

Decision 98-08-017 August 6, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application and request for Nunc Pro Tunc Authority, Authority to Merge Corporations, to Split Stock and to Issue Common Stock, and for Expedited Ex Parte Relief.

ORIGINAL

Application 98-04-034
(Filed April 22, 1998)

OPINION

Summary

In this decision we grant the application of California Western Railroad, Inc. (California Western or applicant) for retroactive approval of previous stock issues, and for prospective approval of a transaction which would merge California Western Land Associates, Inc. (Land Company) into the applicant, split applicant's currently outstanding shares of common stock 2.407 for 1, and make a new public offering of an additional 614,000 common shares. Upon conclusion of this transaction, the applicant's present shareholders will have a 50.5% share ownership of California Western, and the newly offered shares will constitute the remaining 49.5%.

No protest has been filed in response to the application. We have held no hearing, and we make no determination under Public Utilities (PU) Code Section 822 concerning the fairness of the transaction or the underlying stock issues. The application is granted ex parte, as requested by the applicant.

Background

The applicant is a common carrier railroad engaged in interstate commerce. The application states that it operates railroad passenger excursion and commuter services, and common carrier freight service, between Fort Bragg

and Willits, California.¹ We recently relieved the applicant from certain regulatory requirements in connection with its operation of excursion services, but the company otherwise remains subject to regulation under various provisions of the PU Code. (Decision (D.) 98-01-050.)

California Western was organized as a close corporation under California law in July 1996 under the name CWRR, Inc., and the affiliated Land Company was concurrently incorporated as a California close corporation.² According to the application, the two corporations were organized to acquire the assets of California Western, an Arizona corporation. The directors and shareholders of the two corporations were, and have remained, identical. In order to obtain operating authority from the federal Surface Transportation Board (STB) to operate the railroad, CWRR, Inc. filed a verified notice of exemption under 49 CFR Section 1150.31 on August 9, 1996.³ On August 12, 1996, the STB published its notice of exemption. (STB Finance Docket No. 33005, 61 FR 42936 (August 19, 1996).)

¹ The characterization of some of California Western's passenger services as commuter service may be misleading. No trains are operated specifically to serve commuters; the terminology is used to refer to certain tariffs which govern multiple rides. According to the application, commuter passengers constitute about one percent of California Western's total business.

² On May 30, 1997, CWRR, Inc.'s articles were amended to change its name to California Western Railroad, Inc.

³ By this means certain types of applicants can bypass the formal application procedure specified in 49 U.S Code Section 10901. See 49 CFR Section 1150.1 *et seq.* The STB approves the acquisition by publishing a notice in the Federal Register within 30 days of the filing without making a determination of public convenience and necessity. The exemption is effective 7 days after it is filed, and the filing thus creates a presumption of public convenience and necessity. The exemption is void *ab initio* if the notice contains false or misleading information.

According to the companies' audited combined financial statements, on August 1, 1996, the applicants' Board of Directors approved the sale of 171,350 shares to certain stockholders for \$5.00 per share. Pursuant to a Stockholders' Agreement dated August 16, 1996, for each share of CWRR, Inc. stock purchased, the stockholders received a share of Land Company stock. In order to maintain identical ownership in both companies, the shares are restricted in that the stockholder may not sell shares of either company without selling the identical shares in both companies. No authority was requested from this Commission for the initial stock issuance.

The asset purchase was completed on August 16, 1996. The total purchase price and closing costs for acquisition of the assets was \$1,642,503. Initial capitalization consisted of \$855,750 received in exchange for issuance of the common stock to the initial investors, and the proceeds of a mortgage in the amount of \$900,000 secured by all of the railroad's property. The applicant's resultant initial working capital was \$113,247. The applicant acquired the entire business operation of the railroad, and Land Company holds title to all of the real property used in the railroad's operation.⁴

In March 1997, the companies sold 20,000 shares of common stock for \$5.00 per share, with the acquiring stockholders receiving a share in each company. However, the proceeds from these sales were not allocated to each company, as was done initially. All proceeds were recorded as CWRR common stock. This was part of the sale of a total of 50,000 shares to new investors for a

⁴ Note 7 of the audited financial statements indicates that the proceeds from the initial sale of shares were allocated between CWRR, Inc. and Land Company, based upon the respective company's pro-rata share of the assets acquired during the purchase of the railroad. This resulted in 68% and 32% of the proceeds being allocated to CWRR, Inc. and Land Company, respectively.

total consideration of \$250,000 after the initial issuance. No authority was requested from the Commission for any part of this stock issuance. Sometime after May 31, 1997, an additional 38,879 shares were issued to stockholders for \$194,385. No authority was requested from the Commission for this stock issuance.

