

FINANCE DOCKET NO. 22632<sup>1</sup>

ERIE-LACKAWANNA RAILROAD COMPANY LOAN GUARANTY

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*Decided November 12, 1963*

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1. In Finance Docket No. 22632, application, as amended, for a loan guaranty of \$5.0 million under part V, denied.
2. In Finance Docket No. 22633, application for authority under section 20a to issue promissory notes evidencing the loan and to pledge certain securities as collateral therefor, dismissed.

*M. C. Smith, Jr., F. G. Hoffmann, Louis Hering, and Clyde Mitchell* for applicants.

REPORT OF THE COMMISSION

BY THE COMMISSION:

By application in Finance Docket No. 22632, filed May 29, 1963, as amended and supplemented, Erie-Lackawanna Railroad Company seeks guaranty by this Commission under part V of the Interstate Commerce Act, as amended, of a loan in the amount of \$5.0 million, for the purpose of reimbursing its treasury for certain capital expenditures from its own funds made after January 1, 1957. The proceeds of the loan would be used for general corporate purposes. The lender party to the application is the First National City Bank, of New York, N. Y., as trustee under a collateral trust agreement for the benefit of the holders of the notes evidencing the proposed loan to be issued thereunder. The proposed loan would be made by New York State Teachers Retirement System. In Finance Docket No. 22633 applicant seeks authority under section 20a of the act to issue promissory notes evidencing the proposed loan and to pledge certain of its bonds as collateral therefor.

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<sup>1</sup>This report also embraces Finance Docket No. 22633, Erie-Lackawanna Railroad Company Securities.

In a letter received September 9, 1963 from Tri-County Teachers Retirement Council, Inc., of Plainview, N. Y., that organization urges that the applications be denied.<sup>2</sup> In view of our findings herein, no comment on this protest is deemed necessary.

As originally filed, a guaranty of a loan of \$15.0 million was sought, which would bear interest at the rate of 4 3/4 percent per annum, would be secured by collateral hereinafter described, and would mature serially in installments of \$750,000 each during 1969 through 1973 and installments of \$2,250,000 each during 1974 through 1978. Applicant was advised informally by the Commission that the guaranty of a loan of \$15.0 million could not be approved. Subsequently, in a letter dated October 7, 1963, applicant states "\*\*\*we have carefully reviewed our present situation and our plans, and our conclusion is that a loan of \$5 million will enable us to meet our financial needs and to embark upon our rehabilitation program which, we believe, will put us in the black in 1965." This letter will be considered as an amendment to the instant application. Applicant has not furnished further information as to the repayment terms of the \$5.0 million loan now proposed.

#### PREVIOUS PART V LOAN

By order of division 3, dated June 6, 1961, in Finance Docket No. 21494, hereinafter called the previous loan, a \$15.0 million loan guaranty was authorized for applicant for the same purpose. Applicant initially proposed to use the proceeds of the previous loan toward the cost of additions and betterments, including construction of certain facilities such as connecting tracks and yard facilities to effect the consolidation of the forces, facilities, and operations of the predecessor railroads (Erie Railroad Company and The Delaware Lackawanna and Western Railroad Company). By order of the Commission in *Erie R. Co. Merger*, 312 I.C.C. 185, decided September 13, 1960, hereinafter called the *Merger* case, the merger of Lackawanna into Erie was approved and the name

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<sup>2</sup>It urges denial for reasons set forth in the letter, which include, among other things, applicant's deficits in net income from 1958 to 1962 inclusive, aggregating \$84.1 million; its dwindling working capital; its estimated deficit of \$13.0 million for 1963; and the "doubtful value" of the emergency bonds based on Moody's rating of applicant's credit. The letter concludes that approval of the loan would not be consonant with section 504(a)(4) of part V and, further, would not be in the best interest of the 110,000 members of the New York State Teachers Retirement System. It appears that Tri-County Teachers Retirement Council, Inc., is a compulsory member of the New York State Teachers Retirement System.

of the surviving corporation was changed to Erie-Lackawanna Railroad Company. However, for reasons set forth hereinafter, applicant found it necessary to use almost the entire proceeds of the previous loan for working capital purposes.

While the merger was consummated on October 17, 1960, a Federal court injunction obtained by labor unions delayed the consolidation of the forces and facilities of the two railroads until approximately May 16, 1961. Throughout the interim period between approval of the merger by the Commission in September 1960 and the lifting of the injunction in the labor dispute following the favorable Supreme Court decision on May 1, 1961, applicant's earnings and its current position suffered principally as a result of a sharp decline in operating revenues. During that time, applicant suffered an actual out-of-pocket cash loss of approximately \$11.5 million.

