

Decision No. 215

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In the matter of the application of
BIG FOUR ELECTRIC RAILWAY COMPANY,
a corporation, for an order author-
izing the issuance of 100,000 shares
of Capital Stock, par value \$100,000
.....

Application No. 144.

Frank A. Duryea, for Applicant.

Gordon, Commissioner.

O P I N I O N

On July 12, 1912, the BIG FOUR ELECTRIC RAILWAY COMPANY, a corporation, filed with this Commission an application for an order authorizing the issuance of 35,000 shares of its capital stock, having the par value of \$35,000. The proceeds of the sale of this stock were to be used partly to discharge the present indebtedness of the company and the remainder towards the construction of its proposed line of railroad. One reason given by applicant for desiring to issue this stock was that after such issuance the holders of stock would then be legally qualified to vote upon and authorize the execution of a mortgage and the issuance of bonds thereunder, from the sale of which the company proposed to construct its line of railroad.

The hearing was held at Tulare on August 17, 1912. It appeared at the hearing that the purposes for which the proceeds of the sale of 35,000 shares of capital stock were to be used were not clearly set out in the application, and further that the issuance of this stock would not permit the applicant to accomplish other purposes desired. The applicant then stated its intention of filing with the Commission an amended application in which the issuance of 100,000 shares of capital stock of the par value of \$100,000. would be prayed for, and requested that the evidence and testimony taken on the

hearing be considered as applicable to the amended application and that action be taken on the amended application without further hearing. The Commission indicated that this could be done and the hearing proceeded with this understanding.

On August, 25, 1912, applicant filed an amended application for an order authorizing the issuance and sale of 100,000 shares of capital stock of the par value of \$100,000., the proceeds of sale of which are to be used to pay its present indebtedness and to continue the work of constructing its railroad. The exhibits required by the Commission have been duly filed by applicant, among others, a statement showing its expenditures for "Road and Equipment", list of subscribers to the capital stock, statement of cash receipts and disbursements, and financial condition, all as of July 31, 1912.

Applicant's articles of incorporation in the office of the Secretary of State, filed on May 18, 1912, show that it proposes to construct a standard gauge railroad to be operated by electricity, gasoline motor, or other lawful motive power from the City of Tulare, Tulare county, California, in an easterly and southeasterly direction, via the towns of Woodville and Poplar, to the city of Porterville; also a branch line from the city of Tulare to the city of Visalia in Tulare county, California. The estimated length of the railroad, including the branch line, is stated in the articles of incorporation to be about thirty-four (34) miles.

The authorized capital stock of applicant is 500,000 shares of the par value of \$500,000. The capital stock subscribed as shown by its articles of incorporation is 35,000 shares of the par value of \$35,000., of which ten (10) per cent in cash has been paid in to the treasurer.

The maps and profiles filed with the application indicate that when applicant has completed its road, the track mileage will be as follows:

Main Line: Tulare to Porterville, ----- 50.25 miles;
 Main Line: Tulare to Visalia, ----- 11.00 miles;
 Sidings and Spur Tracks, ----- 3.75 miles;
 Total Mileage all Tracks, ----- 45.00 miles.

The estimated cost of building and equipping the railroad in accordance with plans and specifications attached to the application is \$600,000. This amount, however, includes \$90,000. "Cost of Sale of Bonds and Stock", which deducted from the estimate given above indicates the actual cost of road in money would be \$510,000.

A copy of a contract entered into on July 30, 1912, between the Avery Investment Company of San Francisco and applicant was filed which shows that the investment company has the right to sell all stocks and bonds which applicant may issue and receive therefor a commission of fifteen (15) per cent. Unless specially authorized by applicant all stocks and bonds shall be sold at par.

The applicant has filed a statement of expenditures on account of "Road and Equipment" as of July 31, 1912, which have been vouchered and registered on the books of the company as follows:

1.	Engineering, -----	\$ 1,722.80;
2.	Right-of-Way, -----	110.00;
4.	Grading, -----	1,481.54;
12.	Roadway Tools, -----	31.35;
40.	Law Expenses, -----	542.75;
41.	Interest, -----	40.00;
44.	Commissions on sale of stock,	8,490.90;
44.	Miscellaneous Office and General Expenses, -----	<u>1,054.80;</u>
	<u>T o t a l</u> -----	\$15,473.94.

In addition to the above, applicant has filed a statement of "unregistered invoices" payable as of July 31, 1912, on account of "Road and Equipment" aggregating \$2,869.57. In addition applicant has borrowed on notes and otherwise \$2,500. in cash. The total indebtedness which applicant has incurred up to July 31, 1912, therefore, appears to be \$18,865.51.

