

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA.

In the matter of the application of SOUTH PACIFIC COAST RAILWAY COMPANY and SOUTHERN PACIFIC COMPANY for an order approving agreement entered into by said companies under date of December 4, 1913, modifying the lease made by South Pacific Coast Railway Company to Southern Pacific Company, dated July 1, 1887.

Application No. 1006.

- Guy V. Shoup for applicants.
- Pillsbury, Madison & Sutro, Felix T. Smith and Parker Maddux for Savings Union Bank and Trust Company, Intervenor.
- Tobin & Tobin for Mrs. W. K. Vanderbilt and Mrs. Theresa Oelrichs.
- M. M. Jones for Oakland Chamber of Commerce, Intervenor.

THELEN, Commissioner.

O P I N I O N .

This is an application for authority to modify subsection 5 of Article III of a lease from South Pacific Coast Railway Company to Southern Pacific Company, dated July 1, 1887, with reference to the sum of money to be paid each year as rental by the Southern Pacific Company to the South Pacific Coast Railway Company. The Savings Union Bank and Trust Company was granted leave to intervene and protested against the application being granted on the ground that if the proposed change in the lease be consummated, the amount of money available for the retirement of outstanding bonds would be diminished. The Chamber of Commerce of Oakland also appeared and urged that if the moneys to be paid by the Southern Pacific Company to the South Pacific Coast Railway Company under said lease are not all necessary to pay the interest on the bonds of the South Pacific Coast Railway Company, as the interest falls due from time to time, this money should be used to install more frequent and efficient train service on the line owned by the South Pacific Coast Railway Company between Oakland and Santa Cruz.

South Pacific Coast Railway Company was incorporated on May 21, 1887. This company is a consolidation and amalgamation of seven other railroad corporations, known as the Santa Cruz and Felton Railroad Company, South Pacific Coast Railroad Company, Bay and Coast Railroad Company, Oakland Township Railroad Company, San Francisco and Colorado River Railroad Company, Felton and Pescadero Railroad Company and Almaden Branch Railroad Company. The property owned by the South Pacific Coast Railway Company, the new corporation, consisted of a certain ferry line between the City and County of San Francisco and the City of Alameda, and certain steam ferry boats used thereon, and of a railroad commencing at the eastern terminus of said ferry, in the Bay of San Francisco, and running thence through the City of Alameda and through the County of Alameda, the County of Santa Clara and the County of Santa Cruz, to the town of Santa Cruz, forming with said ferry a continuous line from San Francisco to Santa Cruz, and of various branches thereof, and also of a line of railroad from the City of Alameda to the City of Oakland, together with certain telegraph lines.

On July 1, 1887, the South Pacific Coast Railway Company executed its deed of trust or mortgage to The Farmers' Loan and Trust Company, of New York City, to secure an issue of first mortgage bonds of the face value of \$5,500,000, payable 50 years after date, and bearing interest at the rate of 4% per annum. The interest is payable semi-annually on the first day of January and July of each year. Among other provisions, the deed of trust or mortgage provides in Article VI thereof, for a sinking fund to be applied to the redemption of the bonds. In this article, the South Pacific Coast Railway Company agreed that on July 1, 1912 and annually thereafter, until the payments previously made should, with the interest earned thereon, be sufficient to fully pay and redeem all the bonds, it would pay to the trustee the sum of \$220,000, in gold coin, in four equal quarterly payments. Each year advertisement shall be made for the receipt of bids for the sale to the sinking fund of so many bonds.

as the funds at that time on hand applicable to such purposes will redeem at or near par and accrued interest, and it is made the duty of the trustee to the extent of such funds, to purchase and redeem such bonds as may be offered at or below par and accrued interest, preference being given to the lowest bids received. In accordance with the provisions of this trust deed or mortgage, the South Pacific Coast Railway Company issued its 4%, 50-year gold bonds, in the total amount of \$5,500,000, as therein provided.

