

Decision No. 49783

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
CALIFORNIA INTERSTATE TELEPHONE COMPANY
and
INTERSTATE TELEGRAPH COMPANY
and
CALIFORNIA ELECTRIC POWER COMPANY

for an Order

(a) Authorizing California Interstate Telephone Company to purchase from California Electric Power Company all the capital stock of Interstate Telegraph Company;

(b) Authorizing Interstate Telegraph Company to convey and transfer to California Interstate Telephone Company all its properties and assets;

(c) Authorizing California Interstate Telephone Company to acquire all the properties and assets and to assume all the obligations and liabilities of Interstate Telegraph Company;

(d) Authorizing California Interstate Telephone Company to render service in the territory now served by Interstate Telegraph Company in California;

(e) Authorizing Interstate Telegraph Company to discontinue service in such territory; and

(f) Authorizing California Interstate Telephone Company (1) to issue and sell 300,000 shares of its common stock (\$5 par value), (2) to issue and sell \$1,500,000 principal amount of its 4-3/4% debentures, due 1974, and to deliver to California Trust Company, as trustee, an indenture dated February 1, 1954, with respect to said debentures, and (3) to issue and sell \$4,200,000 principal amount of its First Mortgage Bonds, 4-1/4% Series, due 1979, and to deliver to Bank of America National Trust and Savings Association its indenture dated February 1, 1954, describing and securing said bonds.

Application
No. 35155

James C. Greene, of O'Melveny & Myers, for California Interstate Telephone Company; Donald J. Carman, for Interstate Telegraph Company and California Electric Power Company; J. J. Deuel, for California Farm Bureau Federation, interested party; W. W. Dunlop, for the staff of the Commission.

O P I N I O N

In this proceeding an order of the Commission is sought authorizing the transfer of the stock and properties of Interstate Telegraph Company to California Interstate Telephone Company and the issue of bonds, debentures and shares of common stock by California Interstate Telephone Company.

The application was filed with the Commission on February 16, 1954. A public hearing was held before Commissioner Craemer and Examiner Coleman in Riverside on March 8, 1954, at which time the matter was taken under submission. The Commission has received no protests to the granting of applicants' requests.

Interstate Telegraph Company is a Nevada corporation engaged in providing telephone service in portions of the counties of Alpine, Mono, Inyo, Kern and San Bernardino in California and in portions of the counties of Douglas, Lyon, Esmeralda and Mineral in Nevada. It is, and since its organization in 1910 has been, a wholly-owned subsidiary of California Electric Power Company and its predecessors or affiliates and in the construction of its facilities it has been financed by those companies. At the close of 1953 it had 10,919 company-owned telephones and a recorded net investment in its properties of \$7,455,229.

The application shows that California Electric Power Company now desires to divest itself of ownership of Interstate Telegraph Company, so as to confine its activities primarily to the operation of its electric properties and business, and that it has entered into an agreement to sell all the outstanding capital stock of Interstate Telegraph Company to California Interstate Telephone Company for a base price of \$7,500,000 as of August 31, 1953. The arrangements

contemplate that immediately upon acquisition of such stock California Interstate Telephone Company will cause Interstate Telegraph Company to be dissolved and its properties conveyed to it. Upon thus succeeding to the properties, California Interstate Telephone Company proposes to continue with the operation of the telephone business and to undertake to carry to completion the construction program in which Interstate Telegraph Company now is engaged.

To finance the acquisition of the existing properties and to provide funds for new construction, California Interstate Telephone Company proposes, and now seeks authorization, to issue \$4,200,000 in principal amount of First Mortgage Bonds, 4-1/4% Series, due 1979, \$1,500,000 in principal amount of 4-3/4% debentures due 1974 and 300,000 shares of common stock of the par value of \$5 each. Subject to receiving authorization from the Commission, it proposes to sell the bonds and debentures by means of a direct placement at their face value to seven institutional buyers and to sell its shares of stock to a group of underwriters represented by William R. Staats & Co. for \$9.765 a share for resale to the public at \$10.50. At the prices indicated, it will receive \$2,929,500 for such shares and \$5,700,000 for its bonds and debentures, a total of \$8,629,500.

