

Decision No. ✓

ORIGINAL

Decision No. 2397

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the Investigation)
by the Railroad Commission upon its)
own initiative into the financial)
condition of the United Railroads)
of San Francisco.)

Case No. 610

Jesse W. Lillienthal and William M. Abbott
for United Railroads of San Francisco.
Frederick B. Van Vorst for California Railway
and Power Company.
E. J. McCutchen for certain bondholders of
United Railroads of San Francisco.

BY THE COMMISSION.

OPINION

On May 28, 1914, this Commission issued an order insti-
tuting on its own motion, an investigation into the entire financial
condition of the United Railroads of San Francisco with a view to
making such order or orders as might be necessary to insure the ful-
fillment of the obligations of this corporation to the public.

The order calling this investigation was as follows:

"ORDER"

"WHEREAS, it appears that the following sums were taken
from the funds of United Railroads of San Francisco, to-wit:

March, 1913	-----	\$577,815.70
April, 1913	-----	160,000.00
May, 1913	-----	158,900.00
June, 1913	-----	180,000.00
July, 1913	-----	19,400.00

and that none of such money was used for or in connection with
any of the property or business of United Railroads of San
Francisco, and that none of such money has been replaced or
restored; and

"WHEREAS, it appears that United Railroads of San
Francisco was at the time of such withdrawal of money, in a
financial condition, and now is in a financial condition such
as requires this money to give adequate service to the public
and to meet its obligations; and

"WHEREAS, it appears that the accounts of the United Railroads of San Francisco are not in a form which truly indicates its financial condition; and

"WHEREAS, an inquiry should be made into the matter of the establishment and maintenance of a depreciation account, and

"WHEREAS, it appears that the directors of United Railroads of San Francisco should cause to be restored the money taken as aforesaid, or present a plan for the restoration of such moneys,

"NOW, THEREFORE, IT IS HEREBY ORDERED by the Railroad Commission of the State of California that an investigation be instituted on its own motion into the entire financial condition of United Railroads of San Francisco, with a view to making such order or orders as may be necessary to insure the fulfillment of the obligations of United Railroads of San Francisco to the public and its bondholders and other creditors; And that such investigation be set down for hearing before Commissioner Edgerton for the 17th day of July, 1914, at San Francisco, at 10 o'clock A.M.

"IT IS HEREBY FURTHER ORDERED that the directors of United Railroads of San Francisco either make proof at such hearing of the restoration of the money taken as above described, or present a plan at such hearing for the restoration of such money.

"Dated at San Francisco, California, this 28th day of May, 1914."

The necessity for such an investigation became apparent while the Commission had under consideration Application No. 1076, wherein the United Railroads of San Francisco asked for authority to issue car trust certificates of the face value of \$300,000.00

In Decision No. 1536, dated May 22, 1914, attention was called to the fact that Mr. Patrick Calhoun, former president of United Railroads of San Francisco, had withdrawn from the company's treasury the sum of \$1,096,110.70 and had applied it to purposes foreign to the railway corporation, and that Mr. Jesse W. Lilienthal, upon taking the office of president, had obtained from Mr. Calhoun a promissory note for \$1,096,110.70, payable one day after date, in favor of the railroad company. The note, which was secured by stock of the Solano Irrigated Farms, was subsequently written down in the books of the com-

pany as of a value of \$1.00.

Hearings were held on July 20, August 24 and August 28, 1914. Officers and former directors of United Railroads of San Francisco were called as witnesses, as well as officials of the city and county of San Francisco and employees of the Commission. A memorandum of authorities was submitted by McCutchen, Olney and Willard, as counsel for owners of certain United Railroads of San Francisco bonds, and a brief was filed by Frederick V. Van Vorst on behalf of United Railroads of San Francisco.

The Commission endeavored to ascertain the nature of the authority granted to the president of United Railroads of San Francisco to withdraw funds and the circumstances surrounding the withdrawal of \$1,096,110.70. The Commission inquired into the surplus of United Railroads of San Francisco, giving particular attention to the cancellation of common capital stock to the face value of \$1,200,000, and the addition of that amount to surplus; to the method of recording the sinking fund payments; to the matter of proper depreciation charges; to the ability of United Railroads of San Francisco to pay dividends; to the franchise obligations of the company, and in connection therewith, the claim of officials of the City of San Francisco that there is an unfulfilled obligation to pave a large amount of street surface; and generally, to all matters pertaining to the financial condition of this corporation.

It appears that at a special meeting of the directors of United Railroads of San Francisco, held August 16, 1912, this resolution, introduced by Director Ford and seconded by Director Mullally, was unanimously adopted:

RESOLVED, that all sums of money hitherto drawn by the President of this Company, and all advances hitherto made by him to, or disbursements made on account of, any person or corporation, be, and the same are hereby ratified, approved and confirmed; and

"BE IT FURTHER RESOLVED, that the President of this Company be, and he is hereby authorized to draw such further sum and to make such further advances to, or disbursements on account of, any corporation as he may deem for the best interests of this company."

At a special meeting of the stockholders, held on August 21, 1912, according to the minutes, special attention was called to the resolution ratifying and approving the drawings of money and disbursements made by the President and authorizing further disbursements by him in the company's interest. Upon motion of Mr. Terey L. Ford, seconded by Mr. H. V. Willcutt, the stockholders ratified, approved and confirmed the action of the Board of Directors in adopting the resolution above quoted.

