?

The Witness: Still A today.

The Court: Has Standard & Poor's [383] changed its rating of the Port Authority bonds since 1971?

The Witness: I believe not, your Honor. T 382-19 to 383-3.

* * *

Excerpts from Testimony of Lester Murphy, Jr.

LESTER V. MURPHY, JR., James Lane, Lloyd Harbor, Long Island, New York, sworn.

Direct Examination by Mr. Landis:

Q. Mr. Murphy, by whom are you employed and in what capacity? A. Barr Brothers & Company, 40 Wall Street, vice president of the firm responsible for trading positions in dollar bonds.

Q. What is your educational background, Mr. Murphy? A. Colgate University, 1949, graduated with a BA.

Q. How long have you worked in the municipal bond field? A. Twenty-five years.

Q. When did you begin your employment with Barr Brothers? A. October of 1950.

Q. And what is your present position with [384] Barr Brothers? A. I am a principal in the firm. We are now a corporation. I worked in the Trading Department. As I say, I am responsible for the dollar positions and also cover institutional accounts.

Q. When was Barr Brothers incorporated? A. 1971.

Q. And what was your capacity prior to that? A. Prior to that, we were a partnership. I was in partnership in the firm from, I believe, it was 1959; basically involved in the same capacity as I am now.

Q. And you are presently a stockholder in the firm? A. Yes, I am.

Q. Is it privately-held? A. Yes.

Q. And prior to reaching the position of partner in 1959, what were your duties and areas of responsibility? A. I started as a trainee, in 1950, started from there; became a junior trader and then into institutional sales.

Q. And since 1961, what have been your responsibilities, your duties and areas of responsibility? A. Again, in the field of responsibility in the trading position of the firm.

Excerpts from Testimony of Lester Murphy, Jr.

【385】 Q. What are your day-to-day activities in that posture? A. Well, I sit at a training desk that is a long table with a lot of direct wires to banks, other major stock exchange firms, municipal bond dealers and maintain markets in several hundred issues of municipal bonds, much like a specialist might be on the New York Stock Exchange.

Q. What are the areas of business that Barr Brothers does? A. We are involved in underwriting municipal bonds and dealing in municipal bonds in a secondary market.

Q. Do I understand your testimony to be that you are involved in the dealing operation, the secondary market dealing operation? A. I maintain an active market in roughly two hundred issues, yes.

Q. What is the size of the firm? A. Total employees, we are relatively small, about 35 employees, we have slightly in excess of two million capital, principally amongst four principal stockholders.

Q. How old is the firm? A. Over fifty years old.

Q. How would you characterize the status of the firm in the municipal bond trading in the secondary market?
T 383-8 to 385-25.

* * *

【386】 A. We maintain, I'd say, daily trading positions that range anywhere from five to eighteen million. I'd say that our current inventory positions have been running around twelve or thirteen million bonds.

Q. Are you a large or a small trader, how would you characterize it? A. I'd say in the secondary market, big traders.

Q. How big compared to the other traders? A. I'd say in the field of dollar bonds, I regard ourselves as probably in the top three as for dollar volume business.

Excerpts from Testimony of Lester Murphy, Jr.

Q. Who are the other two? A. Salomon Brothers and Weeden.

Q. Are they competitors of yours? A. Very highly competitive.

Q. Describe the clientele of Barr Brothers? A. Well, our clientele, as I say, I sit at a trading desk and probably speak to or handle two hundred phone calls a day and the type of people I would talk to would be banks, [387] trust companies, other major municipal bond dealers as well as large stock exchange firms.

Q. I believe you said that Barr Brothers is considered the dealer in the business? A. Correct.

Q. Do you deal with brokers in the business? A. Well, to give you an insight as to what a dealer is, we maintain markets and we deal with our own capital and if we position bonds, it is for our own accounts. We attempt to buy bonds naturally at a spread whereby we can make a profit, very much like somebody that is in a used car lot, who is standing there and looking at cars coming in, willing to make a bid, hopefully, to sell them at a profit.

We are standing in a marketplace every day maintaining active markets, providing a function of making markets and hopefully intend to make a profit on the spread. T 386-7 to 387-16.

[390] Q. Do you deal in bonds of the Port Authority of New York and New Jersey? A. Yes, we do.

Q. Is your clientele in this regard local or national? A. National.

Q. Do you specialize in particular bonds?

Does the firm specialize in certain bonds? [391] A. We tried—we have developed a reputation of being very active in what we call the dollar bond market, which encompasses most of your toll roads, power authority type facilities,

Excerpts from Testimony of Lester Murphy, Jr.

Port facilities, bonds of that nature which were issued in term form and are traded in dollars as opposed to being traded on a yield basis.

Q. When you say you make a market, what does that term mean? A. A market would entail offering to the caller the bid side of the market and the offered side of the market and the size which is of very important consideration in making the market; not that the quote is in 85 bid offered at 86, how big is that market?

Q. In other words, you mean the size of the commitment you are willing to make when you make the market? A. Size of the market is part of the market. Very often you might have a market that is 85-6, but it is only good for \$25,000. Whereas in other securities it might be good for a million dollars. So size is as important a consideration in the market.

Q. How long has Barr Brothers been dealing in Port Authority bonds making the [392] market? A. I would say since the late '40's.

Q. How much trading volume has Barr Brothers done in the course of the day's trading in Port bonds in the secondary market over the last three years? A. I would say that our daily turnover in volume is approximately a total of about two-and-a-half million. And I would say that our Ports turnover can range anywhere from 100,000 in a day to one million and a half. But I would say on an average it is probably more like in the neighborhood of ten percent of our total turnover.

The Court: Which would be what?

The Witness: On say two-and-a-half million dollar turnover—

The Court: \$250,000?

Excerpts from Testimony of Lester Murphy, Jr.

The Witness: Yes, \$250,000, but depending upon the activity of the market in certain issues.

I mean, we might trade two million Ports in one day. It is a fluctuating situation.

Q. Does your firm deal in Port Authority bonds in greater volume than others? **[393]** A. I could not answer that. I sort of pride ourselves as being one of the three most active firms in that field.

Mr. Landis: I offer the witness as an expert here.

The Court: Are there any questions on qualifications?

Mr. Sovern: No. T 390-17 to 393-8.

* * *

[394] By Mr. Landis:

Q. Mr. Murphy, you, of course, are aware that this litigation involves the repeal of the 1962 covenant of the Port Authority that controls the Port Authority, are you not?
A. Yes, I am.

Q. What is your general understanding of what that 1962 covenant involves? A. My general understanding it limited the scope of mass transit for the Port Authority.

Q. Are you familiar with the covenant in any greater detail than you just described? A. The covenant?

Q. The 1962 covenant. A. No, nothing more than that.

Q. In your business are you in any way involved in the analysis of municipal bonds? A. Well, as I said before, we are making positions for our own account in a greater number of issues and we try to keep abreast of the current financial positions of all the issues that we deal in.

Q. Meaning the trading situation? A. Well, we keep—we receive naturally **[395]** earnings statements from the

Excerpts from Testimony of Lester Murphy, Jr.

toll roads, the power facilities and other agencies in whose securities that we trade. So we try to keep abreast of the financial situation in everything that we deal in. If there is a situation that appears that it's faltering financially naturally we want to be aware of this.

Q. In 1973 did Barr Brothers own any Port Authority bonds? A. Yes, we did.

Q. You own any now? A. Yes, we do.

Q. What effect did the repeal of the 1962 covenant that took place early in 1974 have on Barr Brothers' attitude toward the Port Authority bonds?