Consistent with this account of share transactions, the most recent combined financial statement shows 260,229 shares of California Western common stock, and an equivalent number of shares of Land Company shares, issued and outstanding.

As noted above, the applicant did not ask this Commission to authorize the issuance of any of these shares. Applicant does not explain its failure to seek authorization for the initial issue, although with respect to the subsequent issues the application offers the explanation that applicant was "under the impression that such issuance was subsumed within the federal exemption authorizing acquisition of control." (P. 7.) The application states that the uses to which all funds raised through stock issues have been put are the repair of storm and disaster damage, performance of deferred maintenance, purchase of maintenance-related assets, and maintenance of working capital.

The applicant proposes to issue more shares of common stock to the public to raise an additional \$4.6 million as part of a three-part transaction. First, Land Company will merge into California Western, leaving California Western as the surviving corporation holding all assets. Land Company's real estate would be transferred to California Western, and all outstanding shares in Land Company would be canceled. Because the two companies have identical share ownership, no new California Western shares would need to be issued, and no exchange of shares would be necessary. Second, California Western would split its common stock 2.407 shares for 1, resulting in 626,404 shares of common stock

issued and outstanding.⁵ The boards of the two companies have determined the amount of capital which will have to be raised for capital projects, and have decided that the present shareholders should retain 50.5% ownership of the surviving company after the stock transaction. Accordingly, the third part of the transaction is to issue additional common shares to be offered publicly in return for the remaining 49.5% ownership interest.

The applicant calculates that the new issue must consist of 614,000 additional common shares in order to maintain an ownership ratio of 50.5/49.5% between current and prospective shareowners. The offering price is set at \$7.50 per share to raise a total of \$4,605,000 from the sale of this number of shares.⁶ At the conclusion of the transaction the total capitalization of the corporation would be \$5.9 million with 1,249,404 shares of stock issued and outstanding, according to the applicant.

According to the application, the purposes for which these proceeds would be used are:

1. Rehabilitation or upgrading of track and structures to handle 265,000-lb. gross weight cars (compared to 240,000-lb. maximum gross weight cars currently) for handling traffic of the railroad's principal shipper. The current weight limitation places this customer at a competitive disadvantage because it must pay a higher rail rate per unit than other lumber companies, and many shipments are allegedly lost to the railroad as a result. The

⁵ We note that when we multiply the number of issued and outstanding shares, 260,229, by 2.407, the product is 626,371 shares, rounded down to the nearest whole number. We do not know the reason for the discrepancy between the figure offered in the application and that which we obtain by means of this computation.

⁶ Our calculation of the number and price of newly issued shares would differ slightly from that of the applicant, based upon the number of currently outstanding shares. See previous note. Shares issued both before and after the new issuance would be of the same class.

applicant has given this project the highest priority, and estimates that 47% of the proceeds of the new stock issuance will be devoted to this purpose.

2. Acquisition of a diesel locomotive and passenger cars to restore Willits-based passenger trains, which were eliminated some years ago.
3. Acquisition of an additional steam locomotive and passenger train set to add more steam-powered passenger trains out of Fort Bragg.
4. Refurbishment of passenger equipment, stations, and facilities.
5. Replacement of debt with equity to reduce fixed charges, currently amounting to about \$96,000 annually.

The applicant states that the public offering of the new shares will be made pursuant to a permit issued by the California Commissioner of Corporations, and a Regulation A Exemption from the United States Securities and Exchange Commission.

Discussion

Section 817 of the PU Code specifically restricts the issuance of stock by a public utility to use for certain enumerated purposes.⁷ Those purposes include the acquisition of property; construction, completion, extension, or improvement of its facilities; improvement or maintenance of its service; and discharge of lawful obligations.

⁷ Applicant is a common carrier, see PU Code Section 211, and is therefore a public utility under California law. PU Code 216(a). Provisions in the PU Code which regulate public utilities in general regarding the issuance of securities consequently apply to the activities of the applicant. Jurisdiction to regulate the issuance of stock or other evidence of ownership by a public utility is vested in this Commission. See PU Code Section 816.

Before a public utility may issue stocks and stock certificates, it must obtain an order from this Commission authorizing the issue, stating the amount of the issue and the purposes to which the proceeds are to be applied, setting forth the Commission's opinion that the things to be paid for by the issue are reasonably required for the purposes specified in the order, and specifying that such purposes are not reasonably chargeable to operating expenses or income. PU Code Section 818. In addition to refusing or granting permission for the issue, the Commission may grant permission for the issue in lesser amount than applied for, or grant it subject to such conditions as it deems reasonable and necessary. PU Code Section 819.