While the evidence does not establish the author of the resolution, it clearly shows that it was not prepared by those who introduced or seconded it, and further establishes that these directors and others as well were practically "dummy directors".

They sought to justify their action in sponsoring and supporting such a resolution on the ground that it was desired by Mr. Calhoun.

The testimony of Mr. A. M. Dahler, treasurer of United Railroads of San Francisco, shows that ever since the San Francisco fire of 1906, it had been the custom to pay out cash upon the order and receipt of the President. However, the books show no regular and systematic withdrawal of funds until August, 1912.

It appears that whenever the President desired funds, he sent his representative to the treasurer's office. The representative always called for gold. Upon making the payment, the treasurer would take his receipt. The receipt was placed in the cash box and counted as cash. A note would be made in a memorandum book, such as "Patrick Calhoun, debtor".

Not until the amount of the receipts began to approximate \$1,000,000, according to the testimony, did the treasurer report to the secretary and ask that a voucher be made out and the

amount properly entered. In July, 1913, the treasurer upon the instruction of the accountants, entered the amount in the books.

The testimony of other witnesses shows that the amount withdrawn was carried on the books of the company, first as cash, then as an account receivable and later as a note receivable.

Because the money withdrawn from the treasury of the United Railroads was supposed to have been invested in the properties controlled by Solano Irrigated Farms, a land project in Solano County, California, Mr. Jesse W. Lilienthal was requested to ascertain from the books of that company, the amount of money actually put into that project by Mr. Calhoun. At the hearing held August 24, 1914, Mr. Jesse W. Lilienthal submitted this statement:

Total payments for land at cost (not shown on Solano books) -----	\$617,608.70
Total cash advances by Mr. Calhoun (as disclosed by Solano books) --	<u>552,914.00</u>
Total -----	\$1,180,522.70
Advanced by United Railroads of San Francisco -----	1,096,110.70
Advanced by others (estimated) -----	<u>292,000.00</u>
Total -----	<u>\$1,388,110.70</u>
Unaccounted for -----	\$ 207,588.00

If this statement is correct, it would indicate that of the \$1,096,110.70 withdrawn from the funds of the United Railroads, \$207,588.00 did not go into the Solano project. This sum of \$207,588.00 remains unaccounted for.

This Commission has no authority to inquire into the financial affairs of other than public utility corporations, nor should it be called upon to proceed into the necessary inquiry to trace the money diverted from United Railroads of San Francisco nor to determine the full legal responsibility for such diversion. Accordingly, the Commission transmitted to the District Attorney of the City and County of San Francisco, a transcript of the evidence taken in this proceeding, and this transcript is now in the possession of the District Attorney.

The Commission next addressed its attention to the question of the dividends paid by United Railroads of San Francisco. This question involves the reduction of the common capital stock of United Railroads of San Francisco; the surrender of common stock certificates to the par value of \$851,400 held by Railroad Power and Development Company, the purpose and method of recording the sinking fund payments; proper depreciation charges/ ^{and} the obligations of United Railroads of San Francisco to its bondholders and creditors and to the public.

The directors of United Railroads of San Francisco at a meeting held December 21, 1908, voted, in view of the capital losses sustained through the earthquake and fire of April, 1906, and through the subsequent strike of its employees, to reduce the common capital stock of the corporation from the par value of \$20,000,000 to the par value of \$16,800,000.

The stockholders of United Railways Investment Company, the holding company of United Railroads of San Francisco, at a meeting held May 1, 1908, consented to the reduction of the capital stock of United Railroads of San Francisco, in the amount indicated above, provided such reduction did not reduce the entire capital stock of United Railroads of San Francisco to an amount less than its indebtedness, and provided further, that no reduction be made upon the books of United Railways Investment Company as to the cost of its investment in the stock of United Railroads of San Francisco by reason of such a reduction.

On February 5, 1909, the board of directors of United Railroads of San Francisco adopted this resolution:

WHEREAS, the reduction in the common stock of the United Railroads of San Francisco to the amount of --- \$1,200,000 as authorized by resolution adopted at the special meeting of the Directors of this Company, held on December 21, 1908, reducing the company's liabilities to that extent, has warranted a credit to Profit and Loss account of a corresponding amount, and WHEREAS, the Profit and Loss account of the Company has not heretofore

received credit for the reduction of the company's liabilities to the extent of the investments of the various sinking fund reserves of the United Railroads of San Francisco, and its subsidiary companies;

"BE IT RESOLVED, that the Controller be and he hereby is directed and empowered to enter to the credit of said Profit and Loss Account an amount of \$1,200,000 (the par value of the common capital stock cancelled and retired) and a further amount of \$2,096,814.53 (the invested amounts of sinking fund reserves) and to credit profit and loss account in the future, the amount of similar sinking fund investments, as made."

While the books of United Railroads of San Francisco showing the actual entries as authorized by the board of directors are not available, the evidence clearly shows that the profit and loss account was credited with \$1,200,000 because of the reduction of the capital stock and was further credited from time to time with amounts in the sinking fund reserves. Mr. John F. Forbes, resident partner of Haskins and Sells, the firm which audits the books of United Railroads of San Francisco, defended the action of the company on the ground that the surplus or profit and loss account was a mere clearing account. If Mr. Forbes' theory were carried to its logical conclusion, there would be nothing to prevent the board of directors from increasing or decreasing the capital stock of a corporation, and thereupon charging or crediting the amount to profit and loss, and thus there could be created a surplus or deficit at will.