The Court: June of 1974, be more precise, the repeal became effective.

Q. (Continuing) Well, the process that became effective in June of 1974. A. Well, as I recall we were hopeful at the time that Governor Wilson would veto that, because we felt that if the covenant was repealed we felt it would have a very poor effect on the [396] market and we have always maintained the positions both long and short in Port issues, but when Governor Wilson signed that he signed it with, as I understand, remember reading in the press, with a fair amount of reluctance and hoped that the decision could be finally settled in the courts.

With the idea in mind that the Port Authority would become more involved in mass transit we were extremely cautious about our positions, and I'd say adopted a much more conservative trading attitude as far as our positions in Port bonds.

Q. What do you mean by "extremely cautious" and more conservative trading attitude? A. Well, on the initial signing by Governor Wilson or right after the signing of this repeal we noticed that there was a number of Port bonds

Excerpts from Testimony of Lester Murphy, Jr.

that seemed to be offered for sale in the market, and in appraising our markets every day and looking to whom buys and sells the securities, we felt that the market trend was down, and we tended to take a very cautious position as far as how many bonds we were long and tried to play the market on what I would say was the short side.

Q. Would you explain that, the short side? **[397]** A. A short sale is selling a security that you don't own, hope to cover it back at a profit. In other words, in maintaining a market if a market was 85-86 and if we could make a sale at 85½ without owning the bonds we would make that sale with the hope that the market would decline and cover that bond back in at a profit.

Q. Does the term "spread" have some relationship to your operation? A. Well, spread refers to profit margin. I would say that we wanted more spread, more profit margin than any commitments that we took in Ports, because the market was subject to a fair amount of selling in Port bonds.

Q. Why did the repeal of the covenant change Barr Brother's attitude towards Port bonds? T 394-1 to 397-17.

* * *

[398] The Witness: Well, I would say that with the repeal of the covenant it was paramount in most people's minds that deal in these securities that there was a breach in the contract, and we felt that with a breach in the contract that, first of all, it was something I don't think I've experienced since I've been in the business, and secondly, we felt that the spread in the Port Authority operations into greater mass transit would have a very poor effect on the performance of their bonds, and that other institutions indicated that to us, and that, therefore, we adopted

Excerpts from Testimony of Lester Murphy, Jr.

a position of much more conservative, much more conservative attitude towards our long positions.

[399] Q. You spoke of investors. What effect did the repeal have on the attitude of investors towards Port bonds? A. Well, part of their function in the marketplace is to try to track certain relationships of various dollar bonds. We don't do any professional analysis or advice in the form of investment counselling. We merely provide markets and spread relationships, and we have found that for many years that you could, when certain spreads develop, that you could talk a customer into selling a bond and buying, let's say Ports, but we found that subsequent to this repeal of the covenant, that most of the major institutions that we did business with, and I wouldn't say most, I don't know of any that would then buy Port Authority bonds. They crossed it off their list.

Q. Did you have any direct communication with those institutions? A. Yes. T 398-9 to 399-20.

* * *

[401] By Mr. Landis:

Q. And the investors that you communicated with, without identifying what they said to you, what was the nature of the communications?

The Court: What was the subject matter?

Q. (Continuing) The subject matter. A. Well, as I said we attempt to provide a service to institutions whereby we are calling markets, showing spread relationships.

We found that institutionally Port Authorities were no longer an acceptable exchange in that the investor, institutional-type of investor, sophisticated type investor would

Excerpts from Testimony of Lester Murphy, Jr.

not any longer buy Port Authorities. If he was to sell a Kansas Turnpike or Indiana Turnpike wheretofore he would **[402]** buy Ports when a certain spread relationship developed, he no longer would buy Ports.

Q. Without trying to name every one, which institutions do you refer to, what are the names of them? A. The names of the accounts?

Q. Yes. A. Well, I'd say Fireman's Fund, which is a large insurance company in San Francisco, major banks in Chicago, the First National Bank of Chicago, major banks in New York City, Bankers Trust Company, First National City Bank, insurance companies, the Connecticut General, the Hartford Fire Group and others.

[403] By Mr. Landis:

Q. And those have been customers over the years as to Port bonds? A. That's correct.

Q. You indicated in your testimony that there would be exchanges, you gave some examples. Do those have a name, those exchanged, trades? A. Swaps.

Q. Exactly what does that entail and what are the reasons for it also? A. Well, to try to be simple, if that investor was able to sell, say, a million par value bonds at 80 and buy a very similar bond quality-wise intrinsically at 75, he might very often make the trade because from the proceeds from the sale, he is able to buy more bonds and therefore increase his income and in the case of the Ports, the spreads had widened to, in some of the trades, I recall, to 15 points or more but it was no longer a question of spread relationships. It was a turndown of the security based on how good the investor thought the intrinsic value of the Port bond had become after the repeal.

Excerpts from Testimony of Lester Murphy, Jr.

Q. In other words, despite the increased spread, you could not interest people in [404] taking back Port bonds?

A. Correct.

Q. Do you have an example of that, could you give an example? A. The names I had cited that had normally been [buyers of] Port Authority bonds, no longer would consider them as a fair, acceptable return.

Now, Bankers Trust had a large swap in November of last year and they would not take anything, they wouldn't take any Ports back. Anybody who sold Ports that we did with major trust companies for tax swapping purposes, did not buy Ports back. They were willing to sell the bonds, but they were not willing to buy them back.

Q. You previously referred to the impact of the repeal on the price of the Port Authority bonds. Would you explain that in more detail? A. Well, the repeal, as I say, changed not only our attitude but changed the institutions' attitude about whether or not they were willing to own this bond with the threat of the Authority becoming involved in mass transit.

Now, most institutional investors and most people in our business, historically, know that [405] mass transit financing of which there have not been that many, but the ones that I am familiar with, most of them got in serious trouble.

Bi-State, which is a joint agency between Illinois and Missouri sold a bond for the purposes of mass transit. Those bonds are presently in default. Chicago Transit Authority had severe difficulties with their debt and I found that the word "mass transit" or "transit facility bonds" is one that literally shows deficits and widening spread, so that the quality of the bond, I find, is unacceptable institutionally.

Excerpts from Testimony of Lester Murphy, Jr.

Q. During this time of price decline that you referred to, what other factors were at work? A. Well, as I said before, I said that one of the factors was that it was a change in the investor's attitude on what he believed was a contract between the states and that he felt that if they could do this with this bond and become involved with mass transit, even though it might have to involve a certain coverage test, it was a politically dangerous position because, as we all know, the subway fares, etcetera, are more or less sacrosanct and I think anyone who is familiar with or following [406] the MTA, has recognized that they are in deep financial problems. Also, I think that a major change in the thinking was that the last experience we had along this line was the Triborough Bridge & Tunnel Authority which hoped to alleviate some of the MTA's financial burdens and they went to the bondholders, obtained a two-thirds vote of the bondholders, offered the bondholders a quarter of one-percent over the existing interest rates on the outstanding bonds and closed the lien so that the MTA would then be able to get the surplus over a 120 coverage so that this was a radical departure, I'd say, from the previous type changes that I have seen made in bond indentures.