Shortly before approval of the guaranty of the previous loan applicant advised us that its cash position had become precarious and that it would need the entire proceeds of the first scheduled disbursement thereof (\$6.2 million) to bolster its working capital position. Under the loan agreement filed therein, applicant would take down \$6.2 million at the first disbursement of the loan immediately following approval of the guaranty by the Commission; and the remaining \$8.8 million was to be taken down as the construction program incident to the merger progressed. In view of applicant's serious financial situation, our order in the previous loans did not restrict the use of the loan proceeds to the specific capital expenditure projects listed in the application and, accordingly, applicant was allowed to use the funds to meet pressing current obligations. It took applicant some time to take any meaningful actions towards implementing its merger plans for consolidation of facilities, elimination of duplicate facilities with related reductions in personnel, and construction work necessary to physically connect the tracks and other facilities of the predecessor railroad. This situation, coupled with a continuing sharp decline in revenues, delayed or practically nullified anticipated savings in operations from the merger. In November 1961 applicant requested that an additional \$2.5 million of the proceeds of the previous loan be disbursed before December 1, 1961, and the disbursement was made on that date. The third and final installment of the previous loan in the amount of \$6.3 million was disbursed to applicant on January 3, 1962.

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## FINANCIAL DATA

On total operating revenues of \$220.4, \$211.0, and \$210.9 million in 1960, 1961 and 1962, applicant suffered deficits in net income of \$20.0, \$26.5, and \$16.6 million. For the first 8 months of 1963 revenues totaled \$136.8 million as against \$141.1 million for the same period in 1962. The deficit in net income for the first 8 months of 1963 was \$13.0 million compared with \$12.3 million for the same period in 1962. As seen, applicant's operations during the period January 1, 1960 to August 31, 1963 have produced a staggering total deficit in net income of \$76.1 million. Income statements for the years 1959 to 1962, and for the first 8 months of 1963, compared with the same period in 1962 are included in appendix A.

As of December 31, 1959, applicant had working capital (excess of current assets over current liabilities) of \$22.5 million and cash and temporary cash investments of \$23.0 million. As of August 31, 1963 it had a deficit in working capital (excess of current liabilities over current assets) of \$325,825, actual treasurer's cash of \$4.8 million, and no temporary cash investments. It is not practicable to determine precisely what applicant's cash loss from operations has been as a result of the aforementioned \$76.1 million total deficit in net income. However, as indicated in appendix A, after deducting depreciation accruals (which do not represent a cash outlay), the out-of-pocket loss on that basis for 1960, 1961, and 1962 aggregated approximately \$18.2 million. On the same basis, the out-of-pocket loss for the first 8 months of 1963 was \$4.0 million, bringing the overall cash loss from operations for the period January 1, 1960 to August 31, 1963 to approximately \$22.2 million. The cumulative impact of such cash losses is also reflected in applicant's balance sheet as of August 31, 1963. Balance sheet statements as of December 31, 1961 and 1962 and as of August 31, 1963 are attached as appendix B. As indicated earlier applicant's *net* current assets dropped from \$22.5 million, with cash or its equivalent of \$23.0 million as of December 31, 1959 to a deficit position of \$325,825 as of August 31, 1963 (current liabilities in excess of current assets). Hence, its net current assets were depleted by almost \$23.0 million during the aforementioned period. Precise information as to actual treasurer's cash is readily available only for the period April 1, 1962 to September 30, 1963. Such data are reflected in appendix

A. These cash flow statements reflect actual treasurer's cash receipts and disbursements, including the receipts, for example, from sale of real estate and scrap which are not reflected in the income statements and, accordingly, are not reflected in the aforementioned deficits in net income. As seen in appendix A, applicant lost actual cash in 10 of the months in the indicated 18-month period and the total cash loss for the period was approximately \$5.2 million. For a more recent trend, applicant had a net actual cash loss of approximately \$1.7 million in the first 9 months of 1963. For the month of August such loss was \$1.1 million. In September applicant showed a slight cash gain of \$164,000.

In brief, while it is not possible to determine applicant's cash loss precisely, based on information set forth in the next succeeding paragraph, it appears that applicant's cumulative deficit in net income of \$76.1 million during the period January 1, 1960 to August 31, 1963 resulted in an actual out-of-pocket cash loss of between \$20.0 and \$23.0 million. Applicant was able to survive during that period only by the injection of the \$15.0 million proceeds of the previous loan and by sale of real estate and other property.

