ANNUAL REPORT
TO
STOCKHOLDERS
YEAR ENDED DECEMBER 31,
1938

STANDARD GAS AND ELECTRIC
COMPANY
INCORPORATED
ANNUAL REPORT
TO THE STOCKHOLDERS OF
STANDARD GAS AND ELECTRIC
COMPANY
(Incorporated in Delaware)

YEAR ENDED
DECEMBER 31,

1938
STANDARD GAS AND ELECTRIC COMPANY

BOARD OF DIRECTORS

VICTOR EMANUEL, Chairman

BENJAMIN L. ALLEN    JOHN K. MACGOWAN
GEORGE N. ARMSBY      THOMAS A. O'HARA
JAMES BRUCE           HAMILTON PELL
BERNARD W. LYNCH      THOMAS J. WALKER

OFFICERS

BERNARD W. LYNCH . President
A. S. CUMMINS
G. W. KNOUREK
E. H. NIEHOFF

Vice-President and Secretary
. Treasurer
Assistant Secretary and Assistant Treasurer

INCORPORATED IN DELAWARE APRIL 29, 1910
May 15, 1939

TO THE STOCKHOLDERS:

Your directors submit herewith the twenty-ninth annual report of Standard Gas and Electric Company covering operations for the year ended December 31, 1938.

Following the practice of your Company since its incorporation in 1910, the accounts of the Company and those of its subsidiary and affiliated companies have been examined and certified for the past year by independent certified public accountants.

Balance sheet and income and surplus accounts of Standard Gas and Electric Company appear on pages 8 to 16 and consolidated balance sheet and consolidated income and surplus accounts of Standard Gas and Electric Company and its subsidiaries on pages 19 to 36. In the consolidated balance sheet and statement of consolidated income and surplus accounts there are treated as subsidiaries only those companies in which Standard Gas and Electric Company owns more than 50% of the voting stock, and the subsidiaries of such companies, with the exception that, because of pending reorganization or receivership proceedings, the following corporations are not considered as subsidiaries therein: Deep Rock Oil Corporation, Pittsburgh Railways Company (and the companies operated by it) and Pittsburgh Motor Coach Company, all of which are in process of reorganization under Section 77B of the Bankruptcy Act, and The Beaver Valley Traction Company (in receivership), and the subsidiaries of such companies.

On page 17 of this report there is included a statement of securities owned by Standard Gas and Electric Company and on page 18 there will be found the names of its subsidiary and affiliated companies. Annual reports have been issued by subsidiary and affiliated companies of Standard Gas and Electric Company and are available to any security holder of this Company upon request.

This Company’s income for the year suffered drastically, principally due to a reduction in the amount of dividends paid by the Philadelphia Company whose subsidiaries serve the highly industrialized Pittsburgh area. However, most of the other companies in the system recorded some gains in 1938 and during the latter months of that year, when there was a further pick-up in general business, that improvement was also felt by the Pittsburgh companies.

In spite of these diminished earnings, for the first time in a number of years there is cause for some encouragement. Much has been accomplished by the various companies
in the system to meet the trend of present-day regulation, such as capital adjustments, the providing of increased reserves for depreciation as well as those for other purposes, rate reductions and the simplification and modernization of rate schedules, added improvements to, and the extension of, service, and the adoption of numerous other changes believed to be in the public interest.

The properties of the companies in the system, serving important and growing areas, have proven records of their ability to provide adequate service. Sound operating practices, combined with far-reaching load building policies which have played an important part in maintaining revenues during this period of greatly reduced industrial activity, should assure substantial increases in revenues once genuine recovery gets under way. These properties, administered by progressive managements with long years of experience, are capable of handling large amounts of additional business with substantially their present facilities. Further, as a result of changes already carried out together with those being planned, their capital structures should be such as to permit the raising of such funds as might later be needed for capital purposes.

Although the operating companies in the Standard Gas and Electric Company system have impressive records in bringing down the cost of electric service, future progress along this line will be determined largely by the ability of the public to invest in additional electrical appliances and the wiring incidental thereto. In the light of this fact, the completely electrified home is a considerable way off. Even if electricity were free, many homes would still fall short of complete electrification. While the cost of electricity, of course, has some effect on the use of this energy, the cost of appliances and wiring is of considerably greater importance.

