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Decision No. _____.

ORIGINAL

Decision No. 4833

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA.

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In the matter of the Application of)
CLEAR LAKE RAILROAD COMPANY,)
a corporation, for an order authoriz-) Application Number 651.
ing the issuance of stock and bonds.)

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Haven & Athearn by F.G. Athearn for applicant.

EDGERTON, Commissioner.

THIRD SUPPLEMENTAL OPINION

On September 11, 1917, CLEAR LAKE RAILROAD COMPANY filed its amended second supplemental petition in the above entitled matter. In this petition, applicant requests authority to execute a trust deed substantially in the same form as the trust deed attached to the second supplemental application herein and marked "Exhibit C" to secure the payment of \$500,000.00 face value of first mortgage 6 per cent 25-year bonds, also to execute a trust deed substantially in the same form as the trust deed attached to the second supplemental application herein and marked "Exhibit D" to secure the payment of \$500,000.00 face value of 25-year 6 per cent cumulative participating mortgage bonds. Applicant also requests authority to issue \$182,900.00 par value of its common capital stock, \$500,000.00 of its first mortgage bonds and \$500,000.00 of its cumulative participating bonds. Of the stock,

\$150,000.00 as well as the \$500,000.00 of first mortgage bonds are to be issued to Guy L. Hardison as compensation for the construction of applicant's proposed line of railway from Hopland, Mendocino County, to Lakeport, Lake County, a distance of 23 miles; \$25,000.00 of stock applicant desires to issue in exchange for terminal properties at Lakeport, while \$7,900.00 of stock it proposes to issue in exchange for stock issued heretofore without authority from the Commission.

In a former decision the Commission authorized applicant to issue \$25,000.00 of stock for terminal properties. The time within which applicant was permitted to issue the \$25,000.00 of stock has expired. None of the stock has been issued.

Attached to the amended second supplemental application and marked "Exhibit 1" is an agreement between Guy L. Hardison and Clear Lake Railroad Company, which is to be the basis of the contract to be entered into for the construction of applicant's railroad. This agreement, as modified by the waiver filed with the Commission on October 26, 1917 by Guy L. Hardison, in effect provides that there is to be issued to Guy L. Hardison \$500,000.00 of first mortgage bonds together with \$150,000.00 par value of capital stock, or such an amount as may be authorized by the Railroad Commission, to finance the construction of the railroad. The contractor is under no obligation to begin construction until there have been obtained valid subscriptions for \$250,000.00 of applicant's cumulative participating bonds. It is further provided in this agreement that Guy L. Hardison shall pay all construction expenditures including overhead charges, and be responsible for the operation of the road for a period of 30 days after its completion. The agreement contemplates that at least 51 per cent of the stock

authorized by the Railroad Commission will be issued to Guy L. Hardison to assure him control of the company. He is unwilling to undertake the construction and financing of this enterprise unless he is given control thereof during the time that it is necessary to carry out the financial plans here involved.

As above indicated, applicant intends to execute a trust deed securing the payment of \$500,000.00 face value of 6 per cent 25-year bonds. This trust deed is to be a lien on all of applicant's property now owned or hereafter acquired. The proposed trust deed provides that all of applicant's surplus earnings, that is --all of its gross earnings from operation less an amount necessary for operating expenses, maintenance and fixed charges, including taxes, shall be paid into a sinking fund for the purchase and redemption of first mortgage bonds. All payments by subscribers for cumulative participating bonds must also be paid into this sinking fund. All sinking fund payments must be used by Clear Lake Railroad Company to refund first mortgage bonds.

Applicant proposes to execute a trust deed securing the payment of \$500,000.00 face value of 25-year 6 per cent cumulative participating bonds. The proceeds of these bonds may only be used for the purpose of refunding or redeeming the first mortgage bonds of the railroad. After the participating bonds are certified by the trustee, they are to be delivered to the order of the railroad "upon receipt of payment in full of the full face value of the bonds so to be delivered, or, upon receipt from the railroad or from the trustee of the first mortgage bonds of the railroad, of an equivalent face value amount of the said first mortgage bonds". The first mortgage bonds refunded with all interest coupons detached and canceled, shall be delivered to the trustee under the trust deed securing the payment of the cumulative participating bonds as security for said bonds.