On the same day, viz., July 1, 1887, the South Pacific Coast Railway Company executed a lease of its property to the Southern Pacific Company for the term of 55 years from July 1, 1887. The Southern Pacific Company agreed that it would, during the continuance of the lease, preserve and maintain the property in as good condition as it was when it received it; that it would continue to operate the railroads and ferries of the lessor and that the service to be rendered would be at least equal to the service rendered by the lessor at the time of making the lease; that it would pay all taxes and assessments levied or charged against the property; that it would pay all expenses and charges incident to the operation and running of the railroads, ferries and telegraph lines of the lessor; and that it would guarantee the payment of the principal and interest of the bonds of the lessor. Subsection 5 of Article III of the lease reads as follows:

"That it (Southern Pacific Company) will, during the continuance of this lease, pay as rent for the said demised premises, including said ferry boats and telegraph lines, an annual sum equivalent to four per cent. on the five million five hundred thousand dollars of bonded debt of said party of the first part, secured by a mortgage on the said demised premises and every part thereof; that is to say, the sum of two hundred and twenty thousand dollars per annum, in the gold coin of the United States, of the present standard and fineness, in semi-annual installments on the thirty-first day of December, and the thirtieth day of June of each year, to be used by the party of the first part in paying the interest on the said bonds, and that from and after the first day of July, one thousand nine hundred and twelve, the said party of the second part shall further pay as rent for the said demised premises a further sum annually of two hundred and twenty thousand dollars, in the like gold coin in four equal quarterly payments, viz:; on the thirtieth day of September, the Thirty-first day of December, the thirty-first

day of March and the thirtieth day of June, and said payments are to be made to the Farmers' Loan and Trust Company in the City of New York, the trustee named in the mortgage, to secure the said bonds issued by the party of the first part, or to its successors in trust; which said payments shall be used for and constitute a sinking fund for the redemption of the said five million five hundred thousand dollars of said bonds issued by the party of the first part, such payments to continue at the times hereinbefore specified, until the payments previously made shall, with interest earned thereon, and the accretions thereto be sufficient to fully pay and redeem said bonds, also that it shall and will during said period, keep and maintain an office for the transaction of the business of the party of the first part, both in the City of New York and in the said City and County of San Francisco."

Upon the execution of said lease, the Southern Pacific Company entered into the possession of the properties of the South Pacific Coast Railway Company, and subsequently thereto it has continuously maintained and operated said properties. The Southern Pacific Company has expended over \$200,000 in changing the gauge of the railroad from narrow to standard gauge; over \$600,000 in widening tunnels; over \$280,000 in electrification in Alameda; and over \$100,000 in installing block signalling, interlocking and kindred protective devices. During the last ten years, the Southern Pacific Company claims to have spent for additions and betterments on this property, the sum of \$1,949,562.14.

The petitioners now ask for a modification of Section 5 of Article III of the lease, so as to read as follows:

"That it (Southern Pacific Company) will, during the continuance of this lease, pay as rent for the said demised premises, including said ferry boats and telegraph lines, an annual sum equivalent to four per cent. on the outstanding bonded debt of said party of the first part, secured by a mortgage on the said demised premises and every part thereof; such payment to be made in the gold coin of the United States, of the present standard and fineness, in semi-annual installments on the thirty-first day of December, and the thirtieth day of June of each year, to be used by the party of the first part in paying the interest on the said bonds, and that from and after the first day of July, one thousand nine hundred and twelve, the said party of the second part shall further pay as rent for the said demised premises a further sum annually of two hundred and twenty thousand dollars, in the like gold coin in four equal quarterly payments, viz: on the thirtieth day of September, the thirty-first day of December, the thirty-first day of March and the thirtieth day of June, and said payments are to be made to the Farmers' Loan and Trust Company in the City of New York, the trustee named in the mortgage, to secure the said bonds issued by the party of the first part, or to its successor in the trust; which said payments shall be used for and constitute

a sinking fund for the redemption of the said five million five hundred thousand dollars of said bonds issued by the party of the first part, such payments to continue at the times hereinbefore specified, until the payments previously made shall, with the interest earned thereon, and the accretions thereto, be sufficient to fully pay and redeem said bonds, also that it shall and will during said period, keep and maintain an office for the transaction of the business of the party of the first part, both in the City of New York and in the said City and County of San Francisco."

