

ORIGINAL

Decision No. 34961

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
ASSOCIATED TELEPHONE COMPANY, LTD.,
a corporation, for an Order of the
Commission authorizing it upon change
of terms of preference of preferred
stock, to issue shares of its stock in
exchange for shares now outstanding.

Application No. 24621

O'Melveny & Myers by Harry L. Dunn,
for Applicant.

BY THE COMMISSION:

O P I N I O N

Associated Telephone Company, Ltd. asks permission
to submit to its stockholders a proposal to amend paragraph
(e) of Article VI of its Articles of Incorporation, now read-
ing:

"(e) The shares of Cumulative Preferred Stock, \$1.25
Series, shall be entitled to voting rights on
the basis of one (1) vote per share with the
right to vote cumulatively in electing directors."

to read:

"(e) Except as otherwise provided by law or by these
articles the shares of Cumulative Preferred Stock,
\$1.25 Series, shall not be entitled to voting
rights. In case any quarterly dividend on said
Cumulative Preferred Stock, \$1.25 Series, shall
not be paid when payable and shall remain unpaid
for a period of sixty days, then until such de-
faulted dividend shall be paid, the shares of
such stock shall be entitled to voting rights
on the basis of one (1) vote per share with the
right to vote cumulatively in electing directors."

Applicant proposes a further amendment to said Article VI by adding thereto paragraph (j), reading as follows:

"So long as any shares of Cumulative Preferred Stock \$1.25 Series are outstanding and whether or not full voting power shall at the time be vested in the holders of such stock as hereinabove provided, the corporation shall not take any action specified in Clauses (a), (b), or (c) following without the affirmative vote or written consent in favor of the taking of such action by the holders of at least a majority of the shares of such Cumulative Preferred Stock \$1.25 Series at the time outstanding, or if the holders of 33-1/3% or more of such shares of stock vote against or disapprove in writing the taking of such action:

- "(a) Amend the Articles of Incorporation so as to create any class of shares preferred as to dividends or assets over the Cumulative Preferred Stock \$1.25 Series, or change the rights and preferences of the then outstanding shares of Cumulative Preferred Stock \$1.25 Series; provided, however, that nothing in this Clause (a) contained shall authorize the adoption of any amendment of the Articles of Incorporation by the vote or consent of the holders of a less number of shares of Cumulative Preferred Stock \$1.25 Series or of any other class of stock or of all classes of stock than shall at the time be required for the adoption of such amendment by the laws of the State of California at the time applicable thereto;
- "(b) Pay any dividends on shares of stock junior to the Cumulative Preferred Stock \$1.25 Series (other than dividends paid in, or presently thereafter repaid to the corporation for, or as a capital contribution with respect to, stock junior to the Cumulative Preferred Stock \$1.25 Series) or make any other distribution by purchase of shares or otherwise with respect to shares of stock junior to the Cumulative Preferred Stock \$1.25 Series, except out of earned surplus, and unless at the time of the declaration of such dividends or the making of such distribution, there shall remain to the credit of earned surplus account, after deducting such dividends and distribution, an amount at least equal to the annual dividend requirements of all then outstanding shares of Cumulative Preferred Stock \$1.25 Series; or

"(c) Issue any shares of Cumulative Preferred Stock \$1.25 Series or of any class of stock ranking equally with or senior to the said preferred stock unless the net income of the corporation available for the payment of dividends for a period of twelve consecutive calendar months within the fifteen calendar months immediately preceding such issue shall have been at least two times the annual dividend requirements of all outstanding shares of stock ranking equally therewith or senior thereto, including the shares proposed to be issued."

The proposed amendments will not become effective until approved by the holders of at least a majority of the voting power of applicant's outstanding stock, including at least two-thirds of the outstanding shares of the preferred stock.

Applicant further asks the Commission to authorize it, in the event its stockholders approve said amendments, to issue stock in exchange for stock now outstanding, and to find that the terms and conditions of the proposed exchange of stock are fair.

Associated Telephone Company, Ltd. is a California corporation. It owns and operates telephone systems in numerous cities and towns, and territories contiguous thereto, in the Counties of Los Angeles, Orange, Riverside, San Bernardino and Santa Barbara.

For the ten months ended October 31, 1941, applicant submits an income statement showing the following:

Operating Revenues		\$5,702,539.41
Operating Expenses including Depreciation and Taxes:		4,658,019.05
Operating Expenses	\$2,310,602.81	
Depreciation	1,097,234.79	
Extraordinary Retirements	1,380.00	
Amortization of Intangible Property	303.71	
State and Local Taxes	636,255.46	
Federal Income Taxes	323,850.00	
Federal Excess Profits Tax	199,650.00	
Other Federal Taxes	<u>88,742.28</u>	
Net Operating Income		1,044,520.36
Other Income (Debit)		14,721.55
Income Available for Fixed Charges, Dividends and Surplus		1,029,798.81
Fixed Charges:		428,980.21
Interest on Funded Debt	406,793.50	
Other Interest Deductions	5,096.01	
Interest During Con- struction - Cr.	20,000.00	
Amortization Discount on Funded Debt	<u>37,090.70</u>	
Net Income		<u>\$ 600,818.60</u>

Applicant has an authorized stock issue of 600,000 shares, divided into 300,000 shares of no par value common stock and 300,000 shares of no par value Cumulative Preferred Stock, \$1.25 Series.