As any of the cumulative participating bonds are redeemed and canceled, a like amount of first mortgage bonds deposited with the trustee under the trust deed of the participating bonds shall be redeemed and canceled. If the company fails to pay interest on the cumulative participating bonds, no foreclosure can be had. The interest, however, is cumulative. If the bonds are not paid at maturity, the trustee may and upon being requested in writing by the holders of a majority in amount of the bonds outstanding shall proceed to take the necessary steps to enforce the provisions of the trust deed.

Applicant has been taking subscriptions for \$350,000. of the cumulative participating bonds under an agreement which substantially provides that no bonds shall be issued until fully paid; that 10 per cent of the subscriptions shall be paid within 30 days after the railroad is completed and placed in regular operation; that the balance of the subscriptions is due 20 years after the date of the first payment; that subscribers may pay the balance prior to the due date; that the deferred payments shall bear interest at a rate not exceeding 6 per cent per annum, provided that the interest on the deferred payments shall be computed at a rate sufficient only to make up the deficiency in the interest charges on the first mortgage bonds which the railroad has failed to earn; that to secure the payment of the subscriptions the railroad shall have a lien on the subscribers' properties described in the subscription agreement; that all payments shall be made to the trustee and that such payments together with the net earnings of the company shall be used to refund or redeem first mortgage bonds or cumulative participating bonds; that the subscription agreement shall not become effective until subscriptions have been obtained for \$350,000 of cumulative participating bonds and that the company agrees to begin the construction of the road within

thirty days after subscriptions for \$350,000.00 of these bonds have been obtained and that said construction shall be completed within eight months thereafter.

Paragraph 3 of the subscription agreement reads in part as follows:

"The intent and meaning of this agreement, and the expectations of the parties hereto, being, that if the earnings of said Company are sufficient to meet its operating charges, taxes and assessments, depreciation and interest on outstanding First Mortgage Bonds, and the said sinking fund is sufficient to retire the First Mortgage Bonds within the said twenty (20) year period, the subscribers will not be called upon for any portion of the deferred amounts of their subscriptions, and that the Cumulative Participating Bonds, that are to be held in trust by said Trustee, for the subscribers, will be automatically retired and canceled as the outstanding First Mortgage Bonds are paid and canceled, and that the Cumulative Participating Bonds, which are to be issued to the subscribers when paid for, as herein provided, will be paid and canceled before the stockholders can participate in any of the earnings of the road."

It appears that to date subscriptions have been secured for approximately \$209,000.00 of the cumulative participating bonds. As said above, the subscribers for these bonds can not be held liable until valid subscriptions have been secured for \$350,000.00 face value of the bonds. The contractor on the other hand is obligated to begin the construction of the road as soon as valid subscriptions have been obtained for \$250,000.00 of the participating bonds from resident and non-resident owners of real property situated tributary to the railroad. Paragraph 2 of the agreement between Guy L. Hardison, the contractor and Clear Lake Railroad Company provides in substance, that the contractor shall at his own cost and expense consummate the plan of

financing the railroad within 90 days after a final order is obtained from the Railroad Commission authorizing the issue of stocks and bonds and the execution of any contracts which must be approved by the Railroad Commission.

The Commission is not called upon to approve either the agreement which is the basis of the construction contract, or the subscription agreement for cumulative participating bonds. I believe, however, that there should be filed with the Commission a complete copy of each subscription for participating bonds, and that the Commission should be informed of any and all payments made on said subscriptions and of the application of the moneys thus received.

The interest of the Commission goes primarily to the amount of stock and bonds to be issued to finance the construction of this road. It is not within the province of the Commission to advise investors. In this instance, J. B. Rogers, interested in the financing of Clear Lake Railroad Company informs the Commission that the subscribers for cumulative participating bonds have full knowledge of the financial plans of applicant. We may, therefore, assume that the subscribers realize that the 10 per cent paid on their subscriptions within 30 days after the road is completed will in effect be used to reimburse the contractor in part for his construction expenditures. True, this money will be used to redeem first mortgage bonds, but the fact remains that the bonds will be issued to Guy L. Hardison in part payment for the construction of the road.

While it is proposed by the Railroad to charge such rates as to permit the retirement of the bonds out of earnings, a matter of which the subscribers ^{for participating bonds} are apparently aware, it should be understood that the Commission in no way in this proceeding approves the company's proposed rate schedule.

