Decision No. 39694

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

In the Matter of the Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a corporation, for an order authorizing it (a) to offer 328,125 common shares for subscription and sale for cash at $100 per share to the holders of its preferred and common shares, and (b) to issue and sell $75,000,000 principal amount of Forty Year ____% Debentures due October 1, 1986.

Application No. 27709

Pillsbury, Madison & Sutro, by John A. Sutro; and Arthur T. George, for applicant.

ROWELL, Commissioner

FIRST SUPPLEMENTAL OPINION

The issue of the debentures referred to in this application was authorized by Decision No. 39368, dated August 27, 1946. In that decision it was indicated that a further hearing would be held on the application, insofar as it involved the issue of 328,125 shares of common stock by The Pacific Telephone and Telegraph Company. Such further hearing was held on November 20 in the Commission's Courtroom in San Francisco. At that time and place Hon. George H. Flagg, Public Utilities Commissioner of Oregon, and Hon. A. J. Zimmerman, Director of the Department of Public Utilities of the State of Washington, also held hearings on applications filed with these agencies by The Pacific Telephone and Telegraph Company for permission to issue 328,125 shares of common stock.

The Pacific Telephone and Telegraph Company asks permission to offer 328,125 common shares of stock for subscription at par to the holders of its common and preferred stock of record on a date to be fixed hereafter by the Board of Directors in the ratio of one common share for each ten preferred and/or common shares then held. It will use the proceeds to reimburse its treasury because of income expended for the acquisition of properties and the improvement of its facilities. Thereafter the stock proceeds will be used, to the extent that they are sufficient, to pay indebtedness due American Telephone and Telegraph Company, hereinafter referred to as American Company.

The Pacific Telephone and Telegraph Company hereafter referred to as applicant is a corporation organized under the laws of California. It owns and operates, directly or through subsidiary corporations, a general telephone system in the States of California, Oregon, Washington, Nevada and part of Idaho. As of October 31, 1946, it reports assets and liabilities as follows:

Assets	
Plant and Other Investments:	
Telephone plant in service	$423,858,794.70
Telephone plant under construction	8,944,246.57
Property held for future telephone use	916,639.69
Telephone plant acquisition adjustment	700,032.07
Total telephone plant	434,419,713.03
Miscellaneous physical property	148,181.70
Investments in subsidiary companies	202,479,927.39
Other investments	648,232.88
Total plant and other investments	637,696,055.00
Current Assets:	
Cash	2,947,397.35
Special cash deposits	498,703.58
Working funds	133,280.53
Notes receivable	609.91
Accounts receivable	15,796,551.93
Material and supplies	7,129,641.77
Total current assets	26,506,185.07
Prepaid Accounts and Deferred Charges:	
Prepayments	1,978,792.84
Discount on Capital Stock - Net	4,817,811.12
Other deferred charges	843,178.81
Total prepaid accounts and deferred charges	7,639,782.77
Total Assets	$671,842,022.84

Liabilities

Capital Stock:	
Common Stock - par value ($100 per share) (Authorized 4,000,000 shares; outstanding 2,461,250 shares)	$246,125,000.00
Preferred Stock - par value ($100 per share) 6% cumulative (Authorized and outstanding 820,000 shares)	82,000,000.00
Total capital stock	328,125,000.00
Funded Debt:	
Forty year 2-3/4% Debentures due December 1, 1985	75,000,000.00
Forty year 2-7/8% Debentures due October 1, 1986	75,000,000.00
Total funded debt	150,000,000.00
Current and Accrued Liabilities:	
Advance billing for service and customers' deposits	2,301,457.21
Accounts payable and other current liabilities	16,399,187.05
Accrued liabilities not due:	
Taxes	9,886,319.96
Interest	1,039,062.50
Rents	2,162.00
Total current and accrued liabilities	29,628,188.72
Deferred Credits:	
Unamortized premium on funded debt	3,059,833.66
Other deferred credits	100,381.08
Depreciation and Amortization Reserve	153,599,312.45
Unappropriated Surplus	7,329,306.93
Total Liabilities	$671,842,022.84

As indicated by its balance sheet, applicant's properties have been financed primarily through the issue of common stock, preferred stock, debentures and the investment of its depreciation reserve and surplus. Applicant's permanent capitalization as of October 31, 1946, consisted of the following outstanding stocks and debentures:

Item	Amount	Percent
Common stock	$246,125,000	51.48
Preferred stock 6%	82,000,000	17.15
Debentures	150,000,000	31.37
Total	$478,125,000	100.00

