A. 33643 EB

Decision No. 47643

ORIGINAL

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 issue 703,375 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 $35,000,000 principal amount of Twenty-seven Year ____% Debentures due November 15, 1979, and (c) to execute and deliver an Indenture to be dated November 15, 1952.

Application No. 33643

Arthur T. George for applicant; Charles H. Heltzel, Public Utilities Commissioner of the State of Oregon; John F. Donovan, for the Commission's staff.

OPINION

In this application The Pacific Telephone and Telegraph Company requests the Commission to enter an order authorizing it to issue and sell, at par, 703,375 shares of its common stock of the aggregate par value of $70,337,500, and to issue and sell $35,000,000 in principal amount of Twenty-seven Year Debentures due November 15, 1979. Applicant 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 shareholder 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.

The purpose of the proposed financing is to reimburse the treasury, in part, for moneys expended up to June 30, 1952, for the acquisition of properties and for the construction, completion, extension and improvement of applicant's facilities and of those of its subsidiary, and through such reimbursement to obtain funds to repay temporary bank loans which applicant reports amounted to $55,700,000 on June 30, 1952, and which it estimates will aggregate approximately $114,000,000 at the close of the year. In a balance sheet filed in this proceeding, applicant reports current assets as of June 30, 1952, in the amount of $85,576,395.38, and current and accrued liabilities as of the same date, in the amount of $159,981,386.35, including the short term bank loans of $55,700,000.

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 to finance permanently a part of the cost of its construction program, as well as to place itself in a position to meet future requirements. Consideration, however, must be given to the form the proposed financing will take.

The record shows that during the period from 1946 to 1951, inclusive, applicant's gross expenditures for plant amounted to $1,070,120,000 and that during 1952, according to Exhibit 5, they will aggregate $205,402,000 and during 1953, $244,555,000. It has been, and apparently will continue to be, applicant's practice to meet its capital requirements with temporary financing in the form of short-term bank borrowings and periodically to refinance itself with permanent securities consisting of debt and equity capital. In this proceeding applicant presented testimony through three witnesses in support of its position that a substantial portion of its present financing should be accomplished through the issue of common stock rather than some other form of security.

In Exhibit 1 applicant presented a series of charts showing its capitalization ratios as of December 31, 1945, and June 30, 1952, and estimated for December 31, 1952, giving effect to the proposed financing. These ratios are as follows:

	Dec. 31, 1945	June 30, 1952	Dec. 31, 1952
Debt	20.7%	42.5%	39.4%
Preferred stock	19.5	7.2	6.8
Equity capital	59.8	50.3	53.8
Total	100.0%	100.0%	100.0%

However, applicant reports it is faced with additional borrowings in the amount of $135,000,000 during 1953 which will increase its debt ratio to 45.5%. Should it finance itself entirely through the medium of borrowed money at this time, instead of through the issue of common shares as proposed, the debt capital would rise to approximately 51% in 1953, according to the calculations that have been submitted in the exhibit. In this connection, ✓ applicant asserts that its low debt ratio at the beginning of the post war period was a controlling factor in enabling it to borrow money to meet its capital requirements and because these requirements are continuing at a high level, it urges that it now is desirable for it to restore its borrowing capacity through the issue of common stock so as to place itself in a stronger position for the future.

In Exhibit 2 applicant introduced data showing the estimated effect on earnings of substituting alternate forms of permanent capital for $70,000,000 of short-term notes. The exhibit indicates that giving effect to federal taxes on income, the issue of shares of common stock, instead of 3-1/4% debentures, would decrease the net income available to the common shares by $1,058,089, but that this amount would be equivalent to a reduction in the rate of return on total capital of one-tenth of one percent. The exhibit shows that a decrease in earnings of this extent is no greater in magnitude than that which is experienced from time to time as a result of month to month fluctuations in revenues.

Exhibit 7 contains statistical data showing that the investment quality of not only debt capital but also of common stock deteriorates as the debt ratio increases. The exhibit includes a graphic presentation indicating that for utilities having debt ratios of between 30% and 70% the return on total capital decreases as the debt ratio decreases, and, conversely, that the return required on total capital increases as the debt ratio increases.

In reviewing this matter it is clear that should applicant engage in debt financing to meet its present requirements, instead of providing for them in part through the issue of stock, it would realize at the outset certain savings in taxes on income. If it were necessary to give consideration only to the 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 must also be taken into consideration by the Commission in the determination to be reached in this proceeding. The evidence is clear and the Commission is cognizant of the fact that applicant must continue to raise substantial sums of money to meet future demands of its customers. To provide for such future demands and to assure continuing adequate service, it is in the public interest that applicant, in arranging its financing, should look to the long range effect rather than to the present time, and should endeavor to establish a balanced and elastic capital structure which will permit it to obtain under the most favorable terms the additional capital it will need in the future when different economic conditions may prevail. The record in this proceeding indicates that a portion of the funds now required can be obtained through the issue of shares of common stock and it is the opinion of the Commission that applicant should take advantage of its ability to sell such shares and thus to reserve its borrowing capacity for a future date when equity financing might not be feasible.

Accordingly, the order in this matter will authorize the issue of shares of common stock and debentures in line 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 applicant should be allowed to earn on its investment in plant.

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, 1953, may offer 703,375 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 new common share for each nine 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 March 31, 1953, may execute and deliver an indenture to be dated November 15, 1952, in substantially the same form as that filed in this proceeding as an exhibit attached to the application, and may issue and sell $35,000,000 in principal amount of Twenty-seven Year Debentures due November 15, 1979, 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 said purposes, or 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. As soon as available, applicant shall file three copies of its prospectus.

5. The authority herein granted to execute an indenture and to issue and sell debentures will become effective when the Commission by supplemental order has fixed the price at which said debentures may be sold and when applicant has paid the fee prescribed by Section 1904 of the

Public Utilities Code, which fee is $11,750. In other respects, the authority herein granted will become effective twenty (20) days after the date hereof.

Dated at San Francisco, California, this 2nd day of September, 1952.

R. E. [illegible]
President

Justus F. Craemer

Kenneth Potter

Peter E. Mitchell

Commissioners