FINANCE DOCKET No. 65.

IN THE MATTER OF THE APPLICATION OF THE DELAWARE, LACKAWANNA & WESTERN RAILROAD COMPANY FOR AUTHORITY TO ISSUE CAPITAL STOCK AND TO DISTRIBUTE IT AS A DIVIDEND.

Submitted February 15, 1921. Decided April 18, 1921.

Authority granted the Delaware, Lackawanna & Western Railroad Company to issue $45,000,000 of common stock to be distributed as a dividend.

William S. Jenney, *Alfred P. Thom*, and *J. L. Seager* for applicant.

REPORT OF THE COMMISSION.

BY THE COMMISSION:

The Delaware, Lackawanna & Western Railroad Company, a common carrier by railroad subject to the interstate commerce act, seeks authority under section 20a of that act, conditioned upon its disposal of its coal properties and acceptance of certain provisions of the Pennsylvania constitution, to issue capital stock of an aggregate par value equal to the full amount of its corporate surplus, or such part thereof as we may approve, and to distribute such stock pro rata among its stockholders as a dividend. The application was made under oath, signed and filed on behalf of the applicant by one of its executive officers, and notice thereof was given to, and a copy thereof filed with, the governor of each state in which applicant operates. No objection to the granting of the application was made by any state authority.

The applicant operates about 960 miles of steam railroad radiating from the anthracite coal fields of Lackawanna and Luzerne counties, Pa. Its main line extends from Hoboken, N. J., through these fields to Buffalo, N. Y., with numerous branches. Its system, including second, third, fourth, and switch tracks, has approximately 2,700 miles of track, of which about 30 per cent is owned and about 70 per cent leased or controlled. The owned lines are in Pennsylvania and the leased or controlled lines chiefly in New York and New Jersey. It owns 742 locomotives, 28,914 freight cars, and 929 passenger cars.

The applicant is a Pennsylvania corporation, which had its genesis in the Liggetts Gap Railroad Company, organized by special act in 1832, to build and operate a railroad from what is now Scranton,

Pa., northward to the New York state line. The original charter contemplated a toll road open to the public for hauling by wagons and other conveyances. A later act permitted it to furnish "the exclusive motive power," and it eventually gained authority to acquire and operate other railroads, within or without Pennsylvania, to acquire and hold coal lands, and to mine, purchase, and sell coal. The laws of New York authorized it to acquire and operate railroads in that state and to hold lands therein for office and terminal purposes; and it has analogous power from New Jersey. The present corporate name was adopted in 1851.

The original line ran from Scranton to Great Bend, Pa., where it connected with the Erie Railroad. A route was opened to Cayuga Lake and the Erie Canal, by trackage rights over the Erie to Owego, N. Y., and by lease of the Cayuga & Susquehanna Railroad, thence to Ithaca, N. Y. Coal began to move over these routes in 1851. Later a line was built from Scranton to the Delaware River, and the Warren Railroad leased to a connection with the Central Railroad of New Jersey; and in 1868 applicant, by lease of the Morris & Essex Railroad in New Jersey, secured its own through line to New York harbor. A year or two later, by construction of the Valley Railroad between Great Bend and Binghamton, N. Y., and by lease of the Syracuse, Binghamton & New York Railroad and the Utica, Chenango & Susquehanna Valley Railroad, it opened routes to Oswego, on Lake Ontario, and to Utica, N. Y. In 1873, by merger with the Lackawanna & Bloomsburg Railroad, it gained a connection with the Pennsylvania Railroad at Northumberland, Pa., and finally, in 1883, Buffalo, N. Y., and Lake Erie were reached by completion and lease of the New York, Lackawanna & Western. Other branch lines of lesser importance have been built or acquired.

Since its organization the applicant has operated in the dual capacity of mining company and carrier, though the sales end of its coal business was segregated in 1909 following the decision of the Supreme Court of the United States in *United States* v. *Reading Co.*, 226 U. S., 324; 228 U. S., 158. See also *United States* v. *Del., Lack. & West. R. R.*, 238 U. S., 516, and *D., L. & W. Coal Co.* v. *D., L. & W. R. R. Co.*, 49 I. C. C., 203. Early development was confined largely to the extension of facilities to broaden the coal market, and applicant states that prior to 1900 it was not properly equipped to handle any freight other than coal. In that year comprehensive improvements were begun to modernize the road and bring it to a high state of efficiency. These included reconstruction of 30 miles of line north of Scranton, and the building of the "Jersey cut-off" from Portland, Pa., to Hopatcong, N. J., at a cost of over $400,000

per mile. Very large sums have been spent during the last 20 years in carrying out this program of rehabilitation.