Applicant has regularly paid 6% dividends on its preferred stock. In 1941 it paid 7% dividend on its common stock;in 1942,6%;

in 1943, 6.25%; in 1944, 6.25%; and in 1945, 6.5%. During the first quarter of 1946 it paid a dividend of 1-1/2% on its common stock, during the second quarter, 1-3/4%, and during the third quarter, 1-1/2%. The dividend for the fourth quarter has not yet been fixed. Applicant's dividend payments for the first nine months of 1946 amounted to $15,380,937.50, of which $3,690,000 was paid to the holders of its preferred stock and $11,690,937.50 to the holders of its common stock. Exhibit "2" shows applicant's net income, that is, the amount available for dividends and surplus, for the ten months ended October 31, 1946, at $16,165,278.57. In arriving at this net income applicant includes in its income statement $1,935,000 tax refund arising from carry-back excess profits credit.

Applicant is through stock ownership controlled by American Company. The following tabulation shows the number of shares of applicant's outstanding stock, the number owned by American Company, and the number owned by others:

Class of Stock	Shares of Stock Outstanding	Shares Owned by American Company		Shares Owned by Others	
		No.	%	No.	%
Preferred	820,000	640,957	78.17	179,043	21.83
Common	2,461,250	2,198,945	89.34	262,305	10.66
Total	3,281,250	2,938,902	86.55	441,348	13.45

Of the 2,461,250 shares of applicant's common stock now outstanding, all except 180,000 shares were issued under authorizations given by the Railroad Commission in 1924, 1927, 1930 and

1941.[1] The American Company subscribed for its pro rata share of each issue. Although it neither purchased nor sold applicant's stock on the market the percentage of its ownership of total shares of applicant was increased because of the failure of other shareholders to subscribe for the full amount to which they were entitled.[2]

Applicant's Articles of Incorporation were amended July 15, 1946, to provide that its shareholders shall have the right to subscribe for stock on a pro rata basis for each new stock issue. Under its present proposal to issue 328,125 additional shares of common stock at par, it is anticipated that all shareholders will subscribe therefor in the proportion to which they are entitled. If the shares are thus fully subscribed the

(1)

Decision No.	14418,	dated	Dec.30,1924,	$35,000,000,	25 CRC 716
" "	18023,	"	Feb.23,1927,	50,000,000,	29 CRC 404
" "	22111,	"	Feb.11,1930,	87,500,000,	34 CRC 360
" "	34642,	"	Oct. 7,1941,	65,625,000,	43 CRC 737

(2) In 1925 the American Company purchased from applicant at par, 37,235 shares of common stock which were not subscribed for by other stockholders. These shares represented 55% of the total 67,700 shares offered to other stockholders. The market price of the stock was then at about par. In 1927 and again in 1930 the American Company acquired only its pro rata share. In 1941 applicant offered 656,250 common shares of stock to its stockholders pro rata at par. When the issue was announced, the market price per share was $117. When the subscription rights expired it was $99.50 per share. The American Company subscribed for its pro rata share but other stockholders subscribed for only 6,014 shares or 5.52% of the 108,833½ shares offered to them. In January 1942 the unsubscribed shares totalling 102,819 were sold to the American Company at par. At that time the market value was $96.50 per share.

In 1925, the American Company surrendered 100,000 shares of applicant's common stock. Applicant thereupon charged off other intangible capital in the amount of $10,000,000.

proportion held by the American Company will remain unchanged. Applicant is seeking no authority to issue and sell any shares that may not be subscribed for by stockholders in the exercise of their preemptive rights.

The testimony shows that for 1946 applicant estimates its gross construction expenditures at about $120,000,000, and for 1947 at about $200,000,000. It is applicant's intention to borrow money on a temporary basis from the American Company to finance that part of its construction expenditures which it cannot finance from income. Its October 31, 1946, balance sheet shows no indebtedness payable to the American Company. It estimates that at the end of 1946 it will owe the American Company $31,000,000. If it does not issue the 328,125 shares of stock as proposed, its indebtedness by March 31, 1947, will have increased to $60,000,000, and by June 30, 1947, will amount to about $80,000,000. It is evident that even with the sale of the common stock applicant will be required to do further permanent financing in 1947. Such financing will be facilitated by the issue of the 328,125 shares of stock at the present time. Assuming that the shares of stock are issued and that applicant borrows the amount indicated by June 30, 1947, its outstanding common stock will then represent about 49.9%, its preferred stock 14.6%, its debentures 26.8%, and its American Company borrowing 8.4% of its total outstanding securities. Applicant's ratio of debentures to total capitalization is such that it should be able to issue in 1947 on advantageous terms, some form of long term indebtedness to refund indebtedness due the American Company.