[407] Q. You referred to the size of the market in bonds since repeal. Could you explain in detail what you meant? A. The size of the market I would say immediately after the repeal was quite active. I would say that there was substantial selling of Port Authority bonds. As time went on it became increasingly heavier, particularly at the end of the year, because a number of institutions and fiduciaries availed themselves of the opportunity of selling Port bonds to establish tax losses. But the market had been extremely thin. Most dealers were not willing to position much in the way of Port bonds because of the outlook of the Port entering the mass transit field.

Excerpts from Testimony of Lester Murphy, Jr.

Q. Let me direct your attention specifically, to the Port bond issues commonly called the 6's of 06 and 08. Are you familiar with those? A. Yes I am.

Q. In fact those are issues that have their final maturity, the maturity in the years 2006 and 2008 and issues with a coupon at 6 percent. Is that correct? A. That is correct.

Q. Can you take the period now from the time of repeal where you had testified to the condition of the market since that time, take the period from then until December 1974; can you characterize the activity of the [408] prices that were bid for those bonds? A. I would say that in general—

Mr. Sovern: Exactly what dates do you have in mind?

Mr. Landis: From the period roughly of June 1974 to December 1974.

A. I would say that the market in general of Port bonds experienced a rather severe decline. T 401-10 to 408-8.

* * *

Q. Could you characterize the change in price, if any, of the bids for those bonds in the period from December 1974 until today? A. The bonds have had a very, very substantial recovery. I would say that from the middle of December until the present time has been a 20 point recovery in the bonds.

Q. Compared to the general activity of the market during this time, could you characterize the decline and the rise that you have just described? [409] A. I would say that the decline was naturally greater during the period from June through December than the rest of the market. The turn arounds from the first of the year to the present time has been substantially better than the rest of the market.

Excerpts from Testimony of Lester Murphy, Jr.

Q. Can you explain the variations? A. Well, as I have stated before, most dealers, like ourselves adopted a cautious long position. However, most dealers fearful of the tax selling in the bond particularly adopted a position where they were short the bonds. The markets were quite thin. But most dealers like ourselves had rather large short positions in these bonds.

Now, coupled with the lack of selling when tax selling ended at the end of year, coupled with the Federal Reserve's position on money, their posture of easier money, what happened was that dealers who were short these bonds scrambled to try to cover their short position.

So what you had there was a technical situation in the market where a number of dealers were short Ports. Tax selling subsided at the end of December. The bond market took on a strong tone.

Q. You say the bond market, do you refer to the bond market in Ports or generally? A. Generally.

But this accentuated the upward movement of Ports, [410] because I think that people who own Ports now are willing to await the outcome of this case recognizing it was rather imminent.

I think the people who decided to sell sold many months ago. The rest of them are gambling that the Courts will find in their favor. And I have not seen any supply of bonds come into the market. We as dealers cover short positions. It cost us in excess of ten points. T 408-17 to 410-8.

* * *

Q. Would you characterize the upswing that you just described in prices since December 1974 of the Port 6's of 08 and 06? A. Characterize the upswing?

Q. Yes.

The Court: He has.

Excerpts from Testimony of Lester Murphy, Jr.

A. It was a thin market. There was a change in Federal Reserve's posture on money and dealers short covering, a technical situation.

Q. Could you give it a name? A. As an example, I think this might be important, the most dramatic movements on the up side have been in the more second grade quality paper. Jersey Sports which was [411] 7½ percent bonds that had been selling in December at 65 and recovered to 80 today. Urban Development Corporation—New York State Urban Development Corporation, a bond that is under a cloud that had substantial recovery again for the technical reasons I cited about the Ports. So your poorer quality, less regarded tax exempts, that had the slowest recovery because of a technical situation.

Q. Is there a name that describes this adjustment that happened in the prices? A. Is there a name?

Q. Yes. A. I just characterized it as short term technical situation.

Q. Which is what your testimony has been; in other words there is no other magic name.

Has the repeal had any effect on the attitude of investors with regard to other bonds other than the Port Authority? A. Certainly, the number of institutions whom I have cited feel that if a covenant was to be repealed, a so-called contract with the issuing states, the concern now becomes increasingly more acute for bonds that are so-called moral obligation bonds.

In the case of moral obligation bonds the [412] problem is whether the legislatures will appropriate the needed funds to keep them in business. So, I think that the overall position that I have found from the people as a market maker that I talk to from day to day to day is one of increasing greater concern about how good the contract is that they

Excerpts from Testimony of Lester Murphy, Jr.

are buying, and I think will lead to much higher interest rates.

Q. Did the effect go even beyond the moral obligation bonds? A. Yes. There was an issue of Power Authority bonds that sold within the last two weeks a \$150 million issue that normally would have much greater national acceptance than it did. The acceptance was hurt.

Q. Did your firm participate in the underwriting of that bond? A. Yes, we did.

The Court: When you say Power Authority, do you mean the New York State Power Authority?

The Witness: Yes, New York State Power Authority.

Q. I show you exhibits that have been marked P-94 and P-95. You are familiar with these are you not? **[413]** A. Yes I am.

Q. You have seen these before. Yes.

Q. Were the bond issues shown on those documents chosen at your suggestion? A. Were these chosen at my suggestion?

Q. Were they placed there at your suggestion? Was that your thought to create that? A. This particular chart?

Q. Yes. A. Yes sir.

Q. It refers to Kansas and Indiana Turnpike bonds, does it not? A. Yes, that is correct.

Q. Could you describe those issues? A. They are toll road facilities dependent upon the net revenues of the facility to service debt. Traffic naturally would determine the toll revenue income.

Q. Did the issues have similar characteristics to the issues of the Port Authority of New York and New Jersey that are shown on the same P-94?

Excerpts from Testimony of Lester Murphy, Jr.

A. The bonds have similar coupons, similar maturities, similar average life, dependent upon toll revenues—I think they have great similarity.

A number of trade swaps have been done in the past between Port issues in Kansas and Indiana; it has been a very common trade in the past. In a tracking relationship, as you can see here, there is quite a bulge that develops subsequent to the repeal.

Q. Would you consider upon the basis of the knowledge you have expressed and upon the illustration of the movement of bid prices from January 1974 to June 1974, that the issues shown on P-94 are comparable? A. They appear to track pretty closely, yes. T 410-13 to 414-16.

[415] Mr. Laulicht. * * * I would like some voir dire on these documents before they're introduced. T 415-11 to 415-14.

* * *

[417] Mr. Laulicht: Now, you testified, Mr. Murphy, that in January of 1974, you would have regarded Kansas Turnpike issues as roughly comparable to these Port Authority issues. May I ask you whether the Kansas Turnpike, did it run a passenger railroad?

Excerpts from Testimony of Lester Murphy, Jr.

The Witness: Not to my knowledge.

Mr. Laulicht: To your knowledge, did the Port Authority run a passenger railroad on January, 1974?

The Witness: Did the Port Authority?

Mr. Laulicht: Yes.

The Witness: Yes.

Mr. Laulicht: Was that a deficit producing operation?

The Witness: It is. I don't know if it was known at that time.

Mr. Laulicht: You are not sure [418] whether in January, 1974, PATH operated at a deficit?

The Witness: They did, but I can't tell you what it was.

Mr. Laulicht: To your knowledge, did the Indiana toll road run a passenger rail deficit facility in January, 1974?

The Witness: No.

Mr. Laulicht: Did the—either the Kansas Turnpike or Indiana toll road operate a World Trade Center in January, 1974?

Mr. Landis: We will stipulate the whole series of questions Mr. Laulicht is asking.

The Court: How do you know?

Mr. Landis: I suspect that they did not have three airports, they probably did not have tunnels under interstate rivers.