Applicant in its last annual report shows stock outstanding in the sum of \$82,150. The proceeds from the sale of this stock have been used for grading, for purchase of some rails, for the payment of preliminary surveys, and for other purposes. Some of the work done and material acquired will be used in the completion of the road. Obviously, the amount of stock heretofore issued should be taken into consideration in connection with this supplemental application. I am therefore of the opinion that the amount of stock to be issued to Guy L. Hardison as part payment for the road should not exceed \$120,000. I am further of the opinion that the stock and bonds herein authorized to finance the construction of this railroad should be issued only from time to time after the Commission is furnished with detailed construction expenditures.

In the Commission's opinion in this application of November 9, 1916, (Decision No. 3863) authority to issue securities was withheld, among other reasons, because a sufficiently complete presentation of the engineering plans for the proposed lines was not then before the Commission. The presentation of these features is now in such detail as to enable the Commission to make its order.

The revised line appears to be practicable, and the estimate of cost of construction, which has now been furnished and which totals \$532,868.00 for the entire line, including equipment, overheads, and an estimated 10 per cent for contractor's profits, seems sufficient to complete the road.

The proposed location necessitates heavy grade and sharp curves because of the peculiar and difficult topography of the country; but the construction and operation with a proposed Shay engine freight service and gasoline motor passenger service will be feasible.

A check of the Company's estimates of traffic, revenues and expenses leads to the conclusion that from the traffic point of view the Commission is justified in granting the application.

It must, of course, be understood that the cost estimate total of \$532,868.00 is based on roadbed, structures and equipment, as shown in the construction estimate submitted to the Commission. If this estimate or the construction standards should be changed during the course of the building of the road, resulting in either an increase or a decrease of the estimated cost, the Commission reserves the right to change the amount of securities to be issued to the contractor in payment for the road.

The agreement with Hardison (Exhibit 1 of the second supplemental application) provides on page 1 for--

"Clear Lake Railroad Company to enter into a contract with Guy L. Hardison, or with a corporation to be organized by said Hardison, for the construction, equipment, and initial operation of said railroad:"

and further, on page 2, for --

"the said railroad to be built and equipped in accordance with plans, profiles, and specifications to be hereafter filed with said Railroad Commission."

Since the proposed construction standards, plans and specifications, as they have been filed with the second supplemental application, are now in general approved by the Commission in this opinion and order, it would not appear necessary for the Commission specifically to approve the contemplated construction contract unless this contract departs from the plans of construction now before us. I suggest that the contract contain a clause providing that if changes are to be made diminishing or increasing the quantity or extent of the work covered in the contract, the amount payable to the contractor shall then be diminished or increased proportionately and in accordance with the prices specified in the construction estimate referred to.

The authority to issue securities should not, however, become effective until the construction contract has been executed, and approved by ^{and} filed with the Commission.

As suggested by counsel for applicant, I believe that the contractor should give a \$500,000 surety bond to assure the completion of the road and the acquisition of the necessary equipment. A certified copy of this bond should be filed with the Railroad Commission.

I am also of the opinion that any bonuses in land, in cash, or in other forms given by land owners or others who will be benefited by the construction of this line, should accrue to the advantage of the railroad company and should be used either to assist in defraying the cost of construction or in meeting the interest payments on the bonds during the first years of operation. And I recommend a provision in this order that a statement of all bonus payments heretofore made, or hereafter to be made, in connection with this enterprise, be filed with this Commission.

I herewith submit the following form of Order.

SECOND SUPPLEMENTAL ORDER.

CLEAR LAKE RAILROAD COMPANY having applied to the Railroad Commission for authority to execute trust deeds and to issue stock and bonds in the amounts and for the purposes set forth in the foregoing opinion,

And a hearing having been held and it appearing to the Railroad Commission that the money, property or labor to be procured or paid for by such issue is reasonably required for the purpose or purposes specified in the order and that the expenditures for such purpose or purposes are not in whole or in part reasonably chargeable to operating expenses or to income,

IT IS HEREBY ORDERED that CLEAR LAKE RAILROAD COMPANY be, and it is hereby, granted authority to issue \$152,900.00 par value of common capital stock; \$500,000.00 face value of first mortgage 6 per cent 25-year bonds, and \$500,000.00 face value of 6 per cent 25-year cumulative participating bonds.