As a result of the discussions and the studies that have been carried on during recent years, the public is gaining a better understanding of the utility business as it now exists. Public utility management has also undergone significant changes respecting the concept of its obligations and responsibilities. It is hoped that in this new relationship there is being laid the foundation for mutual confidence and cooperation. From it may grow a still broader usefulness for the public and the hoped for stability and future promise for the industry.

From the outset the policy of Standard Gas and Electric Company has been the principle of diversification and the operating properties of its subsidiary and affiliated companies comprise a number of integrated systems serving in different parts of the country and subject to varying economic conditions. Since the incorporation of Standard Gas and Electric Company in 1910, its operating companies have enjoyed a continuous record of expanding service in the public interest. They have been leaders in the principle of constantly better service to a widening circle and increasing number of people at continually lower rates. They have contributed much to the business life of the communities they serve, both to
their economic progress and their social well-being. Through taxation they have borne their full share of the cost of government—local, state and federal.

While this side of the picture is encouraging, there is another which causes concern. The Public Utility Act of 1935 provides for the control and regulation of public utility holding companies. Section 11 of the Act, entitled “Simplification of Holding Company Systems”, provides that the operations of each holding company system shall be limited to a single integrated public utility system, although giving the Commission discretionary powers under certain conditions to permit a holding company to continue to control one or more additional integrated public utility systems.

On August 3, 1938, the Securities and Exchange Commission addressed a letter to this Company requesting it to submit to the Commission, not later than December 1, 1938, its suggestions, plans and programs, even though they might be tentative, looking toward geographical integration and corporate simplification. Under date of November 26, 1938, in compliance with that request, this Company forwarded to the Commission such a tentative plan. Because the plan of any one holding company system, in so far as it calls for the acquisition or disposition of properties, would involve the plans of other systems, it was asked that the details of the plan submitted be kept confidential.

In view of the broad powers vested in the Securities and Exchange Commission, it seems likely that each situation with respect to integration will be treated separately. If so, the extent to which this Company’s system may be changed will not be known until a decision has been made regarding its particular problem. In the meantime, it can only be assumed that, through exchanges of property or otherwise, the service area of the system will be reconstituted so as to serve more concentrated situations.

Your Company is a holding or investment company whose principal assets are common stocks of public utility operating companies and other holding companies that have investments in operating public utilities. Its principal source of income is dividends from such securities. Due to a combination of circumstances, this Company’s income has declined for some years. Some of this loss can be recovered in an enduring business recovery, although it must be borne in mind that there is a growing tendency for regulatory bodies to require that the right of utilities to earn be based-upon the original or historical cost of property, and to lower the measure of return permitted to be earned by operating companies on their property values. Reduced rates for utility service, coupled with the generally higher operating ratios resulting from causes outside of the control of management, have been operating to lower the margin of net earnings of the operating public utility companies so that earnings applicable to common stock dividends are generally less. Demands for further rate reductions continue and taxes in an increasing amount appear certain for some time to come.
While it is recognized that the payment of taxes is the duty of every company and individual, somewhere in the not remote future there will be found a limit as to the tax burden the utility business can bear and continue to furnish the type of service and at the low rates that the public demands. The aggregate tax bill has become one of the largest single items of expense of the companies in the Standard Gas and Electric Company system. Taxes for 1938, totaling $19,675,737.29, amounted to approximately 14.68 per cent of the gross operating revenues of those companies. This amount includes only items charged to the tax expense account in accordance with the uniform systems of accounts. It does not include the large expenditures for gasoline taxes, vehicle and license taxes, certain payroll taxes and additional items that are classified in other accounts. A substantial part of the increasing trend of Federal taxes starting in 1933 is due to the 3 per cent Federal excise tax levied against private electric utilities. This tax on the domestic and commercial sales of these utilities has been in effect since September 1933, when the law was changed to provide that such tax must be absorbed by the utility. Prior to that time it was charged against the consumer. No like tax is now levied on other types of business and publicly owned utilities are exempt altogether from its provision.

Because of these various factors, there has resulted a large shrinkage in the value of this Company’s assets. While the precise amount of this shrinkage is unpredictable at this time and can only be ascertained following the completion of studies now being carried on, it seems improbable that any material part of such shrinkage can be restored.

The securities owned by your Company today are carried on its books at substantially their original cost. These securities were acquired over a long period of years, including in some instances acquisitions in the market for which payment was made in securities of your Company at the then prevailing market price. It is consequently apparent that adjustments will have to be made in the ledger values of these securities on the books of your Company in order that they may more nearly conform to the underlying asset value of such securities on the books of the issuing companies.