PROSPECTIVE EARNINGS AND ABILITY TO REPAY

In the previous loan application, applicant based its projected operating revenues on three levels of carloadings, i.e., in millions, 1.385, 1.454 and 1.524, respectively. Operations for the years 1961 and 1962, the first two complete years after the merger, resulted in actual carloadings of, in millions, 1.221 and 1.154, respectively. The following tabulation compares actual operating results for the years 1961 and 1962 with the estimated projected operating revenues at the lowest level as predicated by applicant in its previous loan application:

Year	Operating revenues			Carloadings		
	Actual	Estimated in previous loan case	Percent under estimate	Actual	Estimated in previous loan case	Percent under estimate
	<i>Millions</i>					
1961 ---	\$211.0	\$229.5	8.77	1.221	1.385	13.43
1962 ---	210.9	229.5	8.82	1.154	1.385	20.01

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The above estimates of operating revenues and carloadings were based on the annual average for the 3-year period 1958-1960, inclusive. As indicated in the foregoing tabulation, applicant's actual revenues fell below its estimates by \$18.5 million in 1961 and \$18.6 million in 1962 or a total of \$37.1 million. That showing is considerably short of its expectations even at the lowest estimated level of carloadings. Applicant indicates that while factors peculiar to years 1960, 1961 and 1962 make this period unrepresentative of future results, it does, however, provide some means of estimating future income. Applicant represents, among other things, that, as measured by the Federal Reserve Bank Index of Industrial Production, 1960 was a recession year; that in 1961, while the general economy showed an increase, production of anthracite and bituminous coal continued to decline and there was a moderate drop in iron and steel production; and that in 1962 iron and steel production was virtually unchanged from 1961 with very little change in revenues, but automobile production resulted in substantially increased revenues. Applicant states that continued losses in less-than-carload and coal revenues offset gains resulting from the modest increase in general economic activity; and that the 1960-1962 period was a period of conflicting trends, with applicant's revenues in each of the years 1961 and 1962 approximating \$211.0 million. Because it believes the decline in coal and less-than-carload revenues is largely ended, applicant now considers the 1961-1962 level as being near the minimum for purposes of projecting future revenues.

In the instant application, projected operating revenues are based on three levels of traffic. Level I is the expected level for the year 1963 and Levels II and III are anticipated levels to be reached by 1965 and 1967. Projected income statements setting forth the three levels of operating revenues and the results thereof are shown on appendix C. Level I is based on past operations and the assumption that 1963 will equal or be slightly less than 1962. Beginning with 1964 the projected revenues are progressively increased about 2.5 percent, based on economic forecasts that the annual average growth in the nation's economy will be approximately 3.5 percent. Yet during the years 1959-1962 its revenues have progressively declined from \$226.1 million in 1959 to \$211.0 million in 1962, with a further decrease of 3.0 percent for the first 8 months of 1963. Based on its actual operations since consummation of the merger, applicant's anticipation of the progressive

annual increases in revenues set forth in its projections is unrealistic. As far as the projections at Levels II and III are concerned, it does not appear that such revenue levels will be reached.

As shown in appendix C, applicant anticipates that certain savings from the merger and additional savings as a result of recent studies by two consulting firms will produce reductions in operating expenses of approximately \$6.9 million annually starting in 1964, with an additional \$0.5 million in 1965. These savings are reflected in applicant's projections for all three levels in appendix C. Analysis of applicant's actual operating expenses indicates certain reductions since 1961 when an all time deficit in net income was experienced; but applicant has been unable to tailor its operating expenses to match declining revenues. Conversely, applicant's equipment rents have consistently increased from \$12.1 million in 1960 to \$15.5 million in 1962; and for the first 8 months of 1963, such rents increased \$1.3 million over the same period in 1962. Projected over the full year 1963, equipment rents would aggregate approximately \$16.8 million. The projections in appendix C show annual equipment rents of \$13.6 million at Level I. It has been over 2 1/2 years since the forces and facilities of the predecessor railroads have been consolidated and it would appear that applicant's management has had ample time to implement most of the planned changes in operating methods. Viewed in the light of its results of operations since 1961 (the first full year after the merger), it would appear that applicant's projections of net income before fixed charges, even at Level I (which are based on net income before fixed charges of \$2.7 million), are beyond reasonably possible attainment.

Applicant has furnished estimates of its ability to repay the proposed loan. The following table shows applicant's estimates of total fixed charges and maturing obligations for the 5-year period 1963 to 1967, and its estimates of funds available to meet the debt requirements of a \$15 million loan.

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*Applicant's estimates of funds available to meet future fixed charges and maturing obligations*

Year	Total fixed charges and maturing obligations	Estimated funds available		Total	Excess of available funds over obligations
		From operations	From sale of scrap and other property		
<i>000 omitted</i>					
1963 ---	\$17,697	\$17,600 <sup>1</sup>	\$3,000	\$20,300	\$2,903
1964 ---	28,760	17,600	3,000	20,300	(8,160) <sup>2</sup>
1965 ---	18,206	17,600	3,000	20,300	2,394
1966 ---	17,510	17,600	3,000	20,300	3,090
1967 ---	18,044	17,600	3,000	20,300	2,556

<sup>1</sup> Level I income before fixed charges \$2,700 (which gives effect to the aforementioned \$6.9 million estimated savings in operating expenses), plus depreciation accruals of \$14,900 included in operating expenses.