The applicant has $42,220,550 par value of stock in the hands of the public and $102,600 of bonds. Its leased lines, most of which, according to its statement, are leased in perpetuity, have $44,222,600 of stock and $53,697,657 of bonds in the hands of the public, a total of $97,920,257, upon which it in effect pays rentals of $5,079,725 yearly. The annual interest on its own funded debt is $6,156. Its situation, therefore, is in a sense equivalent to that of a road having outstanding $42,220,550 of stock and $98,022,875 of funded debt, upon which it pays yearly interest of $5,085,681, or about 5.15 per cent, with a total capitalization aggregating about $150,000 per mile of road and $52,100 per mile of track.

One of the applicant's exhibits shows the following record of its stock issues:

Year.	Par value issued.	Cash value of proceeds.	Year.	Par value issued.	Cash value of proceeds.
1851	$600,000	$450,000.00	1867	$50	$50.00
1852	443,200	343,200.00	1868	2,812,000	2,812,000.00
1853	469,250	369,812.50	1869	1,826,850	1,826,850.00
1854	35,650	35,650.00	1870	2,881,350	2,881,350.00
1855	1,502,900	1,502,900.00	1871	295,250	295,250.00
1856	241,150	241,150.00	1872	895,900	895,900.00
1857	68,100	68,100.00	1873	3,500,000	3,500,000.00
1860	1,722,200	1,722,200.00	1875	2,389,000	2,389,000.00
1861	210,750	210,750.00	1876	311,000	311,000.00
1862	303,000	303,000.00	1909	3,944,000	3,944,000.00
1863	1,236,400	1,236,400.00	1914	12,076,400	12,076,400.00
1864	3,414,450	3,414,450.00			
1865	1,016,550	1,016,550.00	Total, 1919	42,220,400	41,870,962.50
1866	25,000	25,000.00			

The facts of record as to the nature of the proceeds are very meager. It is not shown what portion of the stock was paid for in cash, in service, or in property. Nor, as the effect of the many early consolidations does not appear, is it possible to state what portion may represent estimated value of merged properties. Stock dividends of $10,890,013 are included in the "cash value of proceeds" column. It is therefore a fair conclusion from the record that the original subscribers actually paid for the outstanding stock, in cash or its equivalent, representing direct sacrifice on their part, not in excess of $30,980,950.

The applicant distributed cash dividends of about 72 per cent upon its stock in 1909, of 22½ per cent in 1917, and of 20 per cent in every other year from 1905 to 1919, inclusive. The total dividends from 1853 to and including May 31, 1919, are given as $210,159,430.64, of which nearly $23,000,000 was in stock of the applicant or of its subsidiaries and the remainder in cash. The average rate of dividends during this period was about 12.8 per cent.

Since 1853, according to one of its exhibits, the applicant's net income from transportation has been $208,004,765.04, that from sale of coal $66,009,776.02, that from other sources $40,840,137.99, and its total net income $314,854,679.05. From this the exhibit shows payment of $210,159,430.64 in dividends and $14,233,472.38 in interest, leaving a book surplus of $90,461,776.03. The dividends exceeded the net income from transportation by $2,154,665.60, but net income from that source and sources other than sales of coal exceeded dividends by $38,685,472.39.

The applicant states that these surplus earnings are represented by the following items:

Investments in railroad property		$32,050,645.47
Other investments:		
In mining properties	$2,205,988.00	
In other nonoperating properties	2,344,179.51	
In railroad, etc., stocks and bonds	24,824,046.25	
In other stocks, bonds, etc	14,229,585.67	
In advances to leased roads, etc	10,344,048.64	53,947,848.07
Current assets (excess over current liabilities)		3,136,714.80
Net accounts, U. S. Railroad Administration		1,326,567.69
Total surplus		90,461,776.03

This result is obtained by deducting from the book investment in road and equipment, less reserve for depreciation, the aggregate outstanding stock and funded debt, and assuming that the remainder and the other assets listed were paid for out of surplus earnings.

The applicant contends that its actual surplus is much larger, since its coal properties are carried in these figures at their remaining original cost rather than their value, and since expenditures for additions and betterments were frequently charged to operating expenses prior to 1907.