The Court: What is your point?

Mr. Laulicht: My final question was this: Doesn't the fact that the Port Authority runs a World Trade Center and I take it you're familiar with the problems [419] of the World Trade Center, it runs a deficit railroad and it ran that in January of 1974,

Excerpts from Testimony of Lester Murphy, Jr.

doesn't that tend to make these two issues not comparable?

The Witness: Well, first of all, the Port Authority shows that net revenue, I don't know how you take down their revenues, but they show net revenues on a comparable earnings basis for the facilities. I would consider them comparable.

Mr. Laulicht: I don't understand what you mean "a comparable percentage of revenue." Do you mean to show—

The Witness: The point is if the Port Authority shows 20 million dollars in net revenues this year, I am unable to break down how much is lost in the World Trade Center and how much is made in the airport facilities. I regard the net revenue, the bottom line as a consideration.

Mr. Laulicht: Irrespective of the type of operation that is involved?

The Witness: I would say—

Mr. Laulicht: As long as the [420] bottom line is satisfactory, you feel that is the way to judge a bond. Is that correct?

The Witness: As long as the bottom line, as the bond was presently constituted, yes. I would have considered them equal bonds at that time. T 417-6 to 420-8.

* * *

[421] The Court: Irrespective of the spread that may have existed between [them, they], would be comparable in terms of investment quality and in the demand by institutions for these bonds or their willingness to purchase these bonds.

The Witness: I would say yes.

Excerpts from Testimony of Lester Murphy, Jr.

The Court: And didn't you also testify something to the effect that you arranged swaps by institutions for these bonds or their willingness to purchase these bonds.

The Witness: I would say yes.

The Court: And didn't you also testify something to the effect that you could arrange swaps between these bonds with your institutional clients because they were roughly comparable in the minds of the buyers?

The Witness: That's right.

The Court: That is enough to qualify the exhibits. T 421-2 to 421-23.

* * *

[422] *Direct Examination by Mr. Landis Continued:*

Q. How would you characterize the relationship that is shown on P-94 to have existed between the bid prices on June, 1974, through January of 1975? A. It shows a much greater spread. It appears sometime in June that the bonds no longer tracked. T 422-5 to 422-11.

* * *

[424] The Court: See, they both seem to track roughly on this chart right even into July, don't they? And indeed while the spread may have been widening there through the end of July they're still tracking.

Now, you get the real significant difference in the spread once you get into August where they are really diverging. Now, my question to you, Mr. Murphy is this: Do you know of any external factors affecting the Kansas Turnpike and Indiana Toll bonds between, say, mid-August and mid-November

Excerpts from Testimony of Lester Murphy, Jr.

of 1974, which would have accounted for their increasing in prices?

The Witness: Well, there were—

The Court: Were there any developments on there?

The Witness: You mean as far as [425] changes in their indenture or something to that effect?

The Court: Whatever.

The Witness: Well, the only thing that I can add to it—there was nothing in the way of a change in the bond. The only thing that probably created a greater upswing in those markets was that there was some debt retirement that occurred during that period. The debt retirement that occurred during that period, however, in looking back on it, they were always able to buy bonds on debt retirement under the market. In other words, if a sinking fund was to retire five hundred bonds in a month and the quote was let's say 70-72, it appeared that the sinking fund would be able to buy the bonds under the market. We were in an overall declining market, and a number of institutions were liquidating Kansas and Indiana's, but you did have a sinking fund operation that occurred in that period in that they did buy bonds for retirement.

The Court: All right. So that you are saying that that was one factor that might [426] have caused an increase in those bonds. Right?

The Witness: Yes. But the—

The Court: All right.

By Mr. Landis:

Q. Are you speaking, Mr. Murphy, as to the specifically sharp rise from August to November 1974, in those bonds?

Excerpts from Testimony of Lester Murphy, Jr.

A. I believe roughly that's what the Judge was making reference to, yes.

The Court: Yes, that's what I was making reference to.

Q. Now, characterizing the general trend from June or, perhaps, May of 1974 to the end of, almost the end of January, 1975, let me ask you to repeat your characterization of the general trend. I believe you previously characterized it, but just to lay a foundation for my next question, let me ask you to characterize that general trend.

A. During what period?

Q. From May or June, if you will, of 1974 through January of 1975?

Mr. Sovern: The end of January?

Mr. Landis: The end of the chart. A. Characterize the market for Port bonds?

[427] Q. No, characterize the difference, if any, in the trends of the Turnpike bonds as opposed to the Port Authority bonds all as illustrated on the chart. A. Well, I think the chart speaks for itself, that you had a widening of the tracking. It got extremely broad, I guess, in the months of September and October, and towards the end of December and January you still had a considerably wider tracking, let's say, than historically was the case.

Q. Do you have an opinion as to what external factor caused that wider tracking between the bid prices of the issues? A. I think I testified to that, that we have found that the Port Authority bonds were no longer acceptable on tax swaps. T 424-8 to 427-16.

* * *

Excerpts from Testimony of Lester Murphy, Jr.

[433] [By Mr. Laulicht.] Q. You gave us several reasons why you thought the repeal of the covenant had had an adverse effect, and if I may summarize them, I believe you said that it was the fact that a contract was breached, and to your knowledge that had never happened before, that the increase in Port Authority involvement in mass transportation was not regarded favorably, and then you made some reference to what some other institutions told you and we, I think managed to keep **[434]** that out of the record. Which of those three would you rate as the most important?

The Court: Most important in relation to what?
Let's define that.

Q. (Continuing) In terms of the adverse effect that the repeal of the covenant had?

The Court: On the secondary market?

Mr. Laulicht: Yes, on the secondary market.

A. It would be very hard to break down. When you break a contract down how an institutional investor would weigh that in terms of comparing it with getting the Port Authority involved in mass transit, I know both of them are red herrings. I know that when you mention "rapid transit" or "mass transit" to an institution it's entirely unacceptable, because it's demonstrated that the transit systems throughout this country are largely operating at deficits, and the institutional and professional investor is greatly concerned with security today. He doesn't want to buy something that's possibly going to cost him a lot of money.

Q. Well, why did any investor buy a Port Authority bond since 1962 if he didn't want to **[435]** get involved with something that had to do with mass transportation, and if

Excerpts from Testimony of Lester Murphy, Jr.

it's such a bad word? A. Well, I don't think that the history of the Port Authority has been revolving around mass transit. It's been a well-run, well-organized, well-managed Authority. It's continually shown good revenues.

Q. Is the fear then that by the repeal of the covenant the Port Authority now is going to be suddenly completely enwrapped in mass transit? A. No, I think that the fears, I think I've previously testified to, is that it's a—it's an abrogation of an agreement, it's a contract. It's as if I went and bought a car from General Motors and had a twelve month warranty, and all of a sudden they announced that it's only good for six months. I don't think that I'd buy another General Motors car. And I think this is the feeling in the investment community.

Q. Now, you testified, Mr. Murphy that one of the reasons for the increase in the price of Kansas Turnpike bonds and Indiana toll road bonds as reflected on P-94 was the fact that there was some sinking fund activity. Is that correct? A. Correct.

Q. Can you tell us how much of that [436] increase was attributable to that sinking fund activity? A. I think I can document that the purchasing that the sinking funds did was either at the market or below the market.

In a sense, if I could explain that, Judge, if you had a market that was quoted 70-72 and the trustee entered the market for an offering of 500 bonds he, quite frequently bought bonds at 69, indicating a number of institutions were selling the bonds, because they were too high, and these markets were basically small markets. It was one way that an institution can unload a lot of bonds.