The application essentially asks us to approve all of California Western's past and proposed stock issues, including those for which it previously failed to obtain approval through its error or inadvertence. Our task is to ensure that all stock was (and will be) issued for proper purposes, and that the proceeds were (or will be) applied to those purposes. Although PU Code Section 822 also gives us discretion to approve the terms and conditions of issuance and the fairness of such terms and conditions after a hearing, we have not held a hearing, nor have we made a determination regarding the fairness of any past or future stock issue.

Nunc Pro Tunc Authority for Previous Stock Issues

California Western seeks approval for several previous stock issues, completed in each instance without this Commission's prior approval. California Western explains it was operating under the belief that authority for these stock issues was subsumed under the STB exemption, and now seeks to correct the error. It cites D.97-02-007 as authority for retroactively approving a stock issue that had not received timely approval before the transaction took place, on the

grounds that the issue was for proper purposes and not adverse to the public interest.

The STB exemption process, as explained above, is available in appropriate circumstances as a substitute for formal approval of the construction, acquisition, or operation of a railroad line pursuant to 49 U.S. Code Section 10901. That statute only regulates those activities enumerated in the statute. Although an application for exemption is required to include information about the manner by which the applicant proposes to finance construction or acquisition, and specifically about the kind and amount of securities to be issued, the authority granted under the exemption plainly does not address the financing aspects. 49 CFR Section 1150.6 (a). In the present instance, the Notice published by STB refers only to exempting acquisition of the rail line and other assets from the applicant's predecessor, but makes no reference whatever to the type or manner of financing .

Under these circumstances, the applicant's assertion it was "under the impression" that authority for several stock issues was granted through the exemption process strikes us as disingenuous. Moreover, D.97-02-007, which the applicant cites as authority for granting retroactive approval, is inapposite. In that decision the Commission merely extended authority which had been granted several years before, and which was about to expire at the time the application was filed. To bridge the gap after the authority lapsed until the decision was issued several months later, the Commission granted the authority nunc pro tunc on the decision. Here the Commission has given no prior approval whatever, and the request therefore comes before us for the first time in the present application.

Although the grounds for applicant's request are flawed, the application reflects that the proceeds of previous stock issues were used for proper purposes.

Specifically, the application states that those proceeds were used for acquisition of the railroad and associated property, repair of the property, performance of deferred maintenance, acquisition of maintenance equipment, maintenance of working capital, and payment of interest expense on debt. This is consistent with the results reported in the financial statements submitted with the application, and complies with the requirements of PU Code Section 817, and no harm will result from belated approval. On the other hand, withholding approval of previous stock issues would create a hardship for the investors who have already acquired California Western and its associated properties, and jeopardize rail service which now serves shippers and the general public. Although we disfavor granting retroactive approval of stock issues, we will do so here subject to a requirement that California Western account for its disposition of past stock issuance proceeds pursuant to PU Code Section 824.

Approval of the Merger, Stock Split, and New Stock Issue

California Western's request for approval of the transaction which will result in issuance of approximately 614,000 additional shares of common stock to raise \$4.6 million is timely. We are principally concerned whether the purposes for which the proceeds will be spent will conform to the requirements of PU Code Section 817. Our approval of other aspects of the transaction is essentially ministerial. PU Code Section 854 requires the applicant to secure our authorization to merge Land Company into California Western, but because both companies now have identical ownership, this merger is merely one of form rather than substance. No public interest is involved, and we will approve the merger transaction.

Any permissible use to which the sale proceeds will be applied, as reflected in the application, will benefit the public by improving the safety,

service, and reliability of the railroad. The application sets forth the following list of purposes for which California Western proposes to use the proceeds of the public offering over an 18-month period. The applicant states that if less than the entire \$4.6 million is raised, the proceeds will be used in the indicated order of priority:

1. Cost of Issuance	\$ 200,000
2. Track, Roadbed and Bridge Rehabilitation	1,000,000
3. Purchase Maintenance of Way Equipment	70,000
4. Purchase/Rehabilitation of Locomotives/ Passenger Equipment	250,000
5. Track Roadbed and Bridge Rehabilitation	1,150,000
6. Purchase/Rehabilitation Steam Locomotives	300,000
7. Rehabilitate Existing Coaches	80,000
8. Northspur and Picnic Area Improvements	180,000
9. Willits Depot Rehabilitation	125,000
10. Debt Retirement	1,245,000
TOTAL	\$4,600,000

These purposes comply with PU Code Section 817.* We will therefore approve the proposed transaction.