In order to carry out the provisions of the Supplemental Trust Agreement executed pursuant to the Plan of Reorganization consummated in 1938, the Board of Directors of Standard Gas and Electric Company authorized the creation of a “Reserve for Investments” in the amount of $120,000,000.00 by the transfer of $111,173,241.67 of Capital Surplus and $8,826,758.33 of Surplus Account. The Uniform System of Accounts for Public Utility Holding Companies prescribed by the Securities and Exchange Commission became applicable to your Company on June 1, 1938. In order to conform therewith, and pursuant to recommendations of the independent certified public accountants for your Company, all earnings subsequent to December 31, 1937, have been credited to an account termed “Earned Surplus Since December 31, 1937” and the Surplus Account at January 1, 1938, was closed out as of that date by the application of certain adjustments, including the transfer of the
balance in said Surplus Account, amounting to $7,595,831.55 as of that date, to Reserve for Investments. The Reserve for Investments account, totaling $127,595,831.55, is to be allocated to the respective securities or other property owned by the Company upon a basis to be hereafter determined.

During the closing months of 1938, the Board of Directors of this Company appropriated $1,500,000 of treasury funds to acquire in the open market notes and debentures of the Company. That undertaking resulted in the acquisition of $2,440,000 principal amount of those securities which have been deposited in the Company's treasury at an annual interest saving of $146,400. Studies are now being made to determine whether a program of reducing outstanding indebtedness and fixed interest charges should be continued.

Present income is not sufficient to warrant the resumption of dividends on any class of stock of your Company. The annual dividend requirement on the Prior Preference Stock is $3,178,436 and the annual dividend requirement on the $4.00 Cumulative Preferred Stock is $3,029,768. These preferred stocks have unpaid cumulative dividends aggregating approximately $33,150,000 as of December 31, 1938. Under these circumstances the provisions of the Public Utility Holding Company Act of 1935 may require a recapitalization of the stocks of your Company unless, through integration or otherwise, your Company becomes exempt from the Act.

On August 2, 1938, a final decree was entered by the District Court of the United States for the District of Delaware terminating the proceedings for the reorganization of Standard Gas and Electric Company, except as to certain matters over which the Court reserved jurisdiction, which included causes of action alleged to exist in favor of the Company. By the terms of an order entered by that Court on November 26, 1937, title to these claims had been vested in a Special Trustee. Suit was instituted in that Court by the Special Trustee on July 27, 1938, and is now pending.

Your officers and directors take this opportunity to express their grateful appreciation for the efficient and faithful services rendered by the employes of all the companies in the system.

By Order of the Board of Directors,

BERNARD W. LYNCH

President.

The within report is transmitted to the stockholders of the Company and to others requesting it solely for their statistical information. This report is not a representation, prospectus or circular in respect of any stock or security of any corporation and is not transmitted in connection with any sale or offer to sell or buy any stock or security now or hereafter to be issued or with any preliminary negotiations for such sale.
STANDARD GAS AND
(Incorporated
BALANCE SHEET,

ASSETS

INVESTMENTS—See Note A:

Securities of affiliates:
Companies in which the Company owns more than 50% of the voting stock. ........................................... $ 40,967,796.22
Companies in which the Company owns less than 50% of the voting stock. ........................................... 8,770,065.22
Total securities of affiliates. .................................... $ 249,737,861.44

Other investment securities (valuation based on market quotations or estimated, $5,871,966.25). ......................... 6,596,771.77
Indebtedness of affiliates, not current. ......................... 3,444,609.54
Securities of, and account receivable from, Deep Rock Oil Corporation—a subsidiary (Debtor under Section 77B of the Bankruptcy Act) 34,244,182.17
Securities of, and account receivable from, Mountain States Power Company—an affiliate (Debtor under Section 77B of the Bankruptcy Act) 11,203,600.55
Total investments. ................................................ $305,227,025.47
Less—reserve for investments ................................... 127,595,831.55
Remainder. ...................................................... $ 177,631,193.92

OFFICE FURNITURE AND FIXTURES. .......................... 1.00

CURRENT ASSETS:

Cash on hand and demand deposits.......................... $ 7,510,770.37
Cash, special deposits. ......................................... 1,059.14
Accounts receivable. .......................................... 35,525.90
Dividends receivable and interest accrued on securities of affiliates. ........................................... 987,579.00
Dividend receivable on other investment security. ........ 100,210.00
Total current assets............................................. $ 8,635,144.41

DEFERRED CHARGES:

Unamortized debt discount and expense (including unamortized expenses in connection with proposed extension to October 1, 1940 of the maturity of notes due October 1, 1935). ...................... $ 1,308,926.31
Other deferred charges. ........................................... 9,068.05
Total deferred charges.......................... 1,317,994.36

Total. ...................................................... $ 187,584,333.69

NOTE: The notes appended to this
ELECTRIC COMPANY
in Delaware)

December 31, 1938

LIABILITIES

CAPITAL STOCK—See Note C:

Preferred. .................................................. $ 87,350,943.35

(Prior preference, without par value—authorized, 750,000 shares:

$7.00 cumulative—issued, 378,000 shares, less 9,652 shares reacquired and in treasury, outstanding, 368,348 shares; maximum amount payable in liquidation, $100.00 per share and dividends accumulated and in arrears thereon.

$6.00 cumulative—issued and outstanding, 100,000 shares; maximum amount payable in liquidation, $100.00 per share and dividends accumulated and in arrears thereon.

$4.00 cumulative preferred, without par value—authorized, 1,500,000 shares; issued, 757,642 shares, less 200 shares reacquired and in treasury, outstanding, 757,442 shares; maximum amount payable in liquidation, $50.00 per share and unpaid cumulative dividends.)

Common, without par value—authorized, 10,000,000 shares; issued and outstanding, 2,162,607 shares. ...................... 21,626,070.00

Total capital stock........................................................................ $ 108,977,013.35

FUNDED DEBT:

Twenty year six per cent gold notes, due May 1, 1948 (less $269,000.00 principal amount reacquired and in treasury). ............ $ 14,554,000.00

Six per cent convertible gold notes, due May 1, 1948 (less $155,000.00 principal amount reacquired and in treasury). ........ 9,671,500.00

Six per cent gold debentures, series A, due February 1, 1951 (less $179,000.00 principal amount reacquired and in treasury). .... 14,821,000.00

Six per cent gold debentures, series B, due December 1, 1966 (less $78,000.00 principal amount reacquired and in treasury). .... 9,922,000.00

Six per cent debentures, due February 1, 1957 (less $15,000.00 principal amount reacquired and in treasury). ..................... 366,100.00

Standard Power and Light Corporation six per cent gold debentures, due February 1, 1957 (assumed) (less $726,000.00 principal amount reacquired and in treasury). .................. 22,892,900.00

Total funded debt. ........................................................................ 72,227,500.00

CURRENT LIABILITIES:

Accounts payable:

Affiliate. ........................................................................ $ 4,867.20

Reorganization expenses......................................................... 522,817.46

Other. ............................................................................... 71,559.05

Accrued liabilities:

Taxes—See Note D ............................................................... 127,038.25

Interest ........................................................................ 1,414,197.19

Other. ............................................................................... 24,000.00

Total current liabilities .............................................................. 2,164,499.15

RESERVES:

Insurance—See Note B ........................................................... $ 2,328,000.93

Reorganization expenses, taxes, and other contingencies applicable to periods prior to January 1, 1938. ...................... 1,003,213.73

Total reserves ........................................................................ 3,331,214.66

EARNED SURPLUS SINCE DECEMBER 31, 1937 ............. 884,106.53

Total ........................................................................ $ 187,584,333.69

balance sheet are an integral part thereof.
The term Affiliates as used in the foregoing balance sheet and the accompanying statement of income and surplus accounts of the Company and the notes appended thereto, includes companies 50% or more of the voting stock of which is owned by the Company, and subsidiaries of such companies, and also companies in respect of which the Company owns directly less than 50%, but approximately 40% or more of the voting stock, and subsidiaries of such companies. However, where the term Subsidiary or Subsidiaries has been used in the accompanying balance sheet and statement of income and surplus accounts of the Company, or in the notes thereto, it includes only companies in which the Company owns 50% or more of the voting stock, and their subsidiaries.

