

BEFORE THE RAILROAD COMMISSION
OF THE STATE OF CALIFORNIA.

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ORIGINAL

Decision No. 572

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In the Matter of the Application of :
SOUTHERN PACIFIC COMPANY for the ap- :
proval of a lease of railroad equip- :
ment from Commercial Trust Company :
to Southern Pacific Company and an :
agreement between Harry E. Righter :
and Wm. L. Fry with the Commercial Trust :
Company and Southern Pacific Company, :
and for an order authorizing the issue :
of trust certificates as provided in :
said lease and agreement. :
.....

Application No. 484.

Guy V. Shoup and Henley C. Booth for applicant.

ESHELMAN, Commissioner.

O P I N I O N

This is an application by the Southern Pacific Company to enter into an agreement for the acquisition by lease of railroad equipment and to issue equipment trust certificates and to guarantee these certificates unconditionally as to principal and interest.

While this is in effect an encumbrance upon the property of the Southern Pacific Company for 90% of the purchase price of the equipment involved, as will be pointed out hereafter, yet I do not consider it necessary for the purposes of this application to enter into a consideration of the Southern Pacific Company's financial condition other than to call attention to the fact that this company is operating at a substantial profit at what, under the law, we must assume to be prima facie reasonable rates, and that it has been paying not only interest on all its outstanding obligations in full, but has also been paying dividends upon its stock, which for the fiscal year ending June 30, 1912, amounted to \$16,360,342.32, which was at the rate of 6% upon \$272,672,405 par value of stock. In addition the Company has been carrying over a substantial surplus.

It may therefore be presumed from the outset without a detailed presentation, that the Southern Pacific Company is fully capable of meeting all obligations that could arise under the application herein, and that the same does not constitute an unreasonable addition to its outstanding obligations; particularly is this true, independent of any other fact, since under the application the applicant will secure \$11,429,010 worth of additional new equipment, and will only add to its outstanding obligations the sum of \$10,120,000, as will more fully appear hereafter.

The Southern Pacific Company states in its application that the equipment it now possesses is insufficient and inadequate for its purposes, and that it requires additional equipment to meet the increased demands of traffic. Mr. G. F. Richardson, Superintendent of Transportation for the Southern Pacific Company, testifying for the applicant, states that the equipment to be purchased under the application represents the usual additional equipment needed annually, and that the same is being purchased at a reasonable and fair value, and I see no reason for questioning such statement.

The following equipment and the price to be paid therefor is set out in the application:

3181 Box cars.....	\$ 3,719,601
961 Gondola cars.....	1,026,163
700 Work cars.....	814,078
250 Stock cars.....	850,350
400 Automobile cars.....	573,600
240 Flat cars.....	220,800
200 Tank cars.....	273,500
45 Caboose cars.....	60,660
5 Gasoline motors.....	106,665
84 Electric passenger coaches.....	1,160,369
114 Locomotives.....	2,548,174
25 Tenders.....	75,050
Total.....	<u>\$11,429,010</u>

This equipment applicant desires to use upon the lines of railroad owned or operated by it as lessee, and it is also to be used upon the railway of

Houston and Texas Railroad Company,
Galveston, Harrisburg and San Antonio Railway Company,
Houston, East and West Texas Railway Company,
Portland, Eugene and Eastern Railway Company,
Houston and Texas Central Railway Company,
Morgans, Louisiana and Texas Railroad and Steamship Company,
Peninsula Railway Company,
San Jose Railroads,
Fresno Traction Company,
Stockton Electric Company.

While many of these roads, as well as much of the property of the Southern Pacific Company, upon which the lien is sought to be created, are outside the State of California, the applicant states that it desires the blanket authority so as to remove any doubt of the legality of any of the equipment trust certificates that may be issued.

The plan under which Southern Pacific Company is to lease this equipment and under which the equipment trust certificates are to be issued is covered by two agreements. These are the agreement between Harry E. Righter and William L. Fry, Commercial Trust Company of Philadelphia and Southern Pacific Company, and the lease from Commercial Trust Company of Philadelphia to Southern Pacific Company. The agreement is of March 1st, 1913 by and between Harry E. Righter and William L. Fry of Pennsylvania (vendors of the equipment and known in this agreement as the vendors), Commercial Trust Company of Philadelphia (the trustee herein and designated the trustee), and Southern Pacific Company (designated the company).

Under this agreement the vendors are to deliver the equipment above mentioned to the persons designated by the trustee, who will be the officers of the Southern Pacific Company. The title to the equipment is to be vested with the trustee. The trustee is then to execute a lease of the equipment to the Southern Pacific Company. Upon receipt of the equipment and the execution of the lease to the Southern Pacific Company, the trustee will turn over to the vendors Southern Pacific equipment trust certificates, Series A, not to exceed 90% of the cost of the equipment. As an alternative these equipment trust certificates may be turned over by the trustee to parties named by the vendors upon deposit by such parties of the face value of such certificates. It is further provided in the

agreement that the Southern Pacific Company may at stated times after March 1st, 1918, purchase the equipment.

The lease is dated March 1st, 1913, under the terms of which Commercial Trust Company of Philadelphia, the ~~trustee~~ trustee, leases the equipment above noted to the Southern Pacific Company. The conditions of this lease may be summarized as follows:

(1) As the equipment is delivered by the trustee to the Southern Pacific Company the latter will pay in cash the difference between the cost price of such equipment and the face value of the equipment trust certificates issued against it. The lease is drawn so that this sum shall represent 10% of the cost price, the balance of 90% to be covered by the equipment trust certificates.

(2) The Southern Pacific Company shall pay the reasonable expenses of the trust.