To quote from the evidence:

Mr. Reynolds: "Do you know that this \$1,200,000 that you transferred into surplus under your authority was used to pay dividends?"

Mr. Forbes: "No sir, it was not."

Mr. Reynolds: "How could you have paid dividends if you hadn't had this \$1,200,000 in the surplus account?"

Mr. Forbes: "Well, as a matter of fact, there might have been a deficit—indeed, there was a deficit caused by our making this entry; it was necessary in order to get that deficit that something be done, and this stock was reduced."

Mr. Reynolds: "Did you declare dividends- could you have without the \$1,200,000 being put into surplus have declared dividends?"

Mr. Forbes: "Why, certainly not."

Com. Edgerton: "Then you did pay dividends out of it?"

Mr. Forbes: "No".

It is clear, of course, if the \$1,200,000 had not been put into surplus account, the company, on its own showing, would have had a deficit.

The evidence shows that the charges incident to the so-called graft prosecution were charged against a suspense account, - the idea being that they were to be assumed by the holding companies. A certain amount, after some opposition, was assumed by the Railroad and Power Development Company, which gave its note or notes for the amount assumed. In settlement of this indebtedness, the Railroad and Power Development Company turned over to United Railroads of San Francisco, common stock held by it to the par value of \$851,400. This stock is now in the treasury of United Railroads of San Francisco. Unlike the \$1,200,000 it has not been cancelled, but is held as live treasury stock. The company, therefore, carries among its assets at par, its own common capital stock in the sum of \$851,400 received from a holding company in settlement of account.

Reference has heretofore been made to the action of the Board of Directors in calling upon the controller to credit the profit and loss account with \$2,096,814.53, the amount alleged to have been in the sinking fund reserve February 5, 1909, and with future sinking fund investments.

In the consolidated statement showing the disposition of surplus, January 1, 1906, - June 30, 1914, introduced as evidence by United Railroads of San Francisco, it appears that the surplus account has been credited with the sum of \$4,954,290.12, which sum is said to represent cash invested in securities for sinking fund purposes.

The deed of trust dated June 7, 1902, securing the payment of \$35,275,000, four per cent, twenty-five year sinking fund Gold Bonds of United Railroads of San Francisco, provides that commencing with the year 1905, and on the first day of January of that year, and on the first day of January in each year thereafter, until all of said bonds, principal and interest, shall have been redeemed or paid, there shall be set apart a sum not less than 2% of the gross earnings of United Railroads of San Francisco during the year then next preceding, but in no event to be less than the sum of \$100,000. The deed of trust further provides that all surplus earnings in excess of 5% on the common stock shall be reserved and applied as a sinking fund or for the improvement of the property conveyed by the deed of trust. The moneys in the sinking funds shall be used within sixty days, after being deposited with the trustee, in the redemption of bonds issued under this deed of trust or bonds secured by mortgages now existing upon properties acquired by United Railroads of San Francisco.

The deed of trust dated April 2, 1888, securing the payment of \$2,000,000 Six Per Cent Thirty Year First Mortgage Bonds of "The Omnibus Cable Company", requires the company to set apart from the net income for the purposes of a sinking fund the following amounts:

On April 1, 1898, and annually thereafter until April 1, 1902, inclusive, an amount equivalent to 2% of the bonds outstanding;

On April 1, 1903, and annually thereafter until April 1, 1907, inclusive, an amount equivalent to 4% of the bonds outstanding;

On April 1, 1908, and annually thereafter until April 1, 1912, inclusive, an amount equivalent to 6% of the bonds outstanding;

On April 1, 1913, and annually thereafter until April 1, 1918, inclusive, an amount equivalent to 8% of the bonds outstanding.

All sums paid into the sinking fund shall be and remain irrevocably pledged to the redemption and payment of the bonds at their maturity. The amounts paid into the sinking funds shall be invested

by the directors in good securities. Unless there is a deficit in the sinking fund, interest or dividends or profits arising from the investment of moneys in the sinking fund need not be added to such fund.

The deed of trust, dated October 27, 1882, securing the payment of \$3,000,000 Six Per Cent Thirty Year Bonds of "The Market Street Cable Railway Company", required the company beginning in 1893 and annually thereafter until all bonds are redeemed, to pay out of net income to the trustee for the purpose of creating a sinking fund, a sum equal to \$40,000.00.

The sinking fund payments, required by the deed of trust dated July 12, 1894, securing the payment of \$17,500,600 Five Per Cent Thirty Year bonds of "Market Street Railway Company", begin September 1, 1918, at which time the company is obliged to pay \$150,000 out of net income to the trustee.

Neither the mortgage and deed of trust dated March 1, 1889, securing the payment of \$650,000 Six Per Cent Twenty-Five Year Bonds of "The Ferries and Cliff House Railway Company" nor the mortgage and deed of trust dated May 1, 1889 securing the payment of \$1,000,000 Five Per Cent Thirty Year Bonds of "Sutter Street Railway Company" make any provision for sinking funds.

