

Copy.

Sao Paulo Northern Railroad Company,

Rio de Janeiro

Caixa do Correio 363

February 2nd 1920

Messrs. L. Behrens und Söhne

Hermannstrasse,

HAMBURG.

Dear Sirs,

We hear that you have given instructions to Mr. Gordo to start a legal action against our company in order to get the mortgage of the debentures of the old Araraquara Company reinscribed.

We are most surprised to hear this as such a step is in complete contradiction with all your former acts and agreements in the matter.

We will, therefore, remind you of the circumstances in which we purchased the railroad and our respective positions concerning that transaction.

~~When~~ our company was formed for the purpose of making a bid for that purchase, the railroad was not earning half of the interest charges on the debentures of the old Company (as is proved

by the books of that company which are now our property) though in the prospectus of issue of these debentures it had been erroneously stated that such earnings were materially superior to the interest charges.

It was thus evident that the company could not be reorganised on the basis of maintaining (or renewing) the mortgage deed of the debentures which provided for a yearly fixed sum of interest so much superior to the earning capacity of the railroad. Maintaining such a mortgage deed with its clauses would have rendered a new bankruptcy unavoidable immediately after the first one would have been closed.

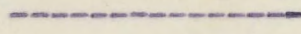
On the other hand, the legal position of the debentures secured by that mortgage was very weak..

As you know, the issue of those debentures had been authorised at a meeting of the shareholders of the Araraquara Company where only a minority of the shares was represented, so that the issue, not being legally authorised, was void.

Also none of the requirements of the Brazilian laws on bearer securities were complied with when the Araraquara Company issued these debentures, which did not bear any signature on behalf of the Company. They were therefore void (as a unanimous decision of the Supreme Tribunal of Brazil decided a few months ago.)

The ordinary creditors of the Araraquara Company were well aware of those facts and were prepared to take steps to try and eliminate the debentureholders, or at least to greatly reduce their claims, unless a satisfactory settlement could be made with

them, taking into account the weak points of the debentureholders position.



We tried then to set up a reorganisation scheme through which the various interests in conflict might be reconciled.

Such an end could not be attained by purchasing the railroad in cash as the maximum amount of money that could have been paid for it at auction would have been insufficient to make any payment to the ordinary creditors (unless they would have first obtained a judicial decision declaring the debentures void and thus prevented their holders from participating in such payment).

On the other hand, by paying in cash the priority claims such as "reclamações reivindicatorias", transfer taxes to the State etc..... and by giving new securities to the debentureholders and to the ordinary creditors a reconciliation of the conflicting interests appeared as being possible.

It was however necessary that the new securities to be offered to the ordinary creditors should have, if not an actual, at least some prospective value.

This was impossible if the mortgage of the old debentures was to be maintained, viz:- if the new debentures to be given to the debentureholders were to be secured by a mortgage similar to that securing the old debentures, as such an arrangement would have stopped the growth of the railway and of its earnings, since it would have been impossible to sell new debentures of the company acquiring the railroad. (Securities junior to such a heavy mortgage debenture issue would evidently have been entirely unsecured, if not valueless, as the earnings of the railroad were not even sufficient to cover the interest charges on that issue.)

If the ordinary creditors were to be paid in securities

which could receive an income only after the accumulated interest on the entire amount of the old debentures would have been paid, it was, therefore, evidently necessary, in order that such securities might have some value, to make arrangements in order that the growth of the railroad (and the consequent increase of its earnings) should not be stopped, so that the ordinary creditors might have hopes to, one day, receive some dividends and see their new securities acquire a market value.

If a mortgage identical to the old one had been created to secure the new debentures, given in payment of the old ones, this would have been obviously impossible since the growth of the railroad would have been stopped.

The idea of giving to the new debentures a mortgage identical to that of the old debentures being thus discarded as unpractical, there were two ways open to reconcile the interests of the debenture-holders and those of the ordinary creditors.

I.- The first way was to reduce the face value of the new debentures (giving, for instance, a new debenture of ten pounds for every old debenture of twenty pounds), the amount necessary to pay the yearly interests on such a reduced issue of debentures being only one half of the amount necessary to pay the interests on the old debentures issue. The ordinary creditors would then hope to, inside of a reasonable length of time, receive some return on their new securities.