Conclusion

We will approve the application. PU Code Section 823(a) prohibits a public utility, without the consent of the Commission, to apply any part of the stock issue, or any proceeds thereof, to any purpose not specified in the Commission's order, or to any purpose specified in the order in excess of the amount authorized for such purpose, or issue or dispose thereof on any terms less favorable than those specified in the order. The burden is therefore upon the applicant to ensure that it uses the proceeds in the manner and to the extent set forth in the application.

In Resolution ALJ 176-2992 dated May 7, 1998, the Commission preliminarily categorized this application as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received. Given this status, public hearing is not necessary and it is not necessary to alter the preliminary determinations made in Resolution ALJ 176-2992.

Findings of Fact

1. Applicant is a common carrier railroad engaged in interstate commerce. Applicant operates railroad passenger and freight services between Fort Bragg and Willits, California.
2. Land Company is a nonutility affiliated with applicant.

* Section 817 specifically allows a public utility to issue stocks for the acquisition of property; the construction, extension, or improvement of its facilities; the improvement or maintenance of its service; the discharge or lawful refunding of its obligations; and the reorganization or readjustment of its indebtedness or capitalization upon a merger, consolidation, or other reorganization. The proposed stock issue would be used for all of these purposes.

3. The directors and shareholders of applicant and Land Company respectively are, and at all material times have been, identical.

4. Applicant obtained its operating authority from the federal STB by filing a verified Notice under 49 CFR Section 1150.31 on August 9, 1996. On August 12, 1996, the STB published the Notice in Finance Docket No. 33005 (61 FR 42936 (August 19, 1996)). The Notice, on its face, does not address any financial aspect of the acquisition, including the issuance of stock to raise funds for the purchase.

5. Applicant and Land Company were organized to purchase the railroad and associated real property and other assets from California Western Railroad, Inc., an Arizona corporation.

6. At the time applicant and Land Company acquired the railroad and other assets, applicant issued 171,350 shares of common stock. For each share of applicant's stock purchased, the stockholders received a share of Land Company stock. No authority was requested from this Commission for applicant's initial stock issue.

7. Between March and the end of May 1997, a total of 50,000 shares of applicant's common stock were issued to investors in various transactions. No authority was requested from the Commission for these stock issues.

8. Sometime after May 31, 1997, 38,879 shares of applicant's common stock were issued. No authority was requested from the Commission for this issue.

9. The application states that the uses to which all funds raised through previous stock issues have been devoted are the repair of storm and disaster damage, performance of deferred maintenance, purchase of maintenance-related assets, and maintenance of working capital. Nothing in the record of this proceeding is inconsistent with the applicant's claim that these proceeds were used in this manner.

10. The applicant proposes to merge with Land Company. Applicant would be the surviving corporation. As part of this transaction all of Land Company's stock would be canceled.

11. Following the merger of applicant with Land Company, applicant proposes to split its issued and outstanding shares 2.407 shares for one.

12. Following the stock split, applicant proposes to issue an additional number of shares to the public in an amount equivalent to 49.5% of the total number of issued and outstanding shares, at a price of \$7.50 per share. All shares would be common stock of the same class. Sale of the new issue is intended to raise approximately \$1.6 million of capital.

13. The applicant states that the purposes for which the proceeds of the proposed issue will be used are to rehabilitate or upgrade track and structures to be able to handle rail cars of 265,000 pounds gross weight; acquire a diesel locomotive and passenger coaches for a new Willits-based passenger operation; acquire an additional steam locomotive and passenger train set for operation of an additional Fort Bragg-based steam train; refurbish passenger equipment, stations and facilities; and replace debt with equity to reduce fixed charges.

14. The items for which the applicant states the proceeds of previous stock issues have been used were reasonably required for the purposes specified in this order, and such purposes were not reasonably chargeable to operating expenses or to income.

15. The items to be paid for by the proposed stock issue are reasonably required for the purposes specified in this order, and such purposes are not reasonably chargeable to operating expenses or to income.

16. Granting this Commission's approval of applicant's previous stock issues must be retroactive.

17. The Commission disfavors granting any authority retroactively, and does so only in extraordinary circumstances.

18. Withholding approval of applicant's previous stock issues would create a hardship for existing investors and jeopardize the operation of common carrier rail services by the applicant.

19. Approving applicant's proposed new issue of approximately 614,000 shares of common stock is in the public interest.

20. No protest has been filed in response to the application.

21. No hearing has been held in this proceeding.

22. No finding is made in relation to the terms and conditions of any transaction which is the subject of this proceeding, or the fairness thereof.