On June 30, 1914, United Railroads of San Francisco, according to its Annual Report filed with this Commission had a funded indebtedness as follows:

Class of Bond or Obligation	T e r m		Total Par Value Authorized	Total par value outstand- ing	Total par- Value not held by respondent Corporation	Rate of Int- er- est
	Date of Issue	Date of maturity				
Ferries & Cliff House Ry. Co.	3/ 1/89	3/1/14	\$ 650,000	\$ 600,000	\$ 600,000	6%
Market St. Cable Railway	10/27/82	1/1/13	3,000,000	1,800,000	1,800,000	6%
Omnibus Cable Co.	4/ 2/88	4/2/18	2,000,000	2,000,000	2,000,000	6%
Market St. Ry. Co.	7/12/94	9/1/24	17,500,000	7,341,000	7,341,000	5%
Sutter St. Ry. Co.	5/ 1/88	5/1/18	1,000,000	1,000,000	1,000,000	5%
United RRs of SF Collateral Trust Bonds	6/ 7/02	4/1/27	35,275,000	23,904,000	23,582,000	4%
Equipment Trust Obligations	2/ 1/06	2/1/16	1,000,000	1,000,000	1,000,000	5%
			700,000	440,000	440,000	6%
Total			\$61,125,000	\$38,085,000	\$37,765,000	

The report shows United Railroads of San Francisco four per Cent Bonds to the face value of \$171,000 in the treasury and \$151,000 in sinking or other funds.

In view of the specific sinking fund provisions of the several deeds of trust, to which reference has been made, and in further view of the fact that this company's principal franchises expire on or before 1929^{and} that it has a funded indebtedness of \$38,085,000 due and payable on or before April 1, 1927; it is not sufficient to say that the public, the bondholders and creditors are not affected by an arrangement or absence of such arrangement to meet the maturing obligations.

We hold that it is the duty of this Commission to consider the financial situation of United Railroads of San Francisco from the point of view of public policy and public interest and not solely from the technical point of view of accounting methods, based on the assumption that the value of the property is equal to the par value of stocks and bonds issued in payment therefor.

While much evidence was introduced in regard to the surplus of United Railroads of San Francisco, a "surplus" as

formerly maintained by many corporations was merely a matter of bookkeeping and did not represent accrued profits.

"Surplus", to quote from Franklin K. Lane's opinion in re "Investigation of Advances in Rates by Carriers in Western Trunk Line, Trans-Missouri and Illinois Freight Committee Territories" 20 I.C.C. 307, 332:-

"as used in railway accounting, means simply the bookkeeping balance of the Profit and Loss Account which, presuming all other values carried on the books to be true, indicates the excess of Assets over Liabilities. It is whatever the railroad management chooses to make it, and depends upon the nature of a railroad's capitalization, the policy of the road, with respect to charges for maintenance, the volume of the dividend, and other factors entirely within the directors' control."

The directors of United Railroads of San Francisco held that the sinking fund payments should be credited to surplus, rather than to a sinking fund reserve account, or other account showing the amount of money set aside to retire bonds. This action was defended by Mr. John F. Forbes of Haskins and Sells, on the ground that whenever the company paid to the trustee the amount called for by the sinking fund provisions of the various deeds of trust, it might consider its indebtedness decreased by the amount of such payment, and increase its surplus accordingly.

Mr. Reynolds, Auditor for this Commission, is of the opinion that the company should show in a separate reserve account the amount of money appropriated to meet sinking fund payments to retire bonds. He takes the position that if such payments are later allowed to appear in surplus account, the corporation through the declaration of dividends out of this surplus, would ostensibly assume to use the same money twice; first, - to retire bonds for sinking fund purposes; and second, -

to pay dividends on the stock. He holds that a corporation of this nature, holding under short term franchises, with deeds of trust and sinking fund provisions such as are here found, should provide for its sinking fund requirements wholly out of earnings. To the extent that these sinking fund requirements are a charge against earnings, Mr. Reynolds holds that they should not later appear in surplus. As he would have the entire sinking fund obligations of this corporation met from earnings, his proposal would not permit of the appearance of sinking fund reserves in any form in the surplus account.

In accordance with this view, and taking into account other items which Mr. Reynolds believes have been improperly carried into surplus account, he has prepared a statement which shows a deficit of this corporation as of June 30, 1913, in the sum of \$4,880,471.48.

In the preparation of this data, Mr. Reynolds was handicapped by the absence of the company's books, a matter which has been previously commented upon by this Commission, and a matter for which no adequate explanation has been, as yet, forthcoming. While we can only refer to previous statements which have been made by this Commission in regard to the methods of this corporation, and particularly in regard to the absence of its books of account, we are not prepared at this time to determine what is a true balance sheet for this corporation. We are persuaded, however, of the correctness of Mr. Reynolds' view that the sinking fund payments of this particular corpora-

tion should be taken from its current earnings, and further that many items have been improperly carried into the surplus account of this utility.

The classification of accounts for electric railways as prescribed by the Interstate Commerce Commission, by the Railroad Commission of the State of California, and by state railroad and public utility commissions generally throughout the United States, clearly contemplates that these sinking fund appropriations and sinking fund reserves should not be carried into the corporate surplus from which dividends might be declared. This rule is particularly applicable to this company because this is a corporation operating upon limited franchises, heavily overburdened with debt. It faces the situation of competition by a municipally owned street railway system. More than any other class of corporation it is under the necessity, if it would do justice to the public and to its creditors, to reduce as far as may be the burdens of its fixed obligations.

