A.32655 MMW

ORIGINAL

Decision No. 46169

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a corporation, for an order authorizing it (a) to offer 633,274 common shares for subscription and sale for cash at $100 per share to the holders of its preferred and common shares, (b) to issue and sell $30,000,000 principal amount of Thirty Year ____% Debentures due November 15, 1981, and (c) to execute and deliver an Indenture to be dated November 15, 1951.	)	Application No. 32655

Arthur T. George, for applicant; Dion R. Holm, City Attorney, and Paul L. Beck, Chief Valuation and Rate Engineer, by Paul L. Beck, for the City and County of San Francisco, interested party; Walter Wessells and John Donovan, for the Commission's staff.

O P I N I O N

The Pacific Telephone and Telegraph Company has filed this application for an order of the Commission authorizing it to issue and sell, at par, 633,274 shares of its common stock of the aggregate par value of $63,327,400, and to issue and sell $30,000,000 principal amount of Thirty Year Debentures due November 15, 1981. It intends to offer the shares of stock for subscription, at par, to the holders of its outstanding shares of preferred and common stock in the proportion of one new common share for each nine preferred and/or common shares standing in the name of each stockholder of record at the close of business on a date hereafter to be fixed, and to offer the debentures for sale at competitive bidding. The debentures will bear interest at the rate to be specified in the successful bid.

Applicant asks permission to use the proceeds to be received from the issue and sale of its shares of common stock and its debentures to reimburse its treasury, to the extent such proceeds are sufficient, for moneys, reported in the aggregate amount of $348,408,266.75, actually expended since October 31, 1922, from income and from other treasury funds, not obtained from the issue of stocks, bonds and notes, for the acquisition of properties and for the construction, completion, extension and improvement of its facilities and of those of its subsidiary. Applicant reports that it has need for such proceeds, after reimbursement of its treasury, to repay temporary bank loans which it reports amounted to $61,800,000 on June 30, 1951, and which it estimates will aggregate approximately $100,000,000 by the close of the year. In a balance sheet filed in this proceeding as Exhibit A, it reports its current assets as of June 30, 1951, in the amount of $72,902,394.37 and its current and accrued liabilities in the amount of $153,137,714.86, including the short-term bank loans of $61,800,000.

It clearly appears that applicant will have need for additional capital funds from external sources to improve its cash position, to meet its bank borrowings, and thus to finance permanently a part of the cost of its construction program. There is presented in this proceeding, however, the question as to the form its additional financing should take.

In the past, applicant has issued debentures, short-term notes and shares of preferred and common stock, and has used earnings from operations in meeting the cost of its properties. In Exhibit 1 it sets forth its estimated capital structure as of December 31, 1951, in the aggregate amount of $1,094,843,986 and its capital ratios before and after giving effect to the proposed financing, as follows:

	Before Financing	After Financing
Debt	45.9%	40.1%
Preferred stock	7.5	7.5
Common stock and surplus	46.6	52.4
Total	100.0%	100.0%

However, applicant reports that it is faced with substantial construction expenditures during 1952, and that it will be compelled to borrow in that year an additional $100,000,000 which will bring its debt ratio up to 45%.

Applicant presented three witnesses[1] who testified in support of its request to finance its expenditures at this time in part through the issue of shares of common stock instead of entirely through the issue of debentures. In Exhibit 1, it reports that its outstanding debt, preferred stock, and common stock and surplus had increased from $419,954,467 at the close of 1945 to $1,051,070,576 at June 30, 1951, and its debt ratio from 20.7% to approximately 44% during the same period. Applicant is of the opinion that its low debt ratio at the beginning of the post-war period made it possible for it to borrow moneys to meet its capital requirements, and that it now is desirable for it to restore its borrowing capacity through the issue of equity capital so as to place it in a strong position to meet demands in the future for new capital. In Exhibit 6 and Exhibit 7, applicant sets forth certain statistical data designed to show that the quality of both bonds and common stock deteriorates as the debt ratio increases, and that the lower the debt ratio of a utility, the lower the rate of return required by it.