NOTE A:

1. The amounts given for securities of affiliates are composite figures compiled from the ledger balances of the related accounts as shown by the books of the Company, which ledger values ate the outcome, in part, of an attempt to express in dollars the results of numerous complicated transactions in many of which the cost or consideration of the assets acquired was either not expressed in cash or required allocation among groups of securities acquired, and, in part, of revaluations made from time to time of securities owned which included increases in the ledger values of some of such securities and decreases in the ledger values of others through credits and charges to the Company’s surplus accounts. Of such securities so revalued some have since been sold and others have been exchanged (including exchanges of securities in property mergers) so that only as to a part thereof are such revaluations reflected in the investments as shown in the balance sheet.

In addition to the acquisition values determined as in the foregoing, the Company’s practice in respect of investments in affiliates has included the capitalization of expenses incurred either at acquisition or subsequently and recorded by it as an element of cost including litigation expenses and settlements.

In accordance with authorizations of the Board of Directors, the balances as of January 1, 1938 in the capital surplus and general surplus accounts of the Company were appropriated to an investment reserve, the amount of which has been deducted above from the carrying values of the investments. Neither the ledger values of these investments nor the remainder thereof after deducting the reserve for investments are stated to represent either present worth, realizable values, cost, or the Company’s equity in the book value of net assets of affiliates as shown by their books.

The reserve for investments is to be allocated to the respective investments owned by the Company upon a basis to be hereafter determined.

2. The item “Securities of affiliates” includes the investments in Class A and Class B common stocks of Northern States Power Company (Delaware) which, as authorized by that company’s stockholders, have been reclassified, the par value per share of the Class A common stock having been reduced from $100.00 to $25.00 each and the capital represented by Class B common stock having been reduced to nil. In connection with the plan of reclassification and pursuant to an order of the Securities and Exchange Commission under provisions of the Public Utility Holding Company Act of 1935, Standard Gas and Electric Company as the holder of substantially all of the Class B common stock of Northern States Power Company (Delaware) has deposited such shares with a depositary under an escrow agreement, which shares are not to participate in any distribution of that company’s assets except by way of dividends payable out of earnings and will not have any voting rights after January 1, 1941. The order requires that such shares, which are carried by the Company at a ledger value of $7,328,397.02, shall be surrendered for cancelation not later than January 1, 1944 unless on or prior to that date the Commission shall have entered an order finding that during any period of twelve consecutive calendar months ending after January 1, 1939, and prior to January 1, 1944, consolodated net income of Northern States Power Company (Delaware) and its subsidiaries available for dividends after provision for fair and reasonable depreciation shall have exceeded the sum of (a) the dividend requirements for such period and dividends in arrears at the end of such period on any stock of that company and of any of its subsidiaries entitled to a preference in the distribution of earnings (other than stock owned by the company or any of its subsidiaries) and (b) the net income applicable to minority interests in the common stocks of its subsidiaries.

The item “Securities of, and account receivable from, Deep Rock Oil Corporation—subsidiary” is stated at the ledger value as shown by the books of Standard Gas and Electric Company of securities of said corporation of $24,901,539.80, owned by Standard Gas and Electric Company, plus an account receivable from
said corporation amounting to $9,342,642.37. Deep Rock Oil Corporation was placed in receivership on or about March 1, 1933 and became a Debtor under Section 77B of the Bankruptcy Act on or about June 7, 1934. A plan of reorganization of Deep Rock Oil Corporation, involving a compromise of the claim of Standard Gas and Electric Company against Deep Rock Oil Corporation on open account, was set aside in February 1939 by the United States Supreme Court by reversal of a decision of the Circuit Court of Appeals for the Tenth Circuit. Negotiations are now in progress for the formulation of a new plan of reorganization.

The item “Securities of, and account receivable from, Mountain States Power Company—an affiliate” is stated at the ledger value, as shown by the books of Standard Gas and Electric Company, of common stock of said company of $4,256,308.03, owned by Standard Gas and Electric Company, plus an account receivable from that company amounting to $6,947,292.52. Mountain States Power Company became a Debtor under Section 77B of the Bankruptcy Act on December 31, 1937. A plan of reorganization has been filed with the Securities and Exchange Commission.

Specific valuation adjustments of these items will be made upon allocation of the reserve for investments, as mentioned in Note A-1 above.