In its annual report to this Commission for the year ending June 30, 1914, United Railroads of San Francisco reports a surplus of \$1,016,632.81. As previously stated, this surplus account has been credited in the sum of \$4,954,290.12, representing sinking fund reserves. If these reserves had not been transferred into surplus, this company would show a deficit on this single accounting change amounting to approximately \$4,000,000. How much greater this deficit might be if other items credited to surplus were otherwise charged, it is not now necessary to determine. Hereafter, if it be necessary, a finding will be rendered as to the proper changes to be made in the accounts of this corporation. For the present, it is sufficient to determine that the surplus reported by this applicant was not a true surplus. Instead we find that there is a deficit. The amount of this deficit we shall not now determine, but shall

that
leave/also to a supplemental order, if such should appear to
be necessary.

While a physical valuation has not been made of the properties of the corporation under discussion, there is no doubt that the indebtedness of this utility is clearly out of proportion to the value of its physical properties. Its total indebtedness is approximately \$41,700,000. It owns, according to its annual report for the year ended June 30, 1914, a total of 136.573 miles of single and 111.183 miles of second track and 9.417 miles of yards and sidings. While the comparison is not by any means complete, the case of the Los Angeles Railway Corporation supplies sufficient corroboration to justify the assumption that the value of the physical properties of United Railroads would not measure up to the amount of its indebtedness. The Los Angeles Railway Corporation, including City Railway Company of Los Angeles, with an owned mileage of 363.86 miles, estimated the depreciated reproduction cost of its physical properties as of December 1, 1913, at \$24,579,566. Surely, United Railroads of San Francisco, with a mileage of 257.173 miles can not, within reason, be expected to show a valuation within approximate approach of its indebtedness.

It is a fact, however, that this corporation has been able to show a heavy earning power. The company has submitted earning statements for the fiscal years 1912, 1913, and 1914, as follows:

ITEM	1912	1913	1914
Operating Revenue	\$8,173,113.91	\$8,589,247.56	\$8,515,893.73
Operating Expenses	4,256,739.35	4,705,828.61	4,722,736.86
Net Operating Revenue	\$3,916,374.55	\$3,883,418.95	\$3,793,156.87
<u>Misc. Income</u>			
Interest on Deposits	6,367.93	3,157.59	110.79
Income from Securities Owned	35,688.49	47,682.65	47,172.05
Other Misc. Income	21,426.08	7,685.94	3,232.19
Total Misc. Income	63,482.50	58,526.18	50,515.03
<u>Gross Income</u>	\$3,979,857.05	\$3,941,945.13	\$3,843,671.90
<u>Deductions from Income</u>			
Taxes, - Total	\$ 402,000.00	\$ 453,200.00	\$ 503,800.00
Interest on Funded Debt	1,950,731.65	1,817,178.58	\$1,719,964.65
" " Floating "	49,162.21	150,487.53	206,294.35
Total Interest	\$1,999,893.86	\$ 1,967,666.11	\$1,926,259.00
Rents for Leased Lines	\$ 84,800.00	\$ 77,300.00	\$ 126,600.00
Other Deductions from Income	----	----	5,573.38
Total Deductions	\$2,486,493.86	\$ 2,498,166.11	\$2,562,232.38
Net Income	\$1,493,363.19	\$ 1,443,779.02	\$1,281,439.52
<u>Disposition of Net Income</u>			
Reserve for Mortgage Sinking funds	387,462.76	405,720.97	382,134.50
Dividends-7% on \$5,000,000 1st. Pfd. Stock	350,000.00	350,000.00	350,000.00
Dividends-1% on \$20,000,000 Pfd. Stock	--	200,000.00	--
Total,	\$ 737,462.76	\$ 955,720.97	\$ 732,134.50
Surplus for Year	\$ 755,900.43	\$ 488,058.05	\$ 549,305.02
Surplus Beginning Year	\$ 292,212.58	\$ 623,798.63	\$ 462,139.24
Surplus before making Profit & Loss Adjustments	\$1,048,113.01	\$ 1,111,856.73	\$1,011,444.26

United Railroads of San Francisco submitted the following statement showing Profit and Loss Adjustments for the fiscal years ending June 30, 1912, 1913 and 1914:

ITEM	1912	1913	1914
Surplus before making Profit & Loss Adjustments,	\$1,048,113.01	\$1,111,856.73	\$1,011,444.26
Profit & Loss Adjustments:			
Credits:			
Profit Invested for Sinking Fund,	927,935.70	661,010.21	233,292.50
Profit from Sale of United Rys. Investment Co. Debenture	--	---	21,900.00
Settlement of Account with Lassen Heights Land Co.	--	---	22,208.50
Refund on 1906 Taxes	--	---	20,899.29
Closing out Reserve for Park & Ocean RR. Co. mortgage	--	---	7,490.85
Cancellation of U.R.R. bonds purchased below par.	--	391,046.00	--
Cancellation of coupon Int. previously accrued	--	25,083.33	--
Closing out Reserve for Market St. Cable Ry. Co. Mort.	--	76,887.67	--
Adjustment of Cables Account	--	4,000.00	--
Accounts Payable written off:	1,515.39	--	---
Miscellaneous	129.50	875.26	611.87
Total Credits:	\$ 929,580.59	\$1,158,902.47	\$ 306,403.01
Debits:			
Depreciation (General Accounts Receivable,	\$ 675,673.30	\$ 257,581.46	\$ 255,201.75
Depreciation of Material and Supplies	1,122.23	1,076,711.70	19,399.00
Writing down value of Sundry Securities,	30,000.00	-	13,260.91
Profits from cancellation of Bonds applied against A & B Commission	-	-	11,352.80
Reduction to Nominal value 3d. Install. to P.P.I.E.	-	391,046.00	-
Settlement of Account with (A. Baum)	-	45,000.00	-
Settlement of claim with U Rys. Investment Co.	-	29,999.00	-
Renewals, Depreciation & Contingencies	98,913.60	8,281.80	-
Discount on Sales of Market St. Ry. Co, 5% bonds	427,507.79	-	-
Reduction to Nominal Value. Matured portion of subscription to P.P.I.E.	70,679.00	-	-
	49,999.00	-	-
Total Debits:	\$1,353,894.92	\$1,808,619.96	\$ 299,214.46
Credited or Debited to Profit & Loss Account	424,314.33	649,717.49	7,188.55
Surplus at Close of Year	623,798.68	462,139.24	1,018,632.81

The company submitted a statement showing the payment of dividends from 1909 to date as follows:

For the fiscal year ending June 30, 1909, 7% on \$5,000,000 first preferred stock -----	\$350,000
For the fiscal year ending June 30, 1910, 7% on \$5,000,000 first preferred stock -----	350,000
For the fiscal year ending June 30, 1911, 7% on \$5,000,000 first preferred stock -----	350,000
For the fiscal year ending June 30, 1912, 7% on \$5,000,000 first preferred stock -----	350,000
For the fiscal year ending June 30, 1913, 7% on \$5,000,000 first preferred stock, \$350,000 2% on \$20,000,000 preferred stock ---- <u>200,000</u>	550,000
For the fiscal year ending June 30, 1914, 7% on \$5,000,000 first preferred stock -----	350,000

At the hearing in this matter, the report of Bion J. Arnold to the City of San Francisco, dated March 31, 1913, was submitted in evidence. Mr. Bion J. Arnold in his report on the "Improvement and Development of the Transportation Facilities of San Francisco" in speaking of the dividends paid by United Railroads of San Francisco says:

"The company's financial difficulties of 1907 and 1908 were undoubtedly increased by its heavy dividend declarations, especially in the first quarter of 1906, when a total of \$1,020,000 was declared. In addition, 2% or \$400,000 was paid after the fire, a total of \$1,420,000 for the fiscal year, or 7.1% on the preferred stock. The net surplus for 1906 was \$877,146, which would have enabled the company to declare a dividend of 4.38% on the preferred, so that approximately 39% of the dividends must necessarily have been paid from accumulated surplus. This practice has also been followed in 1908 and 1910.

"By reason of this relation between surplus and dividends, no attempt has been made in this report to indicate true profit and loss for the various fiscal years. For the period 1903 to 1911, inclusive, it appears that the total dividends as reported by the company aggregate over \$860,000 more than the cumulative surplus from operation, considering depreciation as an actual cash reserve out of income. This means that unless corresponding credits were properly available for the stockholders from sources other than actual income, these excess dividend declarations could not have been founded upon true earning capacity of the operating property."

In its annual report for the year ending June 30, 1914, United Railroads of San Francisco submitted the following statement of assets and liabilities:

ASSETS	ITEM	TOTAL
Cost of Road	\$	\$ -----
Cost of Equipment		-----
General Expenditures		82,419,471.63
Exp. for road & Equip. & General Exp. - Leased line		
Equipment purchased under Trust		940,468.40
Other Permanent Investments:		
Stocks Owned		855,378.40
Funded Debt Owned		863,484.57
Cash and Current Assets:		
Cash	60,975.97	---
Bills Receivable	16,512.41	---
Accounts Receivable	175,075.14	---
Materials and Supplies	635,426.28	---
Prepaid Accounts	14,656.06	902,645.86
Unadjusted Account	---	90,955.70
Other Assets:		
Sinking and Other Special Funds	---	2,074,930.37
GRAND TOTAL,		\$88,147,334.93

LIABILITIES	ITEM	TOTAL
Capital Stock- 1st preferred	\$ --	\$ 5,000,000.00
Capital Stock- preferred	--	20,000,000.00
Capital Stock- common	--	18,800,000.00
Funded Debt	--	38,065,000.00
Current Liabilities:		
Loans and Notes Payable	2,895,120.00	---
Accounts Payable	546,839.79	---
Matured Interest on Funded Debt		
Unpaid	42,610.00	---
Pay Rolls	151,009.45	---
Unclaimed Wages	6,458.00	---
Advertising Contract Deposit	50,000.00	---
Employees' Deposit	10,789.75	---
Unredeemed Tickets	7,221.55	3,710,048.54
Accrued Liabilities:		
Taxes Accrued and not yet due	--	220,093.35
Interest on Funded Debt Accrued and not yet due	--	425,056.65
Misc. Int. Accrued and not yet due	--	26,587.33
Accrued for Sinking Funds not yet due:	--	80,402.11
Reserves	--	781,514.14
Surplus	--	1,018,632.81
GRAND TOTAL		\$88,147,334.93

The question of depreciation charges is also involved in this investigation. It is essential to distinguish clearly between depreciation and sinking fund. The former has for its primary object, the replacement or amortization of property due to age, use, expiration, inadequacy and obsolescence, etc., whereas the purpose of the latter is to retire, pay and discharge indebtedness.