In its 1919 annual report to us the applicant's total corporate surplus is given as $192,112,826.02. The discrepancy between this amount and the $90,461,776.03 shown above is due to the fact that in 1913 and 1917 the book value of the coal properties was increased approximately $100,000,000. It seems that these properties originally cost $17,474,256.06 and that this amount has been reduced by credits for surface sales and royalties, and charge-offs for depreciation and depletion, to the $2,205,988 remaining original cost included above. These lands, however, contain more than 400,000,000 tons of unmined coal, and the applicant, to secure the benefit of the depletion rate in its income tax return, estimating a minimum value of not less than 25 cents per ton, increased its book value as stated and entered a corresponding liability in the appropriated surplus account.

Each year the estimated value and corresponding liability are written down according to the amount mined, at 25 cents per ton.

Article XVII of the Pennsylvania constitution, relating to "Railroads and Canals," adopted in 1873 or earlier, provides in section 5:

> No incorporated company doing the business of a common carrier shall, directly or indirectly, prosecute or engage in mining or manufacturing articles for transportation over its works; nor shall such company, directly or indirectly, engage in any other business than that of common carrier, or hold or acquire lands, freehold or leasehold, directly or indirectly, except such as shall be necessary for carrying on its business; but any mining or manufacturing company may carry the product of its mines or manufactories on its railroad or canal not exceeding fifty miles in length.

Section 10 of the same article provides:

> No railroad, canal or other transportation company, in existence at the time of the adoption of this article, shall have the benefit of any future legislation by general or special laws, except on condition of complete acceptance of all the provisions of this article.

Under a general act of the Pennsylvania legislature approved February 9, 1901, as amended, a corporation created by special law may, with the consent of a majority of its stockholders, increase its capital stock to such an amount as it deems necessary to carry on and enlarge its business. This act, relieving such corporations from prior limitations, expressly provides, however, that it shall not inure to the benefit of any railroad corporation which has not accepted all provisions of said article XVII. Because of its coal properties, the applicant has not accepted those provisions, and according to statement of its counsel it is limited in the increase of its capital to the issuance of stock for new construction of owned lines in Pennsylvania.

The attorney general of Pennsylvania, by direction of the governor of that state, has advised us:

> That this Company (the applicant) cannot avail itself of the statute of this Commonwealth regulating the increase of capital stock, unless it accepts the provisions of the State Constitution nor are the provisions of these laws available to this Company so long as it continues to own and operate coal mines. If, however, this corporation divests itself of its coal properties, and formally accepts the provisions of the State Constitution, it will, under our law, have the right to capitalize its surplus and declare a stock dividend therefor.

Whether or not the applicant is prohibited from issuing stock dividends by its charters is not clear. Counsel stated that he knew of no provision which would permit such dividends. The evidence shows that some stock has been issued for this purpose in the past, but, however that may be, the applicant is now desirous of securing such advantages in the issuance of securities as may result from acceptance of the Pennsylvania constitution, and plans to divest itself of its coal properties. These are now carried on its books at a value somewhat

in excess of $100,000,000. It is said that they are appraised for tax purposes at between $60,000,000 and $70,000,000, and will not be sold for less than $60,000,000. The applicant states that if it is to receive an adequate price for these properties they must be acquired for or in behalf of substantially the same persons who hold its stock. No definite plan has been formulated, but it is suggested that they will be conveyed to a new corporation in return for $60,000,000 or more, par value, of its stock, to be distributed as a dividend to the applicant's stockholders. Possibly payment may be made in part by bonds, carrying no control or voting power, which will be retained by the applicant.

Section 20a of the interstate commerce act makes it unlawful for any carrier to issue stock or other securities unless by order we authorize such issue, and provides that we shall make such order only if we find that the issue—

(a) is for some lawful object within its corporate purposes, and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service, and (b) is reasonably necessary and appropriate for such purpose.

Authority to issue stock can not be claimed as a right. It is within our discretion, subject to the limitation that we shall grant authority only if we are able to make the necessary finding. If the applicant is lawfully entitled to earn a return upon the fair value of property acquired out of surplus this right will persist whether or not the stock issue is permitted.

Assuming that the issue is for a lawful object, is that object "compatible with the public interest" and one "which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service"?