The receipts of applicant have been as follows:

Cash realized from sale of stock, -----	\$ 4,586.00;	
Borrowed on notes and otherwise, -----	2,500.00;	\$6,886.00;
Deduct Cash on hand July 31, 1912, -----		<u>691.53;</u>
Cash actually disbursed, -----		<u>\$6,194.67;</u>

The cash disbursements have been for the following purposes, viz.:

Account of "Road and Equipment", -----	\$ 3,781.59;
Payroll advances, -----	10.40;
Commissions on sale of stock -----	<u>2,402.88;</u>
<u>T o t a l</u> -----	<u>\$ 6,194.67.</u>

Deducting the amount of cash disbursed, viz.: \$6,194.67, from the total indebtedness of applicant as stated above, viz.: \$18,863.51, leaves a balance which applicant is now indebted to various parties of \$12,668.84

This indebtedness is made up as follows:

Account of "Road and Equipment", registered invoices,	\$ 1,191.25;
Account of "Road and Equipment", unregistered "	2,839.57;
Commissions on sale of stock, -----	6,088.02;
Cash borrowed on notes and otherwise, -----	<u>2,500.00;</u>
<u>T o t a l</u> -----	<u>\$12,668.84;</u>
Deduct Cash on Hand, -----	<u>\$ 691.53;</u>
Net Present Indebtedness, -----	<u>\$11,977.51.</u>

The application shows that capital stock has been subscribed and paid for as follows:

In Cash, -----	\$ 4,586.00;
Notes Receivable, -----	25,315.00;
Open book accounts, -----	20,905.00;
Tidewater & Southern Railway Stock, --	<u>6,000.00;</u>
<u>Total Stock Subscribed, -----</u>	<u>\$56,606.00.</u>

The applicant shows that under its contract with the Avery Investment Company the latter has been credited with fifteen (15) per cent of stock subscribed, or \$8,490.90, as commissions for the sale of this stock. On July 31, 1912, the account of this investment company stood on the books of applicant, as follows:

Cash paid on Commissions, ----- \$ 2,402.88;
Amounts due on Commissions, ----- 6,088.02;
T o t a l ----- \$ 8,490.00.

It appears from the above, therefore, that the Avery Investment Company has been credited with fifteen (15) per cent of all capital stock which has been subscribed, regardless of whether such stock was paid for in cash, or notes, or simply held in open account against the subscriber. Also the investment company has been a party to a transaction which is illegal, that is, the exchange of 6,000 shares of capital stock of the applicant for 4,000 shares of capital stock of Tidewater & Southern Railroad Company, and has charged applicant fifteen (15) per cent commission on this transaction. The commissions which have been paid and credited on account of sales of stock by the investment company are unreasonably high. The method of handling and disposing of the stock of applicant as shown by its contract with the investment company should be severely criticised by the Commission, and the practice of paying commissions on stock sales except for actual cash received should be prohibited in the Commission's order. In other words, the salesmen of stock should receive commissions only upon cash sales or as the cash is collected for such sales as may be made for notes.

The statements given above show that of \$4,386. in cash received from sales of stock the investment company has received \$2,402.88; also, that applicant now owes to the investment company \$6,088.02 in cash for stock subscribed upon which nothing has actually been paid. Clearly this develops a practice that is reprehensible and should be forbidden.

The expenditures of applicant so far have resulted in its grading between four (4) and five (5) miles of its proposed railroad between Tulare and Visalia, and also acquiring some equity in franchises and rights-of-way for about twenty-two (22) miles. The greater part of such rights-of-way have been donated but certain amounts must be paid

for portions of same before title will be passed to applicant. It is impossible to estimate the value of the property and rights which applicant has hitherto acquired.

The applicant does not specify the amount which it proposes to realize in cash from the sale of the 100,000 shares of capital stock, the issuance of which is applied for, other than to submit with the application a contract which shows that fifteen (15) per cent commission is to be paid to the Avery Investment Company on all stock sold, whether or not the stock is sold at its par value.

