ORIGINAL

Decision No. 45846

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Associated Telephone Company, Ltd. for an Order authorizing it to issue and sell 350,000 shares of its Common Stock, $20 Par Value.	Application No. 32412
In the Matter of the Application of Associated Telephone Company, Ltd. for Authority to Issue and Sell 350,000 Shares of its Cumulative Preferred Stock, $20 Par Value, 5% 1947 Series, without competitive bidding.	Application No. 32439

Harry L. Dunn, of O'Melveny & Myers, for applicant;
Roger Arnebergh, Assistant City Attorney, for the City of Los Angeles, interested party.

OPINION

In Application No. 32412, Associated Telephone Company, Ltd., applicant herein, requests authority to issue 350,000 shares of its common stock, of the par value of $20 each and of the aggregate par value of $7,000,000, and to sell said shares, at par, to the holder of its presently outstanding shares of common stock.

In Application No. 32439, applicant requests an order exempting from competitive bidding a proposed issue of 350,000 shares of Cumulative Preferred Stock, $20 Par Value, 5% 1947 Series, and authorizing it to sell said shares at a price, or prices, and upon terms hereafter to be submitted to and approved by the Commission.

A public hearing on the two matters was held on June 11, 1951, at which time they were submitted upon a common record.

In exhibits filed in these proceedings, applicant has reported its assets and liabilities as of March 31, 1951. A summary of the same is as follows:

Assets		
Telephone plant and equipment		$101,627,625
Other investments		124,194
Current assets -		
Cash and deposits	$1,611,156	
Notes and accounts receivable	3,565,005	
Material and supplies	3,522,894	
Total current assets		8,699,055
Deferred debits		1,140,374
Total		$111,591,248
Liabilities		
Funded debt		$ 39,618,000
Current liabilities -		
Notes payable	$8,760,000	
Accounts payable	5,806,100	
Other items	5,655	
Accrued liabilities	2,403,160	
Total current liabilities		16,974,915
Inter-company items		99,962
Deferred credits and reserves		19,760,792
Contributions of telephone plant		894,674
Preferred stock		16,358,520
Common stock		16,660,755
Premium on stock		80,848
Surplus		1,142,782
Total		$111,591,248

The outstanding shares of common stock are reported held by General Telephone Corporation.

The record shows that applicant has made arrangements to borrow up to $15,000,000 from banks on short-term loans and that at this time it has drawn down funds in the aggregate amount of approximately $14,000,000. Applicant has filed the present applications for the purpose of paying indebtedness to said banks, of acquiring property, constructing, completing, extending and/or improving its facilities, and/or improving and maintaining its service, and/or reimbursing its treasury for moneys expended from income or from other sources for any one or more of the purposes specified. As shown in some detail in the applications, it estimates its requirements during 1951 and its sources of funds as follows:

Requirements

Gross additions to plant	$24,878,815	
Less-salvage, contributions and other items	2,877,037	
Net		$22,001,778
Payment of bank loans		3,000,000
Increase in working capital		907,826
Total		$25,909,604

Sources of Funds

From operations	$ 6,573,636	
Less-dividends	2,592,338	
Net		$ 3,981,298
Issue of securities		
Common stock	7,000,000	
Preferred stock	7,000,000	
Bonds	8,000,000	
	22,000,000	
Less-expense of issue	125,600	
Balance		21,874,400
Other sources		53,906
Total		$25,909,604

The issue of the $8,000,000 of bonds is not included by the present proceedings. Applicant hopes to dispose of them later in the year.

Although applicant asks for authority to sell its shares of common stock to the holder of the presently outstanding shares, it reports that it has made no commitment and has received none with respect to such sale. It states that it hopes to be able to sell a portion of said shares during June, if its financial condition and other conditions are favorable, and to dispose of the remainder on or before December 31, 1951.

As to the proposed issue and sale of shares of preferred stock, applicant reports that it hopes to dispose of them by means of a negotiated underwriting commencing during the latter part of June.

In making its request for exemption from the Commission's competitive bidding rule, it questions whether it would receive bids, if it invited submission of the same, and states that even if it did receive bids, in its opinion, based on its former experience in selling shares of preferred stock and on prevailing market conditions, it would receive a less favorable offer than it could obtain through negotiation. It points out that there is little institutional interest in its stocks, that 85% of its preferred shares are held in California, that there is but a small volume of transactions in such shares, and that, in its opinion, the underwriters who disposed of its earlier issues, with whom it expects to enter into negotiations, are in the best position to undertake the distribution of the additional shares.