In Decision No. 39368 the Commission said that at the further hearing applicant will be afforded the opportunity to show why the 328,125 shares of common stock should not be offered to its stockholders at a price more nearly approaching market value. Applicant's witness testified that the book value of its common shares of stock is $101.31 per share. As stated above, the American Company owns 89.34% of applicant's outstanding common stock, leaving only 262,305 shares, or 10.66%, held by others. The stock that is traded on the market is part of the 10.66%. Applicant's Exhibit "4" shows that the market price of its common stock has fluctuated widely over the past twenty-one years. In 1925 it sold at $94 per share. It then rose to a high of $220 per share in 1929. In 1932 it sold at a low of $58, and then rose to a high of $153 per share in 1936. In 1942 it sold at a low of $72 per share and in July 1946 at a high of $160.25. In October 1946 it sold at a low of $122.75, and is now selling at about $129 per share. Applicant's witness took the position that the rate-payer would be injured by selling the stock at par only if rates were fixed on the basis of return per share of stock regardless of the amount per share paid into the company's treasury and invested in plant. He did not advocate that method of fixing rates. Applicant's witness testified that selling stock at or above par does not make any difference in the determination of the over-all rate of return which a company is allowed to earn. The earning, he said, is not measured by the dividends paid but by the actual dollars invested in the business, and the return allowed thereon. The distribution of the return realized by a utility is determined by the classes of securities issued by it.

Considering applicant's book investment per share of common stock, its earnings, and the fluctuation in the market price of such stock, it appears proper to authorize applicant to offer the 328,125 shares of common stock to its stockholders at par. Applicant is placed on notice that the Commission does not and will not regard the dividends paid on common stock as determining or fixing the rate of return applicant should be allowed to earn, in the event the Commission is called upon or finds it necessary to review applicant's rates.

Said Decision No. 39368 also raised the question of selling the 328,125 shares of common stock at competitive bidding. Decision No. 38614, dated January 15, 1946, exempts from competitive bidding any security offered pro rata to existing security holders pursuant to any preemptive right or privilege. Applicant in Exhibit "1" cites court decisions and other authorities in support of its contention that the stockholders have as a matter of law the right to subscribe for the shares of stock at par. In view of the authority given herein, there is no need to discuss the legal questions raised by applicant. The Commission desires it to be understood that the action taken by it in this application should not be construed as implying or admitting that the Commission does not have the authority to require the shares of common stock to be sold at competitive bidding or that it does not have authority to require the sale of shares of common stock at more than the par value thereof.

SECOND SUPPLEMENTAL ORDER

The Pacific Telephone and Telegraph Company having applied to the Railroad Commission for permission to issue and sell

328,125 shares ($32,812,500 par value) of common stock, a public hearing having been held and the Commission having considered the evidence submitted at such hearing and it being of the opinion that the money, property or labor to be procured or paid for through the issue of said shares of stock is reasonably required by applicant for the purpose herein stated, that the expenditures for such purpose are not, in whole or in part, reasonably chargeable to operating expenses or to income, and that this application should be granted, subject to the provisions of this order, therefore,

IT IS HEREBY ORDERED as follows:

1. The Pacific Telephone and Telegraph Company may, on or before March 31, 1947, issue and offer 328,125 shares of its common capital stock for subscription and sale, for cash, at not less than $100 per share, to the holders of its preferred and common shares, in the proportion of one (1) common share for each ten (10) preferred and/or common shares outstanding in the name of each shareholder of record on the stock books of applicant at the close of business on a date to be fixed hereafter by applicant's Board of Directors. Any shares of stock not subscribed for by applicant's stockholders or by the purchaser of rights, may not be sold until the Commission by supplemental order has fixed the selling price of such shares.

2. The Pacific Telephone and Telegraph Company shall use the proceeds realized through the issue of said shares of stock to reimburse its treasury because of income expended for additions, betterments and improvements to its properties, and

thereafter shall apply said proceeds to the extent that they are sufficient, to pay indebtedness due American Telephone and Telegraph Company.

3. The Pacific Telephone and Telegraph Company shall file with the Railroad Commission a report, or reports, as required by the Commission's General Order No. 24-A, which order, insofar as applicable, is made a part of this order.