The applicant contends that we should permit the capitalization of the full surplus of the company. It argues that refusal to grant the application would seriously discourage, if not entirely prevent, investment by the public in railway stocks. Some inducement, it says, must be offered investors in stock, to make up for the security and certainty both as to principal and interest afforded by mortgage bonds, and therefore that there must be a chance of more attractive return in the case of stock. It alleges that a refusal to grant this application would be public notice of a lack of advantage in investing in stock. And it suggests that in the event of denial of the application there would be no inducement in the future to use surplus earnings for additions and betterments, and that stockholders

would insist each year upon the distribution of all available earnings.

The applicant points out that the lawful declaration of dividends at a rate high in comparison with that of other railroads in the same territory has led the public to the unwarranted conclusion that it has received and is receiving an excessive return on its investment in property devoted to public use, and that the proposed increase in stock would tend to remove this source of distrust and suspicion. It suggests also that in case of consolidations with other lines the applicant could secure much better terms if its capital stock more nearly represented its value than as at present. Our attention is called to paragraph 6 of section 5 of the interstate commerce act which provides that in the event of consolidation of railroad companies the capitalization of the resulting company "shall not exceed the value of the consolidated properties as determined by the Commission," and it is urged that in view of this provision we should, in our control of securities, endeavor to adjust the capital of carriers to the value of their properties.

There is no proof that the surplus sought to be capitalized is the result of excessive transportation charges. Traffic has been carried by the applicant at rates, controlled by state or interstate regulatory bodies, substantially the same as those applicable over competing lines. And there is no showing that the return from transportation charges upon the fair value of the property owned or used for common-carrier purposes has been excessive. Clearly the amount of the return from the coal property is immaterial except as it tends to explain what might otherwise appear to be excessive carrier return.

The question of the reasonableness of the applicant's past return is not in fact before us at this time. Where the public has found it expedient to adopt a *laissez-faire* policy to encourage utility development, it can not be said, in the absence of regulation, that profits have been illegally collected. The title to the surplus has vested without limitation or condition in the corporation, and benefits the shareholder. The doctrine of implied trust, sometimes applied to donated property by courts and commissions, has no application to excessive return, for the payment of rates carries with it no requirement that the funds be left in the business or used for the public benefit. Its strained application to carriers which have made additions and betterments from surplus would only penalize those who came nearest to benefiting the public. The surplus from income, in such cases, is unrestricted legal property of the company, and ceases to be funds of the public, before the decision to divert it to either dividends or additions and betterments is made.

Such reasoning, however, does not warrant authorization of the issuance of securities merely upon a showing of invested earnings.

To render the proposed issuance "compatible with the public interest," within the meaning of the statute, we are convinced that a substantial surplus should remain uncapitalized as a support for the applicant's credit, providing for emergency needs, offsetting obsolescence and necessary investments in nonrevenue-producing property, and serving as a general financial balance-wheel.

We do not share the applicant's apprehension as to the effects which will follow the required maintenance of such a surplus. Such a reserve is a direct benefit to the stockholder. It maintains the market value of his stock and protects not only his dividends but his pro rata share of the assets available on dissolution.

The terms of possible future consolidations and mergers are not now before us and can be dealt with when the occasion arises.

The applicant claims a total surplus available for capitalization of $90,461,776.03. In view of the proposed sale of its mining property and distribution of the proceeds, the $2,205,988 shown as surplus invested in such properties may be dismissed from further consideration.

Several items of the remaining $88,255,788.03 of the surplus do not fall within that class of assets which we deem it proper to permit the applicant to capitalize. On May 31, 1920, it held in its treasury stocks of railroad, terminal, transfer, and ferry companies to the amount of $9,151,048.75, and bonds of such companies to the amount of $15,672,997.50, making a total of $24,824,046.25. Of this amount, $56,450 was applicant's own stock. The balance consisted mainly of stocks and bonds of lines leased by the applicant. The record discloses no intercorporate relations or other circumstances which bring these holdings within the sphere of securities which could properly be capitalized by a common carrier. It is not necessary for the applicant to hold securities of its leased lines in order to operate its system if, as it states, its leases are in perpetuity. We are unable to form any sound opinion on the record before us as to lines controlled by stock ownership. Neither the actual value nor the earning power of the securities is shown. So far as the record shows all of these securities are in the same class with the recognized shifting assets. The applicant on that date also held in its treasury stocks of advertising, mining, timber, and land companies to the amount of $1,662,813.37, and United States government bonds and certificates of indebtedness, municipal bonds, and steel company bonds to the amount of $12,566,772.30, making a total of $14,229,585.67. These are flexible assets which we deem it improper

to permit applicant to capitalize. If it should be thought desirable to distribute the portion of surplus invested in such securities among the stockholders, the applicant would be able to apportion the securities themselves or distribute the proceeds thereof. They are neither property used or useful in rendering the public service, nor an assured part of any surplus.

