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arrive at a correct conclusion upon the subject of the taxability <u>vel non</u> of the income bonds, it is, I think, necessary to clearly understand the causes which lead to the execution of this funding agreement, as well as the operation and effect of the agreement itself.

5530 The income bond mortgage is dated March 30, 1899, and provides for an issue of $14,000,000 income bonds. Of this authorized issue, nearly all is outstanding. The railway is not, as in the case of an ordinary mortgage, bound to pay interest on these income bonds absolutely, but the bonds bear interest in semi-annual instalments, at the rate of 4% per annum, only <u>if and to the extent earned</u>. Whether or not such interest has been earned, depends, under the provisions of the income mortgage, upon whether or not at the end of any six month's period the company has earned a surplus "over and above its taxes, operating expenses, necessary repairs and maintenance, and interest upon its bonded indebtedness". If it has, then such surplus must, under the requirements of the income mortgage, be devoted to the full extent to the payment of interest on the income bonds. If there is no such surplus, then the interest on the income bonds for the preceding six months' period has not been earned, and therefore, need not be paid. All unearned or unpaid interest, however, is cumulative and constitutes a charge against the future net earnings of the company until paid.

5531 On June 1, 1904, the railroad did not pay the semi-annual instalment of interest maturing that day on its income bonds, upon the theory that such interest had not been earned during the preceding six months. On the like theory the railroad did not pay the semi-annual instalments of interest maturing after that date down to and including June 1, 1906. Thus five coupons were at that time unpaid upon the income bonds, and these unpaid coupons aggregated nearly $1,400,000. Since this interest was cumulative, the railroad faced the necessity of having to devote its entire surplus earnings each year (that is, all that remained after the payment of taxes, operating expenses, necessary repairs, maintenance and interest on its bonded indebtedness) to the payment of this large sum, as well as to the payment of income coupons thereafter maturing.