<sup>2</sup> Excess of obligations over funds available.

The foregoing estimates of applicant's ability to repay the loan are rendered obsolete in view of the new equipment acquisition and repair program recently initiated. The increase in applicant's fixed charges and maturing obligations resulting from that equipment program, which would increase its long term debt by over \$13.5 million, is discussed later herein.

The amount of \$28,760,000 in the foregoing table for fixed charges and maturing obligations in 1964 includes \$11,595,000 principal amount of applicant's first consolidated mortgage 3 3/4 percent bonds, series E, due October 1, 1964. On June 28, 1963 applicant filed an application under section 20b of the act, Finance Docket No. 22684, requesting approval and authorization for the alteration and modification of these bonds. As proposed in that application, applicant would convert these bonds into an equal principal amount of its new Secured Trust Notes. Such notes would be issued under an indenture between applicant and Irving Trust Company, as trustee, and would be limited to the principal amount of \$11,595,000. The notes would mature October 1, 1969, bear interest at 6 percent per annum, and would be without a sinking fund. The notes would be secured by (1) \$11,595,000 principal amount of new series L bonds to be issued for the purpose of refunding the maturing series E bonds, and (2) \$11,595,000 principal amount of another new series of bonds (series M) to be issued under the "Emergency Bond" provision of applicant's mortgage. As discussed under "*Security*," *infra*,

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it is our understanding that under the provisions of applicant's mortgage the total amount of emergency bonds that may be issued is \$15.0 million. By its amendment of the instant application filed September 17, 1963, applicant has offered \$15.0 million emergency bonds to secure the proposed loan. However, no further amendment to the section 20b application has been filed to date.

#### SECURITY

In the application, as originally filed, applicant offered as security for the proposed loan the pledge of \$3,405,000 principal amount of its First Consolidated Mortgage Bonds, series K, (so-called emergency bonds), and its interest, estimated to be approximately \$17.5 million, in certain rolling stock and floating equipment. Applicant's general counsel subsequently advised that applicant would be unable to obtain an opinion from counsel for the lenders as to the validity of the pledge of applicant's right, title and interest in the aforementioned equipment. By amendment filed June 28, 1963, applicant withdrew its previous offer of its right, title and interest in the aforementioned rolling stock and floating equipment and offered as additional security for the proposed loan its equity in the collateral securing the previous loan, which consists of various issues of applicant's bonds, having an aggregate principal amount of \$24.3 million. Based principally on average market prices, the bonds pledged as security for the previous loan have a total collateral value estimated at approximately \$16.1 million. The unpaid balance of principal of the previous loan is \$15.0 million. Thus, applicant's equity in the collateral securing that loan is approximately \$1.1 million, which is a small margin of security in view of applicant's present financial condition.

By further amendment filed September 17, 1963, applicant offered \$15.0 million principal amount of the series K emergency bonds as security in lieu of \$3,405,000 principal amount previously offered. As stated previously, it is our understanding that \$15.0 million principal amount is the maximum amount of such emergency bonds that applicant is permitted to issue under its mortgage. The \$15.0 million principal amount of series K emergency bonds so offered have a collateral value of approximately \$6,450,000, based on the market prices of another series of these bonds (series G), which bear 3 1/8-percent interest, adjusted to include a factor for the 6-percent rate on the series K bonds offered here.

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## USE OF LOAN PROCEEDS

Applicant states, among other things, in justification for the \$15.0 million loan guaranty initially sought, that its pressing needs include:

(1) Unpaid current bills as of the close of business September 11, 1963 - - - - -	\$2,773,000
(2) Minimum needed for repair of freight cars in order to obtain traffic and reduce heavy per diem deficit - - - - -	3,750,000
(3) New Jersey taxes due December 1, 1963 - - - - -	4,548,000
(4) Minimum down payments for \$10.0 million of new freight cars	<u>1,000,000</u>
	<u>\$12,071,000</u>

The foregoing is exclusive of funds needed for certain addition and betterment items totaling approximately \$7.8 million listed in the application, which applicant claims would increase the efficiency of its operations; and other similarly listed items totaling approximately \$4.9 million which applicant states "are needed and desirable in the interest of economy, efficiency and better service." Additionally, by applicant's own estimate at the time the application was filed, it had a deficiency in working capital of approximately \$16.0 million.

In the aforementioned letter of October 7, 1963, applicant states that a smaller loan of \$5.0 million would "enable us to meet our financial needs and to embark upon our rehabilitation program which, we believe, will put us in the black in 1965." As justification for such a conclusion, applicant recites again that the freight car situation is its principal problem; and that under certain plans described briefly in its letter, applicant would solve that problem with the purchase of 575 new cars, and the rehabilitation of about 3,000 old cars, requiring immediate cash outlay of only \$1.0 million, as the downpayment of the 575 new cars. Applicant stated further that, under the present financial plans, the repair of about 3,000 old cars would be worked out without any immediate cash outlay. In response to our request for the full details of such financial plans, the following information was furnished by the applicant:

1. The 575 new cars will cost an estimated \$9,675,000. No order had been placed for these cars and no specific financing had been arranged, but applicant stated: "We anticipate no difficulty, however, in obtaining financing on reasonable and conventional terms, with a downpayment of not more than \$1 million."