Nor is any reason manifest why the applicant should be permitted to issue capital stock against its net account of $1,326,567.69 with the United States Railroad Administration, which is merely an unadjusted balance.

The record contains no showing which would justify our authorizing the applicant to capitalize its investments in nonoperating properties. The reasons for acquiring and holding these properties are not stated, and no present or contemplated future use of them in connection with the applicant's transportation service is shown.

Applicant claims that on May 31, 1920, $32,050,645.47 of its surplus was invested in railroad property and submits an analysis of this item as follows:

Assets (investments):	
In owned roads	$44,632,768.71
In improvement on leased roads	12,818,800.50
In equipment, $36,071,845.42, less accrued depreciation, $18,781,049.16	17,290,796.26
Total assets	74,742,365.47
Liabilities:	
Capital stock	42,277,000.00
Premium on capital stock	70,720.00
Bangor & Portland bonds	320,000.00
Muchmore real estate mortgage	24,000.00
Total liabilities	42,691,720.00
Invested surplus	32,050,645.47

The applicant's lines are stated to have been entirely rebuilt since 1900, the work, with the exception of the construction of the Lackawanna Railroad of New Jersey and the cut-off line in Pennsylvania, being accomplished solely by the use of the applicant's earnings. The testimony is that no charge was made to the capital account in connection with the excess cost of replacements prior to 1914 because no depreciation reserve had been set up, and these expenditures were considered as offsetting depreciation. No comparison of these items is made of record, and the policy as to writing off abandoned property other than equipment is not shown.

The applicant is not seeking to capitalize any equity in its leases of railroad property, but only the amount of earnings said to have been invested by it in the properties of such roads. The evidence is that most of these roads are leased in perpetuity, but that some are leased for the corporate life of the subsidiary line. Without the leases before us we are unable to determine the length or nature of the applicant's tenure, and can not on the present record authorize it to capitalize its total investment in such property.

The applicant has advanced from its earnings $10,344,048.64 to leased and controlled lines. These advances are carried into the capital accounts of such roads and credited by them to the applicant. They differ little from investments in leased lines, and when shown upon the applicant's books as such investments may be capitalized by it.

The applicant seeks to capitalize $3,136,714.80, the excess of its current assets over its current liabilities as working capital necessary in the operation of the road. The record indicates that there are included in its current assets mining materials and supplies valued at $1,364,618.19 which doubtless would be turned over to the purchaser of its coal properties and therefore should not be considered in passing upon this application.

The evidence establishes (1) that the Delaware, Lackawanna & Western Railroad has a large uncapitalized surplus; (2) that the present capitalization is below the actual investment or fair value of the property; (3) that the increase in capitalization which would follow the grant of authority hereinafter suggested would still leave the total capitalization of the applicant below the fair value of the property; and (4) that the remaining uncapitalized surplus will be sufficient to serve the purposes for which a surplus should be accumulated.

We find that the proposed issue of capital stock by the Delaware, Lackawanna & Western Railroad Company as a dividend has been justified to the extent of $45,000,000 and that to that extent it (*a*) is for a lawful object within its corporate purpose and compatible with the public interest, which is necessary and appropriate for and consistent with the proper performance by it of service to the public as a common carrier, and which will not impair its ability to perform that service; and (*b*) is reasonably necessary and appropriate for such purpose; but that the applicant has not justified an authorization of the issuance as dividends of the remainder of its proposed capital stock and that authority therefor should be denied.

We further find that the authorization of the issue of $45,000,000 capital stock as above provided should be conditioned upon the issue of evidences of indebtedness by the leased lines to applicant for the

$10,344,048.64 carried on its books as advances to leased lines, and the transfer by the Delaware, Lackawanna & Western Railroad Company of that sum to the proper subsidiary account under investment in leased lines.

An appropriate order will be entered.