II.- The second way was, not to reduce the face value of the old debentures (thus issuing new debentures of twenty pounds as against the old debentures of the same nominal value), but to issue new unsecured debentures instead of mortgage debentures.

It would thus become possible to create and sell other debentures guaranteed by a mortgage in order to permit financing the construction of branch lines and extensions of the existing railroad and so to increase its earnings. There would then be sufficient probabilities of income returns to the ordinary creditors to make it possible to obtain their consent to a scheme reconciling in that manner their interests with those of the old debentureholders. That second system was in fact adopted in the recent reorganisations of most of the large railroad companies:- Saint Louis and San Francisco, Brazil Railway etc..

When our company was formed we discussed the two systems above outlined with your representative, Mr. Littmann, since it was indifferent to our company on which one of these two systems we would base our bid. Mr. Littmann however declared to us that you were, without any doubt or hesitation, in favour of the second system as against the first one since it made it possible to avoid any permanent loss of capital or of interest to the debentureholders: with that system they would only suffer a temporary delay in the payment of their coupons, but would finally receive the entire amount due to them in the way of interest before the ordinary creditors of the old company (or the shareholders of the new company) could receive any payment.

We then decided to present a bid based on the second system above outlined, at the same time as we formed a syndicate to offer 15 million francs for the railroad in case it would prove impossible to obtain the agreement of the other interested parties (ordinary)

creditors, etc.....) to our other bid.

The matter was then settled between us and Mr. Littmann informed us that you entirely agreed with our prospective bid.

As our financial arrangements were different for the case where we would purchase the railroad entirely in cash and the case where the bid above referred to would be accepted and, in case such bid was accepted, we did not wish to tie up too large an amount of our funds immediately, we took steps to obtain a loan from the Société Anonyme Leu & Co. of Zürich in order to provide for part of the money necessary for the first expenses in connection with the purchase on the basis of the bid referred to.

That company opened us a credit on the basis that, as soon as the sale would have taken place and the mortgage securing the old debentures would have been cancelled (as every such mortgage must be cancelled after the judicial sale of the property-mortgaged) a new mortgage would be made to secure a new issue of debentures, part of which would be deposited in guarantee of the credit open to us. The balance of such debenture issue was to be used for the general purposes of the company, building branch lines, etc.....

In view of the very bad financial conditions then existing, it was considered advisable to limit the authorised amount of such new debenture issue to \$ 1.000.000.00, but our company remained free to repay and replace it by a larger issue of mortgage debentures as soon as financial conditions in general and the credit of your company would permit.

Our intention was to soon afterwards float a new \$ 3.000.000.00 mortgage debentures issue, in order to repay that first

\$ 1.000.000.00 debentures issue and to finance the building of various branch lines and extensions of the railroad which we were contemplating etc....

You were kept closely posted as to the details of that transaction and entirely agreed with it so that, on behalf of the Société Anonyme Leu & Co., you finally guaranteed to the Banco do Commercio e Industria de Sao Paulo all the payments to be made in cash by our company in connection with our bid. The Banco do Commercio e Industria de Sao Paulo gave in their turn their guarantee to the Judge of the bankruptcy in January 1916.

At the same time you sent instructions to the Banco do Commercio e Industria to have the mortgage securing the new debenture issue, above referred to, inscribed as soon as the sale would have taken place and we would wish to take advantage of the credit open to us by the Société Anonyme Leu & Co., (The Banco do Commercio e Industria has confirmed this to us in writing.)

After we had thus come to an agreement with you on that basis you sent instructions to Mr. de Rote, your representative in Sao Paulo, in order that he should support our bid when it would be represented.

Mr. de Rote, preferring however to support the bid of another group refused to follow your instructions to that effect and gave us an excuse that he objected to the fact that the debentures to be issued in payment for the old ones would not be guaranteed by a mortgage.

You then replaced him by Mr. Wissinger.