The number of shares of stock and the stated value of the outstanding stock, the latter as shown in applicant's balance sheet as of October 31, 1941, are reported as follows:

<u>Class of Stock</u>	<u>No. of Shares Outstanding</u>	<u>Stated Value</u>
Common	240,000	\$5,977,075.00
Cumulative Preferred, \$1.25 Series	238,000	5,636,608.00

Applicant's earned surplus, as of October 31, 1941, is reported at \$319,339.19. All of applicant's stock has been issued pursuant to orders of the Railroad Commission. Paragraph (e) of Article VI of applicant's Articles of Incorporation, as indicated, provides that the shares of Cumulative Preferred Stock, \$1.25 Series, shall be entitled to voting rights on the basis of one (1) vote per share with the right to vote cumulatively in electing directors. Paragraph (h) of Article VI of said Articles of Incorporation provides that every share of common stock of the corporation shall be entitled to voting rights on the basis of one (1) vote per share with the right to vote cumulatively in electing directors. All of applicant's common stock is owned by General Telephone Corporation. It owns none of the preferred stock which is owned by about 2,150 different stockholders.

As stated, applicant proposes to amend said paragraph (e) of Article VI of its Articles of Incorporation, and thereby remove the voting rights of the holders of such stock, except as otherwise provided by law or by the Articles of Incorporation. The amended Articles of Incorporation would provide that the holders of such stock have voting rights while any quarterly dividend is more than sixty days in arrears.

Applicant is of the opinion that if this amendment is put into effect, it can join General Telephone Corporation and some of its subsidiaries in filing a consolidated return for excess profits tax purposes.

The real issue is the exchange of nonvoting pre-

ferred stock for voting preferred stock presently outstanding, and the fairness of such exchange. The surrender of the voting rights is definite. Such rights are revived only in the event that any quarterly dividend payment is more than sixty days in arrears. The revival of the voting rights is not dependent upon tax savings which are based upon the assumption that the present excess profits tax law will not be modified and that the Internal Revenue Bureau will concur with applicant's interpretation of the law. The testimony shows an estimated tax saving of \$163,713.34 in 1941 and an estimated tax saving of \$178,478.64 in 1942 were consolidated returns filed for the two years. For years subsequent to 1942, the testimony is to the effect that applicant should benefit by some undetermined extent through the filing of a consolidated excess profits tax return. But no estimate is made of the savings.

As said, applicant asks the Commission to find that the exchange of nonvoting for voting preferred stock is fair, as provided in Section 52 (i) of the Public Utilities Act. Unless such a finding is made, we are not warranted in authorizing applicant to submit its proposal to its stockholders for their approval. In this connection, our attention is called to the fact that the holders of common stock propose to agree that no dividends may be paid on such stock nor may any other distribution be made by the purchase of shares or otherwise with respect to shares of stock junior to the Cumulative Preferred Stock, \$1.25 Series, except out of earned surplus, and unless at the time of the declaration of such dividends or

the making of such distribution, there shall remain to the credit of earned surplus account, after deducting such dividends and distribution, an amount at least equal to the annual dividend requirements of all their outstanding shares of Cumulative Preferred Stock, \$1.25 Series.

It is urged that even though the savings are made through the reduction or elimination of the excess profits tax, it does not follow that the net income of applicant, which is available for preferred stock dividends, will be actually increased. Increases in other taxes, or increases in costs of material and labor may off-set the tax savings. It is, therefore, felt that the limitations on the payment of dividends on common stock will increase the factor of safety for the payment of dividends on the preferred stock.

The safety of dividends is not synonymous with a voice in the management of applicant's properties, and is not a substitute therefor. The holders of preferred stock have provided nearly one-half of applicant's equity capital. They do not occupy the position of a creditor. We are unable to find that it is fair to ask them to surrender their voting rights for what may be but a temporary tax saving. At this very moment the Congress of the United States is considering the revision of the revenue laws. The alleged benefit to the preferred stockholders by reason of possible tax savings is, therefore, uncertain and speculative, while the loss of voting power is definite and concrete.

O R D E R

The Commission having considered the evidence submitted in support of this application and it being of the opinion that this application should not be granted, therefore,

IT IS HEREBY ORDERED that the above entitled application be, and the same is, hereby denied.

Dated at San Francisco, California, this 3rd
day of February, 1942.

Justus P. Cameron
Ray P. Riley
H. Baker
Francis L. Havenner
Arthur Jackson
Commissioners.