DANIELS, *Commissioner*, concurring:

With the result of the report, so far as it goes, I concur; but refrain from giving entire adhesion to the basis which seems to underlie the report. While it is not so stated expressly, it may fairly be inferred that the report accepts applicant's book cost of road and equipment as virtually correct. The report appears to accept as appropriate for capitalization investments in owned roads, in improvements on leased roads, and in equipment (depreciated), to the extent that these items exceed the stock and bond liabilities of the applicant. This invested surplus is put at $32,030,645.45.

To this, advances made out of earnings to leased lines and amounting to $10,344,048.64, provided that they shall hereafter be shown on applicant's books as "investments," are apparently added. These two items aggregate $42,374,694.01. The difference between the $45,000,000 capitalization allowed, and the sum of the two items above is $1,625,305.99 which, I assume, is an allowance for working capital.

If it is appropriate to include in the amount to be capitalized the advances to leased lines, provided they are booked as "investments," I am not able on principle to see the reason for excluding investments out of surplus in the securities of leased lines constituting an integral and permanent part of applicant's system. The New York & Hoboken Ferry Company will illustrate this point. This company is leased to the applicant and serves as a necessary terminal. Its entire capital stock, amounting to $3,300,000, has been acquired by the applicant. Of its bonds applicant holds $1,216,000, while $2,084,000 are in the hands of outside holders. Assuming that the lease obligates the applicant to pay dividends on the stock and interest on the bonds, the acquisition of the stock out of applicant's surplus lessens the fixed charge to just the same degree as if that much additional property had been acquired outright. Applicant simply pays the guaranteed dividend to itself. The fact that the ferry stock will be outstanding and at the same time an equivalent amount of applicant's stock would have been issued is immaterial, inasmuch as there is no double return exacted from the users of the property represented thereby. I can not see any difference in principle in allowing the applicant to issue its stock to cover advances to leased lines, hereafter to be designated "investments," and in allowing capitalization

of surplus invested in the securities of leased lines which are a necessary and permanent part of applicant's system, and which serve in a similar way to augment its net earnings.

Of less practical importance is the denial to capitalize liquid assets in the form of United States government securities amounting to upward of $12,000,000, but the ground given for denial, that they are "flexible assets" which can be distributed directly, or whose proceeds can be distributed directly to applicant's stockholders, seems untenable as a reason for denial of their capitalization. These are now carried as a liability included in surplus. If capitalized, they will be carried as a liability against an approximately equal amount of additional capital stock. As said in *Eisner* v. *Macomber*, 252 U. S., 189, revenue-producing property," etc. But I am not persuaded that the

> Far from being a realization of profits to the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.

So long as such assets are not invested in property used or useful in serving the public, they would, of course, not be included in any rate base on which a fair return is to be computed.

It should be added that the report correctly finds that to render a proposed stock dividend "compatible with the public interest" within the meaning of the statute, "a substantial surplus should remain uncapitalized as a support for applicant's credit, providing for emergency needs, offsetting obsolescence and necessary investments in non-revenue producing property," etc. But I am not persuaded that the entire remainder of applicant's surplus not allowed to be capitalized is requisite for the necessary purposes of a surplus.

POTTER, *Commissioner*, concurring:

For the reason that in my opinion the applicant is entitled to issue additional stock much in excess of $45,000,000, I concur in the report authorizing the issuance of that amount or of such smaller amount as may be issued under the limitations contained in the report. I do not concur in the view that the amount to be issued should be limited to $45,000,000, nor do I concur in all of the reasons or conclusions upon which the report is based.

EASTMAN, *Commissioner*, dissenting:

In a dissenting opinion in *Stock of Chicago, Burlington & Quincy R. R.*, 67 I. C. C., 156, 172, dealing with the application of the Chicago, Burlington & Quincy Railroad Company for authority to issue stock and bonds for dividend purposes, I gave my reasons for believing that in a case like this the capitalization of surplus is contrary to the public interest and ought not to be permitted.

Without restating these reasons at length, I pointed out that there are many who feel that when surplus earnings, over and above reasonable dividends, are invested in carrier property, the public, having provided the funds, has an interest in that property and can not fairly be asked to pay the same return upon it as upon property representing real sacrifice by investors. They believe that it is unjust to ask the public to provide both capital and return, that the circumstances attending the accumulation of such a surplus impose a duty upon the carrier at least to share its advantages with the public, and that this duty may be considered in valuation for rate-making purposes. I showed that the Supreme Court of the United States has not yet held that property acquired from surplus earnings after the payment of reasonable dividends is to be included on equal terms with other property in determining the "fair value" upon which rates are to be based; nor, if we assume that this will be the decision, has it held that the "reasonable return" upon the portion of the value representing such surplus accumulations must correspond with and be as high as the "reasonable return" upon the remainder. I further pointed out that whatever right a carrier may have to a return upon surplus can in no way be lost by refusing to permit its translation into stocks or bonds, but that the granting of such permission may prejudice and impair the rights of the public.