NOTE B:

The insurance reserve represents the excess (accumulated principally in prior years) of amounts received by Standard Gas and Electric Company from its affiliates under a tentative self insurance plan (being the amounts corresponding to the premiums at rates formerly paid for similar insurance) over the amounts paid for insurance by Standard Gas and Electric Company for account of such affiliates, less expenses applicable thereto, plus interest on the accumulated balances with respect to liability insurance from the time of creation of such reserve to December 31, 1938, and with respect to fire insurance from January 1, 1935 to December 31, 1938. The need for consideration of self insurance no longer exists and accordingly it has been concluded that the reserve be distributed to the several affiliates.

NOTE C:

1. The 757,442 shares of $4.00 cumulative preferred stock outstanding include 43 shares issued in the names of nominees and held for delivery in exchange for outstanding scrip.

2. The 2,162,607 shares of common stock outstanding include 573 shares issued in the name of a nominee and held for delivery in exchange for outstanding scrip.

3. Dividends on the prior preference stocks have been paid in full to September 30, 1933, and, for the twelve months ended September 30, 1934, were paid at 30% of the cumulative rates, and since the latter date none has been declared or paid. Dividends on the $4.00 cumulative preferred stock have been paid in full to February 28, 1933, and since that date, none has been declared or paid on this stock. To December 31, 1938 dividends accumulated on the prior preference stock, $7.00 cumulative, not declared or paid amount to $12,763,258.20; on the prior preference stock, $6.00 cumulative, $2,970,000.00; and to November 30, 1938 on the $4.00 cumulative preferred stock, $17,421,166.00; a total of $33,154,424.20.

NOTE D---CONTINGENT LIABILITIES:

The Company was contingently liable at December 31, 1938, as indemnitor of the surety or sureties in connection with surety bonds issued by others for affiliates, aggregating $21,700.00.

The County Assessor of Cook County, State of Illinois, has assessed personal property taxes against the Company of approximately $875,000 for the year 1937 and $618,000 for the year 1938. Proceedings have been instituted to enjoin the collection of these taxes as the officers of the Company believe that the assessments are largely in excess of amounts which will be finally determined for the reason that the Company is a Delaware corporation and its property during those years was located principally outside of the State of Illinois and in the opinion of attorneys for the Company such property was not taxable under the laws of that State. Accordingly no provision has been made for such assessments.

Standard Gas and Electric Company, in connection with the sale to a certain banking group of 100,000 shares of its prior preference stock, $6.00 cumulative, on or about March 24, 1930, agreed in substance that in the event that a final order or decree of any court of competent jurisdiction from which no appeal or stay
should lie should be entered, setting aside all or any part of the transactions consummated between Standard
Gas and Electric Company and Standard Power and Light Corporation on January 7, 1930, and thereafter any
final and conclusive judgment should be entered against any of the members of said banking group by reason
of alleged damages to any purchaser of such stock from them on the ground of failure or inability on their
part to fulfill the representations set forth in the circular under which such shares were marketed, on account
of such rescission or setting aside, Standard Gas and Electric Company should indemnify the members of said
banking group against any such judgment rendered against them respectively and should defend any such
action against any of them at its own cost.

Standard Gas and Electric Company, in connection with the solicitations of deposits of its twenty
year six per cent gold notes and six per cent convertible gold notes, both of which were due October 1, 1935,
under Extension and Deposit Agreement dated June 18, 1935, agreed to indemnify the underwriters from all
loss, liability or expense incurred or sustained under the Securities Act of 1933, as amended, or at common
law or otherwise, arising out of, or based upon, an untrue statement of a material fact, or the omission to
state a material fact in the registration statements or the prospectus, subject to certain exceptions as to state-
ments or omissions based entirely on information furnished to the Company by the underwriters.