2. As to 500 old cars now being repaired, applicant advised it received \$412,500 cash from the sale feature of a "sale and

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repurchase arrangement," representing the salvage value of the cars. Under the repurchase phase of the transaction, the 500 upgraded cars would be sold to the railroad under a conditional sale agreement for \$1,162,500, with no downpayment, providing for principal payments in equal semiannual amounts over a period of 10 years together with interest at 5 percent per annum on the unpaid balance.

3. An additional 2,475 cars similarly would be financed under a "sale and repurchase arrangement." Under the sale feature thereof, the railroad would receive \$1,721,222 representing the salvage value of the cars, of which \$373,189 would be retained by the railroad and the remaining \$1,348,033 would be deposited with the trustee of its first consolidated mortgage to be held subject to further drawdown upon certification of expenditures for additions and betterments.

The railroad has made sufficient expenditures for additions and betterments in the past to enable it to drawdown the full \$1,348,033 from the trustee almost immediately after deposit. Under the repurchase phase of the transaction, the full purchase price of the 2,475 rebuilt cars, \$3,712,500, would be financed under a conditional sale agreement incorporating the same terms as the instrument financing the 500 cars in item 2 above (no downpayment, semiannual payments over a period of 10 years, and with 5-percent interest on the unpaid balance.)

Assuming that applicant would be able to finance the freight car rehabilitation program without immediate cash outlay, the only effect of that feature on the estimated needs included in the foregoing table would be elimination of the \$3,750,000 amount for repair of freight cars, which would reduce the estimated total of \$12,071,000 to \$8,321,000. Although applicant received \$412,500 from sale of the 500 cars now being repaired, which would be reflected in its October accounts, and it would receive \$1,721,222 cash from sale of the 2,475 cars when that financing is arranged in November or December 1963, this would only slightly alleviate its aforementioned large deficit in working capital. As the rebuilt cars are delivered, the required periodic payments on the new equipment obligations incurred for such cars would begin to accrue, which payments must be made from then current cash. While the car repair program initially would be implemented without immediate cash outlay, applicant's cash requirements in the future would be substantially increased as the rebuilt cars are delivered. This increased burden is reflected in the following table:

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*Annual principal and interest requirements of conditional sale agreements covering 500 cars now being rebuilt and the 2,475 cars to be rebuilt*

Year	Principal	Interest	Total
1964 -----	\$487,500	\$287,857	\$725,357
1965 -----	487,500	213,281	700,781
1966 -----	487,500	188,906	676,406
Total burden over next 3 years -----			2,102,544

As previously indicated, the 575 new cars have not been ordered and no specific financing has been arranged. Assuming these new cars, estimated by applicant to cost \$9,675,000, are financed with a \$1.0 million downpayment, with a 15-year maturity, and with repayment in equal semiannual installments of principal together with interest at 5 percent on the unpaid balance, the additional cash outlay would be as follows:

Year	Principal	Interest	Total
1964 <sup>1</sup> -----	\$578,333	\$216,875	\$795,208
1965 -----	1,156,667	390,375	1,547,042
1966 -----	1,156,666	332,542	1,489,208
Total burden over next 3 years -----			3,831,458

<sup>1</sup>Assuming delivery before July 1, 1964 and one semiannual payment in that year.

The aggregate cash outlay in the next 3 years as a result of both the car repair financing and the new car financing would be as follows:

Year	Principal	Interest	Total
1964 -----	\$1,065,833	\$454,732	\$1,520,565
1965 -----	1,644,167	603,656	2,247,823
1966 -----	1,644,166	521,448	2,165,614
Total burden over next 3 years -----			5,934,002

Assuming a \$5.0 million part V loan guaranty is authorized at this time and the new car and car repair financing plans are consummated, applicant's total debt would be increased by \$18,550,000, consisting of the proposed part V loan \$5 million, new car financing (assuming \$1.0 million downpayment) \$8,675,000 and car repair financing \$4,875,000.

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From the foregoing it would appear that a loan of \$5.0 million at this time would be wholly inadequate in view of applicant's present needs. New Jersey taxes alone, which are due December 1, 1963, aggregate approximately \$4.5 million. Even a loan for the full \$15.0 million, initially sought here, would do little more than meet pressing immediate needs.