Q. Institutions aren't unloading Port Authority bonds now, are they? A. No. To my knowledge, they're not, no.

Q. That means that the present price is not regarded by them as too high yet? A. My only feeling there would be,

Excerpts from Testimony of Lester Murphy, Jr.

I think, that they're hopeful that a decision would be such that they won't have to. T 433-18 to 436-20.

* * *

[438] Q. Can you explain to me how it is that the price of Port Authority bonds appears to be in the low 50s in the July period, and it has gone up to 55 as I read this by the end of October. A. It was obviously a tracking in the market or an up tic there. These markets do not continue to go one way all the time.

Q. Didn't you tell me how demoralizing the market in Port Authority bonds was back through the end of the year? A. I characterized the market as having substantial selling immediately after Governor Wilson's signing the repeal. Subsequent to that, dealers like ourselves maintained a low profile as far as long positions. The markets were extremely thin. As **[439]** evidenced by what has happened in the last month, we have had a 20 point increase on very little supply. So when we talk about markets we're not only talking about quotations, we are talking about number of bonds traded, the size of the market which is more of a key factor than the quotes. T 438-11 to 439-6.

* * *

Q. Isn't that what you are saying, that the bond prices don't matter very much if you don't know the [volume]? A. If you were in my business and you made that statement you would be out of business in a hurry. T 439-12 to 439-16.

* * *

[443] Q. Let me ask you this: Assume that I show you that there are variations in the spread from week to week on P-95; do you feel anyone of them by themselves is significant or is going to tell us something? A. I think P-95 is merely a compilation of the numbers that appear in this

Excerpts from Testimony of Lester Murphy, Jr.

period. I think I testified that there was a wider divergence that has developed since the time of the repeal. I have also testified institutionally where we have made swaps with institutions out of Kansas and Indiana's into Ports is no longer an acceptable trade. T 443-3 to 443-14.

* * *

[444] Q. As far as you are concerned, was the decision of the institutions not to buy Port Authority bonds any more than their own investment decision, that is all that represents. Is that not correct? A. That's correct.

Q. As it turns out, assuming that that was the investment decision of the institution in December 1974, as it now looks, how would you characterize the wisdom of that investment decision? A. I would characterize the thinking as completely unchanged. I am unfamiliar with a major institution that would buy Port Authority bonds today.

[445] Q. That was really not my question. My question was wouldn't they have made money if they had another investment decision? A. Institutions don't usually buy and sell to make money. They buy for intrinsic value return. They don't buy and sell something out usually at a point or two profit over a week or two's time. They try to keep their money invested at all times.

Q. You talked about a 20 point profit since December, did you not, Mr. Murphy? A. No, I said—I said yes, there has been a substantial improvement in the price, correct.

Q. Doesn't the swap list concept constitute the playing of a point here and a point here, not twenty points, but a point here and point there? A. You are talking of a swap out of, let's say, Kansas or Indiana?

Q. Yes. A. A swap off of Kansas or Indiana—

Q. That is not my question. My question is you answered a prior question saying that institutions are not interested in a point here and a point there. If that is

Excerpts from Testimony of Lester Murphy, Jr.

true, why do they engage in these swaps you are talking about? **[446]** A. Let me explain that to you, sir. The swap would involve the sale usually of a fairly-large amount of bonds, let's say a million Kansas Turnpikes, at which point if the spread had tracked historically where you normally had a ten point spread and institutions could sell a million Kansas and then buy an issue that was done to a twenty point spread, it would be a very attractive swap, but once you have removed this Port Authority bond as an acceptable swap, the presentation of the spread means nothing.

We have presented these swaps and in a number of cases we are told by institutional accounts we won't buy anything in the New York or New Jersey area.

Q. In other words, Barr Brothers has recommended the purchase of the Port Authority bonds as a part of a swap, has it not? A. We have not recently because our history, as I explained back after the signing of the covenant was such that you don't call up a customer every day and say, "Would you mind buying Ports today," if he told you he won't touch the Ports.

Q. At some point you suggested a swap that would have involved the purchase of Port Authority bonds and from what you are telling us, is **[447]** even a 15 point difference was not enough to make the deal? A. Correct.

Q. But wasn't your bringing that swap to your customers' attention something that you thought would be to the benefit of your customers? A. We have not brought those types of trade to our customers, as I explained to you earlier. We no longer have accounts that buy Ports. T 444-13 to 447-9.

* * *

[448] Q. Let me put it to you this way, would you recommend as part of a swap an investment security that you

Excerpts from Testimony of Lester Murphy, Jr.

considered a dog? A. Would I?

Q. Yes.

The Court: Depends on to whom.

Q. The Banker's Trust Company? A. That would be absurd, they have people who are doing research work, their own analytical staff. First of all, as I say, we don't do business, to speak of, with individuals. If we do one to ten percent of trade, we do trades with additional people who know what the hell they are buying and selling.

Q. Except they are gamblers, as you told us, they are professionals, but they are gamblers? T 448-9 to 448-25.

* * *

[449] Q. Didn't you testify that the people who are now holding the Port Authority bonds and have had a 20 point increase are gambling as a result of this suit? A. No, my testimony was there has been a lack of institutional selling here. Hopeful that this decision will go in favor of the U.S. Trust Company.

Q. Did you use the word "gambling" in this connection, Mr. Murphy? A. Gambling on the outcome of the suit, possibly, I did. T 449-6 to 449-16.

* * *

[450] Q. Let me show you some documents or some news stories fairly quickly.

S-1 is an article that appeared in the Wall Street Journal about the World Trade Center. T 450-21 to 450-24.

* * *

[451] Q. Were you aware of that story at the time, Mr. Murphy? A. That particular story? I cannot testify to that particular story. I have certainly been apprised that the World Trade Center is behind in some of its plans, yes.

Excerpts from Testimony of Lester Murphy, Jr.

Q. As far as you know, have those news stories, similar to what I just showed you in S-1 with respect to the World Trade Center had an adverse effect on the market price of Port Authority Bonds? A. Your question is whether these adverse stories on the World Trade Center, has it had any effect?

The Court: Adverse effect.

Q. Adverse effect on the bond price of the Port Authority in the secondary market? A. To a limited extent, it must have, yes. I can't think for every institutional investor, but I would say if it was I, I think it would.

The Court: Do you have any recollection of discussing the Port Authority problems with the World Trade Center with any of your institutional clients or [their] referring to any news stories in their conversations with you?

[452] The Witness: The only thing, Judge, that I can recall discussing was that the World Trade Center was experiencing some difficulty in renting space, but also that they anticipated to throw off \$20 million to the revenues of the Port Authority.

Now, how they arrived at their costs, etc., I cannot answer those questions. T451-4 to 452-7

* * *

Q. I would like you to pay some attention, if I may, to S-2. This is an article that appeared either on the front page of the Sunday Times or the front page of its financial section in November 1974, a very lengthy article as I am sure you will note. It is headed, "Port Authority has Fallen on Hard Times."

Do you remember reading this article a few months ago? A. I didn't particularly read it. I was familiar with it at

Excerpts from Testimony of Lester Murphy, Jr.

the time. **[453]** Q. How did you become familiar with it if you did not read it? A. In our office every day, we talk about this kind of news.

Q. What kind of discussions did you have in your office about this article? A. Well, just a general discussion as outlined here.