Applicant's proposed financing, in effect, is a substitution of permanent securities for short-term bank loans. Applicant

(1) S. W. Campbell, Vice-President and Comptroller, and Robert W. Mason, Assistant Vice-President of applicant, and Louis A. Mahoney, Vice-President of Halsey, Stuart & Co., Inc.

introduced into the record, in Exhibit 2, data designed to show the effect upon earnings of substituting alternate forms of permanent capital for $63,000,000 of short-term bank loans. Table 6 of that exhibit shows that the issue of shares of stock, as now proposed, would result in taxes on income, using the present 47% tax rate, in the amount of approximately $1,000,000 higher than they would be if the financing were to be accomplished through the issue of 3-1/4% debentures. The effect on the rate of return on total capital as a result of issuing shares of common stock instead of debentures would be to decrease such return by .09%. Applicant introduced evidence to show that a decrease in earnings of this extent is no greater in magnitude than that which it has experienced from time to time as a result of month-to-month fluctuation in earnings.

It is clear that should applicant engage in debt financing to meet its capital requirements at this time, instead of providing for them in part through the issue of shares of common stock, it would realize certain savings in taxes on income. If it were necessary to give consideration only to the company's current need for additional permanent capital, these savings, no doubt, might warrant the financing of the expenditures through the issue of debentures. However, other factors also must be taken into consideration by the Commission in the determination to be reached in this proceeding. The Commission is fully aware of the fact that applicant's construction program is continuing and that annually it must raise substantial funds to meet demands for service.(2) It is important and necessary for applicant to extend and improve its facilities and to provide service for new customers as expeditiously as possible and clearly it is in the public interest for applicant, in arranging its

(2) Exhibit 5 shows for 1951, total estimated gross expenditures for plant in the amount of $172,990,000 and for 1952, $198,902,000.

financing, to endeavor to provide for a structure sufficiently flexible to permit it to obtain under favorable terms the additional capital it will need in the future when different economic conditions may prevail. The record in this proceeding indicates that funds now should be available through the issue of shares of common stock, and in the opinion of the Commission applicant should take advantage of its ability to sell such shares and thus to reserve its borrowing capacity for a later date when equity financing might be difficult.

Accordingly, the order in this matter will authorize the issue of shares of common stock and debentures in accordance with applicant's request. In making this order, however, the Commission wishes to place applicant upon notice that it will not regard the dividends paid on its shares of common stock as determining or fixing the rate of return which it should be allowed to earn on its investment in plant.

In the past, the Commission has found that certain payments to the American Telephone and Telegraph Company and its subsidiary, Western Electric Company, Inc., have been excessive. Applicant should call this statement to the attention of its stockholders in any offering of stock it may make.

O R D E R

A public hearing having been held on the above entitled matter, 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 of the shares of common stock and debentures herein authorized is reasonably required by applicant for the purposes specified herein; and that such purposes, except as otherwise authorized, are not, in whole or in part, reasonably chargeable to operating expenses or to income; therefore,

IT IS HEREBY ORDERED as follows:

1. The Pacific Telephone and Telegraph Company, after the effective date hereof and on or before March 31, 1952, may offer 633,274 shares of its common stock for subscription and sale, for cash at $100 a share, to the holders of its outstanding shares of preferred and common stock in the proportion of one (1) common share for each nine (9) preferred and/or common shares standing 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, and upon receipt by applicant of subscriptions properly executed and the necessary funds, to issue certificates for the appropriate number of shares.

2. The Pacific Telephone and Telegraph Company, after the effective date hereof and on or before December 31, 1951, may execute and deliver an indenture to be dated November 15, 1951, in substantially the same form as that filed in this proceeding as Exhibit C, and may issue and sell $30,000,000 principal amount of Thirty Year Debentures due November 15, 1981, at a price to be fixed by the Commission in a supplemental order in this proceeding.

3. The Pacific Telephone and Telegraph Company shall use the proceeds to be received from the issue and sale of said shares of stock and debentures, other than accrued interest, for the purposes set forth in this application. The accrued interest may be used for general corporate purposes.

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

5. The authority herein granted to issue and sell debentures will become effective when the Commission by a supplemental

order has fixed the price at which they may be sold, and when applicant has paid the fee prescribed by Section 57 of the Public Utilities Act, which fee is ten thousand five hundred ($10,500.00) dollars. In other respects, the authority herein granted will become effective twenty (20) days after the date hereof.

Dated at San Francisco, California, this 4th day of September, 1951.

R. T. [illegible]
President

Justus F. Craemer

Harold P. Huls

Kenneth Potter

Peter E. Mitchell
Commissioners