#### GENERAL DISCUSSION AND CONCLUSIONS

As discussed in our report in the *merger* case, the merger of Lackawanna into Erie gave promise of many benefits to the merging railroads and to the public generally. Operating many parallel routes and serving the same general area, there was great promise of large savings by elimination of duplicate facilities and services. As a matter of fact, the predecessor roads had previously entered into certain voluntary arrangements to eliminate duplicate trackage and service. A review of the Commission's report in the *merger* case shows that studies by independent consultants included estimates of savings of as much as \$13.0 million annually. Those estimates of savings expected from the merger were substantially the same as those used in the previous part V loan application as a basis for the projections of operating expenses and net income. The estimated savings in operating expenses were predicated, among other things on the completion of the projects which would physically unify the facilities of the predecessor roads, and on completion of other projects and acquisition of certain facilities which would increase the efficiency of operation of the combined railroads. In the *merger* case it was shown that funds from sale of scrap and surplus real estate and other property would supply most of the funds for the aforementioned new facilities. As discussed earlier, while the merger was consummated in September 1960, it was not until May 1961 that it was possible to combine the forces and facilities of the two railroads. Meanwhile revenues dropped, and applicant suffered large out-of-pocket losses. Not having been able to go ahead with the aforementioned construction and acquisition of facilities, the estimated savings have not been forthcoming in the amount originally anticipated.

The seriousness of applicant's plight caused certain of its directors recently to insist on a change in management, and as a result, Mr. William White, then president and chief executive officer of Delaware and Hudson, was asked to become president and chief executive officer of applicant. We approved his appli-

cation to serve as chief executive officer of applicant and chairman of the board of Delaware and Hudson. Few other changes in management have been announced to date.

In passing on applications under part V since the inception of the program in 1958, we have been guided by what we believe to be the intent of the Congress in enacting this form of financial relief for railroads. On the one hand, an applicant under part V must, under the provisions of section 504(a)(1), show that it is unable to obtain the necessary funds on reasonable terms without a guaranty, in order to qualify for a guaranty. Stated differently, it must show, and we must find that it is, at least in some respects, a poor credit risk. On the other hand, we must also find, as shown in the provisions of section 504(a)(4), cited below, that the prospective earning power of the applicant, together with the security offered, furnish reasonable assurance of its ability to repay and reasonable protection to the United States. Specifically section 504(a)(4) provides:

(4) unless the Commission finds that the prospective earning power of the applicant carrier, together with the character and value of the security pledged, if any, furnish reasonable assurance of the applicant's ability to repay the loan within the time fixed therefor and reasonable protection to the United States.

In order to give force and effect to the statute, in our consideration of such applications, we have always made every effort to give applicants the benefit of every reasonable doubt. Nevertheless, we may not lawfully depart from the standards fixed by the Congress in our administration of these provisions. In view of applicant's cash attrition from operations since 1960, and the lack of any firm prospect for substantial improvement in applicant's results of operations in the future, the margin of safety afforded by the collateral offered is wholly inadequate to justify the findings required by section 504(a)(4). Applicant and its predecessors have not earned fixed charges since 1957.

Additionally, applicant, under the contingent interest provisions of the indentures of certain issues of its funded debt with total principal amount of \$89.2 million, had accrued and unpaid contingent interest of approximately \$11.4 million as of December 31, 1962.

We find, in Finance Docket No. 22632, that applicant's prospective earning power together with the character and value of the

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collateral offered to secure the proposed loan in the amount of \$5.0 million does not furnish reasonable assurance of applicant's ability to repay the loan within the time fixed therefor and reasonable protection to the United States.

We further find, in Finance Docket No. 22632, in view of the findings in Finance Docket No. 22632, that the application should be dismissed.

An appropriate order will be entered.

VICE CHAIRMAN GOFF, whom COMMISSIONER WEBB joins, dissenting in part:

I favored granting the withdrawn 15-million guaranty application. With this larger sum available, under efficient management, I consider there would have been "reasonable assurance" of applicant's ability to repay.

COMMISSIONER HUTCHINSON did not participate.

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## APPENDIX A

*Erie-Lackawanna Railroad Company income statement*

Income accounts	Years			
	1962	1961	1960	1959
Railway operating revenue	\$210,945,957	\$211,024,844	\$220,419,579	\$226,132,173
Railway operating expense	185,895,877	192,164,820	194,230,072	194,050,373
Net revenue from railway operation	25,050,080	18,860,024	26,189,507	32,081,800
Railway tax accruals	18,861,313	21,213,802	28,108,669	22,320,174
Railway operating income	6,188,767	(2,353,778)	8,080,838	9,761,626
Net rents payable	15,592,225	14,888,387	13,023,650	10,019,711
Net railway operating income	(9,403,457)	(17,242,115)	(9,942,812)	(358,085)
Other income	4,014,038	4,136,716	3,674,814	4,347,380
Total income	(5,389,419)	(13,105,399)	(6,267,998)	4,089,295
Miscellaneous deduction from income	1,549,647	799,422	902,971	1,054,984
Income available for fixed charges	(6,939,066)	(13,904,821)	(7,170,969)	3,034,311
Fixed charges	9,669,002	9,288,869	9,013,530	9,242,628
Income after fixed charges	(16,608,068)	(23,143,690)	(16,184,499)	(6,208,317)
Other deductions	-----	3,345,069	3,811,115	3,811,453
Net income	(16,608,068)	(26,488,759)	(19,995,614)	(10,019,770)
Operating ratio (percent)	88.12	91.06	88.12	85.81
Depreciation accruals	\$14,458,616	\$15,217,423	\$15,305,125	\$15,358,717
Out-of-pocket loss from operation	(2,149,452)	(11,271,336)	(4,690,489)	-----