Q. Did you think that this article might have an adverse effect on secondary prices of Port Authority bonds? A. I don't know how to answer the question. I don't believe that that was discussed at the time because I think that—

The Court: Based upon your experience trading in these bonds?

The Witness: It might have some effect.

The Court: It might?

The Witness: Sure.

Q. If you look a little bit closer at the beginning of the articles, I don't want to take you through it, by any means. There are some very strong statements in this article. You have one New Jersey Commissioner saying "The Port Authority is dead in the water." T452-16 to 453-23.

* * *

[454] A. I would answer that by referring to the chart, P-94, which would indicate to me that there was a more substantial drop during that period in Indiana's and Kansas than there was in Port Authority's, so obviously it did not have that much effect on the market.

Q. That is your opinion, Mr. Murphy? A. I am looking at the chart here. In the middle of November to the end of the year, it looked like the Indiana's and Kansas' suffered a much more severe drop.

Q. Do you know why they suffered their drop? A. There is a pat answer in our business. There are more sellers than buyers.

Excerpts from Testimony of Lester Murphy, Jr.

Q. Besides that pat answer, do you know why they suffered that drop? A. Besides that?

【455】 Q. Yes, do you have any explanation for that drop? A. None, really, that I can think of, no.

Q. Now, if the article did not have that serious an effect, Mr. Murphy, can you tell me why on P-89 for the period of November we see the Port Authority dropping much, much further than the Massachusetts bonds did? That is P-89. T 454-11 to 455-8.

* * *

A. Well, you are taking in a longer prospective there and I think I earlier testified there was substantial selling for Ports bonds in November and December. That is how we got ourselves in the bind on the short positions. T 455-12 to 455-15.

* * *

Excerpts from Testimony of Michael Zarin

[466] [By Mr. Landis] Q. Mr. Zarin, I understand you are employed **[467]** by the Port Authority, is that correct?

A. That's correct.

Q. In what capacity? A. I am Chief of the Finance Division of the Law Department of the Port Authority of New York and New Jersey.

Q. And you are, as I understand it, a member of the Bar? A. I am a member of the Bar of the State of New York.

Q. And you are educated as a lawyer? A. Yes, I am educated as a lawyer.

Q. And with a BA and LLB degree from what? A. I graduated from Dartmouth College with a degree of AB in 1953 and from Columbia Law School I have a JD degree, and graduated in 1956.

Q. How long have you been employed by the Port Authority? A. Since 1956.

Q. And in what capacities? A. I first started as a law assistant and almost immediately became an attorney, upon my admission to the Bar in 1956. And in 1965 I became Chief of what is now known as the Finance Division.

Q. Had you worked in connection with the **[468]** Finance Division prior to 1965? A. Yes. At that time it was essentially a Finance, Taxation, Insurance and Research Division.

Q. Was there some restructuring at that time? A. In 1965 two divisions were created out of the division that I have just mentioned, an Opinions and Appeals Division, and a Finance Division.

Q. Where were you employed before 1965, in what operation? A. Before 1965 I was a member of essentially the same division.

Q. You have had responsibilities in the area of finances of the Port Authority? A. Yes, I have.

Excerpts from Testimony of Michael Zarin

Q. Over the entire period of your employment? A. That is correct.

Q. And are you involved in any organizations in connection with your work outside the Port Authority? A. Yes. I have noted down the outside associations that I think has some bearing on these financial matters. Those include, I am a member of the Standing Committee on Debt Administration of the Municipal [469] Finance Officers Association of the United States and Canada. I am a member of the American Bar Association Local Government Law Section and its committee on liaison with the Securities Industries Association. I am a member of the Municipal Forum of New York. I am Chairman of the Law Committee of the International Bridge, Tunnel and Turnpike Association.

Q. Have you had any post law school education? A. I participated in and completed the Harvard Business School Advance Management Program in 1972. T 466-25 to 469-11.

* * *

Q. Mr. Zarin, you are familiar with the subject matter of this litigation, are you not? [470] A. Yes, I am.

Q. Of course, as we previously established you are familiar with the circumstances under which you are called as a witness. Would you then please explain to the Court as you understand it, the meaning of the 1962 covenant and the relationship of the covenant to the other security provided by statute and contract to the consolidated bondholders of the Port Authority.

The Witness: Your Honor, before I do that, may I make clear something about my position here today?

The Court: Yes.

Excerpts from Testimony of Michael Zarin

The Witness: And that really has a relationship to my position as an attorney for the Port Authority of New York and New Jersey. In that structure I make recommendations to the general counsel of the Port Authority, and he in turn recommends those things which he wishes to the Executive Director and to the Board of Commissioners.

So that not only in my discussion here today, but in practice as far as the Law Department of the Port Authority is concerned, my opinions and the statements are not binding [471] upon the Port Authority even in my work until general counsel has approved them.

And I just want to make clear, as I understand it, the Port Authority is not participating in the particular litigation between the United States Trust Company and the two States, and my appearance today is as a witness in that proceeding.

The Court: You are expressing your own opinions, really.

The Witness: Fine, thank you very much. I might say, of course, that the opinions even that general counsel expresses and gives to the Commissioners, the Commissioners themselves, as you know, being appointed from each State constitute the authority and make those decisions for the Authority subject to gubernatorial veto.

I think since the question is a very broad one I would like to step back just a little bit in time from the time of the covenant to the time when I became aware of the fact that the Port Authority was becoming involved in rail transportation and the efforts to become involved in rail transportation.

Excerpts from Testimony of Michael Zarin

[472] The Court: Well, I am not particularly interested. I don't know whether counsel for the—

The Witness: I don't mean—

The Court: U.S. Trust Company may be, but I am not particularly interested in what the Port Authority may have done with respect to rail mass transit. All I am interested in is the structure of the bonds.

The Witness: That's right, and that is really what I—I don't mean to speak factually on that subject, just to make sure that the legal matter is on the table that we are discussing and the background of the legal matter is in order to become involved in this area. We had to so structure our legal and financial relationships to enable us to do so.

At first, it appears to be extremely difficult to get the deficit operation of any kind because the Port Authority initially was set up as a self-supporting agency, and as a bi-state agency, was one part of its structure.

[473] The other key part of its structure was the self-support structure, so when we were being called upon by the two states to go into passenger rail transportation, being a deficit area, we had to look at the structure again.

At first, we, all of the people who were looking at it, there was no way that we found initially. The first way that we found and developed was in connection with what is now the New York State commuter car railroad program, to which the two states passed legislation enabling each state to pick up the option of guaranteeing the commuter railroad car bonds which would be issued by the Port Authority

Excerpts from Testimony of Michael Zarin

essentially as an agency outside the Port Authority's financial structure.

The Port Authority's experience in issuing bonds, entering its contracts, and building was to be utilized, but not the whole structure which we will talk about in a moment.

New York passed the legislation to that effect, adopted a Constitutional [474] amendment guaranteeing up to 100 million dollars of bonds.

Under that, the Port Authority has purchased and leased to various commuter railroads, including the Long Island Railroad, and what is now the Penn Central system in New York, hundreds of commuter railroad cars and that is a revolving 100 million dollars so that as principal has been paid off over the years, we have actually issued more than a hundred million dollars, but always as a limit of state guarantee.

The bonds are paid via rentals from the commuter railroads and if a rental payment does not come in, the State comes in to pay it. That has never occurred.

After that structure of participation, there was an additional call to the Port Authority to participate in commuter railroad systems and what was developed in order to permit Port Authority participation is the 1962 covenant.