Counsel for the City of Los Angeles offered no objection to the proposed issue and sale of the shares of preferred stock, provided applicant receive a proper price, and no objection to the sale of the shares of common stock in accordance with the application, provided that future financing be so arranged as to restore and maintain a debt ratio of approximately 50 percent and that the earnings per share allowed applicant be commensurate with the price at which such shares are sold. Counsel explained his position in the following words:

> If the Commission sees fit to authorize an operating utility to sell its common stock to its holding company at par, then in our opinion future earnings of the utility should be so regulated that, under a reasonable dividend payout practice, earnings shall only be sufficient to provide for the payment of dividends which bear the same relationship to such selling price that dividends paid by comparable utilities bear to the market price of the stock of such comparable utilities. In other words, in the case of this applicant the market price must be taken as the price at which its stock is sold to its holding company. Therefore, earnings allowed this applicant should be only such as will permit the payment of a dividend producing a percentage yield on such selling price which is similar to the percentage yield on the market price of the stock of other comparable utilities whose stock is sold in the open market.
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> The importance of this principle cannot be overemphasized. Many operating utilities which do not have the

"benefit" of a holding company have been able to realize more than the par value of their stock by sale through issuance of rights to existing stockholders, or by direct sales to the general public. Further, the real cost of equity money to a company can only be accurately determined by the yield required to make its common stock salable. The price at which stock may be sold at a private sale without competitive bidding obviously furnishes no indication as to the value of such stock or the price at which it could be sold on the open market. In such cases the earnings required for equity capital must be determined by the yield of other comparable stocks which are sold in the open market.

The representative of the city offered no testimony in the proceedings. It should be stated at this point, however, that while the fixing of rates is not an issue in these applications, it has not been the policy of the Commission to use the outstanding securities as a base in determining reasonable rates for service nor to regard dividends paid as determining the rate of return or as representing the cost of money obtained through the issue of common stock. Consideration, of course, is given to the financial condition of the company whose rates are being reviewed.

A review of the record clearly indicates that applicant is in need of funds from external sources to enable it to proceed with its construction program and that the issue of shares of stock, rather than bonds, is desirable at this time. Applicant's capital ratios as of March 31, 1951, and pro forma, are as follows:

	Bonds	Preferred	Common
March 31, 1951	54.54%	22.52%	22.94%
Pro forma -			
After proposed issues of stocks	45.73%	26.96%	27.31%
After proposed issue of $8,000,000 of bonds	50.32%	24.68%	25.00%

The application to issue the shares of common stock, and the testimony given at the hearing, would seem to indicate that there is some question as to whether the holder of the presently outstanding shares will exercise its preemptive right to subscribe to the additional offering. It is our understanding that the proposed financing is being undertaken because of the pressing need of meeting bank obligations, now in the amount of $14,000,000, and of making provision for additions to plant. Accordingly, it does not appear to be proper that an offering, under preemptive rights, should remain open for a period as long as that here requested. If the present stockholder is unwilling to subscribe for the additional shares within a reasonable period, we believe applicant should endeavor to make other arrangements to dispose of them.

Because of conditions presently prevailing, we will grant the exemption requested for the sale of the shares of preferred stock. By our action in this proceeding, however, it is not to be taken by applicant, or by any other utility, that in future proceedings we will authorize similar exemptions. Each request of this nature will be considered on its own merits and will be granted or denied in accordance with the showing made at the time.

The authorization herein granted with respect to the issue of shares of preferred stock is of a preliminary nature. Upon being informed of the agreed price and terms of the proposed sale, we will give further consideration to applicant's request. In the event applicant does not receive a satisfactory price for its stock, the exemption granted at this time will lapse.

The issue of the shares of common stock under the preemptive rights granted in applicant's articles of incorporation is exempt from the Commission's competitive bidding rule.

O R D E R

A public hearing having been held on the above entitled matters, and the Commission having considered the evidence and being of the opinion that the application should be granted, as herein provided; that the money, property or labor to be procured or paid for through the issue and sale of the shares of common and preferred stock herein authorized is reasonably required by applicant for the purposes specified herein; and that such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income; therefore,

IT IS HEREBY ORDERED as follows:

1. Associated Telephone Company, Ltd., after the effective date hereof and on or before August 31, 1951, may issue and sell 350,000 shares of common stock, at par, to the holder of its presently outstanding shares of common stock.

2. The issue and sale by Associated Telephone Company, Ltd. of 350,000 shares of Cumulative Preferred Stock, $20 Par Value, 5% 1947 Series, is exempted from the Commission's competitive bidding rule set forth in Decision No. 38614, dated January 15, 1946, provided applicant receives for said shares a price satisfactory to the Commission.

3. Associated Telephone Company, Ltd., after the effective date hereof and on or before December 31, 1951, may issue and sell said shares of Cumulative Preferred Stock, $20 Par Value, 5% 1947 Series, at a price to be fixed in a supplemental order.

4. Associated Telephone Company, Ltd. shall use the proceeds to be received through the issue and sale of said shares of common and preferred stock for the purposes set forth in these applications.

5. The authority herein granted to issue and sell shares of common stock will become effective twenty (20) days after the date hereof. The authority to issue and sell shares of preferred stock will become effective when the Commission by supplemental order has fixed the price at which said shares may be sold. In other respects, the authority herein granted is effective upon the date hereof.

6. Associated Telephone Company, Ltd. shall file with the Commission, as soon as available, two (2) copies of its prospectus and a report showing the names of those to whom said shares were issued, the number of shares sold to each and the consideration received.

Dated at San Francisco, California, this 19th day of June, 1951.

R. E. Mitchell
Harold P. Huls
Kenneth Potter

Commissioners