Consolidated Federal income tax returns filed by the Company for itself and certain of its subsidiaries
or former subsidiaries for the years 1925 to 1932, inclusive, are subject to final review by the Bureau of Internal
Revenue. Under agreements filed with the Bureau of Internal Revenue for the years 1925 to 1928, inclusive,
and under existing regulations prescribed by the Treasury Department applicable to the years 1929 to 1932,
inclusive, the Company has a contingent liability of an indeterminate amount for additional Federal income
taxes and interest thereon of such companies included in the consolidated tax returns. The full amount of
tax liability in connection with the returns for the years 1925 to 1932 has not been finally determined. Any
such liability when finally determined will be allocated to, and charged against the Company and/or certain
of its respective subsidiaries or former subsidiaries, the income of which was included in the respective con-
solidated income tax returns. A review of such returns for the years 1925 to 1932, inclusive, has been made
by the Treasury Department and on November 22, 1935, deficiencies were assessed against Standard Gas and
Electric Company. Subsequently, credits of $22,082.57 for overpayments made for other years by certain
subsidiaries consolidated therein were applied against the above assessments by the Treasury Department.
The net amount of these assessments now outstanding is $4,386,441.10. If this amount is paid, the alloca-
tion (based upon the method of allocation adopted by Standard Gas and Electric Company) would be to
Standard Gas and Electric Company $231,616.16 and to subsidiaries $4,154,824.94. The foregoing amounts
are exclusive of interest. The questions involved in these controversies are such that it is impossible to ac-
curately estimate or determine the amount of actual liability. The principal matters in dispute are depre-
ciation and depletion, loss on retirements of equipment, profit or loss on sale or exchange of investments, and
net losses for prior years. It is the opinion of the officers of the Company that the above assessments are
largely in excess of the maximum liability which will be finally determined. Under agreement dated March
12, 1938, 890,000 shares of Philadelphia Company common capital stock owned by the Company are on de-
posit in escrow to assure payment of the disputed liability for Federal income taxes and statutory interest for
the years 1925 to 1932, inclusive, as may be finally determined. In proceedings under Section 77B which were
consummated in 1938, the District Court of the United States for the District of Delaware has reserved juris-
diction for the purpose of determining and allowing and ordering payment of, or disallowing, the claims of
the Treasury Department. The separate returns of the Company for the years subsequent to 1934 are subject
to final review by the Treasury Department. The accrued liabilities shown in the foregoing balance sheet
include $151,182.06, representing the amount estimated by Standard Gas and Electric Company as applicable
to it as of December 31, 1938 for Federal income tax liability to and including 1938 and interest thereon.
STANDARD GAS AND ELECTRIC COMPANY

STATEMENT OF INCOME AND SURPLUS ACCOUNTS

For the Year Ended December 31, 1938

INCOME FROM DIVIDENDS AND INTEREST:

Dividends from public utility affiliates .................................................. $ 4,788,238.50
Dividends from others ................................................................................. 402,051.00
Interest on funded debt of affiliate ............................................................ 130,625.00
Interest on indebtedness of affiliate—See Note B ...................................... 51,785.96 $ 5,372,700.46

EXPENSES:

Corporate, fiscal and administrative expenses ........................................... $ 231,963.01
Legal service ................................................................................................. 40,576.35
Taxes (other than income taxes) .................................................................... 29,459.26
Provision for Federal income taxes ............................................................... 22,000.00 323,998.62

GROSS INCOME ........................................................................................ $ 5,048,701.84

INCOME DEDUCTIONS:

Interest on funded debt .............................................................................. $ 4,413,918.23
Other interest ................................................................................................ 73,098.47
Federal and state tax on interest on funded debt .................................... 66,704.84
Amortization of debt discount and expense (including amortization of expenses in connection with proposed extension to October 1, 1940 of the maturity of notes due October 1, 1935) ................................................. 155,010.27 4,708,731.81

NET INCOME ................................................................................................ $ 339,970.03

SURPLUS ACCOUNT, JANUARY 1, 1938 ................................................... $ 18,994,638.60

DEDUCT:

Dividends accrued but not declared by public utility affiliates at December 31, 1937, included in income above as declared .......................................................... $ 467,948.31
Reduction in book value of investment in Pacific Gas and Electric Company common stock .......................................................... 454,100.41
Appropriation to reserve for reorganization expenses, taxes, and other contingencies applicable to periods prior to January 1, 1938 .................................................. 1,650,000.00
Appropriation of surplus account balance as at January 1, 1938 to reserve for investments .......................................................... 16,422,589.88 18,994,638.60

SURPLUS ACCOUNT, JANUARY 1, 1938, AS ADJUSTED .............................. Nil

ADD—credit arising from the reacquisition of notes and debentures during the year .......................................................... 544,136.50

BALANCE, DECEMBER 31, 1938—Earned surplus since December 31, 1937 ................. $ 884,106.53

CAPITAL SURPLUS

BALANCE, JANUARY 1, 1938 ........................................................................ $ 111,173,241.67

DEDUCT—Appropriation as at January 1, 1938 to reserve for investments ........................................... 111,173,241.67

BALANCE, DECEMBER 31, 1938 ................................................................ Nil

NOTE: The notes appended to this statement of income and surplus accounts are an integral part thereof.
STANDARD GAS AND ELECTRIC COMPANY
STATEMENT OF INCOME AND SURPLUS ACCOUNT NOTES
For the Year Ended December 31, 1938

NOTE A:
In accordance with the requirements of the Uniform System of Accounts for Public Utility Holding Companies as promulgated by the Securities and Exchange Commission, dividends are included herein on a declared basis.