Under the Public Utilities Act this Commission has the power to fix the minimum price at which stock shall be sold. I suggest that ~~that~~ the Commission prescribe in its order that no stock shall be sold at a greater discount than twenty (20) per cent, such discount to include all commissions which may be paid and other expenses which may be incurred incident to the advertising and sale of the stock. In other words, that the applicant shall realize from the sale of stock not less than eighty (80) per cent of its par value which amount shall be expended towards the construction and equipment of its railroad. I would further suggest that the Commission provide in its order that no further expenditures shall be made until applicant has received in cash not less than fifty thousand (50,000) dollars from the sale of the 100,000 shares of stock, including the cash already received, and also provide that should applicant be unable to derive fifty thousand (50,000) dollars in cash from the sale of said 100,000 shares of stock, that upon application the Commission will authorize the issuance of additional stock which may be sold. With these proceeds, the applicant shall discharge the indebtedness of the company existing on July 31, 1912, except commissions claimed to be due for sale of stock, aggregating \$5,889.49., and also may pay such expenses as have been incurred for building roadbed, salaries of employees and office expenses, provided a verified statement of such expenses has been submitted to and approved by the Commission. After the discharge of

less than the indebtedness outstanding on July 31, 1912, there will remain not [^] \$59,724.51, which applicant shall use towards paying its expenses for month of August, 1912, and for the construction and equipment of its line of railroad. No commissions are to be paid at any time except upon actual cash received from sales of stock.

Subject to the foregoing conditions, I recommend that the application be granted, and submit the following form of order:

O R D E R

Application having been made to the Railroad Commission of the State of California by Big Four Electric Railway Company for an order authorizing the issuance of 100,000 shares of capital stock of the par value of \$100,000., the proceeds of the sale of which are to be used in the construction and equipment of its lines of railroad as set forth in the application, and a hearing having been duly held and it appearing to the Commission that the money which will be received from the sale of said stock is reasonably required and necessary for the construction of the railroad and its equipment as provided in the application, and is not properly chargeable to operating expenses or to income,

IT IS HEREBY ORDERED that permission be hereby granted to Big Four Electric Railway Company to issue 100,000 shares of capital stock of the par value of \$100,000. subject to the following conditions, and not otherwise, to-wit:-

- (1) The stock shall be sold and shall yield to applicant not less than eighty (80) per cent of its par value in cash.
- (2) No commissions shall be paid except on cash actually received by applicant from sale of stock, and such commissions shall not exceed twenty (20) per cent of the par value of such stock.
- (3) The proceeds from the sale of stock shall be used to discharge the outstanding indebtedness of the applicant which on July 31, 1912, aggregated \$5,889.49, not including commissions represented to be due on sales of stock already made. All commissions due on account of

sales of stock now appearing on the books of the company shall be cancelled and no commissions shall be considered due on account of such stock as may have already been sold, except such as has been sold for cash or as same may be paid for in cash, and then such commissions as may be paid shall not exceed the amount specified in the contract for such sale. All commissions which have been paid in excess of the agreed percentage of cash actually received shall be returned to the treasurer of applicant.

(4) After the discharge of the indebtedness of \$5889.19, which had accrued against applicant on July 31, 1912, which does not include any commissions for selling stock, no further expenditures shall be made from cash proceeds of sale of stock until all of said 100,000 shares of stock shall have been sold and not less than \$50,000. in cash realized from same and placed at the disposal of applicant. Should applicant be unable to derive \$50,000. in cash from the sale of said 100,000 shares of stock then upon application the Commission will authorize the issuance of additional stock upon terms similar to those imposed in this order, which applicant may sell. Then applicant shall proceed with the construction of its line of railroad and make such further expenditures as may be necessary in pursuance therewith. No expenditures shall be made, except for the purposes of constructing and equipping the said line of railroad and acquiring the necessary right-of-way to be used in connection therewith. Provided, however, that the applicant may pay such indebtedness as it may have incurred during the month of August, 1912, on account of building its line of railroad, including office expenses and salaries of employees, when a verified statement of such indebtedness has been filed with and approved by the Commission.

(5) The applicant shall keep true and accurate accounts showing all receipts and expenditures as provided by the classifications for such accounts which have been adopted by the Commission and on or

before the 25th day of each month shall make a complete verified report to the Commission in accordance with the provisions of the Commission's General Order No. 24, which order in so far as applicable is made a part of this order.

(6) The applicant shall submit for the approval of the Commission the form of all contracts for the sale or exchange of stock, and before their execution any and all contracts for grading, bridging, track, including materials and labor, equipment of all kinds, and all materials, labor, and property involving costs in excess of \$500.

(7) The authority hereby given to issue said stock shall apply to stock sold by said company on or before the first day of May, 1915.

It is not to be understood from this order that the Commission will hereafter authorize an issue of bonds on the basis of a valuation of \$50,000 alone; before an issue of bonds will be approved by the Commission it will be necessary for additional funds to be realized either from further stock sales or from other sources.

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 10th day of September, 1912.

John W. Cushman
Alfred J. ...
Max ...
Commissioners.