Without a valuation of the property of United Railroads of San Francisco, it is impossible to determine exactly the proper charges incident to depreciation.

The company submitted a statement showing that from January 1, 1906, to June 30, 1914, it had charged on account of depreciation the following amounts:

For Reserves for depreciation, renewals, and contingencies-----	\$2,678,588.42
For Buildings and Materials-----	800,562.69
For loss on Equipment sold-----	43,407.00
For loss on Panama-Pacific Exposition stock-----	79,998.00
For loss on Temporary Frequency Changes-----	16,413.67
For loss account Earthquake, Fire and Strike	<u>1,645,472.06</u>
Total-----	\$5,265,447.84

The depreciation charges during the past three years have been charged against Profit and Loss rather than Operating Expenses.

It is alleged that at the present time, the company has a depreciation reserve of \$450,000.00.

Mr. Black, Vice-President and General Manager of United Railroads of San Francisco maintains that the only elements of the company's property as to which a depreciation account may properly be insisted on are rolling stock and buildings. The cost of repairing track and paving are charged directly to Operating Expenses. He contends that these charges cannot be taken care of through a depreciation reserve. On the rolling stock, said to cost \$4,725,689, Mr. Black would charge 4% depreciation or \$189,027.56 per annum. On buildings, the reproduction cost of which is given at \$1,319,317, he would charge 4% depreciation or \$48,762.68. On miscellaneous equipment valued at \$50,000, he would charge 4% or \$2,000.00. The total depreciation charges amount to \$239,790.24.

Mr. Sachse, Chief Engineer of this Commission, stated that in his opinion United Railroads of San Francisco should charge 10% of its gross operating revenue to depreciation and increase its maintenance charges 25%. Mr. Sachse took occasion to state that his report was preliminary and that no accurate figures could be given without a valuation.

Evidence was introduced showing that since 1902, United Railroads of San Francisco had reconstructed 189.47 miles out of a total mileage of 247.38 miles of single and second track in the City and County of San Francisco.

The Company's Exhibit #7 shows that on or before July 1, 1918, it plans to reconstruct 61 miles of track at an approximate cost of \$1,522,989.00, of which \$527,075.00 will be charged to betterments because of increase in weight of rail, increase in cost of paving, etc. and \$995,914 to operating.

This does not contemplate any additional or new lines. All improvements are to be made out of income. Should the proposed plan be executed, it would mean an annual expenditure of \$507,663.00.

The Company's Exhibit #9 shows total area of streets to be repaired to be 451,650 square feet involving a total cost of \$32,025.00.

Mr. D. J. McCoy, Superintendent of Street Repairs for the City of San Francisco testified that paving remained to be done at an estimated cost of \$1,000,000.

Referring to the company's sinking funds, Mr. Bion J. Arnold, in his report on "Transportation Facilities of San Francisco", on page 81, says:

"The present sinking fund requirements will probably retire \$13,000,000 out of \$40,000,000 now outstanding, leaving \$27,000,000 unfunded debt."

Mr. Arnold, in further reference to the same matter says:

"The sinking fund on U.R.R. 4's was established on about the usual basis for long-term franchise, but is correspondingly inadequate for short terms unless franchise extensions could practically be guaranteed. Under existing conditions, a sinking fund retiring nearly 50% of the debt is needed- sufficient at least to retire the fixed property in the streets that would either revert to the City at maturity or be sold on a salvage basis. The U.R.R. 4's sinking fund will retire only about one-third of the entire issue at maturity, assuming its investment entirely in these same bonds at market value. The retirement by this method is exceedingly advantageous, as the present price secures about a 6% interest rate to the credit of the fund. The sinking fund on the Market Street Ry. 5's (1924) can only retire about one-sixth of the issue at maturity, providing there be no further increase in outstanding bonds of this series, \$10,000,000 of which are yet unissued."

In the matter of an adequate depreciation account, Mr. Black, General Manager of United Railroads of San Francisco, estimated that the annual allowance therefor should be \$239,790.24. Mr. Richard Sachse, Chief Engineer employed by this Commission, expressed the opinion upon his preliminary investigation that the depreciation should be 10 per cent of gross revenues, which would amount for the fiscal year ending June 30, 1914, in round numbers, to \$851,000. Mr. Bion J. Arnold recommends that until the property is reclaimed from its run down condition, a depreciation reserve annuity of 8 per cent of the gross revenues should be established, which for the fiscal year ending June 30, 1914, would amount to \$681,000. In this connection Mr. Arnold says:

"An average depreciation reserve of 3% has been maintained since the consolidation. None was charged off between 1906 and 1909. The rate 6% of the gross earnings per annum now established (1910, 1911) may be fair for the property under normal conditions, if enough is spent upon maintenance, and should be continued on a cumulative basis. But a higher reserve will be necessary for some years-

probably 8% until the property is reclaimed from its present run down condition. A depreciation and renewals reserve should be always available as cash or quick assets, and charged against income as a more or less fixed element of the operating account."

For present purposes, this company should maintain a depreciation reserve not less than that recommended by Mr. Arnold and not above that recommended by Mr. Sachse of this Commission.