The testimony given at the hearing indicates that at this time the cost of the existing properties will be approximately \$7,930,000, which would leave approximately \$700,000 of security proceeds to pay organization and financing expenses and to meet part of the 1954 construction program. The 1954 construction budget is reported in the gross amount of \$1,475,336, as shown in some detail in Exhibit 8, and the organization and financing costs are estimated at \$209,500, including such items as finders' fees, legal costs, underwriting expenses in connection with the debt issues and

miscellaneous items. A pro forma balance sheet as of February 28, 1954, giving effect to the acquisition of properties by California Interstate Telephone Company and the issue of its securities is as follows:

Assets

Telephone and telegraph plant--original cost of plant in service	\$ 8,485,732
Plant acquisition adjustment (excess of cost over original cost)	189,335
Cash	777,272
Working funds	8,835
Accounts receivable (net)	219,320
Materials and supplies	481,878
Prepaid accounts and deferred charges	102,779
Debt expense	130,000
Other debits	<u>34,500</u>
Total assets	<u>\$10,429,651</u>

Liabilities

Accounts payable	\$ 197,984
Accruals for taxes, interest and wages	425,365
Customers' advances for construction	293,299
Depreciation reserve	847,203
Other reserves and deferred credits	36,300
Bonds outstanding	4,200,000
Debentures outstanding	1,500,000
Capital stock outstanding (par value \$5 per share)	1,500,000
Paid in surplus	<u>1,429,500</u>
Total liabilities	<u>\$10,429,651</u>

In exhibits filed during the course of the hearing applicants have reported the gross revenues from the operation of the business for the past five years and the estimated gross revenues for 1954, together with the income available for fixed charges, as follows:

	<u>Gross revenues</u>	<u>Available for fixed charges</u>
1949	\$ 958,153	\$117,016
1950	1,184,688	161,233
1951	1,481,250	167,146
1952	1,816,662	200,767
1953	2,252,562	349,082
1954	2,604,500	589,050

The business has been increasing rapidly. During the period from 1949 to 1953, both inclusive, the number of telephones

has increased from 5,635 to 10,919 and the new construction is designed, in part, to meet the requirements of more subscribers. It should be noted that by Decision No. 48230, dated February 2, 1953, the Commission approved increases in rates for service after March 1, 1953.

Upon the basis of ten months' operations in 1954 by California Interstate Telephone Company, it appears that the fixed charges are estimated at \$258,030 which, under the above estimate, would leave \$331,020 available for equity capital, an amount equivalent to about 10% on such capital.

It is clear that additional external financing will be required to carry on the construction program which has been budgeted for this telephone utility. Presently, California Interstate Telephone Company is giving consideration to an issue of \$400,000 of bonds later in 1954 and to the issue of additional bonds and common stock in 1955. Its capital ratios at the inception of its operations and as estimated for the close of 1954 and 1955 are reported as follows:

	At Outset	December 1954	December 1955
Bonds	48.67%	49.98%	51.57%
Debentures	17.38	16.30	15.06
Common stock equity	33.95	33.72	33.37
Totals	100.00%	100.00%	100.00%

The new corporation proposes to take over and to continue the present operations at the same rates, to transfer to its books the plant and depreciation reserve accounts of the present operator, and to continue the use of the straight line-remaining life method of computing depreciation. The testimony clearly indicates that the new corporation should be in a position to finance itself and that it intends to proceed without delay with the construction and improvement

work now under way and to be undertaken later in the year. According to the record the new corporation intends to take over the personnel of Interstate Telegraph Company and it is clear that the proposed management has had long experience in the construction and operation of utility properties.