In the present case, not only is the 100 per cent stock dividend which the majority have approved open to these and other grave objections, but it might well be denied because of the total lack of strong and compelling reasons in its favor. Briefly summarized, the affirmative grounds urged in support of the application are as follows:

1. At the hearing counsel for the Association of Railway Executives stated:

> That undoubtedly a refusal to grant the application would seriously discourage, if not entirely prevent, the investment by the public in the stocks of such companies. Manifestly there must be some special inducement to invest in stock to make up for the security and certainty, both as to principal and interest, which is afforded by a bond secured by a mortgage. Inasmuch as such certainty can not be given in the case of stock, there must be a chance of more attractive return in the case of stock. One of the weaknesses in the present credit system of the railroads is the fact that in a strictly regulated industry the opportunity for speculative and large returns is almost entirely lacking. In this case is presented an opportunity to impress the public mind with the idea that in a well managed and successful railroad, honestly administered and financed, there still exists a chance to invest profitably in stock and to obtain the usual rewards and to run the risks which the holder of stock always takes.
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> If, instead of using this case to make that impression favorable to investment in stock, the application is denied, it will undoubtedly have a serious tendency to impress the investing public with the view that there is no advantage in

investing in stock, and that such an investor can not hope to receive from such investment anything whatever to compensate for the loss of certainty and safety he would obtain by investing in stock.

I have quoted this at length, because it is the point upon which most stress has been laid. In the light of the facts the absurdity of the claim is clear. Since 1905 the dividends paid by the Lackawanna have averaged well over 20 per cent, and since 1853 the average rate has been about 12.8 per cent. In addition, a surplus of over $90,000,000 has been accumulated. It is difficult to conceive what better encouragement for investing in stock could well be expected, or to grasp the thought that under such circumstances the denial of a 100 per cent stock dividend will cast a pall over the investment market. Stockholders who have received such dividends in the past, who have a prospect of such dividends in the future, and whose investment is now *protected by such a surplus* surely have no reason for complaint.

2. It is urged that the "declaration of dividends at a rate abnormally high when compared with the dividend rate of other railroads operating in the same territory has led to the unwarranted conclusion on the part of the public that applicant has earned and is earning a grossly excessive return on its investment in property devoted to public use," and that "an increase in capital stock as is here proposed would tend to remove this source of distrust and suspicion."

Without pausing to consider whether or not the return has in fact been excessive, it is not made clear in what way this distrust and suspicion have been or are likely to be prejudicial to the Lackawanna. There is no evidence of injury. Nor, apparently, has thought been given to the distrust and suspicion which may be created in the public mind by the declaration, under present railroad conditions, of a stock dividend of 100 per cent.

3. It is said that it is the desire of applicant to extend and improve its lines of railroad by acquisition of or consolidations with other lines, and that it is believed that "much better terms can be obtained in connection with voluntary consolidations if our capital stock represents more nearly our value than as at present." In this connection, our attention is called to the fact that paragraph 6 of section 5 of the interstate commerce act now provides that in the event of consolidation of railroad companies, the capitalization "shall not exceed the value of the consolidated properties as determined by the Commission." It is urged that in view of this provision we should, in the exercise of our control over the issue of securities, "endeavor to adjust the capital of carriers to the value of their properties," Counsel for the Association of Railway Executives amplified this thought as follows:

It will be the beginning now of preparation for the national policy of consolidation, and will tend to prevent the embarrassment of the placing contemporaneously on the market of *immense issues of new securities* when the actual consolidation of many systems is undertaken.

Counsel has overlooked the fact that the provision quoted uses the words "shall not exceed" and not the words "shall equal." Moreover, the valuation of applicant's property has not yet been completed. The terms of future possible consolidations or mergers can be dealt with when the need arises. The thought is staggering that they will be attended by "immense issues of new securities." I am unwilling to believe it.

4. It is suggested that a part of the surplus might now be distributed directly in dividends, and that the declaration of a stock dividend in lieu thereof is in the public interest, since it will preclude such distribution of assets.