For the fiscal year ending June 30, 1914, the company set aside a general depreciation reserve of \$255,000. The necessities of the present situation would be met if the company maintained hereafter for a period of three years a depreciation reserve of \$550,000. This figure is arrived at by taking the amount of the depreciation reserve set up by the company for the last fiscal year in the sum of approximately \$250,000 and adding thereto an additional sum of \$300,000.

The company should be authorized to devote \$250,000 of this depreciation reserve to the purposes to which it has been the practice to devote such reserve. The balance of \$300,000 per year should be set up in a special fund in a bank to be designated by the company, the money in this fund thereafter to be expended at the suggestion of the company with the approval of this Commission either for the purpose of providing improved or additional facilities or extensions. This fund of \$300,000 should be set up in toto by June 30th of the year 1915 to cover the current fiscal year. Thereafter it should be set up monthly and a report thereof made regularly to this Commission.

It was stated in the order calling the hearing in this matter that the directors of this company should either restore the \$1,096,110.70, which Mr. Calhoun was permitted to withdraw, or

present a plan for the return of this sum or a like amount. At the hearing it was stated that a plan was in embryo which contemplated certain surrenders of stock, but no plan has been formally presented to this Commission.

Those who have charge of the affairs of this corporation should proceed by whatever means may be at hand to compel a restitution, if such be possible. In the absence of such a restitution or the presentation of a plan which will bring about the restoration of the funds, this Commission will not look with favor upon any disbursement by this Company in the form of dividends to its stockholders.

Provision is being made herein for a depreciation reserve for a period of three years only. It is the expectation that by the end of the three year period, a complete valuation will have been made of this utility and the Commission will have come into possession of all of the facts bearing upon the value of this company's properties. It will, therefore, be able either at that time or previous thereto to issue an amended order prescribing a fixed and definite depreciation account to be maintained regularly by this corporation.

With the change of the chief executive of United Railroads of San Francisco has come an altered attitude, which promises hope of lasting improvement. Mr. Jesse W. Lillenthal, recently installed as President of United Railroads has expressed a desire to co-operate so far as may be to bring about what may be deemed the necessary requirements of public utility service. The particular problem before this utility, however, is finan-

cial. For the present, at least, it seems imperative that the funds of this corporation be conserved.

In conformity with the views herein expressed the following order is adopted:

O R D E R

The Railroad Commission of the State of California having instituted on its own initiative an investigation into the financial condition of the United Railroads of San Francisco, and the order instituting said investigation having stated that the accounts of said United Railroads^{of} of San Francisco were not in a form which truly indicated its financial condition, and such order having specified that an inquiry would be made into the matter of the establishment and maintenance of a depreciation account by this company, and a public hearing having been held and the Commission being fully apprised in the premises,

IT IS HEREBY FOUND AS A FACT that the accounts and books of account now kept and maintained by United Railroads of San Francisco do not disclose and state the true financial condition of said company, and in particular said accounts and books of account now set out that said company has a surplus, whereas, it is hereby found as a fact that said company has a deficit.

IT IS HEREBY FURTHER FOUND AS A FACT that a proper and adequate depreciation account to be set up and carried by United Railroads of San Francisco is the sum of \$550,000 per annum.

Basing its order on the foregoing findings of fact and on the further findings of fact set out in the opinion preceding this order,

IT IS HEREBY ORDERED that United Railroads of San Francisco establish a depreciation account amounting to \$550,000 per annum until June 30, 1917, or until the further order of this Commission.

IT IS FURTHER ORDERED that said sum of \$550,000 per annum to be carried and set up in a depreciation account as aforesaid shall be set aside and accrued out of the annual earnings of said company. Said depreciation account shall be established so as to show an appropriation from earnings of \$550,000 not later than June 30, 1915, and thereafter said depreciation account shall be credited out of earnings with the sum of \$45,833.33 per month, up to and including June 30, 1917, or until the further order of this Commission. Money accumulated under this order shall be used and expended as follows:

\$300,000 per annum of said sum shall be placed in a bank or banks in the State of California on or before July 15, 1915, and thereafter \$45,833.33 per month shall be placed in a bank or banks in the State of California, said money to be placed in said bank or banks within 15 days after the last day of each month. Said sum of \$300,000 per annum shall be used and expended only

a- For the construction of additional facilities or

extensions and for the fulfilling of franchise obligations of said company.

b- For the improvement of service.

Said sum of \$300,000 per annum, or any part thereof, shall be expended only after United Railroads of San Francisco has submitted a statement to the Railroad Commission of the State of California setting out the purposes for which it is proposed to make expenditures and has received the Commission's authorization approving such expenditures.

Of the sum of \$550,000 per annum hereby ordered to be carried in the depreciation account, \$250,000 per annum thereof may be used by United Railroads of San Francisco without the further order of the Commission for the customary purposes to which its funds heretofore accumulated for depreciation have been used.

IT IS FURTHER ORDERED that United Railroads of San Francisco shall, within 30 days from the date of this order, present to the Commission for its approval a proposed change and correction of its books of account which shall show and reflect the true financial condition of said company as to deficit.

Dated at San Francisco, California, this 17th day of May, 1915.

Max Miller
H. D. Loveland
Alex Gordon
Edwin O. Edgerly
Frank R. Austin
Commissioners.