4. The Pacific Telephone and Telegraph Company shall, on or before June 30, 1947, file with the Railroad Commission a statement showing in detail the expenses incurred because of the issue and sale of said shares of stock.

5. The authority herein granted is effective upon the date hereof.

The foregoing Opinion and Order are hereby approved and ordered filed as the Opinion and Order of the Railroad Commission of the State of California.

Dated at San Francisco, California, this 4th day of December, 1946.

Harold P. Huls

Justus F. Craemer

Ira H. Rowell

Commissioners

A. 27709-A

CONCURRING OPINION

I concur in this order with reluctance as I believe that the company should not be handicapped by a further delay in financing vitally needed improvements and extensions, particularly in view of present unsettled conditions.

I am of the opinion that the company should have taken advantage of present market conditions and financed these improvements through additional bonds or debentures, or the common stock should have been sold under competitive bidding.

I agree with the following statement in the competitive bidding order, Case No. 4761: "It is in the public interest that utilities sell their securities at the highest price obtainable." This redounds to the benefit of the rate payer and cannot prejudice the utility.

I believe it is not mandatory for the Commission to follow the rule contained in the competitive bidding order, that the issuance of securities offered pro rata to existing security holders pursuant to any pre-emptive right or privilege be exempt from competitive bidding. The decision rests entirely with the Commission in the exercise of a sound discretion.

R. E. Mittelstaedt

R. E. Mittelstaedt
Commissioner

I join in the views expressed in the concurring opinion.

Harold P. Hule
Commissioner.

Requested

DISSENTING OPINION

I am dissenting in this case because I feel that the majority opinion and order fails to properly treat and safeguard the interest and rights of those who are obliged to use and must pay for the service provided by this utility.

I wish to state that any plan of financing which might be imposed upon any utility that is not entirely equitable or that is not completely based upon sound economics and the highest possible degree of operating efficiency from an over-all standpoint cannot in time do other than prove financially injurious to, if not the present, the future stockholders as well as the rate payers of any such enterprise.

Even if the 328,125 shares of common stock involved in this decision were to be issued and sold at the full price they would bring in today's prevailing market, the advisability of this utility's issuing this block of stock at the present time, instead of additional bonds, might well be seriously questioned; but for this Commission to permit the issuance of this common stock as a further permanent outstanding obligation upon the rate payer who will be asked from now on to provide sufficient funds to maintain a minimum dividend schedule, and for the Commission not to insist upon its being sold at the highest price obtainable, should be unthinkable.

It is significant that in this majority opinion an earlier decision by the Commission, No. 38614, is referred to as exempting "from competitive bidding any security offered pro rata to existing security holders pursuant to any preemptive right or privilege". Inasmuch as this has been included in the majority opinion, I consider it proper to further state that in line with the written opinion of our legal department in this matter, no one could justifiably or seriously question the authority of this Commission to either refuse the utility in this case the right to issue this stock under the conditions requested, or insist upon this or any other issue of stock being sold under any condition or at any price this Commission may consider proper and reasonable. However, having been offered this opportunity to observe the manner in which this "loophole" clause in the above-mentioned decision, known as the Commission's competitive bidding order, might be taken advantage of in defeating the purpose of that order, I seriously urge that Decision No. 38614 be immediately corrected by Commission amendment.

The majority opinion in this case like many other past decisions of this Commission in a negative manner points out and emphasizes what <u>are not</u> the influencing or determining factors in rate-making procedure by this Commission, but no inkling is given, nor have I ever heard concisely stated, nor have I ever seen plainly set forth in a decision of the California Railroad Commission its formula for establishing utility rates throughout the State of California. I maintain that all utility customers and rate payers, as well as the utility operators themselves, are entitled to immediate action by this Commission by which it will establish and obligate itself to consistently follow a definite clear-cut formula as will control all utility rate-making procedure in the future. Any such formula should contemplate and make provision for sound and appropriate treatment of all phases of utility rate making. Not only are the rate payers and the utilities themselves entitled to concrete action along this line by the Commission without further delay, but the commission staff members are likewise entitled to and are in serious need of such important policy-making guidance by this Commission.

Regulating the quality and standard of utility service, together with the price to be charged the public for that service, is the principal function of this Commission. This was the purpose for which the Commission was created and only by efficiently carrying out such intended purpose can it justify its continued existence.

Frank W. Clark

FRANK W. CLARK
Commissioner