NOTE B:
This item represents interest accrued on open account with Market Street Railway Company, which interest was concurrently accrued and charged to income by that company. Of the above stated amount, $30,362.18, representing the interest from May 25 to December 24, 1938, has not been collected by Standard Gas and Electric Company but has been charged to open account with Market Street Railway Company.

NOTE C:
See Note C to the balance sheet with respect to preferred dividends in arrears.

NOTE D:
See Note D to the balance sheet with respect to Illinois personal property taxes assessed for the year 1938.

NOTE E—AFFILIATED COMPANIES:
The following information relates to accounting practices of certain affiliated companies and should be considered in connection with the financial statements of the Company.

Retirement and Depreciation Reserve Policy
The appropriations for retirement or depreciation reserve as made by the companies during the year 1938 have been made on the basis of amounts determined by the respective companies which amounts have been charged against income and credited to the retirement or depreciation reserve. Retirements and other dispositions of fixed property have been recorded, based on the excess of ledger value (actual or estimated cost or appraised value, depending upon the value at which recorded in the accounts) over the net consideration or salvage value received. The appropriations for retirements do not purport to approximate depreciation on the basis of estimated lives of units of depreciable property, on which basis the companies have computed the amounts claimed on account of depreciation for Federal income tax purposes. Generally, and in the aggregate, the tax deductions for depreciation have substantially exceeded the amounts charged in the books as appropriations for retirements or depreciation.

As to the Philadelphia Company and subsidiaries, provision is being made for depletion of the principal gas producing property, based upon production; in the case of other gas and oil companies depletion is not provided for except in so far as it may be recognized in appropriations to the general retirement reserves.

Reserves for amortization of leaseholds have been created by Philadelphia Company and certain of its subsidiaries for the purpose of amortizing the cost of gas leases acquired subsequent to January 1, 1920, the cost of improvements to a leased transmission line, and the cost of acquiring a lease on coal lands. Appropriations to such reserves are computed with reference to the cost of acquiring the leases and the term, or estimated active life, thereof. In the case of some subsidiaries, amortization of leaseholds is not specifically provided for, retirements thereof being cleared through the general retirement or depletion reserves. No provision has been made for amortization of certain leaseholds acquired prior to January 1, 1920, carried on the books at $1,161,911.34.

It has not been the practice of the companies to provide for amortization of intangible values except in the case of the Company’s Mexican subsidiary (provision for which is included in the retirement reserve), and in some instances for certain limited-term investments.

The Uniform Systems of Accounts prescribed by the Federal Power Commission, effective January 1, 1937, and by certain State Regulatory Commissions, effective January 1, 1937, 1938, or 1939, have been adopted by affiliated companies. These systems require generally that a study and reclassification of property, plant, and equipment (including intangibles) shall be made and that depreciation rather than retirement accounting shall be followed. In most instances the studies by the companies were in progress at December 31, 1938 and until these have been completed it is not known to what extent changes in accounting practice will affect the companies’ accounts or the income of Standard Gas and Electric Company.
Amortization of Other Deferred Charges

In some instances losses on property abandoned or sold are carried as deferred charges; certain losses on such property abandoned are being amortized over a ten-year period ending in 1947.

Preliminary costs of projects abandoned are being amortized by charges against income over five-year periods in accordance with permission granted by regulatory bodies.

Flood and rehabilitation expenses resulting from floods in 1936 and 1937 are being amortized over varying periods. In accordance with accounting made optional in 1936 by The Public Service Commission of the Commonwealth of Pennsylvania (now The Pennsylvania Public Utility Commission), such losses and expenses incurred by certain subsidiary companies of Philadelphia Company are being amortized over a five-year period commencing September 1, 1936 by charges to operating expenses. The losses incurred during 1937 by Louisville Gas and Electric Company (Kentucky) are being amortized by charges to income over a five-year period ending in 1941, in accordance with instructions of the Public Service Commission of Kentucky.

Contractual capital expenditures carried as deferred charges are in process of amortization over the approximate life of the related contract ending in 1948.