The next step, as I remember the procedure, and I think that that being the next step, perhaps I ought to describe a [475] covenant as I understand it because I think before letting me give the background of how we arrived at that point.

In describing the covenant, I will try always to contrast the covenant or to compare the covenant

Excerpts from Testimony of Michael Zarin

with all of the other protections and covenants under the statute and bond resolutions as I understand them.

The 1962 covenant is contained in Section 6 of Chapter 8 of the Laws of New Jersey, 1962, and the concurrent legislation which is Chapter 209 of the Laws of New York State of 1962.

In describing this covenant, your Honor, I think that I should at least initially confine myself to Section 6(b) which has been repealed, if that is agreeable to you.

That covenant is a very exact limitation on the deficit which may be incurred by the Port Authority in connection with passenger railroad facilities, in addition to those of the basic Hudson tube system which the Port Authority commenced operation in the latter part of 1962.

[476] The limitation is in two parts: One part would permit an additional deficit operation if the annual deficits, as measured in the statute, do not exceed ten percent of the General Reserve Fund of the Authority. That ten percent has an alternative computation, and that alternative computation is a computation of equity and amounts invested in facilities which is a one percent calculation, and the one percent calculation is really, as your Honor understands, analogous to ten percent of the General Reserve Fund, and the General Reserve Fund itself, being ten percent of the outstanding debt, ten percent of that amount is one percent.

However, being recognized that the debt of the Port Authority, of course, can be reduced, the General Reserve Fund being reduced, that permitted deficit would narrow. The alternatives would

Excerpts from Testimony of Michael Zarin

measure, would be the amount which the Port Authority has invested in facilities which are paid up, so that you would have the ten percent of the General Reserve Fund plus the one percent [477] of the equity, the amount which has been paid, and the amount paid into the facilities by way of investment of Port Authority funds. These amounts are adjusted so that you essentially cannot bootstrap them by putting money into additional railroad facilities, increasing your debt, increasing the ten percent or in essence increasing the equity amounts.

Those are in broad outline the limitations, and I should point out that I believe you have in the record, the official statement in connection with the 41st series of bonds and the statutory covenant and really probably a more exact summary of it than the one I have been able to give you orally, the one which we have set forth on page 16 and 17 which actually appeared in the 39th series, official statement and all the other official statements.

[478] The Court: In order for me to just comprehend the effect of the covenant that gets us back to the General Reserve Fund.

The Witness: Fine. I intend to do that and I'll do that now.

The General Reserve Fund of the Port Authority is a Reserve Fund, Statutory Reserve Fund, set up under the General Reserve Fund Statutes of the Port Authority, which in its practical effect today states that the Port Authority shall maintain in the General Reserve Fund—and when I say shall maintain, that's to the extent that there are funds available to maintain a reserve equal to 10 percent of the outstanding bonded debt of the Authority.

Excerpts from Testimony of Michael Zarin

It is really the debt which has been issued for terminal and transportation facilities and World Trade Center, of which that outstanding debt issued in the form of bonds for which the General Reserve Fund stands as a security.

10 percent of—the amounts of 10 percent of those bonds equal the present General Reserve Fund, and that is the fund against which this provision is measured that we have been [479] discussing.

The Court: Now, is there any other Statutory Reserve Funds the Port Authority is required to maintain other than the General Reserve?

The Witness: The General Reserve Fund and other statutes contain provisions under which the Authority may enter into agreements with bondholders, but I take it that those are not the agreements that you are talking about. You are talking about strictly statutory ones.

The Court: Statutory ones.

The Witness: And I don't recall that even the Consolidated Bond Reserve Fund is set up under statutory—under the statutes. I believe that that is set up under the Consolidated Bond Resolution.

So my testimony now would be and, of course, some of these questions that will come up are things that I may want to check, but my understanding is that this is the Statutory Fund, the General Reserve Fund is the Statutory Fund.

The Court: All right. Now, at the time the General Reserve Fund was authorized by legislation it was to consist of 10 percent of [480] the par value of all bonds issued by the Port Authority and currently outstanding. Is that your understanding of the General Reserve Fund?

Excerpts from Testimony of Michael Zarin

The Witness: That the intent—well, your Honor, that is the general understanding of it and I don't mean at all ever to quibble except I think I'm here as the person to give some really technical understanding to the extent I'm able.

People in our organization that frequently recall this requirement in conversation, and I'm always careful to point out when that occurs that it's a requirement only in the sense that it's specified in the statute.

If the General Reserve Fund were to fall below 10 percent that is not an occasion for bondholders, for example, to feel that a covenant has been breached.

The Court: No, I understand that.

The Witness: It's only to the extent that there are funds available that we would maintain it at 10 percent.

The Court: Right. The statute does not require you to have the 10 percent there if [481] you don't have it.

The Witness: You've stated it precisely.

The Court: So that's what the statute required as of 1931, and that applied not only to bonds then currently outstanding, but bonds thereafter issued.

The Witness: Bonds thereafter issued of the types stated there, bonds legal for investment and issued for particular terminal transportation purposes. I don't have the statute before me.

The Court: All right. Now, between 1931—well, before we get to that, the statute also authorizes the Port Authority to pledge the monies in the General Reserve Fund for the repayment of interest on bonds thereafter issued by the Authority. Is that correct?

Excerpts from Testimony of Michael Zarin

The Witness: Yes, your Honor.

The Court: Now, after 1931 the Port Authority did build certain facilities under the terms of what I have described in the papers here as the General Reserve Fund Statute?

The Witness: That is correct. T 469-24 to 481-23.

* * *

[502] The Court: Is there anything which should be inserted in this chronological history before we get to the adoption of the consolidated bond resolution?

The Witness: Your Honor, the explanation and discussion which we have just had effectively demonstrates the closing, in my judgment, of all of those prior liens, so that we may, in essence, in our discussion, take all of the prior obligations of the Port Authority before 1952 and say that they really do not need to form part of our discussion because the liens on those bonds were closed by these trusts and the bonds, themselves, while at one time they were so-called "open end issues," in that more could be sold of them, that ability to sell more of those bonds was closed when the consolidated bonds came into being, so I think we do not need at least for the purposes of this discussion, as I understand it, to consider pre-1952-issued obligations.

The Court: And assuming that the Port Authority never issued a consolidated bond and that this is all that was outstanding and then actually all of the revenues coming in for the **[503]** operation of your facilities, for the maintenance charges, could be allocated to any purpose consistent with the charter of the Port Authority? In other words, none of

Excerpts from Testimony of Michael Zarin

these bonds have any call on any revenues that come in?

The Witness: Those bonds, G & R, Air Terminal, Marine Terminal Bonds, are not presently part of the revenue flow.

The Court: Then you do not make any allocation of revenues to any of them aside from the payment of the operating expenses under the facilities themselves?

The Witness: As far as the obligations themselves are concerned, they are satisfied by payments by the Trust Company.

The Court: Does the Port Authority have any bonds outstanding prior to 1952 that were issued prior to 1952 which have any call on any revenues of the Port Authority at the present time?

The Witness: At the present moment, there is no call on any such revenues. I would say that the trust agreement itself provides that all of this is proper during the maintenance **[504]** of the trust. If we were not to maintain the trust for some reason and the trust was not to function, then it is conceivable that the revenue flows would still go to those bonds, because I think the agreement talks about upon the establishment then during the maintenance of the trust, we have defeased the liens. T 502-1 to 504-7.