In support of this application, the Southern Pacific Company drew attention to the fact that under the lease of July 1, 1887, provision is made for a rental to consist of two sums of money, the first being an annual sum equivalent to 4% on the \$5,500,000 of the bonded debt of the South Pacific Coast Railway Company, and the second being the payment on and after July 1, 1912, of the sum of \$220,000 annually to be used as a sinking fund for the redemption of the outstanding bonds. The Southern Pacific Company claims that the intent of these provisions was that the rental payments should be equal to the interest and sinking fund obligations of the South Pacific Coast Railway Company under its bond mortgage but that as bonds were brought in and cancelled, the amount of interest payable on the remaining outstanding bonds would gradually diminish after July 1, 1912, so that it would no longer be necessary to pay the sum of \$220,000 per year to meet interest obligations. The petitioners accordingly ask for a modification of the lease so that it will be necessary to pay as rental an annual sum equal to 4% on only the remaining outstanding bonded indebtedness from time to time, together with the flat sum of \$220,000 per annum for sinking fund purposes.

The Savings Union Bank and Trust Company asked and was granted leave to file a petition in intervention. This company claims to be the owner of bonds of the South Pacific Coast Railway Company having a face value of \$375,000, and protests against the granting of the application on the ground that the funds available for the redemption of bonds would thereby be diminished, with the result that a longer period will elapse before the outstanding bonds are redeemed. In support of its position, this company refers to

Article VI of the lease of July 1, 1887, reading as follows:

"It is distinctly covenanted and agreed between the parties hereto, that this lease is made subject to the terms and lien of the said mortgage or deed of trust, executed by said party of the first part to the said Farmers' Loan and Trust Company as trustee, and that the terms of this lease shall not, prior to the payment of the said bonds, be in any manner changed or altered so as to impair the security of the said mortgage or deed of trust, without the written consent of a majority in amount of the said bondholders."

The company claims that the proposed alteration in the lease would impair the security of the mortgage or deed of trust and points to the fact that the written consent of a majority in amount of the bondholders has not been secured.

The Southern Pacific Company urges that if it should continue to pay into the treasury of the South Pacific Coast Railway Company the sums specified in Section 5 of Article III of the lease, it would be paying funds in excess of those necessary to meet the sinking fund obligations and also the annual interest payments. The Company accordingly claims that as it owns all the stock of the South Pacific Coast Railway Company, it would have the right to declare a dividend of the surplus moneys so paid in excess of the annual payments for interest and sinking fund purposes. The company claims that it is not desirable to take this roundabout method of getting such excess payments back into its own treasury, and accordingly asks for a modification of the lease in the respects hereinbefore pointed out.

The protestant, Savings Union Bank and Trust Company, first urged in reply to this claim that there are certain expense items, such as income tax payments, which the Southern Pacific Company has not obligated itself to pay, and that any excess sums remaining in the treasury of the South Pacific Coast Railway Company after the payment of sinking fund and interest, should be retained for the purpose of paying such expenses. The Southern Pacific Company, without admitting the correctness of this claim, thereupon agreed to enter into a stipulation to pay all taxes and other charges against the South Pacific Coast Railway Company, whether specifically described

in the lease or not. As the Southern Pacific Company owns all the capital stock of the South Pacific Coast Railway Company, it would presumably be compelled in any event to pay all claims against the South Pacific Coast Railway, under its stockholders' liability.

The Savings Union Bank and Trust Company thereupon urged that the entire sum of \$440,000 to be paid annually by the Southern Pacific Company on and after July 1, 1912, is a trust fund for the payment of bonds and interest, and that as the number of outstanding bonds diminishes, so that the interest payments each year become less, the funds remaining in the treasury should be used for the purpose of redeeming additional bonds. There is no point made that the security is not ample to support the bonds, but the Bank points to the fact that the interest on these bonds is only 4% and that it is accordingly desirable to have the bonds redeemed as early as possible, so that the proceeds may be invested in securities bearing a higher rate of interest.

That this Commission's consent must be secured before the lease is altered seems clear, under the provisions of Section 51 of the Public Utilities Act, providing in part that no railroad corporation shall sell, lease, assign, mortgage or otherwise dispose of or encumber the whole or any part of its railroad, necessary or useful in the performance of its duties to the public, without having first secured from this Commission an order authorizing it so to do. As this Commission's consent is necessary for an original lease, it seems likewise necessary for an alteration in the terms thereof.