It is true that not all of the surplus has been invested in physical property but that some of it is represented by securities of affiliated companies which might be distributed directly to the stockholders.

It may be assumed, however, that the considerations which led applicant originally to use surplus cash for the acquisition of these securities, rather than for the declaration of still larger cash dividends to its stockholders, would continue to persuade it to hold these securities in its treasury. Certainly we ought not to assume the contrary. Moreover the *partial* capitalization of surplus which the majority have approved will not preclude their distribution.

5. It is said that if the application is not granted there will be no inducement in the future to use surplus earnings for additions and betterments to the property, but that, instead, stockholders will insist each year upon the distribution of all available earnings.

Of this suggestion it is sufficient to say that if the stockholders should in the future deem such distribution wise and expedient, that situation can be dealt with then. My belief is that nothing of the sort would occur. Certainly it could not happen with regard for sound financial policy and the sanction of public opinion.

6. It is said that capitalization in the past has been controlled by the charter restrictions growing out of the ownership of coal mines, and that if the company is now divested of these coal properties and converted into a transportation industry alone its financial structure should be readjusted so as to "conform now to what it would undoubtedly have been except for the conditions which are now to be changed."

The opportunity of divesting itself of its coal properties and accepting the provisions of the Pennsylvania constitution has always been open to applicant, but it has preferred and prospered

under the charter restrictions from which it now seeks to be free. And why should it be assumed that if applicant had been a transportation industry alone its financial management would have been less sound and conservative?

7. Counsel for the Association of Railway Executives contends that after the stock dividend the capitalization "will more nearly express the truth as to the company's values than the present capitalization." He argues:

> It is of high concern to the public that the truth about values shall be known and that any device or statement that conceals a part of the values shall be corrected. Otherwise the wealth or values that are concealed will not furnish their proportion of the national credit and will not be available for the important uses which all wealth ought to be available for—it will be partially lost or paralyzed.

Aside from the fact that the valuation of railroads which we are now conducting has for its purpose the ascertainment of the "truth about values," this argument rests on the curious notion that property or wealth shown in the form of surplus accumulations is "concealed," and can only be brought to light by the declaration of stock dividends. The worth of the argument may be tested by its logical conclusion, namely, that those are wrong who have fancied that surplus reserves are a support and buttress to credit and that an important part of the wealth of the country will be "lost or paralyzed" unless all corporations proceed to capitalization of surplus assets.

These are the labored reasons that have been urged upon us for the granting of the pending application, and it is manifest that they have neither strength nor weight. They offer no promise of public benefits outweighing the dangers involved. It is not even clear that they offer any promise of genuine private benefit. How can the finding be made, which the statute requires, that the issue is for a lawful object "compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service"?

It is, I think, a matter of regret that the exercise of our new powers of supervision over the issue of railroad securities should be marked in a period of financial depression by approval of the declaration of stock dividends by carriers which have refrained from declaring such dividends in past years of prosperity when such supervision did not exist. Without increasing the volume of railroad property it is proposed to increase the volume of railroad securities at a time when such securities are a drug upon the market. Undercapitalized railroad corporations are a source of strength to the nation, and they are all too few.

ORDER.

Full investigation of the matters and things involved in this proceeding having been had, and the Commission having, on the date thereof, made and filed a report containing its findings of fact and conclusions thereon, which report is hereby referred to and made a part hereof:

It is ordered, That the Delaware, Lackawanna & Western Railroad Company be, and it is hereby, authorized to issue shares of its common capital stock in the aggregate par amount of $45,000,000, and to distribute the same as a dividend pro rata among its stockholders.

It is further ordered, That the issuance of said $45,000,000 of capital stock shall be conditioned upon the issuance of evidences of indebtedness by the leased lines to the applicant for the $10,344,048.64 carried on its books as advances to leased lines, and the transfer by the Delaware, Lackawanna & Western Railroad Company of that sum to the proper subsidiary account under investment in leased lines.

It is further ordered, That within 10 days after such issue, but not later than September 1, 1921, the applicant shall report to the Commission all pertinent facts as to the exercise of the authority herein granted, said report to be in writing and signed and verified by an executive officer of the applicant having knowledge of the facts therein.

And it is further ordered, That nothing herein shall be construed to imply any guaranty or obligation as to said common capital stock, or dividends thereon on the part of the United States.