Amounts in parenthesis denote deficit or loss.

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Cash flow statement\*

	Receipts	Disbursement	Net increase or decrease	Balance at end of month
<i>1962</i>		<i>000 omitted</i>		
April-----	\$19,855	\$18,226	\$1,629	\$11,819
May-----	20,083	22,408	(2,325)	9,494
June-----	18,914	19,483	(569)	8,925
July-----	20,899	22,040	(1,141)	7,784
August-----	19,885	21,146	(1,261)	6,523
September-----	17,075	17,333	(258)	6,265
October-----	23,474	21,835	1,639	7,904
November-----	20,417	23,021	(2,604)	5,300
December-----	20,052	18,647	1,405	6,705
<i>1963</i>				
January-----	22,078	23,754	(1,676)	5,029
February-----	18,116	17,990	126	5,155
March-----	19,689	19,480	209	5,364
April-----	20,490	18,346	2,144	7,508
May-----	20,242	22,582	(2,340)	5,168
June-----	20,653	19,018	1,635	6,803
July-----	19,684	20,569	(885)	5,918
August-----	17,585	18,685	(1,100)	4,818
September-----	17,460	17,296	164	4,982
			(5,208)**	

\*Actual treasurer's cash.

\*\*Net decrease for 18-month period.

Amounts in parenthesis denote decrease.

Erie-Lackawanna Railroad Company income statements

Income accounts	First 8 months of 1963	First 8 months of 1962
Railway operating revenue-----	\$136,826,385	\$141,072,734
Railway operating expense-----	122,101,683	124,695,499
Net revenue from railway operation-----	14,724,702	16,377,235
Railway tax accruals-----	12,235,987	13,492,878
Railway operating income-----	2,488,715	2,884,357
Net rents payable-----	11,471,732	10,158,603
Net railway operating income-----	(8,983,017)	(7,274,246)
Other income-----	3,148,509	2,064,493
Total income-----	(5,834,508)	(5,209,753)
Miscellaneous deduction from income-----	740,919	646,997
Income available for fixed charges-----	(6,575,427)	(5,856,750)
Fixed charges-----	6,406,174	6,463,437
Income after fixed charges-----	(12,981,601)	12,320,187
Other deductions-----		
Net income-----	(12,981,601)	(12,320,187)
Operating ratio (percent)-----	89.24	88.39
Depreciation accruals-----	\$9,499,936	\$9,672,234
Out-of-pocket loss from operations-----	(3,481,665)	(2,647,953)

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## APPENDIX B

*Erie-Lackawanna Railroad Company comparative general balance sheet*

Assets	As of December 31, 1961	As of December 31, 1962	As of August 31, 1963
<b>Current assets:</b>			
Cash -----	\$8,228,594	\$9,664,086	\$6,321,580
Temporary cash investments-----	1,524,641		
Special deposits-----	131,255	115,812	229,232
Loans and notes receivable -----		2,570	1,070
Net balance receivable from agents and conductors -----	6,776,912	7,120,555	6,234,627
Miscellaneous accounts receiv- able -----	7,376,844	9,298,949	7,277,495
Interest and dividends receivable-----	48,043	26,867	7,677
Accrued accounts receivable -----	4,559,254	4,400,094	3,910,430
Working fund advances-----	208,006	203,319	203,069
Prepayments -----	264,759	230,880	394,910
Material and supplies-----	12,314,224	10,851,242	10,961,880
Other current assets-----	62,325	51,874	81,188
<b>Total current assets -----</b>	<b>41,494,857</b>	<b>41,966,248</b>	<b>35,623,153</b>
<b>Special funds:</b>			
Sinking funds -----	1,571	1,568	1,766
Capital and other reserve funds--	209,999	256,324	700,603
Insurance and other funds-----	215,733	215,778	215,779
<b>Total special funds-----</b>	<b>427,303</b>	<b>473,670</b>	<b>918,148</b>
<b>Investments:</b>			
Investments in affiliated com- panies -----	24,079,953	24,057,457	22,837,533
Other investments-----	2,352,641	1,682,693	1,577,746
<b>Total investments -----</b>	<b>26,432,594</b>	<b>25,740,150</b>	<b>24,415,279</b>
<b>Total properties-less depreciation and amortization -----</b>	<b>605,145,177</b>	<b>586,804,686</b>	<b>581,165,317</b>
<b>Other assets and deferred charges:</b>			
Other assets -----	4,390,870	6,377,300	3,144,799
Unamortized discount on long- term debt-----	710,479	672,216	647,295
Other deferred charges-----	2,561,597	3,084,848	2,461,267
<b>Total other assets and de- ferred charges -----</b>	<b>7,662,946</b>	<b>10,134,364</b>	<b>6,253,361</b>
<b>Total assets -----</b>	<b>681,162,877</b>	<b>665,119,118</b>	<b>648,375,258</b>