If the Commission in this proceeding refuses its consent, it is clear that the lease cannot legally be altered. If the proposed alteration in the lease would result in the impairment of the security of the mortgage or deed of trust, the petition should be denied. On the one hand, if the position of the protestants is not valid and if the Southern Pacific Company finds itself unable to secure the written consent of a majority in amount of the bondholders to the proposed change, the refusal of this Commission to grant its consent

would undoubtedly work an injustice. On the other hand, if this Commission should grant the application, the result might be long drawn out litigation on the part of the protestants or others who might believe that their security was being impaired. The Commission does not desire to take action which will work an injustice in the one event or lead to needless litigation in the other. It has occurred to me that it might prove relatively easy to secure the written consent of a majority in amount of the bondholders to the proposed change. Mrs. William K. Vanderbilt and Mrs. Theresa Oelrichs, who own over two million dollars, face value, of the outstanding bonds, were represented by counsel, who stated that in view of the fact that these bonds are guaranteed by the Southern Pacific Company, his clients have no objection to the granting of the application. As bonds of the face value of \$177,000 have already been redeemed, it would seem that it should not be difficult to secure the consent of sufficient of the remaining bondholders so as to amount to a majority of the outstanding bonds. I shall accordingly recommend that no action be taken by the Commission at this time, but that the applicants be granted six months within which to secure the consent of a majority of the owners of the outstanding bonds to the proposed change. If such consent is secured, I shall then recommend that the application be granted, on condition that the Southern Pacific Company agree to pay all charges against the property, including the Federal income tax, and any other charges which may not be included in the lease as now worded. If the Southern Pacific Company finds itself unable within the six months herein specified to secure such consent, it may then again appear before the Commission, whereupon the Commission will determine whether it will grant the application, notwithstanding the failure to secure the written consent of the owners of a majority of the outstanding bonds.

The Oakland Chamber of Commerce was represented at the hearing and opposed the granting of the application on the ground

that any surplus moneys remaining in the treasury of the South Pacific Coast Railway Company, and not necessary to meet the sinking fund requirements and the interest payments of the South Pacific Coast Railway Company's bonds, should be used for the establishment of more frequent and efficient train service between Oakland and points south thereof on the line of the South Pacific Coast Railway Company. The Chamber of Commerce presented several letters from persons complaining of the service and asking that improvements be made therein. As this matter is only collateral to the real issue here presented, and as it would seem inexpedient in this proceeding to go into the entire question of the adequacy of the service of the Southern Pacific Company over this line of railway, I think it would be wiser to leave this matter to a separate proceeding. If the Chamber of Commerce will file a formal complaint with this Commission, complaining of the service on this line of railway, the Commission will be glad to expedite a hearing on such application and to do all in its power to secure a speedy and satisfactory determination of the matter. The present proceeding hardly seems appropriate for this purpose.

I submit herewith the following form of order:

O R D E R.

SOUTH PACIFIC COAST RAILWAY COMPANY and SOUTHERN PACIFIC COMPANY having filed an application for authority to alter Section 5 of Article III of the lease of July 1, 1887, from South Pacific Coast Railway Company to Southern Pacific Company, so as to provide in part that in lieu of the paying each year into the treasury of the South Pacific Coast Railway Company the sum of four (4) per cent on the entire bond issue of the South Pacific Coast Railway Company, the Southern Pacific Company should be obligated to pay only four (4) per cent on the bonds remaining outstanding from time to time, and the Savings Union Bank and Trust Company and the Oakland Chamber of Commerce having asked for and been granted authority to appear in opposition to said petition, and a public hearing having been held

and the application having been submitted and being now ready for decision;

IT IS HEREBY ORDERED AS FOLLOWS:

1. Petitioners herein are hereby given six (6) months time within which to present to this Commission the written consent of the owners of a majority of the outstanding bonds of the South Pacific Coast Railway Company to the proposed change in said lease, whereupon when such consent is presented, this Commission will make its order approving the proposed alteration of the lease.

2. If the petitioners herein endeavor, in good faith, to secure such consent of the owners of a majority of the outstanding bonds of the South Pacific Coast Railway Company, and are unable within six (6) months from the date of this order to secure such consent, they may thereupon apply to this Commission with the request that it make its order granting their application, notwithstanding the failure to secure such consent. The Commission will thereupon take such action as to it may seem at such time just and reasonable.

The foregoing opinion and order are hereby approved and ordered filed as the opinion and order of the Railroad Commission of the State of California.

Dated at San Francisco, California, this 23rd day of March, 1914.

John W. Cochran
W. D. ...
...
Max ...
Edwin O. Edgerston
Commissioners.