(3) The Southern Pacific Company shall pay the taxes accruing on the property and any other taxes that may arise from the transaction.

(4) The principal of these trust certificates shall amount to \$10,120,000, and the principal shall fall due in ten equal installments each year for ten years, beginning March 1st, 1914, and running to March 1st, 1923. The Southern Pacific Company agrees to pay these annual installments as they fall due.

(5) The Southern Pacific Company agrees to pay the dividend or interest warrant on the equipment trust certificates at the rate of 4½% per annum.

(6) The Southern Pacific Company guarantees the principal and interest of these equipment trust certificates unconditionally.

(7) The title to the equipment shall remain with the trustee until the Southern Pacific Company shall complete the payment of principal and interest.

(8) The Southern Pacific Company may purchase the equipment at stated times after March 1st, 1918, by paying the face value of the outstanding equipment trust certificates with a premium of 2½% plus the accrued interest and other accumulations.

(9) Upon default of principal or interest by the Southern Pacific Company all payments fall due, and upon such default the trustee may take possession of and sell the equipment for the benefit of the holders of the equipment trust certificates.

(10) Equipment may be sold by the Southern Pacific Company to outsiders upon deposit with the trustee of amount received and sufficient in addition to make up the full cost price.

(11) New equipment may be substituted if put under the equipment trust certificates.

(12) Each car leased under this agreement shall bear the sign "Southern Pacific Equipment Trust, Series A, Commercial Trust Company, trustee, owner."

(13) The Southern Pacific Company must keep equipment in repair and insured.

(14) Equipment may not be sublet without the consent of the trustee.

It is testified that this is the usual form by which railroads throughout the United States secure their equipment. The issue of equipment trust certificates is also in the usual form. The whole plan reduces itself to this:

Southern Pacific Company desires to purchase equipment which will cost \$11,429,010. Against this will be issued equipment trust certificates to the amount of \$10,120,000, leaving a balance to be paid in cash of \$1,309,010. This cash will be paid from time to time as the equipment is turned over representing approximately 10% of the cost price of such equipment as it is turned over. The equipment trust certificates run for ten years, and therefore all of the equipment will be paid for at the end of ten years. Such a system of paying for equipment seems advisable as equipment depreciates rapidly, and a long term bond might still be outstanding long after the equipment had been worn out completely and discarded.

The Company has followed the usual practice in holding the title to the equipment in the name of the trustee while certificates

are outstanding against it. The lease to the Southern Pacific Company is a ~~xxxx~~ mere formal matter made necessary by the fact that the Southern Pacific Company does not buy the equipment outright but must have the legal right to use the same.

As I see the whole matter it is practically as follows:

The Southern Pacific Company desires to secure a certain amount of equipment for which it does not desire to pay in cash but desires to extend the payments over ten years. Instead of issuing bonds it issues trust certificates covering 90% of the value of the equipment to be acquired and pays the rest in cash as the equipment is delivered. As it was testified by Mr. Richardson that all of this equipment would be needed within the year, it may be assumed that the \$1,309,010 will be paid within the next year and the equipment secured, leaving the Southern Pacific Company in practical ownership of the equipment with a mortgage against the same amounting to 90% of its value upon which the Southern Pacific Company is paying 4½%. The Southern Pacific Company needs the equipment; it is to the interest of the public that it should have it. I am convinced from the evidence that the price paid is not exorbitant. I am clearly of the opinion that the added obligation is not an undue burden upon the applicant, and I recommend that the application be granted and the agreement and lease be approved.

I submit the following order:

ORDER

Application having been made to this Commission by Southern Pacific Company for an order of this Commission authorizing it to enter into a contract with Commercial Trust Company of Philadelphia for the lease of railroad equipment under that certain indenture dated March 1, 1915, and filed with this Commission as part of Exhibit B; and for an order of this Commission authorizing said Southern Pacific Company to enter into an agreement with Harry E. Righter and William L. Fry and Commercial Trust Company of Philadel-

phia providing for an issue of equipment trust certificates of the face value of \$10,120,000 due serially in ten equal annual installments from March 1, 1914 to March 1, 1923, with dividend coupons payable at the rate of 4½% per annum, said equipment trust certificates to be known as "Southern Pacific Equipment Trust Certificates, Series A", and to be issued under that certain indenture dated March 1, 1913, and filed with this Commission as part of Exhibit B; and for an order of this Commission authorizing said Southern Pacific Company to guarantee the payment of principal and dividend coupons of said equipment trust certificates;

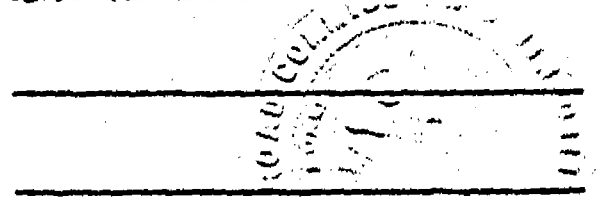
And a hearing having been held and it appearing to this Commission that the equipment to be obtained by Southern Pacific Company under the terms of said lease and said agreement is reasonably required in the conduct of its business, and that said lease and said agreement are proper and reasonable in their provisions,

IT IS HEREBY ORDERED that Southern Pacific Company be authorized, and it is hereby authorized to enter into said contract with Commercial Trust Company of Philadelphia for the lease of said equipment, and to enter into said agreement with Harry E. Righter and William L. Fry and Commercial Trust Company of Philadelphia for the issuance of said Southern Pacific equipment trust certificates, Series A, of the face value of \$10,120,000, and to guarantee the payment of principal and dividend coupons of said Southern Pacific equipment trust certificates.

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 11th day of
April, 1913.

John W. Eschleman
Walter L. Land
Geo. L. Dow



Commissioners.