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*Erie-Lackawanna Railroad Company comparative  
general balance sheet—Continued*

Liabilities and Shareholders' Equity	As of December 31, 1961	As of December 31, 1962	As of August 31, 1963
<b>Current liabilities:</b>			
Traffic and car-service balances—credit -----	\$2,943,241	\$2,844,559	\$1,988,386
Audited accounts and wages payable -----	6,147,151	6,739,636	5,883,741
Miscellaneous accounts payable -	3,344,111	2,911,402	2,238,404
Interest matured unpaid-----	1,544,250	1,680,856	666,337
Dividends matured unpaid-----	24,881	22,961	22,734
Unmatured interest accrued -----	1,272,622	1,262,782	2,284,035
Accrued accounts payable -----	16,191,593	15,915,954	15,186,614
Federal income taxes accrued ---	1,205,414	2,494	12,257
Other taxes accrued -----	4,412,347	4,750,738	6,172,722
Other current liabilities -----	1,553,935	1,773,511	1,493,748
<b>Total current liabilities-----</b>	<b>38,639,545</b>	<b>37,904,893</b>	<b>35,948,978</b>
Long-term debt due within 1 year--	8,664,466	7,462,495	6,164,919
<b>Long-term debt due after 1 year:</b>			
Funded debt unmaturing -----	281,769,200	287,869,200	287,659,200
Equipment obligations -----	32,324,492	27,355,226	26,321,290
<b>Total long-term debt due after 1 year -----</b>	<b>314,093,692</b>	<b>315,224,426</b>	<b>313,980,490</b>
Reserves—Casualty and other reserves -----	3,950,970	4,033,859	3,880,845
<b>Other liabilities and deferred credits:</b>			
Other liabilities -----	17,016,329	16,887,013	16,690,446
Unamortized premium on long-term debt-----	28,906	25,621	23,524
Other deferred credits -----	1,589,403	2,980,798	4,054,606
Accrued depreciation leased property -----	359,477	387,992	401,030
<b>Total other liabilities and deferred credits -----</b>	<b>18,994,115</b>	<b>20,281,424</b>	<b>21,169,606</b>
<b>Shareholders' equity:</b>			
Capital stock -----	162,977,303	162,977,160	162,977,160
Capital surplus-----	31,307,357	31,307,500	31,307,500
Retained income-----	102,535,429	85,927,361	72,945,760
<b>Total shareholders' equity ---</b>	<b>296,820,089</b>	<b>280,212,021</b>	<b>267,230,420</b>
<b>Total liabilities and shareholders' equity -----</b>	<b>681,162,877</b>	<b>665,119,118</b>	<b>648,375,258</b>

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## APPENDIX C

*Erie-Lackawanna Railroad Company projected earnings*

Income accounts	Annual average for 3-year period 1960-62 inclusive	Annual projected earnings		
		1963 Level I	1965 Level II	1967 Level III
		<i>000 omitted</i>		
Operating revenues .....	\$214,130	\$209,500	\$220,800	\$232,500
Operating expenses .....	190,764	177,300	179,300	182,000
Net revenue from railway operations .....	23,366	32,200	41,500	50,000
Railway tax accruals .....	21,061	18,000	18,200	18,300
Railway operating income .....	2,305	14,200	23,300	32,200
Net rents payable .....	14,501	13,600	14,300	15,100
Net railway operating income .....	(12,196)	600	9,000	17,100
Other income .....	8,942	2,800	2,800	2,800
Total income .....	(8,254)	3,400	11,800	19,900
Deductions from income .....	1,084	700	700	700
Income available for fixed charges .....	(9,338)	2,700	11,100	19,200
Fixed charges .....	9,307	9,993	11,379	11,198
Income after fixed charges .....	(18,645)	(7,293)	(279)	7,002
Other deductions (contingent interest) .....	2,386	-----	-----	-----
Net income .....	(21,031)	(7,293)	(279)	7,002
Depreciation included in above .....	14,994	14,900	14,900	14,900

Amounts in parenthesis denote deficit.