The capital ratios include a high percentage of borrowed money. The representatives of the new corporation, in discussing this feature, apparently took the position that the debentures could be considered in the same category as preferred stock for this purpose. They pointed out that the debenture issue will be a closed one, that such debentures will be held by the same institutions who will hold the bonds, and that by issuing debentures instead of preferred stock the corporation will receive tax advantages. In addition, the proposed indenture, which will define the terms of the debentures, will provide for a sinking fund, starting in 1957, to extinguish the debt.

Under the circumstances set forth in this proceeding we are of the opinion that the proposed transfer will not be adverse to the public interest and that the issue of securities, as requested, under negotiated arrangements, should be approved. The action taken herein shall not be construed to be a finding of the value of the properties herein authorized to be transferred.

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 by the issue of the bonds, debentures and shares of stock herein authorized

is reasonably required by California Interstate Telephone Company 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. California Electric Power Company may sell, and California Interstate Telephone Company may acquire, all the outstanding capital stock of Interstate Telegraph Company.

2. Interstate Telegraph Company, in the event that all of its capital stock shall be acquired by California Interstate Telephone Company, may convey and transfer its properties and assets to California Interstate Telephone Company and may discontinue service in the territory in California in which it now operates.

3. California Interstate Telephone Company, in the event that it shall acquire the properties and assets of Interstate Telegraph Company, shall assume the obligations and liabilities of Interstate Telegraph Company and shall render service in the territory in California now served by Interstate Telegraph Company.

4. California Interstate Telephone Company may issue and sell not exceeding 300,000 shares of its common stock at a price of not less than \$9.765 a share, not exceeding \$1,500,000 in principal amount of its 4-3/4% debentures due 1974 at a price of 100% of the principal amount plus accrued interest, and not exceeding \$4,200,000 in principal amount of its First Mortgage Bonds, 4-1/4% Series, due 1979, at a price of 100% of the principal amount plus accrued interest, for the purposes specified in this application. The issues of said shares of common stock, debentures and bonds are exempted from the provisions of the Commission's competitive bidding rule set forth in Decision No. 38614, dated January 15, 1946.

5. California Interstate Telephone Company may execute and deliver to Bank of America National Trust and Savings Association an indenture in, or substantially in, the same form as that filed in this proceeding as Exhibit 3, and may execute and deliver to California Trust Company an indenture in, or substantially in, the same form as that filed as Exhibit 11.

6. California Interstate Telephone 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.

7. The rates, rules and regulations of Interstate Telegraph Company now on file with the Commission shall be refiled within 30 days after the date of transfer under the name of California Interstate Telephone Company, in accordance with the procedure prescribed by General Order No. 96, or, in lieu of such refiling, California Interstate Telephone Company may file a notice of adoption of said presently filed rates, rules and regulations. No increase in the present rates shall be made unless authorized by the Commission.

8. On or before the date of actual transfer, Interstate Telegraph Company shall refund all deposits which customers are entitled to have refunded. Any unrefunded deposits shall be transferred to and become the obligation for refund of California Interstate Telephone Company.

9. On or before the date of actual transfer of the physical properties under the authorization herein granted, Interstate Telegraph Company shall transfer and deliver to California Interstate Telephone Company all records, memoranda and papers pertaining to the construction and operations of the properties of Interstate Telegraph Company.

10. The authority herein granted to issue bonds and debentures will not become effective until California Interstate Telephone Company shall have paid the fee prescribed by Section 1904(b) of the Public Utilities Code, which fee is \$3,350.00. In all other respects, the authority herein granted will become effective upon the date hereof.

11. If the authority herein granted to transfer properties is exercised, California Interstate Telephone Company, within 30 days thereafter, shall notify the Commission in writing of the date of completion of such transfer. The authority herein granted will lapse unless exercised on or before September 30, 1954.

Dated at San Francisco, California, this 16th day of March, 1954.

R. E. Johnson
President

Justin J. Craven

Harriet Potter

W. L. Miller

James Deagan
Commissioners