* * *

[510A] The Court: I guess we are ready for 1952, consolidated bond resolution.

Now, in the sequence in which they occur, I am not so sure whether I am exact in this, would you explain first the 1.3 test under the consolidated bond resolu-

Excerpts from Testimony of Michael Zarin

tion? First of all, what does the consolidated bond resolution cover in terms of facilities?

The Witness: The consolidated bond resolution—

The Court: At the time it was adopted, what did it cover, what did it authorize the Port Authority to do?

The Witness: Well, of course, any [511] resolution—

The Court: At the time it was adopted, what did it cover, what did it authorize the Port Authority to do?

The Witness: Well, of course, any amounts which were to be invested after 1952 through the issuance of the Port Authority obligations beginning with 1952 and extending for quite some period of time thereafter, were consolidated bonds. There were no longer any G & R, air terminal or marine terminal bonds issued, so the consolidated bonds were issued for all the facilities of the Authority from that point on, whether they be bridges and tunnels on which the G & R bonds may have a first lien or air terminal bonds and so forth.

Then the first facility immediately following, in other words, a new facility immediately following on that would have a first lien on consolidated bonds.

The Court: As I understand it from Mr. Goldberg's book, the consolidated bonds could be issued for any purpose whatsoever? T 510A-11 to 511-24.

* * *

[512] The Witness: Yes, your Honor.

The Court: And in fact, historically, you did issue consolidated bonds for improvements to G&R facilities as well as air terminal facilities and marine terminal facilities?

Excerpts from Testimony of Michael Zarin

The Witness: Your Honor, perhaps I should say, just so that my statement is clear, that Mr. Goldberg's sentence says, "After unlimited purposes," that is any purposes that the Port of New York Authority was authorized by statute to go forward with and to use the general reserve fund [513] in connection with.

Now, the general reserve fund, so that we cannot issue for anything but those things that we are authorized to.

The Court: Of course. The general reserve fund substantially applies to the consolidated bonds which were issued by the Port Authority?

The Witness: Yes, your Honor.

The Court: Okay. So these he goes on to say are open-end bonds. In other words, you could continue issuing bonds under the terms of this resolution for old facilities and further improvements and so forth.

The Witness: Yes, subject, of course, to the limitations which your Honor alluded to before.

The Court: Yes. Now, in order to issue a consolidated bond, the 1.3 test must have been satisfied, there must be, I assume, a certification that the 1.3 test will be met.

The Witness: The 1.3 test must be met prior to the issuance of a consolidated bond [514] issue.

The Court: Now, would you explain the 1.3 test?

The Witness: Your Honor, the 1.3 test under the consolidated bond resolution is contained in the consolidated bond resolution adopted on October 9, 1952, by the Port Authority of New York and New Jersey. At that time, the Port of New York Authority.

The Court: What page are you on?

Excerpts from Testimony of Michael Zarin

The Witness: That resolution appears, beginning of page 55 of the official statement with respect to the 41st series. That is Exhibit 2.

The Court: What page then are you on?

The Witness: The consolidated bond resolution, Section 3, commences on page 57, the condition under which bonds have been issued [is] condition 3 appearing on page 59.

The Court: Condition 3.

Now, there are four conditions, any one of which must be met before you can issue a consolidated bond. Is that correct?

【515】 The Witness: Yes.

The Court: Are you saying that the Authority has elected only to issue bonds under condition 3?

The Witness: I am saying, your Honor, that we would issue obligations—that is to say, assuming that there is a project for which Commissioners wish to issue obligations, we would then examine this resolution to determine whether they could be issued and we have found that conditions other than condition 3 are more restrictive and therefore we have used condition 3.

The Court: Have all the bonds been issued under this condition?

The Witness: I believe that that is correct, but I am not absolutely certain. My answer would be yes, within the context of this discussion.

The Court: Then would you explain the requirements of condition 3 which is the 1.3 test?

The Witness: Yes, your Honor, condition 3 is a protection with respect 【516】 to the issuance of debt by the Authority and it measures, in essence, two mathematical, ascertainable facts. One is what will

Excerpts from Testimony of Michael Zarin

the debt service be in the maximum future debt service year on—in this case, really, it is bonds secured by the general reserve fund.

Now, that means that you would take all of—if I may, may we talk in terms of today, of how this would work? We would take all of the obligations, bonded indebtedness, secured by the general reserve fund presently outstanding and determine what is the year in which the maximum debt obligation namely principal and interest is due because the bonds, whether they be serial bonds which come due at a particular time, or sinking fund bonds which require these sinking funds from time to time, term bonds, which have the technical due date, sometime in the future, and I think I have heard that described in court here before.

There are other obligations for payment of principal and interest and you may ascertain as a mathematical matter what year in the [517] future is the largest payment due.

That is a number, whatever it may be.

[518] The Court: All right.

The Witness: And that's throughout the one side of the equation. T 512-13 to 518-3.

* * *

[521] The Court: All right. Now, you have explained then the one part of the equation is the maximum debt service requirement that you can project for the future.

The Witness: That's right. T 521-15 to 521-19.

* * *

[522] Mr. Sovern: Excuse me, your Honor. I'm sorry for interrupting, but as I heard the testimony,

Excerpts from Testimony of Michael Zarin

I want to be sure that I am clear about his. On the first part of the equation Mr. Zarin mentioned only the indebtedness already outstanding. Do you plan to come back with a new indebtedness or should that be pumped in at this point?

The Witness: I think that that is a [523] pertinent observation, your Honor, and that the obligations to be issued, also the debt service on those obligations also are to be included in the balance on the maximum future debt service side of the equation.

The Court: So it is plus the debt service requirement on the bonds to be issued.

The Witness: That is correct.

The Court: Okay. Now, does that complete the one side of the equation, of the formula?

[524] The Witness: It includes one side of the equation in the event the usual test with respect to the issuance of consolidated bonds under the 1.3 test is used; and the way we have usually used them is on the basis of the test of historical revenues.

The Court: Now we are on the other side.

The Witness: That is right.

The Court: Isn't that this formula?

The Witness: In this formula we have—

The Court: The revenues for your best twelve months out of the preceding thirty-six months—is that right?

The Witness: That is correct.

The Court: —must be equal to at least 1.3 times the maximum debt service requirements that you can project into the future. Is that it?

The Witness: That is the statement of the general rule under which we have been operating.

Excerpts from Testimony of Michael Zarin

The Court: Now, these revenues, do they include all revenues?

The Witness: The net revenues.

【525】 The Court: Net revenues.

The Witness: Yes.

The Court: And that is from all facilities?

The Witness: That is from all current facilities of the Port Authority.

The Court: Does anybody have any questions on the 1.3 test? Or is there more to it?

The Witness: I think your Honor fairly stated it; there is more to the 1.3 test then we have just analyzed.

The Court: All right.

The Witness: There is more to the 1.3 test on the technical side, and there is, of course, a great deal more in terms of protections which it furnishes which we of course have not yet gone into. But in terms of the technical side of it, which I think your Honor is addressing at the moment—

The Court: That is right.

The Witness: —the 1.3 test also permits of certain estimates to be made under which the historical revenues which you have discussed may be augmented up to an amount equal 【526】 to 25 percent of the revenues which your Honor stated, that is the historical revenues, namely, the twelve months out of the next preceding thirty-six months, twelve consecutive months.

The Court: Up to 25 percent.

The Witness: That may be done in the event that there is a projection that the revenues to be derived from certain facilities for which the bonds are issued will actually be realized.