IT IS HEREBY FURTHER ORDERED that CLEAR LAKE RAILROAD COMPANY be, and it is hereby, granted authority to execute a trust deed substantially in the same form as the trust deed attached to the second supplemental application herein and marked "Exhibit C".

IT IS HEREBY FURTHER ORDERED that CLEAR LAKE RAILROAD COMPANY be, and it is hereby, granted authority to execute a trust deed substantially in the same form as the trust deed attached to the second supplemental application and marked "Exhibit D".

The authority herein granted to issue stock and bonds is granted upon the following conditions and not otherwise:

- 1.-Stock in the amount of \$120,000.00 may be issued for the purpose of financing in part the construction of applicant's railroad.
- 2.-Stock in the amount of \$25,000.00 may be issued for the purpose of acquiring a one-half interest in terminal properties at Lakeport, having a frontage on Clear Lake and being described in the application herein.
- 3.-Stock in the amount of \$7,900.00 may be issued in lieu of a like amount of stock heretofore issued without authority from the Railroad Commission.
- 4.-The \$500,000.00 of first mortgage bonds herein authorized to be issued shall be used by applicant to finance in part the construction of its line of railway.
- 5.-The proceeds obtained from the issue of \$500,000.00 of cumulative participating bonds herein authorized to be issued shall be used by applicant only for the purpose of redeeming and re-funding its \$500,000.00 face value of first mortgage bonds.
- 6.-None of the stock and bonds herein authorized to be issued to construct applicant's line of railway shall be issued until applicant has filed with the Railroad Commission a copy of

the construction contract proposed to be entered into between applicant and Guy L. Hardison, said contract to provide that payments to the contractor shall be made periodically only after detailed statements of construction expenditures have been furnished to the railroad company, and a copy of such statements filed with the Railroad Commission, and before authority herein granted to issue stock and bonds shall become effective the approval of said construction contract must have been obtained by supplemental order of this Commission.

7. -Applicant shall keep accurate and complete accounts in accordance with the classification as prescribed by the Railroad Commission for steam railroads.
8. -Applicant shall file with the Railroad Commission a complete copy of each subscription for the purchase of cumulative participating bonds, such copy to show any and all conditions under which the subscription was made.
9. -Applicant shall file with the Railroad Commission a statement of all bonuses and grants heretofore paid or to be paid in any way, in cash or in any other form, to any person or corporation in connection with the construction of the railway herein under consideration; and such bonuses or grants, unless otherwise authorized by the Railroad Commission, shall be made payable or assigned to the applicant herein. All moneys or other considerations received in connection with said bonuses or grants shall be held by the applicant and no disposition made thereof until such disposition has been authorized by the Railroad Commission.
10. Applicant shall file for the approval of the Railroad Commission a certified copy of the contractor's surety bond, such bond to be for not less than \$500,000.00.
11. Applicant shall keep separate, true and accurate accounts showing the receipt and application in detail of the proceeds of the sale of the stock and bonds herein authorized to be issued; and on or before the twenty-fifth day of each month the

company shall make verified reports to the Commission stating the sale or sales of said stock and bonds during the preceding months, the terms and condition of sales, the moneys realized therefrom, and the use or application of such moneys, all in accordance with this Commission's General Order No.24, which order, in so far as applicable, is made a part of this order.

12.-The authority herein granted to issue stock and bonds shall not become effective until applicant has paid the fee prescribed by the Public Utilities Act.

13.-The authority herein granted to issue common capital stock and first mortgage bonds shall apply only to such stock and bonds as may be issued on or before October 1, 1918; cumulative participating bonds may be issued at any time hereafter upon the full payment of the subscription price in accordance with the subscription agreement and the trust deed under which the bonds are being issued.

The foregoing Third Supplemental Opinion and Second Supplemental Order are hereby approved and ordered filed as the Third Supplemental Opinion and Second Supplemental Order of the Railroad Commission of California.

Dated at San Francisco, California, this 15th day of November, 1917.

Mary Thelen
H. J. Leland
Albert J. Leland
Edwin C. Edgerton

Commissioners.