Conclusions of Law

1. Applicant is a public utility within the meaning of Section 216 (a) of the PU Code.

2. The purposes for which applicant states the proceeds of all previous stock issues have been used comply with Section 817 of the PU Code.

3. The purposes for which the proceeds of the proposed stock issue will be used comply with Section 817 of the PU Code.

4. Applicant's previous stock issues should be approved nunc pro tunc.

5. Applicant's proposed merger with Land Company should be approved.

6. The approvals granted in the order should be subject to requirements to account for the disposition of the proceeds of stock issues, pursuant to PU Code Section 824.

O R D E R

IT IS ORDERED that:

1. California Western Railroad, Inc. (applicant) is authorized nunc pro tunc to issue 260,229 shares of common stock at a par (stated) value of \$5.00 per share for the purposes of acquiring a railroad and associated property from California Western Railroad, Inc., an Arizona corporation; repairing said property; performing maintenance on said property; acquiring additional equipment and rolling stock for the maintenance of the property; maintaining the level of initial working capital available as of the date of acquisition; and paying interest expense on debt.
2. On or after the effective date of this order, but not more than 30 days after applicant has received all regulatory approvals required by law, applicant is authorized to merge with California Western Land Associates, Inc., with applicant to be the surviving corporation following the merger. All issued and outstanding shares of California Western Land Associates, Inc. shall be canceled, and there shall be no new issue or exchange of shares as part of this merger transaction.
3. Applicant is authorized, immediately upon completion of the merger transaction as specified in the preceding paragraph, to split its then existing shares of common stock in the amount of 2.407 shares for one, such that the total number of shares issued and outstanding shall be the product of 2.407 and the number of shares issued and outstanding upon completion of the merger.
4. Applicant is authorized, immediately upon completion of the stock split as described in the preceding paragraph, to issue additional shares of common stock of the same class as the shares which are then issued and outstanding, at no par value, in a number that is equivalent to 49.5% of the sum of the new issue

and the otherwise issued and outstanding shares, for total consideration not exceeding \$4,600,000.

5. The purposes and maximum amounts for which the proceeds of the newly issued shares may be used are as follows:

(1.) Cost of Issuance	\$ 200,000
(2.) Track, Roadbed and Bridge Rehabilitation	1,000,000
(3.) Purchase Maintenance of Way Equipment	70,000
(4.) Purchase/Rehabilitation of Locomotives/ Passenger Equipment	250,000
(5.) Track Roadbed and Bridge Rehabilitation	1,150,000
(6.) Purchase/Rehabilitation Steam Locomotives	300,000
(7.) Rehabilitate Existing Coaches	80,000
(8.) Northspur and Picnic Area Improvements	180,000
(9.) Willits Depot Rehabilitation	125,000
(10.) Debt Retirement	1,245,000
TOTAL	\$4,600,000

If the total proceeds received from the sale of this issue are less than the maximum authorized by this order, the actual proceeds received shall be applied in the amounts and in the priority order indicated in this paragraph until such proceeds are exhausted. In no event shall the proceeds of this issue be used for any purpose other than the acquisition of property by the applicant; the construction, extension, or improvement of applicant's facilities; the improvement or maintenance of applicant's service; the discharge or lawful

refunding of applicant's obligations; or the reorganization or readjustment of applicant's indebtedness or capitalization as part of the merger and stock issue, without the specific approval of this Commission.

6. In no event may the proceeds of any stock issue authorized by this order be charged to operating expenses or income.

7. Within 30 days after the effective date of this order applicant shall pay all fees with respect to previous stock issues as required by Public Utilities Code (PU) Section 1904.1. The amounts of these fees shall be computed in accordance with PU Code Section 1904 (b), and interest at the legal rate shall be added to each fee from the actual date of the issue until the date of payment of the fee.

8. Applicant shall pay the fee required by PU Code Section 1904.1, and computed in accordance with PU Code Section 1904 (b), before issuing any shares pursuant to Paragraph 4 of this Order.

9. The staff of this Commission shall conduct such inquiry or investigation regarding the disposition of the proceeds of all sales of stocks and stock certificates, in such detail as is necessary, to insure that such disposition has been, and will be, for the purposes specified in this order. The applicant shall account for such disposition in the form and detail required by staff in the

discharge of this duty, and upon reasonable request shall produce such witnesses, books, papers, documents and contracts, and file such data as staff deems to be of assistance in conducting its inquiry or investigation.

This order is effective today.

Dated August 6, 1998, at San Francisco, California.

RICHARD A. BILAS

President

P. GREGORY CONLON

JESSIE J. KNIGHT, JR.

HENRY M. DUQUE

JOSIAH L. NEEPER

Commissioners