As Mr. Wissinger also appeared inclined to favour another bid, and declared that he was not prepared to support ours (giving the same excuse as Mr. de Rote, viz:- that he objected to the new debentures not being mortgage debentures) you replaced him by Mr. Weber and gave to the latter instructions to support our bid (provided, of course, that, at the auction, no bid would be presented, that the three liquidators, the Curador das Massas and the Judge would consider as better than ours for all the creditors of the Araraquara Company.)

Our bid was however considered by all these gentlemen as better than any of the other bids presented, either from the point of view of the debentureholders, or from that of the other creditors, since the fact that the new debentures would not be mortgage debentures permitted to reconcile the various interests in conflict.

The fundamental basis of that bid and of its being accepted was thus that the new debentures given in payment for the old debentures should not be secured by a mortgage.

It was so obviously solely on account of that feature of our bid that it was possible to reach an agreement with the other creditors of the old company that the judge, when authorising the sale, terminantly forbade that the new debentures should be guaranteed by a mortgage.

On the other hand, after our bid had thus been accepted and rendered effective, your representative, Mr. Littmann most distinctly informed us on several occasions of your complete agreement on the matter.

You, yourselves repeatedly did the same, explicitly or implicitly, as for instance when you suggested to us that our contract with the Société Anonyme Leu & Co. should be transferred to your firm.

To sum up the situation :

1st)- You agreed most positively that the new debentures of our company to be given in payment of the old debentures should not be mortgage debentures.

2nd)- You were instrumental in introducing our bid framed along those lines to the Banco do Comercio e Industria.

3rd)- You guaranteed that bid.

4th)- You took steps to have a new mortgage created to guarantee the new debenture issue (which was not to be given to the holders of the old debentures) no limit being fixed to the amount of the subsequent mortgage debentures issues.

5th)- You dismissed two of your representatives because they objected to the non mortgage feature of our bid. (We have written proofs of these facts.

6th)- The fact that no mortgage would secure the new debentures was the ground on which that bid was accepted and,

7th)- The Judge of the bankruptcy, taking the above into consideration, forbade that any mortgage, similar to the old one, should secure the new debentures.

And now four years after the sale has taken place you give powers to a lawyer to take steps to have the mortgage securing the old debentures reinscribed, thus acting in complete contradiction with

all your ~~former~~ former acts and agreement on the matter during these four years or before:

If such instructions could be carried through, they would cause a very great and unjust prejudice to our company, since it would mean that our debentures, given to the old debentureholders, would be void and that our company would have the same heavy fixed charges which caused the bankruptcy of the old company and which the most ordinary common sense would have prevented us from accepting.

We must say that the impression caused in Sao Paulo by your action has been very bad as it is considered as a flagrant breach of the contract solemnly entered into between your firm and the representatives of the various other interests on February 7th 1916, while everybody knows in Sao Paulo that you were in complete agreement with that contract, as the various facts related above are there a matter of public knowledge.

It would really be too easy if one could thus make a transactional agreement, obtaining that the other party would give up part of his claims as against one's corresponding sacrifices and if afterwards one could claim the same rights as one had theoretically before the transactional agreement, (though such theoretical rights might easily been destroyed by the other party if the transaction had not been made.)

Of course no tribunal could seriously consider such a demand since there is a judgement, confirmed by a final decision in appeal, forbidding that the new debentures should be guaranteed by a mortgage.

We are therefore not afraid in the least as to the consequences of your action (all the more so that we can easily prove

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all the facts mentioned above), but we fail to understand why you have decided to adopt such a hostile and unfair attitude against our company, and this in flagrant breach of all your previous agreements, public or private.

In hearing of the suit started on your behalf by Mr. Gordo, we have sent you the following cable to which we are awaiting your reply:

" Gordo nous fait procès en votre nom, disant que
" payames aucun coupon des obligations et que vous
" êtes pas d'accord avec notre achat chemin de
" fer Stop Télégraphiez immédiatement si approuvez
" ces actes de votre représentant pour que puis-
" sions agir immédiatement en conséquence, défen-
" dant nos droits avec documents en notre posses-
" sion" (a) Northern."

Yours very truly,

Sao-Paulo Northern Railroad Company

P.S. We will be obliged if you will address your letters to us in future at the following address :

" Sao Paulo Northern Railroad Company"

Caixa do Correio, 363

Rio de Janeiro.